DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNIG GROUP IN H1 2011

Warsaw, August 26th 2011

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Chapter I. Information on the PGNiG Group

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

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), registered office in Warsaw, ul. Marcina Kasprzaka25, was established as a result of transformation of the state-owned enterprise under the name Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. On October 30th 1996, the Company was entered in the commercial register under the name Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw under entry No. RHB 48382. On November 14th 2001, the Company was entered into the Register of Entrepreneurs of the National Court Register under entry No. 0000059492.

On May 24th 2005, PGNiG S.A. shares were admitted to public trading by virtue of a decision issued by the Polish Securities and Exchange Commission. The Company's debut on the Warsaw Stock Exchange took place on September 23rd 2005. PGNiG S.A. shares have been listed on the Warsaw Stock Exchange since October 20th 2005. Currently, the share capital of PGNiG S.A. 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, such as oil and gas exploration and production, gaseous fuel storage, natural gas trading and natural gas distribution. The upstream operations are one of the key factors securing the Group's competitive position on the liberalised gas market.

1. Structure of the PGNiG Group

As at June 30th 2011, the PGNiG Group comprised PGNiG S.A. (Parent Undertaking), and 40 production and service companies, including:

- 27 subsidiaries of PGNiG S.A.
- 13 indirect subsidiaries of PGNiG S.A.

The following table presents the list of the PGNiG Group members as at June 30th 2011.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of total vote held by PGNiG S.A.
	PGNiG S.A.'s subsidiaries				
1	Poszukiwania Nafty i Gazu Jasło Sp. z o.o.	100,000,000.00	100,000,000.00	100.00%	100.00%
2	Poszukiwania Nafty i Gazu Kraków Sp. z o.o.	105,231,000.00	105,231,000.00	100.00%	100.00%
3	Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.	60,000,000.00	60,000,000.00	100.00%	100.00%
4	GEOFIZYKA Kraków Sp. z o.o.	64,400,000.00	64,400,000.00	100.00%	100.00%
5	GEOFIZYKA Toruń Sp. z o.o.	66,000,000.00	66,000,000.00	100.00%	100,00%
6	Poszukiwania Naftowe Diament Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%	100.00%
7	Zakład Robót Górniczych Krosno Sp. z o.o.	26,903,000.00	26,903,000.00	100.00%	100.00%
8	PGNiG Norway AS (NOK)[1)]	951,327,000.00	951,327,000.00	100.00%	100.00%
9	Polish Oil and Gas Company - Libya B.V. (EUR)[1)]	20,000.00	20,000.00	100.00%	100.00%
10	POGC Trading GmbH (EUR)[1)]	10,000,000.00	10,000,000.00	100.00%	100.00%
11	Operator Systemu Magazynowania Sp. z o.o.	1,000,000.00	1,000,000.00	100.00%	100.00%
12	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
13	Dolnośląska Spółka Gazownictwa Sp. z o.o.	658,384,000.00	658,384,000.00	100.00%	100.00%
14	Górnośląska Spółka Gazownictwa Sp. z o.o.	1,300,338,000.00	1,300,338,000.00	100.00%	100.00%
15	Karpacka Spółka Gazownictwa Sp. z o.o.	1,484,953,000.00	1,484,953,000.00	100.00%	100.00%
16	Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,255,800,000.00	1,255,800,000.00	100.00%	100.00%
17	Pomorska Spółka Gazownictwa Sp. z o.o.	614,696,000.00	614,696,000.00	100.00%	100.00%
18	Wielkopolska Spółka Gazownictwa Sp. z o.o.	1,033,186,000.00	1,033,186,000.00	100.00%	100.00%
19	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
20	PGNiG Energia S.A.	20,000,000.00	20,000,000.00	100.00%	100.00%
21	PGNiG Technologie Sp. z o.o.	120,398,000.00	120,398,000.00	100.00%	100.00%
22	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
23	Polskie Elektrownie Gazowe Sp. z o.o.	1,212,000.00	1,212,000.00	100.00%	100.00%
24	PGNiG SPV1 Sp. z o.o.	20,000.00	20,000.00	100,00%	100.00%
25	PGNiG Finance AB (SEK)[1)]	500,000.00	500,000.00	100.00%	100.00%
26	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
27	NYSAGAZ Sp. z o.o.	6,800,000.00	3,468,000.00	51.00%	51.00%

Companies of the PGNiG Group – contd.

	Subsidiaries of subsidiaries of PGNiG S.A.	Share capital (PLN)	Value of shares held by PGNiG S.A.'s subsidiaries (PLN)	% of share capital held by PGNiG S.A.'s subsidiaries	% of total vote held by PGNiG S.A.'s subsidiaries
1	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%	100.00%
2	Zakład Urządzeń Naftowych Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%	100.00%
3	Budownictwo Naftowe Naftomontaż Sp. z o.o.	44,751,000.00	44,751,000.00	100.00%	100.00%
4	ZRUG Sp. z o.o. (Pogórska Wola)	9,244,000.00	9,244,000.00	100.00%	100.00%
5	Geofizyka Torun Kish Ltd (IRR)[1), 2)]	10,000,000.00	10,000,000.00	100.00%	100.00%
6	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
7	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
8	Zakład Gospodarki Mieszkaniowej Sp. z o.o. (Piła)	1,806,500.00	1,806,500.00	100.00%	100.00%
9	Biogazownia Ostrowiec Sp. z o.o.	105,000.00	105,000.00	100.00%	100.00%
10	Poltava Services LLC (EUR)[1),2)]	20,000.00	19,800.00	99.00%	99.00%
11	Ośrodek Badawczo - Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000.00	2,550,000.00	85.00%	85.00%
12	GAZ Sp. z o.o. (Błonie)	300,000.00	153,000.00	51.00%	51.00%
13	GAZ MEDIA Sp. z o.o. (Wołomin)	300,000.00	153,000.00	51.00%	51.00%

[1)] Figures in foreign currencies.
[2)] Share capital not paid up.

The following changes in the Group's structure took place in H1 2011:

- On February 10th 2011, POGC Trading GmbH was entered in the Court Register in Munich.
- On April 29th 2011, PGNiG S.A. acquired Goldcup 5839 AB. Following the acquisition, the company's name was changed to PGNiG Finance AB. The company's purpose will be to handle the issues of PGNiG Eurobonds. Its share capital amounts to SEK 500,000 (Swedish krona). The company's new name was entered in the Register of Companies in Stockholm on June 20th 2011.
- On June 17th 2011, PGNiG acquired PGNiG SPV1 Sp. z o.o. whose purpose will be to execute power engineering projects. The company's share capital amounts to PLN 20,000 and is divided into 400 shares with a par value of PLN 50 per share.
- On June 23rd 2011, Poszukiwania Nafty i Gazu Kraków Sp. z o.o. incorporated Poltava Services LLC, a subsidiary undertaking in Ukraine. PNiG Kraków Sp. z o.o. holds a 99% stake in Poltava Services LLC.
- On June 29th 2011, PGNiG Technologie Sp. z o.o. acquired 5,000 shares in BN Naftomontaż Sp. z o.o. from minority shareholders. Following the transaction, its shareholding in BN Naftomontaż Sp. z o.o. increased to 100%.

Moreover, in H1 2011, the share capital of PGNiG Energia S.A. was raised by PLN 14,000,000 to PLN 20,000,000. All newly issued shares were acquired by PGNiG S.A. The share capital increase was registered on April 29th 2011.

The chart below presents consolidated companies of the PGNiG Group as at June 30th 2011 (by operating segments).

CONSOLIDATED UNDERTAKINGS OF THE PGNiG GROUP

PGNiG S.A.

- **EXPLORATION AND PRODUCTION**
  - PNiG Jasło Sp. z o.o. – 100%
  - GK PNiG Kraków – 100%
    - Oil Tech International - F.Z.E. – 100%
  - PNiG NAFTA Sp. z o.o. – 100%
  - GEOFIZYKA Kraków – 100%
  - GEOFIZYKA Toruń Sp. z o.o. – 100%
  - PN „Diament" Sp. z o.o. – 100%
  - ZRG Krosno Sp. z o.o. – 100%
  - PGNiG Norway AS – 100%
  - POGC - Libya B.V. – 100%
- **TRADE AND STORAGE**
  - „INVESTGAS" S.A. – 100%
  - Operator Systemu Magazynowania Sp. z o.o. – 100%
- **DISTRIBUTION**
  - Dolnośląska Spółka Gazownictwa Sp. z o.o. – 100%
  - Górnośląska Spółka Gazownictwa Sp. z o.o. – 100%
  - Karpacka Spółka Gazownictwa Sp. z o.o. – 100%
  - GK Mazowiecka Spółka Gazownictwa – 100%
    - Powiśle Park Sp. z o.o. – 100%
  - Pomorska Spółka Gazownictwa Sp. z o.o. – 100%
  - Wielkopolska Spółka Gazownictwa Sp. z o.o. – 100%
- **OTHER ACTIVITY**
  - Geovita Sp. z o.o. – 100%
  - PGNiG Energia S.A. – 100%
  - POGC Trading GmbH – 100%
  - PGNiG Technologie Sp. z o.o. – 100%
    - BUG Gazobudowa Sp. z o.o. – 100%
    - ZUN Naftomet Sp. z o.o. – 100%
    - ZRUG Sp. z o.o. (Pogórska Wola) – 100%
    - BN Naftomontaż Sp. z o.o. – 100%
  - B.SiP.G „Gazoprojekt" S.A. – 75%

2. Employment

The table below presents employment at the PGNiG Group as at June 30th 2011, by segments. As the PGNiG S.A. Head Office provides services to all the segments, it is disclosed separately.

Employment by segments (no. of staff)

	Jun 30 2011
PGNiG S.A. Head Office	844
Exploration and Production	11,737
Trade and Storage	3,801
Distribution	13,871
Other Activities	2,304
Total	32,557

Since January 2009, the Group has had in place the Programme for Employment Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3). Unlike previous employment restructuring programmes, this scheme 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. Any decision to implement the programme may only be made where it is justified by the scope of planned restructuring involving workforce downsizing and/or job shedding.

In February 2011, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted a resolution to apply PLN 1,774,099 from the capital reserve designated as Central Restructuring Fund to provide one-off benefits to 35 employees of ZUN Naftomet Sp. z o.o. who were made redundant.

3. Sale and acquisition of natural gas

The PGNiG Group recorded sales revenue of PLN 11.5bn, with 89% of that figure derived from sales of natural gas.

Sales revenue (PLNm)

	H1 2011
Natural gas, including:	10,313.2
- high-methane gas	9,685.7
- nitrogen-rich gas	627.5
Crude oil	472.3
Condensate	1.7
Helium	26.3
Propane-butane	24.2
Gas storage services	15.3
Geophysical and geological services	209.8
Exploration services	239.9
Other sales	220.7
Total	11,523.4

In H1 2011, the PGNiG Group sold 7.5 billion cubic metres of natural gas, with 96% of that figure represented by sales from the transmission and distribution systems and the balance – by direct sales of natural gas from the fields.

Natural gas sales volume (million cubic metres)

	H1 2011
Trade and Storage	7,216.3
Exploration and Production	332.1
Total	7,548.4

In H1 2011, the volume of natural gas acquired by the PGNiG Group reached 8.1 billion cubic metres, with 73% of that amount sourced from imports, mostly from Russia. Natural gas production from fields in Poland represented 26% of the total volume acquired. The table below sets forth the structure of acquisition of natural gas, measured as high-methane gas equivalent.

Acquisition of natural gas (million cubic metres)

	H1 2011
Imports	5,875.9
Domestic production	2,126.0
Domestic suppliers	53.1
Total	8,055.0

Chapter II. Company's governing bodies

1. Management Board

At its meetings on January 12th 2011 and March 8th 2011, the Supervisory Board appointed the President and the members of the PGNiG S.A.'s Management Board for another joint term of office starting on March 13th 2011. The following persons were re-appointed for the three-year term:

- Michał Szubski – President of the Management Board
- Radosław Dudziński – Member of the Management Board
- Sławomir Hinc – Member of the Management Board
- Marek Karabuła – Member of the Management Board
- Mirosław Szkałuba – Member of the Management Board

Mirosław Szkałuba is the Management Board member elected by employees in the elections which were carried out in January and February 2011.

