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Where are we? Energy market perspective

Key facts

Potential implications

Electricity price and the commodities market

- Electricity prices remain low, but they have growth potential
- **Current relation between fuel prices indicates permanent unprofitability of gas-fired power stations**
- **Adoption of backloading and 2030 proposals, including the EU ETS system reforms**

- Lignite and hard coal remain the most cost-competitive primary energy sources
- Companies with access to own fuel resources and optimisation abilities have the biggest value growth potential
- **Risk of CO₂ price levels in the long run**

Support for RES

- **Rationalisation of the RES support system**

- **Chances exclusively for the most cost-effective projects**

Wholesale market model

- Introduction of first **new mechanisms (ORM)**
- **Work is progressing on the target future electricity market's design**

- Increased remuneration for generation capacity availability
- **Improvement of profitability of conventional generation assets**

Challenges in the downstream area

- **Growth of competition leads to drop in margins and migration of retail customers**
- **Stronger stimuli for prosumers and industrial autoproducers**

- **Customer retention and control over margins as priority**
- **Participation in development of mechanisms rewarding grid reliability and effectiveness of operators**

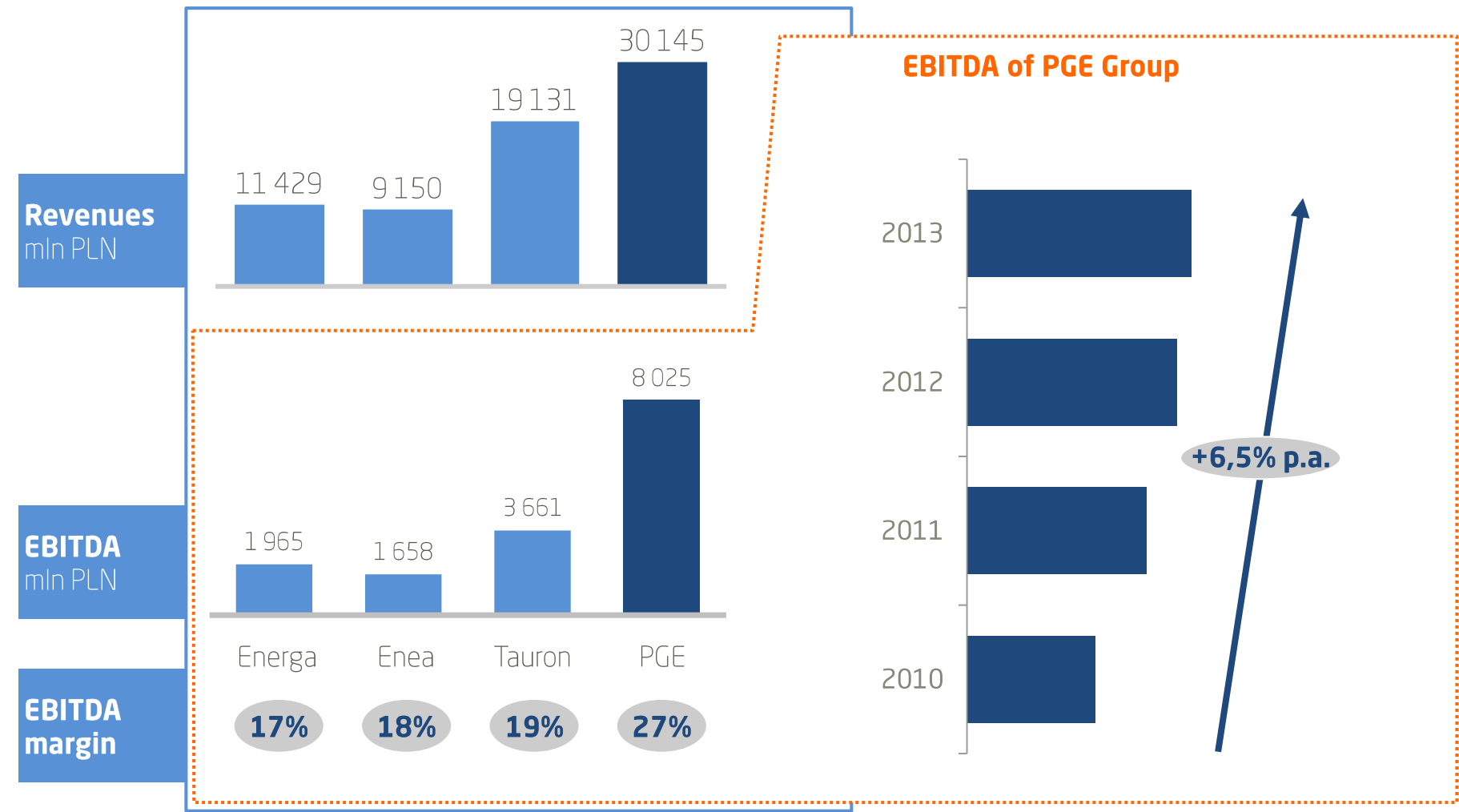
Replacement of generation assets

- Average age of generation assets in Poland is over **30 years**
- **Need for new investments**

- **Increased opportunities for new efficient generation sources**
- **Cost optimisation necessary**

