

Enclosure to the resolution of the Supervisory Board
of PGE Polska Grupa Energetyczna S.A.
no. 89/XI/2019 of 16 April 2019

**THE REPORT OF THE SUPERVISORY BOARD
OF THE COMPANY PGE POLSKA GRUPA ENERGETYCZNA S.A.
ON THE EVALUATION OF THE COMPANY'S POSITION IN THE YEAR 2018, INCLUDING
OPINIONS ON THE COMPANY'S INTERNAL CONTROL, RISK MANAGEMENT AND
COMPLIANCE SYSTEMS AS WELL AS THE INTERNAL AUDIT FUNCTION**

PGE Polska Grupa Energetyczna S.A. (hereinafter also referred to as "PGE", "PGE S.A.", "Company", "Issuer") has been bound by the corporate governance principles specified in the 2016 edition of "The Good Practices of Companies Listed on the Warsaw Stock Exchange" ("The Good Practices") adopted by a resolution of the Board of the Warsaw Stock Exchange, and accepted for application by the Management Board of PGE S.A. in resolution no. 19/03/2016 of 19 January 2016. This report has been prepared on the basis of The Good Practices and includes a brief assessment of the Company's position, taking into consideration its internal control, risk management and compliance systems as well as the internal audit function. This evaluation has been prepared based on the documents submitted by the Management Board, discussions held with the members of the Management Board during the meetings of the Supervisory Board and discussions held during the meetings of the permanent committees operating within the Supervisory Board, as well as the following reports submitted to the Supervisory Board: "The standalone financial statements of the company PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2018", "The Management Board's report on the activities of the company PGE Polska Grupa Energetyczna S.A. and the PGE Capital Group for the year ended 31 December 2018", "The Management Board's report on non-financial information related to the company PGE Polska Grupa Energetyczna S.A. and the PGE Capital Group for the year 2018", and "The annual report on the execution of the PGE CG Compliance Programme in the year 2018".

1. Significant events.

Pursuant to the updated Strategy adopted in September 2016, the mission of the Capital Group of PGE Polska Grupa Energetyczna S.A. ("PGE CG", "PGE Capital Group", "Capital Group", "PGE Group", "Group") is to ensure security and development through reliable deliveries, technical perfection, modern services, and partner relationships.

The PGE Group aspires to maintain its position of the generation sector leader after the year 2020, with the domestic market share of over 40%. The PGE Group is continuing the execution of its flagship investment projects in Opole and Turów and applies a flexible approach to new generation capacity development plans, each time aiming to make the most advantageous decisions in

economic and technical terms, taking into consideration the specific character of a given location as well as the technological conditions of particular assets.

The Company is modernizing its power plants and cogeneration plants in the optimal scopes, ensuring that they comply with the new BAT industrial emissions standards. The implementation of the capacity market, which is a mechanism increasing the country's energy security, will have a positive influence on the economic effectiveness of modernization projects.

On 13 November the transaction for the purchase of shares in the company EDF Polska S.A. (now PGE Energia Ciepła S.A.) was finalized. In consequence, the installed electricity generation capacities of the PGE Groups increased by 25% to reach the level of 16.23 GWe at the end of 2018. The PGE Group strengthened its position of the leader in the power generation segment and became the largest generator of heat in the country with an 18% share in the Polish heat generation market.

The PGE Group intends to strengthen its position in the segment of renewable energy sources ("RES") and to generate approximately 25% of energy from RES in 2030. Thanks to the successful results of the RES auctions carried out in November 2018, the PGE Group will execute a project called "Klaster". The project provides for the construction of three wind farms with the combined capacity of 97.17 MW together with accompanying infrastructure and a connection to the grid by the middle of 2020. On 5 December 2018 the PGE Group invited a group of business partners to participate in talks about the construction and operation of wind farms with the combined capacity of up to 2545 MW to be located on the Baltic Sea. The talks constituted the first stage of the offshore programme of the PGE Capital Group. In 2019 the Company expects to obtain a decision on environmental conditions for this investment project. According to the adopted schedule, the evacuation of power from the PGE Group's first offshore wind farm could take place in approximately 2025 and the commercial operation of the farm could start in 2026.

The additional result of the Company's ambitious RES objective will be its increased involvement in the segment of photovoltaic systems and diffuse energy sources. The PGE Group is carrying out a few pilot projects in the area of micro-grids and energy clusters which are to help it to develop an optimal business model.

In order to maintain its position of the power generation leader the PGE Group has at its disposal three strategy options, thanks to which it can make optimal choices in the context of the future power and climate policies:

- the construction of offshore wind power plants with the combined capacity of up to 2545 MW.

The Offshore Programme was launched in 2009. In 2012 the special purpose vehicles Baltica 1, 2 and 3 obtained permits for the construction and operation of artificial islands to be used as locations for the installation of offshore wind farms with the combined capacity of 3.5 GW. At present the works within the Offshore Programme focus on the locations Baltica 2 and 3, referred to jointly as the "Baltica" Project. The location Baltica 1 is considered as a potential future area for the subsequent stage of the Project. In 2014 Baltica 3 signed a grid connection agreement with the company Polskie Sieci Elektroenergetyczne S.A. for 1045 MW. In January 2019 Baltica 2 obtained technical conditions for the connection of 1498 MW.

The activities in the technical area of the Baltica Project concentrate primarily on the following:

- carrying out works aimed at obtaining a decision on environmental conditions – in December 2017 an application for the issue of such a decision was submitted to the Regional Environmental Protection Directorate in Gdańsk,
 - conducting a campaign of windiness measurements by means of a floating lidar and actions aimed at acquiring windiness data from other reference sources,
 - developing an optimal plan of the layout of turbines and conducting preparations for preliminary productivity analyses,
 - developing a power evacuation concept and securing the availability of land for a connection route and a terminal,
 - preparing a campaign of preliminary geotechnical studies aimed at the exploration of the geological and geotechnical conditions of the Baltica Project locations with a view to an optimal selection of a type of foundations. The offshore projects and proposals concerning solutions supporting their development are presented in various fora, e.g. during the sessions of parliamentary teams.
- building Poland's first nuclear power plant, after developing a model guaranteeing the economic effectiveness of a potential investment project and taking into consideration the investment possibilities of the PGE Group.

PGE EJ1 sp. z o.o. ("PGE EJ1") is a company belonging to the PGE Capital Group and directly responsible for preparing an investment process, conducting environmental and local studies, obtaining all necessary decisions constituting prerequisites for the construction of Poland's first nuclear power plant and the execution of the whole investment project. In the future PGE EJ1 is to fulfil the function of the nuclear power plant operator. The company PGE EJ1 was established in 2010. In 2014 the companies Enea S.A., KGHM Polska Miedź S.A. and TAURON Polska Energia S.A. ("Partners") signed an agreement with PGE under which each of them bought 10% (jointly 30%) of shares in PGE EJ1. The agreement obliges the parties to finance jointly, in proportion to held shares, all activities connected with the planned investment project. In the fourth quarter of 2018 the PGE Management Board expressed its interest in buying all shares in PGE EJ1 from the other Partners. The objective of PGE is to restructure PGE EJ1 with respect to operations and costs as well as to integrate the company with the activities of the PGE Group, which should ensure a better utilization of the Group's intellectual and organizational potential in the area of nuclear power generation. All Partners confirmed their initial interest in selling their shareholdings in PGE EJ1. It will be possible to finalize the transaction after the value of PGE EJ1 has been assessed by an independent consultant and all interested parties have obtained necessary corporate approvals.

- modern coal-based power generation, including the exploitation of new lignite deposits, in the case of an essential softening of the climate policy.

Actions under the project called "Obtaining a concession for the mining of lignite from the Złoczew deposit" were initiated in the year 2008.

In the years 2008-2018 a number of analyses and studies were carried out. They provided information on the deposit, for example its structure, quality parameters, hydrogeology,

and technological conditions related to lignite extraction. At the same time works were being carried out with a view to obtaining a mining concession. The most important of them are as follows:

- actions aimed at obtaining a decision on the environmental conditions for the undertaking called “The exploitation of the Złoczew deposit”,
- actions aimed at achieving the compatibility of the studies of the conditions and directions of spatial development of the four communes located in the area of the Złoczew deposit,
- submitting an application to the Ministry of the Environment for the issue of a concession.

In connection with appeals against the environmental decisions and spatial development studies, the deadline for the issue of a concession is not known yet. It is not possible to obtain a concession if the planned investment project is not included in the spatial development studies and before the environmental decisions become legally valid and final.

Significant events in 2018.

■ **THE CALL TO SUBSCRIBE FOR THE SALE OF SHARES IN THE COMPANY ZESPÓŁ ELEKTROCIĘPŁOWNI WROCŁAWSKICH KOGENERACJA S.A. AND ITS RESULT.**

On 1 February 2018 the PGE Management Board announced the call to subscribe for the sale of 2,383,999 dematerialized ordinary bearer shares issued by the company Kogeneracja S.A. and giving the right to 16.00% of the total number of votes at General Meetings of the company Kogeneracja S.A. The price proposed in the call was PLN 81.80 PLN per share. The subscription period lasted from 21 February 2018 to 6 March 2018. The result of the call was the sale of 1,202,172 shares in the company Kogeneracja S.A., giving the right to 1,202,172 votes at General Meetings of the company Kogeneracja S.A. and constituting 8.07% of the total number of shares and votes at General Meetings.

■ **THE EXECUTION OF A CREDIT AGREEMENT FOR PLN 4.1 BILLION**

On 17 September 2018 PGE entered into a renewable credit agreement with a consortium of the following banks: Powszechna Kasa Oszczędności Bank Polski S.A. with its registered office in Warsaw, Intesa Sanpaolo S.p.A. with its registered office in Turin, acting through the agency of its branch Intesa Sanpaolo S.p.A. Spółka Akcyjna Oddział w Polsce with its registered office in Warsaw, MUFG Bank (Europe) N.V. with its registered office in Amsterdam and Santander Bank Polska S.A. with its registered office in Warsaw (“Banks”).

The subject matter of the agreement is the Banks’ providing PGE with a renewable credit line for up to PLN 4,100 million.

■ **THE CALL TO SUBSCRIBE FOR THE SALE OF SHARES IN POENERGIA AND ITS RESULT**

On 22 May 2018 the PGE Management Board announced the call to subscribe for the sale of 45,443,547 ordinary bearer shares, i.e. all shares issued by the company Polenergia S.A., giving the

right to 100% of votes at General Meetings of the company Polenergia S.A., at the price of PLN 16.29 per share. PGE was also an entity intending to purchase shares in response to the call.

In view of the fact that some conditions had not been met, PGE decided to withdraw from the planned purchase of shares in the company Polenergia S.A.

■ **A CHANGE IN THE DATE OF THE COMMISSIONING OF UNITS 5 AND 6 IN OPOLE**

In consequence of the negotiations conducted with the General Contractor (the consortium of the companies Polimex-Mostostal S.A., Mostostal Warszawa S.A. and Rafako S.A.) and GE Power, the participants agreed the new dates of the commissioning of units 5 and 6 in the Opole Power Plant and confirmed the amount of the remuneration due to the General Contractor on condition that the agreed unit commissioning deadlines were met.

The new commissioning dates declared by the General Contractor were 31 May 2019 for unit 5 and 30 September for unit 6. On 10 October 2018 PGE GiEK, a subsidiary of PGE, and the General Contractor entered into an annex to the agreement for the construction of power generation units 5 and 6 in the Opole Power Plant. The new date for the commissioning of unit 5 was established at 15 June 2019.

■ **THE EXECUTION OF AN AGREEMENT WITH PGG**

On 20 November 2018 PGE entered into an agreement for the delivery of hard coal with the company Polska Grupa Górnicza S.A. ("PGG"). In the agreement, the parties specified approximate volumes of hard coal deliveries for the companies PGE Górnictwo i Energetyka Konwencjonalna S.A. ("PGE GiEK"), Zespół Elektrociepłowni Wrocławskich KOGENERACJA S.A. and PGE Energia Ciepła S.A. for the years 2019-2022.

