DIRECTORS' REPORT ON THE PGNIG GROUP'S OPERATIONS IN H1 2010

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, August 12th 2010

Contents

Chapter I: Information on the PGNiG Group

The PGNiG Group is the only vertically integrated gas company in Poland, holding the leading position in most segments of the domestic gas sector. 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.), with registered office in Warsaw, ul. Marcina Kasprzaka 25, 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 WSE 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.

The scope of the PGNiG Group's business comprises exploration for deposits, extraction and storage of gaseous fuels as well as trade in and distribution of natural gas. The natural gas and crude oil production are among the key factors securing the Company's competitive advantage on the liberalised gas market. The core business of the PGNiG Group includes trade in and distribution of natural gas. The trading activities are handled by PGNiG S.A. and the distribution is carried out by six Distribution System Operators – members of the Group.

1. Structure of the PGNiG Group

As at June 30th 2010, the PGNiG Group comprised PGNiG S.A. (the parent undertaking) and 36 production and service companies, including:

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

The table below presents a list of the Group members as at June 30th 2010.

Companies of the PGNiG Group

	Name	Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of the total vote held by PGNiG S.A
	Subsidiaries of PGNiG S.A.				
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	„INVESTGAS" S.A.	502,250.00	502,250.00	100.00%	100.00%
11	Dolnośląska Spółka Gazownictwa Sp. z o.o.	658,384,000.00	658,384,000.00	100.00%	100.00%
12	Górnośląska Spółka Gazownictwa Sp. z o.o.	1,300,338,000.00	1,300,338,000.00	100.00%	100.00%
13	Karpacka Spółka Gazownictwa Sp. z o.o.	1,484,953,000.00	1,484,953,000.00	100.00%	100.00%
14	Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,255,800,000.00	1,255,800,000.00	100.00%	100.00%
15	Pomorska Spółka Gazownictwa Sp. z o.o.	614,696,000.00	614,696,000.00	100.00%	100.00%
16	Wielkopolska Spółka Gazownictwa Sp. z o.o.	1,033,186,000.00	1,033,186,000.00	100.00%	100.00%
17	B.S. i P.G. „Gazoprojekt" S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
18	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%	100.00%
19	Zakład Urządzeń Naftowych Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%	100.00%
20	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
21	Budownictwo Naftowe Naftomontaż Sp. z o.o.	44,751,000.00	39,751,000.00	88.83%	88.83%
22	PGNiG Energia S.A.	5,000,000.00	5,000,000.00	100.00%	100.00%
23	Górnictwo Naftowe Sp. z o.o.	50,000.00	50,000.00	100.00%	100.00%
24	„NYSAGAZ Sp. z o.o."	6,800,000.00	3,468,000.00	51.00%	51.00%
25	ZRUG Sp. z o.o. (Pogórska Wola)	4,300,000.00	4,300,000.00	100.00%	100.00%
26	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
27	PPUiH „TURGAZ" Sp. z o.o. w likwidacji (in liquidation)	176,000.00	90,000.00	51.14%	51.14%
	Subsidiaries of subsidiaries of PGNiG S.A.	Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of the total vote held by PGNiG S.A.
28	Geofizyka Torun Kish Ltd (IRR)[1), 2)]	10,000,000.00	10,000,000.00	100.00%	100.00%
29	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
30	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
31	Zakład Gospodarki Mieszkaniowej Sp. z o.o. (Piła)	1,806,500.00	1,806,500.00	100.00%	100.00%
32	Biogazownia Ostrowiec Sp. z o.o.	5,000.00	5,000.00	100.00%	100.00%
33	„Polskie Elektrownie Gazowe" Sp. z o.o.[3)]	2,500,000.00	1,288,000.00	51.52%	51.52%
34	GAZ Sp. z o.o. (Błonie)	300,000.00	153,000.00	51.00%	51.00%
35	GAZ MEDIA Sp. z o.o. (Wołomin)	300,000.00	153,000.00	51.00%	51.00%
36	NAFT-STAL Sp. z o.o. w upadłości (in bankruptcy)	667,500.00	450,000.00	67.40%	67.40%

1) Figures shown in foreign currencies
2) Share capital not paid up.
3) 51.52% of the shares in the company are held by PGNiG Energia S.A., and the remaining 48.48% - by PGNiG S.A.

The following changes in the Group's structure took place in H1 2010:

- On January 11th 2010, PGNiG Energia S.A. was registered with the National Court Register.
- On January 19th 2010, GEOFIZYKA Kraków Libya JSC w likwidacji (in liquidation) was deleted from the Libyan commercial register.
- On May 12th 2010, a new company under the name of Biogazownia Ostrowiec Sp. z o.o. was incorporated; its entire share capital of PLN 5,000 was acquired for cash by PGNiG Energia Sp. z o.o. The company was registered with the National Court Register on May 13th 2010.
- On June 29th 2010, the District Court in Krosno issued a decision declaring bankruptcy, involving liquidation of the bankrupt's assets, of NAFT-STAL Sp. z o.o. w upadłości (in bankruptcy).
- On June 14th 2010, PGNiG Energia S.A. purchased 1,288 shares in Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation), representing 51.52% of the company's share capital, from PGE Energia Odnawialna S.A. On June 30th 2010, the Annual General Shareholders Meeting of Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation) resolved that the company would continue as a going concern and repealed the previous decision to put it into liquidation.

In H1 2010, the following share capital increases were registered with the National Court Register:

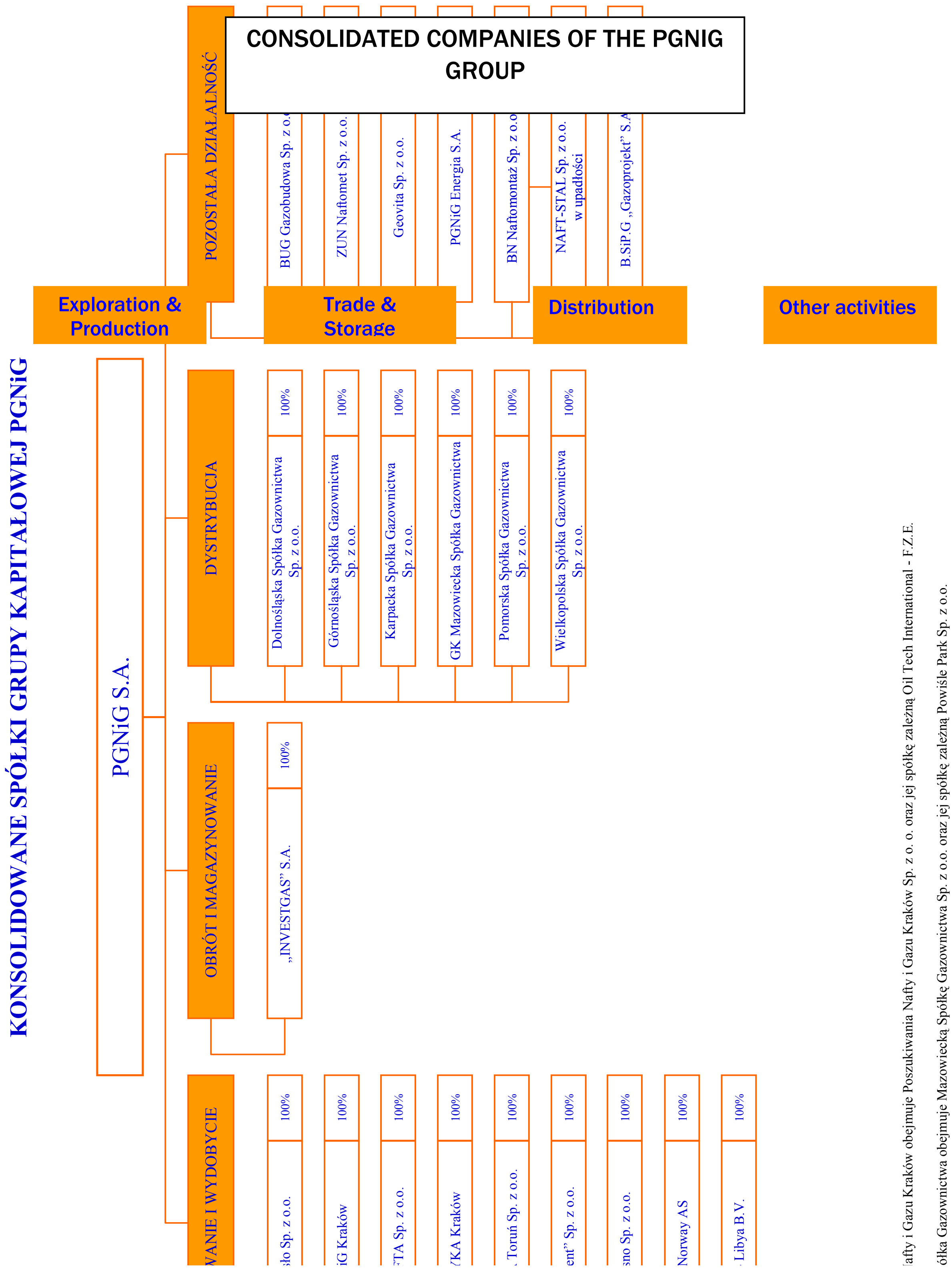
- Share capital increase at Górnośląska Spółka Gazownictwa Sp. z o.o. by PLN 850,000, to PLN 1,300,338,000, effected on January 4th 2010.
- Share capital increase at Powiśle Park Sp. z o.o. by PLN 3,000,000, to PLN 81,131,000, effected on February 5th 2010.

Events Subsequent to the End of the Reporting Period

On July 14th 2010, PPUiH TURGAZ Sp. z o.o. w likwidacji (in liquidation) was deleted from the National Court Register.

On July 30th 2010, the Extraordinary General Shareholders Meeting of Górnictwo Naftowe Sp. z o.o. adopted a resolution on amendments to the company's articles of association, an increase of its share capital by PLN 2,000,000, and acquisition for cash of all of the newly issue shares by PGNiG S.A. As soon as the changes are registered with the National Court Register, the company will change its name to PGNiG Technologie Sp. z o.o. These steps have been taken in connection with commencement of the process of consolidation of construction and assembly companies and engineering design companies within the PGNiG Group.

The chart below presents the consolidated companies of the PGNiG Group as at June 30th 2010 (by operating segments).



The Poszukiwania Nafty i Gazu Kraków Group comprises Poszukiwania Nafty i Gazu Kraków Sp. z o.o. and its subsidiary Oil Tech International F.Z.E.
The Mazowiecka Spółka Gazownictwa Group comprises Mazowiecka Spółka Gazownictwa Sp. z o.o. and its subsidiary Powiśle Park Sp. z o.o.

2. Employment

The table below presents employment at the PGNiG Group as at June 30th 2010, 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)

	June 30th 2010
PGNiG S.A. Head Office	838
Exploration and Production	11,751
Trade and Storage	3,824
Distribution	13,840
Other activities	2,081
Total	32,334

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. A 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 April 2010, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted a resolution to apply PLN 1,070,002 from the capital reserve designated as Central Restructuring Fund to provide one-off benefits to 23 employees of PNiG Kraków Sp. z o.o. who were being made redundant.

3. Sale and Acquisition of Natural Gas

The PGNiG Group recorded sales revenue of PLN 10.8bn, with 91% of that figure derived from sales of natural gas.

