# DIRECTORS' REPORT ON THE PGNIG GROUP'S OPERATIONS IN H1 2009

Polskie Górnictwo Naftowe i Gazownictwo SA

Warsaw, August 12th 2009

# 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.), registered office at ul. Marcina Kasprzaka 25, Warsaw, Poland, 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 Company’s share capital amounts to PLN 5.9bn and is divided into 5,900,000,000 shares.

The scope of the PGNiG Group’s business comprises exploration of reserves, 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. Organisational Structure of the PGNiG Group

As at June 30th 2009, the PGNiG Group comprised PGNiG S.A. (the parent undertaking) and 34 production and service companies, including:

- 26 subsidiaries of PGNiG S.A.;
- 8 indirect subsidiaries of PGNiG S.A.

The table below shows the Group members as at June 30th 2009.

Companies of the PGNiG Group:

| | Company | 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)] | 497,327,000.00 | 497,327,000.00 | 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. | 1,288,680,000.00 | 1,288,680,000.00 | 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.SiP.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 | Górnictwo Naftowe Sp. z o.o. | 50,000.00 | 50,000.00 | 100.00% | 100.00% |
| 23 | NYSAGAZ Sp. z o.o. | 3,700,000.00 | 1,887,000.00 | 51.00% | 51.00% |
| 24 | ZRUG Sp. z o.o. (Pogórska Wola) | 4,300,000.00 | 4,300,000.00 | 100.00% | 100.00% |
| 25 | BUD-GAZ PPUH Sp. z o.o. | 51,760.00 | 51,760.00 | 100.00% | 100.00% |
| 26 | PPUiH TURGAZ Sp. z o.o. w likwidacji (in liquidation) | 176,000.00 | 90,000.00 | 51.14% | 51.14% |
| | Subsidiaries of PGNiG S.A.'s subsidiaries | Share capital (PLN) | Shareholding of PGNiG S.A.'s subsidiaries (PLN) | % of share capital held by PGNiG S.A.'s subsidiaries | % of the total vote held by PGNiG S.A.'s subsidiarie s |
| 27 | GEOFIZYKA Kraków Libya JSC (LYD)[1), 2)] | 1,000,000.00 | 600,000.00 | 60.00% | 60.00% |
| 28 | Geofizyka Torun Kish Ltd (Rial)[1), 3)] | 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. | 78,131,000.00 | 78,131,000.00 | 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 | GAZ Sp. z o.o. (Błonie) | 300,000.00 | 153,000.00 | 51.00% | 51.00% |
| 33 | GAZ MEDIA Sp. z o.o. (Wołomin) | 300,000.00 | 153,000.00 | 51.00% | 51.00% |
| 34 | NAFT-STAL Sp. z o.o. | 667,500.00 | 450,000.00 | 67.40% | 67.40% |

1) Figures shown in the foreign currencies specified.
2) Paid up: LYD 300,000.00, including LYD 180,000.00 paid by GEOFIZYKA Kraków Sp. z o.o.
3) Not paid up.

On April 22nd 2009, the Extraordinary General Shareholders Meeting of PPUiH TURGAZ Sp. z o.o. adopted a resolution to dissolve the company and place it in liquidation.

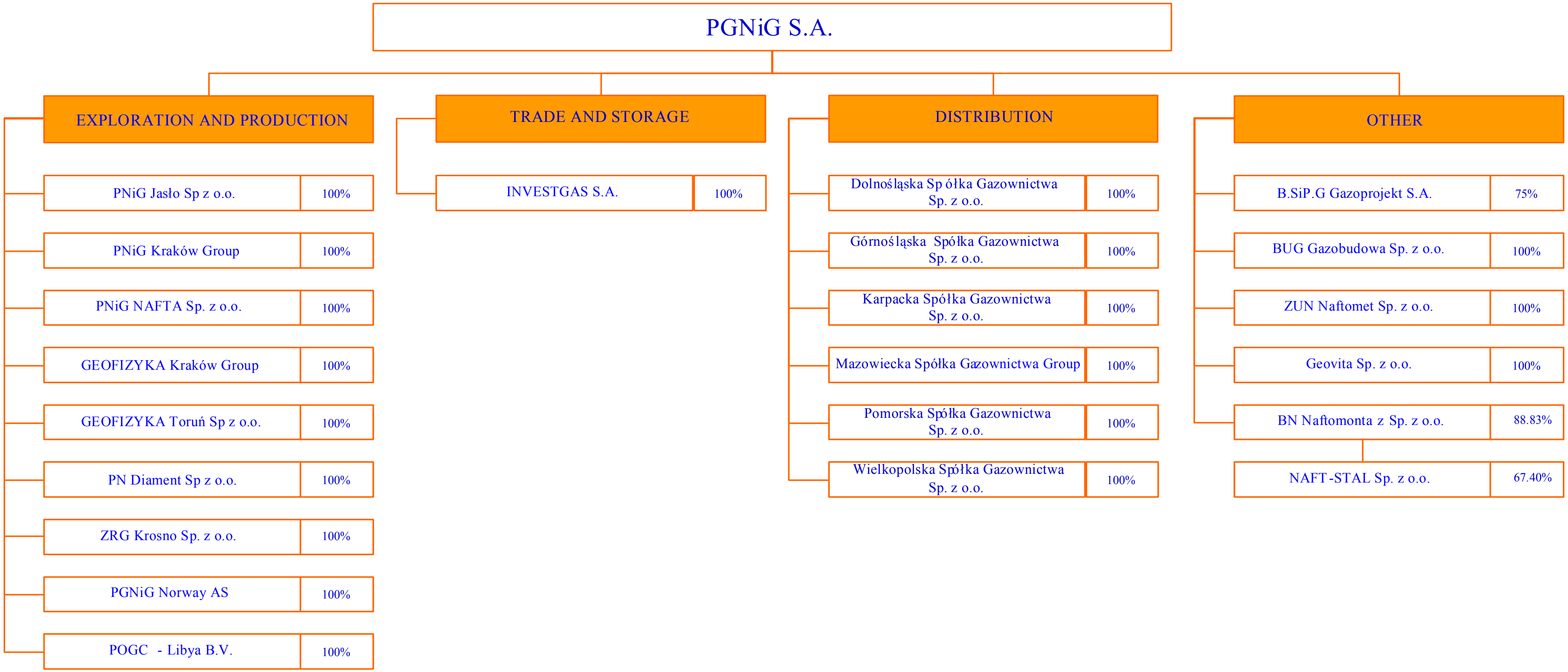
The following changes in the Group's structure occurred in H1 2009:

- Registration of share capital increase at Wielkopolska Spółka Gazownictwa Sp. z o.o. by PLN 54,899,000, to PLN 1,033,186,000, effected on January 22nd 2009;
- Share capital increase at Mazowiecka Spółka Gazownictwa Sp. z o.o. by PLN 4,062,000, to PLN 1,255,800,000; the increase was registered with the National Court Register on May 11th 2009; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Dolnośląska Spółka Gazownictwa Sp. z o.o. by PLN 3,321,000, to PLN 658,384,000; the increase was registered with the National Court Register on May 12th 2009; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Registration of share capital increase at Górnośląska Spółka Gazownictwa Sp. z o.o. by PLN 10,808,000, to PLN 1,299,488,000, effected on June 22nd 2009.

In H1 2009, Mazowiecka Spółka Gazownictwa Sp. z o.o. and Biuro Studiów i Projektów Gazownictwa Gazoprojekt S.A. established a special purpose vehicle operating under the name Powiśle Park Sp. z o.o. of Warsaw, which has been designated to construct MSG Sp. z o.o.'s head office as well as residential apartments and office and commercial space for sale. The company was established for the period required to complete the investment project. The share capital of the new company amounts to PLN 78,131,000. MSG Sp. z o.o. acquired 76,131 shares in the company's share capital, with a par value of PLN 1,000 per share, for a total of PLN 76,131,000, while B.S. i P.G. Gazoprojekt S.A. acquired 2,000 shares in the company's share capital, with a par value of PLN 1,000 per share, for a total of PLN 2,000,000. Powiśle Park Sp. z o.o. was entered in the National Court Register on March 18th 2009.

The chart below presents the consolidated companies of the PGNiG Group as at June 30th 2009 (by operating segments).

## CONSOLIDATED COMPANIES IN THE PGNiG GROUP




The PNiG Kraków Group comprises PNiG Kraków Sp. z o.o. and Oil Tech International - F.Z.E. (subsidiary).

The GEOFIZYKA Kraków Group comprises Geofizyka Kraków Sp. z o.o. and GEOFIZYKA Kraków Libya JSC (subsidiary).

The Mazowiecka Spółka Gazownictwa Group comprises Mazowiecka Spółka Gazownictwa Sp. z o.o. and Powiśle Park Sp. z o.o. (subsidiary).

# 2. Employment

The table below presents the employment at the PGNiG Group's consolidated companies as at June 30th 2009, by segments. PGNiG S.A.'s Head Office provides services to all segments. Accordingly, it is disclosed separately.

Employment by segments (no. of staff)

| | Jun 30 2009 |
|---|---|
| Head Office | 829 |
| Exploration and Production | 10,946 |
| Trade and Storage | 3,840 |
| Distribution | 13,757 |
| Other activities | 2,042 |
| Total | 31,414 |

On December 11th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted the Programme for Employment Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3). The programme became effective in January 2009. Unlike previous employment restructuring programmes, this programme 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 would be justified by the scope of planned restructuring involving workforce downsizing and/or liquidation of positions. The programme was not launched before June 30th 2009.

# 3. Sale and Acquisition of Natural Gas

In 2008, the PGNiG Group recorded sales revenue of PLN 10.3bn, with 91% of that figure derived from sales of natural gas.

Sales revenue (PLNm)

| | H1 2009 |
|---|---|
| Natural gas, including: | 9,382.0 |
| - methane-rich gas | 8,628.2 |
| - nitrogen-rich gas | 753.8 |
| Crude oil | 317.6 |
| Condensate | 0.9 |
| Helium | 15.7 |
| Propane-butane | 17.6 |
| Geophysical and geological services | 124.0 |
| Exploration services | 191.1 |
| Other sales | 204.7 |
| Total | 10,253.6 |

In H1 2009, the PGNiG Group sold 7bn $m^3$ 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 deposits.

Natural gas sales volume (million $m^3$)

| | H1 2009 |
|---|---|
| Trade and storage | 6,666.8 |
| Exploration and production | 341.9 |
| Total | 7,008.7 |

In H1 2009, the volume of natural gas acquired by the PGNiG Group reached 6.8bn $m^3$, with 70% of that amount sourced from imports, mostly from Russia. Natural gas production from domestic deposits represented 29.7% of the total volume acquired. The table below sets forth the structure of natural gas supplies measured as methane-rich gas equivalent.

Acquisition of natural gas (million $m^3$)

| | H1 2009 |
|---|---|
| Imports | 4,774.9 |
| Domestic production | 2,025.0 |
| Domestic suppliers | 21.1 |
| Total | 6,821.0 |

# Chapter II: Governing Bodies of PGNiG S.A.

## 1. Management Board

As at January 1st 2009, the composition of the Management Board of PGNiG S.A. was as follows:

- Michał Szubski – President
- Mirosław Dobrut – Vice-President and Director for Investments and Technology
- Sławomir Hinc – Vice-President and Financial and Economic Director
- Radosław Dudziński – Vice-President and Director for Strategic Projects
- Mirosław Szkałuba – Vice-President and HR and Restructuring Director

On January 28th 2009, the Supervisory Board of PGNiG S.A. appointed Waldemar Wójcik as Vice-President and Oil Mining Director.