As at June 30th 2011, the composition of PGNiG S.A.'s Management Board and the functions assigned to its members were as follows:

- Michał Szubski – President of the Management Board
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Marek Karabuła – Vice-President, Petroleum Mining
- Mirosław Szkałuba – Vice-President, Trade

2. Supervisory Board

On April 20th 2011, the General Shareholders Meeting of PGNiG S.A. appointed the members of the PGNiG S.A.'s Supervisory Board for another joint term of office starting on May 1st 2011. The following persons were re-appointed for the three-year term:

- 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

Agnieszka Chmielarz, Mieczysław Kawecki and Jolanta Siergiej are Supervisory Board members elected by employees in the elections carried out January and February 2011.

Until June 30th 2011, there were no changes in the composition of the Supervisory Board of PGNiG S.A.

Chapter III: Shareholder structure

As at June 30th 2011, the share capital of PGNiG S.A. 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 of them conferred the right to one vote at the General Shareholders Meeting. The shareholder structure as at June 30th 2011 is shown in the table below.

Shareholder structure

Shareholder	Number of shares as at Jun 30 2011	% of share capital held as at Jun 30 2011	Number of votes conferred by shares held	% of total vote at GM as at Jun 30 2011
State Treasury	4,272,416,557	72.41%	4,272,416,557	72.41%
Other shareholders	1,627,583,443	27.59%	1,627,583,443	27.59%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

PGNiG shares and shares in the related undertakings of PGNiG S.A. held by management and supervisory personnel

The table below shows PGNiG shares held by the management and supervisory personnel as at June 30th 2011.

PGNiG shares held by the management and supervisory personnel

Name	Title	Number of shares	Par value of shares (PLN)
Michał Szubski	President of the Management Board	6,825	6,825
Mirosław Szkałuba	Vice-President of the Management Board	9,425	9,425
Stanisław Rychlicki	Chairman of the Supervisory Board	9,897	9,897
Mieczysław Kawecki	Secretary of the Supervisory Board	19,500	19,500
Jolanta Siergiej	Member of the Supervisory Board	9,425	9,425
Mieczysław Jakiel	Proxy	30,101	30,101
Tadeusz Kulczyk	Proxy	21,316	21,316

Agreements which may give rise to future changes in the stakes held by the existing shareholders and bondholders

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

Control of employee stock option plans

On October 1st 2010, the eligible employees' rights to acquire PGNiG shares free of charge expired. As a result, agreements for free-of-charge disposal of the Company shares may be entered into only by the heirs of eligible employees who filed – on or before October 1st 2010 – a petition with a court seeking a declaration that they had acquired the eligible employees' rights by way of inheritance. As at June 30th 2011, 59,227 eligible employees or their heirs (96.3% of the total number of eligible persons) acquired 727,583,442 shares, representing 97% of the pool of shares available to be acquired free of charge by eligible persons.

55,250 PGNiG shares acquired free of charge by members of the Company's Management Board were admitted to stock-exchange trading on July 1st 2011.

Chapter IV: Regulatory environment

1. Licences

As at June 30th 2011, PGNiG S.A. held the following licences granted by the President of the Energy Regulatory Office under the Energy Law:

- one licence for trade in gaseous fuels
- one licence for international trade in natural gas
- one licence for storage of gaseous fuels
- one licence for trade in liquid fuels
- one licence for electricity production

On October 7th 2010, the President of the Energy Regulatory Office issued a decision changing the scope of the licence for storage of gaseous fuels by introducing changes in the working capacities of the Mogilno Underground Gas Storage Cavern Facility due to the technical conditions determining the facility's manner of operation, while refusing to introduce similar changes as regards the working capacities of the Husów Underground Gas Storage Facility. Moreover, the President of the Energy Regulatory Office refused to exclude from the licence scope the storage facility working capacities which are used by the production segment or by the Transmission System Operator, as requested by PGNiG S.A. due to the fact that pursuant to the Polish Energy Law such capacities are not storage facilities as defined in this act. On November 2nd 2010, PGNiG S.A. filed an appeal against that decision through the agency of the President of the Energy Regulatory Office to the Regional Court of Warsaw – the Court of Competition and Consumer Protection. Pursuant to its decision of June 21st 2011, the Court of Competition and Consumer Protection started proceedings on the case. By the date of this report, the appeal proceedings had not been concluded.

By virtue of the decision of the President of the Energy Regulatory Office of July 11th 2011, PGNiG S.A. obtained a licence for electricity trading for the period from July 12th 2011 to December 31st 2030.

As at June 30th 2011, the Company held the following licences granted under the Geological and Mining Law:

- 92 licences for exploration for and appraisal of crude oil and natural gas deposits
- 1 licence for appraisal of a salt deposit
- 218 licences for production of crude oil and natural gas from deposits
- 9 licences for underground gas storage (underground gas storage facilities)
- 3 licences for storage of waste

2. Changes in PGNiG S.A.'s tariffs

Until July 14th 2010, settlements with customers were made according to the Gaseous Fuel Tariff (Part A – Gaseous Fuel Supply Tariff No. 3/2010) where the gaseous fuel price that was changed by an adjustment effective as of January 1st 2011.

On February 11th 2011, PGNiG S.A. applied to the President of the Energy Regulatory Office requesting a change to the Gaseous Fuel Tariff (Part A – Gaseous Fuel Supply Tariff No. 3/2010). The Company requested a change of the gaseous fuel price and an extension of the effective term of the changed tariff until May 31st 2011. As the term for which the tariff was approved expired, the

President of the Energy Regulatory Office URE discontinued the proceedings by virtue of its decision of May 16th 2011.

On March 30th 2011, PGNiG S.A. applied to the President of the Energy Regulatory Office requesting approval of Gaseous Fuel Tariff (Part A – Gaseous Fuel Supply Tariff No. 4/2011).

In his decision of June 30th 2011, the President of the Energy Regulatory Office approved the Gaseous Fuel Tariff (Part A – Gaseous Fuel Supply Tariff No. 4/2011) which applies in settlements with customers from July 15th 2011. Average charges for the supply to customers of high-methane gas (E), Lw nitrogen-rich gas and Ls nitrogen-rich gas increased respectively by 8.9%, 7.6% and 6.3%.

The new tariff introduces a broader range of settlement options available to customers from tariff groups 1-3, who will be able to choose a settlement system suitable to their needs. Customers from tariff groups 6-11 are classified according to a gas consumption variance ratio. Based on such a criterion, a customer may be classified to one of three (instead of two, as was the case previously) tariff groups (a, b, c), depending on the assigned ratio value. Additionally, customers will be able to enter into agreements providing for gas collection on an intermittent basis.

In his decision of May 12th 2011, the President of the Energy Regulatory Office, in response to an application from PGNiG S.A., extended the term of Gaseous Fuel Tariff (Part B – Gaseous Fuel Storage Services Tariff No. 1/2010) until September 30th 2011. On July 22nd 2011, PGNiG S.A. applied to the President of the Energy Regulatory Office requesting approval of a new Gaseous Fuel Storage Services Tariff.

The following tables show the average tariffs (in PLN per cubic meter) used in settlements with customers purchasing gaseous fuels, by fuel type and place of receipt.

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.4623	2.5779	4.7%
W-2	1.9047	2.0167	5.9%
W-3	1.7238	1.8340	6.4%
W-4	1.5928	1.7036	7.0%
W-5 - W-7C	1.4474	1.5629	8.0%
W-8A - W-10C	1.2090	1.3185	9.0%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
S-1	1.7738	1.8537	4.5%
S-2	1.3553	1.4415	6.4%
S-3	1.2334	1.3152	6.6%
S-4	1.0765	1.1911	10.7%
S-5 - S-7B	1.0520	1.1225	6.7%
S-8 - S-10	0.9309	1.0113	8.6%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
Z-1	1.3764	1.4575	5.9%
Z-2	1.2553	1.3255	5.6%
Z-3	1.1062	1.1749	6.2%
Z-4	0.9908	1.0954	10.6%
Z-5 - Z-7B	1.0289	1.0825	5.2%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.4154	2.5468	5.4%
W-2	1.9701	2.0803	5.6%
W-3	1.6906	1.8014	6.6%
W-4	1.6085	1.7314	7.6%
W-5 - W-7C	1.4552	1.5854	8.9%
W-8A - W-11C	1.2053	1.3243	9.9%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.3037	2.4284	5.4%
W-2	1.8709	1.9928	6.5%
W-3	1.6224	1.7450	7.6%
W-4	1.5688	1.6960	8.1%
W-5 - W-7C	1.4654	1.5918	8.6%
W-8A - W-10C	1.1805	1.2933	9.6%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.6563	2.8082	5.7%
W-2	1.7818	1.9019	6.7%
W-3	1.5811	1.7044	7.8%
W-4	1.5372	1.6918	10.1%
W-5 - W-7C	1.4119	1.5658	10.9%
W-8A - W-10C	1.1142	1.2341	10.8%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.5089	2.6499	5.6%
W-2	1.9095	2.0396	6.8%
W-3	1.6856	1.8144	7.6%
W-4	1.6121	1.7530	8.7%
W-5 - W-7C	1.4680	1.6114	9.8%
W-8A - W-10C	1.1857	1.3075	10.3%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
W-1	2.5548	2.6742	4.7%
W-2	1.8365	1.9479	6.1%
W-3	1.6972	1.8085	6.6%
W-4	1.6031	1.7181	7.2%
W-5 - W-7C	1.4125	1.5291	8.3%
W-8A - W-10C	1.1610	1.2698	9.4%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
S-1	1.7685	1.8642	5.4%
S-2	1.3279	1.4032	5.7%
S-3	1.1944	1.2723	6.5%
S-4	1.1009	1.1974	8.8%
S-5 - S-7B	1.0513	1.1246	7.0%
S-8 - S-10	-	-	

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
Z-1	1.6174	1.6976	5.0%
Z-2	1.2034	1.2649	5.1%
Z-3	1.0664	1.1314	6.1%
Z-4	0.9826	1.0645	8.3%
Z-5 - Z-7B	0.9588	1.0184	6.2%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (in %)
	1	2	2/1
E-1A - E-2C	1.0630	1.1818	11.2%
Lw-1 - Lw-2	0.8271	0.9130	10.4%
Ls-1 - Ls-2	0.6730	0.7564	12.4%

3. Changes in the tariffs of Gas Distribution Companies

Until July 14th 2011, settlements with customers receiving services from the Gas Distribution Companies were made according to Tariffs for Gaseous Fuel Distribution Services, approved by the President of the Energy Regulatory Office on May 17th 2010.

By virtue of its decisions of June 30th 2011, the President of the Energy Regulatory Office approved the Tariffs for Gaseous Fuel Distribution Services provided by the Gas Distribution Companies which apply in settlements with customers as of July 15th 2011.

4. Regulatory risks

Changes in laws and regulations

Further changes in the laws governing the operation of the gas sector companies are to be expected in 2011. First of all, the Gas Law is planned to be adopted, which will supersede the Energy Law with respect to the regulation of the gas industry. The Gas Law will also implement the regulations included in the Third Energy Package adopted by the European Parliament, including the Directive of the European Parliament and of the Council concerning common rules for the internal market in natural gas, repealing Directive 2003/55/EC.

Work is also in progress on amending the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gaseous fuels and on settlements in gaseous fuels trading (the Tariff Regulation).

Legal changes, including delays in amending legal acts, create risks stemming from uncertainty as to the scope of regulatory changes and shorter time for adaptation to such changes, which might adversely affect the financial performance and growth prospects of the PGNiG Group.

Energy Efficiency Act

The Energy Efficiency Act came into force on August 11th 2011. The Act implements the provisions of 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 S.A., 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 S.A.'s ability to cover the costs of its core operations depends on the 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 S.A.'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 accept the assumptions adopted by PGNiG S.A. with respect to the main drivers of cost changes and profit targets allowing for business risk. Consequently, the Energy Regulatory Office frequently refuses to accept the tariff prices and charge rates applied for by PGNiG S.A. Setting tariff prices and charge rates at levels which are too low translates into lower profitability of PGNiG S.A.'s operations.