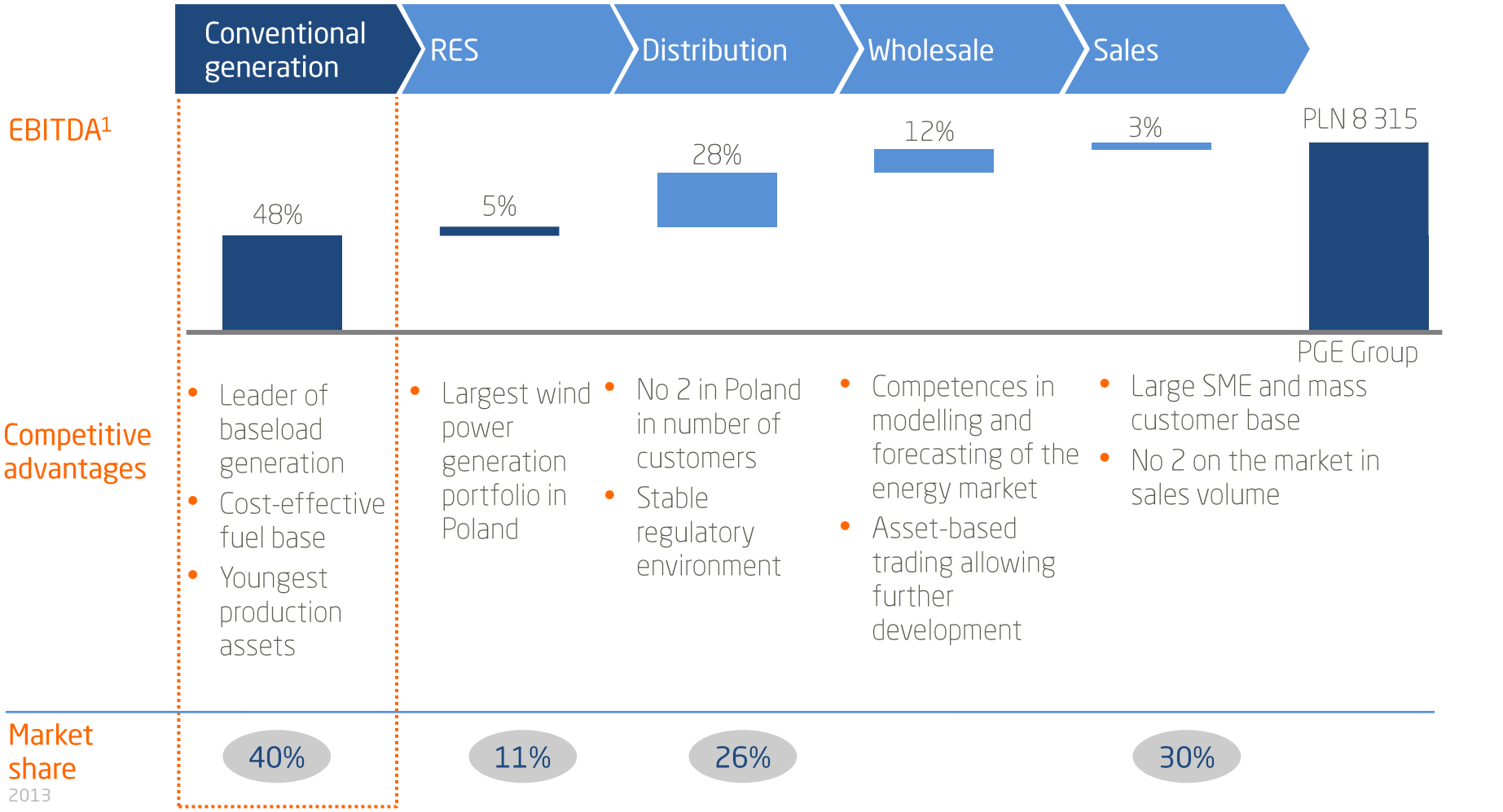
PGE is the largest and most profitable energy group in Poland

Millions PLN, 2013

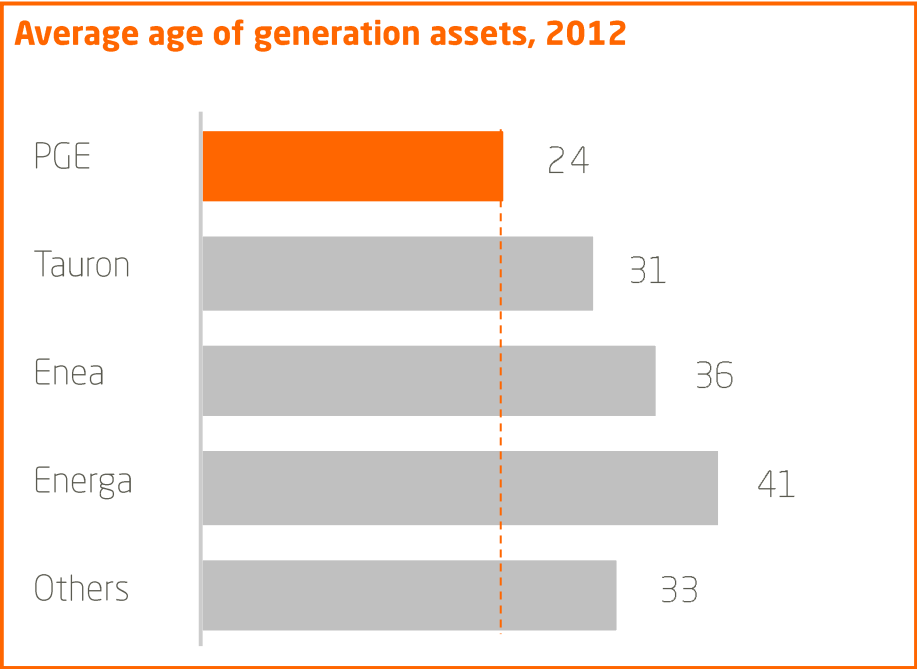
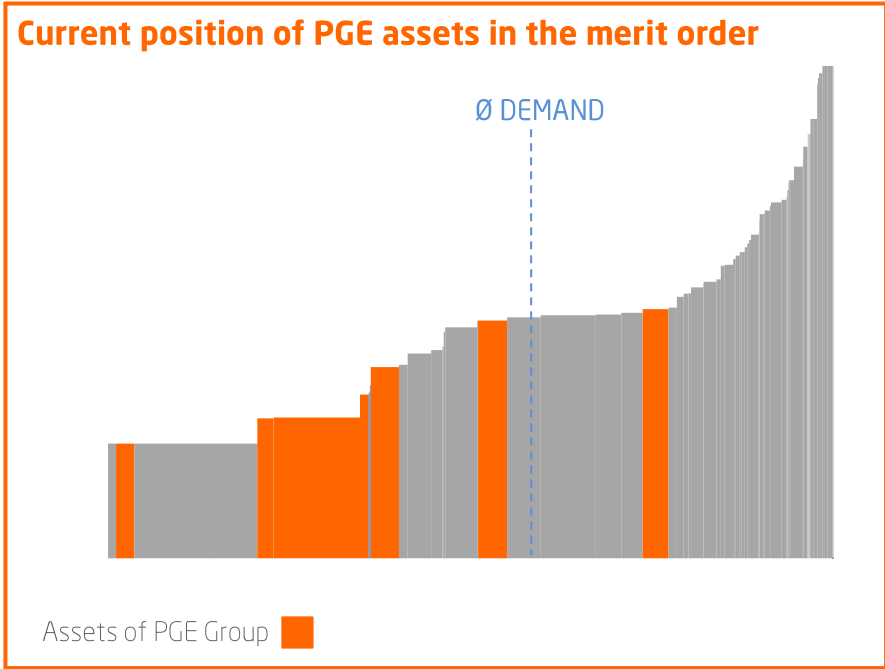