As at June 30th 2009, the composition of the Management Board of PGNiG S.A. was as follows:

- Michał Szubski – President
- Mirosław Dobrut – Vice-President and Director of Investments and Technology
- Sławomir Hinc – Vice-President and Financial and Economic Director
- Radosław Dudziński – Vice-President and Director of Strategic Projects
- Mirosław Szkałuba – Vice-President and HR and Restructuring Director
- Waldemar Wójcik – Vice-President and Oil Mining Director

## 2. Supervisory Board

As at January 1st 2009, the Supervisory Board of PGNiG S.A. was composed of:

- Stanisław Rychlicki – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Member of the Supervisory Board
- Grzegorz Banaszek – Member of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Marek Karabuła – Member of the Supervisory Board
- Maciej Kaliski – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

On June 16th 2009, Maciej Kaliski resigned from his position as Member of the Supervisory Board of PGNiG S.A.

As at June 30th 2009, the Supervisory Board was composed of eight persons:

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

- Jolanta Siergiej – Member of the Supervisory Board.

# 3. Proxies

As at January 1st 2009, there were two four proxies for PGNiG S.A.:

- Ewa Bernacik
- Waldemar Wójcik
- Marek Dobryniewski
- Stanisław Radecki

On February 14th 2009, the Management Board of PGNiG S.A. appointed Tadeusz Kulczyk and Zbigniew Król as proxies and revoked the power of proxy granted to Waldemar Wójcik and Marek Dobryniewski. On April 28th 2009, the Management Board of PGNiG S.A. revoked the power of proxy granted to Zbigniew Król and appointed Mieczysław Jankiel as proxy.

As at June 30th 2009, there were two four PGNiG S.A. proxies:

- Ewa Bernacik
- Stanisław Radecki
- Tadeusz Kulczyk
- Mieczysław Jankiel.

# Chapter III: Shareholder Structure

Employee Shares

On June 25th 2008, the Ministry of State Treasury disposed of one share in PGNiG S.A. The transaction was concluded on general terms. 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. The acquisition of shares free of charge will result in a decrease of the State Treasury's share of the total vote from 84.75% to 72.03%. The process of signing agreements on the acquisition of shares free of charge commenced on April 6th 2009. As at June 30th 2009, 50,174 eligible persons acquired 598,830,048 shares, representing approximately 80% of the total number of shares which may be acquired free of charge, and over 10% of the Company's share capital.

Shareholder Structure

As at June 30th 2009, the State Treasury was the only shareholder who held 5% or more of the Company's share capital, conferring the right to 5% or more of the total vote at the Company's General Shareholders Meeting. PGNiG S.A.'s share capital amounted to PLN 5,900,000,000 and comprised 5,900,000,000 shares with a par value of PLN 1 per share. Shares of all series, that is Series A, Series A1 and Series B shares are ordinary bearer shares and each confer the right to one vote at the General Shareholders Meeting. PGNiG S.A.'s Articles of Association do not provide for any limitations in the exercise of voting rights attached to PGNiG S.A. shares. The table below shows the shareholder structure of PGNiG S.A. as at June 30th 2009.

Shareholder Structure

| Shareholder | No. of shares as at Jun 30 2009 | % of share capital as at Jun 30 2009 | No. of votes conferred by shares | % of total vote at GM as at Jun 30 2009 |
|---|---|---|---|---|
| State Treasury | 4,401,169,951 | 74.60% | 4,401,169,951 | 74.60% |
| Other | 1,498,830,049 | 25.40% | 1,498,830,049 | 25.40% |
| In total | 5,900,000,000 | 100.00% | 5,900,000,000 | 100.00% |

The number of shares held by the State Treasury as at June 30th 2009 was determined on the basis of the data submitted by Centralny Dom Maklerski PEKAO S.A., which acts as an intermediary in the delivery of the shares to the eligible persons. Given the ongoing process of delivering the shares to the eligible persons, the number of shares held by the State Treasury is gradually decreasing, while the number of shares held by the eligible persons is growing.

Shares held by the management and supervisory staff

The table below shows the number of PGNiG S.A. shares and shares in related undertakings held by the management and supervisory staff as at June 30th 29009.

Shares held by the management staff

| Name and Surname | Number of shares as at Dec 31 2008 | Change in the number of shares held | Number of shares as at Jun 30 2009 | Par value (PLN) |
|---|---|---|---|---|
| Michał Szubski | 0 | + 6,825 | 6,825 | 6,825 |
| Mirosław Dobrut | 0 | + 19,500 | 19,500 | 19,500 |
| Mirosław Szkałuba | 0 | + 9,425 | 9,425 | 9,425 |

On July 8th 2009, Waldemar Wójcik, Member of the Management Board, acquired free of charge 19,500 shares with a total par value of PLN 19,500.

Shares held by the supervisory staff

| Name and Surname | Number of shares as at Dec 31 2008 | Change in the number of shares held | Number of shares as at Jun 30 2009 | Par value (PLN) |
|---|---|---|---|---|
| Stanisław Rychlicki | 8,272 | + 1,625 | 9,897 | 9,897 |
| Mieczysław Kawecki | 0 | + 19,500 | 19,500 | 19,500 |
| Jolanta Siergiej | 0 | + 9,425 | 9,425 | 9,425 |

Shares held by the proxies

| Name and Surname | Number of shares as at Dec 31 2008 | Change in the number of shares held | Number of shares as at Jun 30 2009 | Par value (PLN) |
|---|---|---|---|---|
| Stanisław Radecki | 0 | + 19,500 | 19,500 | 19,500 |
| Mieczysław Jakiel | 10,601 | 0 | 10,601 | 10,601 |
| Tadeusz Kulczyk | 1,816 | +19,500 | 21,316 | 21,316 |

# Chapter IV: Regulatory Environment

## 1. Licenses

May 15th 2009 saw the expiry of the licence for transmission and distribution of gaseous fuels, dated April 30th 1999.

As at June 30th 2009, the Company held the following licences granted by the President of the Polish Energy Regulatory Authority (URE) 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

As at June 30th 2009, PGNiG S.A. held the following licences granted under the Geological and Mining Law:

- 77 licences for exploration and prospecting of crude oil and natural gas reserves,
- 217 licences for production of crude oil and natural gas from reserves,
- 9 licences for underground gas storage,
- 4 licences for waste matter storage.

## 2. Changes in PGNiG S.A.'s Tariffs

Until May 30th 2009, settlements with customers were made according to Tariff No. 1 for Gaseous Fuels, approved by virtue of the decision issued by the President of URE on April 10th 2008, whose part relating to the price for gaseous fuels was changed by the President of URE by virtue of the decision dated October 17th 2008.

On February 13th 2009, PGNiG S.A. filed a request to the President of URE for approval of Tariff No. 1/2009 for Gaseous Fuels (renamed as Tariff No. 2/2009 for Gaseous Fuels in the course of the proceedings). The Tariff was divided into two parts: Part A and Part B.

On May 7th 2009, by virtue of the decision issued of the President of URE, Tariff No. 2/2009 for Gaseous Fuels designated as Part A was approved, which became effective for settlements with customers as of June 1st 2009.

By virtue of the decision of December 31st 2008, PGNiG S.A. was appointed by the President of URE as the Storage System Operator for the period from January 1st 2009 to December 31st 2025. In his decision, the President of URE obliged PGNiG S.A. to prepare a draft tariff for services consisting in storage of gaseous fuels within six months from the date of the Company's appointment as the Storage System Operator, that is by July 1st 2009. On May 25th 2009, PGNiG S.A. filed a request to the President of URE for approval of the Gaseous Fuels Tariff designated as Part B ("Tariff No. 1/2009 for storage of gaseous fuels"). Tariff No. 1/2009 for storage of gaseous fuels was approved by virtue of the decision of the URE President dated June 16th 2009. The tariff became effective for settlements with customers as of July 1st 2009.

The following table shows a summary of average tariffs 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.

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.3773 | 2.3598 | -0.7% |
| W-2 | 1.8367 | 1.8066 | -1.6% |
| W-3 | 1.6591 | 1.6341 | -1.5% |
| W-4 | 1.5486 | 1.5175 | -2.0% |
| W-5 –W-7B | 1.4258 | 1.3802 | -3.2% |
| W-8 – W-10 | 1.2012 | 1.1322 | -5.7% |

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| S-1 | 1.6307 | 1.6291 | -0.1% |
| S-2 | 1.2170 | 1.2132 | -0.3% |
| S-3 | 1.1330 | 1.1333 | 0.0% |
| S-4 | 1.0079 | 1.0045 | -0.3% |
| S-5 –S-7B | 0.9909 | 0.9806 | -1.0% |
| S-8 – S-10 | 0.8638 | 0.8390 | -2.9% |

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| Z-1 | 1.3640 | 1.3539 | -0.7% |
| Z-2 | 1.1401 | 1.1399 | 0.0% |
| Z-3 | 1.0324 | 1.0321 | 0.0% |
| Z-4 | 0.9141 | 0.9115 | -0.3% |
| Z-5 –Z-7B | 0.9367 | 0.9273 | -1.0% |

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

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.3164 | 2.3161 | 0.0% |
| W-2 | 1.8852 | 1.8858 | 0.0% |
| W-3 | 1.6166 | 1.6172 | 0.0% |
| W-4 | 1.5332 | 1.5335 | 0.0% |
| W-5 –W-7B | 1.4212 | 1.4017 | -1.4% |
| W-8 – W-10 | 1.1952 | 1.1354 | -5.0% |

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

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.1701 | 2.1597 | -0.5% |
| W-2 | 1.8211 | 1.8153 | -0.3% |
| W-3 | 1.5735 | 1.5656 | -0.5% |
| W-4 | 1.4747 | 1.4618 | -0.9% |
| W-5 –W-7B | 1.3960 | 1.3680 | -2.0% |
| W-8 – W-10 | 1.1655 | 1.1002 | -5.6% |

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

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.5734 | 2.5416 | -1.2% |
| W-2 | 1.7764 | 1.7423 | -1.9% |
| W-3 | 1.5529 | 1.5212 | -2.0% |
| W-4 | 1.5001 | 1.4772 | -1.5% |
| W-5 –W-7B | 1.4001 | 1.3603 | -2.8% |
| W-8 – W-10 | 1.1180 | 1.0399 | -7.0% |

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

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.4382 | 2.4357 | -0.1% |
| W-2 | 1.8418 | 1.8422 | 0.0% |
| W-3 | 1.6117 | 1.6120 | 0.0% |
| W-4 | 1.5507 | 1.5356 | -1.0% |
| W-5 –W-7B | 1.4266 | 1.4130 | -1.0% |
| W-8 – W-10 | 1.1862 | 1.1384 | -4.0% |

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

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| W-1 | 2.3865 | 2.3860 | 0.0% |
| W-2 | 1.8045 | 1.7745 | -1.7% |
| W-3 | 1.6162 | 1.6140 | -0.1% |
| W-4 | 1.5197 | 1.5189 | -0.1% |
| W-5 –W-7B | 1.3870 | 1.3568 | -2.2% |
| W-8 – W-10 | 1.1468 | 1.0835 | -5.5% |

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| S-1 | 1.6572 | 1.6576 | 0.0% |
| S-2 | 1.2700 | 1.2702 | 0.0% |
| S-3 | 1.1375 | 1.1364 | -0.1% |
| S-4 | 1.0354 | 1.0352 | 0.0% |
| S-5 –S-7B | 1.0158 | 1.0070 | -0.9% |

| | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| Z-1 | 1.6690 | 1.6685 | 0.0% |
| Z-2 | 1.1387 | 1.1359 | -0.2% |
| Z-3 | 0.9991 | 0.9926 | -0.6% |
| Z-4 | 0.9247 | 0.9210 | -0.4% |
| Z-5 –Z-7B | 0.8672 | 0.8487 | -2.1% |

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

| Tariff group | 2008 | 2009 | Change (in %) |
|---|---|---|---|
| E-1A – E-4B | 1.1207 | 1.0439 | -6.9% |
| Lw-1 – Lw-4 | 0.8001 | 0.7658 | -4.3% |
| Ls-1 – Ls-4 | 0.7692 | 0.7236 | -5.9% |

# 3. Changes in the Tariffs of Gas Companies

Until May 30th 2009, settlements with customers receiving services from the Gas Companies were made according to Tariffs for Gaseous Fuel Distribution Services, approved by the President of URE on April 10th 2008.