In 2011, the President of the Energy Regulatory Office once again unilaterally extended the effective period of an applicable tariff. The Company believes 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 gaseous fuel to customers in the period by which the tariff effective period is extended by the President of the Energy Regulatory Office. As a result, it should be expected that in the next proceedings to approve tariffs this factor may be taken into consideration in the tariff calculation.

Demand for natural gas

The current methodology for calculation of prices and charge rates is based on forecast values; accordingly, revenue is encumbered with forecasting risk. Inaccurate estimates of demand, affecting the accuracy of forecast purchase and supply volumes as well as the value of costs on which the determinations of prices and charge rates are based, may adversely affect financial performance. An increase in demand from customers above the forecast level would necessitate additional purchases under all existing contracts which allow such a possibility (in numerous cases, at prices higher than forecast).

Purchase price of imported gas

Prices of imported gas are determined 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 acquisition 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 error risk. 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.

Chapter V: Exploration and Production

1. Exploration

In H1 2011, the PGNiG Group was involved in hydrocarbon exploration and appraisal projects which it implemented either on its own or in collaboration with partners. 34,177 m of exploration/appraisal drillings were performed in the Group's licence areas, including 33,308 m in Poland, and 869 m in Pakistan. Also, 488 km of 2D seismic surveys and 444 sq km of 3D seismic surveys were performed as part of exploration work. Furthermore, the PGNiG Group cooperated with third parties in such parties' licence areas in Poland and on the Norwegian Continental Shelf.

In H1 2011, the Group provided services to third parties as part of projects consisting in exploration for hydrocarbons, metal ores and geothermal water. For external customers, the Group performed 87,935 m of drillings, 2,707 km of 2D seismic surveys, and 903 sq km of 3D seismic surveys, as well as performed well servicing activities such as major remedial treatments, workovers, well abandonment services and services consisting in application of enhanced recovery techniques.

1.1. Exploration in Poland

Out of 14 wells the test results of which are known (10 exploration wells and 4 appraisal wells), 5 wells (including 3 exploration wells and 2 appraisal wells) were classified as positive (in these wells gas flows were identified). 9 wells yielded negative results. Moreover, 4 wells were worked over, including 3 with positive results. The dry well was abandoned.

In H1 2011, the PGNiG Group conducted exploration work in search for unconventional gas and hydrocarbons in deep formations, as part of which the Tymowa-1 borehole was completed and drilling of the Lubocino-1 (shale gas) and Piaski-3 boreholes continued. No hydrocarbon flow was identified in the Tymowa-1 borehole. Further testing is planned in the case of the Lubocino-1 and Piaski-3 boreholes. Additionally, drilling of the Dukla-1 well, with a planned depth of 5,500 m, commenced.

The PGNiG Group also conducted geophysical work in the Carpathian Mountains and in Polish Lowlands. In its own licence areas, in H1 2011 the Company performed 488 km of 2D seismic surveys, and 3D seismic surveys covering an area 444 sq km..

As at June 30th 2011, the Group's recoverable reserves were:

- 93.4 billion cubic metres of natural gas measured as high-methane equivalent,
- 21.3 million tonnes of crude oil.

<u>Joint ventures in Poland</u>

In H1 2011, PGNiG S.A. collaborated with other entities in areas covered by licences awarded to PGNiG S.A., FX Energy Poland Sp. z o.o., and Aurelian Oil & Gas PLC.

Under licences awarded to PGNiG S.A., work continued in the following areas:

- "Płotki" – in cooperation with FX Energy Poland Sp. z o.o.
- "Płotki" – "PTZ" – in cooperation with FX Energy Poland Sp. z o.o. and Calenergy Resources Poland Sp. z o.o.
- "Poznań" – in cooperation with FX Energy Poland Sp. z o.o.
- "Bieszczady" – in cooperation with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o.
- "Sieraków" – in cooperation with Orlen Upstream Sp. z o.o.

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, 274N) – in cooperation with FX Energy Poland Sp. z o.o.
- "Ostrowiec" (blocks 163 and 164) – in cooperation with FX Energy Poland Sp. z o.o.
- "Kutno" – in cooperation with FX Energy Poland Sp. z o.o.

Under licences awarded to Aurelian Oil & Gas PLC, work was performed in the following areas:

- "Karpaty Zachodnie" – in cooperation with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of Aurelian Oil & Gas PLC)
- "Karpaty Wschodnie" – in cooperation with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of Aurelian Oil & Gas PLC)

As far as the "Płotki" and "Płotki" – "PTZ" areas are concerned, production continued from the Roszków field in the "Płotki" area and from the Zaniemyśl field in the "Płotki" – "PTZ" area. In the "Poznań" area, in H1 2011 gas production continued from the Środa Wielkopolska gas field and production of gas began from the Kromolice field. Work also started on development of the Winna Góra gas field. Drilling of the Lisewo-1k exploration borehole yielded a positive result. Furthermore, work commenced to drill the Pławce-2 exploration borehole with a planned depth of 4,000 m in search for tight gas. 3D field work commenced in the Żerków-Pleszew area during H1 2011 as well.

In the "Bieszczady" licence area, work continued in H1 2011 to drill the Niebieszczany-1 deep borehole. Additionally, 2D field work was carried out in the Paszowa-Brzegi Dolne area. 2D seismic work is planned to start in H2 2011 in the Jaśliska-Baligród area.

In the "Sieraków" area, the Sieraków-5 borehole was drilled in H1 2011. As no hydrocarbon flow was identified in the borehole, work was commenced to re-analyse the area.

In the "Warszawa-Południe" area work commenced within block 254 to drill the Machnatka-2 exploration borehole with a planned depth of approximately 4,500 m. Analytical work continued for the "Ostrowiec" area. In the "Kutno" area, preparatory work was conducted to drill the Kutno-2 deep exploration borehole with a planned depth of 6,450 m.

In H1 2011, 136 km of 2D seismic was acquired in the "Karpaty Wschodnie" area and work commenced on processing of the data. Work also started on acquisition of a new 2D seismic survey in the Jordanów area.

1.2. Exploration abroad

Pakistan

PGNiG S.A. conducts exploration work in Pakistan on the basis of an agreement on hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. 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 S.A. (operator) – 70%, PPL – 30%. In H1 2011, work was under way on workover of the Hallel-1 borehole, and drilling of the Hallel-X1 horizontal borehole commenced. During H1 2011, work was also conducted on processing of the 2D and 3D seismic data acquired in 2010. Processing of this data will continue and its interpretation will start in H2 2011.

Denmark

Since the execution of the agreement on assignment of interests in 2007, PGNiG S.A. has been engaged in exploration activity in the 1/05 licence area in Denmark. Currently, the licence interests are: PGNiG S.A. (operator) – 80%, Nordsøfonden – 20%. A drilling plan was prepared in H1 2011 and submitted to Danish Energy Agency (DEA). In H2 2011, drilling of an exploration borehole will commence.

Egypt

In Egypt, PGNiG S.A. has been conducting exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement (EPSA) with the government of Egypt of May 17th 2009. The Company holds a 100% interest in the licence. In connection with unstable political situation in Egypt, at the beginning of 2011 the Polish employees of the PGNiG S.A. Egypt Branch were temporarily withdrawn from the country, which, however, did not entail any delays in the exploration work. In H1 2011, field gravimetric surveys along with their interpretation were completed. 1,600 km of 2D profiles are planned to be acquired in the second half of the year.

Norway

On the Norwegian Continental Shelf, PGNiG Norway AS and its partners are implementing the Skarv/Snadd/Idun development project. PGNiG Norway AS holds a 12% interest in the licence; other interest holders are British Petroleum (operator, 24%), Statoil (36%) and E.ON Ruhrgas (28%).

In H1 2011, the floating production, storage and offloading (FPSO) unit which is to be used to produce hydrocarbons from the Skarv field, was transported to Norway. Installation of all the submarine structures (foundation slabs, pipelines, etc.) on the Skarv and Idun fields was also completed. Installation of the FPSO on location at sea and launch of production from the Skarv field is planned in the second half of 2011.

Furthermore, in H1 2011 an appraisal well was drilled in the Snadd North field, discovered in 2010. On the other hand, work in licence area PL419 was abandoned, given negative results from the exploration well which was drilled there.

Following licencing round awards, in H1 2011 PGNiG Norway AS acquired in the Norwegian Continental Shelf:

- a 20% interest in licence PL599, the direct operatorship of which was awarded to BG Norge AS (40% interest),
- a 30% interest in licence PL600, the direct operatorship of which was awarded to Dana Petroleum (70% interest).

On June 18th 2011, due to low permeability of the formations accumulating the gas discovered in licence area PL326, the interest holders decided not to proceed with any further work under this licence.

Libya

Polish Oil and Gas Company - Libya B.V. conducted exploration work in the area of licence No. 113, located in the Murzuq petroleum basin. By February 2011, the Company acquired 3,000 km of 2D profiles and 1,087 sq km of 3D profiles, and carried out a number of geological analyses. Furthermore, in H1 2011 work was conducted in cooperation with PGNiG S.A. on evaluation of the 2D seismic data.

In connection with the political situation in Libya, in February 2011 all Polish employees of POGC-Libya B.V. were withdrawn from the country. In March 2011, the company gave notice to National

Oil Corporation of a *force majeure* event, which suspended performance of the Exploration and Production Sharing Agreement (EPSA) until the situation which provides the basis for such a notice ceases to apply. Any decision to continue the work depends on the political developments in Libya.

1.3. Exploration services

In H1 2011, companies from the exploration and production segment provided services consisting in exploration, appraisal, research and production hole drillings and drillings for the purposes of underground gas storage facilities. In Poland, drillings were performed primarily for PGNiG S.A. Outside the PGNiG Group, drilling work was performed for KGHM Polska Miedź S.A. in the copper licence area, as well as for companies searching for unconventional gas, such as Energia Zachód Sp. z o.o. (tight gas), Saponis Investments Sp. z o.o. (shale gas), NWR Karbonia Sp. z o.o. (mineral deposits), Zakład Komunalny Kleszczów Sp. z o.o. (geothermal water), Calenergy Resources Poland Sp. z o.o., and FX Energy Poland Sp. z o.o. Drilling services abroad were performed mainly in Kazakhstan, Uganda, Czech Republic, Pakistan, Mozambique, and Ukraine. Drillings in Libya for Turkish Petroleum Overseas Company were interrupted by the military conflict.

The PGNiG Group companies also performed specialised well mining related services, including services consisting in application of enhanced recovery techniques, mud services or cementing services. They carried out remedial treatments, workovers and well abandonment or major well maintenance work. In Poland, these auxiliary services were performed mainly for the PGNiG Group. Work provided outside the Group included well servicing activities for Energia Zachód Spółka z o.o. and Transwiert Sp. z o.o., workovers and well servicing treatments for FX Energy Poland Sp. z o.o., and application of enhanced recovery techniques for RWE Dea AG S.A. and Park Wodny – Bania Sp. z o.o. Work performed abroad included application of enhanced recovery techniques using coiled tubing in the Czech Republic and Slovakia, cementing services in Lithuania, workovers in Russia, and Datawell services in Ukraine.

In H1 2011, companies from the exploration and production segment performed geophysical services consisting in seismic field work, seismic data designing and acquisition, as well as seismic data processing and interpretation, and also performed geophysical surveys and drilling services. In Poland, the companies carried out seismic work for FX Energy Poland Sp. z o.o., Chevron Polska Energy Resources Sp. z o.o., ExxonMobil Global Services Company, Lane Energy Poland Sp. z o.o., Orlen Upstream Sp. z o.o., Oculis Energy Sp. z o.o. and RWE Dea AG S.A. On the foreign markets, well logging services were performed for NAFTA A.S. in Slovakia and MND Production A.S. in the Czech Republic, seismic data acquisition – for customers from India and Germany, and seismic data processing – mainly for customers from India and the USA. For the PGNiG Group, the companies performed the full range of geophysical services.

2. Production

In H1 2011, PGNiG S.A. produced a total of 2.1 billion cubic meters of natural gas (measured as high-methane gas equivalent) and 212.6 thousand tonnes of crude oil. The table below shows PGNiG S.A.'s production volumes in H1 2011.

