

**A REPORT OF THE SUPERVISORY BOARD
OF PGE POLSKA GRUPA ENERGETYCZNA S.A.
ON THE EVALUATION OF THE COMPANY'S POSITION IN THE
YEAR 2012, INCLUDING AN EVALUATION OF THE COMPANY'S
INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM**

PGE Polska Grupa Energetyczna S.A. ("PGE S.A.", "PGE", "the Company") is bound by the corporate governance principles specified in "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.

This report has been drawn up based on chapter III item 1 sub-item 1) of the Good Practices; it contains 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 2012.

1. Significant events in the Company and Capital Group

The Supervisory Board evaluates positively activities undertaken by PGE Polska Grupa Energetyczna S.A. in 2012 and identifies those of them which, according to the Supervisory Board, had the strongest direct influence on the functioning and the value of the Company and the Capital Group.

1.1 A reviewed strategy for the years 2012 – 2035.

In February 2012 the Supervisory Board approved the document prepared by the Management Board and entitled "A Reviewed Strategy of PGE Polska Grupa Energetyczna S.A. for the Years 2012-2035".

1.2 The finalization of the wind farms acquisition process commenced in 2012.

On 19 February 2013 PGE S.A. and Energa Hydro Sp. z o.o. (a subsidiary of Energa S.A.) signed an agreement with DONG Energy Wind Power A/S for the acquisition of a portfolio of Polish wind farms from that Danish company. PGE S.A. is to acquire wind farms with an installed capacity of 60.5 MW and a package of planned projects with a combined capacity of about 555 MW, including 130 MW in projects at advanced development stages.

On 26 February 2013 PGE S.A. and Energa Hydro Sp. z o.o. (a subsidiary of Energa S.A.) signed an agreement with Iberdrola Renovables Energía, S.A.U. for the acquisition of a 75% shareholding in Iberdrola Renewables Polska Sp. z o.o., which manages a portfolio of wind farms in Poland. Under the agreement, PGE S.A. is to acquire three wind farms with a combined installed capacity of 70.5 MW and contractually guaranteed reception of generated electricity and certificates as well as a package of planned wind farm projects.

The transactions of acquiring wind farms from Iberdrola and DONG Energy constitute another step in the implementation of the PGE Capital Group's development strategy in the area of onshore wind energy. The completion of the transactions with Iberdrola and DONG Energy will strengthen the position of the PGE Capital Group on the renewable energy market. Capacity installed in the wind segment of renewable energy sources will rise from 138 MW to about 270 MW. Additionally, the two transactions will allow PGE to broaden its portfolio of advanced wind farm projects which may be commissioned in the nearest future.

1.3 The reorganization and optimization of the corporate structure of the PGE Capital Group.

- Within the scope of the non-core project, in the years 2009-2012 PGE disposed of 71 non-core assets: it sold all shareholdings in non-core companies, completed liquidation or bankruptcy proceedings in 12 companies, redeemed shares in 1 company, and sold 23 other non-core assets.
- In December 2012 the Company was working intensively on the launching of the WEKTOR project which in 2013 replaced the non-core project and whose scope comprised all subsidiaries and minority companies within the PGE Capital Group. The objective of the WEKTOR project is the further improvement in the operating efficiency of the PGE Capital Group, the reorganization and optimization of the corporate structure, which will result in the following:
 - focus on the core business activity,
 - synergy at the level of the PGE Capital Group,
 - increase in return on assets,
 - improved flexibility of managerial processes,
 - lower operating costs,
 - improved competitive position of the PGE Capital Group.

1.4 The launching of the project for the development of the PGE Capital Group's Operating Model.

In 2012 the Company started to implement the project for the development of the PGE Capital Group's Operating Model which provides for the integration of activities between the Business Lines and the Corporate Centre. The project's major objectives include stronger emphasis on the operating activities and the utilization of the synergy effects resulting from the centralization of the managerial, decision-making, planning and analytical functions. In its final shape, the Operating Model is to allow coordination between margins management and investment activities at the level of the PGE Capital Group.

1.5 The implementation of a centralized and integrated SAP system in the PGE Capital Group.

In 2012 the Company started the process of implementing a centralized and integrated SAP ERP (Enterprise Resource Planning) information system in the PGE Capital Group.

1.6 The reorganization of the Shared Services Centre Development Programme in the areas of IT and telecommunication in the PGE Capital Group.

In 2012 the Company reorganized the Shared Services Centre Development Programme in the areas of IT and telecommunication with respect to its concept and method of implementation, i.e. in the field of the IT services consolidation process in PGE Systemy S.A. and the field of telecommunication in Exatel S.A.