Sales revenue (PLNm)

	H1 2010
Natural gas, including:	9,758.2
- high-methane gas	9,154.9
- nitrogen-rich gas	603.3
Crude oil	374.1
Condensate	1.9
Helium	21.5
Propane-butane	22.3
Geophysical and geological services	136.3
Exploration services	208.1
Other sales	239.5
Total	10,761.9

In H1 2010, the PGNiG Group sold 7.5 billion cubic meters of natural gas, with 95% of that figure accounted for by revenues from the transmission and distribution systems and the balance – by direct sales of natural gas from fields.

Natural gas sales volume (million cubic meters)

	H1 2010
Trade and Storage	7,152.4
Exploration and Production	348.7
Total	7,501.1

In H1 2010, the volume of natural gas acquired by the PGNiG Group reached 7.7 billion cubic meters, with 71.8% of that amount sourced from imports, mostly from Russia. Natural gas production from domestic reserves represented 27.5% of the total volume acquired. The table below sets forth the structure of natural gas supplies measured as high-methane gas equivalent.

Acquisition of natural gas (million cubic meters)

	H1 2010
Imports	5,498.3
Domestic production	2,103.9
Domestic suppliers	51.3
Total	7,653.5

Chapter II: Company's Governing Bodies

1. Management Board

As at January 1st 2010, the composition of the Management Board of PGNiG S.A. was as follows:

- Michał Szubski – President
- Mirosław Dobrut – Vice-President, Gas and Trade
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Chief Financial Officer
- Mirosław Szkałuba – Vice-President, Social Dialogue and Assets
- Waldemar Wójcik – Vice-President, Oil Mining

On April 26th 2010, Mirosław Dobrut resigned from his position as Vice-President of the Management Board for Gas and Trade, with effect from April 30th 2010. The reason for Mirosław Dobrut's resignation was his appointment as President of the Management Board of SGT EUROPOL GAZ S.A.

On May 12th 2010, Marek Karabuła, Member of the Supervisory Board, was delegated to temporarily stand in as Vice-President of the Management Board for Gas and Trade in the period from June 1st to August 31st 2010.

As at June 30th 2010, the composition of the Management Board of PGNiG S.A. was as follows:

- Michał Szubski – President
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Chief Financial Officer
- Marek Karabuła – Vice-President, Gas and Trade
- Mirosław Szkałuba – Vice-President, Social Dialogue and Assets
- Waldemar Wójcik – Vice-President, Oil Mining.

On July 19th 2010, the Supervisory Board of PGNiG S.A. appointed Marek Karabuła as Member of the Management Board of PGNiG S.A.

2. Supervisory Board

The composition of the Supervisory Board of PGNiG S.A. did not change in H1 2010 and as at June 30th 2010 was as follows:

- Stanisław Rychlicki – Chairman
- Marcin Moryń – Deputy Chairman
- Mieczysław Kawecki – Secretary
- Grzegorz Banaszek – Member
- Agnieszka Chmielarz – Member
- Marek Karabuła – Member
- Mieczysław Puławski – Member
- Jolanta Siergiej – Member

On July 19th 2010, Marek Karabuła resigned from his position as Member of the Supervisory Board of PGNiG S.A.

Chapter III: Shareholder Structure

Employee Stock

On June 25th 2008, the Ministry of State Treasury disposed of one share in PGNiG S.A. Pursuant to the Commercialisation and Privatisation Act, dated August 30th 1996, eligible employees or their heirs gained the right to acquire the Company shares free of charge as of October 1st 2008. The right will expire on October 1st 2010. The eligible persons have the right to acquire, free of charge, up to 15% of the shares acquired by the State Treasury on the Company registration date, that is up to 750,000,000 Series A1 bearer shares with a par value of PLN 1 per share. The Company shares acquired free of charge by eligible employees or their heirs cannot be traded before July 1st 2010, and the shares acquired free of charge by members of the Company's Management Board cannot be traded before July 1st 2011. As a result of the free-of-charge acquisition of the Company shares, the State Treasury's share of the total vote will decrease from 84.75% to 72.03%. The start date for executing agreements on the acquisition of Company shares free of charge was April 6th 2009. Until June 30th 2010, 57,702 eligible persons acquired 713,630,894 shares (representing approximately 95.2% of the pool of shares available to be acquired free of charge and over 12% of the Company's share capital).

As the lock-up period applicable to employee shares pursuant to the Commercialisation and Privatisation Act of August 30th 1996 expired on June 30th 2010, on July 1st 2010 749,944,750 shares in PGNiG S.A. were assimilated to the existing shares and introduced to trading on the Warsaw Stock Exchange. 55,250 shares acquired by Members of the Management Board have not been assimilated or introduced to stock-exchange trading, yet. They will be assimilated and introduced to stock-exchange trading on July 1st 2011.

Shareholder Structure

As at June 30th 2010, 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 2010 is shown in the table below:

Shareholder structure

Shareholder	Number of shares as at Jun 30 2010	% of share capital held as at Jun 30 2010	Number of votes conferred by shares held	% of total vote at GM as at Jun 30 2010
State Treasury	4,286,369,105	72.65%	4,286,369,105	72.65%
Others	1,613,630,895	27.35%	1,613,630,895	27.35%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

PGNiG Shares Held by Management and Supervisory Personnel

The table below shows PGNiG shares and shares in PGNiG S.A.'s related undertakings held by the management and supervisory personnel as at June 30th 2010:

Shares held by management personnel

Name	Number of shares as at Dec 31 2009	Change in number of shares held	Number of shares as at Jun 30 2010	Par value of shares (PLN)
Michał Szubski	6,825	-	6,825	6,825
Mirosław Szkałuba	9,425	-	9,425	9,425
Waldemar Wójcik	19,500	-	19,500	19,500

Shares held by supervisory personnel

Name	Number of shares as at Dec 31 2009	Change in number of shares held	Number of shares as at Jun 30 2010	Par value of shares (PLN)
Stanisław Rychlicki	9,897	-	9,897	9,897
Mieczysław Kawecki	19,500	-	19,500	19,500
Jolanta Siergiej	9,425	-	9,425	9,425

Shares held by commercial proxies

Name	Number of shares as at Dec 31 2009	Change in number of shares held	Number of shares as at Jun 30 2010	Par value of shares (PLN)
Mieczysław Jakiel	30,101	-	30,101	30,101
Tadeusz Kulczyk	21,316	-	21,316	21,316

Chapter IV: Regulatory Environment

1. Licences

As at June 30th 2010, the Company held the following licences granted by the President of the Polish 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 August 17th 2009, PGNiG S.A. filed a request with the President of the Energy Regulatory Office to approve a change in the scope of licence for gaseous fuels storage. The licence scope is changed to reflect exclusion of working capacities of the storage facilities which are used by PGNiG S.A. in production or by the Transmission System Operator, as well as changes in the working capacities of the Mogilno and Husów Underground Storage Facilities, resulting from technical conditions of operation. By the date of this Report, the proceedings before the President of the Energy Regulatory Office had not been concluded.

As at June 30th 2010, the Company held the following licences granted under the Geological and Mining Law:

- 89 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 May 31st 2010, settlements with customers were made according to Gaseous Fuel Tariff No. 2/2009, approved by virtue of the decision issued by the President of the Energy Regulatory Office on May 7th 2009.

On February 12th 2010, PGNiG S.A. filed a request with the President of the Energy Regulatory Office for approval of PGNiG S.A.'s Gaseous Fuel Tariff.

By virtue of his decision of May 17th 2010, the President of the Energy Regulatory Office approved the PGNiG S.A.'s Gaseous Fuel Tariff which has been effective for settlements with customers since June 1st 2010. The new Tariff comprises:

- Part A – "Gaseous Fuel Supply Tarriff No. 3/2010," which will remain in effect until November 30th 2010; and
- Part B – "Gaseous Fuel Storage Services Tariff No. 1/2010," which will remain in effect until May 31st 2011.

The following table shows a summary of average tariffs (PLN per cubic meter) used in settlements with customers purchasing gaseous fuels, by fuel type and place of receipt.

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

	2010	2009*	Change (in %)
W-1	2.4073	2.3528	2.3%
W-2	1.8265	1.7798	2.6%
W-3	1.6838	1.6249	3.6%
W-4	1.5742	1.5206	3.5%
W-5 –W-7B	1.4273	1.3752	3.8%
W-8 – W-10	1.1587	1.1207	3.4%

	2010	2009*	Change (in %)
S-1	1.7686	1.6798	5.3%
S-2	1.3437	1.2450	7.9%
S-3	1.2181	1.1371	7.1%
S-4	1.0583	1.0002	5.8%
S-5 – S-7B	1.0301	0.9612	7.2%
S-8 – S-10	0.8735	0.8241	6.0%

	2010	2009*	Change (in %)
Z-1	1.3897	1.3124	5.9%
Z-2	1.2377	1.1419	8.4%
Z-3	1.0865	1.0100	7.6%
Z-4	0.9715	0.9130	6.4%
Z-5 – Z-7B	1.0055	0.9296	8.2%

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

	2010	2009*	Change (in %)
W-1	2.3981	2.3142	3.6%
W-2	1.9388	1.8665	3.9%
W-3	1.6488	1.5846	4.1%
W-4	1.5693	1.5129	3.7%
W-5 – W-7B	1.4627	1.4080	3.9%
W-8 – W-10	1.1881	1.1441	3.8%

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

	2010	2009*	Change (in %)
W-1	2.3057	2.2241	3.7%
W-2	1.8178	1.7483	4.0%
W-3	1.5886	1.5245	4.2%
W-4	1.5336	1.4697	4.3%
W-5 – W-7B	1.4422	1.3845	4.2%
W-8 – W-10	1.1664	1.1233	3.8%

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

	2010	2009*	Change (in %)
W-1	2.6210	2.5681	2.1%
W-2	1.7665	1.7210	2.6%
W-3	1.5520	1.5085	2.9%
W-4	1.4994	1.4592	2.8%
W-5 – W-7B	1.4115	1.3728	2.8%
W-8 – W-10	1.0942	1.0609	3.1%

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

	2010	2009*	Change (in %)
W-1	2.5192	2.4457	3.0%
W-2	1.8964	1.8459	2.7%
W-3	1.6611	1.6050	3.5%
W-4	1.5875	1.5336	3.5%
W-5 – W-7B	1.4712	1.4252	3.2%
W-8 – W-10	1.1476	1.1194	2.5%

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

	2010	2009*	Change (in %)
W-1	2.5206	2.4259	3.9%
W-2	1.8355	1.7731	3.5%
W-3	1.6749	1.6151	3.7%
W-4	1.5712	1.5159	3.6%
W-5 – W-7B	1.4005	1.3545	3.4%
W-8 – W-10	1.1324	1.0964	3.3%

	2010	2009*	Change (in %)
S-1	1.7620	1.6803	4.9%
S-2	1.3222	1.2637	4.6%
S-3	1.1800	1.1407	3.4%
S-4	1.0799	1.0388	4.0%
S-5 – S-7B	1.0371	1.0192	1.8%

	2010	2009*	Change (in %)
Z-1	1.6440	1.5663	5.0%
Z-2	1.2071	1.1522	4.8%
Z-3	1.0465	1.0067	4.0%
Z-4	0.9740	0.9359	4.1%
Z-5 – Z-7B	0.9385	0.9197	2.1%

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

Tariff group	2010	2009*	Change (in %)
E-1A – E-4B	1.0410	1.0114	2.9%
Lw-1 – Lw-4	0.8033	0.7549	6.4%
Ls-1 – Ls-4	0.6652	0.6175	7.7%

* The average 2009 prices have been determined based on the structure of sales adopted for the calculation of Tariff No. 3/2010, in accordance with the tariff calculation methodology.