PGE has a strong position in all segments of the value chain, whereas nearly 50% of EBITDA is generated in the area of conventional generation

Millions PLN, 2013

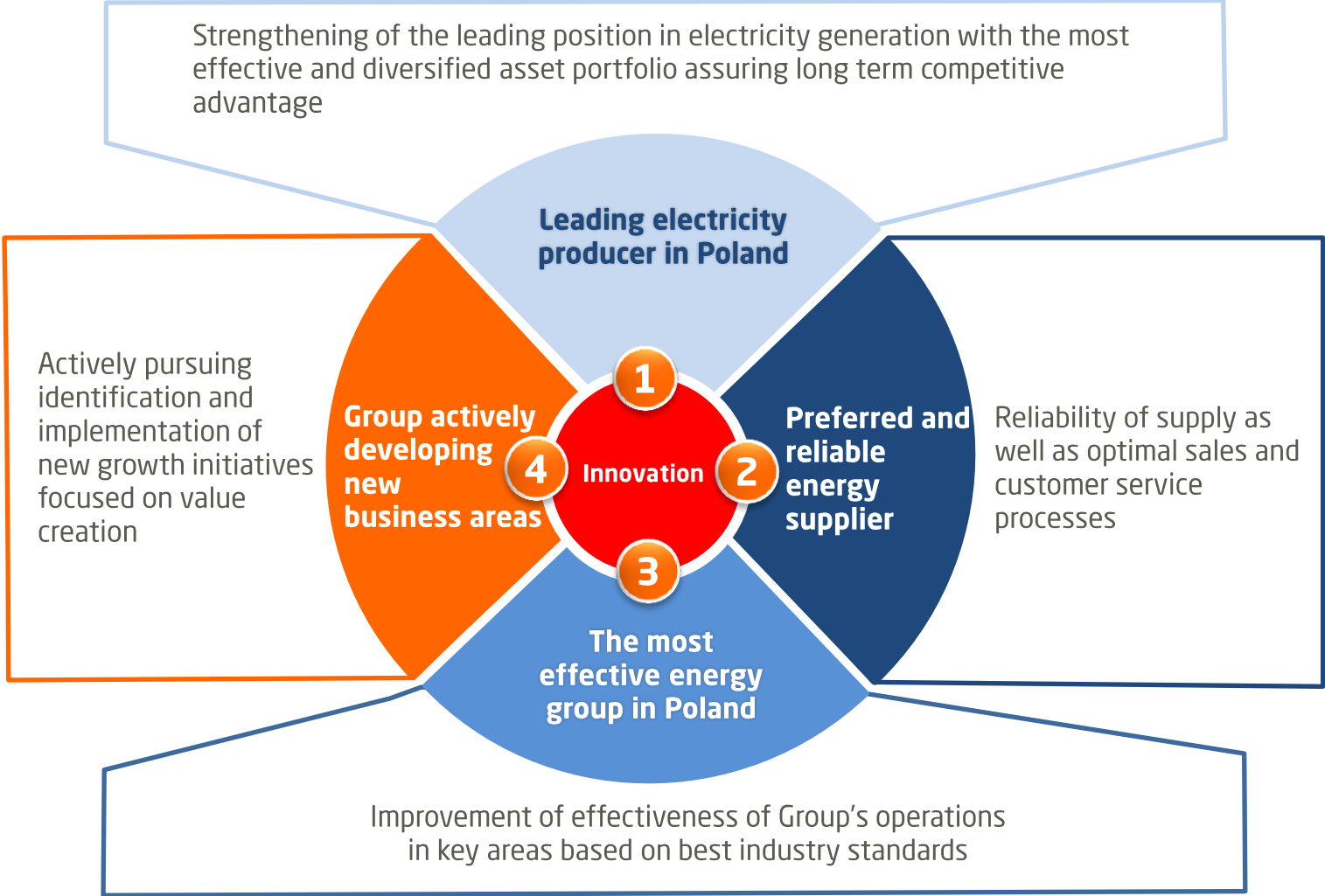


PGE's generation portfolio is currently the most competitive



- **PGE has the most competitive generation portfolio on the Polish market**
- **The Group is producing electricity and heat based on generation units operating mainly in baseload**
- **In the future PGE will maintain its competitive advantage due to cost-effective fuel base and investments in new highly efficient generation assets**

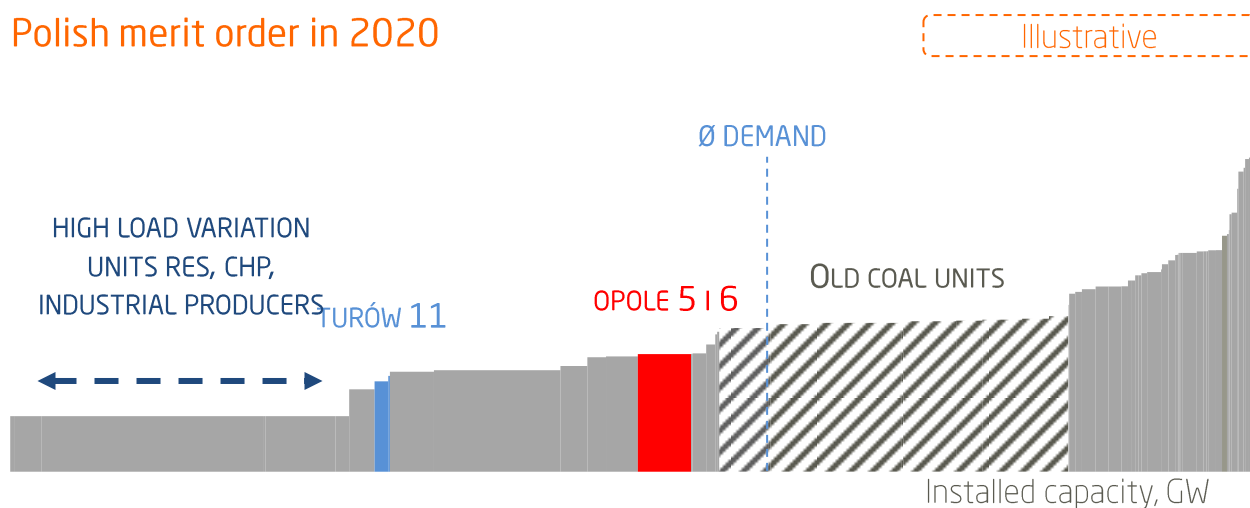
The strategic goal of PGE is value creation for shareholders