1.7 The signing of a framework agreement for the exploration and extraction of shale hydrocarbons.

On 4 July 2012 PGE S.A. entered into a framework agreement for the exploration and extraction of shale hydrocarbons. The parties to this agreement are PGE Polska Grupa Energetyczna S.A., Polskie Górnictwo Naftowe i Gazownictwo S.A., ENEA S.A., KGHM Polska Miedź S.A. and TAURON Polska Energia S.A.

1.8 The continuation of the preparatory activities in the area of nuclear energy.

On 5 September 2012 PGE S.A. signed a Letter of Intent concerning participation in the preparation, construction and operation of a nuclear power plant. The parties to the Letter of Intent are PGE Polska Grupa Energetyczna S.A., KGHM Polska Miedź S.A., Tauron Polska Energia S.A. and ENEA S.A.

Furthermore, within the scope of activities related to nuclear power generation, after the previous selection of three potential locations in November 2011, the Company continued preparations for location and environmental studies, in particular with respect to the acquisition of necessary permits to access the locations to be covered by the studies.

1.9 The restructuring of the Poland-Sweden DC connection

Within the scope of the restructuring of the Poland-Sweden DC connection, on 31 August 2012, based on the agreements signed on 23 August 2012 by PSE S.A., Svenska Kraftnat, SwePol Link AB, SwePol Link Poland, PGE and Vattenfall, SwePol AB and SwePol Poland sp. z o.o. sold an asset portfolio to the Polish and Swedish operators, PSE S.A. and Svenska Kraftnat, respectively. In consequence of this transaction, PGE Polska Grupa Energetyczna S.A. received back advance payments for energy transmission for the amount of SEK 413.6 m (PLN 206 m). The transaction allowed PGE Polska Grupa Energetyczna S.A. to withdraw from a commercially ineffective business activity.

1.10 A verdict in the arbitration proceedings with Alpiq.

From 2009 PGE Polska Grupa Energetyczna S.A. was a party to the arbitration proceedings with the company Alpiq. The proceedings were conducted before the Arbitration Tribunal in Vienna. The subject of the dispute was Alpiq's claims resulting from default in the performance of an electricity supply agreement entered into on 28 October 1997. On 12 September the Arbitration Tribunal issued a verdict which obliged PGE Polska Grupa Energetyczna S.A. to pay for the benefit of Alpiq the amount of EUR 43,203,986.60 plus interest in the combined amount of EUR 4,054,923.55. The total value of PGE's liability is EUR 47,258,910.15. Simultaneously, the Arbitration Tribunal ordered Alpiq to pay for the benefit of PGE Polska Grupa Energetyczna S.A. the total amount of EUR 1,462,622.23 incurred as costs of the arbitration proceedings. Thus the final amount to be paid by PGE Polska Grupa Energetyczna S.A. for the benefit of Alpiq after deducting the costs of the arbitration proceedings awarded to PGE Polska Grupa Energetyczna S.A. equals EUR 45,796,287.92, which, in view of the original amount of damages claimed by Alpiq (approximately EUR 168 m plus interest) and uncertainty related to the verdict of the Austrian Arbitration Tribunal, should be regarded as the Company's success.

1.11 The termination of the agreement for the sale of shares in Energa S.A. with its registered office in Gdańsk.

On 29 September 2010 the Management Board of PGE S.A. entered into an agreement with the State Treasury represented by the State Treasury Minister for the sale of a shareholding in Energa S.A. with its registered office in Gdańsk. The subject of the Agreement was 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 7.5 billion. Carrying out the transaction required PGE's acquiring the consent of the President of the Office for Competition and Consumer Protection for concentration (condition precedent). On 13 January 2011 the President of the Office for Competition and Consumer Protection issued a decision preventing PGE S.A. from acquiring shares in Energa S.A. The decision became final and legally valid on 12 June 2012, i.e. PGE was bound by a prohibition against concentration, and the agreement for the sale of Energa S.A. shares was terminated.

1.12 The implementation of the Consolidation Programme.

Within the scope of the Consolidation Programme:

- on 2 January 2012 the merger of the following companies was entered in the register: Dychowskie Przedsiębiorstwo Eksploatacji Elektrowni "Eldeks" Sp. z o.o., Elektrownia Wiatrowa Kamieński Sp. o.o. and PGE Energia Odnawialna S.A.,
- on 12 March 2012 the District Court for Łódź Śródmieście in Łódź, the 20th Economic Division of the National Court Register, issued an order to enter the merger of PGE Górnictwo i Energetyka Konwencjonalna S.A. with PGE Elektrownia Opole S.A. in the register.