In the decisions of May 7th 2009, the President of URE approved the Tariffs for Gaseous Fuel Distribution Services for the Gas Companies. For settlements with customers, the tariff is effective as of June 1st 2009.

# 4. Regulatory Risks

Legislation Changes

The second half of 2009 should see further changes in the laws governing the operation of gas sector companies, in particular the Energy Law, whose amended version was approved by the Council of Ministers in May 2009. Further changes to the Energy Law may be required to reflect the adoption of the Third Energy Package by the European Parliament, which includes 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. Furthermore, drafting of another regulation, crucial for the operation of the gas market and outlining detailed terms of the gas system operation, has been at the drafting stage since 2007. Once the amended laws become effective, the tariff regulation will need to be amended.

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.

Tariff Calculation

PGNiG S.A.'s ability to cover costs of its core operating activities depends on the prices approved by the President of URE. While approving tariffs for a given period, the President of URE 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 URE may consider certain cost unjustified. Moreover, the President of URE 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 URE may also refuse 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 and Prospecting 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 licenses for exploration and prospecting of deposits or the implementation of a strategy providing for acquiring access to own hydrocarbon reserves. At present, competition in the domestic market is limited. However, after having been granted 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

In H1 2009, the exploration and production segment was engaged mainly in off-tariff sale of natural gas, as well as sale of crude oil and other products. Natural gas was sold mainly to industrial customers, which accounted for 86.6% of the total sales volume. The table below sets forth sales of the key products to third parties:

Sales of key products of the PGNiG Group

| | | Unit | H1 2009 |
|---|---|---|---|
| 1. | Natural gas, including: | million $m^3$ | 341.9 |
| | - methane-rich gas | million $m^3$ | 22.4 |
| | - nitrogen-rich gas* | million $m^3$ | 319.5 |
| 2. | Crude oil | thousand tonnes | 266.1 |
| 3. | Condensate | thousand tonnes | 0.7 |
| 4. | Helium | million $m^3$ | 1.1 |
| 5. | Propane-butane | thousand tonnes | 10.9 |
| 6. | Nitrogen | thousand kilos | 797.1 |
| 7. | Sulphur | thousand tonnes | 13.8 |

*Millions of cubic metres measured as methane-rich gas equivalent.

## 1. Exploration

In H1 2009, the PGNiG Group conducted work related to exploration and prospecting for hydrocarbon reserves, as part of which it performed 121,388.5 metres of drillings, 4,222.3km of 2D seismic surveys and 1,598.5km$^2$ of 3D seismic surveys. The projects were performed both for the PGNiG Group and for external companies domestically and abroad. For own needs, the PGNiG Group performed 35,746 metres of drillings, 1,763.3km of 2D seismic surveys and 599.5km$^2$ of 3D seismic surveys.

### 1.1. Exploration in Poland

Domestically, PGNiG S.A. conducted drillings and geophysical work in the Carpathian mountains, Carpathian Foreland and Polish Lowlands. Drilling work covered 19 boreholes, including 14 exploratory boreholes and five prospecting boreholes. The work on seven of the boreholes started in 2008. From among the eight boreholes with known deposit-related results, five (four gas boreholes and one crude oil borehole) were classified as positive, while three other boreholes were classified as negative.

In H1 2009, PGNiG S.A. continued joint projects with FX Energy Poland Sp. z o.o. in the following areas: Płotki, Płotki–PTZ, Poznań and Blok 255; it also continued to cooperate with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o. in the Bieszczady area. Furthermore, PGNiG S.A. commenced drilling of exploratory borehole Ostrowiec-1 (the Ostrowiec area) as part of the Agreement on Joint Operations signed on February 27th 2009 with FX Energy Poland Sp. z o.o.

## 1.2. Exploration Abroad

In H1 2009, the PGNiG Group was active in licence areas in Norway, Libya, Pakistan, Denmark and Egypt.

Norway

PGNiG Norway AS holds a 15% interest in licences covering the Skarv and Snadd fields (PL 212, PL 212B and PL 262). The remaining interests are held by British Petroleum, as the operator (30%), StatoilHydro (30%) and E.ON Ruhrgas Norge (25%).

Reserves are developed by BP and PGNiG Norway AS, StatoilHydro and E.ON Ruhrgas. As a result of combining the Skarv and Snadd fields with the Idun field, the companies' approximate shares in the exploration and production area are as follows:

- British Petroleum (the operator) 24%
- StatoilHydro 36%
- E.ON Ruhrgas Norge 28%
- PGNiG Norway AS 12%

Effective as of January 1st 2009, PGNiG Norway AS acquired the following interests in licences located on the Norwegian Continental Shelf:

- 30% interest in the PL 350 licence under an agreement with StatoilHydro Petroleum AS (free of charge)
- 25% interest in the PL 419 licence under an agreement with Nexen Exploration Norge AS (for a token amount of NOK 1).

Following the completion of the licence awarding process in April 2009, PGNiG Norway AS came to own a 35% interest in licence PL 521 on the Norwegian Continental Shelf. The ownership was registered in the name of PGNiG Norway AS on May 15th 2009.

In H1 2009, the Skarv field development project was in progress. Production from the field is to begin in 2011.

Libya

Polish Oil and Gas Company - Libya B.V. carries out exploration under licence No. 113 located in the Murzuq petroleum basin (western Libya) pursuant to the Exploration and Production Sharing Agreement (EPSA) of February 25th 2008 concluded with the Libyan government. In H1 2009, 2D and 3D imaging commenced, and seismic surveys will continue through the second half of 2009.

Pakistan

PGNiG S.A. conducts exploratory work in Pakistan under an agreement between PGNiG S.A. and the Pakistani government dated May 18th 2005, concerning exploration and production of hydrocarbons in the area covered by the Kirthar licence. Exploratory work in the Kirthar block area is conducted in cooperation with Pakistan Petroleum Ltd. (interests/project cost participation: PGNiG S.A. – 70%; PPL – 30 %). In H1 2009, drilling work was conducted on the first exploration borehole, Rehman-1. In July 2009, the work was completed and the borehole was classified as positive.

Denmark

On December 6th 2007, PGNiG S.A. executed an agreement concerning assignment of an interest in the 1/05 exploration licence in Denmark and took over the operator functions under the licence.

In March 2009, PGNiG S.A. purchased a 40% interest in licence 1/05 from the existing holder, i.e Odin Energi A/S. The interests currently held in the licence are as follows: PGNiG S.A. – 80%, Nordsofonden – 20%. 3D shots are scheduled for the second half of 2009.

Egypt

In 2007, PGNiG S.A. won a tender for the Bahariya exploration licence (Block 3) in Egypt. On May 17th 2009, the Company and the Egyptian government entered into an exploration and production sharing agreement. In the second half of 2009, PGNiG S.A. plans to perform reprocessing activities, carry out 1,450 km 2D of seismic surveys and commence a gravimetric analysis.

## 1.3. Exploration Services

In H1 2009, exploration and production companies conducted drilling work, maintenance and geophysical work for the PGNiG Group and third parties in Poland and abroad.

Domestically, the companies provided drilling services, including for the purposes of underground hydrocarbon storage facilities. As far as external customers are concerned, drilling of the Toruń TG-1 geothermal well, for the Lux Veritatis Foundation, was completed and boreholes were drilled in areas covered with copper deposit licences for KGHM. A major part of the companies' revenues was derived from services contracted by foreign investors. These were mainly drilling projects in Kazakhstan, Pakistan, Egypt, Libya, Uganda, Hungary and Ukraine. Additionally, drilling of a geothermal well was continued in Germany.

Specialist maintenance related to borehole mining was performed by the exploration and production companies chiefly in Poland. The performed services included production intensification, flushing, cementing, and other specialist drilling, measuring and laboratory services. The companies also performed reconstruction and drill liquidation services; they also liquidated the effects of borehole mining. The main customers for the services performed in Poland were the PGNiG Group companies. Maintenance work was also performed for companies outside of the PGNiG Group, including FX Energy Poland Sp. z o.o., PRWiG Warszawa, and Petrobaltic S.A. The exploration and production companies also provided services to customers in such countries as Kazakhstan, Ukraine, Lithuania and Latvia.

The exploration and production companies provide geophysical services related to field seismic surveys, processing and interpreting seismic data, and taking geophysical measurements. Geophysical services were performed both in Poland and abroad, for the PGNiG Group and external customers. Foreign markets included India, Pakistan, Libya, Thailand and Germany. Furthermore, the companies provided geophysical drilling services in certain EU states, including the Czech Republic and Slovakia.

# 2. Production

Two of PGNiG S.A.'s branches, the Zielona Góra Branch and the Sanok Branch, carry out production of natural gas and crude oil in Poland. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 20 mines (including 12 gas mines, and 8 oil and gas mines), while the Sanok Branch produces methane-rich and nitrogen-rich natural gas and crude oil at 46 mines (including 26 gas mines, and 20 oil mines and oil and gas mines). The Odolanów Branch is responsible for the processing of nitrogen-rich gas from the mine operated by the Zielona Góra Branch into helium and LNG.

In H1 2009, PGNiG S.A. produced a total of 852.0m $m^3$ of methane-rich gas and 1,173.0m $m^3$ of nitrogen-rich gas (methane-rich gas equivalent); 641.2m $m^3$ of gas was denitrided at the Odolanów Branch. The crude production volume totalled 260.9 thousand tonnes. The table below sets forth PGNiG S.A.'s production in H1 2009:

Production structure

| | | Unit | H1 2009 |
|---|---|---|---|
| 1. | Natural gas, including: | million $m^3$* | 2,025.0 |
| | - methane-rich | million $m^3$ | 852.0 |
| | - nitrogen-rich | million $m^3$* | 1,173.0 |
| 2. | Crude oil | thousand tonnes | 260.9 |
| | - Zielona Góra Branch | thousand tonnes | 238.5 |
| | - Sanok Branch | thousand tonnes | 22.4 |
| 3. | Condensate | thousand tonnes | 6.7 |
| 4. | Sulphur | thousand tonnes | 13.2 |
| 5. | Propane-butane | thousand tonnes | 11.1 |
| 6. | Helium | million $m^3$ | 1.0 |
| 7. | LNG | million $m^3$ | 8.7 |

*Methane-rich equivalent.

In H1 2009, seven new boreholes were put in operation in the Sanok Branch area (Łuków boreholes No. 2, 3, 5 and 6, and Żołyń boreholes No. 75, 83 and 84). The new boreholes increased the natural gas production capacity by ca. 9,420 $m^3$/hour.
In H1 2009, PGNiG S.A. conducted a number of projects aiming to maintain the volumes of gas and crude oil produced from the developed fields. In H1 2009, production borehole drilling on the Trzebownisko field was completed. With a view to limiting the natural decline in production, 18 non-producing boreholes were overhauled. In addition, efforts were intensified to maintain or enhance the capacity of production boreholes. In connection with a pressure decrease at the Jodłówka reserve, compressor assembly work was commenced.
The exploration and production segment uses underground storage facilities in Brzeźnica, Strachocina and Swarzów. The chief objective of underground gas storage is to secure the necessary storage capacity to handle the produced gas during the low-demand periods. Besides, the underground storage facilities enable optimum production from domestic deposits during the year and provide tools for rational management of natural gas reserves. The table below sets forth the available capacities of the underground storage facilities as at June 30th 2009.

