

**THE REPORT OF THE SUPERVISORY BOARD
OF PGE POLSKA GRUPA ENERGETYCZNA S.A.
ON THE EVALUATION OF THE COMPANY'S POSITION IN THE
YEAR 2010, INCLUDING AN EVALUATION OF THE COMPANY'S
INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM**

Since the first day of the Company shares' listing on the Warsaw Stock Exchange, i.e. since 6 November 2009, PGE Polska Grupa Energetyczna S.A. ("PGE S.A.", "PGE", "Company"), has been bound by the corporate governance principles specified in "The Good Practices of Companies Listed on the Warsaw Stock Exchange" adopted by a resolution of the Board of the Warsaw Stock Exchange in July 2007. At the stage of preparations for the Company's initial public offering the PGE Management Board adopted a resolution to follow the Good Practices.

Pursuant to chapter III item 1 sub-item 1) of the Good Practices, the PGE Supervisory Board submits a brief evaluation of the Company's position, including an evaluation of the internal control system and an evaluation of the risk management system. This evaluation has been prepared based on the documents submitted by the Management Board, discussions conducted with the members of the Management Board during the meetings of the Supervisory Board and discussions during the meetings of the permanent committees operating within the Supervisory Board, as well as the financial statements and the Management Board's report on the Company's activities.

I. AN EVALUATION OF THE COMPANY'S POSITION IN 2010

The Supervisory Board evaluates positively the position of **PGE Polska Grupa Energetyczna S.A. in 2010**. The Company continued the process of building and strengthening its value as the dominant entity in the Capital Group of PGE Polska Grupa Energetyczna S.A. (PGE CG", "PGE Group", "Group")

The most important events of 2010 comprised the following:

- the completion of the share conversion process and the merger of PGE with PGE Energia S.A. and PGE Górnictwo i Energetyka S.A.,
- the completion of the merger of the companies undergoing consolidation by the acquisition of their assets by the particular consolidating companies (with the exception of PGE Elektrownia Opole S.A. in the area of Conventional Power Generation),
- the merger of PGE with PGE Electra S.A. completed on 31 December 2010,
- the adoption of a new business model in PGE CG taking into consideration: (i) the requirements of article 49a of the Energy Law introducing an obligation to sell electricity on a power exchange and (ii) changes in the structure of PGE CG after consolidation,
- a continuation of work in the areas of nuclear power generation, including the creation of organisational, legal and administrative conditions for the construction of nuclear power plants in Poland,
- a continuation of work within the scope of "A Concept of Managing Non-core Assets within PGE CG",

In comparison to 2009, the Company recorded:

- a 10% increase in the balance sheet total to PLN 32,003 million,
- a 6% increase in equity to PLN 28,520 million,
- a 110% increase in net profit to PLN 2,920 million.

More information on the Company's activities in 2010 is presented below.

1. Basic information on PGE Polska Grupa Energetyczna S.A.

1.1. Changes in the organisation and management of PGE S.A. and the PGE Capital Group

1.1.1. Changes in the organisation and management of PGE S.A.

During the period ended 31 December 2010 PGE S.A. did not stop any of its significant activities.

As a result of the implementation of the Consolidation Programme, PGE S.A. was merged with PGE Górnictwo i Energetyka S.A. and PGE Energia S.A. In consequence of the merger, the companies being acquired (PGE Górnictwo i Energetyka S.A. and PGE Energia S.A.) were dissolved without conducting any liquidation proceedings. In consequence of the merger, the equity of PGE S.A. was increased by the amount of PLN 1,396,937,270.

Additionally, on 16 February 2010 the Management Board adopted a decision concerning a merger of PGE S.A. with its subsidiary PGE Electra S.A. On 20 October 2010 the Management Board approved the PGE Electra S.A. Merger Plan, and on 8 December 2010 the Extraordinary General Meeting of PGE S.A. and the Extraordinary General Meeting of PGE Electra S.A. adopted resolutions concerning the merger of PGE Polska Grupa Energetyczna S.A. with PGE-Electra S.A. The merger was registered on 31 December 2010. The merger was carried under a procedure stipulated in article 492 § 1 item 1 and article 515 § 1 of the Commercial Companies Code, i.e. by way of transferring all assets of the Company Being Acquired to PGE S.A. (merger by acquisition), without any increase in PGE's share capital. As at the time of the merger registration, all the competences of PGE Electra S.A. were taken over by PGE S.A., which fulfils the role of the Corporate Centre of the PGE Capital Group.

1.1.2. Changes in the organisation and management of the Capital Group

In 2010 two strategic projects were executed in the PGE Capital Group: the PGE Consolidation Programme and a project entitled "A Concept of Managing Non-core Assets within the PGE Capital Group". Additionally, the Group continued work in the area of nuclear power generation.

The Consolidation Programme

In 2010 the PGE Capital Group implemented its Consolidation Programme whose objective was the adjustment of the Group's ownership and management structure to the activities conducted in its major business lines and the achievement of a situation where in each business line there is just one company holding all assets and conducting all operations within a particular area of the Group's activities.

As a result of the Consolidation Programme in 2010 there was a formal and legal merger of the entities in the following business areas: (i) conventional power generation (previously: mining and generation); (ii) renewable power generation; (iii) electricity distribution; (iv) electricity retail sales.