■ **THE RESULTS OF POWER MARKET AUCTIONS**

In November and December 2018 the first three power market auctions were carried out for the years 2021, 2022 and 2023. In consequence of the auctions, PGE contracted power for the Group's existing, modernized and new power generation units. The contracts for the new power generation units in the Opole and Turów Power Plants were entered into for a period of 15 years, which guarantees stable and long-term revenues for their readiness to supply power to the system. Such revenues are to supplement those achieved for the sale of electricity. The achieved closing prices were the following: 240.32 PLN/kW/year (2021), 198.00 PLN/kW/year (2022) and 202.99 PLN/kW/year (2023). In the case of long-term power supply contracts, the achieved prices will be subject to annual indexation based on the average annual consumer price index.

■ **A PRELIMINARY INTEREST IN PURCHASING ALL SHARES IN THE COMPANY PGE EJ1**

On 28 November 2018 the PGE Management Board expressed its preliminary interest in the purchase of all shares in the company PGE EJ1 sp. z o.o. It will be possible to finalize the transaction after the value of PGE EJ1 has been assessed by an independent consultant and all interested parties have obtained necessary corporate approvals.

■ **AN ANNEX TO THE AGREEMENT WITH POLSKA GRUPA GÓRNICZA FOR THE SUPPLY OF HARD COAL FOR UNITS 5 AND 6 IN THE OPOLE POWER PLANT**

On 30 November 2018 the Company received information on PGG's signing an annex to the agreement of 13 August 2013 for the supply of hard coal for power generation units 5 and 6 in the

Opole Power Plant. In the annex, the parties adjusted the provisions of the agreement to the currently applicable formal and legal requirements and withdrew from determining coal prices on the basis of indexes related to average energy prices, average market coal prices and average emission allowance prices. The parties established the price of hard coal for the period until 31 December 2022.

■ **THE COMMENCEMENT OF TALKS ON POTENTIAL COOPERATION ON THE CONSTRUCTION OF A 1000 MW POWER GENERATION UNIT IN THE OSTROŁĘKA POWER PLANT**

In response to the invitation from the companies Energa S.A. and Enea S.A., on 7 January 2019 the companies initiated talks that could result in the Company's participation in the building of a 1000 MW power generation unit in Ostrołęka. At present the project is being carried out by the companies Energa S.A. and Enea S.A.

■ **INFORMATION ON CREDIT OR LOAN SURETIES OR GUARANTEES GRANTED BY THE COMPANY OR ITS SUBSIDIARIES**

As at 31 December 2018 PGE S.A. and its subsidiaries had not granted any other entities or subsidiaries any credit sureties or guarantees whose value constituted the equivalent of at least 10% of the Company's share capital.

■ **THE COMPETENCE MODEL OF THE PGE CAPITAL GROUP**

Created for and implemented in the whole Group, the Architecture of Positions is a starting point for subsequent HR solutions and tools. Prepared on the basis of the Architecture of Positions and implemented in the whole Group in 2018, the Competence Model constitutes a set of all competencies for the whole organization taking into consideration both the sources of the Company's competitive advantages described in the mission, values and strategic principles of the PGE Group and the requirements connected with particular organizational roles and resulting from the execution of tasks in the particular substantive areas. THE SAP HRM system was implemented in all Business Lines and in the following companies: PGE S.A., PGE Systemy S.A., PGE Synergia sp. z o.o. and PGE Dom Maklerski S.A.. Among other things, it makes it possible to manage systemically the Competence Model and the Competence Assessment in the information system.

In 2018 the Company introduced the Employee Competencies Assessment System based and on the Architecture of Positions and connected with the Competence Model. Actions in this area were started on a trial basis in PGE S.A. and in 2019 implementations will be carried out in the selected companies of the PGE Group.

■ **INNOVATIONS IN PGE**

Innovation is one of the pillars of the business strategy of the PGE Group. By 2020 the Group will have spent in total approximately PLN 400 million on the area of research, development and innovation. A half of the sum will be PGE's own funds, while the other will come from external sources. PLN 50 million a year to come from the Company's own funds is to be spent on the development of new technologies, products and business lines.

Capital investments in startups are the responsibility of the company PGE Ventures sp. z o.o. ("PGE Ventures"), which is a specialist corporate investment fund, while the company PGE Nowa Energia sp. z o.o. deals with project incubation and acceleration at the earliest stage of development.

In 2018 the company PGE Ventures carried out 6 capital investment projects, acquiring shares in the most innovative technological startups of strategic importance for the PGE Group. Taking

advantage of financing available under the programme carried out by the company Polski Fundusz Rozwoju S.A. ("PFR") and the National Centre for Research and Development (NCBiR), PGE Ventures established two satellite funds with the combined capitalization of PLN 140 million. The investment target of both external funds is startups connected with the value chain of the PGE Group or characterized by a high level of innovation and growth potential.

Furthermore, the company PGE Ventures is active in the broad academic environment. For the company, higher education institutions are both a source of interesting investment projects and a base for establishing business relations in the future. PGE Ventures offers universities free workshops on the venture capital market and broadly understood enterprise. The objective of these initiatives is to stimulate business interests in university students in Poland, to raise young people's awareness of the conditions of building businesses based on innovation and creativity. In 2018 the team of PGE Ventures conducted such workshop at the Warsaw University of Technology within the scope of the BEST Engineering Meeting and in the Warsaw School of Economics within the scope of the educational cycle entitled "Build a good startup with PGE Ventures".

In 2018 PGE Ventures signed a letter of intent with Collegium Mazovia Innovative School of Higher Education in Siedlce. Among other things, its subject matter is getting the company involved in providing active support for the second edition of the competition called "The second forum of the young – Enterprising Eastern Poland" addressed to secondary schools. The forum will be held in 2019. Its objective will be to popularize knowledge of business enterprise and to promote the idea of conducting one's own business activities among young people.

2. Description of the business activities of the PGE Capital Group.

The Capital Group of PGE Polska Grupa Energetyczna S.A. is the largest vertically integrated producer of electricity and heat in Poland. Thanks to the combination of its own raw materials base, electricity generation and distribution network, the PGE Group guarantees the security and reliability of power supply to more than 5 million households, businesses, and institutions.

The parent company of the PGE Capital Group is PGE S.A. In 2018 the PGE Capital Group's business activities were organized in five segments:

- **Conventional Generation**

The operation objective of the segment is the mining of lignite, the generation of electricity and heat in the Group's conventional power plants, as well as the transmission and distribution of heat.

- **Renewable Generation**

The operation objective of the segment is the generation of electricity from renewable sources and in pumped storage hydropower plants.

- **Trade**

The operation objective of the segment is trade in electricity all over the country, wholesale of electricity in the domestic and foreign markets, trade in emission allowances, property rights and fuels, as well as the provision of Corporate Centre services to the companies belonging to the PGE Group.

- **Distribution**

The operation objective of the segment is the provision of services related to the supply of electricity to end users by means of high-, medium-, and low-voltage networks and facilities.

■ Other Activities

The subsidiary companies provide the PGE Capital Group with such services as the acquisition of financing the form of Eurobonds, as well as IT, telecommunication, accounting, personnel and transport management services. Other Activities include also the operations of subsidiaries established for the purposes of preparing and developing the nuclear power plant construction project, managing investment funds, and investing in startups.

3. Changes in the organisation of the Company and the Capital Group.

Mergers. On 26 February 2018 the Extraordinary General Meetings of the company ELTUR - SERWIS sp. z o.o. (the acquiring company) and the company TOP SERWIS sp. z o.o. (the company being acquired) adopted resolutions on the merger of the companies under Article 492 § 1 point 1 of the Commercial Companies Code (merger by acquisition) by transferring all assets of the company being acquired to the acquiring company in return for the share which the acquiring company granted to PGE S.A. as the sole shareholder in the company being acquired. The share capital of the acquiring company was increased by PLN 50,000, i.e. from the amount of PLN 34,824,500 to the amount of PLN 34,874,500. The merger of the companies was entered in the National Court Register on 12 April 2018.

The Extraordinary General Meetings of the companies PGE Energia Odnawialna S.A. (the acquiring company) and the company PGE Energia Natury PEW sp. z o.o. (the company being acquired), on 29 March 2018 and 27 March 2018 respectively, adopted resolutions on the merger of the companies under Article 492 § 1 point 1 of the Commercial Companies Code (merger by acquisition) by transferring all assets of the company being acquired to the acquiring company without issuing new shares in the acquiring companies in return for the shares in the company being acquired, pursuant to Article 516 of the Commercial Companies Code, and by dissolving the company being acquired without conducting a liquidation process. The company PGE Energia Odnawialna S.A. was the sole shareholder in the company PGE Energia Natury PEW sp. z o.o. The merger of the companies was entered in the National Court Register on 2 May 2018.

On 9 July 2018 the Extraordinary General Meeting of the company PGE Energia Ciepła S.A. (the acquiring company) and the Extraordinary General Meeting of the company Investment III B.V. with its registered office in Amsterdam, Netherlands (the company being acquired) adopted resolutions on the cross-border merger of the companies under Article 492 § 1 point 1 in connection with Article 516¹ of the Commercial Companies Code (merger by acquisition) by transferring all assets of the company being acquired to the acquiring company without issuing new shares in the acquiring companies in return for the shares in the company being acquired, pursuant to Article 515 in connection with Article 516 of the Commercial Companies Code, and by dissolving the company being acquired without conducting a liquidation process. The company PGE Energia Ciepła S.A. was the sole shareholder in the company Investment III B.V. The merger of the companies was entered in the National Court Register on 4 September 2018.

Division of companies. The Extraordinary General Meetings of the companies PGE GiEK and PGE EC adopted resolutions on the division of the company PGE GiEK (the company being divided) under the procedure provided for in Article 529 § 1 point 4 of the Commercial Companies Code by transferring

some of assets of the company PGE GiEK, i.e. 6 branches of the company PGE GiEK (Branches), i.e. (1) Bydgoszcz Cogeneration Plant Branch, (2) Gorzów Cogeneration Plant Branch, (3) Zgierz Cogeneration Plant Branch, (4) Lublin Wrotków Cogeneration Plant Branch, (5) Kielce Cogeneration Plant Branch and (6) Rzeszów Cogeneration Plant Branch, to the company PGE EC (the acquiring company). The Branches constitute organized parts of the enterprise related functionally to the generation of electricity as well as the cogeneration of electricity and heat, as well as the distribution of electricity and heat. The transfer of the Branches to the company PGE EC was carried out by lowering the share capital of PGE GiEK by the amount of PLN 406,847,180 and raising the share capital of PGE EC by the amount of PLN 763,432,450, by redeeming 40,684,718 shares in PGE GiEK with a par value of PLN 10.00 each and creating new 76,343,245 registered shares in PGE EC with a par value of PLN 10.00 each. As the sole shareholder in PGE GiEK, PGE S.A. acquired all new shares in the raised share capital of PGE EC in return for the redeemed shares in PGE GiEK. The division of the companies was entered in the National Court Register on 2 January 2019.

Liquidation of companies. On 4 December 2018 the Extraordinary General Meeting of the company Centralny System Wymiany Informacji sp. z o.o., in which the company PGE Dystrybucja S.A. holds 4 shares constituting 20% of its share capital, adopted a resolution on the dissolution of the company and the opening of its liquidation process.

4. The economic and financial position

The key financial results of PGE S.A.