Available capacities of the underground storage facilities used by the exploration and production segment

| | million $m^3$ |
|---|---|
| Brzeźnica | 65.0 |
| Strachocina | 150.0 |
| Swarów | 90.0 |

# 3. Investments

In H1 2009, the PGNiG Group's capital expenditure on property, plant and equipment and on intangible assets in the Exploration and Production Segment amounted to PLN 828.5m. Below are described the major projects in the segment.

Exploration

In the area of exploration, capital expenditure totalled PLN 221.2m, including PLN 184.4m incurred mainly on positive boreholes and boreholes which had not been completed. In H1 2009, five positive boreholes were drilled. The remaining capital expenditure was incurred on projects implemented abroad and three negative boreholes and was charged to costs of the current reporting period.

The Skary Project

The development plan for the Skary reserve provides for 16 boreholes to be drilled, including seven oil extraction boreholes, five natural gas extraction boreholes and four injectors. At a later stage of the reserve life, the injectors will be transformed into gas producers in order to fully exploit the reserve potential. In H1 2009, the development of the Skary reserve was continued. The expenditure incurred in H1 2009 amounted to PLN 404.0m. Mobilisation of the drilling equipment was postponed until the beginning of 2010 as a result of changing the provider of the drilling platform. Production is planned to be launched in 2011.

Lubiatów-Międzychód-Grotów Project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów reserves of crude oil and natural gas and to facilitate transport, storage and sale of crude oil, natural gas, liquid sulphur and propane-butane mixture from the LMG Crude Oil and Natural Gas Mine. The LMG project involves:

- construction of the LMG Central Facility to serve as a hub for collection, distribution and treatment of reservoir fluids,
- construction of the Dispatch Terminal in Wierzbno to support collection and shipment of crude oil in rail tank cars and handle the pumping of crude oil collected from the LMG Crude Oil and Natural Gas Mine to the PERN Druzhba Pipeline,
- construction of a gas pipeline to the Denitriding Plant in Grodzisk to support the transmission of surplus gas from the LMG Mine to Grodzisk Denitriding Plant.

H1 2009 saw the start of preparations to implement the investment project named "LMG Project – Central facilities, borehole areas, pipelines and other infrastructure". The expenditure incurred in H1 2009 was PLN 8.4m. The total value of the project is estimated at approximately PLN 1.6bn.

The Grodzisk Project

The objective of this project is to support the sale of gas from nitrogen-rich reserves after the gas has been treated (cryogenic denitriding of nitrogen-rich gas) to the parameters of methane-rich gas. The Grodzisk Denitriding Plant is constructed with a view to increasing nitrogen-high gas production volume at the existing mines and from reserves earmarked for development. The project provides for the development of the Wielichowo, Ruchocice and Paproć W reserves, connection of the Elżbieciny and Jabłonna boreholes, development of the Nowy Tomyśl 2k borehole, modernisation of the Paproć Natural Gas Mine (KGZ Paproć), the extension of the KGZ Paproć-Cicha Góra Natural Gas Mine, construction of the Przyłęk-KGZ Paproć gas pipeline network and construction of the Grodzisk Denitriding Plant. The target capacity of the Denitriding Plant will be ca. 35,000 $m^3/h$. In H1 2009, the following tasks were completed: development of the Nowy Tomyśl 2k borehole and construction of the Grodzisk Denitriding Plant. The technological start-up of the Denitriding Plant took place in May

2009. The expenditure incurred in H1 2009 was PLN 18.5m. The completion of the Grodzisk Project is planned for 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 expenditure incurred in H1 2009 was PLN 10.6m. The total cost of the project is estimated at approximately PLN 220m.

Other Investment Projects

Other projects involve the development of documented or exploited natural gas reserves, maintenance and recreation of hydrocarbons production capacity or are related to the functioning of the production business segment. Key investment tasks included:

- modernisation and extension of the existing natural gas mines
- development of the Rylowa-Rajsko natural gas reserve
- development of the Łukowa natural gas reserve
- development of the Kaleje natural gas reserve
- development of the Żołynia boreholes
- development of the Rudka boreholes
- upgrade of production installations at the Odolanów denitriding plant
- purchase and modernization of plant and equipment for drilling and geophysical works
- purchases of ready-to-use investment assets as well as backup and infrastructure.

Underground Gas Storage Facilities

In H1 2009, PGNiG S.A. continued the extension of the available capacity of the Strachocina storage facility (completion of the drilling of five horizontal boreholes and the beginning of the drilling of another borehole). The Company also continued the construction of the surface infrastructure of the new nitrogen-rich gas (Ls) storage facility PMG Daszewo and nitrogen-rich gas (Lw) storage facility PMG Bonikowo. The expenditure incurred in H1 2009 totalled PLN 71.7m.

# 4. Planned Exploratory Work

Exploration in Poland

In 2009, PGNiG S.A. plans to conduct geophysical and drilling works at exploratory boreholes (including work conducted in cooperation with foreign companies) in the Carpathians, Carpathian Foreland, the Fore-Sudetic Monocline, the Lublin basin and the Pomeranian anticlinorium.

Exploration Abroad

In H1 2009, the PGNiG Group took a number of steps to acquire new sites for exploration and new licence areas in the North Africa, Central Asia and the North Sea. All these efforts will be continued in 2009. Furthermore, the PGNiG Group plans to press ahead with the exploratory work in the licence areas in Denmark, Egypt, Pakistan, Libya, and Norway.

Underground Gas Storage Facilities

In H2 2009, PGNiG S.A. will proceed with the construction of the surface installations of the Bonikowo facility. The Company also plans to commence construction work of the surface infrastructure for the gas storage facilities in Strachocina. Construction of the PMG Daszewo facility is planned to be completed in H2 2009.

Natural Gas Production

PGNiG S.A. is following an investment programme aimed at increasing, in a longer perspective, the natural gas production capacity. As part of the programme, the Company plans to develop new reserves and boreholes, modernise and expand the existing natural gas mines, and build new underground gas storage facilities and expand the existing ones. Moreover, PGNiG will take steps to maintain the volume of hydrocarbons production from fields already in use at the current levels.

The plans for 2009 assume a natural gas production volume of 4.3bn $m^3$ annually (methane-rich equivalent) with a calorific value of 39.5 $MJ/m^3$. In H2 2009, the Kaleje reserve and new boreholes in Żołynia, Chałupki Dębniańskie and Łukowa reserves will be placed in operation. In order to improve the production volume to approximately 4.5bn $m^3$, in the next few years PGNiG S.A. intends to develop and commence production on a number of documented natural gas deposits, including in Wielichowo, Ruchocice, Roszków and Międzychód (nitrogen-rich gas reserves in western Poland) as well as in Łukowa, Jasionka – Phase II, Kupno, Pilzno – Phase II and Rudka – Phase II (methane-rich gas reserves in the Province of Rzeszów).

Crude Oil Production

In 2009, preparations to implement the "LMG Project – Central facilities, borehole areas, pipelines and other infrastructure" were commenced. The development of the Lubiatów-Międzychód-Grotów (LMG) reserve aims at increasing PGNiG's crude oil production output. The Company plans that in 2009 the crude oil production will reach more than 500 thousand tonnes. A significant increase in crude oil production is expected in 2013, when the LMG reserve is developed and placed in operation, and is to amount to approximately 0.9m tonnes annually.

# 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 reserve sites have deposits of hydrocarbons which can qualify as a reserve. 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 documented new reserves, do not offset the production from the existing deposits, PGNiG S.A.'s documented producible reserves will decrease pro rata to the current production volumes.

The size of resources 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 reserve site. Irrespective of the methods applied, data on economically viable producible 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 lasts six to eight years, while the hydrocarbon production cycle lasts from 10 to 40 years. Deposit parameters established in the course of preparing the relevant documentation are reviewed upon deposit development. Each downgrade of the size of the resources or production quantities may lead to a lower revenue and adversely impact PGNiG S.A.'s financial performance.

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 and prospecting of deposits, that is implementation of a strategy providing for gaining access to own hydrocarbon resources. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG S.A. Thus it is probable that such companies would submit their bids in tender offers 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 PGNiG S.A., given the Group's financial and human resources. This competitive edge of other market players is particularly important on the international market. However, the risk of competition seems to be decreasing in the wake of the intensifying global financial crisis.

Delayed Work

Under the currently binding Polish legal regulations, obtaining a licence for exploration and prospecting 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 winning bid is awarded in a tender for licence until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is obliged to arrange for numerous formalities, 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 for a work contractor. Under the currently binding legal regulations, another several months pass before an agreement with the work 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 exploratory work.

Formal and legal issues beyond PGNiG S.A.'s control include:

- local governments' failure to adopt local land development plans (MPZPs)
- obstacles in incorporating investment projects into the MPZPs
- 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 Exploratory Work

Exploratory work is capital consuming, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed on prices of casing pipes and lifting casing used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploratory work. 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 legal regulations concerning safety and health at work, as well as environmental protection. 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 Nature 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 clear 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 of natural gas and crude oil deposits. In countries where PGNiG S.A. operates highly qualified staff is difficult to recruit.

Unpredictable Events

Hydrocarbon reserves developed by PGNiG S.A. are usually located at great depth, which is accompanied by extremely high pressures, and many of them include hydrogen sulphide in its chemical composition. Consequently, there exists a high degree of 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 Legal Regulations

The legal 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 PGNiG S.A. 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 S.A. 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 the inhabitants of these countries live. The risks specified above may lead to limitation, suspension or discontinuation of the Company'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 investor behaviour with regard to demand for exploratory work in the next few years. Companies providing services abroad are threatened with losing certain markets and the scope of their foreign projects being limited. Furthermore, currency fluctuations have a bearing upon the companies' financial results, since a significant portion of their revenues is generated in foreign currencies.

# Chapter VI: Trade and Storage

## 1. Purchases

In H1 2009, 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- and short-term contracts with Gazprom eksport OOO as well as the medium- and short-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 eksport OOO, dated September 25th 1996, which will remain in force until 2022;
- Agreement on sales 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 sales of the Lasów 2008 natural gas executed with VNG-Verbundnetz GAS AG, dated September 29th 2008, in force from October 1st 2008 to October 1st 2011;
- Contract for summer supplies of natural gas to Poland, executed with Gazprom eksport OOO on June 1st 2009, in force until September 30th 2009.

Given the non-delivery of gas under the agreement on sales of natural gas executed with ROSUKRENERGO AG on November 17th 2006, in force until January 1st 2010 and providing for possible extension until January 1st 2012, on June 1st 2009 PGNiG S.A. entered into an agreement with Gazprom eksport OOO on summer supplies of natural gas, in the amount of approximately 1 billion $m^3$.

On June 29th 2009, PGNiG S.A. executed an agreement with Qatargas Operating Company Ltd. on LNG supply. Under the agreement, approximately 1 million tonnes of LNG per year will be supplied for a period of twenty years, starting from 2014.