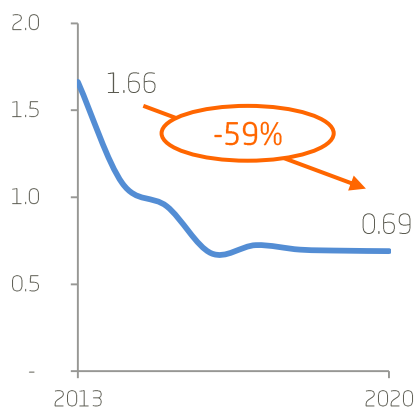
Leading producer - building competitive advantage through modernisation and construction of high efficiency conventional units based on domestic resources

Polish merit order in 2020

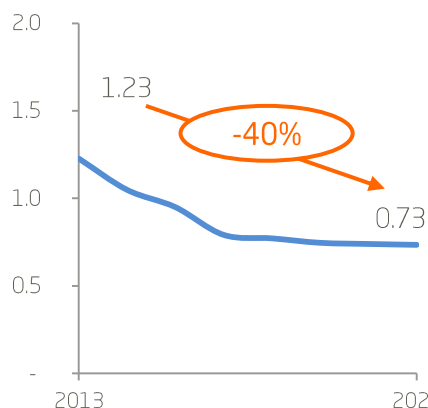


- By 2019 new high efficiency units in Opole and Turów with the most competitive cost of electricity generation
- During 2014-2020 planned outlays for modernisation of Group's existing generation assets - PLN 18.5 bn (increase of installed capacity, increased efficiency, adaptation to requirements on SO₂, NO_x and particulate matter emissions)

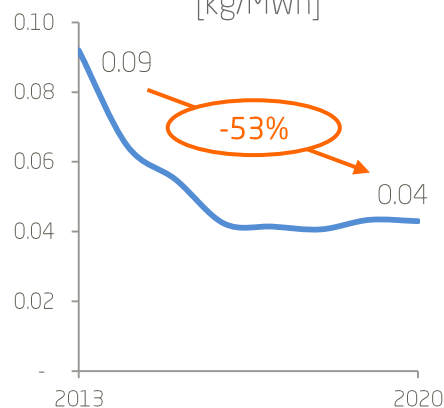
Expected SO₂ emission [kg/MWh]



Expected NO_x emission [kg/MWh]



Expected particulates emission [kg/MWh]

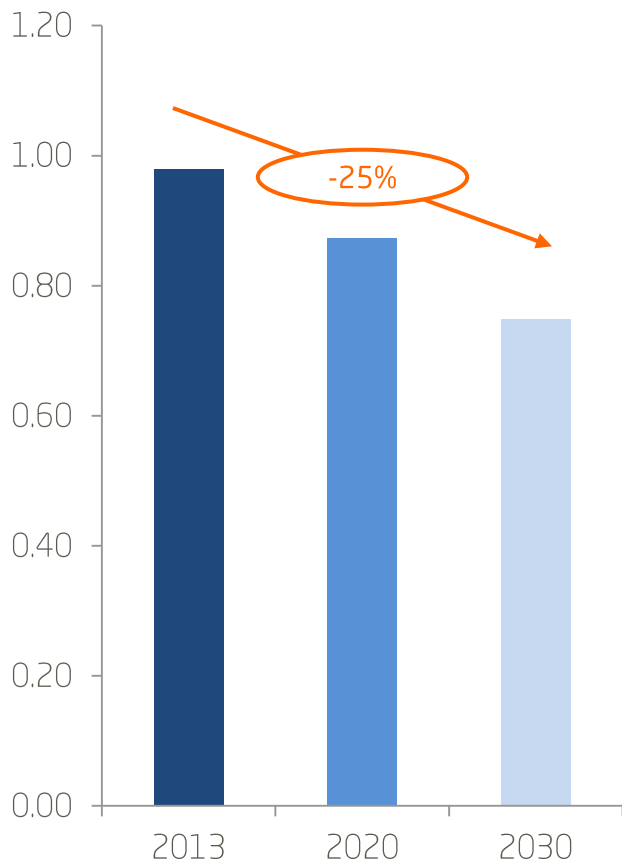




Leading producer - diversification of generation portfolio through implementation of low-carbon investments (Nuclear Power Programme, RES) in business models assuring their economic predictability

Unit emissions of CO₂ at PGE Group

[t/MWh]



Construction of the first nuclear power plant as the key investment lowering the carbon intensity of generation portfolio of PGE Group

- **Maintaining the leading role of PGE in the project**
- Development of the support system necessary from the point of view of project financing and the interest of customers
- Selection of the strategic partner and definition of cooperation rules, cooperation with domestic partners, elaboration of project financing structure
- **Making the investment decision and application for the decision in principle in 2017** based on the form of support system and results of the integrated proceedings
- **Beginning of construction of the first unit around 2020**

New capacities in wind power plants

- Onshore wind farms under construction – additional **234 MW by 2016**
- Projects in the pipeline – implementation of **~880 MW dependent on the final form of the support system**
- **Construction or acquisitions of subsequent RES projects depending on their efficiency**, potential for the Group's value creation and the future support system



Leading producer - maintaining the position of the leading operator of regulatory assets

PGE's regulatory assets

Installed capacity, MW



Dolna Odra Power Plant

- Special intervention and regulatory role in the transmission system
- Technical lifetime horizon - 2035
- Units 1 and 2 since 2016 in the Interventional Cold Reserve mechanism – operation for assurance of security of supply in the entire transmission system
- Between 2007 and 2013 investment outlays amounted to over PLN 700 million
- Further investments necessary in order to a/o adapt the units to the requirements of the IED Directive
- The key determinant of the future of the Dolna Odra Power Plant will be the conditions offered for maintaining and increasing the capacity of this plant by the TSO*

Pumped-storage power plants

- PGE is expanding and modernising the regulatory assets to fully utilise the potential of cooperation with PSE S.A. Between 2000 and 2013 the modernisation – restoration outlays amounted to PLN 1.2 billion
- Further investments are planned up to 2020 in the amount of around PLN 380 million intended to assure highest operating standards and high availability of assets
- The ultimate form of the investment programme will depend on the form as well as terms and conditions of agreements on system services