Within the scope of the Consolidation Programme, on 3 and 16 August 2010 the extraordinary general meeting of the companies belonging to the PGE Capital Group adopted relevant resolutions concerning mergers (merger resolutions). With respect to these resolutions, a small number of shareholders put forward motions to ascertain their invalidity

and, consequently, to declare them null and void. Additionally, the plaintiffs motioned for the security of their claims by the suspension of the implementation of the merger resolutions and the suspension of the registration procedure.

The said actions concern the merger resolution of PGE Elektrownia Opole S.A. and the merger resolutions of some companies consolidated within the business line of mining and conventional power generation (the cases managed by PGE Górnictwo i Energetyka Konwencjonalna S.A.) as well as the merger resolution adopted by the shareholders of PGE Górnictwo i Energetyka S.A. (the case managed by PGE S.A.).

With respect to the said actions, PGE S.A. and the other sued companies prepared their statements of defence and are actively participating in the conducted proceedings in which they question all allegations presented by the shareholders. In the opinion of PGE S.A. and the other sued companies, the shareholders' allegations are fictitious, and their objective is to question the share exchange parity, which is inadmissible under the resolution appeal procedure.

In one of the actions filed by a shareholder in the fund Secus Investement Sp. z o.o., on 21 January 2011 the Regional Court in Łódź, the 10th Economic Division, gave a verdict in which the plaintiff's action was dismissed.

Furthermore, registrations procedures resulting from the appeal against a decision to register the merger within the business line of conventional power generation.

After the District Court examines the case again, it may again issue a decision to register the merger or issue a decision preventing the merger and providing for the deletion of the existing entry. As at the date of this report it is not possible to identify the probability of particular scenarios or the time when the matters will be settled eventually. Therefore, the Consolidated Financial Statements of PGE CG does not include the consequences of a possible change in the decision of the District Court concerning the registration of the merger of the companies.

PGE Górnictwo i Energetyka Konwencjonalna S.A. took necessary steps to have the complaints formulated by the minority shareholders dismissed. Legal expert opinions acquired by PGE Górnictwo i Energetyka Konwencjonalna S.A. indicate unequivocally that the consolidation process should not be realistically threatened by the actions initiated by the minority shareholders.

At this stage of the legal proceedings, it is not possible to unequivocally foresee decisions of the courts adjudicating in the above actions.

Work within the scope of the Consolidation Programme, including the building of an organisational structure and the identification of effectiveness and competitiveness improvement programmes are being continued.

A concept of managing non-core assets within the PGE Capital Group

In 2010 the PGE Capital Group continued activities in the area of "A Concept of Managing Non-core Assets within PGE CG" whose objective is a transparent separation of the Company's core business activity from other activities as well as a disposal and reorganisation of such non-core assets.

Within the scope of the project executed in the years 2009 - 2010, the Group sold shares in 22 companies, finalised the liquidation and bankruptcy procedures in 9 companies, and effected a redemption of shares in 1 company. Among the remaining assets, 4 holiday houses and 4 other assets were disposed of. Additionally, in 2010 the Group continued the process of disposing of shares of one company listed on the stock exchange (Bank Ochrony Środowiska S.A.).

After the balance sheet date, the Group sold shares in the company Agencja Rynku Energii S.A., which previously had been owned by PGE S.A., and a block of shares in one of the companies listed on the stock exchange (Bank Ochrony Środowiska S.A.).

In 2011 the Group will finalise the sale of subsequent blocks of shares in companies which are not related to the power sector; such blocks of shares constitute parts of particular portfolios of assets earmarked for disposal. The group will implement further stages in the reorganisation of the activities related to hotel, security, transport, and medical services. The processes of the liquidation and bankruptcy of companies not related to power generation will be finalised.

1.2 Share capital and ownership structure

On 31 August 2010 the District Court for the capital city of Warsaw registered the merger of PGE S.A. with its subsidiaries PGE Górnictwo i Energetyka S.A. and PGE Energia S.A. In consequence of the merger, the share capital of PGE S.A. was increased from PLN 17,300,900,000 to PLN 18,697,837,000, i.e. by the amount of PLN 1,396,937,000 by an issue of 139,693,727 shares, including 73,241,482 series C bearer shares, and 66,452,245 series D bearer shares with a par value of PLN 10.00 each.

Furthermore, on 8 October 2010 the State Treasury sold 186,978,000 PGE S.A. shares constituting 9.99% of the Company's share capital and giving the right to exercise 186,978,000 votes at the General Meeting, representing 9.99% of the total number of votes. After that transaction the State Treasury holds 1,295,640,538 shares representing 69.29% of the Company's share capital.

As at the date of this report, the share capital of PGE S.A. equals PLN 18,697,837,270 and is divided into 1,869,783,727 shares with a par value of PLN 10.00 each.

The existing shares making up the Company's share capital have been issued and fully paid up. There are no preferred shares; all shares have the same rights incorporated in them, and in particular, each share gives the right to one vote at the General Meeting. All existing shares have been established pursuant to the relevant provisions of the Commercial Code, Commercial Companies Code and Company Statutes.