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

Structure of natural gas supplies by supply sources (million $m^3$)

| | H1 2009 | % |
|---|---|---|
| Imports, including: | 4,774.9 | 99.6% |
| - Gazprom eksport OOO | 4,286.4 | 89.7% |
| - VNG AG | 485.7 | 10.2% |
| - Other foreign suppliers | 2.8 | 0.1% |
| Domestic suppliers | 21.1 | 0.4% |
| Total: | 4,796.0 | 100.0% |

In 2009, supplies of gas from the eastern markets were disrupted as a result of the conflict between Russia and Ukraine. Furthermore, gas supplies from ROSUKRENERGO AG have been suspended since January 2009, although the relevant agreement remains in force until January 1st 2010. As a result of reducing and then finally discontinuing gas supplies delivered through the Drozdovitse cross-border point, gas supply routes were changed and more gas has been delivered through the Vysokoye cross-border point. Gas supplies delivered through Drozdovitse were resumed, but gas volumes are lower, as a result of the failure of deliveries under the ROSUKRENERGO AG agreement. In order to secure a sufficient level of gas supplies to its customers, PGNiG S.A. increased the use of gas held in storage facilities. Following discussion with Gazprom eksport OOO, the Company secured a temporary increase in the volume of gas collected under the effective agreement and a short-term contract was executed for supplies of natural gas in summer.

On July 28th 2009, PGNiG and VNG-Verbundnetz Gas AG concluded a Framework Agreement for Sale and Purchase of Natural Gas. The Framework Agreement defines the general terms of cooperation in the area of sale and purchase of natural gas, whereas detailed terms of individual supplies, such as quantity and price, will be defined on a case-by-case basis in Individual Agreements to be concluded in the future.

The Baltic Pipe Project

The objective of the project is to create a direct pipeline for the supply of natural gas from Denmark to Poland and also, in future, from Poland to Denmark. On January 29th 2009, the Extraordinary General Shareholders Meeting of PGNiG S.A. decided to sell the documentation related to the implementation of the Baltic Pipe project to OGP GAZ-SYSTEM S.A. According to current plans, OGP GAZ-SYSTEM S.A. is to take responsibility for the execution of the project going forward.

The Skanled Project

The Skanled consortium was established for the purpose of constructing the Skanled gas pipeline to connect a gas terminal on the Norwegian Continental Shelf with Sweden and Denmark. PGNiG S.A. acquired a 15% stake in the project and became one of its 15 shareholders.

On April 29th 2009, the members of the Skanled Consortium decided to suspend the implementation of the Skanled gas pipeline project as a result of changed macroeconomic conditions, withdrawal of most Scandinavian companies from the consortium and inability to ensure supplies of natural gas which was to be transmitted through the gas pipeline.

## 2. Sales

In H1 2009, PGNiG S.A. signed comprehensive agreements for supply of gaseous fuel, from both transmission and distribution systems, to 42.1 thousand new customers, including 41 thousand households.

Pursuant to the provisions of the Polish Energy law, in 2008 PGNiG S.A. commenced replacement of commercial agreements with comprehensive agreements. The process is expected to be completed by December 31st 2009. In H1 2009, all Company's customers received drafts of comprehensive agreements on provision of gaseous fuel sale and transmission services.

The key products sold by this segment are methane-rich natural gas and nitrogen-rich gas. In H1 2009, sales of natural gas (methane-rich equivalent) dropped by approximately 5% (or 360.6 million $m^3$) year on year. The decrease in sales volume was due to lower demand for gaseous fuel from PGNiG S.A.'s customers caused by the global economic crisis. The PGNiG Group sold gas both in Poland and on international markets. The structure of H1 2009 sales by the Trade and Storage segment is presented in the table below.

Sales structure of key products

| | | Unit | H1 2009 |
|---|---|---|---|
| 1 | Natural gas, including: | million $m^3$ | 6,666.8 |
| | - methane-rich gas | million $m^3$ | 6,270.5 |
| | - nitrogen-rich gas* | million $m^3$ | 396.3 |

| | | | |
|---|---|---|---|
| 2 | Propane-butane | thousand tonnes | 1.0 |

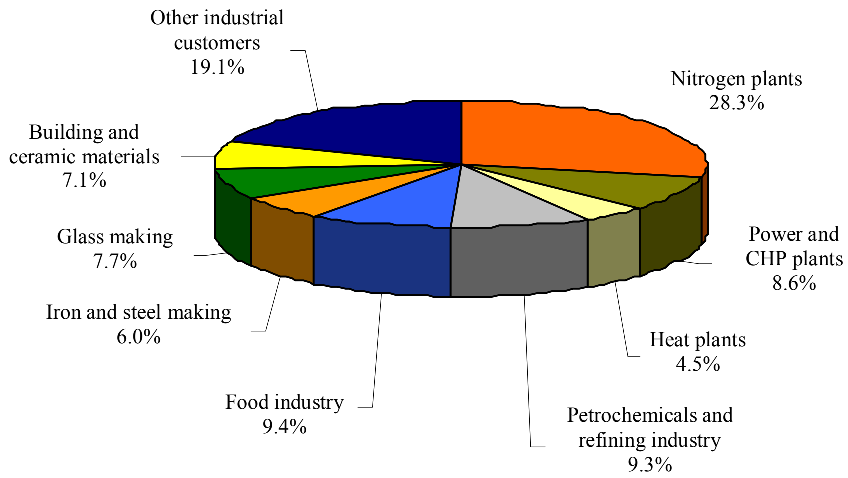
*Measured as methane-rich gas equivalent.

The Group's main customers who purchased natural gas included chemicals sector, the steel industry and the power sector, as well as households. Households make up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base (approximately 6.4m). Their share in the sales volume is 31%. The most prominent share in the natural gas sales was claimed by industrial customers (55%). The table below presents the structure of natural gas sales measured as methane-rich gas equivalent broken down by major customers.

Sales of natural gas supplied via the transmission grid (million m$^3$)

| | H1 2009 | % |
|---|---|---|
| Industrial customers | 3,663.1 | 54.9% |
| Trade and services | 846.4 | 12.7% |
| Households | 2,064.7 | 31.0% |
| Wholesale customers | 70.6 | 1.1% |
| Exports | 22.0 | 0.3% |
| Total | 6,666.8 | 100.0% |

Sales of natural gas
to industrial customers in H1 2009




On April 30th 2009, PGNiG S.A. and Wielkopolska Spółka Gazownictwa Sp. z o.o. completed phase I of the process of switching the left-bank part of Poznań and the East Poznań Province from less caloric nitrogen-rich gas to high-caloric methane-rich gas, which covered approximately 123 thousand customers from 1–4 tariff groups. The change will improve the security and throughput capacity of distribution network and increase the number of executed connection agreements, which in turn will lead to higher volume of methane-rich gas sales.

In H1 2009, PGNiG S.A. and Mazowiecka Spółka Gazownictwa Sp. z o.o. launched an investment project to switch the customers in Pisz in the Province of Olsztyn which receive propane-butane-air gas to LNG-based methane-rich gas (E). Following the completion of the investment project, the sales volume of methane-rich gas in Pisz will increase.

# 3. Storage

On December 31st 2008, the President of URE appointed PGNiG S.A. as the Storage System Operator for the period January 1st 2009 – December 31st 2025. Detailed terms of providing gaseous fuels 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.

The Trade and Storage segment uses a part of the capacities of underground storage facilities for its own purposes. Short-term fluctuations in the demand for natural gas are balanced out with the supplies from the Underground Gas Storage Cavern Facility Mogilno located in worked-out salt caverns, which is operating at full capacity. The capacities of the Underground Storage Facility Wierzchowice and the Underground Storage Facility Husów are used to minimise the effect of an uneven demand for natural gas in summer and winter seasons, to meet the obligations under the Take or Pay Contracts for imports, to safeguard the continuity and security of natural gas supplies and to meet the obligations under sales agreements providing for the delivery of natural gas to customers' premises.

In addition, the capacities of the Underground Storage Facility Wierzchowice, Underground Storage Facility Husów and the Underground Gas Storage Cavern Facility Mogilno help the Group comply with the obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of a Threat to National Fuel Security or a Disruption on the Petroleum Market, dated February 16th 2007. Working capacities of the storage facilities as at June 30th 2009 are presented in the table below.

Available capacities of storage facilities in the Trade and Storage segment

| | million $m^3$ |
|---|---|
| Husów | 350.0 |
| Mogilno | 370.0 |
| Wierzchowice | 575.0 |

The reduction in working capacities of the Husów Underground Storage Facility and Mogilno Underground Gas Storage Cavern Facility results from technical conditions of their operation.

# 4. Investment Projects

The amount of capital expenditure incurred in the Trade and Storage segment for property, plant and equipment and intangible assets was PLN 480.8m.

In H1 2009, PGNiG S.A. continued the extension of working capacities of the existing methane-rich gas storage facilities: the Mogilno Underground Gas Storage Cavern Facility and the Wierzchowice Underground Storage Facility, where construction and installation of surface facilities was launched. In addition, in connection with the planned construction of a new methane-rich gas storage facility, Kosakowo Underground Gas Storage Cavern Facility, the Company commenced drilling five boreholes. The capital expenditure incurred in H1 2009 on the underground gas storage facilities amounted to PLN 309.7m.

In addition, the investment projects in the Trade and Storage segment mainly included projects involving transmission assets (in line with the investment plan of OGP GAZ-SYSTEM S.A. and the procedures specified in the agreement for the technical preparation and execution of projects for the purposes of the transmission grid, PGNiG S.A. carried out projects involving transmission assets, which are subsequently incorporated in the register of tangible assets under lease agreements), purchase of real estate, telecommunications and data transmission projects and purchase of ready-to-use investment assets.

# 5. Activities Planned in the Trade and Storage Segment

The Boernicke-Police Interconnection

Trade with the German market is the rationale for constructing the Boernicke-Police interconnection linking Poland and Germany. In 2008, PGNiG S.A. launched the construction of a 14-kilometers gas pipeline Tanowo-Dobieszczyn. In February 2009, the Company received a permit to construct the final section of the gas pipeline in the territory of Poland, namely Tanowo-Trzeszczyn (Police).

Natural Gas Purchase

Given the non-delivery of gas under the contract with ROSUKRENERGO AG, which account for approximately 25% of imported gas, PGNiG S.A. is taking action to obtain gas from alternative sources. Therefore, the existing structure of gas imports may change.

Cogeneration

In H1 2009, PGNiG S.A. carried out activities aimed at establishing a power segment. As part of those activities, the Company launched negotiations with its partners on the possibility of constructing gas cogeneration units. The implementation of these projects will allow the Company to introduce a new offering of heat and electricity sale and supplies to end users.

In addition, the Company launched the work on constructing gas-fired energy sources at its facilities, which will help optimise the purchases of electricity and heat for PGNiG S.A.'s own purposes. The commissioning of first gas-fired energy sources is scheduled for 2010–2011.

Underground Gas Storage Facilities

In 2009, PGNiG S.A. will continue its investment projects in the area of construction and extension of underground gas storage facilities. The Company will commence drilling three horizontal operational boreholes, reconstructing one borehole at the Wierzchowice Underground Storage Facility and leaching an additional cavern at the Mogilno Underground Gas Storage Cavern Facility. The Company will also continue the work related to the construction of a new methane-rich gas storage facility, namely the Kosakowo Underground Gas Storage Cavern Facility.

PGNiG S.A. will provide gaseous fuel storage services at the Mogilno Underground Gas Storage Cavern Facility and in the part of the Wierzchowice Underground Storage Facility and Husów Underground Storage Facility, which are classified as storage facilities within the meaning of the Energy Law.

# 6. Trade- and Storage-Related Risks

Substitution

The major risk factor posing a threat to gas market growth is the price of natural gas, which is high relative to the price of alternative energy sources, especially coal. The surge in fuel prices may translate into lower gaseous fuel consumption owing to cost-saving by customers and their transition to alternative fuels. As a result of the economic slowdown in Poland there exists a threat that some PGNiG S.A.'s customers may start to actively seek alternative energy sources or other suppliers. This situation is particularly applicable to energy-consuming branches, where the price of natural gas is a significant cost driver.