Key financial data	Unit	Year ended 31 December 2018	Year ended 31 December 2017	Change %
Sales revenues	PLN million	11,450	9,185	25%
Earnings before interests and taxes (EBIT)	PLN million	549	541	1%
Earnings before interest, tax, depreciation and amortisation (EBITDA)	PLN million	562	557	1%
EBITDA margin	%	5%	6%	
Net profit/loss	PLN million	-203	4,544	-
Net profit/loss per share	PLN	-0.11	2.43	-
Net cash from operating activities	PLN million	558	801	-30%
Net cash from investing activities	PLN million	-2,563	-582	340%
Net cash from financing activities	PLN million	407	-318	-
Working capital	PLN million	-660	2,032	-
Shares and interests in subsidiaries	PLN million	32,024	32,568	-2%
Net debt/EBITDA	x	11.34	10.36	

Revenues from geographical areas

PGE S.A. achieves revenues mainly in the domestic market – over 99%.

Key EBITDA deviations in PGE S.A. (PLN million)

	EBITDA 2017	Sale of power	Revenues from ZHZW and ZDEE contracts	Sale of gas and PM	Result on other activities	Operating expenses	EBITDA 2018
Deviation		-196	346	-17	-97	-31	
EBITDA 2017	557	199	455	8	135	240	
EBITDA 2018		3	801	-9	38	271	562

The key factors influencing the results achieved by PGE S.A. on a year-to-year basis were as follows:

- The lower result on the sale of electricity is mainly the effect of giving up the margin added to the prices of electricity sold to the company PGE Obrót S.A. The remuneration for securing electricity supplies related to retail sales results from the separate agreement for securing electricity supplies ("ZDEE agreement" or "ZDEE") and is recognized in revenues under the the agreement for the commercial management of generation capacities ("ZHZW agreement" or "ZHZW") and ZDEE.
- The increase in revenues under ZHZW and ZDEE from the companies belonging to the PGE Capital Group results from the Company's entering into the following agreements: (i) as of January 2018, with the company PGE Obrót S.A., for the provision of the ZDEE service (ZDEE agreement), (ii) as of July 2018, with the company PGE Energia Ciepła S.A., for the provision of the ZHZW service on behalf of the company PGE Energia Ciepła S.A. (ZHZW agreement). Additionally, the increase in revenues results also from the higher value of electricity trade managed on behalf of PGE GiEK.
- The lower result on the sale of gas is mainly the consequence of the balancing of transactions with the companies PGE Obrót S.A. and Enesta sp. z o.o. by gas purchases in the spot market. Gas supplied to the companies PGE Obrót S.A. and Enesta sp. z o.o. in consequence of a failure to balance demand reported by customers was sold to those companies at a fixed price.
- The lower result on other activities was caused mainly by the fall in revenues from support/licence agreements.
- The increase in operating expenses results from higher personnel costs caused by an increase in employment (e.g. in July 2018 60 employees were transferred from PGE S.A. to PGE Energia Ciepła S.A.), higher expenses on sponsoring and advertising activities, as well as higher costs of IT services.

Table: Financing activities.

PLN million	Year ended 31 December 2018	Year ended 31 December 2017	change %
Financial revenues	638	4,594	-86%
Dividends from PGE CG companies	46	2,872	-98%
Interest	428	368	16%
Revaluation	161	63	156%
Reversal of write-downs	0	1,289	-
Other, including gains on disposal of investments, positive exchange differences	3	2	50%
Financial expenses	1,336	586	128%
Interest	329	327	1%
Revaluation	204	0	-
Write-down	799	253	216%
Other, including negative exchange differences and other	4	6	-33%
Result from operating activities	-698	4,008	-

The key factors influencing the financial results achieved by PGE S.A. on a year-to-year basis were as follows:

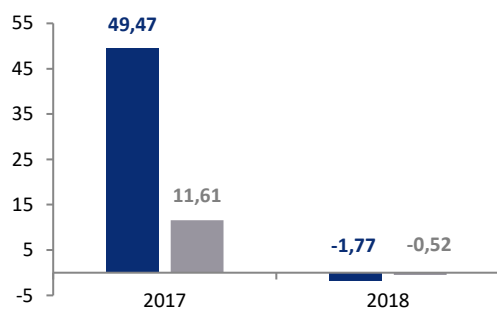
- Lower revenues from dividends result mainly from the absence of dividends from the companies PGE GiEK and PGE Dystrybucja S.A. in 2018.
- Higher revenues from interest result mainly from the higher level of interest on loans granted to the companies within the PGE Group and interest on bonds issued by those companies and held by PGE.
- In 2018 changes in the write-downs concerning the value of fixed financial assets comprise the creation of write-downs related to expected credit losses concerning shares in the companies PGE Obrót S.A. and PGE Sweden AB. In 2017 the company PGE S.A. recognized revenues from a partial decrease in the write-down on the value of shares in the company PGE Obrót S.A. as well as costs related to the following write-downs: the write-down on the value of shares in the company Exatel S.A., the partial write-down on the value of shares in the company PGE EJ 1, and the partial write-down on the value of bonds issued by the company Autostrada Wielkopolska S.A.
- Revenues and costs related to revaluations comprise the valuation of forward transactions related to trade in emission allowances, trade in financial instruments, and the valuation of options for the purchase of shares in the company Polimex-Mostostal S.A.

Net debt and basic financial ratios of PGE S.A.

Table: The Company's net debt as at 31 December 2018 and 31 December 2017.

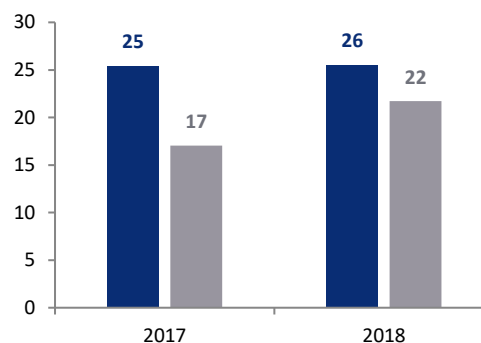
PLN million	As at 31 December 2018	As at 31 December 2017
Cash at bank and in hand	211	732
Overnight deposits	0	1
Short-term deposits	0	1,099
Funds in VAT accounts	24	0
Cash and cash equivalents	235	1,832
Held-to-maturity investments (short-term deposits)	0	0
Short-term loans and debt securities (GK PGE)	3,360	1,744
Loans and receivables – cash pooling	1,204	134
Cash and cash equivalents at Company's disposal	4,799	3,710
Short-term credits and loans	4,098	188
Issued short-term bonds	0	1,000
Short-term liabilities – cash pooling	1,446	576
Long-term credits and loans	5,628	7,714
Issued long-term bonds	0	0
Gross financial debt (short- and long-term)	11,172	9,478
Net financial debt	6,373	5,768

Figures: Basic financial ratios



■ Rentowność sprzedaży netto ROS [w %]
■ Rentowność kapitału własnego ROE [w %]

Return on sales [%]
Return on equity [%]



■ Szybkość obrotu należnościami [w dniach]
■ Szybkość obrotu zobowiązań [w dniach]

Receivables turnover [days]
Payables turnover [days]

The key operating results of PGE S.A.

Table: Trade in electricity (TWh).

Sales volume	2018	2017	change %
Electricity sales to PGE CG	44.92	38.59	16%
Electricity sales in the exchange market and bilateral transactions outside PGE CG	2.70	4.84	-44%
Sales within BG and BM	1.27	1.25	2%
Total electricity sales	48.89	44.68	9%

PGE S.A. fulfils the function of a competence-based wholesale trade centre for PGE CG. The increase in the volume of sold electricity on a year-to-year basis in 2018 is the effect of the increase in the trade volume, especially in transactions with the company PGE Obrót S.A. The objective of electricity sales to the company PGE Obrót S.A. is securing the demand of retail customers for electricity supplies.

Table: Natural gas sales volume [TWh]

Sales volume	2018	2017	change %
Sales of gas to PGE CG	2.99	3.21	-7%
Sales of gas outside PGE CG	2.68	4.31	-38%
Total sales of gas	5.67	7.52	-25%

The lower natural gas sales volume on a year-to-year basis is mainly the effect of the decrease in gas sales to entities outside the PGE Group and on the exchange. This is the result of the lower competitiveness of PGE's offer, which is the consequence of the fact that in the middle of 2017 the Stocks and Reserves Act had come into force. The Act requires that gas importers be obliged to maintain/purchase storage capacities, and in this sector the company PGNiG S.A. is the monopolist in the Polish market. If the costs of such services are taken into consideration, it turns out that PGE S.A. imports gas, mainly from Germany, whose price is not competitive. Consequently, such gas cannot be offered to large customers in the OTC market and the Company cannot be an active trader on the TGE exchange.

The sale of gas to GK PGE decreased to a considerable extent due to the lower demand for this fuel from the generation units operated by PGE GiEK. There was also a decrease in the volume of supplies to the company PGE Obrót S.A., which results mainly from lower sales to large customers in the professional segment and the effect of losing two customers with the history of considerable gas consumption, i.e. Grupa Żywiec and Nida Media, which were not replaced by any new customers with comparable gas consumption volumes.

5. The sponsoring policy.

PGE S.A. has implemented and follows its own Sponsoring Policy. It was adopted by the PGE Management Board in resolution no. 296/59/2015 of 30 September 2015, within the scope of the document entitled The Brand Strategy. Another document regulating sponsoring activities is The Principles of Conducting Sponsoring Activities within PGE CG adopted by the Management Board of PGE S.A. in resolution no. 18/03/2014 of 21 January 2014 and by the Supervisory Board of PGE S.A. in

resolution no. 160/IX/2014 of 29 January 2014. Additionally, on 28 November 2017 the Management Board adopted resolution no. 521/88/2017 concerning the General Procedure – The Principles of Conducting Sponsoring Activities within PGE Polska Grupa Energetyczna S.A. and the other companies belonging to the PGE Capital Group, while the Supervisory Board of PGE S.A. adopted this procedure in resolution no. 297/X/2017 of 13 December 2017.

The compliance of the followed sponsoring policy with The Principles of Conducting Sponsoring Activities in PGE Polska Grupa Energetyczna S.A. and the other companies belonging to the PGE Capital Group is evaluated every year on the basis of an examination of the effectiveness of sponsoring activities carried out by an independent external auditor. An evaluation of conducted activities is included in a yearly report submitted to the Management Board and the Supervisory Board of PGE S.A. The effect of a positive evaluation of the conducted sponsoring policy is annual resolutions of the Management Board of PGE S.A. accepting relevant reports as well as the acceptance of information on the results of inspections carried out by the Supervisory Board of PGE S.A.

The Supervisory Board considers the sponsoring policy of PGE S.A. as reasonable.

6. Charitable and social activities.

The PGE Capital Group is actively involved in various social activities. The main areas of the Company's involvement in social affairs were defined in "The General Management Procedure for Activities in the Area of Social Involvement in the PGE Group" adopted in 2014. PGE follows also "The Good Practices in the Areas of the Social Accountability of Business in Companies with State Treasury shareholdings" adopted by the State Treasury Ministry in 2016. An important document establishing standards for activities in the social area is the PGE CG Code of Ethics and its leading principle, i.e. "We care about relationships with local communities".

PGE is committed to long-term and well-planned social and business activities. PGE cares about the development of the areas where it conducts its business activities, improves local communities' quality of life, supports local events, and first of all provides stable employment. The local governments of the communes where the PGE Group conducts its business activities are its important partners in cooperation for the benefit of the local communities. In its operational area, the company PGE Dystrybucja S.A. organizes annual Energy Fora for city presidents, town mayors and commune leaders, where participants discuss the most important issues relating to cooperation between the company and local governments.

The pillars of the Company's social commitment are these two corporate foundations: the PGE foundation and the PGE Heat Energy Foundation.

The PGE Foundation has conducted its activities since 2011. Its task is to support the development of local communities and the implementation of original social programmes. The Foundation is active particularly in the following areas: social assistance, science and education, health care and medicine, national culture and heritage, as well as ecology and environmental protection.