On July 2nd 2010, PGNiG S.A. filed an application with the President of the Energy Regulatory Office requesting that the President's decision of May 17th 2010 approving PGNiG S.A.'s Gaseous Fuel Tariff (Part A – "Gaseous Fuel Supply Tarriff No. 3/2010") be declared invalid with respect to its effective period, citing the fact that the President of the Energy Regulatory Office had unilaterally decided to extend that period by two months. By this Report date, the proceedings were still pending before the President of the Energy Regulatory Office.

On July 23rd 2010, the Company filed an application with the President of the Energy Regulatory Office requesting adjustment of the Gaseous Fuel Tariff (Part A – "Gaseous Fuel Supply Tarriff

No. 3/2010") with respect to the prices of gaseous fuels (except for propane-butane-air and decompressed propane-butane).

3. Changes in the Tariffs of Gas Companies

Until May 31st 2010, settlements with customers receiving services from the Gas Companies were made according to Tariffs for Gaseous Fuel Distribution Services, approved by the President of the Energy Regulatory Office on May 7th 2009.

In the decisions of May 17th 2010, the President of the Energy Regulatory Office approved the Tariffs for Gaseous Fuel Distribution Services provided by the Gas Companies. For settlements with customers, these Tariffs are effective as of June 1st 2010.

4. Regulatory Risks

Legal Changes

The second half of 2010 should see further changes in the laws governing the operation of the gas sector companies. 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. Regulation of the Minister of Economy on detailed terms of operation of the gas system (the so-called "systemic regulation") became effective in July 2010. Therefore, work on amending of the tariff regulation can be expected to start soon.

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

Draft Law on Energy Efficiency

In 2009, a draft law on energy efficiency, implementing Directive 2006/32/EC of the European Parliament and of the Council of April 5th 2006 on energy end-use efficiency and energy services into the Polish law, was being prepared. Under certain provisions contained in the draft law, the power sector is given favourable treatment, which may lead to a situation where electricity providers are subsidised at the expense of other energy sectors (including the gas sector) and where the competitive balance among particular energy carriers is disrupted. Upon its enactment, the law will also require PGNiG S.A., as a gas trading company, to purchase white certificates or, alternatively, to pay the non-compliance penalty. This in turn will drive up the cost of regulated activities and, consequently, inflate the price paid by customers. Furthermore, after it is implemented, the law is bound to hinder the development of the Polish gas market, thus undermining a fundamental assumption of *Poland's Energy Policy Until 2030*.

Tariff Calculation

PGNiG S.A.'s ability to cover costs of its core operating activities depends on the prices approved by the President of the Energy Regulatory Office. While approving tariffs for a given period, the President of the Energy Regulatory Office considers other external factors which are beyond PGNiG S.A.'s control. In an attempt to protect weaker customers, while verifying costs of operating activities the President of the Energy Regulatory Office may consider certain cost unjustified. Moreover, the President of the Energy Regulatory Office does not always accept the assumptions adopted by PGNiG

S.A. with respect to main drivers of cost changes and profit targets allowing for business risk. Consequently, the Energy Regulatory Office frequently refuses to accept tariff prices and charge rates applied for by PGNiG S.A. Lower tariff prices and charges might adversely affect PGNiG S.A.'s profitability.

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 results. An increase in demand above the forecast level would necessitate additional purchases under all existing contracts (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 fuel prices on the international markets affect the prices of imported gas. Each, even 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 customers or the changes in selling prices may lag behind the changes in import prices.

Licences for Exploration for and Appraisal of Deposits

In recent years, the increase in prices of fuels on global markets has led to increased interest in exploration activities. There is a risk of competition from other companies active on the Polish market seeking licences for exploration for and appraisal of deposits or the implementation of a strategy providing for acquiring access to own hydrocarbon reserves. Having obtained relevant licences, PGNiG S.A.'s competitors will enter the Polish market. A strong competitive edge may be gained especially by large companies which enjoy established positions on the international markets and have access to much greater financial resources compared with PGNiG S.A., helping them to accept the high risk of exploration activities in Poland.

Chapter V: Exploration and Production

1. Exploration

In H1 2010, the PGNiG Group conducted work related to exploration for and appraisal of hydrocarbon deposits, as part of which it performed 105,383 metres of drillings, 4,232.5km of 2D seismic surveys and 1,542.7km^2 of 3D seismic surveys. The projects were performed both for the PGNiG Group (in the areas of its exploration and deposit development activities) and for external companies domestically and abroad.

1.1. Exploration in Poland

In H1 2010, the PGNiG S.A. conducted exploration and appraisal work in the Carpathian mountains, Carpathian Foothills, Polish Lowlands and the Lublin Province. Reservoir test results were obtained in the case of four wells, including three exploration wells and one appraisal well. Two wells were classified as positive, and two as dry. In total, PGNiG S.A. completed 12,590m of drillings.

In H1 2010, PGNiG S.A. completed drilling of the Markowola-1 well. The well is located in the Pionki-Kazimierz licence area in the Lublin Province. As an analysis of geophysical data confirmed the probability of presence of an unconventional gas (tight gas) deposit, a hydraulic fracturing operation was carried out in the Markowola-1 well in July 2010.

Geophysical work in Poland was conducted by PGNiG S.A. in the Carpathian mountains and in Polish Lowlands. In H1 2010, the Company acquired 409.4km of 2D seismic and 368.4km^2 of 3D seismic data.

As at June 30th 2010, the volume of reserves approved by the Minister of Environment was:
- 95.3 billion cubic meters of natural gas, measured as high-methane gas equivalent;
- 20.8 million tonnes of crude oil.

<u>Joint Ventures in Poland</u>

In H1 2010, PGNiG S.A. was engaged in joint venture projects with the following partners:

- FX Energy Poland Sp. z o.o., in the following areas: "Płotki," "Płotki"-"PTZ", "Poznań", "Blok 255" and "Ostrowiec"
- Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o. in the "Bieszczady" area
- Orlen Upstream Sp. z o.o. in the "Sieraków" area
- Energia Karpaty Zachodnie Sp. z o.o. Sp. k. in the following areas: "Budzów", "Bielsko-Biała", "Bestwina" and "Cieszyn", and
- Energia Karpaty Wschodnie Sp. z o.o. Sp. k. in the "Mszana Dolna" and "Jordanów" areas.

In the "Płotki" area, production was conducted from the Kłęka field and the Roszków field. In H1 2010 production from the Kłęka field was ended and decision was made to abandon the well and decommission the infrastructure. Total volume of natural gas produced from the Kłęka field was approx. 76 million cubic meters. In the "Płotki"-"PTZ" area, production continued on the Zaniemyśl gas field.

With respect to the "Poznań" area, reprocessing and interpretation of the Żerków-Pleszew 3D seismic survey was completed. In July 2010, PGNiG S.A. obtained licences to produce natural gas from the

Kromolice, Kromolice S and Środa Wielkopolska fields in the "Poznań" area. In H2 2010, drilling of the Lisewo-1k and Pławce-2 (tight gas) boreholes is planned to commence.

Despite discontinued production from the Wilga field ("Blok 255") and no hydrocarbon flow identified in the Ostrowiec-1 borehole, analyses of the available material continued during H1 2010 to identify any further exploration potential in these areas.

With respect to the "Bieszczady" area, in H1 processing and interpretation of the Kostarowce-Zahutyń 2D seismic profiles in the Carpathian mountains was completed, and location of the Niebieszczany-1 borehole was determined. Drilling of the Niebieszczany-1 borehole is planned to commence in H2 2010.

In the "Sieraków" area, the Sieraków-4 well was worked over and tested. Sieraków-3 exploration well is planned to be drilled in H2 2010.

In H1 2010, reprocessing work commenced with respect to approx. 3,000km of 2D seismic profiles covering licence areas in which the Company cooperates with Energia Karpaty Zachodnie Sp. z o.o. Sp. k.

1.2. Exploration Abroad

PGNiG Norway AS

In the Norwegian Continental Shelf, jointly with its partners, PGNiG Norway AS is implementing a project to develop the Skarv, Snadd and Idun fields. The licence interest holders are: PGNiG Norway AS – 12%, British Petroleum – 24% (operator), Statoil – 36% and E.ON Ruhrgas – 28%. Work on the project proceeds as scheduled, and the project implementation status is now over 80%. As part of the Skarv project, first production wells were drilled in H1 2010. Plans for H2 2010 include completion of construction of the floating production, storage and offloading (FPSO) unit and its transfer to Norway. Production is expected to start in 2011.

In H1 2010, PGNiG Norway AS jointly with its partners discovered a new oil and gas field (Snadd North) in the PL 212 licence area, in the vicinity of the Skarv field. PGNiG Norway AS' interest in the field is 12%, and the other licence interests are held by British Petroleum – 24%, Statoil – 36% and E.ON Ruhrgas – 28%. The recoverable reserves of the Snadd North field are initially estimated at 9 to 16 billion cubic meters of natural gas. Development of the Snadd North field is planned to start in 2011.

Furthermore, in H1 2010 in the Norwegian Continental Shelf PGNiG Norway AS:
- acquired a 15% interest in the PL 558 licence following completion of a licence round; E.ON Ruhrgas is the licence operator
- bought from Statoil Petroleum AS a 10% interest in the PL 326 licence, in the area of which presence of a natural gas accumulation has been confirmed (the Gro field); other licence interest holders are: Shell – 50%, Statoil – 30%, Gaz de France SUEZ – 10%.

POGC-Libya B.V.

Polish Oil and Gas Company - Libya B.V. conducted exploration work in the area of licence No. 113, located in the Murzuq petroleum basin. In H1 2010, the company completed phase I and phase II of the 2D seismic work, as part of which 3,027km of 2D seismic data was acquired. Furthermore, the company continued processing of seismic data and started interpretation of geophysical data. The data processing and interpretation work will continue into H2 2010.

Pakistan

PGNiG S.A. continued exploration work in Pakistan in the Kirthar licence area, jointly with Pakistan Petroleum Ltd. (interests held: PGNiG S.A. – 70%, PPL – 30%). In H1 2010, tests were completed to define the output of the Rehman-1 exploration borehole, and acquisition of 3D seismic data started. Activities planned for H2 2010 include completion of the 3D seismic field operation and commencement of workover of the Hallel-1 borehole.

Denmark

In Denmark, PGNiG S.A. was engaged in exploration activity in the 1/05 licence area. The interest holders in the licence are: PGNiG S.A. (operator) – 80%, Nordsofonden – 20%. In H1 2010, acquisition and processing of the 3D and 2D seismic data was completed. Furthermore, advanced processing of seismic data started, and is expected to be completed in H2 2010. Results of the above work will provide the basis for a potential decision to drill an exploratory borehole.

Egypt

In Egypt, PGNiG S.A. conducted exploration work in the Bahariya licence area (Block 3). The Company holds a 100% interest in the licence. In H1 2010, reprocessing of 2,000km of 2D seismic data began; it was completed in July 2010. Work planned for H2 2010 includes gravimetric analysis.