2. Activities of the PGE Capital Group

2.1. A description of the activities of the Capital Group

PGE Polska Grupa Energetyczna S.A. the dominant entity in the Capital Group of PGE Polska Grupa Energetyczna S.A. The Group's business activities are currently organized in five segments:

- Conventional Power Generation (previously: Mining and Generation), which comprises the mining of lignite and generation of heat and electricity from conventional sources, as well as the transmission and distribution of heat,
- Renewable Power Generation, which comprises the generation of electricity from renewable sources and in pumped storage hydropower plants,
- Wholesale Trade in electricity and related products as well as fuels,
- Distribution of electricity,
- Retail sales of electricity.

The wholesale trade in electricity and related products is conducted directly in PGE S.A. It is the Company's core activity. Within the scope of the remaining activities, PGE S.A. provides so-called supporting services for the benefit of the companies belonging to the Capital Group, leases IT systems and rents office space.

Apart from the above five major business lines, the PGE Group conducts activities also in other areas, including telecommunication. The Group comprises also other companies

whose major business activities consists in providing auxiliary services to companies from the power and mining sectors. Such services comprise, among others:

- construction, repair and modernisation work as well as investment work related to power generation equipment,
- the performance of comprehensive diagnostic tests and measurements of power generation machines and equipment,
- the management of by-products of coal and lignite combustion, the development and implementation of technologies based on the utilisation of such products and the restoration of derelict industrial areas,
- medical and social welfare services.

2.2. Major domestic and foreign investments

In 2010 PGE had investments classified as investments in financial instruments at the level of PLN 30,065.8 million in comparison to PLN 27,480.5 million in 2009.

As the parent company of PGE CG, PGE S.A. performs the functions of ensuring that all companies in the Capital Group have sufficient funds to finance their investments and current operations. The instrument used by the Company for this purpose is bonds. The value of such bonds as at 31 December 2010 was PLN 4,937.5 million in comparison to PLN 2,452.5 million as at 31 December 2009.

Acquisition of shares in Energa S.A.

On 29 September 2010 the Management Board of PGE S.A. entered with the State Treasury ("Seller") represented by the Minister of the State Treasury into an agreement for the sale of shares in Energa S.A. with the registered office in Gdańsk. The subject of the agreement is the acquisition of 4,183,285,468 Energa S.A. shares, constituting 84.19% of the company's share capital for the price of PLN 7,529,913,000.

The completion of the transaction required PGE's obtaining a relevant acquisition permit from the President of the Office for Competition and Consumer Protection (condition precedent).

On 13 January 2011 the President of the Office for Competition and Consumer Protection issued a decision preventing PGE S.A. from the acquisition of Energa S.A. shares.

In connection with this, on 18 January 2011 PGE S.A. and the State Treasury signed an annex to the agreement of 29 September 2010 for the sale of shares in Energa S.A. Under this annex, the parties determined that the validity period of the agreement would be 12 months from the date of its execution; the State Treasury and PGE S.A. decided to suspend the flow of term of the validity of the agreement until the time of the legally binding completion of the court proceedings concerning an appeal against the decision of the President of the Office for Competition and Consumer Protection preventing the concentration of PGE S.A. and Energa S.A.

On 28 January 2011 the Regional Court in Warsaw the Court for Competition and Consumer Protection, through the President of the Office for Competition and Consumer Protection, received an appeal of PGE S.A. against the decision of the President of the Office for Competition and Consumer Protection preventing the concentration of PGE S.A. and Energa S.A. In its appeal, the Company motioned for a change of the decision in whole and for a content related judgement through issuing a decision allowing the concentration of PGE and Energa S.A., or a possible annulment of the decision.

2.3. Description of significant agreements

Below we present agreements which, in the opinion of PGE S.A., are agreements entered into within the ordinary scope of business activities and are of significant importance for the Company's activities.

2.3.1. Agreements with power generators within the PGE Group

In 2010 PGE S.A. started to purchase electricity for the year 2011 on the basis of commercial agreements entered into with the producers belonging to the PGE Capital Group. In connection with the amendment to the Energy Law of 9 August 2010, which in article 49a regulates the sale of electricity by enterprises dealing with its generation (the so-called "exchange obligation"), all previous agreements between PGE S.A. and such producers were terminated.

Simultaneously, with respect to electricity not covered by this obligation, an agreement was entered into with PGE Górnictwo i Energetyka Konwencjonalna S.A. This is an agreement for an indefinite period of time. Under this agreement, electricity is purchased on the basis of transaction arrangements.

2.3.2. Agreements for the delivery of coal

2010 was the second year of centralised purchases of power coal for the power plants and cogeneration plants belonging to PGE CG. In 2010 these plants were supplied with coal by PGE Electra S.A. on the basis of agreements entered into mainly with domestic producers of coal. Annual agreements for the purchase and resale of coal were concluded at the beginning of 2010. During the course of the year the volume of purchased coal was supplemented with spot agreements or relevant annexes to the purchase agreements. In December 2010 PGE S.A. signed an agreement with Kompania Węglowa S.A. for the delivery of coal in the years 2011-2013 with the estimated value of about PLN 3.9 billion. In consequence of the merger of PGE Electra S.A. with PGE Polska Grupa Energetyczna S.A., which was completed on 31 December 2010, by way of general succession, all coal purchase agreements were transferred to PGE Polska Grupa Energetyczna S.A.