In 2018 the PGE Foundation prepared a special project entitled "The Heroes of Our Future" and addressed to the participants of the Warsaw Uprising. Within the scope of the project, more than 500

Warsaw Insurgents received benefits which they could spend on medicines, health care, utility bills, or other expenses. The project was carried out by the PGE Foundation, which provided 100% of funds necessary for financing the benefits, in cooperation with the Cultura Memoriae Foundation, which was the project operator, and with the Bureau for Veterans and Repression Victims Affairs, the Association of Warsaw Insurgents, and the Worldwide Association of AK Soldiers, Warsaw Region.

The Foundation also continued the programme called “A Parcel for the Veteran” consisting in the provision of parcels to Warsaw Insurgents, soldiers of the Polish Underground State, and former prisoners of German concentration camps. Just like in the case of the project called “The Heroes of Our Future”, the sole sponsor for “A Parcel for the Veteran” was the PGE Foundation and its operator was the Cultura Memoriae Foundation. The project created opportunities not only for giving combatants Christmas presents but also meetings and discussion of representatives of different generations.

The PGE Foundation supported also the memory of the heroes of World War II by co-financing the organization of “The International Little Insurgent Cup Football Tournament” organized by the Foundation for the Development and Promotion of Youth Sport. It also continued cooperation with the Warsaw Uprising Museum, participating in the organization of the outdoor exhibition entitled “Let's Keep Them in Our Memory”.

Last year was also marked by the foundation's support for initiatives connected with the centenary of the regaining of independence by Poland. It financed various anniversary celebrations, concerts, monuments, and other forms of commemorating this historical event. One of the more interesting tasks was participation in the organization of the centenary of the acquisition of electoral rights by women in Poland, which was held in the Polish consulate in New York.

As part of the celebrations of the centenary of the regaining of independence by Poland, the PGE Foundation took part in the project aimed at obtaining the manuscript of “The Deluge” for the Museum of Henryk Sienkiewicz in Wola Okrzejska. It also provided financial support necessary for the performance of restoration works in the Oak Hall of the Cistercian Abbey in Henryków and the exhibition of a true copy of the Book of Henry, a historical document of paramount importance to the Polish heritage and European culture, entered in the UNESCO list called “Memory of the World” in 2015.

PGE supports also local communities through its employee volunteering programme called “We Help”. It is a response to the needs of local communities, mainly in the areas where the PGE Capital Group conducts its business activities. Such needs are identified the best by employees who are members of local communities themselves. It is PGE employees who, supported by the Company, prepare their own projects aimed at introducing important, permanent, and positive changes in their environment. Their projects are targeted at various groups of inhabitants, e.g. children, teenagers, people with disabilities, single mothers, and the poor. Programme participants develop also a Network of Regional Leaders. It is a place for further development of those volunteers who have already gained some experience, carrying out their own projects. At present there are 740 PGE volunteers. During the period of five years they carried out 220 projects all over the country, including 18 projects developed and completed by the employees of PGE S.A. Launched 16 years ago, “A Schoolbag Full of Energy” is another project targeted at families in need. In cooperation with local social assistance centres, first-year pupils from families in difficult social circumstances receive schoolbags full of necessary supplies. In 2018 the PGE Foundation together with the companies PGE GiEK and PGE EJ 1 distributed more than 619 “energy-filled schoolbags” containing the most important school supplies.

As a socially responsible corporation, PGE supports also education in the area of the safe and economical consumption of electricity. Pursuing this mission, the PGE Foundation prepared an extraordinary adventure for kindergarten and primary school pupils – a theatrical performance about the safe use of electricity entitled “How Click and Buzz Were Enlightened”. In 2018 the spectacle was shown in 262

educational institutions all over the country, and the necessary knowledge was received by over 23,000 children.

The PGE Heat Energy Foundation constitutes the other important pillar of social commitment of the PGE Group. In 2018 under the auspices and with the participation of the Deputy Prime Minister, Minister of Culture and National Heritage, the PGE Heat Energy Foundation in cooperation with the Institute of National Remembrance inaugurated the project entitled “The Tablets of Remembrance” aimed at revitalizing monuments connected with the 80th anniversary of the outbreak of World War II. The project is a trilateral social and education initiative with the following three basic objectives:

- to display and honour places of remembrance marked with tablets and monuments and describing heroic and dramatic events of World War II,
- to ensure that information on historical facts reaches foreign tourists,
- to popularize places of remembrance and to improve their recognizability.

For the centenary of the regaining of independence by Poland, the PGE Heat Energy Foundation in cooperation with the Katowice Film Studio and the Jagiellonian Club prepared a 60 seconds’ educational spot within the scope of the social campaign concerning the national flag.

In 2018, for the 22nd time, the PGE Heat Energy Foundation organized the All-Poland Artistic Song Festival in Rybnik addressed to talented artists sensitive to music. The foundation is also active in the domain of sport. Responding to the needs of people aged 55+, it organized the All-Poland Senior Citizens’ Olympic Games – YOU WIN. It was an event of a sports and recreational character dedicated to senior citizens who wanted to develop their physical activity. Such activity improves senior citizens’ quality of life by strengthening their social relations, physical and mental conditions. The meeting of 400 participants of the Games from seven cities had also a positive impact on intra-generational integration. Besides sports competition events, the foundation provided participants with the opportunity to take advantage of free medical examinations of eyesight or hearing as well as free services, including therapeutic massages and pearl baths, provided by the Therapeutic Rehabilitation Centre of the PGE Heat Energy Foundation.

The branches and companies belonging to PGE Energia Ciepła conduct support programmes for socially sensitive recipients. Their beneficiaries are non-governmental organizations, foundations and associations providing help to people in difficult social or financial circumstances as well as families in need identified by local social assistance centres. The value of support provided by the PGE Heat Energy Foundation through the projects and programmes targeted at socially sensitive persons amounted to more than PLN 400,000 in 2018 and more than PLN 3.5 million during the past 10 years.

The foundation is also carrying out the programme called “Let’s Share Heat” aimed at supporting non-governmental organizations providing assistance to people in need, e.g. the poor, people with disabilities or children requiring special care, by financing the purchase of heat and hot water from a district heating network. Applications for donations can be filed by organizations which have the status of a non-governmental organization, deal with providing assistance to people in need, and have access to a municipal district heating network. No arrears on payments for heat or hot water is a prerequisite for receiving support under this programme. In 2018 the PGE Heat Energy Foundation adopted a resolution to provide support to twenty-five non-governmental organizations.

Every year since 2008 the company Elektrociepłownia Zielona Góra S.A. has made donations for social assistance programmes targeted at Zielona Góra inhabitants in difficult social circumstances. The objective of the programme is to help such people to pay their heating bills. They need to meet the criteria provided for in the Social Assistance Act and consume heat energy supplied by the municipal heat distribution network. Every year PGE representatives and the President of Zielona Góra enter into an agreement under which a donation is transferred to the account of the City Office of Zielona Góra with the proviso that it has to be spent on tasks related to the programme. Only natural persons can be beneficiaries of the programme and their qualification is the responsibility of the Municipal Social Assistance Centre. During the period of ten years more than 1900 families took advantage of this opportunity.

In Pomerania, PGE Energia Ciepła and the heat distributor in Gdynia, the company OPEC Sp. z o.o. are involved in the campaign called "Forward This Heat". Its aim is to support the most interesting initiatives implemented by non-governmental organizations and social assistance entities in the TriCity area. In 2018 the leading topic of the campaign and submitted projects was "The inter-generation city in open social spaces". In an Internet ballot in which almost 20 000 votes were cast, cash awards were granted to three non-governmental organizations active in Gdańsk and Gdynia. The tenth jubilee edition of the programme was conducted under the following motto: "Social innovations made to human measure".

The company PGE EJ1, which at present is conducting location and environmental studies aimed at the selection of the final location for the construction of a nuclear power plant, has been involved in a continuous dialogue and cooperation with local communities since the time of indicating potential locations. One of the forms of cooperation in the area of corporate social responsibility is the Localization Communes Development Support Programme launched in 2015. Its objective is strengthening partner relationships with the location communities and authorities of the three localization communes of Gniewin, Choczew and Krokowa, as well as the districts of Puck and Wejherowo. The programme consists in financing and co-financing inhabitants' and local governments' initiatives in the area of educational and informational activities concerning nuclear power generation, actions related to the labour market, and support for vocational development (the districts of Wejherowo and Puck), cooperation in the execution of communal infrastructural projects, charitable initiatives, and sponsoring projects. The beneficiaries of the programme include local governments, inhabitants, organizations active in the area of the localization communes, and tourists visiting the region. Decisions on providing financing for projects are made by the consultative board consisting of the representatives of the local governments, the local communities, and the company PGE EJ 1. In the years 2015-2018 financial support for projects executed under the programme amounted to PLN 7.2 million.

The programme is a response to the needs and expectations of the local communities, which perceive it as an important initiative. It supports both large scale initiatives of the local governments such as the construction of roads, pavements, or village community halls and initiatives of small local farmers' wives' associations or day care centres. In conducted public opinion polls, the local communities described the PGE EJ 1 company as friendly, honest, reliable and supportive of the region. The programme is evaluated positively by the inhabitants – four out of five (79%) are of the opinion that it is important for the local community.

The company PGE Toruń S.A. helps local institutions and public benefit organizations providing assistance to children from poor families, the sick, the disabled, and those exposed to the risk of social exclusion. Thanks to support provided under programmes carried out by the company, it was possible to buy necessary equipment or to broaden the scope of the organization's activities, thus increasing the number of beneficiaries. The company cooperates with Alfa Sport Toruń on the organization of the Games of the Disabled, and also is involved in sponsoring climbing competitions organized by the Foundation for the Disabled "ARKADIA".

In 2018 the company PGE Energia Odnawialna S.A. for the seventh time sponsored the All-Poland Water Machines Tournament for junior and senior secondary schools from all over Poland. The participants were tasked with building a model of a machine transforming water's potential and kinetic energy into mechanical energy. The machines were evaluated in the two independent categories of "power" and "efficiency". The All-Poland Wind Machines Tournament had a similar character and formula. The year 2018 witnessed its seventh edition. The participants were tasked with building a model of a machine transforming wind's energy into mechanical energy. Individually or in groups of two or three, the participants were to design and make wind turbine blades with a diameter of up to 500 mm.

There are six Voluntary Blood Donor Clubs in the branches of PGE GiEK and PGE Energia Ciepła S.A. with a few hundred members. The members belonging to the clubs donate blood on a regular basis during the course of a year and get involved in assistance programmes targeted at local communities by, for example, visiting the youngest patients in hospitals and donating blood for particular health care institutions. In 2018 the company PGE GiEK was awarded the medal of the 60th Anniversary of Voluntary Blood Donation of the Polish Red Cross for outstanding merit in the effective support for the Voluntary Blood Donation movement.

In 2018 employees from all key companies of the PGE Group joined the all-Poland initiative of Polish power generation sector employees called "A Drop of Energy for the Independent". The campaign was launched by the Foundation "A Drop of Energy" managed by the company Energa, and was conducted under the patronage of the energy minister Krzysztof Tchórzewski and the health minister Professor Łukasz Szumowski.

Within the campaign, from 7 August to 11 November 2018 as many as 501 employees, 385 men and 116 women, of the companies belonging to the PGE Group donated blood in their local Voluntary Blood Donation clubs as well as regional blood donation stations located all over the country. Each donated "drop" means 450 ml of blood donated to regional blood banks.

In 2018, under the new Lumi PGE brand, the Company prepared a special offer called "Current from the Heart" and addressed to the inhabitants of Warsaw. Purchasing electricity, PGE customers can support a selected charitable organization (Rak'n'Roll, Caritas or ViVa).

The foundations declared concrete projects to be financed with funds received from Lumi PGE and its customers:

- Rak'n'Roll – psycho-oncological therapies,
- Caritas – assistance for children in hospices,
- Viva – thermal insulation of places where animals spend the night.