1.3. Exploration Services

In H1 2010, companies from the exploration and production segment provided services consisting in core/exploratory hole drillings and drillings for the purposes of underground gas storage facilities. In the Polish market, drilling services were performed mainly for PGNiG S.A. For non-PGNiG Group members, drilling services were performed for KGHM Polska Miedź S.A. (in the copper licence area) and for RWE Dea AG S.A. (a geological/exploration borehole) and for PWiK Gołdap Sp. z o.o. (a geothermal borehole). The PGNiG Group companies were also engaged in exploration for unconventional gas for Geometric Drilling Ltd (coalbed methane), Lane Energy Poland Sp. z o.o. (shale gas) and Energia Zachód Sp. z o.o. (tight gas). Drilling services abroad were performed mainly in Libya, Kazakhstan, Pakistan, Uganda, Egypt and Slovakia.

The PGNiG Group companies performed specialised well mining related services, including services consisting in application of enhanced recovery techniques, mud services or cementing services. They also performed remedial treatments, workovers, well abandonment services and major well maintenance work. In Poland, these auxiliary services were performed mainly for the PGNiG Group. Outside the PGNiG Group, cementing services were performed for Geotermia Mazowiecka S.A., Warbud S.A. and LOTOS Petrobaltic S.A. and workover&drilling services were performed for FX Energy Poland Sp. z o.o. The PGNiG Group companies also rendered a number of specialised services in Lithuania and Ukraine and performed well workovers in the Czech Republic and Russia.

In H1 2010, companies from the exploration and production segment performed geophysical services consisting in seismic field work, seismic data processing and interpretation and seismic data designing and acquisition. In the Polish market, the companies carried out 2D and 3D seismic data acquisition work for RWE Dea AG S.A., Orlen Upstream Sp. z o.o., Aurelian Oil and Gas PLC, and Lane Energy Poland Sp. z o.o. In the foreign markets, 2D and 3D seismic data acquisition work was performed for clients in Libya, Pakistan, India and Thailand. For the PGNiG Group, the companies performed the full range of geophysical services.

2. Production

Natural gas and crude oil production in Poland is conducted by two PGNiG S.A. branches, the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 21 mines (including 13 gas mines, and 8 oil and gas mines), while the Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 46 mines (including 26 gas mines, and 20 oil-and-gas and oil mines).

In H1 2010, PGNiG S.A. produced a total of 2.1 billion cubic meters of natural gas (high-methane gas equivalent) and 226.8 thousand tonnes of crude oil. The table below shows the volumes of PGNiG S.A.'s production in H1 2010:

Production volumes

		Unit	H1 2010
1	Natural gas, including:	million cubic meters*	2,103.9
a	high-methane, including:	million cubic meters	797.4
	- Zielona Góra Branch	million cubic meters	0
	- Sanok Branch	million cubic meters	797.4
b	nitrogen-rich, including:	million cubic meters *	1,306.5
	- Zielona Góra Branch	million cubic meters *	1,265.4
	- Sanok Branch	million cubic meters *	41.1
2	Crude oil	thousand tonnes	226.8
	- Zielona Góra Branch	thousand tonnes	203.2
	- Sanok Branch	thousand tonnes	23.6

* Measured as high-methane gas equivalent.

In H1 2010, four new wells (Pantalowice 6k, Pantalowice 5k, Zalesie 15k and Przemyśl 280k) came on stream in the Sanok Branch area. Total production capacity addition from these wells is approx. 11.7 thousand cubic meters per hour.

In H1 2010, PGNiG S.A. was engaged in various activities aimed at maintaining the gas and oil output from the currently producing fields, e.g. the company completed drilling of the Buszewo 6k production well. To counteract the natural decline in production yields, sixteen old wells, whose technical conditions made further production impossible, were subject to major remedial treatment. Additionally, a number of well stimulation operations were carried out (consisting in fracturing, acidizing or application of other enhanced recovery techniques) in order to sustain or increase the rates of recovery or to improve absorption rates in injectors. Two compressors were also installed on the Jodłówka field to raise the pressure of gas supplied to the transmission network.

The processing of crude oil generates commercial products such as condensate, sulphur and propane-butane. A part of the nitrogen-rich gas produced from a well operated by the Zielona Góra Branch is processed into high-methane gas by the Odolanów Branch. The cryogenic nitrogen removal process also generates helium and LNG. Technological tests are currently under way at the Grodzisk Wielkopolski denitriding plant, where nitrogen-rich gas is processed into high-methane gas and LNG.
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 2010

1	Natural gas, including:	million cubic meters	348.7
	- high-methane gas - nitrogen-rich gas*	million cubic meters million cubic meters	26.5 322.2
2	Crude oil	thousand tonnes	231.0
3	Condensate	thousand tonnes	1.1
4	Helium	million cubic meters	1.6
5	Propane-butane	thousand tonnes	9.7
6	Nitrogen	thousand kg	565.8
7	Sulphur	thousand tonnes	11.9

* Measured as high-methane gas equivalent.

In H1 2010, PGNiG S.A.'s foreign customers accounted for 41% of total sales in the case of crude oil, and for 83% in the case of helium. Crude oil was sold to German refineries (through the Druzhba pipeline), whereas most of the helium volume was sold in liquid form to a foreign wholesale customer, who resells the product in European countries.

Underground Gas Storage Facilities

In H1 2010, PGNiG S.A. continued work on extension of the existing high-methane gas underground storage facility in Strachocina as well as on construction of a new nitrogen-rich (Lw) gas storage facility in Bonikowo. The table below sets forth the working capacities of the underground storage facilities used to store produced gas as at June 30th 2010.

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

High-methane gas	H1 2010
Brzeźnica (E)	65.0
Strachocina (E)	150.0
Swarzów (E)	90.0
Nitrogen-rich gas	
Daszewo (Ls)	30.0

3. Investment Projects in the Exploration and Production Segment

The expenditure incurred by the PGNiG Group in H1 2010 on investments in property, plant and equipment and intangible assets in the Exploration and Production segment amounted to PLN 853.4m. The segment's major projects are described below.

Exploration

In the area of exploration, capital expenditure totalled PLN 108.3m, including PLN 95.5m incurred on wells which have not been completed yet, two wells drilled with positive results, and work abroad. The remaining expenditure was incurred on wells which proved to be dry, and was charged to expenses in the current reporting period.

Skarv Project

The project involves development of the Skarv, Snadd and Idun fields on the Norwegian Continental Shelf from a floating production, storage and offloading (FPSO) platform. Under the project, 16 wells will be drilled. In H1 2010, the first production wells were drilled. The expenditure incurred on the project in H1 2010 totalled PLN 308.8m. Production is expected to begin in 2011.

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 Crude Oil and Natural Gas Mine.

H1 2010 saw the continuation of preparatory work for the Central Facility construction and the design work for the construction of a gas pipeline to the Grodzisk Denitriding Plant under the investment sub-project "LMG Project – Central Facility, well areas and other infrastructure". The expenditure incurred in H1 2010 was PLN 118.8m. The total value of the project is estimated at approximately PLN 1.6bn.

Grodzisk Project

The objective of this project is to support the sale of gas produced from nitrogen-rich gas fields after it has been processed to achieve the parameters of high-methane gas (cryogenic nitrogen removal). The Grodzisk Denitriding Plant has been constructed with a view to increasing nitrogen-rich gas production from the existing wells and from reserves which are planned to be developed.

In H1 2010, the Company was engaged in construction work at the KGZ Paproć-Cicha Góra Natural Gas Mine as well as in development work on the Wielichowo and Ruchocice fields (including work to hook up the Elżbieciny, Jabłonna and Łęki wells). The target capacity of the Denitriding Plant will be ca. 35 thousand cubic meters per hour. The expenditure incurred in H1 2010 was PLN 59.6m. The Grodzisk project is scheduled for completion in 2011. The total value of the project is estimated at PLN 463m.

Gas Pipeline to KGHM

The project involves the construction of a high-pressure gas pipeline and optic-fibre cable along with infrastructure, from the Kościan Natural Gas Mine (KGZ Kościan) to KGHM Polkowice/Żukowice, in order to enable the Company to sell natural gas directly to KGHM Polkowice/Żukowice. The pipeline construction continued in H1 2010. The expenditure incurred in H1 2010 was PLN 6.1m. The total cost of the project is estimated at approximately PLN 220m.

Other Investment Projects in the Production Segment

Other projects involved development of gas reserves, including those already in production, projects executed in order to maintain or replace hydrocarbon production capacity, and projects related to the functioning of the hydrocarbon production segment. Key investment tasks included:

- modernisation and extension of the existing natural gas mines;
- development of the Góra Ropczycka gas field;
- development of the Sarzyna and Zalesie wells;
- upgrade of the KRIO production installation as well as of the helium liquefaction and LNG installations at the Odolanów denitriding plant;
- purchases of ready-to-use investment assets as well as backup facilities and infrastructure.

Underground Gas Storage Facilities

In H1 2010, PGNiG S.A. completed drilling of two new directional wells at the Strachocina Underground Gas Storage Facility. Furthermore, work continued on extension of the surface part of the existing high-methane gas underground storage facility in Strachocina as well as on construction of a new nitrogen-rich (Lw) gas storage facility in Bonikowo. The expenditure incurred in H1 2010 was PLN 94.6m.

4. Planned Activities

<u>Exploration</u>

In 2010, the PGNiG Group plans to conduct exploration activities involving geophysical and drilling work in the Carpathian mountains, Carpathian Foothills and in the vicinity of Gdańsk and Poznań. Drilling of the Tymowa-1, Piaski-3, Pławce-2 (tight gas) and Lubocino-1 (shale gas) exploration wells is scheduled for H2 2010. The PGNiG Group also intends to take further steps with a view to acquiring new sites for exploration and new licence areas in North Africa and Iraq. The Group plans to carry on the exploration work in its licence areas in Denmark, Libya, Egypt, Norway and Pakistan.

<u>Exploration services</u>

In H2 2010, the PGNiG Group will continue drillings in Uganda, the Czech Republic, the Ukraine as well as in Poland, where the drilling services will be provided mainly for KGHM Polska Miedź S.A., Lane Energy Poland Sp. z o.o. and Energia Zachód Sp. z o.o. Workovers, well abandonment services and specialised well mining related services will be performed in the Czech Republic, Russia and the Ukraine. Geophysical work will be carried out for Lane Energy Poland Sp. z o.o. and for customers in India.

<u>Natural Gas Production</u>

The plans for 2010 assume a natural gas production volume of 4.3 billion cubic meters of high-methane gas equivalent with a calorific value of 39.5 MJ/m^3. Maintenance of gas output levels will be achieved owing the launch of production from the Wielichowo and Ruchocice fields (gas from these fields will constitute input for the denitriding plant in Grodzisk Wielkopolski). Moreover, in H2 2010, production will be launched at the Jasionka – Phase II, Kupno, Morawsko and Palikówka fields. In order to increase the production volume to approximately 4.5 billion cubic meters, in the next few years PGNiG S.A. intends to develop and commence production from a number of gas reserves, including in Międzychód, Jabłonna, Elżbieciny (nitrogen-rich gas deposits in western Poland) and Rudka – Phase II (high-methane gas deposits in Subcarpathia).