Production volumes

		Unit	H1 2011
1	Natural gas, including:	million cubic metres*	2,126.0
a	high-methane, including:	million cubic meters*	807.1
	- Zielona Góra Branch	million cubic meters	0
	- Sanok Branch	million cubic meters	807.1
b	nitrogen-rich, including:	million cubic metres*	1,318.9
	- Zielona Góra Branch	million cubic metres*	1,283.4
	- Sanok Branch	million cubic metres*	35.5
2	Crude oil	thousand tonnes	212.6
	- Zielona Góra Branch	thousand tonnes	188.8
	- Sanok Branch	thousand tonnes	23.8

* Measured as high-methane gas equivalent.

In the operating area of the Sanok Branch, the Jeżowe field came on stream and 10 wells were hooked up on fields where production has already been under way for some time. Total production capacity addition attributable to the newly hooked-up wells is approximately 12 thousand cubic meters of gas per hour. In the operating area of the Zielona Góra Branch, the fields newly coming onstream included Elżbieciny, Jabłonna, Jabłonna S and Jabłonna W, with an aggregate production capacity of approximately 18 thousand cubic meters of gas per hour (measured as high-methane gas equivalent). The gas produced from these fields is sent to the Grodzisk Denitriding Plant. Moreover, the Kromolice field, with a production capacity of approximately 5.6 thousand cubic meters per hour (measured as high-methane gas equivalent), was brought onstream as part of the cooperation with FX Energy Poland Sp. z o.o.

To counteract the natural decline in production yields, 17 wells whose technical condition made further production impossible were subject to major remedial treatment in H1 2011. Additionally, a number of well stimulation operations were carried out in order to sustain or increase the rates of recovery or to improve absorption rates in injectors.

Crude oil and natural gas recovered from underground deposits are processed to obtain commercial products. The table below sets forth off-tariff sales of natural gas (including LNG), as well as sales of crude oil and other products to external customers by volume. The key natural gas customers were industrial customers, accounting for 84% of the total sales volume.

Sales structure of key products

		Unit	H1 2011
1	Natural gas, including:	million cubic meters	332.1
	- high-methane gas	million cubic meters	30.0
	- nitrogen-rich gas*	million cubic meters	302.1
2	Crude oil	thousand tonnes	217.9
3	Condensate	thousand tonnes	0.8
4	Helium	million cubic meters	1.6
5	Propane-butane	thousand tonnes	8.9
6	Nitrogen	thousand kg	221.0
7	Sulphur	thousand tonnes	10.5

* Measured as high-methane gas equivalent.

In H1 2011, PGNiG S.A. continued to sell crude oil to Rafineria Trzebinia S.A. and TOTSA TOTAL OIL TRADING S.A. under the agreements executed in 2009, as well as to Rafineria Nafty Jedlicze S.A. under a ten-year contract executed in 2007.

The PGNiG Group's foreign customers accounted for 35% of the total sales volume in the case of crude oil, and for 75% in the case of helium. Crude oil was sold to a German refinery (through the Druzhba pipeline), whereas most of the helium volume was sold in liquid form to foreign wholesale customers, who resell the product in European countries.

Underground gas storage facilities in the Exploration and Production segment

The PGNiG Group continued work on extension of the Strachocina Underground Gas Storage Facility. In H1 2011, gas injection tests commenced to determine the facility's operating parameters. The table below sets forth working capacities of the underground storage facilities used to store produced gas as at June 30th 2011.

Working capacities of the underground storage facilities used by the Exploration and Production segment (million cubic metres)

High-methane gas	Jun 30 2011
Brzeźnica (E)	65.0
Strachocina (E)	150.0
Swarzów (E)	90.0
Nitrogen-rich gas	Jun 30 2011
Daszewo (Ls)	30.0
Bonikowo (Lw)	200.0

3. Planned activities

Exploration

In H2 2011, The PGNiG Group plans to carry out geophysical work and drillings in Poland on a few dozen of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The

Group plans to implement projects focused on exploring new potential in the area of unconventional reserves (tight gas and shale gas), where little appraisal has so far been made. The planned activities include further operations in the Lubocino-1 borehole (shale gas), completion of drilling of the Pławce-2 borehole (tight gas; a project implemented in cooperation with FX Energy Poland Sp. z o.o.), continued drilling of the Dukla-1 borehole and commencement of drilling of further boreholes. In Pakistan and Egypt, the Group plans to continue geophysical work, while in Denmark it will carry on with drilling of an exploration well. Moreover, in H2 2011 the PGNiG Group will be involved in activities aimed at acquiring new hydrocarbon exploration licences in the United States.

Exploration services

In H2 2011, the PGNiG Group will provide drilling services in Egypt, Libya, Ukraine and Slovakia.

In Poland, the Group's planned operations include drillings as part of exploration for hydrocarbons, including unconventional reserves, as well as in search of metal ores.

The PGNiG Group will perform workovers, well abandonment services and services consisting in application of enhanced recovery techniques and measurement of reservoir parameters in Ukraine, the Czech Republic, Russia and Denmark, and for customers in the Polish market. Geophysical services will be provided to Chevron Polska Energy Resources Sp. z o.o., FX Energy Poland Sp. z o.o., DPV Service, Energia Zachód Sp. z o.o., RWE Dea AG S.A. and other customers in Poland, as well as to customers in Germany, Austria, Egypt and India.

Natural gas production

The Group's plans for 2011 assume an annual natural gas production volume of approximately 4.3 billion cubic meters of high-methane gas equivalent with a calorific value of 39.5MJ per cubic meter. In H2 2011 the PGNiG Group intends to start production from the Nowosielec and Łękawica fields and from two wells in the Dzików field, and to hook up one well in the Kromolice S field (project implemented in cooperation with FX Energy Poland Sp. z o.o.).

The date of commencement of production from the fields in the Norwegian Continental Shelf, initially scheduled for August 2011, will be postponed to the end of 2011. The production launch date has been changed in connection with the tests carried out at the shipyard and additional work required on the FPSO unit. PGNiG S.A. will publish updated forecasts of natural gas production from the Skarv field once it receives relevant data from the field operator.

Crude oil production

Production of crude oil in 2011 is estimated at about 460 thousand tonnes from domestic fields. The reduction in the planned production follows from a temporary discontinuation of collection by one of the customers of the gas obtained in the process of degassing of the crude oil produced in Dębno, as well as from the need to limit crude oil supplies to customers due to an unplanned repair of the main crude oil storage tank at the Dębno production facility.

The date of commencement of production from the fields in the Norwegian Continental Shelf, initially scheduled for August 2011, will be postponed to the end of 2011. The production launch date has been changed in connection with the tests carried out at the shipyard and additional work required on the FPSO unit. PGNiG S.A. will publish updated forecasts of natural gas production from the Skarv field once it receives relevant data from the field operator.

Underground gas storage facilities

Extension of the Strachocina Underground Gas Storage Facility is planned to be completed in H2 2011. The project is designed to increase the facility's working capacity to 330 million cubic metres.

4. Risks related to Exploration and Production

Resource discoveries and estimates

The main risk inherent in exploration activity is the risk of failure to discover reserves, 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 counterbalance the depletion of the currently producing reserves, PGNiG S.A.'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 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 the full business cycle from the commencement of exploration to the launch of production from a developed field takes six to eight years, while the hydrocarbon production cycle lasts from 10 to 40 years. Formation characteristics defined at the stage of preparing the relevant documentation are reviewed after production starts. Each downgrade of the size of the reserves or production volume may lead to a lower revenue and adversely impact PGNiG S.A.'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 with respect to acquisition of licences for exploration for and appraisal of hydrocarbon deposits. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG S.A. Thus it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences. Competitors are also able to identify, value, offer and purchase a larger number of fields (including operator status and licences) than it is possible in the case of PGNiG S.A., given its financial and human resources. This competitive advantage enjoyed by other market players is particularly important on the international market.

Delayed work

Under the currently binding 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 year. As regards business activity on foreign markets, it may take even two years from the time that the tender for licence is awarded until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is obliged to make numerous 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. As a result, another several months pass before an agreement with the contractor is signed. In addition, companies must frequently wait for a very long time before their imported equipment receives customs clearance. These factors create the risk of delayed exploration work.

Formal and legal issues beyond PGNiG S.A.'s control include:
- local governments' failure to adopt local land development plans;
- obstacles in incorporating investment projects into the local land development plans;
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions;
- amendments to the current planning and development concept;
- 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 S.A.'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 an entire investment project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploration work is capital consuming, given the prices of energy carriers and materials. Cost of exploration work is especially sensitive to steel prices, which are passed on to prices of casing pipes and lifting casing that is used in drilling. Any increase in prices of energy and materials translates into an increase in the cost of exploration work. Moreover, profitability of foreign exploration projects will to a significant extent depend on the prices of oil derivative products and fluctuations of currency exchange rates.

Legal regulations concerning safety, environmental protection and health

Ensuring compliance with environmental laws and regulations in Poland and abroad might significantly increase the PGNiG S.A.'s costs of operations. Currently, PGNiG S.A. incurs significant capital expenditure and costs on harmonising 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 in the scope of entering the areas of the occurrence of protected plant species and habitats of protected animals. The tendency to tighten up the environmental protection regulations is present also in other countries where PGNiG S.A. conducts exploration activity.

Qualified personnel

The presence of foreign companies on the Polish market has intensified the phenomenon whereby highly qualified employees with extensive professional experience are taken over. This risk is especially high with respect to professionals specialised in oil and gas exploration. In countries where PGNiG S.A. operates, highly qualified staff is difficult to recruit.

Unpredictable events

Hydrocarbon deposits developed by PGNiG S.A. are usually located at great depth, which is accompanied by extremely high pressures, and many of them include hydrogen sulphide in its chemical composition. Consequently, there exists a high risk of an explosion, eruption or hydrocarbon leakage, which in turn may pose a threat to people (workers and local inhabitants), natural environment and also production equipment.

Changes in laws and regulations

The laws and regulations in some countries change frequently and unexpectedly, causing problems to entities involved in exploration activity. This may be a particular threat in countries where the law changes depend on decisions made by authoritarian governments.

Political and economic situation

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

In some areas where PGNiG S.A. is present there is a risk of social and political destabilisation. Changes of governments may bring to a halt the processes of state administration issuing permits to conduct business in the petroleum sector. Additionally, these countries are at risk of internal conflicts and social unrest caused by poor social and demographic conditions in which their inhabitants live. The risks specified above may lead to a limitation, suspension or discontinuation of PGNiG S.A.'s activities.

In certain countries, the exploration business is hindered by lack of adequate infrastructure, which may be an obstacle in transporting equipment, staff and materials to the sites. Providing supplies and ensuring appropriate health care may also be a problem. These risks may lead to a limitation or suspension of the Company's exploration activities.

Chapter VI: Trade and Storage

1. Purchase

In H1 2011, the PGNiG Group derived natural gas from imports and, to a limited extent, from domestic suppliers. PGNiG S.A. imported natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with Gazprom Export as well as the medium-term gas supply agreements with VNG-Verbundnetz Gas AG:

- contract with Gazprom Export for sales of natural gas to the Republic of Poland, dated September 25th 1996, which will remain in force until 2022;
- agreement with VNG-Verbundnetz Gas AG for sales of the Lasów natural gas, dated August 17th 2006, which will remain in force until October 1st 2016;
- agreement with VNG-Verbundnetz Gas AG for sales of the Lasów 2008 natural gas, dated September 29th 2008, in force until October 1st 2011.

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

Structure of natural gas purchases by supply sources (million cubic metres)

	H1 2011	%
Imports, including:	5,875.9	99.1%
- Gazprom Export	5,356.8	91.2%
- VNG AG	448.9	7.6%
- Other foreign suppliers	70.2	1.2%
Domestic suppliers	53.1	0.9%
Total	5,929.0	100.0%

From January 1st 2011, NAK Naftogaz Ukrainy suspended gas deliveries via the Zosin near Hrubieszów cross-border point on the Polish-Ukrainian border, where gas is supplied to Poland under a gas supply agreement of October 26th 2004. As at this report date, NAK Naftogaz Ukrainy has not resumed gas deliveries to the Hrubieszów area. PGNiG S.A. is looking for other suppliers who could guarantee gas deliveries to the Zosin terminal. Despite the suspension of gas supplies from Ukraine, the Hrubieszów area has been receiving sufficient gas supplies to meet the local demand.