The Supervisory Board considers the charitable and social policy of PGE S.A. as reasonable.

7. The remuneration policy.

The PGE Capital Group is one of the five largest employers in Poland, ensuring stable employment for more than 41,000 people in more than 200 locations all over Poland. Thanks to their experience and commitment, it is possible to build an organization based on values, where social responsibility combines with business objectives. The PGE Group pursues the achievement of the ambitious goal of being the most efficient power generation group in Poland.

On 9 September 2016 the Act on the Principles of Determining Remuneration for People Managing Some Companies of 9 June 2016, the so-called new Chimney Act, entered into force. The new Act regulates, among other things, the manner of establishing the principles of determining remuneration for members of management boards and supervisory boards in companies where the State Treasury is a shareholder (e.g. PGE), and in particular specifies how remuneration is determined and granted to members of management boards and supervisory boards (the principles of determining remuneration for members of management boards and supervisory boards are adopted by a general meeting, while a supervisory board adopts resolutions on concrete conditions of remunerating members of a management board). The Act also specifies selected clauses of agreements for the provision of management services to be entered with members of management boards.

On 14 December 2016 the Extraordinary General Meeting convened upon a motion submitted by the Minister of Energy representing the State Treasury acting in the capacity of a shareholder adopted resolution no. 4 on the shaping of the principles of remuneration for members of the Management Board of PGE Polska Grupa Energetyczna S.A., which was amended subsequently by resolution no. 37 adopted by the Ordinary General Meeting held on 27 June 2017. According to this resolution, the remuneration of members of the Management Board consists of a fixed part constituting a monthly basic salary and a variable part constituting supplementary remuneration for a given financial year, depending on the achievement of managerial objectives. In accordance with the aforementioned resolutions adopted by the General Meetings, in 2017 the Supervisory Board adopted resolutions concerning the execution of agreements for the provision of management services with members of the Management Board, consistent with the principles specified in the new Chimney Act. In 2018 the Supervisory board established managerial objectives and indicators determining their achievement.

The remuneration package for the employees and directors of PGE S.A. consists of a permanent part (comprising a base salary), a variable part (comprising annual bonuses for directors, quarterly bonuses for other employees, annual awards depending on the achievement of the Company's objectives, and individual discretionary awards for outstanding achievements) as well as non-payroll benefits. Since 2014 PGE S.A. has used market payroll data to monitor the competitiveness of its remuneration packages. Annual bonuses for directors and quarterly bonuses for employees depend on a degree to which individual objectives have been achieved (management by objectives). Furthermore, PGE S.A. provides its employees with an extensive system of non-payroll benefits such as medical services, the employee pension plan, low-cost meals, electricity consumption compensation, partial or complete financing of professional training courses. PGE S.A. employees receive also benefits from the Corporate Social Benefits Fund.

8. Factors important for development.

According to the Supervisory Board, the factors listed below will influence the Company's and the Capital Group's financial results at least in the next quarter:

Market environment	
Demand	<ul style="list-style-type: none"> • The volume of demand for electricity and heat. • Seasonality and weather conditions.
Energy market	<ul style="list-style-type: none"> • The prices of electricity on the wholesale market. • The prices and tariffs on the retail electricity and heat market. • The heat transmission and distribution tariffs and electricity distribution tariffs.
Related markets	<ul style="list-style-type: none"> • The prices of property rights (energy origin certificates). • The availability and prices of fuels used in the generation of electricity and heat, in particular the prices of hard coal, natural gas and biomass, as well as fuel transport costs. • The prices of CO2 emission allowances.
Development of new technologies	<ul style="list-style-type: none"> • We observe the growing competitiveness of wind (including offshore) and photovoltaic technologies, which is confirmed by prices achieved in RES auctions. • In some countries – the visible and dynamic growth of new full-scale energy storage technologies providing, among others, regulatory services. • The systematic development of prosumer power generation and the dynamic growth in the number of micro-installations. • The development of electromobility.
Power generation and transmission infrastructure	<ul style="list-style-type: none"> • The availability of cross-border transmission capacities. • Increased power generation capacities in the national power system, including those based on renewable energy sources and cogeneration. • The development and modernisation of power grids.
Trends in electricity and fuel markets	<ul style="list-style-type: none"> • Hard coal in international markets in a slightly falling trend because of high stocks and the expected economic downturn. • The hard coal mining investment projects underway in Poland should result in an increase in the extraction of this fuel. • Simultaneously, it is expected that the commissioning of new high efficiency power generation units will be followed by a lower demand for this fuel for power generation purposes. • According to forecasts, Poland and the region will be witnessing a systematic increase in demand for natural gas in view of new investments in gas-fired power generation units and high efficiency cogeneration units, as well as a gradual change in the composition of the fuel mix in Germany. • The simultaneous development of natural gas delivery channels (the extension of the LNG terminal, the Baltic Pipe project, the infrastructural projects of LNG exporters).

Macroeconomic environment

- The Act of 28 December 2018 regulates electricity prices for end users.
 - Increasing trading capacities at transmission interconnections with Germany after the completion of grid-related investment projects.
 - Implementing the power market mechanism making it possible to ensure revenues for power generation units construction and modernization projects in view of limited possibilities of acquiring support for the existing coal-fired units as of 2025.
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- The symptoms of the economic downturn in the euro zone:
 - the European Commission's GDP forecast for 2019: 1.3%,
 - a deep fall in industrial production (-4.2% y/y),
 - PMI for industry: 50.5 points (in February 2019: 49.2 points).
 - The interest rates of the central banks in the majority of the developed economies are at very low or negative levels. In the event of recession, the lack of tools for further monetary stimulation can constitute a problem.
 - The risk of the introduction of barriers in international trade may translate into a lower growth in global GDP.
 - The real GDP growth in 2018 at the level of 5.1% (preliminary estimates of the Central Statistical Office).
 - The main growth factors were domestic demand and investments. The end of the year witnessed a slowdown in the growth of private consumption and net export.
 - Both the EC and NBP forecast a considerable fall in the growth of GDP:
 - 2019: 3.5-3.6%,
 - 2020: 3.2-3.4%.
 - Among numerous warning signals, special attention should be paid to the following:
 - the fall in the PMI index for industry below 50 points to 47.6 points in December 2018, which indicates a slowdown in the industrial sector. Simultaneously, it is the lowest level of the PMI index since 2013,
 - the slowdown in GDP growth in the euro zone,
 - the expected lower growth in public investments and EU funds absorption.
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Domestic regulatory environment

- The Act on the promotion of electricity from high efficiency cogeneration. It will ensure stable revenues (for up to 15 years) covering the costs of the extensive modernization and construction of new cogeneration units.
 - The amendment to the Act on renewable energy sources. With respect to biomass – revoking the requirement concerning the share of so-called local biomass, which increases freedom in the purchase of this fuel. Easier access to support sources for low-power wind farms and PV systems (the elimination of administrative restrictions).
 - The amendment to the Act on renewable energy sources with respect to changes in the obligatory amounts of the redemption of energy origin certificates. In 2017 the energy origin certificate redemption obligation covered 15.4% of the volume of sold electricity, and in 2018 it rose to 17.5%.
 - The amendment to the Act on the water law. The elimination of the previous doubts concerning interpretations related to the payment of fees for water services.
 - The Act on electromobility and alternative fuels. The Act aims to shape the electromobility market (charging services) and determines the rules for the development and operation of the infrastructure allowing the use of alternative fuels in transport, including technical requirements to be met by such infrastructure.
 - The amendment to the Act on the energy law. The amendment to the Act on the energy law includes a number of changes, e.g.:
 - Introducing comprehensive regulations applicable to energy storage.
 - Introducing an obligation to install remote reading energy meters and establishing a measurement information operator.
 - The amendment to the Act on the energy law – a power exchange obligation. Introducing a 100% power exchange obligation and maintaining the earlier exclusions from this obligation (e.g. energy from RES or cogeneration). The regulation of reserve sales.
 - The Act on the establishment of maximum energy prices in 2019. The Act influences the operations of energy trading companies because of the obligation to establish electricity sale and distribution prices in 2019 at the level of the 2018 prices and to amend already executed agreements.
 - The regulation of the Minister of Energy changing the regulation concerning the detailed rules of shaping and calculating tariffs
-

and settlements in electricity trading. The changes may concern the following:

- The mechanism of including differences in revenues factually achieved in the previous years in the so-called regulatory account in the tariffs of power system operators in relation to revenues resulting from the tariffs approved for these years.
- The use of the qualitative regulation mechanisms in the tariff process of power system operators.
- The calculation of discounts for failure to meet electricity quality parameters and customer service quality standards.

Foreign regulatory environment

- The EU ETS Directive, as well as implementing and delegated acts. The improvement of the competitiveness of renewable and gaseous energy sources at the expense of power generation units fired with hard coal and subsequently with lignite. An increase in the operating costs of conventional power generation. As of 2012 possible direct support for investment projects from the Modernization Fund and the Innovation Fund.
 - The RED II Directive. Promoting the development of renewable energy sources in the power generation, heat generation and transport sectors with a view to achieving a 32% share of RES in the consumption of energy in the EU as a whole in 2030.
 - The Governance Regulation. Introducing a framework for pursuing EU energy and climate goals by establishing a system of establishing and monitoring goals by Member States.
 - The EED Directive. Promoting improvement in energy efficiency with respect to both primary energy and final energy with a view to achieving a 32.5% improvement in energy efficiency in the EU as a whole in 2030.
 - The EMR Regulation. Developing a legal framework for the further integration of the internal electricity market. The EMD Directive. The main goals of the EMD Directive revision:
 - Strengthening the consumer's position in the electricity market.
 - Protecting energy-poor and sensitive consumers.
 - Ensuring decarbonisation, particularly by promoting and developing electromobility.
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9. Risks and threats to PGE S.A. and the PGE Capital Group.

As the Corporate Centre responsible for the management of the Group, PGE S.A. creates and implements solutions in the area of integrated risk management architecture in the PGE Capital Group. In particular, it develops risk management policies, procedures, standards and practices, prepares and develops internal IT tools supporting the process, determines global appetite for risk and relevant limits, and monitors their levels.

Similarly to other entities in the power generation sector, the companies belonging to the PGE Capital Group are exposed to risks and threat resulting from the specific character of their business activities and the functioning in the particular market and regulatory environment.

The most important risks and threats to which the Company and the PGE Capital Group are exposed include the following:

- **market and product risks related to the prices and volumes of the products and services offered by the Group, in particular:**
 - The market prices of electricity and related products,
 - Electricity sales and distribution volumes,
 - Tariffs (regulated prices),
 - The purchase of fuels and raw materials,
- **property risks related to the development and maintenance of fixed assets, in particular:**
 - Breakdowns,
 - Damage to assets,
 - Development and capital expenditures,
- **operational risks related to the course of the current economic processes, in particular:**
 - Generation of electricity and heat,
 - Fuels management,
 - Human resources
 - Social dialogues,
 - IT and technological systems,
 - Ethics,
- **regulatory and legal risks related to the fulfilment of requirements imposed by both external and internal legal environments, in particular:**
 - Legal changes in the support systems,
 - Environmental protection,
 - Concessions,
 - Discriminatory actions,
 - Taxes,
 - Information security and personal data protection,
 - Occupational health and safety,
- **financial risks related to financial management, in particular:**
 - Contractor credit risks,
 - Liquidity risks,
 - Interest rate risks,
 - Currency risks.