<u>Crude Oil Production</u>

In H1 2010, work continued on the sub-project "LMG Project – Central Facility, well areas, and other infrastructure". Development of the Lubiatów-Międzychód-Grotów (LMG) field aims at increasing PGNiG S.A.'s crude oil production output. The production target for 2010 has been set at over 500 thousand tonnes. A significant increase, to approximately 0.9m tonnes annually, is expected in 2013, after the development of the LMG field is completed and production starts, and after five production wells on the Barnówko-Mostno-Buszewo (BMB) field come on stream. Two of the five wells on the BMB field are scheduled to be hooked up in H2 2010.

Underground Gas Storage Facilities

In 2010, PGNiG S.A. plans to complete construction of the Bonikowo Underground Storage Facility, with a working capacity of 200 million cubic meters. At the Strachocina Underground Storage Facility, work will continue on extending the surface part, and there are also plans to drill one more well. Extension of the Strachocina storage facility, designed to increase its working capacity to 330 million cubic meters, is scheduled to be completed in 2011.

5. 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 exploratory risk. This means that not all the identified potential deposit sites have deposits of hydrocarbons which can qualify as an accumulation. Whether or not such deposits exist depends on a number of geological factors. Furthermore, the actual quantity and quality of the accumulated hydrocarbons may differ from estimates. When the results of successful exploration activity, in the form of new reserves, do not offset the production from the existing reserves, the PGNiG Group's recoverable reserves will decrease pro rata to the current production volumes.

The size of reserves and production projections may be erroneous due to flaws in the measurement 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. The 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 parameters established in the course of preparing the relevant documentation are reviewed after the production starts. Each downgrade of the size of the reserves or production quantities may lead to a lower revenue and adversely impact the PGNiG Group'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 deposits, that is implementation of a strategy providing for gaining access to own hydrocarbon resources. Certain competitors of the PGNiG Group, especially those active globally, enjoy strong market positions and have financial resources larger than those of the PGNiG Group. 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 define, value, offer and purchase numbers of fields (including the operation thereof and underlying licences) larger than it would be possible in the case of the PGNiG Group, given the Group's financial and human resources. This competitive edge of 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. Under the currently binding regulations, 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 work

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 prices of casing pipes and lifting casing that is used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploration work. Moreover, profitability of foreign exploratory projects will to a significant extent depend on the movements in prices of oil derivative products and in exchange rates.

Legal Regulations Concerning Safety, Environmental Protection and Health

Ensuring compliance with environmental law 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 exploratory activity.

Qualified Personnel

The presence of foreign companies on the Polish market intensified the companies’ takeover of highly qualified employees with extensive professional experience. This risk is especially high with respect to professionals specialised in the exploration for natural gas and crude oil deposits. In countries where the PGNiG Group operates highly qualified staff is difficult to recruit.

Unpredictable Events

Hydrocarbon deposits developed by the PGNiG Group 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 conducting exploratory activity. This may be a particular threat in countries where law changes depend on the decisions of authoritarian governments.

Political and Economic Situation

Some countries where the PGNiG Group carries out exploratory activity face the risk of armed conflicts or terrorist attacks, which may result in limitation, suspension or discontinuation of the exploration and production business there.

In some areas of the PGNiG Group’s operations 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 activity related to oil. 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 limitation, suspension or discontinuation of the PGNiG Group’s operations.

In certain countries, the operations of exploration companies may be hindered by lack of adequate infrastructure, which may be an obstacle in transporting equipment, staff and materials to the sites. There may also arise problems in providing supplies and ensuring appropriate health care. These risks may lead to limitation or suspension of the Company’s exploratory activity.

Given the continuing global economic crisis, there is a significant degree of uncertainty as to the behaviour of investors in the exploration segment in the next few years. With prices of crude oil persisting at relatively low levels, demand for new exploration has faltered and a number of planned bids were withheld. Companies providing services abroad are facing the risk of losing certain markets and the risk of the scope of their foreign engagements being limited. Furthermore, currency fluctuations have a bearing on these companies’ financial results, since a significant portion of their revenues is generated in foreign currencies.

Chapter VI: Trade and Storage

1. Purchases

In H1 2010, 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 agreements for gas supplies from VNG-Verbundnetz GAS AG:

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

The table below presents the natural gas supply structure measured as high-methane gas equivalent.

Structure of natural gas supplies by supply sources (million cubic meters)

	H1 2010	%
Imports, including:	5,498.3	99.1%
- Gazprom Export	4,977.9	90.6%
- VNG AG	447.0	8.1%
- Other foreign suppliers	73.4	1.3%
Domestic suppliers	51.3	0.9%
Total	5,549.6	100.0%

<u>New Agreements</u>

On January 27th 2010, a trilateral Memorandum of Understanding was signed between PGNiG S.A., Gazprom Export and SGT EUROPOL GAZ S.A. The Memorandum of Understanding provides for extending the existing contract for the supply of natural gas from the Russian Federation to Poland until December 31st 2037, with an option to further extend it until December 31st 2045, and increasing the volume of natural gas supplies under the contract. The Memorandum of Understanding also provides for extending the term of the contract for the transit of natural gas through the Polish territory via the SGT EUROPOL GAZ S.A.'s pipeline, with other terms and conditions of the contract remaining unchanged. PGNiG S.A. is currently waiting for an inter-governmental agreement to be executed between the governments of the Republic of Poland and the Russian Federation. Once the government documents have been executed, PGNiG S.A. and Gazprom Export will sign an annex amending the Yamal contract.

On March 18th 2010, PGNiG S.A. executed a regasification services contract with Polskie LNG S.A. of Świnoujście. Under the contract, Polskie LNG will provide LNG regasification services to PGNiG S.A. at the LNG terminal in Świnoujście for a period of 20 years starting from July 1st 2014. In order to ensure proper performance of the contract, Polskie LNG S.A. agreed to construct a terminal which is to reach full operational capacity by July 1st 2014. Execution of the regasification services contract will enable PGNiG to fulfil the LNG purchase conditions under the LNG purchase agreement concluded between PGNiG S.A. and Qatargas Operating Company Ltd. in June 2009.

2. Sales

Pursuant to the requirements of the Polish Energy Law, in H1 2010 PGNiG S.A. continued the replacement of commercial agreements with comprehensive agreements.

In H12010, PGNiG S.A. signed comprehensive agreements for the supply of gaseous fuel, both from the transmission system and from the distribution system, to 29.3 thousand new customers.

On June 16th 2010 PGNiG S.A. and Grupa LOTOS S.A. executed a comprehensive agreement on supply of gaseous fuel. The agreement provides for the supply of gaseous fuel starting from December 16th 2011. The annual supplies of natural gas will be 403 million cubic meters in 2012, while the target annual volume is 447 million cubic meters. The estimated value of the agreement in the period of five years amounts to approximately PLN 2.2bn.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. In H1 2010, sales of natural gas rose by approx. 7% (or 485.6 million cubic meters) year on year. This sales volume increase was mostly due to low temperatures during the winter, which boosted demand for gaseous fuel from households. Demand from industrial customers rose as well, mostly in those industries which benefited from the economic recovery, i.e. the power sector (power plants and CHP plants), and the refining and petrochemicals industries. The PGNiG Group sold gas chiefly on the domestic market. The sales structure of the Trade and Storage segment in H1 2010 sales is presented in the table below.

Sales structure of key products

		Unit	H1 2010
1	Natural gas, including:	million cubic meters	7,152.4
	- high-methane gas	million cubic meters	6,872.6
	- nitrogen-rich gas*	million cubic meters	279.8
2	Propane-butane	thousand tonnes	1.0

*Measured as high-methane gas equivalent.

The Group's main customers purchasing natural gas included companies from the chemicals, steel and power sectors, as well as households. Households made up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base (approximately 6.4m). Their share in the total sales volume was 32%. The most prominent share in the natural gas sales was claimed by industrial customers (54%). The table below presents the structure of natural gas sales (measured as high-methane gas equivalent) broken down by major customers.

System sales of natural gas (million cubic meters)

	H1 2010	%
Industrial customers	3,860.5	54.0%
Trade and services	925.2	12.9%
Households	2,256.4	31.5%
Wholesale customers	85.3	1.2%
Exports	25.0	0.4%
Total	7,152.4	100.0%

In H1 2010, 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. This investment process is scheduled for completion in H2 2010.

On July 30th 2010, PGNiG S.A. and KGHM Polska Miedź S.A. executed a comprehensive agreement on sale of gaseous fuel. The agreement provides for the sale of natural gas (Lw) to be used as a power source to the Głogów and Polkowice collection points in the target amount of 266 million cubic meters per annum. The gaseous fuel will be delivered through the distribution network of Wielkopolska Spółka Gazownictwa Sp. z o.o. The agreement is effective from its date until June 30th 2033, with a possibility to set the start date of gas deliveries between July 1st 2012 and December 31st 2012. The estimated value of the agreement is approximately PLN 4.0bn.

On August 3rd 2010, PGNiG S.A. executed arrangements to terminate the natural gas sale agreements of December 1st 2003 with Energetyka Sp. z o.o. (a subsidiary of KGHM Polska Miedź S.A.), providing for the supply of gas to be used for power generation purposes. The agreements were terminated due to the parties' inability to meet the contractual terms of natural gas deliveries as well as in connection with the execution of a new agreement on the supply of natural gas to KGHM Polska Miedź S.A.

3. Storage

On January 1st 2009, PGNiG S.A. was appointed as the Storage System Operator. 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", which took effect on July 1st 2009. After public consultations, on May 17th 2010, the revised "Rules of Provision of Storage Services" came into force.

In compliance with the Rules, in 2009 PGNiG S.A. made available a total of 627 million cubic meters of working storage capacity as part of bundled services provided on a continuous or interrupted basis. On July 1st 2010, under a short-term agreement, PGNiG S.A. made available an additional 8 million cubic meters of working storage capacity on a continuous basis for the needs of third-party access (TPA) as part of a bundled services arrangement.

In H1 2010, PGNiG S.A. continued to expand the working capacities of the existing high-methane gas storage facilities in Wierzchowice (Underground Gas Storage Facility) and in Mogilno (Underground Gas Storage Cavern Facility). In Mogilno, work related to the construction of four caverns was performed. Moreover, the Company conducted work related to the construction of a new high-methane gas storage facility, namely the Kosakowo Underground Gas Storage Cavern Facility. The Company continued the construction of a leaching installation along with pipeline for brine discharge, as well as drillings for the needs of the 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)

	H1 2010
Husów	350.0
Mogilno	377.9
Wierzchowice	575.0

4. Investment Projects in the Trade and Storage Segment

In H1 2010, capital outlays of PLN 215m were made on work related to the construction of the surface installations of the Wierzchowice Underground Gas Storage Facility, extension of the working capacity of the Mogilno Underground Gas Storage Cavern Facility (a high-methane gas storage facility) and drilling work for the new high-methane gas storage facility, the Kosakowo Underground Gas Storage Cavern Facility. In total, the capital expenditure incurred on property, plant and equipment and intangible assets in the Trade and Storage segment was PLN 233.2m.