New agreements

On March 21st 2011, PGNiG S.A. and Gazprom Export signed an annex to the contract of September 25th 1996 providing for sales of natural gas to the Republic of Poland. The parties agreed on an option to increase the daily offtake at the Vysokoye cross-border point to 15 million cubic metres, with the annual contracted volumes remaining unchanged.

On May 13th 2011, PGNiG and Vitol SA concluded an Individual Agreement for natural gas supplies to a cross-border terminal located on the Polish-Czech border in the Cieszyn area. Under the agreement, approximately 550 million cubic metres of gas per annum will be delivered in the period from October 1st 2011 to October 1st 2014. The gas will be supplied via a newly built interconnector, which has connected the gas systems of Poland and the Czech Republic.
On May 13th 2011, PGNiG S.A. and VNG-Verbundnetz Gas AG signed an Individual Agreement for summer gas supplies to the Lasów cross-border terminal. Under this agreement, gas was supplied in the period from May 17th to July 3rd 2011.

On June 30th 2011, PGNiG S.A. and VNG-Verbundnetz Gas AG signed an Individual Agreement for summer gas supplies to the Lasów cross-border terminal. Under this agreement, gas is to be supplied in the period from July 3rd to September 30th 2011, or until the full contracted volume is offtaken.

2. Sale

In H1 2011, PGNiG S.A. signed comprehensive agreements for the supply of gaseous fuel, both from the transmission system and from the distribution system, to 31.0 thousand new customers.

On March 11th 2011, a comprehensive agreement for the supply of gaseous fuel was signed with Elektrociepłownia Stalowa Wola S.A. The fuel will be used to fire the CCGT unit. The planned annual offtake is to amount to approximately 540 million cubic metres. The agreement was concluded for 14 years, starting from the launch of supplies. Performance of the agreement will commence upon fulfilment of certain conditions precedent. The value of the agreement throughout its term is estimated at approximately PLN 9.7bn.

In the period June 27th–29th 2011, PGNiG S.A. executed six agreements with Gas Distribution Companies, including:

- Dolnośląska Spółka Gazownictwa Sp. z o.o.
- Górnośląska Spółka Gazownictwa Sp. z o.o.
- Karpacka Spółka Gazownictwa Sp. z o.o.
- Mazowiecka Spółka Gazownictwa Sp. z o.o.
- Pomorska Spółka Gazownictwa Sp. z o.o.
- Wielkopolska Spółka Gazownictwa Sp. z o.o.

Under the agreements, the Gas Distribution Companies will provide gaseous fuel distribution services to PGNiG S.A. The agreements remain in effect from June 29th 2011 to June 28th 2015. The estimated aggregate value of the agreements over their entire term is approximately PLN 14bn.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. In H1 2011, sale of natural gas remained flat year on year. The PGNiG Group sold gas chiefly on the domestic market. The sales structure of the Trade and Storage segment in H1 2011 is presented in the table below.

Sales structure of key products

		Unit	H1 2011
1	Natural gas, including:	million cubic meters	7,216.3
	- high-methane gas	million cubic meters	6,944.7
	- nitrogen-rich gas*	million cubic meters	271.6
2	Propane-butane	thousand tonnes	0.9

* Measured as high-methane gas equivalent.

The Group's main customers purchasing natural gas included companies from the chemical, metallurgical and power sectors, as well as households. Households made up the largest group of customers purchasing natural gas, accounting for 97% of the Group's entire customer base (approximately 6.4m). Their share in the total sales volume was 29%. The most prominent share in the natural gas sales volume was claimed by industrial customers (57%). The table below presents the structure of sales of natural gas (measured as high-methane gas equivalent) by major customers.

Sales of natural gas entering the national grid (million cubic meters)

	H1 2011	%
Industrial customers	4,085.4	56.6%
Trade and services	873.2	12.1%
Households	2,118.7	29.4%
Wholesale customers	116.1	1.6%
Exports	22.9	0.3%
Total	7,216.3	100.0%

In H1 2011, PGNiG S.A. and Mazowiecka Spółka Gazownictwa Sp. z o.o. continued an investment project to switch the customers in Pisz (Olsztyn Province) who receive propane-butane-air to high-methane gas (E) produced from LNG.

Moreover, PGNiG S.A. and ZRUG Sp. z o.o. of Poznań continued to execute an investment project under an agreement on the construction of a gas network in the Rakoniewice municipality. The project involves the construction of 75 km of a medium-pressure gas pipeline. Implementation of this project will contribute to an increase in the number of new connection agreements as well as to higher volumes of gas sold.

In H1 2011, PGNiG S.A. launched a project entitled "Provision of Category E Gaseous Fuel to Ełk and Olecko with the Use of LNG". This project represents another phase of a larger project to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (the PESO project). Construction of installations under the project is planned to be completed in 2013.

3. Storage

PGNiG S.A. has been acting as the Storage System Operator since 2009. In March 2011, PGNiG S.A. applied to the President of the Energy Regulatory Office requesting the appointment of Operator Systemu Magazynowania Sp. z o.o. as the Storage System Operator for gaseous fuels and the granting of a licence for storage of gaseous fuels in storage facilities. These steps were taken with a view to meeting the obligations under Regulation (EC) No. 715/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005. As at this report date, relevant proceedings were still under way.

Detailed terms of providing gaseous fuel storage services (working capacity, injection capacity, withdrawal capacity) and sale of storage services are compiled in the "Rules of Provision of Storage Services". After public consultations, on June 30th 2011, the revised "Rules of Provision of Storage Services" came into force.

In H1 2011, the PGNiG Group continued works related to the construction of four caverns in the Mogilno Underground Gas Storage Cavern Facility and construction a new high-methane gas underground storage facility (the Kosakowo Underground Gas Storage Cavern Facility). The Group also carried on with construction of the surface part of the Wierzchowice Underground Gas Storage Facility. The table below presents the working capacities of the underground gas storage facilities.

Working capacities of the storage facilities in the Trade and Storage segment (million cubic meters)

	Jun 30 2011
Husów	350.0
Mogilno	377.9
Wierzchowice	575.0

4. Planned activities

In H2 2011, the PGNiG Group will continue the extension of the Mogilno Underground Gas Storage Cavern Facility and of the Wierzchowice Underground Gas Storage Facility. Construction of the surface part of the Wierzchowice Underground Gas Storage Facility is planned to be completed at the end of 2011. Moreover, the Company will continue the construction of a new high-methane gas storage facility, i.e. the Kosakowo Underground Gas Storage Cavern Facility.

5. Risks related to Trade and Storage

Competition

At present, PGNiG S.A. is the largest supplier of natural gas in Poland. PGNiG S.A.'s share in the gas market is estimated at approximately 98%. The remaining 2% is represented by suppliers from outside the PGNiG Group which usually purchase gas from PGNiG S.A. However, there is a risk that in the coming years PGNiG S.A.'s existing and potential customers may be taken over by other entities trading in natural gas. Among them are local gas distributors that own transmission infrastructure and offer – in addition to traditional network gas supply – innovative gas supply solutions involving the use of LNG.

Storage

Pursuant to the Act on Mandatory Stocks, as of October 1st 2012, the volume of mandatory stocks must be increased from 20 to 30 days of average annual imports. If there are delays in execution of the investment process, a risk exists that PGNiG S.A. will not be able to build up such stocks due to insufficient storage capacities.

Requirement to diversify supplies of imported gas

On December 16th 2010, the President of the Energy Regulatory Office imposed a PLN 2m fine on PGNiG S.A. for breaching the terms and conditions of its licence for international trade in natural gas, by failing to comply with the requirement to diversify supplies of imported gas in 2007 and 2008. 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. On January 4th 2011, PGNiG S.A. filed an appeal against the decision imposing a fine through the agency of the President of the Energy Regulatory Office to the Regional Court of Warsaw. The Company challenged in full the decision of the President of the Energy Regulatory Office, citing, among other things, breach of the Constitution, erroneous interpretation and improper application of the Energy Law. Moreover, in order to avoid similar situations in the future, PGNiG S.A. submitted an inquiry to the Constitutional Tribunal 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 no changes are made to the aforementioned Regulation, the President of the Energy Regulatory Office may keep on imposing fines on the Company for failing to comply with the diversification requirement until gas stars to be delivered to the Company from other directions (e.g. through the LNG terminal).

Chapter VII: Distribution

1. Business of the Gas Distribution Companies

In H1 2011, the core business of the Gas Distribution Companies consisted in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane/butane and coke-oven gas, via the distribution network. On the basis of a decision issued by the President of the Energy Regulatory Office, since mid-2007 the Gas Distribution Companies have enjoyed the status of Distribution System Operators.

The Gas Distribution Companies also performed work consisting in extension and modernisation of the gas network, as well as in connection of new customers to both the existing and the newly built network sections. Furthermore, the Gas Distribution Companies continued the replacement of the most failure-prone sections of cast iron piping and the modernisation of gas piping with long operating lives whose continued operation posed a safety hazard and resulted in substantial gas loss.

The key investment projects carried out as part of gas network extension and modernisation by the Gas Distribution Companies in H1 2011 included:

- continuation of design work related to the upgrade of an approximately 61 km long high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski; the project is designed to improve the safety of network operation; project implementation is scheduled for completion in 2015;
- continuation of design work as part of the project to connect to the gas network the municipalities and communes of Blachownia, Herby, Wręczyca Wielka, Kłobuck, Opatów, and Krzepice; the project involves construction of (i) an approximately 18 km long high-pressure gas pipeline from Blachownia to Kłobuck along 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) an approximately 52 km long medium-pressure gas pipeline serving Wręczyca Wielka and Kłobuck;
- commencement of design work related to the upgrade of an approximately 37 km long high-pressure gas pipeline from Parszów to Kielce; the project, scheduled for completion in 2015, is designed to improve the safety of network operation;
- continuation of construction (stage 2) of a high-pressure pipeline as part of investment project "Duplex Supply for the City of Toruń"; the project is 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; in H1 2011 the design and cost estimate documentation for the high-pressure gas pipeline from Ostaszewo to Różankowo was completed and all building permits were obtained;
- completion of revitalisation of an approximately 20 km long section of the high-pressure gas pipeline from Zdzieszowice to Płużniczka in Olszowa (economic zone in the Ujazd commune);
- continuation of design work for phase 1 of gas network connection to Długołęka, Domaszczyn, Kamień and Szczodre in the Długołęka commune; the project involves construction of a medium-pressure gas pipeline and a pressure reduction station;
- commencement of design work related to switching the customers in Suwałki who receive propane-butane-air to high-methane (E) gas; the project involves construction of an LNG regasification station, an approximately 21 km long medium-pressure gas pipeline along with connections, and a pressure reduction station.

The Gas Distribution Companies also executed projects involving connection of new areas to the gas network for which they obtained EU co-financing. The largest of these projects included:

- continuation of project named "Construction of a High-Pressure Gas Network Connecting Szczytno, Młynowo and Muławki near Kętrzyn and Installation of Gas Distribution Systems in the Szczytno, Młynowo and Muławki Communes"; the project involves construction of high-pressure gas pipelines with an aggregate length of approximately 83 km; in H1 2011, phase 1 of the construction commenced (high-pressure gas pipeline from Szczytno to Rybno) and a contractor was selected to prepare the design and cost estimate documentation for the Młynowo–Muławki section of the high-pressure gas pipeline and the pressure reduction station in Mikołajki;
- continuation of project named "South-Eastern Supply for the City of Gdańsk and Installation of Gas Distribution Systems in Wiślinka and Wyspa Sobieszewska"; the project involves construction of a high-pressure gas pipeline from Kolnik to Gdańsk along with the auxiliary structures and a pressure reduction station, construction of a high-pressure metering station and the connection for Grupa LOTOS S.A., installation of medium-pressure gas distribution systems in the village of Wiślinka and on the Wyspa Sobieszewska island; project implementation is scheduled for completion at the end of 2015; in H1 2011, the work focused on obtaining the legally required approvals and permits;
- commencement of design work related to the construction of a 56 km long high-pressure gas pipeline from Kamień to Włodawa; project implementation is scheduled for completion at the end of 2015;
- continuation of the project to install gas distribution systems in the communes of Komprachcice and Dąbrowa; the project involves construction of 62 km of medium-pressure gas pipelines, which are planned to be placed in service in 2011-2012; in H1 2011, building permits for the project were obtained;
- preparation of documentation for the tender to select a contractor to execute stage 1 of the project to install gas distribution systems in the Prażmów, Tarczyn, Góra Kalwaria and Żabia Wola communes; the project involves construction of approximately 100 km of a medium-pressure pipeline and of approximately 1,400 connections in 2011-2014.