2.3.3. PGE S.A. bond issue programme with the maximum value of PLN 10 billion

On 9 November 2010 PGE S.A. entered into two agreements providing for the establishment of a bond issue programme ("Programme"):

(i) the Bond Purchase Commitment Agreement ("Commitment Agreement") in which the Company's partners are Bank Polska Kasa Opieki S.A., Banca Infrastrutture Innovazione e Sviluppo S.p.A., Nordea Bank Polska S.A., ING Bank Śląski S.A. (in the capacity of the Lead Arrangers) as well as Bank Polska Kasa Opieki S.A., Banca Infrastrutture Innovazione e Sviluppo S.p.A., Nordea Bank AB, Nordea Bank Polska S.A. and ING Bank N.V. (in the capacity of the Programme Underwriters), and ING Bank Śląski S.A. (in the capacity of the Issue Agent);

(ii) the Bond Issue Programme Agreement, ("Programme Agreement") in which the Company's partners are ING Bank Śląski S.A. (in the capacity of the Agent, Issue Agent, Paying Agent and Depository) as well as Bank Polska Kasa Opieki S.A. and Nordea Bank Polska S.A. (in the capacity of the Agents, Paying Sub-Agents and Sub-Depositories).

The Programme's maximum amount comprising the maximum allowable nominal amount of bonds issued and unredeemed under the Programme is PLN 10 billion. The Programme was concluded for a period of 36 months as of the date of signing the agreements and will expire on 8 November 2013 at the latest.

Bonds are covered by an issue guarantee, i.e. the Programme Underwriters' obligation to purchase bonds issued by the Company under the Programme included in the Commitment Agreement. After additional underwriters (specified in the Commitment Agreement) have entered into the Commitment Agreement, the maximum aggregate underwriting amount may not exceed the Programme's maximum amount, i.e. PLN 10 billion. The Programme Underwriters are obliged to purchase bonds in the period from 15 November 2010 to 31 October 2013.

Bonds are to be issued under the procedure specified in article 9 paragraph 3 of the Bond Act (Journal of Laws of 2001, no. 120, item 1300, as amended) based on the Programme

Agreement and the Issue Terms as dematerialised bearer discount bonds (bearer zero-coupon bonds).

Within the scope of the Programme, the Company may issue zero-coupon bonds with a maturity period, principally, of 1, 3 or 6 months, but not more than 6 months. The maturity period of the last bond series may be specified differently (but it may not be shorter than 7 days and longer than 6 months) and determined in such manner that the redemption date of the last series of bonds not later than the date of the Programme's maturity.

Bonds issued under the Programme will be denominated in the Polish zloty (PLN), with a par value of one bond equal to PLN 100,000. As a matter of principle, the bonds will have a guaranteed profitability specified as a reference rate plus a guaranteed margin. The reference rate is WIBOR applicable to deposits for a term corresponding to a given bond maturity period (different profitability determination principles are applicable to bonds in the last issue and bonds issued for the purpose of the so-called rollover of the bonds from the previous issues). The bondholder will be entitled to monetary benefits only.

Bonds issued within the scope of the Programme will constitute the Company's unsubordinated and unsecured liability.

The Company may use funds acquired from the bond issue: (i) to finance the Company's current operations, (ii) to finance investment and capital expenditures planned for the duration of the Programme and related to the activities of the Company or the companies belonging to the PGE Capital Group, and (iii) to refinance the Company's financial debt.

As at 31 December 2010 PGE S.A. did not have any bonds issued under this Programme.

2.3.4. Agreement for the purchase of Energa S.A. shares

On 29 September 2010 the Management Board of PGE S.A. entered with the State Treasury ("Seller") represented by the Minister of the State Treasury into an agreement for the sale of shares in Energa S.A. with the registered office in Gdańsk. The finalisation of the transaction requires that the Court for Competition and Consumer Protection issue a positive decision concerning the appeal of PGE S.A. against the decision of the President of the Office for Competition and Consumer Protection preventing the concentration of PGE S.A. and Energa S.A. A detailed description of the agreement is included in chapter 2.2.

2.3.5. An agreement for the acquisition of shares in PGE Górnictwo i Energetyka Konwencjonalna S.A., PGE Obrót S.A. and PGE Dystrybucja S.A. from the State Treasury

On 28 December 2010 PGE Polska Grupa Energetyczna S.A. and the State Treasury ("Seller") entered into an agreement providing for PGE's acquisition of shares in the following companies: PGE Górnictwo i Energetyka Konwencjonalna S.A. with the registered office in Bełchatów, PGE Obrót S.A. with the registered office in Rzeszów, and PGE Dystrybucja S.A. with the registered office in Lublin. The subject of the agreement is the acquisition of 69,582,441 shares in PGE Górnictwo i Energetyka Konwencjonalna S.A., 686,389 shares in PGE Obrót S.A. and 14,299,180 shares in PGE Dystrybucja S.A. constituting respectively 10.69% of the share capital of PGE Górnictwo i Energetyka Konwencjonalna S.A., 13.87% of the share capital of PGE Obrót S.A., and 1.47% of the share capital of PGE Dystrybucja S.A., for the combined price of PLN 3,098,387,214.39.