5. Planned Activities

Natural Gas Purchase

In H2 2010, PGNiG S.A. does not plan any material changes in the structure of its natural gas supply sources relative to the previous periods. Since 2009, PGNiG S.A. has been in negotiations with Gazprom Export concerning the provisions of the existing contract for natural gas supply. Execution of the annex to the contract is conditional on the conclusion of the inter-governmental agreement between the governments of the Republic of Poland and the Russian Federation, which as at this Report date has not yet been signed. The Company also took a number of steps with a view to diversifying its gas supply sources.

Underground Gas Storage Facilities

In H2 2010, PGNiG S.A. will continue the extension of the Wierzchowice Underground Gas Storage Facility and the Mogilno Underground Gas Storage Cavern Facility. The target working capacity of the facility in Mogilno is 800 million cubic meters. The first stage of the extension of the Wierzchowice Underground Gas Storage Facility from the existing working capacity of 575 million cubic meters to 1,200 million cubic meters is planned to be completed at the end of 2011. In addition, the Company will continue the construction of a new high-methane gas storage facility, namely the Kosakowo Underground Gas Storage Cavern Facility, which is ultimately to consist of ten underground caverns with a total working capacity of 250 million cubic meters.

6. Risks Related to Trade and Storage

Gas Supplies

In June 2010, there were again some disruptions in gas supplies from the east. Given the policy pursued by the main supplier and the political and economic situation in the transit countries, disruptions in gas supplies may also occur in the future. Moreover, there is a risk that demand for gaseous fuel in 2010 will not be fully met by supplies, as the amounts secured in import contracts are not sufficient. This situation is attributable to the fact that the inter-governmental agreement between the governments of the Republic of Poland and the Russian Federation has not been signed.

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.. Suppliers from outside the PGNiG Group which trade in natural gas operate mostly in the areas which have not been covered by the gas pipeline networks. The aforementioned companies include local gas distributors that own transmission infrastructure and offer – in addition to traditional network gas supply – innovative solutions of the natural gas supply involving the use of LNG. An intensified commercial activity of competitors which aims at attracting current and potential customers of PGNiG S.A. may pose a tangible threat of customer churn.

Higher Receivables

In connection with the economic crisis, which resulted a downturn on the markets of PGNiG S.A.'s customers and a deterioration in the financial standing of customers purchasing gas, mainly those from the chemicals industry, there may still be some difficulties with timely settlement of payments for the supplied gaseous fuel.

Storage

The implementation of 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, into the Polish law may significantly reduce PGNiG S.A.'s power to influence the gas storage services market.

Another risk factor is related to a potential deficit of funding required for the planned capex. If the investments in the Mogilno Underground Gas Storage Cavern Facility, the Kosakowo Underground Gas Storage Cavern Facility, the Strachocina Underground Gas Storage Facility and the Wierzchowice Underground Gas Storage Facility are not co-financed by the European Union, PGNiG S.A. will have to seek additional funding to finance its investment projects.

Chapter VII: Distribution

1. Business of the Gas Companies

In H1 2010, the core business of the Gas Companies consisted in the transmission *via* the distribution network of high-methane and nitrogen-rich gas, as well as small amounts of propane/butane and coke-oven gas. On the basis of a decision issued by the President of the Energy Regulatory Office, the Gas Companies enjoy the status of Distribution System Operators since mid-2007.

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

The largest investment projects related to the extension of the gas infrastructure in which the Gas Companies were engaged in H1 2010 included:

- continued design work on the project providing for the connection of the towns of Herby and Blachownia to the gas-supply system; the multi-year project comprises construction of high- and medium-pressure gas pipelines and two pressure reduction and metering stations; the implementation is scheduled for completion in 2015;
- continued design work on the project providing for the connection of Komprachcice and Dąbrowa to the gas-supply system; the project comprises construction of approx. 62 km of medium-pressure gas pipelines; the pipelines are scheduled for launch in 2011–2012; implementation of further phases of the investment project depends to a large extent on securing EU funds;
- continued implementation of the project involving switching customers in Pisz (the Olsztyn Province) who receive propane-butane-air gas to LNG-based high-methane (E) gas; this is the first pilot phase of the project to switch Pisz, Ełk, Suwałki and Olecko (the PESO project) to high-methane gas, implemented in cooperation with PGNiG S.A.;
- continuation of the second phase of construction of a high-pressure gas transmission pipeline from Werbkowice to Zamość; the project is designed to increase the volume of transmitted natural gas and connect the Ukrainian high pressure pipeline with the Polish gas grid;
- continued construction of an approx. 30-km long high-pressure gas pipeline from Kowala to Jędrzejów, including a first-grade pressure reduction and metering station.

The Gas Companies have also undertaken steps designed to secure financing for the key network investment projects from EU funds under the Infrastructure and Environment Operational Programme.

In H1 2010, the Distribution Segment's capital expenditure on property, plant and equipment and intangible assets reached PLN 385.1m.

The table below presents the volume of gas transmitted *via* the distribution grid, the length of the distribution network, the number of metering devices and the employment as at June 30th 2010.

Gas Companies – Key Data

	Unit	DSG	GSG	KSG	MSG	PSG	WSG
Volume of gas transmitted through the distribution system	million cubic meters	559.9	920.3	1,085.9	1,166.8	552.5	910.9
Length of network, excl. connections	km	7,773.3	20,799.9	44,498.1	18,663.3	9,430.7	15,229.0
Number of metering devices	thousand	747.2	1,298.6	1,421.9	1,497.2	741.0	905.4
Headcount as at June 30th 2010	person	1,412	2,612	3,311	2,921	1,761	1,823

2. Planned Directions for Development in the Distribution Segment

Major investment projects to be implemented in H2 2010 include:

- construction of an approx. 31km long high-pressure gas pipeline from Kolnik near Pszczółki to Gdańsk, with a gas connection to Grupa LOTOS S.A.; the pipeline will be used to supply gas to Grupa LOTOS S.A. and – as an additional source – to supply gas to the medium-pressure distribution network of the city of Gdańsk and its surrounding areas;
- continued implementation of the project to connect the towns of Herby and Blachownia as well as Komprachcice and Dąbrowa to the gas-supply system;
- reconstruction of a decommissioned high-pressure coke-gas pipeline from Czarnocin to Ujazd; the pipeline will allow for the supply of gas to a new economic zone in Ujazd in the Opole Province and will enable the Silesia and the Opole Province distribution networks to be connected in the future;
- continuation of the second phase of construction of a high-pressure gas transmission pipeline from Werbkowice to Zamość as well as continuation of construction of a high-pressure gas pipeline from Kowala to Jędrzejów, including a first-grade pressure reduction and metering station; the projects are scheduled for completion in late 2010 or early 2011.

In the next few years, the Gas 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

The liberalisation of the gas market boosts the activity of gas suppliers who are the competitors of the Gas Companies. Over the last few years, those suppliers showed regular and steady activity, gradually developing their gas networks and acquiring new customers, both among households and businesses. Another issue which affects the Gas Companies' competitive position is the tariff policy of the Energy Regulatory Office, as it prevents the Gas Companies from operating a flexible pricing policy for their key customers. With the lack of flexible pricing, customers may find the offering of the competition attractive.

Legislation

An important factor with a bearing on the Gas Companies' operations is the long time required to prepare an investment project. Complex provisions of the Construction Law and environmental regulations impose the obligation to prepare adequate documentation and procure numerous approvals and decisions in order to obtain a building permit. Additionally, lack of up-to-date land use plans or zoning plans covering the communes crossed by the gas pipelines results in new projects not having the status of public benefit investments, which causes problems to obtaining permits for extension of gas networks. An overlong execution of new investment projects may inhibit the increase in the volumes of transmitted gas.

Lower Volumes of Transmitted Gaseous Fuel

The consequences of the global economic crisis for Poland include: an economic slowdown, lower scale of key investment projects or suspension of their execution, and higher unemployment rate. There is a risk that the demand for natural gas and distribution services will decline in connection with deteriorating economic standing of manufacturing companies (as they will scale down or suspend their production activities).

Substitution

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

Chapter VIII: Other Activities

1. Segment Activities

In H1 2010, the segment companies were engaged in work related to the construction of transmission pipelines, upgrade of distribution and metering stations, construction and assembly work related to development of natural gas reserves, construction of technical installations of underground gas storage facilities, manufacture of drilling equipment, repair of coal mining equipment, design of gas transport installations as well as hotel and restaurant services and spa centre services. Moreover, operations in the power sector were launched.

In H1 2010, 30.0km of gas transmission pipelines were built, with the average diameter of 500.7mm, both for external customers and for the Group's own needs. Major contracts performed in the period included construction of a DN 500 gas pipeline in Subcarpathia for OGP GAZ-SYSTEM S.A., DN 500/800 gas transmission pipelines is Slovenia, a DN 300 gas pipeline delivering gas to Jędrzejów and a DN 350/200 gas pipeline along with a optic-fibre cable and infrastructure from the Kościan Natural Gas Mine (KGZ Kościan) to KGHM Żukowice for the PGNiG Group.

Furthermore, for other PGNiG Group members, the segment companies provided principally construction and assembly services, including in connection with the development of the Wielichowo and Ruchocice fields, construction of the surface part of the Bonikowo Underground Gas Storage Facility, extension of the surface part of the Strachocina Underground Gas Storage Facility, and upgrade of the Szopienice gas distribution station. The segment companies also manufactured drilling equipment, including surface pressure equipment, heads, casing heads and parts of production equipment.

For external customers, the segment companies manufactured equipment and spare parts for oil platforms and drill ships, as well as spare parts for construction machinery. The companies also provided services consisting in designing gas transmission infrastructure, construction and assembly work related to alteration of the Rozwadów gas distribution and metering station and repairs of coal mining equipment, as well as hotel and restaurant services and spa centre services.

On May 7th 2010, PGNiG S.A., PGNiG Energia S.A, TAURON Polska Energia S.A. and Elektrownia Stalowa Wola S.A. signed a project execution agreement concerning "Construction of a CCGT Unit in Stalowa Wola" which concerned the definition of the terms and conditions and the carrying out of an investment project involving the construction of a combined cycle gas turbine unit with capacity of 400MW electrical power and 229MW thermal power. For the purpose of construction and subsequent operation of the CCGT CHP plant, a special-purpose vehicle (SPV) was established under the name Elektrociepłownia Stalowa Wola S.A. The SPV is wholly owned by Elektrownia Stalowa Wola S.A.

Moreover, in H1 2010, PGNiG Energia S.A. commenced the process of streamlining the costs of purchase of electricity for the needs of the PGNiG Group.

<u>Investment Projects</u>

In H1 2010, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 3.9m. Major investment projects included purchase of production plant and equipment, purchase of computer hardware and vehicles, and extension and modernisation of real property.

Planned Activity

In H2 2010, the segment companies will continue the work started in the preceding reporting period, but they will also start new projects. For instance, projects which will be continued include the construction of the DN 500 gas pipeline in Subcarpathia and of the surface part of the Bonikowo Underground Gas Storage Facility, development of the Wielichowo and Ruchocice fields and upgrading of the Szopienice gas distribution station. New projects will comprise construction of gas transmission pipelines in Slovenia, Germany and Poland (the Mieszalnia-Kłodawa and Taczalin-Radakowice sections) as well as construction of a compressor station in Jarosław and of the Tworzeń compressor station along with a pipeline and the water and sewage system.