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 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. Some of the aforementioned companies own a transmission infrastructure. New entities are becoming increasingly active on the Polish market. These entities are local gas distributors which offer 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 the PGNiG Group may pose in the future a tangible threat of customer churn.

Reduced Volume of Gaseous Fuel Sales

The effects of the global economic crisis include slower economic growth in Poland, difficulties in selling production in many segments of the economy and deterioration of companies' financial standing. This resulted in a reduced demand for gaseous fuel from the Company's customers in 2009. Moreover, the difficulties that the companies are having with raising financing for new investment projects may curb increases in gas sales volumes.

Higher Receivables

In connection with the ongoing economic crisis in Poland, which results in a downturn on the markets of PGNiG S.A.'s customers and a deterioration in the financial standing of customers purchasing gas, some difficulties may occur with timely settlement of payments for the supplied gaseous fuel.

Gas Supplies

In H1 2009, the deliveries of natural gas from the markets east of Poland were disrupted again and no gas under the ROSUKRENERGO AG contract was supplied. The demand for natural gas was wholly satisfied by temporarily increasing the volumes of gas supplied by Gazprom eksport OOO, expanding the use of gas from underground storage facilities, and executing a contract with Gazprom eksport OOO for gas supplies in summer. With a view to compensating for the lost volumes of gas under the ROSUKRENERGO AG contract, PGNiG S.A. works towards securing gas from alternative sources. Taking into consideration the policy pursued by the key supplier and the political and economic environment in the transit countries, disruptions in gas supplies are likely to reoccur in future.

Storage

Since the provisions of the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas require the Company to increase mandatory stocks of gas, in the coming years PGNiG S.A. may be exposed to the risk of shortages in working capacity, withdrawal capacity and injection capacity. As a result, working output and available capacity used to meet PGNiG S.A.'s commercial needs may be insufficient during winter time. If storage facilities are lent for use to third parties, there is a potential risk of insufficient capacity and output to secure a sufficient level of mandatory stocks, as required under the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas.

Another risk factor is a possibility of a deficit of funding required for the planned capex. If the European Commission refuses to co-finance projects at 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, PGNiG S.A. will be required to seek additional funding in the amounts requested for the projects.

# Chapter VII: Distribution

## 1. Business of the Gas Companies

The core business activity of the Gas Companies is the transmission of methane-rich and nitrogen-rich gas as well as small quantities of propane-butane and coke-oven gas via the distribution network. On the basis of the decision issued by the President of URE, the Gas Companies enjoy the status of Distribution System Operators.

In H1 2009, in order to increase the volume of transmitted gas and maintain their current market positions, the Gas Companies extended and modernised their gas networks and connected new customers to their distribution grids.

The Gas Companies modernised gas piping with long operating lives and largely worn out, which did not guarantee the safe operation of the gas system. The Distribution System Operators also replaced the most failure-prone sections of cast iron piping whose continued operation posed a safety hazard and resulted in substantial gas loss. The implementation of the programme of replacement of cast iron piping and the regular technical inspections of the network resulted in a drop in the share of gas loss in sales.

The Gas Companies also connected new customers to both the existing and extended networks. They took steps to obtain co-financing for the projects of delivering gas to new areas under the EU Operational Programme – Infrastructure and Environment.

In addition, the Gas Companies continued the projects consisting in the supply of gas to areas not covered by the gas distribution network, using the LNG facilities.

The largest investment projects related to the extension of gas infrastructure carried out by the Gas Companies in H1 2009 included:

- continuation of the connection of the villages of Herby and Blachownia to the gas distribution network (the project provides for the construction of 41km of high pressure and medium pressure gas pipelines), and continuation of the connection of the villages of Komprachcice and Dąbrowa to the gas distribution network (the project provides for the construction of approximately 62 kilometres of gas pipelines),
- continued construction of the Bytów-Słupsk high-pressure pipeline and a pressure regulating and metering station; the primary objective of the Bytów-Słupsk extension is to improve security of gas supplies to Słupsk and its vicinity, as well as to enable connection of municipalities and communes located along the pipeline to the gas network; this project will ensure diversification of gas supplies and connect the two gas systems supplying the Pomerania region, i.e. the system covering the area serviced by PSG Sp. z o.o. and the system operated by WSG Sp. z o.o.;
- continued construction of the Witkowo-Trzemeszno high-pressure pipeline of approximately 22km, with a pressure regulating and metering station of the 1st degree in Chłądów, and the construction of a medium-pressure pipeline of approximately 30km in the Witkowo commune,
- continued reconstruction of the Zdzieszowice-Blachownia pipeline of approximately 5km,
- completion of the first stage of construction of the Werbkowice-Zamość high-pressure transmission pipeline; the project is designed to connect the Ukrainian high pressure network with the pipeline coming from with the domestic gas grid.

In H1 2009, the Distribution Segment's capital expenditure on property, plant and equipment and intangible assets reached PLN 459.0m.

The table below presents the volume of gas transmitted through the distribution grid, the length of the distribution network, the number of metering devices and the employment as at June 30th 2009.

Key information on the Gas Companies

| Gas Companies | UNIT | DSG | GSG | KSG | MSG | PSG | WSG |
|---|---|---|---|---|---|---|---|
| Volume of gas transmitted through the distribution system | million $m^3$ | 510.6 | 723.4 | 1,029.6 | 1,058.2 | 483.3 | 831.4 |
| Length of network (excluding connections) | km | 7,670.2 | 20,620.8 | 44,041.3 | 18,416.5 | 9,124.2 | 14,877.4 |
| Number of metering devices | thousand | 746.1 | 1,301.3 | 1,408.6 | 1,491.7 | 738.1 | 899.0 |
| Employment as at Jun 30 2009 | person | 1,397 | 2,593 | 3,295 | 2,903 | 1,757 | 1,812 |

## 2. Planned Directions for Development in the Distribution Segment

Regulations providing for reduction in $CO_2$ emissions encourage the public power sector to consider using natural gas as the primary source of energy, thus offering prospects of higher natural gas sales. The growth of natural gas sales volumes is reflected in the quantities of natural gas transmitted and indirectly affects the economic condition of the Gas Companies.

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

- extension of pipeline infrastructure for new customers,
- best utilisation of the network resources by connecting new customers to the existing network (the so-called "network densification"),
- ensuring the necessary transportation capacities and sources of supply for the gas system,
- replacement of cast iron piping and modernisation of high-, medium- and low-pressure networks,
- overview of infrastructure, with a particular focus on an overview of reduction and metering stations in terms of their profitability,
  - use of new natural gas distribution systems by employing LNG technologies,
  - delivery of natural gas to the areas that are not serviced by gas distribution companies,
  - implementation of IT tools to analyse network operation in order to determine free capacities and "bottlenecks",
- cooperation with local and territorial authorities,
- securing funds to finance investment projects under the EU Infrastructure and Environment Operational Programme.

## 3. Risks Related to Distribution

Direct Competition

The liberalisation of the gas market is likely to boost the activity of gas suppliers who are the competitors of the PGNiG Group's Gas Companies. Over the last few years, the activity of those suppliers has been regular and steady. They have gradually developed their gas networks and acquired new customers, both among individuals and businesses. Another issue which poses a serious threat to the Gas Companies' business is the tariff policy of the URE, 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 very attractive.

Legislation

An important factor with a bearing on the Gas Companies’ operations is the long time required for preparation of a project. The Construction Law and environmental protection regulations impose the obligation of preparing the documentation and obtaining numerous approvals and decisions in order to obtain a building permit.

Lower Volume of Transmitted Gaseous Fuel

The consequences of the ongoing global economic crisis for Poland include: an economic slowdown, lower scale of key projects or suspension of their execution, 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 result in a loss of the existing and prospective customers for distribution services, which in turn may weaken the position of the Gas Companies on the local energy markets.

# Chapter VIII: Other Activities

In H1 2009, the segment performed work for the Group's own purposes as well as for external customers in Poland and abroad.

In H1 2009, the segment companies executed work related mainly to the construction of transmission pipelines, upgrade of distribution and metering nodes, construction and assembly work concerning: development of natural gas deposits, construction of technical installations of underground gas storage facilities, production of drilling equipment, repair of coal mining equipment, design of installations for gas transport as well as hotel and catering services and SPA centre services.

In H1 2009, the companies constructed 30.8km of transmission pipelines, both for external customers and for the Group's own needs.

For the customers from within the PGNiG Group, the segment provided construction and assembly services, including the construction of the Daszewo Underground Storage Facility and upgrade of the Karlino Crude Oil and Natural Gas Mine. Additionally, work on the development of natural gas deposits in Łuków and the Roszków-1 borehole was performed. The companies also upgraded gas distribution and metering nodes. Drilling equipment, including pressure equipment used in surface development of boreholes was also produced. For external customers, the companies produced equipment and spare parts for oil platforms and drill ships and provided such services as construction of water and sewage installations and repairs of coal mining equipment.

Investment Projects
In H1 2009, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 16.4m. The investment projects included extension and upgrade of buildings and facilities, purchase of production plant and machinery as well as purchase of transport vehicles and computer hardware.

Planned Activity
A decline in demand for products offered by the fuel and power industry can be seen both in Poland and foreign markets. Despite unfavourable market conditions, the segment companies plan to maintain and strengthen their positions in the industry of drilling equipment, gas system designing and construction and assembly services at oil and gas facilities. They seek to enter other segments of the Polish market and foreign markets, among other things, by offering such services as construction of water supply and sewage systems, together with the auxiliary infrastructure.

Risks
The segment companies are exposed to a range of unfavourable factors. The business and financial standing of the companies is to a significant extent affected by legal regulations and administrative procedures to be followed in the preparation of investments and obtaining building permits, including in particular with respect to environmental protections requirements. Other adverse factors are the provisions of the Public Procurement Act, as they protract the investment process.

The construction and assembly services market, in which "turn-key" projects (design, delivery, execution) are gaining significance, is exposed to financial risk. To execute such project, the companies form consortiums with contractors and extend their range of services with the services of general project manager. Such increased range of services leads to increased operating expenses, driven mainly by the cost of financing the projects with external funds and by the cost of staff training. The incurred expenses not always translate into higher income and the earned profit may not be satisfactory in relation to the capital expenditure.

# Chapter IX: Environmental Protection

Liquidation of Boreholes

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to liquidate worked-out mining caverns, eliminate the danger and damages caused by mining activities and restore land to its original previous condition. Liquidation of boreholes and mining pits prevents leakage of crude oil and natural gas to the surface and to watercourses. In addition, there is a risk that escaping gas may accumulate in unliquidated gas boreholes, posing a fire hazard. Consequently, PGNiG S.A. liquidated 24 worked-out boreholes and mining pits in H1 2009. The liquidated boreholes included drilling holes which were tens of years old and mining pits which dated back to the 19th century.

Carbon Credit Trade System

Under the existing carbon credit trading system (CCTS), in H1 2009 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2008 and brought the volumes of carbon dioxide emission in line with the amounts stipulated by the permit held. Following the cancellation of the carbon credits used in 2008, 26,597 Mg $CO_2$ credit units were retained. In that settlement period, the system included the facilities of the Odolanów Branch, Zielona Góra Branch and the Mogilno Underground Gas Cavern Storage Facility.