The transaction was a continuation of the process of consolidation and structure simplification within the PGE Capital Group. The transaction concerned minority shareholdings in the key companies of the PGE Group acquired by the State Treasury in consequence of the share conversion process implementation as provided for in the Act on the principles of acquiring shares from the State Treasury within the framework of the consolidation process for companies in the power generation sector (Journal of Laws of 2007, no. 191, item 1367). 1367).

After the finalisation of the transaction PGE Polska Grupa Energetyczna S.A. holds:

- 91.03% of the share capital of PGE Górnictwo i Energetyka Konwencjonalna S.A. (7.88% of shares in this company is held by PGE Obrót S.A., and 0.02% shares in this company is held by PGE Energia Odnawialna S.A.),
- 99.31% of the share capital of PGE Obrót S.A.,
- 10.05% of the share capital of PGE Dystrybucja S.A. (89.91% of shares in this company is held by PGE Obrót S.A.).

2.3.6. Memorandum concerning nuclear power industry cooperation

In 2010 one of the major events related to the implementation of the "nuclear project" was the signing of two memoranda concerning cooperation within the scope of nuclear power generation with the American-Japanese concerns GE Hitachi Nuclear Energy Americas and Westinghouse Electric Company LLC. Together with a memorandum signed with the French company Electricite de France S.A. (EDF) in November 2009, PGE has signed three memoranda whose objective is the examination of the feasibility of the development of nuclear reactors in a given technology and the construction of the first nuclear reactor in Poland by the year 2020. Cooperation with each of these companies is based on the activities of working teams which are currently carrying out analyses in the areas of location criteria, a transmission grid, legal aspects, a project implementation schedule, permit acquisition deadlines as well as financial and market analyses.

2.4. Major achievements in research and development

Nuclear power generation

In 2010, PGE S.A. continued its work in the areas of nuclear power generation. PGE S.A. prepared an analysis of the best solutions (organizational, financial legal and corporate solutions) concerning the management and execution of nuclear power plant construction projects. Upon the order of PGE S.A., Agencja Rynku Energii S.A. prepared a study presenting a long-term forecast for a development of power sources. The study has taken into account, inter alia, the energy policy of Poland and European Union. Besides, potential possibilities for a development of the domestic power system in the years 2010-2050 have been examined - each of the presented variants shows a necessity for a development of nuclear power generation.

The works related to the selection of a location for the nuclear power plant. 6 locations have been selected from the list of possible locations received from the Government Commissioner for Nuclear Energy and proper analyses have been carried out. Further works will be based upon the conclusions from this report.

Cooperation memoranda have been signed with foreign partners (Electricite de la France SA, GE-Hitachi Nuclear EnergyAmericas LLC, Westinghouse Electric Company LLC). Within the cooperations with the potential suppliers, the reports concerning the development feasibility of the nuclear reactors, in such technologies as EPR, ABWR/ESBWR and AP1000 respectively, were prepared as well as the ones dealing with the construction feasibility of the first nuclear power unit in a given technology in Poland by the year 2020.

At the current stage of preparation it is necessary for the government to adopt by the first half of 2011 "the Programme for the Polish nuclear power generation". The key legal regulations need to be introduced and the final decisions about the location of the nuclear power plant need to be taken (by the end of 2013). It is also necessary to take the decision related to the selection of the technology supplier. It will also be necessary to develop a cooperation model, to select a partner for the nuclear power plant construction and to develop the financing rules for the project. Furthermore, it is needed to select a technical advisor experienced in the preparation and management of large investment projects in the field of nuclear power generation.

3. The economic and financial position

3.1. The financial results achieved by PGE S.A.

Profit and Loss Account

Table 1. The Profit and Loss Account has been prepared in accordance with the Polish Accounting Standards (in thousands PLN)	Period 1-12	Period 1-12	% change
	2010	2009	
Net revenue from sales of products, goods and materials	11,663,346.3	12,532,100.4	-6.9%
Cost of products, goods and materials sold	11,330,513.8	11,895,786.5	-4.8%
Gross sales result	332,832.5	636,313.9	-47.7%
% of income from total sales	2.9%	5.1%	
Selling expenses and General and administrative expenses	114,675.1	156,088.1	-26.5%
Profit on sales	218,157.4	480,225.9	-54.6%
Other operating revenue	12,747.5	13,882.3	-8.2%
Other operating expenses	15,914.6	56,005.0	-71.6%
EBIT	214,990.3	438,103.1	-50.9%
% of income from total sales	1.8%	3.5%	
Finance income	2,857,519.3	1,462,861.8	95.3%
Finance costs	62,052.6	211,430.0	-70.7%
Gross profit	3,010,457.1	1,689,534.9	78.2%
% of income from total sales	25.8%	13.5%	
Income tax expense	90,023.2	100,361.8	-10.3%
Other obligatory reductions of profit	10.4	198,142.1	-100.0%
Net profit	2,920,423.5	1,391,031.0	109.9%
% of income from total sales	25.0%	11.1%	
EBITDA	235,227.7	459,079.9	-48.8%
% of income from total sales	2.0%	3.7%	

PGE's net profit reached the level of PLN 2,920.4 million in the financial year ended 31 December 2010, which is a 109.9% increase over the results of the financial year ended 31 December 2009.