Despite the fall in demand for products offered by the energy sector, 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 mines, as well as with respect to gas system designing and construction and assembly services for oil and gas facilities. The companies are planning to enter other market segments in Poland and abroad, such as planning of investments involving construction of biomass-fired heat- or electricity-generating installations, installations for transport and storage of CO_2, fuel pipelines, and construction of water supply and sewage systems along with the auxiliary infrastructure.

In H2 2010, PGNiG Energia S.A. is planned to acquire a 50% stake in Elektrociepłownia Stalowa Wola S.A. SPV. A condition necessary for the company to acquire the shares is approval of the transaction by the President of the Office of Competition and Consumer Protection. PGNiG Energia S.A. is also planning to commence operations in the wholesale power trading business.

2. 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. In the area of designing gas transport installations, consolidation of design offices specialised in designing installations for production, storage, transmission and distribution of gas, as well as setting up new design offices within gas industry operators, are unfavourable phenomena which adversely affect the design companies' capacity to form consortia with execution companies and secure new orders.

Moreover, the presence of competitors in the local markets has entailed a risk of these rival companies taking over specialised staff with extensive professional experience.

Economic Situation

Operations of the segment companies depend to a large extent on the scale of ongoing investment projects in the area of oil and gas exploration and production, which stimulates higher or lower demand for the products and services offered. The global economic crisis has resulted in some of the projects being abandoned.

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 cogeneration systems. Higher crude oil prices on 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 profitability of power projects is the fact that the government administration have not adopted a clear position on whether to maintain the gas cogeneration support system in the form of "yellow certificates" beyond 2012.

Chapter IX: 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 wells and mining pits prevents leakage of crude oil and natural gas to the surface and to watercourses. Furthermore, if gas wells remained unplugged, there would be a risk that escaping gas could accumulate inside, posing a fire hazard. In H1 2010, PGNiG S.A. plugged and abandoned 15 wells which had reached their economic limit.

Carbon Credit Trading System

Under the existing carbon credit trading system (CCTS), in 2010 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2009 and reconciled the volumes of carbon dioxide emission with the permit held. Following the cancellation of the carbon credits used in 2009, 23,622 Mg CO_2 credit units were retained. In the discussed settlement period, the following facilities were included in the system: the Odolanów Branch, Zielona Góra Branch and the Mogilno Underground Gas Cavern Storage Facility.

Environmental Management System

In H1 2010, the Company continued to implement the Environmental Management System at WSG Sp. z o.o. and started implementation of the system at MSG Sp. z o.o.

Methane Emissions

In H1 2010, the Company continued work on defining standardised methane emission indicators and unifying the methods for calculating the volume of 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 2010, the Company carried out supplementary tests and surveys concerning properties located in Toruń, Koźmin Wielkopolski, Gorzów Wielkopolski, Szczecin, Katowice – Mysłowice, Reszel, Gryfice, Czersk, Zabrze (ul. Pyskowicka), Radków and Szprotawa. Reclamation work on properties in Wrocław, Świdnica, Jugowice, Lądek Zdrój and Ziębice, with the total area of approx. 60 thousand square metres, was completed by the end of July 2010.

Supplementary tests and surveys concerning properties located in Kargowa, Zabrze, Wałbrzych, Łabiszyn and Międzylesie, as well as land reclamation work on the properties in Bartoszyce, Radków, Pyrzyce and Koźmin Wielkopolski, with the total area of 24 thousand square metres, have been scheduled for H2 2010.

Chapter X: Other Information

Distribution of the 2009 Profit

On April 29th 2010, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution on the distribution of the 2009 net profit in the amount of PLN 665.9m. Distributions from the profit were allocated in the following manner:

- PLN 117.4m was allocated to the Company's statutory reserve funds;
- PLN 472.0m was allocated to dividend payments (PLN 0.08 per share), of which PLN 340.0m will be distributed to the State Treasury as non-cash dividend (the assets to be distributed as dividend and the valuation method will be defined in a separate resolution of the General Shareholders Meeting), with a proviso that additional cash will be distributed to the State Treasury if the value of the non-cash assets is below PLN 400.0m;
- PLN 8.9m was allocated to increase the Company's social benefits fund;
- PLN 54.6m was allocated to awards for the Company's employees;
- PLN 13.0m was allocated to increase the Central Restructuring Fund capital reserve.

In addition, retained profit of PLN 53.6m was allocated to increase the Company's statutory reserve funds.

The Annual General Shareholders Meeting of PGNiG S.A. set July 27th 2010 as the dividend record date and October 4th 2010 as the dividend payment date.

Discharge Granted to Management Board and Supervisory Board Members in Respect of Their Duties

On April 29th 2010, 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 2009.

Appointment of a Qualified Auditor

On May 25th 2010, Deloitte Audyt Sp. z o.o. was appointed to audit the financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group for the financial years 2010, 2011 and 2012.

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 declare invalidity of resolutions by the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG S.A. to pay additional contributions in the amount 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 invalidity of the resolution concerning redemption of shares and the resolution concerning additional contributions.

- The proceedings based on PGNiG S.A.'s action 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 January 19th 2005, whereunder PGNiG S.A. was obliged to pay additional contributions in the amount of PLN 25,999,998, are pending before the Regional Court of Warsaw and the Warsaw Court of Appeals. By virtue of the ruling of October 31st 2008, the

Regional Court dismissed PGNiG S.A.'s action. On July 30th 2009, the Court of Appeals reversed the ruling of the first instance and remanded the case for re-examination.

- Proceedings based upon PGNiG S.A.'s action 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, whereunder PGNiG S.A. was obliged to pay additional contributions in the amount of PLN 6,552,000, were brought before the Regional Court of Warsaw. By virtue of the ruling of May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision on securing the claim (the temporary injunction order). The proceedings to rescind or declare invalidity of the resolution on additional contributions and to maintain the security for the claim (the temporary injunction order) have been held before the Court of Appeals and the Regional Court of Warsaw since 2008. On December 21st 2009, the Court of Appeals reversed the Regional Court's ruling of May 30th 2008 (by virtue of which the Company's claim to rescind or declare invalidity of the resolution on additional contributions to equity had been dismissed) and remanded the case for re-examination by the Regional Court. By virtue of the ruling of May 25th 2010, the Court of Appeals once again reversed the Regional Court's decision reversing the decision concerning security for the claim (the temporary injunction order), and referred the case to the Regional Court of Warsaw.

Dispute with Bartimpex S.A.

On August 9th 2005, in connection with a motion filed by PHZ Bartimpex S.A., the President of the Office of Competition and Consumer Protection ruled that the Company pursued anti-competitive practices through abusing its dominant position on the domestic natural gas transmission market, this being manifested in the refusal to provide the services of transmitting natural gas extracted outside Poland, and imposed a fine on PGNiG S.A. in the amount of PLN 2m along with an order to repay the costs of proceedings for the benefit of PHZ Bartimpex S.A. The President of the Office of Competition and Consumer Protection also stated that the abovementioned practices had ceased on June 2nd 2003.

On August 31st 2005, PGNiG S.A. appealed against the decision. The case was heard successively by the following courts: the Regional Court of Warsaw, the Warsaw Court of Appeals, and the Supreme Court. In connection with the cassation complaint filed by PGNiG S.A., on July 15th 2009 the Supreme Court revoked the Court of Appeals' decision and remanded the case for re-examination by the Court of Appeals.

By virtue of its ruling of January 5th 2010, the Court of Appeals reversed the decision issued by the President of the Office of Competition and Consumer Protection on August 9th 2005, dismissed PHZ Bartimpex S.A.'s appeal, and ordered the President of the Office of Competition and Consumer Protection to reimburse PGNiG S.A. for the costs of the appeal and cassation proceedings.

Chapter XI: Financial Performance

The financial statements of the PGNiG Group have been prepared in accordance with the International Financial Reporting Standards (IFRS) endorsed by the European Union (EU) as at June 30th 2010.

The accounting policies applied in preparing the consolidated financial statements are presented in the consolidated financial statements of the PGNiG Group for the period ended June 30th 2010.

1. Financial Standing

In H1 2009, the PGNiG Group posted net profit of PLN 994.2m, up by PLN 1,487.2m relative to the figure recorded in H1 2009.

Summary information on the PGNiG Group's financial standing in H1 2010 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards and comprising:

- statement of financial position
- income statement
- statement of cash flows
- selected financial ratios.

Consolidated Statement of Financial Position (PLNm)

ASSETS	Jun 30th 2010	Dec 31 2009
Non-current assets	25,516.6	24,657.0
Property, plant and equipment	23,621.2	22,888.9
Investment property	6.9	7.5
Intangible assets	192.2	173.4
Investments in associated undertakings valued with equity method	556.2	556.5
Financial assets available for sale	86.1	89.8
Other financial assets	279.8	299.9
Deferred tax assets	725.3	591.6
Other non-current assets	48.9	49.4
Current assets	6,467.8	6,416.9
Inventories	1,383.6	1,258.9
Trade and other receivables	2,578.9	3,680.0
Current income tax receivable	8.8	199.4
Prepayments and accrued income	259.0	55.3
Financial assets available for sale	3.6	7.5
Assets from derivative financial instruments	138.0	18.0
Cash and cash equivalents	2,093.8	1,196.3
Assets held for sale	2.1	1.5
Total assets	31,984.4	31,073.9

Consolidated Statement of Financial Position (PLNm) – continued

EQUITY AND LIABILITIES	Jun 30 2010	Dec 31 2009
Equity	22,045.3	21,437.3
Share capital	5,900.0	5,900.0
Foreign exchange differences on translation of foreign operations	(33.2)	(51.2)
Share premium account	1,740.1	1,740.1
Other capital reserves	12,236.3	11,455.4
Retained earnings/(deficit)	2,189.8	2,382.5
Equity (attributable to equity holders of the parent)	22,033.0	21,426.8
Equity attributable to non-controlling interests	12.3	10.5
Non-current liabilities	3,790.2	3,737.6
Loans, borrowings and debt securities	68.2	44.1
Provisions	1,361.7	1,315.8
Deferred income	1,074.9	1,090.7
Deferred tax liabilities	1,267.2	1,268.4
Other non-current liabilities	18.2	18.6
Current liabilities	6,148.9	5,899.0
Trade and other payables	2,987.5	2,733.4
Loans, borrowings and debt securities	1,733.1	1,984.1
Liabilities from derivative financial instruments	317.5	260.4
Current income tax receivable	221.0	47.4
Provisions	258.6	240.3
Deferred income	631.2	633.4
Total liabilities	9,939.1	9,636.6
Total equity and liabilities	31,984.4	31,073.9

Consolidated Income Statement (PLNm)

	H1 2010	H1 2009
Sales revenue	10,761.9	10,253.6
Total operating expenses	(9,560.2)	(10,932.8)
Raw materials and energy used	(5,940.7)	(7,672.9)
Employee benefits	(1,282.8)	(1,228.5)
Depreciation and amortisation	(745.2)	(762.5)
Contracted services	(1,518.1)	(1,285.4)
Cost of products and services for own needs	361.5	359.6
Net other operating expenses	(434.9)	(343.1)
Operating profit/(loss)	1,201.7	(679.2)
Finance income	34.8	169.9
Finance expenses	(19.5)	(67.4)
Share in net profit/loss of undertakings accounted for using the equity method	(0.4)	(0.2)
Pre-tax profit/loss	1,216.6	(576.9)
Corporate income tax	(222.4)	83.9
Net profit/loss	994.2	(493.0)
Attributable to:		
Equity holders of the parent	991.9	(493.4)
Non-controlling interests	2.3	0.4
	994.2	(493.0)

Consolidated statement of cash flows (PLNm)

	H1 2010	H1 2009
Net cash provided by/used in operating activities	2,638.5	1,095.6
Net cash provided by/used in investing activities	(1,439.8)	(1,698.2)
Net cash provided by/used in financing activities	(302.3)	527.5
Change in net cash	896.4	(75.1)
Cash and cash equivalents at beginning of period	1,196.3	1,420.9
Cash and cash equivalents at end of period	2,092.7	1,345.7

Financial Ratios

Profitability

	H1 2010	H1 2009
EBIT (PLNm) operating profit	1,201.7	(679.2)
EBITDA (PLNm) operating profit + depreciation/amortisation	1,946.9	83.3
ROE net profit* to equity at end of period	-	-
NET MARGIN net profit* to sales revenue	9.2%	-4.8%
ROA net profit* to assets at end of period	-	-

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

Liquidity

	H1 2010	2009
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	1.0	1.1
QUICK RATIO current assets (net of prepayments and accrued income) less inventories to current liabilities	0.8	0.9

Debt

	H1 2010	2009
DEBT RATIO total liabilities to total equity and liabilities	31.1%	31.0%
DEBT/EQUITY RATIO total liabilities to equity*	45.1%	45.0%

*Equity attributable to equity holders of the parent.