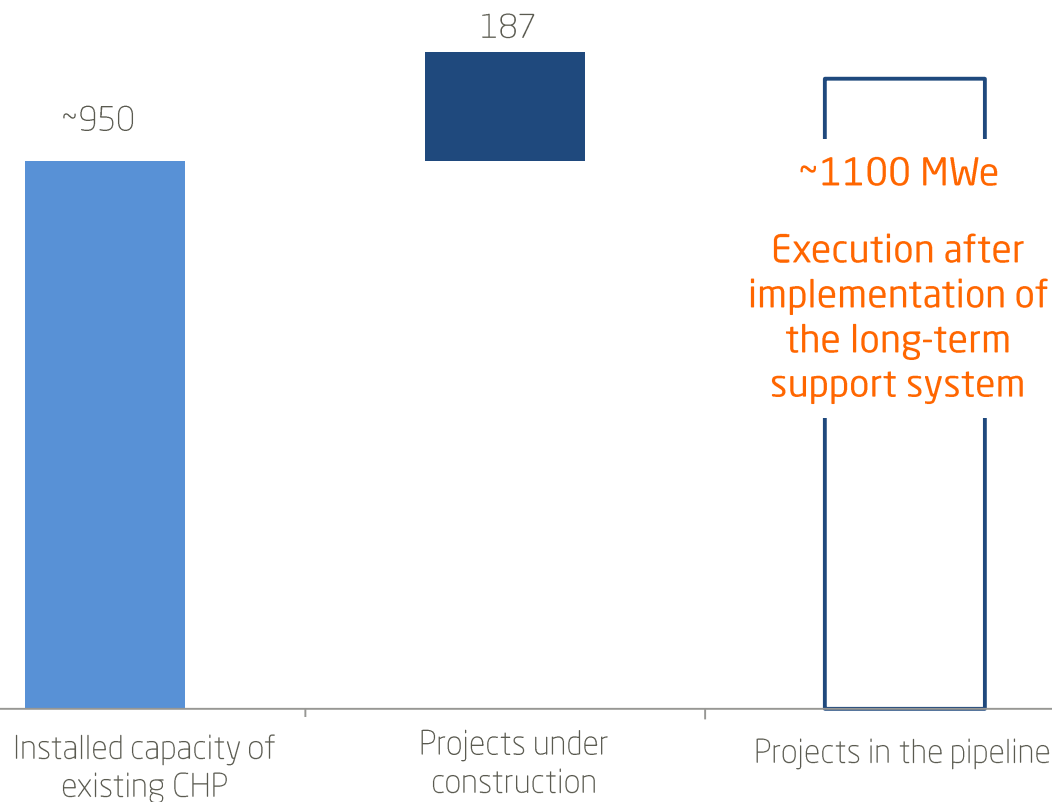
*Transmission System Operator



Leading producer - development of cogeneration in combination with the long term support system

Construction of new electric capacity in CHP and projects in the pipeline

[MWe]



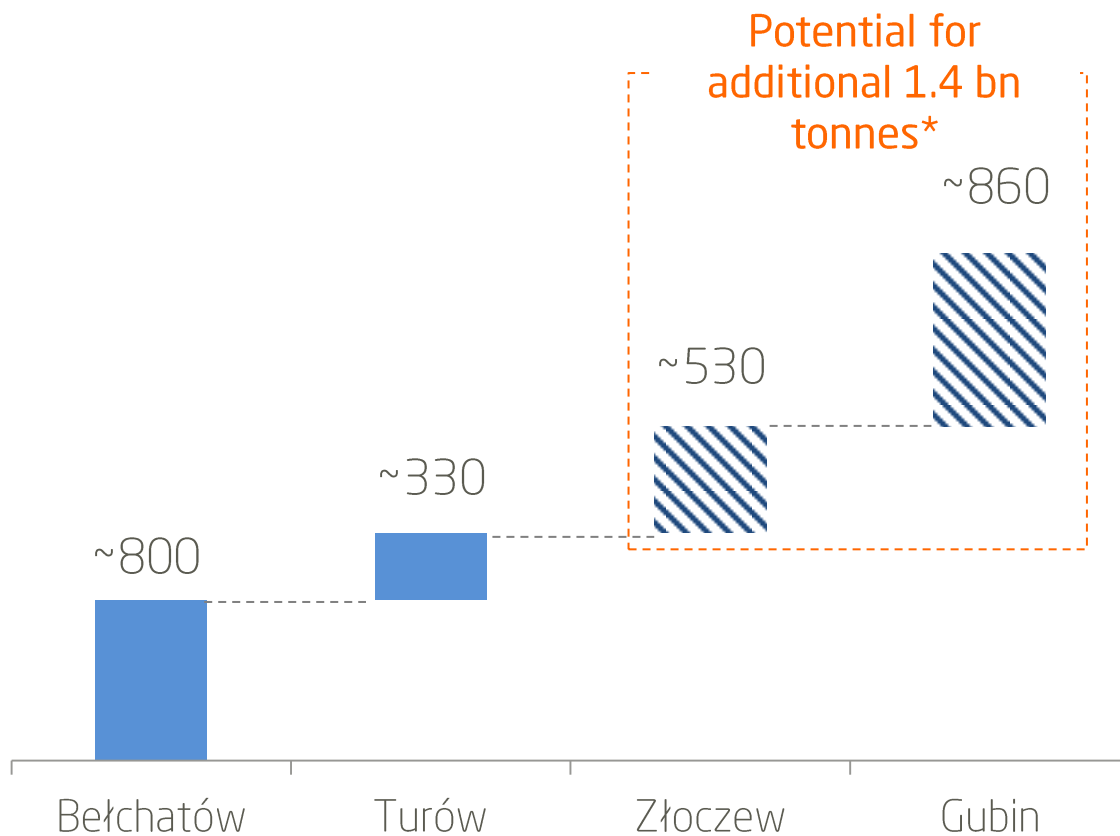
- 187 MWe CHP capacity under construction
- Execution of subsequent projects after the long-term support system is implemented
- At selected locations there is a need to develop joint strategies with local governments for assurance of heat supply security
- In the cogeneration segment preference is given to investments in expanding the value chain



Leading producer - securing the fuel base for conventional energy generation as a strategic option depending on the direction of the European Union's climate policy

Industrial resources of lignite

[millions of tonnes]