10. Evaluation of the internal control, risk management and compliance systems as well as the internal audit function.

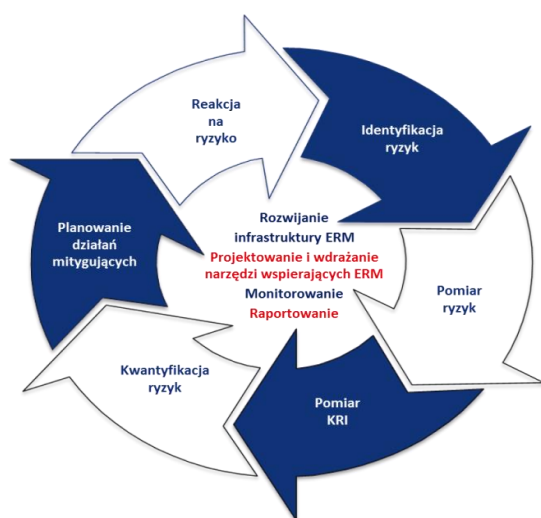
10.1. The internal control and risk management systems.

PGE S.A. operates an internal control system as well as a corporate risk management system. These systems comprise all solutions developed and implemented by the Company's management and employees with a view to achieving a reasonable assurance that the Company's business objectives are being achieved. It is the Management Board that is responsible for the establishment of these systems as well as their development, functioning and respective strategies.

The key elements of the Company's internal control system and risk management systems include the following:

- 1) the Company's internal processes, both automatic and manual control mechanisms (mitigating actions) limiting the level of risks related to the achievement of business objectives,
- 2) the Group's corporate risk management process allowing the Company the orderly and comprehensive - on the basis of the approach common for the whole Group - identification, measurement, monitoring and current management of financial and non-financial risks occurring during the course of business operations. The objective of these activities is to maintain risks accompanying the activities of the PGE Group and exerting considerable influence on its value at an appropriate level with respect to determined business objectives by limiting negative consequences of such threats or taking pre-emptive or corrective measures.

In the PGE Capital Group, risk management is based on the GRC (Governance – Risk – Compliance) model. It makes it possible to adjust and integrate the process at all management levels in the particular operating areas. The establishment of the Risk Committee reporting directly to the Management Board ensures the supervision over the effectiveness of the risk management processes in the Group. The definition of functions within the corporate risk management system allows an independent evaluation of particular risks, their impact on the PGE Capital Group as well as the limitation of control of significant risks specific for the use of the concept of capital exposed to risk by means of dedicated instruments. Isolating a separate compliance function within the PGE Groups guarantees that its business activities are consistent with the applicable legal regulations and ensures that the adopted internal standards are also complied with.



The PGE Capital Group consistently develops its comprehensive corporate risk management system. Risk is assessed and analysed in the key companies belonging to the Group. Ultimately, the system will cover all companies in the PGE Capital Group. The mechanisms of identifying areas exposed to risks and manners of measuring their intensity are subject to continual verification and improvement; thanks to this, significant risks concerning the particular operating segments are maintained within the

predetermined limits by reducing the negative consequences of such risks and taking pre-emptive or corrective measures, in accordance with the presented cycle.

Reakcja na ryzyko	Reaction to risk
Identyfikacja ryzyk	Risk identification
Pomiar ryzyk	Risk measurement
Pomiar KRI	KRI measurement
Kwantyfikacja ryzyk	Risk quantification
Planowanie działań mitygujących	Mitigating actions planning
Rozwijanie infrastruktury ERM	ERM infrastructure development
Projektowanie i wdrażanie narzędzi wspierających ERM	ERM support tools development and implementation
Monitorowanie	Monitoring
Raportowanie	Reporting

Risk mitigating activities are presented below.

Market and product risks.

Activities:

- The use of the uniform process organization principles within the context of commercial strategies and medium-term planning (the strategy of securing the key exposures in the area of electricity and related products trading corresponding to appetite for risk in a mid-term perspective).
- Determining a position security level on the basis of the results of measuring the electricity and related products price risk based on “at risk” measures. Target security levels are determined with respect to the Group's financial position, in particular taking into consideration the objectives resulting from the adopted strategy.
- Examining, monitoring and analysing the markets of electricity and related products in pursuit of the optimal utilisation of the PGE Group's generation and trading potential.
- Acquiring new customers – diversification of the channels of reaching end customers and target groups by maintaining a comprehensive product portfolio and adjusting offers to the market.
- Maintaining the present customers – a diversified portfolio of loyalizing offers as well as activities of an acquisitive character and special offers dedicated to customers lost to competitors.

- Paying special attention to the high quality of customer service by building employees' competencies and shaping relationships in the areas of both corporate and individual customers.
- Using tools supporting customer relations processes and allowing better planning and organization of sales processes.

Property risks.**Activities:**

- Pursuing actively the strategy of developing and modernizing the Company's own generation capacities and adjusting them to the increasingly demanding environmental requirements.
- Carrying out current and planned repairs in accordance with the highest sectoral standards – the power plants operated by the PGE Group are characterized by the lowest failure rate in the country.
- Diversifying the current structure of production sources with respect to power generation technologies.
- In case of breakdowns or damage to property, the Company takes out insurance covering its most important generation assets.
- Assets are insured on the basis of insurance cost analysis, the available capacities of insurance markets with respect to particular risks or particular types of assets, costs related to possible assets replacement, and potentially lost revenues.
- The Company systematically improves the reliability of energy supply to end users by modernizing its distribution network.

Operational risks.**Activities:**

- Optimizing costs, for example, by monitoring the prices and reserves of fuels as well as securing their supplies by means of long-term contracts with suppliers and pricing formulas.
- Securing the sales margin by purchasing the missing emission allowances.
- Optimizing the lifetime of equipment and the availability of key assets.
- Overhauls, repairs and modernizations of assets.
- PGE's active participation in traineeship programmes and cooperation with educational centres in order to ensure the inflow of qualified employees.
- Assessing and training the personnel with a view to their optimal deployment in the Group's structure.
- Conducting intensive and effective dialogues with social partners in order to prevent the escalation of any disputes and to develop the most advantageous

solutions in the area of employment and related costs within the PGE Capital Group.

Regulatory and legal risks.

Activities:

- The monitoring of implemented and proposed legal changes ensures that the activities conducted in the basic business segments are compliant with the applicable regulations and that the PGE Capital Group can use solutions which take into consideration possible changes in the legal environment.
- The active participation of PGE S.A. in the activities of the Polish Electricity Associations, which has its own office in Brussels. Through its activities, the Company influences actively the proceeding and shaping of EU regulations, and also participates in dialogues with EU institutions.
- Adjusting internal regulations and business practices so that the conducted activities are consistent with the sector regulations and the applicable legal regulations.
- Improving the Group's activities relating to the protection and improvement of the natural environment by implementing technological and organizational solutions ensuring the effective and efficient management of this area.

Financial risks.

Activities:

- Before a transaction is entered into, the Company conducts an assessment of the business partner, determines the partner's rating and credit limit, which are regularly updated and monitored. Exposures exceeding the determined limits are secured in accordance with the PGE Capital Group's credit risk management policy.
- The Group uses a central financing model according to which, as a matter of principle, external financing is acquired by PGE S.A. The Group's subsidiaries take advantage of various sources of intra-group financing, and the risk of losing liquidity is monitored by means of the tools of periodic planning related to the conducted operating, investing and financing activities.
- With respect to the currency risk and interest rate risk, the PGE Capital Group has adopted internal principles of managing these risks. The companies belonging to the PGE Capital Group enter into derivative transactions related to instruments based on an interest rate and/or currency (IRS, CCIRS) exclusively for the purpose of securing identified exposures to the risks.

The PGE Group does not focus exclusively on risks related to its ongoing activities. The processes of identification, assessment and analysis are also applied to risks with potential impact on the functioning of the Group in a longer time horizon. The highest management level evaluates their influence on the achievement of the Group's objectives, its image and operational continuity. These activities allow the PGE Capital Group to prepare for new challenges and secure its long-term development.

While threats to the ongoing activities influence the Group's functioning and financial results, risks of a strategic character may determine success in implementing a particular strategy or the future of the whole organization. Their identification is of key importance for ensuring the stability of the PGE Group.

Some of the identified strategic risks are presented below.

- Cyber security
- Powers of nature
- Law
- Environmental restrictions
- Sector development vision
- Human resources
- Employee and customer security
- Competition
- Technological revolution
- Macroeconomy and geopolitics

Internal control and risk management mechanisms.

In particular, the following internal control and risk management mechanisms are used in the process of drawing up the Company's financial statements: internal procedures regulating the process, the mechanisms of managing IT systems used in financial information recording and reporting as well as their protective mechanisms, the principles of supervision over the preparation of financial statements, the principles of the verification and evaluation of financial statements, internal audits and corporate risk management as well as other elements of control.

The accounting policy of the PGE Capital Group consistent with the International Financial Reporting Standards ("IFRS") as approved by the European Union is obligatory for all PGE companies following the IFRSs in drawing up their statutory financial statements and reporting packages for consolidation purposes. Before every reporting period the companies subject to consolidation receive from PGE S.A. detailed guidelines concerning the methods and deadlines for closing their account books, drawing up and submitting reporting packages, as well as a specimen package updated for a particular period.

The Company keeps its account books in the integrated IT system. The system ensures the division of competences, the consistence of postings in the books, and control between the general ledger and subsidiary ledgers. There exists a possibility of modifying the functionality of the system in order to ensure the suitability of technical solutions for the changing accounting rules and legal regulations.

The preparation of standalone and consolidated financial statements is the responsibility of the Director of the Reporting and Taxes Department. The preparation of reporting packages subject to consolidation is the responsibility of the management of particular companies.

An independent evaluation of the reliability and correctness of the financial statements prepared by PGE and the companies subject to the process of consolidation is carried out by certified auditors.

The PGE Capital Group operates a multi-stage process of approving financial statements, including also the participation of the Supervisory Boards. It is the Supervisory Board that evaluates the separate and consolidated financial statements of PGE. One of the permanent committees of the Supervisory Board is the Audit Committee. Its duties include, among others, monitoring the independence of the certified auditor, monitoring the effectiveness of the internal control systems, and reviewing periodic and annual financial statements of the Company. The standalone financial statements of the companies subject to the process of consolidation are evaluated by their respective Supervisory Boards. The financial statements are approved by General Meetings.

The Supervisory Board evaluates positively the functioning of the internal control system and the risk management system in PGE S.A. in 2018.

10.2. Internal audit.

As a company listed on the regulated market managed by the Warsaw Stock Exchange, PGE S.A. follows the WSE's recommendations included in the 2016 edition of the document entitled "The Good Practices of Companies Listed on the Warsaw Stock Exchange" concerning the maintenance of an effective internal audit function corresponding to the Company's size as well as the type and scale of the conducted business activities. In PGE S.A. and in the PGE Capital Group, the internal audit function is fulfilled by the Group's own structures established and developed in accordance with the international standards of the internal audit professional practice promoted by the international auditors' organization – the Institute of Internal Auditors (IIA). The audit structures comprise all important companies belonging to the PGE Capital Group, with the leading role comprising the conduct of audits in the PGE Group as well as coordination and supervision over the activities of the audit structures in the PGE CG companies played by the PGE Audit Department ("AD").

In PGE S.A., internal audit functions on the basis of the formally adopted Internal Audit Regulations, which define internal audit as "independent and objective activities whose objective is to increase the value of the PGE Capital Group and improve its operating activities. It consists in a systematic and orderly evaluation of the processes of risk management, the mechanisms of internal control, and organizational governance, which contributes to the improvement of their functioning. It helps the organization to achieve its objectives, providing information on the effectiveness of such processes as well as consultancy services." Internal audit covers all organizational units and operational areas of the PGE Capital Group with the exception of the protection of classified information, which is regulated by the Classified Information Protection Act of 9 February 2018 (consolidated text: Journal of Laws of 2018, item 412, as amended). Audit results are presented to the Management Board and the Audit Committee.

Audit Regulations

The Internal Audit Regulations in the PGE S.A. Capital Group determine the rules of conducting internal audits in PGE and the companies belonging to the PGE Group, the ethical standards applicable to internal auditors as well as the rules of conduct related to the coordination of inspections and audits conducted in the PGE Group by external entities.