2. A description of the activities of the Capital Group

PGE Polska Grupa Energetyczna S.A. is the parent company in the PGE Capital Group.

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.

In 2012 the Group's power producers sold electricity to PGE S.A. through the regulated markets and power exchanges (within the scope of the regulations of Article 49a clauses 1 and 2 of the Energy Law, i.e. the so-called "power exchange obligation") and directly to external customers. Energy purchased by PGE S.A. on the regulated markets and power exchanges as well as from external contractors was resold to the companies from the PGE Capital Group such as the Retail Sales Company and the Distribution Company, the contractors from beyond the PGE Group, on the domestic and foreign markets. The Retail Sales company from the PGE Capital Group made electricity purchases also from the local power generation sources located at the area where the company performs the role of the sales company ex officio.

In 2012 PGE Polska Grupa Energetyczna S.A. purchased hard coal for the power plants as well as CHP plants belonging to the PGE Capital Group from a number of suppliers. The

major hard coal supplier is Kompania Węglowa S.A., with a 65% share in annual hard coal deliveries to PGE.

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 consist 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.

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

In 2012 PGE Polska Grupa Energetyczna S.A. changed its equity participation in the following entities:

- on 23 December 2011 the Extraordinary General Meeting of PGE Energia Jądrowa S.A. adopted a resolution on increasing the Company's share capital from PLN 87,500,000 to PLN 103,500,000, i.e. by the amount of PLN 16,000,000, by issuing 640,000 registered shares with a par value of PLN 25.00 each. All shares in the company's increased capital were acquired by PGE Polska Grupa Energetyczna S.A. in return for a contribution in cash. The increase in the company's share capital was entered in the National Court Register on 19 January 2012;
- in the first quarter of 2012 PGE Polska Grupa Energetyczna S.A. acquired from minority shareholders 3750 registered shares in PGE Górnictwo i Energetyka Konwencjonalna S.A. (constituting in total a 0.0005% shareholding in the company's capital). The purchase of these registered shares by PGE S.A. resulted from a privatization agreement under which the employees of PGE Zespół Elektrociepłowni Bydgoszcz S.A. (now PGE GiEK S.A. Oddział Zespół Elektrociepłowni Bydgoszcz) were entitled to sell the allocated block of shares to the majority shareholder;
- on 12 March 2012 the District Court for Łódź Śródmieście in Łódź, the 20th Economic Division of the National Court Register, issued an order to enter the merger of PGE Górnictwo i Energetyka Konwencjonalna S.A. with PGE Elektrownia Opole S.A. in the register. The companies belonging to the PGE Capital Group have the following shareholdings in PGE Górnictwo i Energetyka Konwencjonalna S.A.: PGE Polska Grupa Energetyczna S.A. (91.20%) and PGE Obrót S.A. (7.37%);
- on 30 December 2011 PGE Polska Grupa Energetyczna S.A. and PGE Energia Odnawialna S.A. signed a *datio in solutum* agreement which settled a liability of PGE Energia Odnawialna S.A. under dividend payable to PGE Polska Grupa Energetyczna S.A. Under this agreement, the fulfilment of its conditions resulted in the assignment of a title to 103,196 ordinary registered shares (constituting a 0.015% shareholding in the company's capital) in PGE Górnictwo i Energetyka Konwencjonalna S.A. for the benefit of PGE Polska Grupa Energetyczna S.A. in order to release PGE Energia Odnawialna S.A. from its liability to pay a part of the due dividend. On 15 March 2012 a change was entered in the shares register of PGE Górnictwo i Energetyka Konwencjonalna S.A. The change concerned the said assignment of the title to the shares. On that day PGE Energia Odnawialna S.A. stopped being a shareholder in PGE Górnictwo i Energetyka Konwencjonalna S.A.;

- on 18 January 2012 the Extraordinary General Meeting of PGE Obrót S.A. adopted a resolution concerning a forced buyout of shares constituting 0.24% of the company's share capital and held by minority shareholders for the benefit of PGE Polska Grupa Energetyczna S.A., under Article 418 of the Commercial Companies Code. In April 2012 the execution of this resolution resulted in the acquisition of 11,716 shares in PGE Obrót S.A. by PGE Polska Grupa Energetyczna S.A. Furthermore, on 7 May 2012, under a sales agreement, PGE acquired from the State Treasury 46 shares in PGE Obrót S.A., which constituted 0.00093% of the company's share capital. Additionally, on 20 August and 12 October 2012 PGE Obrót S.A. carried out the forced buyout of its 4159 and 11,809 shares, respectively. The full buyout amount was transferred to the accounts of the interested shareholders and thus 15,968 shares became the company's treasury shares to be redeemed under Article 418¹ § 4 of the Commercial Companies Code.