The table below presents the volume of gas transmitted via the distribution system, the length of the distribution network, the number of customers, the number of new customers connected to the network, and the employment as at June 30th 2011.

Gas Distribution Companies – key data

	Unit	DSG	GSG	KSG	MSG	PSG	WSG
Volume of gas transmitted via the distribution system	million cubic meters*	524.0	901.4	1,087.2	1,141.5	522.2	856.0
Length of network, excl. connections	km	7,744.1	20,961.7	44,899.5	19,024.5	9,658.0	15,590.3
No. of gas customers served by the company	thousand	746.8	1,302.2	1,436.9	1,507.2	741.5	911.4
No. of new gas customers connected to the network	thousand	2.6	2.9	2.4	10.4	2.1	3.4
Employment	persons	1,428	2,612	3,309	2,922	1,773	1,827

2. Planned directions for development in the Distribution segment

The largest investment projects planned to be implemented in H2 2011 include:

- continuation of project named "Construction of a High-Pressure Gas Network Connecting Szczytno, Młynowo and Muławki near Kętrzyn and Installation of Gas Distribution Systems in the Szczytno, Młynowo and Muławki Communes";

- continuation of project named "South-Eastern Supply for the City of Gdańsk and Installation of Gas Distribution Systems in Wiślinka and Wyspa Sobieszewska";
- continuation of design work related to the upgrade of the Sandomierz–Ostrowiec Świętokrzyski and the Parszów–Kielce high-pressure gas pipelines;
- continuation of work on the project to install gas distribution systems in the towns of Herby and Blachownia;
- commencement of construction work in Komprachcice and Dąbrowa;
- installation of gas distribution systems in the Prażmów, Tarczyn, Góra Kalwaria and Żabia Wola communes.

In the next few years, the Gas Distribution Companies will focus on maintaining their existing market position and further increasing the volumes of transmitted gas, by:

- extending the pipeline infrastructure to reach new customers,
- ensuring adequate transmission capacity and securing sources of gas supply for the gas distribution system,
- replacing socket joint piping and modernising high-, medium- and low-pressure networks,
- introducing new LNG-based gas distribution systems,
- distributing biogas,
- improving the quality of customer service,
- using EU funds to refinance the extension of distribution systems.

3. Risks related to Distribution

Direct competition

Liberalisation of the gas market boosts the activity of gas suppliers who are competitors of the Gas Distribution Companies. Companies transmitting natural gas are steadily expanding their gas networks and winning new customers. Additionally, companies have emerged which offer natural gas supplies using LNG. The market entry barriers are definitely lower here, as entry into the LNG segment requires significantly lower capital expenditure. Moreover, LNG suppliers do not need to incur high expenditure when transferring operations to another geographical area. Another issue which affects the Gas Distribution Companies' competitive position is the tariff policy pursued by 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.

Chapter VIII: Other Activities

1. Segment activities

In H1 2011, approximately 50 km of gas transmission pipelines were built by the segment companies, both for external customers and for the Group’s own needs. Major contracts performed in the analysed period included construction of a DN 300 gas pipeline from Mieszalnia Kłodawa to the LMG Oil and Gas Production Facility and a DN 200 gas pipeline from the Kościan Gas Production Facility to KGHM Żukowice/Polkowice for PGNiG S.A., a DN 500 gas pipeline from Taczalin to Radakowice for OGP GAZ-SYSTEM S.A., and a DN 800 gas pipeline for Geoplin Plinowodi (Slovenia).

For the PGNiG Group, the segment companies provided mainly construction and assembly services, including in connection with development of the Rylowa-Rajsko field and Barnówko 12, Mostno 8k and 9H wells in the BMB field, hooking up of the Elżbieciny and Jabłonna wells, and expansion of the Paproć-Cicha Góra Gas Production Facility and of the Strachocina Underground Gas Storage Facility. Moreover, the segment companies prepared design documentation for gas transmission systems and manufactured drilling equipment, including surface pressure equipment, heads, casing heads and spare parts for production devices.

For external customers, the segment companies manufactured equipment and spare parts for oil platforms and drill ships, as well as spare parts for the coal mining industry. Other services provided by the companies included designing of gas transmission infrastructure and construction and assembly work related to alteration of the Jarosław gas distribution and metering station, construction of the DN 250 oxygen pipeline from Dąbrowa Górnicza to Zawiercie and construction of the sewage system in Dąbrowa Górnicza. Moreover, the companies were involved in repair of coal mining equipment and welding work on the DN 1400 OPAL gas pipeline in Germany. They also provided hotel and restaurant services and spa centre services.

In H1 2011, PGNiG Energia S.A. continued the organisational and investment activities related to “Construction of a CCGT Unit in Stalowa Wola” project, as part of which an agreement on operation of an SPV (Elektrociepłownia Stalowa Wola S.A.) was signed, the share capital of the SPV was increased, and a procedure for selecting a general contractor was initiated.

Events subsequent to the end of the reporting period

On August 23rd 2011, PGNiG SPV 1 Sp. z o.o., a wholly-owned subsidiary of PGNiG S.A., and Vattenfall AB executed a preliminary share purchase agreement. The agreement provides for the purchase of 24,591,544 shares in Vattenfall Heat Poland S.A., representing over 99.8% of the share capital and conferring the right to over 99.8% of the total vote at the General Shareholders Meeting of Vattenfall Heat Poland S.A.

The value of the transaction as at the preliminary agreement execution date was approx. PLN 2.96bn, which corresponded to an enterprise value of approximately PLN 3.5bn. The final purchase price will depend on the closing date of the share purchase transaction. The shares are registered shares with a par value of PLN 10.00 per share and a total par value of PLN 245,915,440.00.

The ownership of the shares will be transferred following execution of the final share purchase agreement, subject to a condition precedent, i.e. clearance of the business concentration by the President of the Office of Competition and Consumer Protection. If the clearance is not obtained within nine months, the agreement will expire.

To finance the price of the acquisition of the shares in Vattenfall Heat Poland S.A. along with all the related transaction costs, PGNiG S.A. advanced to PGNiG SPV 1 Sp. z o.o. a loan of up to PLN 3.78bn, to be repaid by December 31st 2012.

Acquisition of shares in Vattenfall Heat Poland S.A. represents an implementation of one of the PGNiG Group's strategic goals in the energy sector. The core business of Vattenfall Heat Poland S.A. is co-generation of heat and electricity. The installed capacity of the company's generating units is 4.8 GW of thermal power and 1 GW of electrical power, which satisfies approx. 75% of the heat demand on the Warsaw market. The company's main customer is SPEC S.A.

2. Planned activities

In H2 2011, the segment companies will continue the work commenced in the preceding reporting period as well as start new projects. The projects to be continued include construction of the DN 300 gas pipeline from Mieszalnia Kłodawa to the LMG Oil and Gas Production Facility, the DN 200 gas pipeline from Kościan Gas Production Facility to KGHM Żukowice/Polkowice, and the DN 800 gas pipeline in Slovenia, as well as development of the Rylowa-Rajsko field and wells on the BMB field. In addition, the segment companies are planning to win new contracts, including for construction of gas transmission pipelines and gas production facilities, extension of gas reduction stations, and construction of a sewage system.

The segment companies intend to maintain their market positions with respect to manufacturing of drilling equipment, including surface equipment components for conventional and unconventional fields and drilling platforms and apparatus for oil and gas production facilities, as well as with respect to designing of gas systems and construction and assembly services for oil and gas facilities.

In H2 2011, PGNiG Energia S.A. will continue work related to the "Construction of a CCGT Unit in Stalowa Wola" project. The company will also continue efforts to become a member of the Polish Power Exchange and commence trading in proprietary rights to certificates of origin for electricity.

3. Risks related to Other Activities

Legislation

Administrative regulations and procedures related to the preparation of investment projects and obtaining building permits, including in particular with respect to compliance with the environmental requirements, significantly deter investment projects and expose the companies to additional costs due to potential delayed performance of contracts, and to the risk of lower sales revenue.

Competition

The operations of companies offering construction and assembly services and 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 growing competition from new consortia.

Power generation projects

Our involvement in power generation projects will to a large extent depend on the prices of CO_2 emission allowances, which, if they fall, will result in low profitability of electricity generation in gas-fired cogeneration systems. Higher crude oil prices on the global markets, resulting in increased prices of natural gas, will contribute to lower competitiveness of gaseous fuel relative to power coal. Moreover, an uncertainty factor affecting the profitability of power projects is the fact that the government administration have not adopted a clear position on whether to maintain the gas-fired cogeneration support system in the form of "yellow certificates" beyond 2012.

Chapter IX: Investments

In H1 2011, the PGNiG Group's capital expenditure on property, plant and equipment and intangible assets amounted to PLN 1,956.1m. The table below presents the expenditure in the individual operating segments.

Capital expenditure (PLNm)

	H1 2011
Exploration and Production	1,245.4
Trade and Storage	357.8
Distribution	347.5
Other Activities	5.4
Total	1,956.1

Below are described the key investment projects implemented by the PGNiG Group.

Exploration

The PLN 239.6m capital expenditure on exploration was incurred chiefly on eight wells drilled with positive results (including three workover wells), wells the drilling of which is still under way, and on ten wells which proved to be dry (including one workover well), where the related expenditure was charged to expenses in the current reporting period.

Skarv project

The project involves the development of fields on the Norwegian Continental Shelf using a floating production, storage and offloading (FPSO) unit, which was transported to Norway in H1 2011. Moreover, installation of all the submarine structures (foundation slabs, pipelines, etc.) on the Skarv and Idun fields was also completed in H1 2011. Expenditure incurred on development of the Skarv field in H1 2011 amounted to PLN 326.6m.

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 Denitriding Plant to provide for transmission of surplus gas from the LMG Oil and Gas Production Facility to the Grodzisk Denitriding Plant.

In H1 2011, construction of the LMG Central Facility was underway. The total project value is estimated at approximately PLN 1.6bn. The expenditure made in H1 2011 amounted to PLN 291.5m.

Grodzisk project

The objective of this project is to ensure that gas produced from nitrogen-rich gas fields can be sold; to this end, such gas must be processed to achieve the parameters of high-methane gas (cryogenic nitrogen removal). The Grodzisk project involved, among other things, development of the Paproć W, Wielichowo and Ruchocice fields, development of the Nowy Tomyśl 2k well, modernisation of the Paproć Gas Production Facility, construction of the gas pipeline from Przyłęk to the Paproć Gas Production Facility, and construction of the Grodzisk Denitriding Plant.

In H1 2011, work on extension of the Paproć-Cicha Góra Gas Production Facility and development of the Elżbieciny and Jabłonna wells was continued. The Grodzisk project is scheduled for completion at the end of 2011. The total value of the project is estimated at approximately PLN 463m. The expenditure made in H1 2011 amounted to PLN 62.0m.

Underground gas storage facilities (Exploration and Production)

In H1 2011, work related to extension of the Strachocina Underground Gas Storage Facility was continued – nine wells were drilled. Moreover, construction and assembly work was completed and gas injection tests commenced to determine the facility's operating parameters.

With respect to underground gas storage facilities used by the Exploration and Production segment, expenditure of PLN 64.8m was incurred principally on continued construction of the surface part of the Strachocina Underground Gas Storage Facility.

Underground gas storage facilities (Trade and Storage)

Capital expenditure on underground gas storage facilities in the Trade and Storage segment amounted to PLN 324.7m and related to:

- construction of the surface part of the Wierzchowice Underground Gas Storage Facility;
- continued leaching work in the caverns of the Kosakowo Underground Gas Storage Facility
- construction of four caverns in the Mogilno Underground Gas Storage Cavern Facility.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 347.5m. As part of their investment activities, the Gas Distribution Companies chiefly connected new customers to their grids and upgraded and expanded the gas network. For a discussion of key investment projects of the Distribution segment, see Chapter VII Distribution.