Relative to the corresponding period of 2009, the Group's operating profit rose by PLN 1,880.9m (or 227%). The strengthening of the Group's financial position followed primarily from improved margins on high-methane gas sales in the Trade and Storage segment.

Exploration and Production

The Exploration and Production segment posted operating profit of PLN 339.8m, up by PLN 236.4m year on year. This higher profit followed chiefly from a decrease in net other operating expenses, including in particular lower impairment losses on exploration and production assets. The PGNiG Group also generated higher margins on sales of crude oil, due to higher crude prices on the global markets. Moreover, following the launch of the new denitriding plant in Grodzisk Wielkopolski, production of nitrogen-rich gas rose by 11%. Increased supplies of gas for denitriding and implementation of projects to switch customers to high-methane gas resulted in 15% lower nitrogen-rich gas sales volume.

Trade and Storage

The PGNiG Group's financial performance improved primarily in the Trade and Storage segment. At the end of H1 2010, the segment posted PLN 342.26m in operating profit, that is by PLN 1,416.2m more than in H1 2009. Such strong improvement in the operating result was due to higher margins generated on high-methane gas sales, attributable to:

- a 30% fall in unit purchase costs of imported gas
- a ca. 3% drop in the average gas sale prices.

The 30% decline in unit purchase costs of imported gas was the key driver of margin expansion on the high-methane gas sales. The steady, moderate growth in crude oil prices observed since Q2 2009 resulted in relatively stable purchase prices of imported gas for the Company. Moreover, lower unit costs of gas imports were partly due to a decline in the average USD exchange rate of about 10% relative to H1 2009.

The margins on high-methane gas sales improved despite the fall in average gas selling prices by about 3%. This fall was due to two subsequent changes in the gaseous fuel tariff rates and charges. In June 2009, the President of the Energy Regulatory Office approved a tariff with the average gas price reduced by 8.8%, whereas effective from June 2010, the average price of high-methane was raised by 4.8%.

<u>Distribution</u>

Operating profit in the Distribution segment was PLN 526.1m and was by PLN 224.4m higher year on year, mainly due to an increase in rates and charges for network services and higher gaseous fuel sales volume. Higher rates and charges for network services were introduced following the approval by the President of the Energy Regulatory Office of two subsequent increases in tariff prices (in June 2009 and June 2010). Higher network services sales volume was attributable to higher demand for gaseous fuels in the heating season.

Segments' Operating Results

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

	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,
Inter-segment 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 profit of undertakings accounted for using the equity method	-	(0.4)	-	-	-	(0.4)
Pre-tax profit/loss	,	,	,	,	,	1,216.6
Corporate income tax	-	-	-	-	-	(222.4)
Net profit/loss	,	,	,	,	,	994.2
Capital expenditure on property, plant and equipment and intangible assets	(853.4)	(233.2)	(385.1)	(3.9)	-	(1,475.6)

Financial data of the PGNiG Group's segments for H1 2009 (PLNm)

	Exploration and Production	Trade and Storage	Distribution	Other activities	Eliminations	Total
Sales to external customers	953.2	9,190.3	26.6	83.5	-	10,253.6
Inter-segment sales	562.8	107.3	1,509.3	86.4	(2,265.8)	-
Segment's total revenue	1,516.0	9,297.6	1,535.9	169.9	(2,265.8)	10,253.6
Segment's expenses	(1,412.6)	(10,371.2)	(1,234.2)	(174.3)	2,259.5	(10,932.8)
Operating profit/loss	103.4	(1,073.6)	301.7	(4.4)	(6.3)	(679.2)
Net finance expenses	-	-	-	-	-	102.5
Share in profit of undertakings accounted for using the equity method	-	(0.2)	-	-	-	(0.2)
Pre-tax profit/loss						(576.9)
Corporate income tax	-	-	-	-	-	83.9
Net profit/loss						(493.0)
Capital expenditure on property, plant and equipment and intangible assets	(828.5)	(480.8)	(459.0)	(16.5)		(1,784.8)

In H1 2010, result on financing activity dropped by PLN 87.2m year on year. The decline was chiefly due lower reversals of impairment losses on financial investments following reversal of impairment losses on disputed interest and a loan advanced to SGT EUROPOL GAZ S.A. in 2009.

The balance sheet as at June 30th 2010 shows a balance-sheet total of PLN 31,984.4m, up by PLN 910.5m (or 3%) year on year.

The largest item of assets was property, plant and equipment, which stood at PLN 23,621.2m as at the end of H1 2010, up by PLN 732.3m (or 3%) on December 31st 2009. This increase was primarily due to investment projects implemented by the PGNiG Group, as well as revaluation of assets, mainly those related to the exploration and production business.

There was a significant change in deferred tax assets. Relative to December 31st 2009, this item rose by PLN 133.7m (or 23%). This increase was chiefly attributable to investment tax credits to which PGNiG Norway AS is entitled. In the subsequent financial years, these tax credits will reduce the tax base.

As at June 30th 2010, current assets totalled PLN 6,467.8m, up by 50.9m (or 1%) compared with the end of 2009.

Within current assets, the most significant changes concerned trade and other receivables, which fell by PLN 1,101.1m (or 30%) compared with the end of 2009, due to the seasonal decrease in the natural gas sales volume.

During the period under review, inventories rose by PLN 124.7m (or 10%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage facilities. The increase in inventories was caused by higher gas acquisition costs.

There were significant changes in the Group's prepayments and accrued income, which grew by PLN 203.7m from the end of 2009. This rise was due to the recognition in assets of the costs of real estate tax (which are gradually released to the P&L), including primarily the tax on gas pipelines and infrastructure.

Cash and cash equivalents stood at PLN 2,093.8m and were by PLN 897.5m (or 75%) higher than the figure reported at the end of 2009, primarily due to higher cash provided by current operating activities.

The value and structure of the current assets held by the PGNiG Group continued to guarantee the Group's full capacity to settle all its liabilities in a timely manner. Liquidity ratios deteriorated slightly: current ratio fell from 1.1 to 1.0, and quick ratio dropped from 0.9 to 0.8.

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2009, the Group's equity increased by PLN 608.0m (or 3%). The level of equity was mainly affected by the net profit generated in the period (of PLN 994.2m) and the payment of non-cash and cash dividend (of PLN 472.0m) as part of distribution of the previous year's profit.

As at June 30th 2010, current liabilities increased by PLN 249.9m (or 4%) relative to the level reported as at December 31st 2009. The level of current liabilities was chiefly the effect of a PLN 254.1m increase in trade payables, mainly in connection with the dividend to the State Treasury, a PLN 173.6m rise in current tax liabilities, and a PLN 251.0m drop in current loans and borrowings following repayment of credit facilities.

The ratios reflecting the relation between equity and other items of equity and liabilities were similar to those reported at the end of 2009. The debt to equity ratio rose from 45.0% to 45.1% as at the end of H1 2010, whereas the debt ratio (total liabilities to total equity and liabilities) went up from 31.0% to 31.1%.

Transactions concluded on non-arms' length terms

In H1 2010, 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 2010, 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 2010, the PGNiG Group did not publish any financial forecasts.

2. Projected Future Financial Performance

Factors of key importance to the financial performance of the PGNiG Group will include crude oil prices on international markets, the situation on foreign-exchange markets, and the position adopted by the President of the Energy Regulatory Office regarding gaseous fuel tariffs.

Prices of crude oil and petroleum products have been moderately rising on global markets for over a year. If this trend continues in the forthcoming periods, the PGNiG Group will benefit from relatively stable prices of imported gas.

The situation on currency markets exerts a major influence on the financial results posted by the PGNiG Group. Since April 2010, the US dollar has been rapidly appreciating against the złoty. The strengthening of the US dollar has an adverse effect on the costs of purchase of imported high-methane gas. If the US dollar appreciates further, the profitability of high-methane gas trading may deteriorate.

Although the current tariffs have been approved to stay in effect until November 2010, PGNiG S.A. has filed a new application with the President of the Energy Regulatory Office requesting approval of the PGNiG S.A. Gaseous Fuel Tariff which would apply in settlements with customers from September 2010. The requested increase of natural gas selling prices is justified by the appreciation of the US dollar. The group's future margins on natural gas trading will substantially depend on the decision of the President of the Energy Regulatory Office regarding the rates and charges for gaseous fuels in the revised tariff.

The PGNiG Group has taken steps to secure financing for its day-to-day operations and extensive investment activity. On June 10th 2010, PGNiG S.A. executed an agreement with six banks (Pekao SA, ING Bank Śląski SA, PKO BP SA, Bank Handlowy w Warszawie SA, Societe Generale SA and BNP Paribas SA Polish Branch) concerning a bond issue programme with a value of up to PLN 3.0bn (the "Programme"). Under the Programme, effective until July 31st 2013, PGNiG S.A. will be able to issue discount and coupon bonds with maturities ranging from one month to one year. Proceeds from the first issue were used to repay a multi-currency loan which matured on July 27th 2010, and proceeds from subsequent issues will be used to meet general liquidity needs.

The funds at the disposal of the PGNiG Group companies ensure timely financing of all current and planned expenditure related to the core business and investing activities. The expenditure is financed using credit facilities contracted with banks and borrowings from PGNiG S.A. In order to enhance security of financing, PGNiG S.A. has a liquidity reserve in the form of overdraft facility agreements (for a total amount of PLN 240.0m).

In H2 2010, the PGNiG Group intends to maintain a high level of capital expenditure on investments, including mainly investment projects designed to enlarge underground gas storage facilities, increase hydrocarbon production capacity and diversify gas supply sources, as well as on projects related to exploration for and appraisal of crude oil and natural gas reserves or building of the Group's power generation segment.

Management Board

President	Michał Szubski	________________
Vice-President	Radosław Dudziński	________________
Vice-President	Sławomir Hinc	________________
Vice-President	Marek Karabuła	________________
Vice-President	Mirosław Szkałuba	________________
Vice-President	Waldemar Wójcik	________________