Environmental Management System

In H1 2009, the Company implemented the Environmental Management System at the head office. As part of the system operation, staff training was continued, internal audits were performed and the system was reviewed by the Company's Management Board. Following the completion of the internal audit, the Company's head office obtained a certificate of compliance with Standard PN-EN ISO 14001 for the Environmental Management System.

Methane Emissions

In H1 2009, the Company continued the work on defining standardised methane emission ratios and unifying the methods for calculating the volume of methane emissions. Standardised and reliable methane emission ratios will help reduce the cost of environmental fees and charges.

Land Reclamation and Research Concerning Non-Productive Assets

Pursuant to the Environmental Protection Law, PGNiG S.A. conducts research work and land reclamation 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 environmental quality standards. In H1 2009, the Company completed the reclamation work on the property in Sławno, which was later approved without reservations by the County Governor Office. The work was performed in 2006–2009 and comprised liquidation of tar tanks, purification of soil and ground on bioremediation fields and purification of underground water with the use of a treatment facility. In addition, a non-public procurement procedure was prepared in order to award, by way of a limited tender, work consisting in reclamation of the properties located in Wrocław, Świdnica, Jugowice, Lądek Zdrój and Ziębice. The land reclamation work is to be completed by the end of this year. The total area of the properties amounts to over 60 thousand square metres.

# Chapter X: Other Information

Distribution of 2008 Profit

On June 23rd 2009, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution on the 2008 net profit distribution in the amount of PLN 546.2m. Distributions from profit were allocated in the following manner:

- PLN 1.4m was allocated to the Company's statutory reserve funds,
- PLN 531.0m was allocated to dividend payments (PLN 0.09 per share), of which PLN 382.5m will be distributed as non-cash dividend to the State Treasury in the form of transmission subsystems, along with their constituent and accessory parts which are necessary for the use of such subsystems, with a proviso that additional cash will be distributed to the State Treasury if the value of the non-cash assets is below PLN 382.5m,
- PLN 8.8m was allocated to increase the Company's social benefits fund,
- PLN 5.0m was allocated to increase the Company's capital reserves.

In addition, retained profit of PLN 42.3m was allocated in the following manner:

- PLN 39.8m was allocated to awards for the Company employees,
- PLN 2.5m was allocated to increase the Company's statutory reserve funds.

The Annual General Shareholders Meeting of PGNiG S.A. set August 26th 2009 as the dividend record date and October 2nd 2009 as the dividend payment date.

Approval for the Performance of Duties

On June 23rd 2009, the Annual General Shareholders Meeting of PGNiG S.A. adopted resolutions on the approval of the financial statements and the Director's Report on the activities of PGNiG S.A., on approval of the consolidated financial statements and the Director's Report on the activities of the PGNiG Group, and on granting approval to members of the Management and Supervisory Boards of PGNiG S.A. for the performance of their duties in the financial year 2008.

Actions Against PI GAZOTECH Sp. z o.o.

- PGNiG S.A.'s action instituted against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolutions of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG S.A. to pay additional contributions in the amount of PLN 52m. The proceedings started on March 7th 2006 and have been held before the Regional Court of Warsaw, the Warsaw Court of Appeals and the Supreme Court. In response to a cassation complaint filed by PGNiG S.A., in the ruling of May 14th 2009 the Supreme Court allowed PGNiG S.A.'s objection that the agenda for the General Shareholders Meeting of PI GAZOTECH Sp. z o.o. held on April 23rd 2004 lacked the necessary detail, reversed the ruling issued by the Warsaw Court of Appeals on February 4th 2008 and remanded the case for re-examination by the Court of Appeals.

- The proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 25,999,998, held before the Regional Court of Warsaw. By virtue of the ruling of October 31st 2008, the Regional Court dismissed PGNiG S.A.'s action. PGNiG S.A. filed an appeal against the ruling. The security for the claim was maintained until the ruling became final. PGNiG S.A. advised the Court of Appeals of the ruling issued by the Supreme Court on May 14th 2009 and which is of relevance for the discussed case. On July 30th 2009, the

Court of Appeals reversed the ruling of the first instance and remanded the case for re-examination.

- The proceedings based upon PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 6,552,000, instigated before the Regional Court of Warsaw were concluded in the first instance. On May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision on securing the claim. The proceedings to maintain the security for the claim have been held before the Court of Appeals and the Regional Court of Warsaw since July 22nd 2008. On February 17th 2009, PGNiG S.A. filed a complaint concerning the Regional Court's repeated reversal of the decision on securing the claim. On April 23rd 2009, the Warsaw Court of Appeals once more reversed the District Court's decision on reversing the decision concerning security for the claim, and referred the case to the District Court of Warsaw. PGNiG S.A. advised the Court of Appeals of the ruling issued by the Supreme Court on May 14th 2009 and which is of relevance for the discussed case.

Dispute with Bartimpex S.A.

On August 9th 2005, in connection with a motion filed by PHZ Bartimpex S.A., the President of the Anti-Trust and Consumer Protection Authority ruled that the Company pursues 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. The President of the Anti-Trust and Consumer Protection Authority also stated the abovementioned practices ceased as of June 2nd 2003. By virtue of his decision of August 9th 2005, the President of the Anti-Trust and Consumer Protection Authority imposed a fine on PGNiG S.A. in the amount of PLN 2,000,000 along with an order to repay the costs of proceedings for the benefit of PHZ Bartimpex S.A.

On August 31st 2005, PGNiG S.A. appealed against the decision. As a consequence, on January 31st 2007 the Regional Court of Warsaw issued a verdict reducing the fine imposed on PGNiG S.A. to the amount of PLN 500,000.

Both parties filed appeals to the decision issued by the court of the first instance. On March 27th 2008, the Court of Appeals changed the Regional Court's decision. Accordingly, a fine of PLN 2,000,000 was imposed and PGNiG's appeal was dismissed. On September 1st 2008, PGNiG S.A. filed a cassation complaint against the decision of the Court of Appeals of March 27th 2008. The Supreme Court accepted PGNiG S.A.'s complaint for examination.

Dispute with EMFESZ NG Sp. z o.o.

On March 9th 2006, proceedings before the President of URE were instigated upon a motion filed by EMFESZ NG Polska Sp. z o.o. regarding refusal to execute an agreement on provision of gaseous fuel storage services. On June 11th 2007, a team of URE experts completed their work aimed at preparing an expert opinion on the technological feasibility of provision of gas storage services by PGNiG S.A. to third parties.

Afterwards, by virtue of subsequent documents, the President of URE was continuously postponing this date up to February 24th 2008. On February 25th 2008, he issued a decision suspending the proceedings until the decision of the European Commission on the introductory issue regarding examination of the President of URE's stand on PGNiG's request for temporary exemption from the obligation to store gaseous fuels.

The European Commission did not approve of the temporary exemption of PGNiG S.A. from the obligation to store gaseous fuels. Accordingly, the President of URE re-opened the suspended proceedings on July 30th 2009.

# Chapter IX: 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 (the EU) as at June 30th 2009.

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 2009.

## 1. Financial Standing

In H1 2009, the PGNiG Group posted a net loss of PLN 493.0m. The net financial result was by PLN 1,552.3m (147%) lower relative to the figure recorded in H1 2008.

Summary information on the PGNiG Group's financial standing in H1 2009 is presented in the financial statements shown below, prepared in accordance with the International Financial Reporting Standards:

- the balance sheet
- the income statement
- the cash flow statement
- the selected financial ratios

Consolidated Balance Sheet (PLNm)

| ASSETS | Jun 30 2009 | Dec 31 2008 |
|---|---|---|
| Non-current assets | 23,572.4 | 22,573.6 |
| Property, plant and equipment | 21,445.1 | 20 587.0 |
| Investment property | 7.9 | 8.2 |
| Intangible assets | 159.8 | 151.7 |
| Investments in associated undertakings valued with equity method | 556.7 | 556.9 |
| Financial assets available for sale | 92.5 | 42.9 |
| Other financial assets | 653.9 | 676.6 |
| Deferred tax asset | 617.3 | 514.9 |
| Other non-current assets | 39.2 | 35.4 |
| Current assets | 5,718.9 | 7,171.7 |
| Inventories | 1,358.8 | 1,721.3 |
| Trade and other receivables | 2,587.4 | 3,716.9 |
| Current income tax receivable | 191.1 | 59.6 |
| Prepayments and accrued income | 212.2 | 70.3 |
| Financial assets held for sale | 7.2 | 6.5 |
| Derivative financial instrument assets | 15.5 | 174.2 |
| Cash and cash equivalents | 1,346.0 | 1,421.9 |
| Assets available for sale | 0.7 | 1.0 |
| Total assets | 29,291.3 | 29,745.3 |

Consolidated Balance Sheet (PLNm) – continued

| EQUITY AND LIABILITIES | Jun 30 2008 | Dec 31 2007 |
|---|---|---|
| Equity | 19,752.4 | 20,715.9 |
| Share capital | 5 900.0 | 5 900.0 |
| Currency-translation differences on foreign-currency undertakings | (7.6) | (39.1) |
| Share premium account | 1,740.1 | 1,740.1 |
| Other reserve funds | 11,422.2 | 10,729.1 |
| Retained earnings/(deficit) | 688.4 | 2,376.8 |
| Equity (attributable to equity holders of the parent) | 19,743.1 | 20,706.9 |
| Equity attributable to minority interests | 9.3 | 9.0 |
| Non-current liabilities | 5,110.3 | 4 058.7 |
| Loans, borrowings and debt securities | 1,117.7 | 41.1 |
| Provisions | 1,561.3 | 1,501.9 |
| Deferred income | 1,137.4 | 1,139.3 |
| Deferred tax liability | 1,271.9 | 1,352.3 |
| Other non-current liabilities | 22.0 | 24.1 |
| Current liabilities | 4,428.6 | 4,970.7 |
| Trade and other payables | 2,971.1 | 3,222.5 |
| Loans, borrowings and debt securities | 370.8 | 871.8 |
| Liabilities under derivative financial instruments | 232.5 | 16.7 |
| Current tax liability | 42.1 | 47.5 |
| Provisions | 199.3 | 173.4 |
| Deferred income | 612.8 | 638.8 |
| Total liabilities | 9,538.9 | 9,029.4 |
| Total equity and liabilities | 29,291.3 | 29,745.3 |

Consolidated Income Statement (PLNm)

| | H1 2009 | H1 2008 |
|---|---|---|
| Sales revenue | 10,253.6 | 9,259.6 |
| Total operating expenses | (10,932.8) | (7,967.1) |
| Raw materials and energy used | (7,610.2) | (4,893.8) |
| Employee benefits | (1,228.5) | (1,036.4) |
| Depreciation and amortisation | (762.5) | (721.4) |
| Contracted services | (1,348.1) | (1,338.9) |
| Cost of products and services for own needs | 359.6 | 307.9 |
| Other net operating expenses | (343.1) | (284.5) |
| Operating profit/(loss) | -679.2 | 1,292.5 |
| Financial income | 169.9 | 110.9 |
| Financial expenses | (67.4) | (33.6) |
| Share in profit/(loss) of undertakings valued with equity method | (0.2) | 0.1 |
| Pre-tax profit/(loss) | -576.9 | 1,369.9 |
| Corporate income tax | 83.9 | (310.6) |
| Net profit/(loss) | -493.0 | 1,059.3 |
| attributable to: | | |
| equity holders of the parent | -493.4 | 1,059.6 |
| minority interests | 0.4 | -0.3 |

Consolidated Cash Flow Statement (PLNm)

| | H1 2009 | H1 2008 |
|---|---|---|
| Net cash provided by/used in operating activities | 1,095.6 | 1,977.6 |
| Net cash provided by/used in investing activities | (1,698.2) | (1,099.6) |
| Net cash provided by/used in financing activities | 527.5 | (5.9) |
| Change in net cash | (75.1) | 872.1 |
| Cash and cash equivalents at beginning of period | 1,420.9 | 1,584.9 |
| Cash and cash equivalents at end of period | 1,345.7 | 2,457.0 |

Financial Ratios

### Profitability Ratios

| | H1 2009 | H1 2008 |
|---|---|---|
| EBIT (PLNm)<br>operating profit | -679.2 | 1,292.5 |
| EBITDA (PLNm)<br>operating profit + depreciation/amortisation | 83.3 | 2,013.9 |
| ROE (Return on Equity)<br>net profit * to equity at end of period | -2.5% | - |
| NET MARGIN<br>net profit * to sales revenue | -4.8% | 11.4% |
| ROA (Return on Assets)<br>net profit * to assets at end of period | -1.7% | - |

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

### Liquidity Ratios

| | H1 2009 | 2008 |
|---|---|---|
| CURRENT RATIO<br>current assets (net of prepayments and accrued income) to current liabilities | 1.2 | 1.4 |
| QUICK RATIO<br>current assets (net of prepayments and accrued income) less inventories to current liabilities | 0.9 | 1.1 |

### Debt Ratios

| | H1 2009 | 2008 |
|---|---|---|
| DEBT RATIO<br>total liabilities to total equity and liabilities | 32.6% | 30.4% |
| DEBT/EQUITY RATIO<br>total liabilities to equity * | 48.3% | 43.6% |

*Equity attributable to equity holders of the parent.