Other Activities

In H1 2011, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 5.4m. Major investments included purchase of vehicles, production plant and equipment, computer hardware, licences, software, and land, and extension and modernisation of real property.

Chapter X: Environmental protection

Well abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to properly abandon worked-out mining caverns, eliminate the danger, repair any damage caused by mining activities, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and to water courses. Furthermore, if gas wells remained unplugged, there would be a risk that escaping gas could accumulate inside, posing a fire hazard. In H1 2011, one bored well and two dug wells were plugged.

Carbon credit trading system

Under the existing carbon dioxide emission trading scheme (ETS), in H1 2011 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2010. After reconciling its CO_2emissions with emission rights held and cancelling used allocations for 2010, the remaining amount was 18,278 Mg CO_2 of free emission units. In the trading period, installations participating in the scheme were those of the Odolanów Branch, the Zielona Góra Branch and the Mogilno Underground Gas Storage Cavern Facility. Emission from those installations amounted to 81,156 Mg CO_2.

Methane emissions

In H1 2011, detailed registration of methane emissions from the gas distribution system commenced. Its purpose is to estimate the size of methane emissions from particular components 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 S.A. conducts diagnosis tests and surveys and land reclamation work in the areas which became polluted due to past activities (including traditional activities related to gas) with a view to restoring them to the condition required under the environmental quality standards. In H1 2011, supplementary tests and surveys concerning properties located in Kargowa, Zabrze, Łabiszyn and Międzylesie were completed, and land reclamation work on the properties in Pyrzyce and Koźmin Wielkopolski, with a total area of 9,000 sq m, was commenced. In H2 2011, supplementary tests and surveys will be carried out on the property in Mrągowo and reclamation work will be performed on the properties in Kargowa and Radków.

Integrated management system

In H1 2011, Wielkopolska Spółka Gazownictwa Sp. z o.o. implemented an Integrated Management System. The result of an audit performed to certify the system was positive.

Chapter XI: Other information

Distribution of the 2010 profit

On April 20th 2011, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution to distribute the 2010 net profit of PLN 1,702.1m in the following manner:

- PLN 921.6m was allocated for contribution to the Company's statutory reserve funds;
- PLN 708.0m was allocated for dividend payment (PLN 0.12 per share), of which up to PLN 30.1m will be transferred to the State Treasury as non-cash dividend in the form of transmission system components, and as cash dividend (the difference between the value of dividend due given the number of shares held by the State Treasury and the final value of the non-cash dividend);
- PLN 9.1m was allocated for contribution to the Company's social benefits fund;
- PLN 58.4m was allocated for awards (bonuses) for the Company's employees;
- PLN 5.0m was allocated for contribution to the Central Restructuring Fund capital reserve.

In addition, retained earnings of PLN 76.5m was allocated for contribution to the Company's statutory reserve funds.

The Annual General Shareholders Meeting of PGNiG S.A. set July 20th 2011 as the dividend record date and October 6th 2011 as the dividend payment date.

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

On April 20th 2011, the Annual General Shareholders Meeting of PGNiG S.A. approved the financial statements and the Director's Report on the operations of PGNiG S.A., as well as the consolidated financial statements and the Director's Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG S.A. in respect of their performance of duties in the financial year 2010.

Stalowa Wola CCGT Unit Construction Project

On March 11th 2011, three significant agreements were signed as part of the "Construction of a CCGT Unit in Stalowa Wola" project:

- an agreement on the operation of an SPV (Elektrociepłownia Stalowa Wola S.A.) between PGNiG S.A., PGNiG Energia S.A., TAURON Polska Energia S.A., Elektrownia Stalowa Wola S.A. and Elektrociepłownia Stalowa Wola S.A. (which superseded the agreement of May 7th 2010 on preparation and implementation of the investment project involving construction of a CCGT unit in Stalowa Wola, along with the annex)
- comprehensive agreement for supply of gaseous fuel to Elektrociepłownia Stalowa Wola S.A. between PGNiG S.A. and Elektrociepłownia Stalowa Wola S.A.
- agreement on sale of electricity by Elektrociepłownia Stalowa Wola S.A. to PGNiG Energia S.A. and TAURON Polska Energia S.A.

Performance of the agreements will commence upon fulfilment of certain conditions precedent.

Eurobond issue

On August 25th 2011, PGNiG S.A. signed the documentation for an Eurobonds issue programme worth up to EUR 1.2bn with PGNiG Finance AB and three banks (Societe Generale SA, BNP Paribas SA and UniCredit Bank AG). Moreover, on August 25th 2011, PGNiG S.A. granted a guarantee of up to EUR 1.5bn in respect of repayment by PGNiG Finance AB of liabilities under the Eurobonds issued as part of the programme. The guarantee remains valid until December 31st 2026.

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

PGNiG S.A.'s action instituted against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolutions of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG S.A. to pay an additional contribution of PLN 52m. The proceedings 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 S.A.'s claims and declared the resolution concerning share redemption and the resolution concerning the additional contributions as 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. The Regional Court of Warsaw accepted the appeal for consideration. On July 4th 2011, PGNiG S.A. filed with the Warsaw Court of Appeals a response to the appeal.

Proceedings instigated by PGNiG S.A. against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the Extraordinary General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, under which PGNiG S.A. was obliged to pay an additional contribution of PLN 25,999,998, were held before the Regional Court and the Court of Appeals of Warsaw. By virtue of its ruling of October 18th 2010, the Regional Court of Warsaw rescinded the resolution on additional contributions. 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. The Regional Court of Warsaw accepted the appeal for consideration. On June 28th 2011, PGNiG S.A. filed a response to the above appeal with the Warsaw Court of Appeals.

Proceedings instigated by PGNiG S.A. against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, under which PGNiG S.A. was obliged to pay an additional contribution 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. During its session held on April 11th 2011, the Regional Court issued a decision suspending the proceedings to rescind or declare invalidity of the resolution on additional contributions.

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 S.A. on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interest of other business players or consumers and impeding the development of market conditions necessary for the emergence or growth of competition by refusing to sell gaseous fuel under a comprehensive agreement to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. As at this report date, the proceedings were still under way.

On July 4th 2011, PGNiG S.A. received a notification of instigation of anti-trust proceedings by the President of UOKiK concerning abuse of dominant position by PGNiG S.A. on the domestic natural gas retail market. In the President's opinion, the abuse consisted in impeding the emergence or growth of competition on the domestic natural gas wholesale and retail markets by limiting the possibility to terminate agreements for supplies of gaseous fuel. On August 1st 2011, PGNiG S.A. sent a letter to the President of UOKiK in which it challenged, in its entirety, the charge of abuse of dominant position by the Company on the domestic natural gas market and applied for the proceedings to be discontinued.

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

Chapter XII: Financial performance

The interim consolidated financial statements of the PGNiG Group for the six months ended June 30th 2011 have been prepared in accordance with the International Financial Reporting Standards (IFRS) endorsed by the European Union (EU) as at June 30th 2011.

The accounting policies applied in preparing the interim consolidated financial statements are presented in the interim consolidated financial statements of the PGNiG Group for the six months ended June 30th 2011.

1. Financial performance

In H1 2011, the PGNiG Group posted net profit of PLN 1,004.9m, up by PLN 10.7m relative to the figure recorded in H1 2010. The increase in net profit is principally attributable to a PLN 151.9m improvement of result on financing activity.

Summary information on the PGNiG Group's financial standing in H1 2011 is presented below in financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- consolidated statement of financial position,
- consolidated income statement,
- consolidated statement of cash flows, and
- selected financial ratios.

Consolidated statement of financial position (PLNm)

ASSETS	Jun 30 2011	Dec 31 2010
Non-current assets	28,357.8	27,432.9
Property, plant and equipment	26,686.6	25,662.2
Investment property	9.5	9.9
Intangible assets	240.9	246.7
Investments in equity-accounted associated undertakings	555.4	555.8
Financial assets available for sale	51.2	170.5
Other financial assets	9.7	39.9
Deferred tax assets	729.6	676.8
Other non-current assets	74.9	71.1
Current assets	5,980.2	6,883.3
Inventories	1,513.4	1,049.6
Trade and other receivables	2,590.0	4,061.2
Current income tax receivable	228.0	229.6
Prepayments and accrued income	263.2	78.8
Financial assets available for sale	30.5	8.8
Derivative financial instrument assets	316.2	77.9
Cash and cash equivalents	1,034.5	1,373.3
Non-current assets held for sale	4.4	4.1
Total assets	34,338.0	34,316.2

Consolidated statement of financial position (PLNm) – contd.

EQUITY AND LIABILITIES	Jun 30 2011	Dec 31 2010
Equity	23,892.1	23,519.5
Share capital	5,900.0	5,900.0
Currency translation differences on foreign operations	(71.4)	(57.3)
Share premium account	1,740.1	1,740.1
Other capital reserves	14,178.0	12,268.2
Retained earnings/(deficit)	2,135.6	3,655.1
Equity (attributable to owners of the parent)	23,882.3	23,506.1
Equity attributable to non-controlling interests	9.8	13.4
Non-current liabilities	5,299.5	4,973.3
Loans, borrowings and debt securities	1,196.1	969.9
Provisions	1,572.0	1,501.1
Deferred income	1,097.7	1,089.2
Deferred tax liabilities	1,412.1	1,392.0
Other non-current liabilities	21.6	21.1
Current liabilities	5,146.4	5,823.4
Trade and other payables	3,187.9	3,291.5
Loans, borrowings and debt securities	632.1	1,229.2
Derivative financial instrument liabilities	162.2	104.4
Current tax liabilities	126.6	226.0
Provisions	309.1	289.6
Deferred income	728.5	682.7
Total liabilities	10,445.9	10,796.7
Total equity and liabilities	34,338.0	34,316.2

Consolidated income statement (PLNm)

	H1 2011	H1 2010
Sales revenue	11,523.4	10,761.9
Total operating expenses	(10,450.6)	(9,560.2)
Raw and other materials used	(6,890.1)	(5,940.7)
Employee benefits	(1,380.2)	(1,282.8)
Depreciation and amortisation	(776.9)	(745.2)
Contracted services	(1,567.5)	(1,518.1)
Cost of products and services for own needs	481.4	361.5
Net other operating expenses	(317.3)	(434.9)
Operating profit/(loss)	1,072.8	1,201.7
Finance income	192.7	34.8
Finance expenses	(25.5)	(19.5)
Share in net profit/(loss) of equity-accounted undertakings	(0.4)	(0.4)
Pre-tax profit/(loss)	1,239.6	1,216.6
Income tax	(234.7)	(222.4)
Net profit/(loss)	1,004.9	994.2
Attributable to:		
Owners of the parent	1,003.5	991.9
Non-controlling interests	1.4	2.3
	1,004.9	994.2

Consolidated statement of cash flows (PLNm)

	H1 2011	H1 2010
Net cash provided by/used in operating activities	2,256.5	2,638.5
Net cash provided by/(used in) investing activities	(2,107.9)	(1,439.8)
Net cash provided by/used in financing activities	(487.5)	(302.3)
Net change in cash	(338.9)	896.4
Cash and cash equivalents at beginning of period	1,372.9	1,196.3
Cash and cash equivalents at end of period	1,034.1	2,092.7

Financial ratios

Profitability

PROFITABILITY	H1 2011	H1 2010
EBIT (PLNm) operating profit	1,072.8	1,201.7
EBITDA (PLNm) operating profit + depreciation/amortisation	1,849.7	1,946.9
ROE net profit* to equity at end of period	4.2%	-
NET MARGIN net profit* to sales revenue	8.7%	9.2%
ROA net profit* to assets at end of period	2.9%	-

* Net profit for the financial year attributable to owners of the parent.

Liquidity

LIQUIDITY	Jun 30 2011	Dec 31 2010
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	1.1	1.2
QUICK RATIO current assets (net of prepayments and accrued income) less inventories to current liabilities	0.8	1.0

Debt

DEBT	Jun 30 2011	Dec 31 2010
DEBT RATIO total liabilities to total equity and liabilities	30.4%	31.5%
DEBT/EQUITY RATIO total liabilities to equity*	43.7%	45.9%

* Equity attributable to owners of the parent.