The Company's net profit margin (the ratio of net profit to total sales revenues) equalled 25.0%. An increase in the net profit was caused mainly by better result from the financial operations, in particular due to the increase in dividend payouts made by subsidiary companies by PLN 1,454.6 million.

In 2010 PGE's total sales revenues from products, goods and materials reached the level of PLN 11,663 million, which means a 7% decrease over those of 2009. The decrease of revenues from electricity trading by PLN 761.1 million was caused by a lower volume of traded electricity by 3.7 TWh and a lower price of electricity sold by 1.1 PLN/MWh. An average price of the electricity sold in 2010 was 188.8 PLN/MWh. Thus, it was nominally lower than the one in 2009 (189.9 PLN/MWh). However, during the first two months of 2009, the electricity price included an excise tax. After the elimination of the excise tax influence, the prices of the electricity sold by PGE SA in 2010 increased in comparison to the analogous values in 2009 by approx. 2 PLN /MWh.

Cost of sales in 2010 amounted to PLN 11,330.5 million, which constituted a 4.8% decrease over 2009. A decrease in cost of sales resulted from PGE's lower costs of purchasing electricity by PLN 457.6 million compared to 2009. At the higher electricity purchase price by 3.71 PLN/MWh in comparison with the previous year, the lower electricity purchase costs resulted from the lower by 3.7 TWh volume of purchased electricity. The higher prices of

electricity in 2010 were also influenced by higher generation costs resulting mainly from higher prices of raw materials and an increase in CO2 emission allowance prices.

In 2010 total selling expenses of PGE S.A. reached PLN 7.9 million, which was a decrease by PLN 53.8 million compared to the previous year. A reduction in selling expenses resulted mainly from the reduction of transmission capacity reservations at the connection between Poland and Sweden

In 2010 general and administrative expenses of PGE S.A. amounted to PLN 106.8 million and were by PLN 12.4 million higher than in the previous year. The growth of the general and administrative expenses was caused mainly by the growth of the Company's marketing and image activities costs (an increase in advertising and sponsoring costs by over PLN 5 million) and by incurring the costs related to the execution of the Consolidation Program (an increase in consulting services costs by approx. PLN 3 million net).

Within other operating costs in 2010 a provision for transmission costs was created in the amount of PLN 11.7 million PLN. Besides, in 2009 in connection with the carried out valuation there was increased a provision for litigation with foreign customers related to the performance of trade agreements by PLN 43.6 million, and in 2010 the provision was released in the amount of PLN 11.5 million.

The reduction in financial costs by PLN 149.4 million is caused mainly by lower costs related to the issued bonds (interests + issue related charges) by PLN 104.7 million and with an increase in 2009 of the deductions revaluating investment value resulting from the valuation adjustment of the bonds of Autostrada Wielkopolska S.A. by PLN 29.4 million.

The Company's asset position

As at 31 December 2010 and at 31 December 2009 the Company's fixed assets had the book value of PLN 32,002.9 million and PLN 29,060.8 million, respectively. A PLN 2,942.1 million increase in the value of fixed assets was caused by: (i) an increase in the value of long-term and short-term investments by PLN 2,586.0 million, including the stocks and the shares by PLN 3,256.9 million and the bonds issued by the companies from the Capital Group by PLN 2,485.1 million, which contributed to (ii) a decrease in cash and cash equivalents by PLN 3,001.8 million.

The increase of assets in the stocks and shares item was mainly related to the purchase from the State Treasury of the shares in such companies as PGE Górnictwo i Energetyka S.A., PGE Obrót S.A., PGE Dystrybucja S.A. of the value of PLN 3,098.4 million.

As at 31 December 2010 the Company held the bonds issued by PGE GiEK Oddział Elektrownia Bełchatów, PGE GiEK Oddział Elektrownie Turów, PGE GiEK Oddział Zespół Elektrowni Dolna Odra, PGE GiEK Oddział KWB Bełchatów, PGE GiEK Oddział ZEC Bydgoszcz. The companies from the Capital Group finance mainly their generation assets by issuing the bonds purchased by PGE S.A.

Statement of cash flows

As at 31 December 2010 the total sum of operating, investment and financing cash flows in PGE S.A. equalled PLN (-) 3,152.1 million.

The difference between the cash and cash equivalents presented in the balance sheet and the one presented in the cash flow statements is PLN (-) 9.0 million and it results mainly from foreign exchange differences from cash valuation (PLN -8.8m) and from the change in interest rates on deposits.

Net operating cash flows in 2010 equalled PLN 324.2 million as compared to PLN 468.8 million in 2009, which was a decrease of 31%. This was first of all the result of the Company's achieving a lower electricity trading result compared to the previous year. The decrease of the electricity trading result was caused by the following:

(i) an increase in unit prices of electricity purchase and by (ii) a decrease of the volume of sold electricity, which was explained in detail in the previous chapters.