In March 2018 the Regulations were modified in connection with the extension of their application from the companies constituting the Business Lines of the PGE Capital Group to all companies belonging to the PGE Capital Group – in particular to the company PGE Energia Ciepła S.A. and its subsidiaries as well as the subsidiaries of PGE S.A. supervised operationally by PGE GiEK. Some of the provisions of the

Regulations were also changed based on the experiences resulting from the performance of audit tasks in 2017.

On the basis of the Regulations, the Audit Department supervises and coordinates the substantive side of the activities of all internal audit cells and independent positions in the PGE CG companies. In 2018, besides PGE S.A., the internal audit structures functioned in 18 companies.

Audit plan

Internal audit activities in the PGE Capital Group are of a planned character. The activities of the Audit Department are based on an annual audit plan which is approved at the level of the Management Board. The plan is built on the basis of audit needs identified and reported by the Supervisory Board, members of the Management Board and directors of the PGE S.A. organizational units, as well as other audit needs occurring in the PGE CG companies.

The audit plan addresses the issues of audit tasks to be carried out in whole by the audit teams of the Audit Department and tasks to be performed jointly with the auditors of the PGE CG companies (under the supervision of an Audit Department coordinator) – such tasks constitute opportunities for providing comprehensive information on an examined area at a level of the PGE Group (from many companies).

The audit plan for 2018 included 12 planned audits concerning such operating areas of PGE S.A. and the PGE Group as investments, purchasing processes, environmental protection, inventory management, GDPR.

Ad hoc measures

Irrespective of the execution of an audit plan, the Audit Department may apply ad hoc audit measures initiated at the request of a member of the PGE Management Board supervising the Audit Department. Furthermore, the Audit Department may conduct explanatory procedures for the purpose of preliminary verification of information on possible irregularities – the result of such a procedure is the ascertainment that there are or there are not reasons for initiating an ad hoc audit measure.

Monitoring of recommendations

The implementation of recommendations from audit tasks is the responsibility of the management of relevant organizational units in PGE or the PGE CG companies. Pursuant to the Internal Audit Regulations, the Audit Department monitors the process of implementing given recommendations.

Audits in 2018

In total, during the course of 2018 the Audit Department carried out 39 audits, including 12 audits from the 2018 audit plan, 6 audits planned in previous years, and 21 ad hoc audits.

Increasing resources of the Audit Department

The recruitment of new auditors was carried out together with the Human Capital Management Department. The procedure was addressed to both PGE CG employees and candidates from outside the Group. As a result of the conducted recruitment procedure, seven candidates were selected and employed successively in the period from June to September 2018.

As at 1 January 2018 the Audit Department employed 17 people. This number rose to 24 employees by 31 December 2018.

The Audit Academy

In order to develop PGE CG auditors' knowledge and skills, the Audit Department organized another cycle of professional workshops called the Audit Academy (the first edition of this training took place in 2017). Planned for the years 2018-2019, the present edition offers its participants a choice of such training topics as preparation for the acquisition of a CIA certificate, detection of irregularities, GDPR, elements of financial audits, operation of selected SAP modules, the public procurement law and PGE CG purchasing regulations, soft training (time or stress management, team work, communication skills).

More than 70 PGE CG auditors expressed interest in participating in particular workshops offered by the Audit Academy (including 23 employees from the Audit Department).

Coordination and monitoring of external inspections

Since 30 January 2017 the Audit Department is obliged to maintain an entrepreneur inspection register. In 2018 the Audit Department coordinated 7 inspections conducted by the Supreme Chamber of Control, the National Bank of Poland, the Social Insurance Institution, the National Labour Inspection, and the National District Sanitary Inspector.

The Audit Department maintains a repository of knowledge of inspections carried out by external control authorities (in 2018 443 inspections were initiated in the PGE CG companies).

The Supervisory Board evaluates positively the performance of the internal audit function in PGE S.A. in 2018.

10.3. The compliance management system.

1. Compliance in the PGE Capital Group.

The PGE Capital Group includes employees and organizational units dedicated to the compliance system. IN PGE S.A. it is the Compliance Department Director reporting directly to the PGE Management Board and the Audit Committee of the PGE Supervisory Board. The particular PGE CG companies and branches have dedicated Compliance Coordinators (58 persons in the whole PGE Group); some of them are managers of larger organizational units. The personnel of the PGE CG companies includes trained coaches who conduct training events dedicated to the Ethical Code and anti-corruption policy.

Furthermore, some PGE CG companies have entered into agreements with an external company (selected under a purchasing procedure) – an expert in ethical standards – for the provision of the so-called "Impartial Advisor" service. An Impartial Advisor acts in the form of a hotline in the area of mobbing, discrimination, or harassment. Additionally, employees have the possibility to make an appointment with a lawyer or psychologist.

The PGE Capital Group adopted its Ethical Code in 2016 and since then it has been building its compliance system. The development of its particular elements requires, among other things, the performance of an ethical audit. In view of the fact that compliance solutions have been voluntarily implemented in the PGE for a short time, such an audit has not been carried out yet. The performance of the first ethical audit has been planned for the year 2020.

The compliance management system in the PGE Capital Group comprises solutions applicable to all employees of the PGE Capital Group, including its management personnel; it is to be implemented in all companies belonging to the PGE Capital Group.

The main objective of the compliance function in the PGE Capital Group is to support the implementation of the Strategy of the PGE Capital Group as the most effective and flexible power utility in Poland and to minimize non-compliance risks which could result in penalties, fines or tarnished reputation in consequence of non-compliance with regulations and standards sanctioned by the law or constituting the best practices in the sector.

In order to achieve successfully the aforementioned key objectives, the PGE Capital group:

- develops the organisational culture of the PGE Capital Group on the basis of the legal compliance principle, the ethical standards and the sustainable business principles which are reflected particularly in such internal regulations as the code of ethics, the code of conduct for business partners, and the anti-corruption policy;
- implements clear and transparent processes ensuring the possibility of identifying, clarifying and immediately eliminating any cases of non-compliance;
- conducts education activities and communicates issues related to compliance with the law and internal regulations as well as compliance and business integrity.

2. The organization of the compliance function in the PGE Capital Group.

The Supervisory Board of PGE S.A.

The Supervisory Board supervises and monitors the compliance management system within the PGE Capital Group, evaluates the effectiveness of the compliance system and function on the basis of, among other things, periodic reports. The tasks related to the ongoing supervision and monitoring of the compliance system will be the responsibility of the Audit Committee of the Supervisory Board.

The Management Board of PGE S.A.

Within the internal control system, the Management Board of PGE S.A. implements and maintains, besides the risk management function and the internal audit function within the internal control system, an effective compliance management system, implements adequate and effective solutions ensuring that the employees and executives of the PGE Capital Group will conduct business activities in an honest and ethical manner consistent with the legal and regulatory obligations and with the adopted internal regulations of the PGE Capital Group. The Management Board of PGE S.A. in particular manages the course of compliance management in PGE CG and ensures resources necessary for the effective execution of the process, provides the organizational unit competent for compliance affairs with necessary access to information and data indispensable for the execution of its tasks, determines the main directions in compliance management in PGE CG, provides the Supervisory Board (including its Audit Committee) with relevant information and reports concerning the functioning of the compliance management system in PGE CG.

Compliance Department in PGE S.A.

A PGE S.A. organizational unit performing the compliance function in PGE CG; the Compliance Department Director reports to a member of the Management Board.

The structure of compliance in the business lines and segments of the PGE Capital Group as well as the other companies belonging to the PGE Capital Group.

In the business lines and business segments, the compliance function is performed through appointed compliance coordinators.

3. The performance of the compliance programme in 2018.

The basic tool used to perform the compliance function in PGE CG is an annual compliance programme. In the period covered by this report of the Supervisory Board, the PGE Capital Group followed “The Compliance Programme for the year 2018” adopted by the PGE Management Board in resolution no. 206/29/2018 of 19 April 2018. The programme was completed in full; in particular, the following tasks were carried out in PGE CG:

The implementation of the Ethical Code in the PGE Capital Group comprises the continuation of a series of training events in this area.

PDC values – an element of the PGE CG organizational culture.

- A concept was developed for an assessment of employees’ competencies with respect to attitudes consistent with the values of the PGE Group.
- Employees were assessed in terms of interpretation and actions consistent with the PDC values. Additionally, the PDC values were included in the Group Strategy.

The implementation of the principles of the Ethical Code of PGE CG – prevention of corruption.

The Ethical Code of the PGE Capital Group was adopted in June 2016 in a resolution of the Management Board. In order to implement the rules of the Ethical Code the following actions were carried out in 2018:

- Implementing the regulations concerning the prevention of conflicts of interest and resulting from the PGE CG Anti-corruption Policy.
- Monitoring gift-related issues in the PGE CG companies.
- Providing consultancy on the application of the Anti-corruption Policy provisions.
- Checking the consistency of the internal regulations of the PGE S.A. Departments with the Anti-corruption Policy of the PGE Capital Group.

As at 31 December 2018 the compliance structures functioned in 23 PGE CG companies. Each of them was assessed with respect to the occurrence of cases of corruption.

In the corruption prevention area, the PGE CG companies are obliged to follow the provisions of the Ethical Code and the Anti-corruption Policy adopted by the PGE Management Board on 13 October 2017. The policy has been implemented in the decisive majority of the PGE CG companies. In the same period, the members of the management board of the PGE CG companies were trained in the application of the Anti-corruption Policy in the PGE Capital Group.

Provision concerning anti-corruption activities are included in the Ethical Code and the Code of Conduct for Business Partners. Both of them are available on the respective websites of each company belonging to the Group. The companies are obliged to ensure that all their employees are familiar with and trained with respect to their provisions. The companies confirm the performance of required training actions in reports submitted on a quarterly basis.

The implementation of the principles of the Ethical Code of PGE CG – prevention of irregularities.

- The Company developed a model of cooperation among the Departments of Security, Audit, Risk, and Compliance with respect to the monitoring and investigation of irregularities.
- The areas characterized by particular exposure to the risk of irregularities were identified.

- A cycle of training was started as a form of a preventive action.

The implementation of the principles of the Ethical Code of PGE CG – representation expenses and business trips in PGE CG.

In order to define precisely the rules, according to the principle that representation expenses and trips offered or provided to PGE CG employees by third parties in connection with conducted business activities should be unambiguously aimed at facilitating business talks, answers were provided to questions asked by employees having doubts in such matters. Answers were given to 23 questions altogether.

The implementation of the principles of the Ethical Code of PGE CG – prevention of irregularities in the area of competition and consumer protection.

- The Trading Area conducted an audit of solutions for REMIT and obtained a legal opinion for a model of cooperation with the company PGE Energia Ciepła S.A.
- The Area of Retail Sales and Distribution System Operator ensures comprehensive and ongoing monitoring of matters related to competition and consumer protection.

The implementation of the principles of the Ethical Code of PGE CG – the OHS Policy.

In order to develop and operationalize the principle that “The employees’ health and safety are a priority for us”, the Company undertook actions aimed at implementing this principle in business processes. The result was a draft procedure called “Managing occupational health and safety in the PGE Capital Group”.

Identification of legal acts and internal regulations

PGE S.A. undertook actions aimed at increasing transparency in the particular working areas exposed to risks as well as simplifying internal procedures. The Compliance Department reviewed and provided opinions on DSZ documents (substantive opinions were given on 76 DSZ regulations).

The identification of legal acts and internal regulations in the Compliance areas in 20 PGE CG companies was updated.

Changes in the law, regulatory requirements, and applicable internal regulations in 2018 – the most important new regulations that entered into force in 2018:

- Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) and a package of legislative changes implementing the Regulation to the Polish law, including the Personal Data Protection Act;
- Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AML/CTF) and the Act on the prevention of money laundering and terrorist financing of 1 March 2018;
- The Regulation of the Minister of Finance of 29 March 2018 on current and periodical information to be released by issuers of securities and the conditions for recognizing as equivalent information required under the laws of a country which is not a Member State (Journal of Laws of 2018, item 757);
- Directive 2014/65/EU on markets in financial instruments (MiFID II);

- Directive (EU) 2016/943 of the European Parliament and of the Council 2016/943 of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure.