- Currently the Złoczew and Gubin projects are at the stage of obtaining the required administrative permits
- In both cases we are assuming obtaining the production licences after 2016
- Construction of new power plants depends on the future form of the climate policy
- The new build projects at Gubin and Złoczew deposits will be reviewed taking into account the development strategy for the complete generation portfolio of the company
- Active analysis of possibilities to secure other fuel resources in conventional energy area

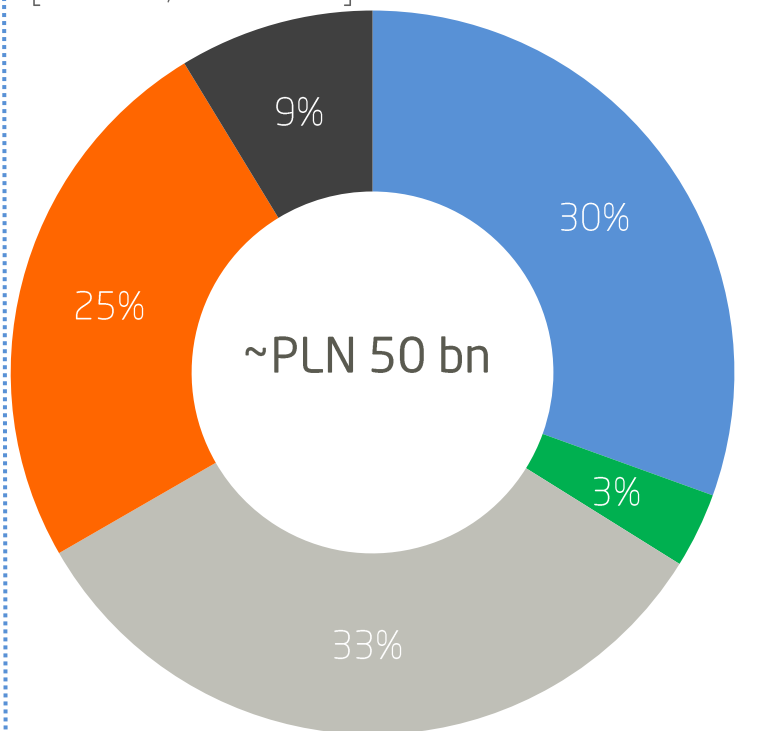
* estimates



Leading producer - PGE is implementing an ambitious investment programme

Investments by PGE planned for 2014-2020

[Nominal, net of VAT]



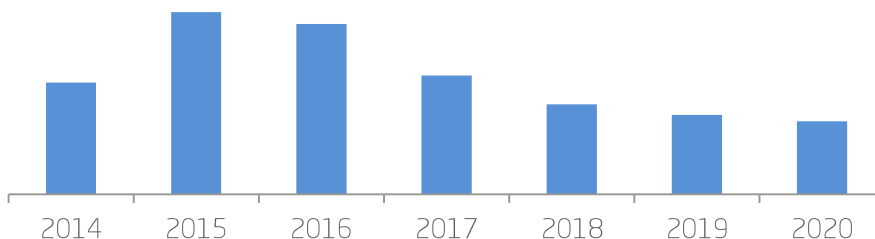
- New conventional capacity
- New RES capacity
- Modernisation and restoration of existing generation assets
- Development and modernisation of distribution networks
- Other

Main areas of investments:

- New conventional capacity ~PLN 15.2 bn
- New RES capacity ~PLN 1.7 bn
- Modernisation and restoration of existing generation assets ~PLN 16.3 bn
- Development and modernisation of distribution networks ~PLN 12.3 bn

- Between 2014 and 2016 spending on preparation of launching the nuclear programme will amount to ~PLN 0.7 bn

Expected CAPEX breakdown





Preferred supplier - reorganisation of the sales process based on effective trading strategy

Key strategic initiatives:

Corporate customers

- Effective margin management at the PGE Group level
- Assuring maximum contracting for generation units of PGE Group

SMEs

- Focus on retention of historical customers while maintaining the margin levels
- Acquisition of customers through improvement of customer service quality and product offering expansion

Households

- Acquisition of new customers, expansion of product offering
- Reduction of service and sales costs
- Development of modern IT tools supporting the sales process

Focus on understanding the needs of the customers and improvement of customer service quality

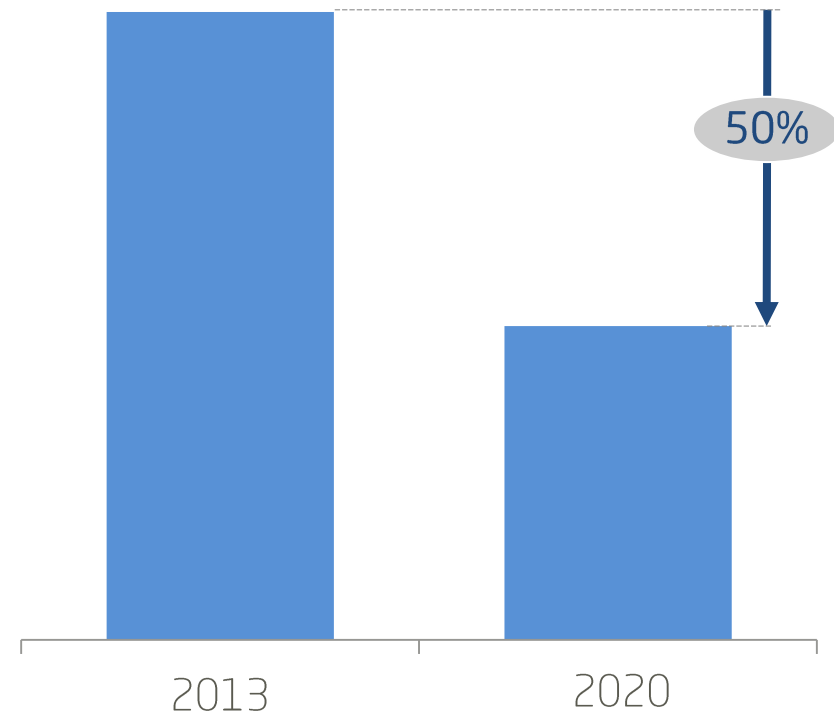


Preferred supplier - assuring reliability of supply through operational and investment efficiency in distribution

Key initiatives in distribution

- Significant improvement of grid reliability by 2020
- Optimisation of operational costs in the context of possible change of the tariff system through restructuring and standardisation of processes
- Directing the investment outlays at projects to the largest extent limiting the level of undelivered energy
- Total investment outlays in the distribution segment: ca. PLN 12.3 bn between 2014 and 2020