In 2010 investment cash flows equalled PLN (-)3,547.2 million as compared to the positive ones of PLN 585.4 million in 2009. The decrease in net investment cash flows in 2010 by PLN 4,132.7 million resulted mainly from the expenditures for the purchases of shares and interests as well as bonds issued by the companies from the Capital Group.

In order to streamline its ownership structure in 2010 and 2009, PGE S.A. incurred expenditures for the purchase of shares and interests in the companies to the amounts of PLN 3,205.5 million and PLN 270.5 million respectively.

The difference between expenditures incurred by PGE S.A. for the purchase of bonds issued by the companies belonging to PGE CG and income from their buyback equalled PLN (-) 2,264.9 million in 2010 and PLN (-) 2.0 million in 2009.

Net cash flows from financial activities in 2010 were PLN 79.9 million as compared to PLN 2,174.8 million net cash flows from financial activities in 2009. The lower cash flows from financial activities in 2010 as compared to those in 2009 were conditioned mainly by cash flows from the issue of new PGE S.A. shares on the Warsaw Stock Exchange to the amount of PLN 5,917.5 million.

As a result of the bond issue programme, in 2010 PGE S.A. obtained net cash inflows of PLN 1,244.5 million, while in 2009 the Company incurred the expenditures equalled to PLN (-) 2,002.3.

In 2010 dividend payments and payments from profit to the State Treasury amounted PLN 1,333.6 million, while in 2009 PLN 1,162.4 million.

In 2010 there were net cash flows from credits in the current account of PLN 177.0 million, while in 2009 there was a repayment of credits in the current account in the amount of PLN (-) 437.8 million.

3.2. Financial ratios

Table 2. Financial ratios	Period 1-12 2010	Period 1-12 2009
Return on sales ROS (%)		
net financial result x 100% / net sales revenues	25.0%	11.1%
Return on equity ROE (%)		
net financial result x 100% / (equity - net financial result)	11.4%	5.4%
Debt ratio (w %)		
total debt x 100% / total liabilities	10.9%	7.3%
Current ratio		
current assets / current liabilities	2.9	3.3

3.3. Financial resources management and financial liquidity

After its successful debut on the stock exchange the Company had considerable financial surpluses. Besides, in 2010 PGE S.A. generated income from operations, from the dividends collected from its subsidiary companies, from bond issues as well as from short-term credits. The funds generated in such a way were spent by PGE S.A. on financing investment projects and refinancing credits in the companies from the Group by purchasing bonds issued by these companies. They were also used for streamlining its ownership structure and for 2009 dividend payouts to its shareholders.

Table 3. Indebtedness (in thousand PLN)	Period 1-12 2010	Period 1-12 2009	% change
Bank credits	229,805.2	52,783.0	335.4%
Debt securities	1,781,326.4	503,758.5	253.6%

Indebtedness	2,011,131.6	556,541.5	261.4%
Cash and cash equivalents	259,447.3	3,411,515.8	-92.4%

The results achieved by PGE S.A. and by the companies from the Group as well as the open credit limits ensure sufficient funds for financing the Company's current operations.

4. Important factors for the development of PGE S.A. and PGE Capital Group

According to the expectations, the factors listed below will exert an influence upon the resulted of the Company and the Group in the perspective of at least year 2011:

- the prices of electricity on the wholesale market;
- the prices of property rights resulting from renewable energy certificates;
- the availability and the prices of the fuels used for electricity and heat production, in particular the prices of hard coal, natural gas and heating oil;
- the availability and the prices of CO₂emission allowances;
- the availability of trans-boarder transmission capacities,
- amendments to the Energy Law and other acts concerning the introduction of an obligation to sell electricity by way of tenders or through power exchanges by generators belonging to vertically integrated groups and entitled to receive compensations under the LTC Act and the introduction of the support system for the power generated in highly efficient cogeneration in the units fired with methane released during the underground mining activities in operating, being liquidated or closed down hard coal mines or fired with gas obtained from biomass processing;
- a possible adverse outcome of legal disputes, tax disputes or other contingent liabilities; the most important of them are presented in the Note VI.37 of Supplementary information and explanations to the Financial Statements of PGE S.A.;
- the changes in the macroeconomic environment of PGE S.A., particularly in interest rates and currency exchange rates whose value influences the evaluation of assets and liabilities disclosed by the Group;
- the verdict of the Court of Competition and Consumer Protection on the appeal made by PGE S.A. related to the decision of the President of the Office of Competition and Consumer Protection (UOKiK) concerning the purchase of ENERGA S.A. shares;
- the speed of implemented changes resulting from the Consolidation Programme;
- the speed of the performance of works on "A Concept of Managing Non-core Assets within PGE CG",
- the building of PGE CG's target organisational model and strong corporate centre.

5. Risks and threats to PGE S.A. and the PGE Capital Group

The activities of PGE S.A. and main companies from the PGE Capital Group, for which PGE S.A. is the parent company, similarly to the activities of other entities operating in the power generation sector, are exposed to a number of risks and threats, both external ones related to the market, legal or regulatory environments and internal ones related to the conduct of business operations.