Relative to the corresponding period of the previous year, the Company recorded a PLN 128.9m drop in EBIT as a result of lower margins on high-methane gas sales.

Exploration and Production

The Exploration and Production segment posted operating profit of PLN 446.5m, up by PLN 106.7m on H1 2010. This increase was primarily attributable to higher profitability of crude oil sales, which improved considerably on H1 2010. Prices at which PGNiG S.A. sold crude were up by 34%, mainly due to crude returning to stronger price performance on the global markets. Operating profit of the Exploration and Production segment advanced also on higher revenue from sales of geophysical, geological and exploration services, in connection with intensified exploration for shale gas in Poland. Furthermore, the PGNiG Group recorded a 1% rise in production of gaseous fuels and a 5% increase in gas output at the denitriding plants.

Trade and Storage

The PGNiG Group's financial performance deteriorated primarily in the Trade and Storage segment, which posted PLN 135.1m in operating profit, that is by PLN 207.5m less than in H1 2010. This came as a result of a significant deterioration of profitability of high-methane gas sales, primarily due to a 13% rise in the unit purchase price of imported gas. High prices of imported gas were driven by higher crude oil prices on the global markets. In addition, the Group increased the volume of gas imports by

7% and reduced the amount of gas drawn from storage facilities by 21%, thus building up the gas stocks.

The main currency in which gas import prices are denominated, the US dollar, depreciated relative to H1 2010. However, the decline was not enough to offset the increase in prices of imported gas pushed up by higher crude oil prices.

The margins on high-methane gas sales deteriorated despite a 5% year-on-year increase in the average gas selling prices and charge rates. Given growing prices of crude oil, in February 2011 PGNiG S.A. applied to the President of the Energy Regulatory Office requesting an increase in the tariff prices of natural gas with effect from April 1st 2011. However, the President of the Energy Regulatory Office did not approve a new tariff until June 30th 2011, effective in settlements with customers as of July 15th 2011. Delayed introduction of the new tariff resulted in the Group losing margin on natural gas sales.

The decline in operating profit of the Trade and Storage segment was limited due to lower net other operating expenses, attributable primarily to higher reversals of impairment losses on trade receivables.

Distribution

The Distribution segment's operating result was PLN 502.0m, down by PLN 24.1m year on year, due to an increase in operating expenses, including mainly amortisation/depreciation and employee benefits. The higher amortisation/depreciation charges were caused by a higher gross value of the Distribution segment's fixed assets (following completion of new investments in assets) and a reversal of impairment losses on the assets of Dolnośląska Spółka Gazownictwa Sp. z o.o. and Mazowiecka Spółka Gazownictwa Sp. z o.o. in 2010. The segment's profitability was down despite the higher rates and charges for network services, introduced in June 2010.

Segments' operating results

Financial data of the PGNiG Group's segments for H1 2011 (PLNm)

H1 2011	Exploration and Production	Trade and Storage	Distribution	Other Activities	Eliminations	Total
Sales to external customers	1,275.3	10,094.6	54.6	98.9		11,523.4
Intersegment sales	564.4	152.9	1,777.2	160.2	(2,654.7)	-
Total segment's revenue	1,839.7	10,247.5	1,831.8	259.1	(2,654.7)	11,523.4
Segment's expenses	(1,393.2)	(10,112.4)	(1,329.8)	(256.3)	2,641.1	(10,450.6)
Operating profit/loss	446.5	135.1	502.0	2.8	(13.6)	1,072.8
Net finance expenses						167.2
Share in net profit/loss of equity-accounted undertakings		(0.4)				(0.4)
Pre-tax profit/loss						1,239.6
Corporate income tax						(234.7)
Net profit/loss						1,004.9

Financial data of the PGNiG Group's segments for H1 2010 (PLNm)

H1 2010	Exploration and Production	Trade and Storage	Distribution	Other Activities	Eliminations	Total
Sales to external customers	1,055.2	9,552.9	43.2	110.6	-	10,761.9
Intersegment sales	596.7	178.3	1,791.7	98.0	(2,664.7)	-
Segment's total revenue	1,651.9	9,731.2	1,834.9	208.6	(2,664.7)	10,761.9
Segment's expenses	(1,312.1)	(9,388.6)	(1,308.8)	(192.9)	2,642.2	(9,560.2)
Operating profit/loss	339.8	342.6	526.1	15.7	(22.5)	1,201.7
Net finance expenses	-	-	-	-	-	15.3
Share in net profit/loss of equity-accounted undertakings	-	(0.4)	-	-	-	(0.4)
Pre-tax profit/loss						1,216.6
Corporate income tax	-	-	-	-	-	(222.4)
Net profit/loss						994.2

The strengthening of the PGNiG Group's financial position followed primarily from a better result on financing activities (up by PLN 151.9m), attributable to considerably higher foreign exchange gains and the disposal of shares in Zakłady Azotowe w Tarnowie-Mościcach S.A.

The balance sheet as at June 30th 2011 shows a balance-sheet total of PLN 34,338.0m, up by PLN 21.8m relative to the end of 2010.

Property, plant and equipment, of PLN 26,686.6m as at the end of June 2011 (up by PLN 1,024.4m, or 4%, on December 31st 2010) was the largest item of the Group's assets. The increase in the value of property, plant and equipment was primarily attributable to the investment projects implemented by the PGNiG Group, as well as to revaluation of assets.

Another significant item of the balance sheet is represented by financial assets available for sale, which amounted to PLN 51.2m as at June 30th 2011, down by PLN 119,3m (or 70%) from the end of 2010. The decline in the value of this item was caused by the disposal of shares in Zakłady Azotowe w Tarnowie-Mościcach S.A.

Other financial assets stood at PLN 9.7m and were down by 30.2m relative to December 31st 2010 due to a change in the presentation of the current portion of receivables under lease of transmission assets to OGP GAZ-SYSTEM S.A.

As at June 30th 2011, current assets were PLN 5,980.2m, down by PLN 903.1m (or 13%) relative to December 31st 2010.

Within current assets, the most significant changes concerned trade and other receivables, which fell by 1,471.2m (or 36%) compared with the end of 2010. The fall was attributable to the seasonal decrease in the volume of gaseous fuel sales.

During the period under review, inventories rose by PLN 463.8m (or 44%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage facilities. The rise in the value of inventories was primarily caused by the increase in gas stocks and the unit purchase price of imported gas.

Cash and cash equivalents stood at PLN 1,034.5m, which represents a PLN 338.8m (25%) decrease relative to the end of 2010, chiefly on the back of higher expenditure on current operations and investing activities.

The value and structure of the current assets held by the PGNiG Group continued to guarantee its full capacity to settle all its liabilities in a timely manner. The current ratio was 1.1 compared with 1.2 as at the end of December 2010, whereas the quick ratio fell from 1.0 to 0.8.

Equity is the primary source of financing of the PGNiG Group’s assets. Relative to the end of 2010, the Group’s equity rose by PLN 372.6m (or 2%). The level of equity was mainly affected by the net profit generated in the period (of PLN 1,004.9m) and the payment of non-cash and cash dividend (of PLN 708.0m) as part of distribution of the previous year’s profit.

As at June 30th 2011, non-current liabilities amounted to PLN 5,299.5m, up by PLN 326.2m (7%) relative to the end of December 2010 mainly as a result of an increase in loans, borrowings and debt securities as well as in long-term provisions.

Non-current loans, borrowings and debt securities stood at PLN 1,196.1m as at the end of June 2011, up by PLN 226.2m (23%) on December 2010. The key factor which contributed to the debt increase was another drawdown of the credit facility by PGNiG Norway AS.

Relative to the end of December 2010, the Group recorded a PLN 70.9m (5%) growth in long-term provisions. This increase was primarily due to the revaluation of provisions for decommissioning of hydrocarbon production assets.

Relative to the end of December 2010, current liabilities went down by PLN 677.0m (12%), primarily due to a drop in loans, borrowings and debt securities as well as in trade and other payables.

Current loans, borrowings and debt securities stood at PLN 632.1m as at the end of June 2011, down by PLN 597.1m (49%) on December 2010. Current debt declined following the redemption of domestic notes by the PGNiG Group. In H1 2011, the Group issued domestic notes with an aggregate par value of PLN 3,100.0m. As at June 30th 2011, debt under the outstanding notes totalled PLN 500.0m.

Trade and other payables declined by PLN 103.6m, primarily on the back of a seasonal drop in purchases of transmission services.

The ratios reflecting the relationship between equity and other items of equity and liabilities improved. As at the end of June 2011, debt to equity ratio fell from 45.9% to 43.7%, whereas the debt ratio (total liabilities to total equity and liabilities) decreased from 31.5% do 30.4%.

Transactions concluded on non-arms’ length terms

In H1 2011, PGNiG S.A. and its subsidiaries did not enter into any material related party transactions on terms other than the market terms.

Guarantees and sureties

In H1 2011, PGNiG S.A. and its subsidiaries did not issue any sureties in respect of repayment of credit facilities or loans or guarantees to any single entity or its subsidiary whose aggregate value would be equivalent to 10% or more of PGNiG S.A.’s equity.

Feasibility of meeting published performance forecasts

In H1 2011, the PGNiG Group did not publish any financial forecasts.

2. Projected future financial performance

Key factors with a bearing on the PGNiG Group's financial performance will include crude oil prices on international markets, conditions prevailing on the currency markets, and the stance taken by the Energy Regulatory Office regarding tariffs for gaseous fuel.

The financial position of the PGNiG Group is substantially influenced by the prices of crude oil and petroleum products. The crude prices currently prevailing on the global markets include a high risk premium connected with adverse developments in the global political and economic environment. If the current situation continues, crude prices on the global markets will remain high in the forthcoming quarters. On the other hand, resolution of the crisis in Libya and increase in oil production in this country may significantly reduce crude prices.

The PGNiG Group is significantly exposed to changes in foreign exchange rates and consequently to fluctuations in the PLN prices of imported gas. In H1 2011, the foreign exchange market remained fairly stable and the US dollar, though slightly volatile, followed a clear downward trend. A continuation of this trend into the following quarters of 2011 will restrain imported gas price growth.

Another factor with a bearing on the PGNiG Group's financial performance is the level of prices and charges set forth in the tariffs for gaseous fuel. The President of the Energy Regulatory Office has approved a new gaseous fuel tariff, which applies in settlements with customers from July 15th to December 31st 2011. Prices and charges related to the sale of high-methane gas increased on average by 8.9%. Prices of gaseous fuel alone rose by 12.6% on average, whereas network charges were reduced by nearly 1%. Nevertheless, the situation on the commodity markets remains so unstable that the increase in gas selling prices provided for in the new tariff may not be enough to cover higher purchase costs of imported gas. Moreover, lower network charges may adversely affect the financial performance of the Distribution segment.

Given the high level of its current and planned capital expenditure, the PGNiG Group intends to use external financing raised through domestic and foreign note issues. The Group started issuing domestic notes in 2010. On July 21st 2011, the value of the programme was increased from PLN 3bn to PLN 5bn and the term of the agreement was extended by two years, i.e. until July 31st 2015. Also, in H2 2011 the PGNiG Group is planning to carry out its first issue of Eurobonds. A mandate agreement providing for the arrangement of a EUR 1.2bn Eurobond issue programme was signed on September 17th 2010.

In the coming quarters, the PGNiG Group intends to maintain a high level of investment expenditure, mainly on projects designed to extend the underground gas storage facilities, increase hydrocarbon production capacity, and diversify 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 Group's power generation segment.

In connection with the political situation in Libya, in February 2011 all Polish employees of POGC-Libya B.V. were withdrawn from the country. Any decision to continue the work depends on the political developments in Libya. Moreover, at the end of 2011 the PGNiG Group plans to commence oil and gas production from the Skarv field on the Norwegian Continental Shelf.

Members of the Management Board

President of the Management Board	Michał Szubski	
Vice-President of the Management Board	Radosław Dudziński	
Vice-President of the Management Board	Sławomir Hinc	
Vice-President of the Management Board	Marek Karabuła	
Vice-President of the Management Board	Mirosław Szkałuba	