Internal regulations of PGE CG in the compliance areas and guidelines formulated in 2018:

- The Anti-corruption Policy of the PGE Capital Group PGE REGL 00100/B – an amendment
- In April 2018 an amendment was made to Enclosure 1 to the Anti-corruption Policy of the PGE Capital Group. Within the scope of the amendment, the Compliance Department in cooperation with other Departments of PGE S.A. formulated conditions for identifying acceptable, unacceptable and conditionally acceptable gifts.
- Furthermore, Enclosure 5, i.e. a declaration of the absence of a conflict of interest, was added to the Anti-corruption Policy of the PGE Capital Group.
- A Draft General Procedure for the Prevention of Money Laundering (AML) in PGE S.A. and GK PGE companies - a project created by the Compliance Department, at present at the stage of evaluation by the PGE S.A. Departments.
- According to recommendations, the document entitled “Recommending actions concerning the manner of conduct with respect to PGE CG employees being a party to proceedings concerning corruption or other criminal activities” was prepared. The document is at the last stage of analysis and after its completion it will be submitted to the PGE Management Board for the approval of its content and the determination of the manner of its implementation in the PGE Group.

Risk management in the compliance area

In 2018 the Company undertook actions aimed at improving the risk management process, and in particular:

- The content of the non-compliance risk sheets was modified.
- The corruption risk sheets and the irregularities risk sheets were separated.
- A catalogue of 12 risks of particular interest to the Compliance Department was established.
- In PGE S.A., the Compliance Department together with the Risk Department verify compliance risks in PGE CG companies. Such risks are identified in 24 PGE CG companies. The Risk Department coordinates the performance of tasks in this area in 6 Business Lines, and the Compliance Department in the remaining 18 PGE CG companies. Both departments recommended the preparation of a risk management policy in the PGE Capital Group.
- In order to determine the manner of conduct with respect to monitoring the risk of non-compliance in implementing new obligations resulting from the generally applicable law, such requirements, including those specified in the generally applicable law, were identified. The Company also carried out an information campaign in this respect, in the form of mailing addressed to the PGE CG companies.

Assessment of compliance in PGE CG companies

Compliance assessment is a regular review of activities with respect to their compliance with the applicable law and internal regulations carried out in the form of self-assessment by particular management boards. The Compliance Department provides support to the PGE CG companies in their performance of compliance assessment. Subsequently, the Compliance Department collects and

analyses assessment results and indicates areas requiring improvement in the area of non-compliance risk management.

In 2018 the compliance assessment procedure was carried out in 31 PGE CG companies.

Compliance programmes of PGE CG companies in 2018.

In 2018 the Compliance Department provided support in adopting and implementing compliance programmes to 24 PGE CG companies being direct subsidiaries of PGE S.A., 1 subsidiary of PGE GiEK (Epore sp. z o.o.), and 8 subsidiaries of PGE Energia Ciepła S.A., i.e. 33 companies altogether.

Anti-discrimination procedure in PGE CG

The Company prepared a draft anti-discrimination procedure for the PGE Capital Group, which was presented to the representatives of HR units in the PGE CG companies. At present the document is the subject of consultations with the Human Capital Management Department and subsequently will require opinions from the Legal Department and the social partners.

In PGE S.A., the Human Capital Management Department organized a cycle of training aimed at making PGE employees familiar with the issues of mobbing and harassment. The companies PGE GiEK, PGE Energia Ciepła S.A. and PGE Systemy S.A. also organized similar training events and additionally developed an e-learning programme dedicated to these issues.

Information security

The Company monitored and assessed the implementation of the GDPR Regulation in the PGE Capital Group. It also analysed the solutions used in the procedure of reporting violations of GDPR in the company PGE Obrót S.A. Within the scope of the GDPR programme, the Company developed a joint approach to introducing personal data protection systems in the PGE CG companies. The majority of the PGE CG companies appointed Personal Data Protection Supervisors or established relevant dedicated positions. The companies fulfil the information obligation on an ongoing basis. A few companies recorded cases of questions or incident notifications. None of the reported incidents required a notification to the Personal Data Protection Office.

Monitoring and testing plan

The Company checked the status of compliance with the applicable internal regulations concerning the following issues:

- Personal data protection with respect to employment relationships.
- A review of compliance with the rules applicable to the forms of employment and the building of a sense of belonging to the PGE Capital Group.
- A review of the implementation of the declaration on the DZKL Strategy: all employees are employed in compliance with the highest safe work environment organization standards and the basic form of employment is a contract of employment for an indefinite period of time.
- The application of the bonus granting regulations and management by objectives.
- A review of the application of the holiday approval rules as well as other actions in SAP HR.

Compliance Academy

- The adaptation of new employees – within the scope of adaptation workshops, coaches in the particular PGE CG companies made new employees familiar with the principles of the

Ethical Code of the PGE Capital Group. Within six months from the date of hiring, all employees participate in a workshop on the PDC values and the principles specified in the Ethical Code of the PGE CG. After the workshop employees sign declarations of compliance with the Ethical Code of the PGE Capital Group, which are kept in personnel files.

- The implementation of the Ethical Code in the PGE Capital Group comprises the continuation of a series of training events in this area.
- Within the scope of the adaptation programme called "Turn Power On", Compliance Department Director Ewa Gąsiorowska conducted a series of workshops whose participants became familiar with the principles included in the Ethical Code of the PGE Capital Group and the Anti-corruption Policy of the PGE Capital Group. Four meetings were held in 2018.
- As part of training for the newly appointed coordinators, the Compliance Department organized two workshops during which the participants became familiar with the tasks, functions, responsibilities and structure of the Compliance Department in the PGE Capital Group. The number of workshop participants exceeded 20 persons.
- The Company's obligation to conduct training in the prevention of money laundering results from the Act on the prevention of money laundering and terrorist financing. In connection with this obligation, the Company identified companies where the risk of the occurrence of such irregularities is the highest and started a series of related training from such companies. In 2018 three training events were held.

The PGE CG companies participated in communication activities aimed at promoting the PDC values and the principles of the Ethical Code of the PGE Capital Group as well as preventing corruption and protecting information. Some communication activities were characterized by the personal involvement of members of management boards in the promotion of the PDC values. Managers referred to the values during meetings with employees and media interviews.

The Supervisory Board evaluates positively the functioning of the compliance management system in PGE S.A. in 2018.

11. 11. An evaluation of the Company's fulfilment of its information obligations.

11.1. The information obligations concerning the application of the principles of corporate governance specified in the Regulations of the Warsaw Stock Exchange.

In 2018 PGE was bound by the corporate governance principles specified in the 2016 edition of "The Good Practices of Companies Listed on the Warsaw Stock Exchange" ("The Good Practices"). The Good Practices were adopted by the Board of the Warsaw Stock Exchange in resolution no. 26/1413/2015 of 13 October 2015. They came into force on 1 January 2016 and should be followed by PGE as of that date.

The Management Board accepted The Good Practices for application in its resolution no. 19/03/2016 of 19 January 2016. The Management Board exercises due diligence with respect to compliance with the principles of The Good Practices.

In 2018 the Company followed The Good Practices with the exception of the following 2 recommendations: IV.R.2, VI.R.1.

Recommendation IV.R.2 included in Chapter IV “The General Meeting and relations with shareholders” concerns an obligation to provide shareholders with a possibility to participate in a general meeting based on the use of means of electronic communication.

The PGE Management Board proposed twice that the shareholders amend the Company Statutes and the Regulations of the General Meeting, introducing provisions allowing the organisation of general meeting in a manner specified in The Good Practices. The shareholders did not approve the proposal at the Ordinary General Meeting held on 30 May 2012 and at the Extraordinary General Meeting held on 27 June 2013. The Management Board does not rule out the possibility of following the aforementioned principle in the future.

According to the Management Board, non-compliance with the aforementioned principle will have no impact on the reliability of the information policy and does not create any risk of limiting or hindering the shareholders’ participation in general meetings. The Company provides a real-time broadcast of the General Meeting.

Recommendation VI.R.1 included in Chapter VI “Remuneration” concerns the possession of a remuneration policy and principles of determining such a policy for the members of the company's bodies and key managers.

In 2018 the Company did not have a developed uniform remuneration policy and principles of determining such a policy. PGE and its subsidiaries are obliged to comply with the provisions of various Collective Labour Agreements which limit its freedom in the shaping of remuneration policies. At the end of June 2017 PGE implemented the uniform rules of remunerating members of the Management Boards and the Supervisory Boards of the companies belonging to the PGE Capital Group, pursuant to the principles specified in the Act on the Principles of Determining Remuneration for People Managing Some Companies of 9 June 2016. On 13 November 2017 the PGE Capital Group was joined by the company PGE Energia Ciepła S.A. and its subsidiaries, in which the principles of remunerating members of corporate governing bodies were adjusted to those applicable in the PGE Group during the course of 2018.

11.2. The information obligations concerning the application of the principles of corporate governance specified in the rules of providing current and periodic information by issuers of securities.

Applicable as at the date of publishing the PGE 2018 annual report, i.e. 12 March 2019, the Regulation of the Minister of Finance of 29 March 2018 on current and periodical information to be released by issuers of securities and the conditions for recognizing as equivalent information required under the laws of a country which is not a Member State (Journal of Laws of 2018, item 757) obliges issuers of securities to publish announcements about the application of the corporate governance principles in an annual report on an issuer's activities (§ 70 clause 6 point 5). In 2019, pursuant to the aforementioned Regulation, the Company made a relevant declaration in “The Management Board's report on the activities of the company PGE Polska Grupa Energetyczna S.A. and the PGE Capital Group for the year 2018 ended 31 December 2018” concerning the application of the corporate governance principles in the year 2018, which was published on 12 March 2019, including on the corporate website www.gkpge.pl pursuant to principle I.Z.1.12 of The Good Practices.

The aforementioned declaration includes information which fulfils the requirements of the aforementioned Regulation, including:

- Information on the collection of the corporate governance principles binding the Company in 2018,

- Information on refraining from the application of the corporate governance principles,
- Information on the diversity policy,
- A description of the basic features of the systems of internal control and risk management related to the process of drawing up standalone and consolidated financial statements,
- Information on the Company's shareholders holding significant blocks of shares,
- Information on the Company's shareholders having special controlling powers,
- A description of limitations in the exercise of voting rights related to existing shares,
- A description of limitations in the assignment of titles to securities issued by the Company,
- Information on the rules of amending the Company Statutes,
- A description of the manner of the functioning of the General Meeting and its basic powers as well as the shareholders' rights and their exercise,
- A description of the rules concerning the appointment and dismissal of managers as well as their powers,
- Information on the composition and activities of the Company's management and supervisory bodies as well as their committees,
- Additional information concerning the audit committee, including information on the fulfilment of the independence criteria, knowledge and skills of the members of the committee, the policy of selecting an audit firm,
- Information on remuneration of the members of the governing bodies of PGE S.A.,
- Information on shares and other securities.

The Supervisory Board evaluates positively the manner of the Company's fulfilment of its information obligations concerning the application of the corporate governance principles as specified in the Regulations of the Warsaw Stock Exchange and the rules of providing current and periodic information by issuers of securities.

Chairperson of the Supervisory Board
of the company PGE Polska Grupa Energetyczna S.A.

Anna Kowalik

Members of the Supervisory Board:

Janina Goss

Tomasz Hapunowicz

Grzegorz Kuczyński



Supervisory Board

PGE Polska Grupa Energetyczna S.A.

Mieczysław Sawaryn

Jerzy Sawicki

Artur Składanek

Radosław Winiarski