The Group's operating result fell by PLN 1,971.7m (or 153%) relative to the corresponding period of 2008. The reduction in operating result was primarily caused by a considerable loss on operating activities in the Trading and Storage segment

Exploration and Production

The operating profit in the Exploration and Production segment amounted to PLN 255.9m and was by PLN 373.6m (or 59%) lower than in the corresponding period of the previous year. This lower profit followed chiefly from the recognition of impairment charges for production assets and poorer profitability of crude oil sales. Due to low crude oil prices on the global markets, the PGNiG Group sold the product at prices which were 31% lower than in the same period of 2008.

Trading and Storage

In the Trading and Storage segment, the PGNiG Group posted an operating loss of PLN 1,226.1m (a decline of PLN 1,659.8 from the figure reported for H1 2008). This poorer operating result was due to lower profitability of methane-rich gas sales, which in turn followed from:

- a 73% rise in unit purchase costs of imported gas,
- failure to adjust the rates and charges specified in the tariffs for gaseous fuels to reflect the cost of gas purchases.

The unit cost of imported gas grew mainly as a result of changes on the currency market. Relative to the corresponding period of 2008, the average exchange rate for the US dollar rose by 47%, whereas the euro appreciated by 28%. The increase in the prices of imported gas was also driven by the situation on the global oil and petroleum market. As a result of these developments, the negative margin on the sales of imported gas expanded by more than ten-fold. Losses on sales of imported gas were not offset by the high profits derived from sales of the Company’s own production.

The rising costs of gas purchases were limited by a 12% drop in the volume of imported gas caused by non-delivery of gas under the contract with ROSUKRENERGO AG. To ensure sufficient gas supply to the customers, the PGNiG Group increased gas withdrawal from the underground storage facilities by 38%.

Despite the fact the President of the URE approved two increases in gas prices in 2008, the prices did not compensate the PGNiG Group for the high unit cost of imported gas, which resulted in a loss on sales of methane-rich gas in H1 2009. Furthermore, as a result of approval by the President of URE of the new tariff, which took effect on June 1st 2009, the average price of gas was reduced by approximately 9% relative to its previous level.

<u>Distribution</u>

In H1 2009, the Group’s Distribution Segment posted an operating profit of PLN 301.7m, higher by PLN 48.0m (or 19%) than in the corresponding period of 2008. This growth was a result of approval of the new tariffs for the Gas Companies at the end of April 2008, with the simultaneous decrease in the volume of transmitted gas

PGNiG Group's segments (PLNm)

| H1 2009 | Exploration and Production | Trade and Storage | Distribution | Other activities | Elimi-nations | Total |
|---|---|---|---|---|---|---|
| Sales to external customers | 953.2 | 9,190.3 | 26.6 | 83.5 | - | 10,253.6 |
| Inter-segment sales | 651.5 | 107.3 | 1,509.3 | 86.4 | (2,354.5) | - |
| Segment's revenue | 1,604.7 | 9,297.6 | 1,535.9 | 169.9 | (2,354.5) | 10,253.6 |
| Segment's cost and expenditure | (1,348.8) | (10,523.7) | (1,234.2) | (174.3) | 2,348.2 | (10,932.8) |
| Operating profit/(loss) | 255.9 | (1,226.1) | 301.7 | (4.4) | (6.3) | (679.2) |
| Net financial expenses | - | - | - | - | - | 102.5 |
| Share in profit of undertakings valued with equity method | - | (0.2) | - | - | - | (0.2) |
| Pre-tax profit/(loss) | | | | | | (576.9) |
| Corporate income tax | - | - | - | - | - | 83.9 |
| Net profit/(loss) | | | | | | (493.0) |

| H1 2008 | Exploration and Production | Trade and Storage | Distribution | Other activities | Elimi-nations | Total |
|---|---|---|---|---|---|---|
| Sales to external customers | 1,129.3 | 8,047.3 | 11.9 | 71.1 | | 9,259.6 |
| Inter-segment sales | 566.0 | 522.4 | 1,745.4 | 75.5 | (2,909.3) | - |
| Segment's revenue | 1,695.3 | 8,569.7 | 1,757.3 | 146.6 | (2,909.3) | 9,259.6 |
| Segment's cost and expenditure | (1,065.8) | (8,136.0) | (1,503.6) | (149.2) | 2,887.5 | (7,967.1) |
| Operating profit/(loss) | 629.5 | 433.7 | 253.7 | (2.6) | (21.8) | 1,292.5 |
| Net financial expenses | - | - | - | - | - | 77.3 |
| Share in profit of undertakings valued with equity method | - | 0.1 | - | - | - | 0.1 |
| Pre-tax profit/(loss) | | | | | | 1,369.9 |
| Corporate income tax | - | - | - | - | - | (310.6) |
| Net profit/(loss) | | | | | | 1,059.3 |

The balance sheet of the PGNiG Group as at June 30th 2009 shows a balance-sheet total of PLN 29,291.3m, down by PLN 454.0m (2%) relative to the end of 2008.

Property, plant and equipment account for the largest share of assets. Their value disclosed as at June 30th 2009 was PLN 21,445.1m, up by PLN 858.1m (4%) from the end of 2008. The increase is attributable primarily to investment activities undertaken by the PGNiG Group and changes related to revaluation of assets primarily involved in exploration and production activities.

As at June 30th 2009, current assets totalled PLN 5,718.9m, down by 1,452.8m (20%) compared with the end of 2008.

Trade and other receivables fell by PLN 1,129.5m (30%) compared with the end of 2008, mainly due to seasonal decreases in the volumes of natural gas sales.

During the period under review, the value of inventories fell by PLN 362.5m (21%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage facilities. The decline in the volume of stored natural gas was caused mainly by increased withdrawal of gas from storage in Q1 2009 due to higher demand for gas fuel grew in the heating season and non-delivery of gas under the contract with ROSUKRENERGO AG.

Relative to the beginning of 2009, prepayments and accrued income rose by PLN 141.9m (202%), mainly due to the recognition over time of costs related to real estate tax, including primarily tax applicable to gas pipelines and infrastructure.

Cash and cash equivalents stood at PLN 1,346.0m and were lower by PLN 75.9m (5%) from the figure reported at the end of 2008. Cash and cash equivalents remained at a level comparable to the value reported as at December 31st 2008 despite high operating losses because the Group contracted sizeable debt.

The deteriorated financial standing of the Group affected the liquidity ratios. The current ratio dropped from 1.4 to 1.2, while the quick ratio fell from 1.1 to 0.9. Despite the decline in liquidity ratios, the value and structure of current assets held by the PGNiG Group still enables it to settle all its current liabilities in a timely manner

The main financing source of the PGNiG Group's assets was equity, whose value dropped by PLN 963.5m (5%) compared with 2008. The change was largely caused by the net loss incurred during the current period (PLN 493.0m) and distribution of the previous year's profit as non-cash and cash dividend (PLN 531.0m).

The value of non-current liabilities disclosed in the liabilities and equity part of the balance sheet grew by PLN 1,051.6m (26%) relative to the end of 2008, mainly due to a PLN 1,076.6m rise in received loans and borrowings. A considerable increase in external financing was required to finance current investment activities and cover the current period's operating losses.

As at June 30th 2009, current liabilities were lower by PLN 542.1m (11%) relative to the figure as at December 31st 2008. The decline in current liabilities was driven mainly by:

- PLN 251.4m (8%) drop in trade and other payables as a result of a seasonal reduction in the volume of imported gas, accompanied by an increase in liabilities under dividend
- PLN 501.0m drop in liabilities under current loans and borrowings as a result of presentation change and reclassification to non-current liabilities

The drop in current liabilities coincided with a PLN 215.8m increase in liabilities under derivative financial instruments.

The ratios reflecting the relation between equity and other items of equity and liabilities changed relative to the end of 2008. The total debt-to-equity ratio rose from 43.6% to 48.3% as at the end of H1 2009, whereas the debt ratio (total liabilities to total equity and liabilities) went up from 30.4% to 32.6%.

Transactions concluded on terms deviating from the market terms

In H1 2009, PGNiG S.A. and its subsidiaries did not enter into any material related party transactions on terms deviating from the market terms.

Guarantees and Sureties

In H1 2009, PGNiG S.A. and its subsidiaries did not grant any credit sureties 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 2009, the PGNiG Group did not publish any financial forecasts.

# 2. Forecast Financial Performance

The level of rates and charges specified in the tariffs for gaseous fuels are one of the key factors with a bearing on the financial standing of the PGNiG Group. As a result of approving the new tariff, the average gas price was reduced by approximately 9%. Since the tariff currently in force failed to compensate for the substantial increase in the unit purchase cost of imported gas in H1 2009, the Group's financial standing in the future will be determined by movements in the prices of crude oil and petroleum products on international markets and by the situation on the currency markets.

In H1 2009, crude oil prices stabilised and were lower relative to the corresponding period of 2008. However, we have seen a steady upward drift in crude oil prices starting from January 2009. Since prices of imported gas are correlated with the market prices for crude oil and petroleum products, the prices of imported gas should be expected to gradually rise. Therefore, the PGNiG Group's ability to generate profits with the current tariff maintained will be conditional on currency exchange levels. Since March 2009, currency exchange levels have been steadily falling. Continuation of this trend in the coming months should be beneficial for the Company's financial standing.

The PGNiG Group anticipates the profitability of its production activities to deteriorate, chiefly due to the change in the tariff for gaseous fuels. The drop should be partly offset by higher profitability on crude sales in connection with the anticipated growth in crude prices.

The PGNiG Group plans to maintain the necessary level of capital expenditure on investment projects, chiefly on projects aimed at increasing the production capacity, diversifying gas supply sources and expanding underground gas storage facilities. The wide-ranging investment activities will be financed from operating cash flows and available credit facilities.

Members of the Management Board

| | | |
|---|---|---|
| President | Michał Szubski | ______________________ |
| Vice-President | Mirosław Dobrut | ______________________ |
| Vice-President | Radosław Dudziński | ______________________ |
| Vice-President | Sławomir Hinc | ______________________ |
| Vice-President | Mirosław Szkałuba | ______________________ |
| Vice-President | Waldemar Wójcik | ______________________ |