SAIDI* reduction target



*SAIDI - System Average Interruption Duration Index – minutes lost; unplanned electricity outages (excluding catastrophic events)



Effective Group - organisation restructuring to reduce costs and increase revenues

PGE will continue with organisational restructuring focused on operational cost reduction and increasing revenues

Conventional power

- Consistent implementation of operational effectiveness improvement programmes
- Increase of asset utilisation and efficiency

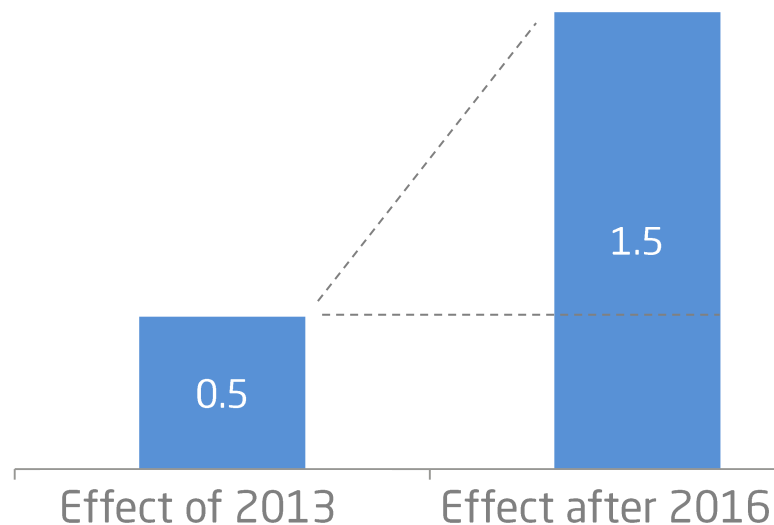
Distribution and retail trade

- Reduction of grid losses and interruptions in supply
- Operational restructuring programmes

Renewable energy

- Rationalisation of fixed costs

Effects of efficiency improvement - sustainable EBIT impact in PLN bn





Effective Group - active dialogue with the stakeholders concerning the regulatory environment

- Definition of a consistent Group-wide regulatory strategy with particular focus on tools guaranteeing financial predictability of investment projects
- Impact assessment of domestic and EU regulations from the point of view of the entire Group
- Building understanding with the key stakeholders who have influence over formation of the regulatory environment
- Strengthening regulatory activities on the EU forum by supporting establishment of the Polish power sector representation in Brussels

Conventional energy

- **Optimal regulatory environment stimulating investments and stable utilisation of generation assets**

Nuclear energy

- **Mechanisms assuring economic predictability of the project** - optimal from the point of view of both the transmission system as well as electricity end-customers

RES

- **Supporting rational support system** that prefers cost-effective projects

Distribution

- Participation in formation of mechanisms rewarding **distribution network reliability and efficiency of operators**



Effective Group - implementing the best corporate governance practices (1/2)

Human Resources Management (HRM)

- Supporting employee professional and competence development
- Development of a Group Key Staff Management system allowing effective achievement of strategic goals
- Improving the effectiveness of Human Capital management by implementing a HRM strategy that defines key areas: organisational culture, recruitment policy, remunerations, competences and development, assessments, social relations
- Labour cost control at PGE Group
- Assuring strategic HRM management by establishing a decision-competence centre with simultaneous centralisation of operating functions

Business decisions support and efficiency management

- Focus on financial efficiency based on business analytics (advanced tools and business support)
- Implementation of advanced data warehouse and unified business intelligence tools for the Group

Optimisation and standardisation of supporting processes

Accounting, HR and payroll:

- Maximising the effects of scale and specialisation
- Uniform standard of operation
- Optimal resource utilisation
- Separation of operational functions from strategic management

Purchasing:

- Common purchasing procedures – leveraging the effect of scale
- Consistent and more effective supplier management

IT and telecommunications:

- Automatisations of standardised processes
- Consolidation and centralisation of solutions
- Significant cost reductions
- More effective and quickly implemented development projects



Effective Group - implementing the best corporate governance practices (2/2)

PGE will be implementing its elaborated operating model with clear division of responsibilities within a process-oriented organisational structure

Role of the Corporate Centre (CC)

- Development PGE's strategy
- Management of the total margin in combination with optimal utilisation of generation units
- Supervision over and optimisation of the operations and investments of PGE Group
- Regulatory management, risk management
- Direct owner's supervision over Group companies
- Delivery of support function in the Group
- Development of innovation strategy and supervision over its implementation
- Building the image and the brand of PGE
- Building the HRM strategy in the Group



Role of the business lines

- Day-to-day focus on operations and investments
- Working on improvement of effectiveness of operating processes
- Support of decision processes for which CC is responsible



Growth - new products and business areas

Initially identified growth areas:

Dual fuel

- Retention and growth of customer base
- Attractiveness of offering in retail sales segment
- Leveraging operational synergies, including the existing structures and processes – cost to serve

Modern infrastructure as future value leverage

- Infrastructure for e-mobility
- Distributed energy generation and energy storage management
- Electrification of home heating

Auxiliary energy services for customers

- Complete energy solutions for customers
- Strategic partnership with players from outside of the energy sector