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

- the risk related to the macroeconomic situation in Poland and abroad,
- the risk of intensifying competition (the freedom of choosing an electricity provider),
- the risk of lower demand for electricity and heat,
- the political risk,
- the risk of changes in the law and other regulations concerning the Company's activities, as well as changes in their interpretation and application,
- the risk related to the requirement to hold a licence,
- the risk of an obligation to sell publicly electricity,
- the risk connected with a potential breach of anti-monopoly regulations,
- the risk related to the application of the provisions of the Excise Tax Act,
- the risk related to the CO2 emission reduction programme,
- the risk of limitations in the emission of substances other than CO2 and more stringent BAT standards,
- the risk of interruptions in the delivery of fuels to our power plants, cogeneration plants and heat plants,
- the risk related to the atmospheric factors,
- the risk related to the provision of financing services,
- the risk of lowering or withdrawing the PGE's rating,
- the risk related to the termination of long-term electricity sales contract,
- the risk of transfer prices,
- the risk related to court, arbitration and administrative proceedings,
- the risk of not achieving the expected synergies resulting from the consolidation of the PGE Capital Group.

II. AN EVALUATION OF THE INTERNAL CONTROL SYSTEM AND AN EVALUATION OF THE RISK MANAGEMENT SYSTEM

PGE operates an internal control system as well as a 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 and particular organisational units' 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 PGE's internal control and risk management systems include the following:

- a) the Company's internal processes, both automatic and manual control mechanisms limiting the level of risks related to the achievement of business objectives,
- b) the formalised risk management process allowing the Company the orderly and comprehensive - on the basis of the methodology common for the whole Group - identification, measurement and current management of financial and non-financial risks occurring during the course of business operations. Risk management is to provide information on threats to the achievement of business objectives and to limit the negative consequences of such threats; this should support the fulfilment of the strategic objectives, the current operations, the achievement of planned and adopted financial objectives as well as to ensure the conduct of activities in accordance with the law and the formal internal regulations. Risk management allows PGE to take preventive or corrective action in response to threats to the fulfilment of business objectives. Risk management is a central function which, nevertheless, covers the

whole Group and is supported by all companies belonging to the Group. PGE's central risk management team determines the methodology of risk management and is responsible for its implementation. The major objective of the team's activities is to generate up-to-date and reliable knowledge of threats to PGE CG's operation and to contribute to the limitation of such threats' potential consequences. In order to ensure the achievement of this objective, PGE, in cooperation with the companies belonging to PGE CG, is responsible in particular for the execution of the following tasks:

- the identification of risks and preparation of registers of risks for the particular business segments,
- the measurement and quantification of risks as well as the preparation of risk maps for the particular business segments,
- the development of risk management models for the particular business segments; risk analysis, including the determination of risk management strategies, methods and tools,
- the monitoring and reporting of risk management results.

The so-called risk owners (the companies belonging to the Group, PGE's organisational units) are responsible for current risk management, in accordance with the determined methodology.

- c) the internal audit whose objective is carry out an independent and objective evaluation of the internal control and risk management systems. PGE's internal audit functions on the basis of the internal audit regulations developed in accordance with the international standards of professional internal audit practices. Audits comprise planned and summary audit tasks both in the parent company and the Group's other companies. Audit plans are developed based on risk analyses. Audit results are reported to the PGE Management Board. Recommendations resulting from conducted audits are successively implemented by the responsible entities (the Group's companies, PGE's organisational units), and their implementation status is monitored periodically.
- d) the dedicated function of investigative control focusing on the identification of malfeasances and the conduct of evidence and protective proceedings in PGE and PGE CG; it develops also the systems monitoring the Group's activities with respect to the identification of potential cases of infringing on business security.
- e) the controlling function; in its scope, periodic managerial reports are evaluated with respect to the rationality of information included in them, in particular within the context of analysing deviations from the assumptions adopted in financial plans.

In particular, the following internal control and risk management tools 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. 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. Two firms have been selected to audit the 2010 financial statements prepared in the key companies of the PGE Capital Group. They will be responsible for the review of half-annual financial statements as well as the preliminary and major audit of the financial statements. PGE CG 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. The separate financial statements of the companies subject to the

process of consolidation are evaluated by their respective Supervisory Boards. The financial statements are approved by the General Meetings of the particular companies.

According to the Company Statutes, the Supervisory Board exercises permanent supervision over the Company's operations in all areas of activity.

Once a year the Supervisory Board adopts its own plan of work taking into consideration the necessity of the Board's becoming familiar with important materials describing the Company's financial position and providing information on possible risks.

The Supervisory Board supervises the Company's internal control system mainly through its Audit Committee. The major objective of the Audit Committee is providing the Supervisory Board with recommendations and opinions concerning matters belonging to its scope of operation, i.e. the examination of the correctness and effectiveness of conducting internal financial inspections in the Company and PGE CG and cooperation with the Company's auditors.

The Supervisory Board evaluates positively the internal control system as well as the risk management used in PGE Polska Grupa Energetyczna S.A. in the year 2010.

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

Marcin Zieliński

Vice Chairperson of the Supervisory Board

Mr Maciej Bałtowski

Members of the Supervisory Board:

Mr Jacek Barylski

Ms Małgorzata Dec

Mr Czesław Grzesiak

Mr Grzegorz Krystek

Mr Katarzyna Prus

Mr Zbigniew Szmuniowski

Mr Krzysztof Żuk