In consequence of the aforementioned buyouts, the company holds 16,852 treasury shares acquired under a forced buyout procedure provided for in Article 418¹ §4 of the Commercial Companies Code and 243 shares which were not distributed among the company's shareholders within the process of consolidation of the companies belonging to the PGE Capital Group. Hence, the company holds 17,095 treasury shares, which constitute 0.346% of the company's share capital. The remaining shares (constituting 0.104% of the total number of shares) held by a minority shareholder are the subject of a forced buyout procedure, under Article 418¹ of the Commercial Companies Code.

In consequence of the aforementioned transactions, PGE Polska Grupa Energetyczna S.A. holds 99.55% of shares in the share capital of PGE Obrót S.A.;
- on 10 May 2012 the Ordinary General Meeting of PGE Dystrybucja S.A. adopted a resolution concerning a forced buyout of bearer shares series I held by the minority shareholders of PGE Dystrybucja S.A., representing 0.02% of the company's share capital. On 24 July 2012 the shareholder of PGE Polska Grupa Energetyczna S.A. effected a money transfer to the account of PGE Dystrybucja S.A. as payment for the buyout and thus acquired 192,126 shares from the minority shareholders under a forced buyout procedure. Furthermore, on 30 August 2012 PGE Polska Grupa Energetyczna S.A. acquired from the State Treasury 2713 shares constituting 0.000278% of the share capital of PGE Dystrybucja S.A.

In consequence of the aforementioned transactions, the only shareholders in PGE Dystrybucja S.A. are PGE Obrót S.A. with an 89.911% shareholding and PGE Polska Grupa Energetyczna S.A. with a 10.075% shareholding. Furthermore, the company holds 131,873 treasury shares, which constitutes 0.014% of the total number of shares; these treasury shares are to be redeemed;
- on 13 June 2012, the General Meeting increased the share capital of PGE Systemy S.A. from PLN 5,000,000 to PLN 125,000,000, i.e. by PLN 120,000,000. 12,000,000 new shares series D, each with a par value of PLN 10.00, were acquired by the company's sole shareholder, i.e. PGE Polska Grupa Energetyczna S.A. The increase in the company's share capital was entered in the National Court Register on 16 July 2012;
- on 07 September 2012 the Extraordinary General Meeting of PGE Energia Jądrowa S.A. adopted a resolution on increasing the Company's share capital from PLN 103.500.000 to PLN 113.500.000, i.e. by the amount of PLN 10.000.000, by issuing 400.000 registered shares with a par value of PLN 25.00 each. All shares in the company's increased capital were acquired by PGE Polska Grupa Energetyczna S.A. in return for a contribution in cash. The increase in the company's share capital was entered in the National Court Register on 4 October 2012;
- in December 2012 PGE Polska Grupa Energetyczna S.A. acquired from minority shareholders 418,027 shares in EXATEL S.A., which constituted 5.00% of the company's capital.

Furthermore, on 23 January 2013 PGE Polska Grupa Energetyczna S.A. acquired from a minority shareholder 3.885 shares in EXATEL S.A., which constituted 0.0465% of the company's capital.

In consequence of the aforementioned transactions, PGE Polska Grupa Energetyczna S.A. holds 99.98% of shares in the share capital of EXATEL S.A.

On 1 February 2012 PGE Polska Grupa Energetyczna S.A. established a company called PGE Dom Maklerski S.A. with its registered office in Warsaw. PGE is the sole shareholder of the new company. On 19 April 2012 the company was entered in the National Court Register.

On 6 July 2012 the liquidation process of ELECTRA Bohemia s.r.o. with its registered office in the Czech Republic was initiated. PGE Polska Grupa Energetyczna S.A. holds 100% of shares in the company.

On 1 August 2012 a change was effected in the name and registered office of ELECTRA Deutschland GmbH. The company's current name and registered office are as follows: PGE Trading GmbH with its registered office in Berlin.

On 22 October 2012 PGE Serwis Sp. z o.o. was deleted from the Register of Entrepreneurs.

4. The economic and financial position

During the period ended 31 December 2012 PGE S.A. did not stop any of its significant activities.