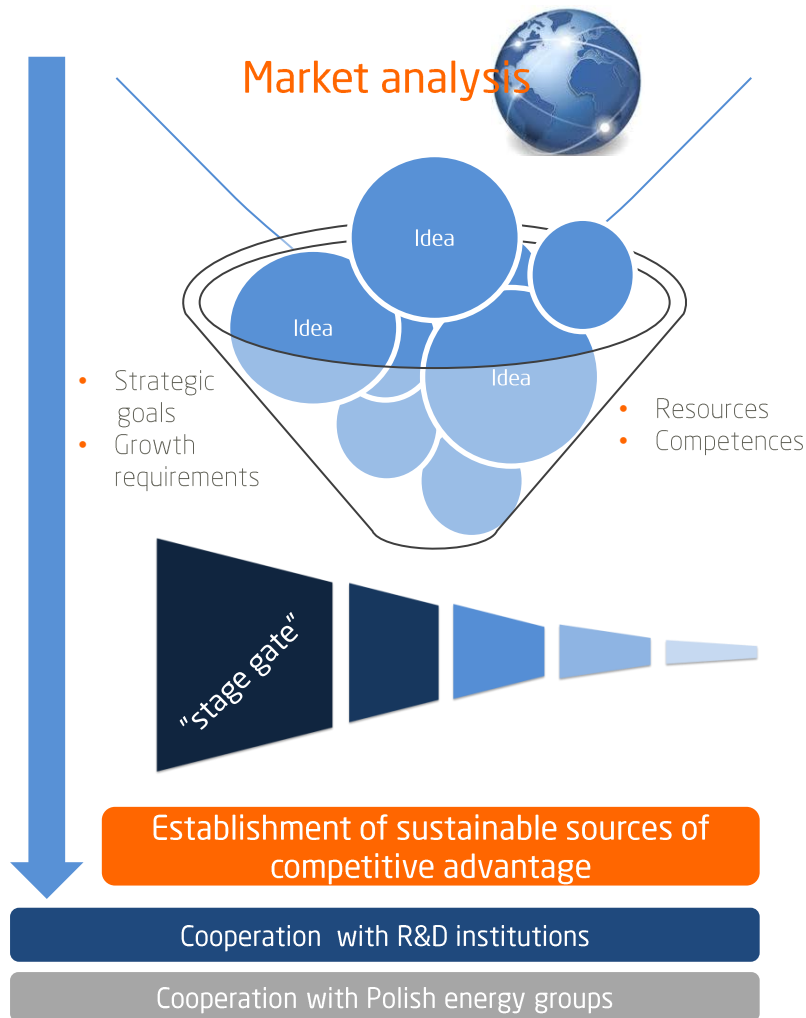
Other directions of growth

- Thermal treatment of municipal waste (waste to energy)
- New technologies using domestic fuel resources
- Energy advisory services
- Development of wholesale trade (new markets and new products)



Innovation - market environment analysis, identification and use of innovative solutions for achievement of strategic goals

Innovation management



- Analysis of trends and changes in the energy sector that have potential influence on the future business model of the Group
- Implementation of Group-wide common approach to identification of R&D directions based on:
 - Goals of PGE Group's strategy
 - Strategic Goals for Business Lines
 - Analysis of growth requirements
- Coordination of growth initiatives of Business Lines
- Implementation of "stage gate" approach to evaluation and selection of proposals for R&D initiatives
- Cooperation with R&D institutions on innovation initiatives
- Identification of synergies and commencement of cooperation with other Polish energy groups on R&D arena

The Group aspires to:

- Spend at least 1.5 % of annual net profit as of 2015 on R&D activities
- Maximise external financing

PGE - a socially responsible Group



Security of Supply

- Nearly 75% of energy based on own resources
- Strategically securing the fuel base for conventional energy
- Long-term contracts for supply of hard coal, natural gas and biomass
- Reduction of energy supply outages in distribution
- Improvement of customer service quality and customer supply security



Sustainable Development

- New investments and modernisations using the most environment friendly technologies
- New high efficiency and low emission conventional units
- Growth of low-carbon assets portfolio
- Re-cultivation of ex-mine land
- Collaboration with environment protection organisations



Corporate Social Responsibility

- Care for development of human capital and work health and safety
- Participation in pro-environmental programmes
- Collaboration with local communities
- Business conduct based on ethics and values
- Educational activities

Strategy of GK PGE in summary (1/2)



Leading electricity
producer in Poland



Preferred and reliable
energy supplier

- Construction of new high-efficiency units in Opole and in Turów with total gross capacity of ~ 2290 MW by 2019
- Implementation of the nuclear power project in a business model assuring profitability of investment, commencement of construction of the first unit around 2020
- Additional 234 MW installed capacity of PGE in wind farms by 2016. Further growth of the RES portfolio dependent on the final shape of future support system
- Growth of cogeneration in combination with long term support system. 187 MWe new cogeneration capacity under construction
- Total planned CAPEX for 2014 to 2020 in range of ~ PLN 50 bn, of which ~ PLN 15.2 bn for new conventional generation capacities
- Full utilisation of regulatory assets for generation of added value
- Securing fuel base for conventional energy as strategic option
- Reorganisation of the sales process based on effective trading strategy
- Reduction of electricity supply disruptions by 50% until 2020 for PGE Dystrybucja customers
- Focus on understanding customer needs and improvement of customer service quality
- Optimisation of cost to serve through:
 - redirecting traffic from direct channels to remote and self-service channels
 - implementation of Customer Relations Management tools (CRM)
 - Improving the effectiveness of back-office and service functions through process optimisation
 - optimisation of processes in metering data acquisition, service connections and technical maintenance

Strategy of GK PGE in summary (2/2)



**Most effective
energy group
in Poland**



**Group that
actively develops
new business
areas**



Innovation

- Restructuring of the organisation that shall bring **sustainable impact** on EBIT of the Group amounting to PLN 1.5 bn after 2016
 - Active dialogue with stakeholders in the area of regulatory environment
 - Optimisation of management processes and support functions in the Group
 - Implementation of the elaborated operating model
 - Implementation of **Group-wide effective financial and risk management process**
 - **Effective investment portfolio management process** and **close monitoring** of their progress
-
- Development of new products and business areas. Initially identified growth areas:
 - dual fuel
 - **comprehensive energy solutions for customers**, strategic partnerships with players from outside of the energy sector, energy advisory services
 - infrastructure for **e-mobility**, **distributed energy generation** and **energy storage management**, electrification of home heating waste to energy and new technologies using domestic energy resources
 - Development of operations in wholesale trade, a/o by entering new wholesale trade markets, **development of trading and structured instruments**
-
- Analysis of market environment and **identification and use of innovative solutions for achievement of strategic goals**
 - Use of the potential and competences of the PGE Group for generation of revenues in new business areas, cooperation with R&D institutions and domestic partners

Financial aspirations¹

• Level of EBITDA	EBITDA 2013	PLN 8-9 bn 2015-2020
• Maintaining the current dividend policy	40-50% of consolidated annual net profit	
• Effects of planned activities relating to improvement of effectiveness - sustainable impact on EBIT	PLN 0.5 bn Effect in 2013	PLN 1.5 bn Effect after 2016
• Maintaining long-term ratings	Moody's A3 Stable outlook	Fitch BBB+ Stable outlook
• Planned CAPEX 2014-2020	~PLN 50 bn	
• Annual R&D spending between 2015 and 2020	min. 1.5% of net profit	

 ¹ Based on market and macroeconomic assumptions adopted by PGE