In 2012 the Company recorded:

- balance sheet total of PLN 30,390.6 million
- equity of PLN 29,296.5 million
- net profit of PLN 784.0 million

Table: Basic financial ratios

Table: basic financial ratios	Year	
	2012	2011
Return on sales (%)	7.4%	44.9%
net profit x 100% / net sales revenues		
Return on equity (%)	2.7%	16.6%
net profit x 100% / (equity - net profit)		
Debt ratio (%)	3.6%	3.9%
liabilities x 100% / total equity and liabilities		
Current ratio	3.4	4.5

current assets / current liabilities

4.1. Statement of comprehensive income

PLN thousand	Period 1-12 2012	Period 1-12 2011	% change
Sales revenues	10,604,261.1	10,137,893.2	5%
Cost of sales	10,085,579.9	9,786,839.5	3%
Gross sales result	518,681.2	351,053.7	48%
% of sales revenues	4.9%	3.5%	
Selling expenses and general and administrative costs	145,903.1	139,761.5	4%
Profit on sales	372,778.1	211,292.2	76%
Other operating revenues	184,802.1	5,637.3	3178%
Other operating expenses	2,642.0	40,851.5	-94%
EBIT	554,938.2	176,078.0	215%
% of sales revenues	5.2%	1.7%	
Finance income	535,170.3	4,888,979.3	-89%
Finance costs	104,582.7	105,359.1	-1%
Gross profit	985,525.8	4,959,698.2	-80%
% of sales revenues	9.3%	48.9%	
Income tax expense	201,528.1	406,142.7	-50%
Net profit	783,997.7	4,553,555.5	-83%
% of sales revenues	7.4%	44.9%	
EBITDA	574,209.9	199,493.3	188%
% of sales revenues	5.4%	2.0%	

In the financial year ended 31 December 2012 PGE's profit on sales equalled PLN 372.8 million, which constituted a 76% increase over the result of the financial year ended 31 December 2011. This increase resulted from the broadening of the range of services provided to the Group's power plants in the area of generation capacities management. In the financial year ended 31 December 2011 net profit of PGE Polska Grupa Energetyczna

S.A. reached the level of PLN 784.0 million. The greatest change in comparison to the results of the previous year occurred in financial income - PLN 4,476.7 million. This was caused by PGE's failure to collect dividends from the companies belonging to the main segments of the Group and the extraordinary gain from the sale of Polkomtel S.A. shares in 2011.

The 2% increase in revenues from sales of finished goods and merchandise as compared to those in 2011 resulted mainly from higher revenues from electricity sales. An increase in the sales of services results mainly from the implementation of the agreement for the commercial management of the generation capacities of PGE GiEK S.A. in May 2012.

In 2012 the total operating costs of PGE Polska Grupa Energetyczna S.A. amounted to PLN 10,338.7 million, which was 3% more than in 2011.

Cost of goods sold in 2012 amounted to PLN 10,085.6 million, which constitutes an increase by 3% compared to 2011. An increase in cost of goods sold was affected by higher costs of electricity purchases by PLN 509.9 million as compared to 2011 (increase by 6.6%). Higher costs of electricity purchases resulted from a higher volume of purchased energy (by 1.5 TWh) at the average energy purchase price PLN 5.32/MWh higher than a year before. The higher electricity purchase price in 2012 was the result of higher market prices.

In 2012 total selling expenses of PGE S.A. amounted to PLN 12.4 million; they were PLN 4.9 million lower than in 2011. The lower level of total selling expenses resulted from changes in the cost allocation system and the absence of a settlement fee for the agency services provided by PSE Operator S.A. in relation to the transmission of purchased and sold energy.

The general and administrative expenses of PGE S.A. in 2012 amounted to PLN 133.5 million and were PLN 11.1 million higher than a year before. The higher level of the general and administrative expenses was determined by higher payroll costs resulting from changes in the structures of employees and managers.

The other operating costs fell by PLN 38.2 million as compared to 2011. In 2011 the Company increased its provision for commercial disputes with foreign customers by PLN 36.1 million; in 2012 the amount of the provision remained unchanged.

In 2012 financial expenses fell by PLN 0.8 million in comparison to the previous year; bond issue costs were PLN 65.6 million lower; the Company wrote down the value of its shares in AWSA Holland II B.V. by PLN 64.5 million.

4.2. Statement of financial position

Assets of PGE S.A. as at 31 December 2012 and as at 31 December 2011 amounted to PLN 30,390.6 million and PLN 33,216.6 million, respectively.

A reduction in the value of assets resulted first of all from the lower level of bank deposits and cash (a fall by PLN 2,168.6 million) and held bonds (a fall by PLN 1,142.1 million). As at 31 December 2012 the Company held bonds issued by PGE GiEK SA, PGE Energia Odnawialna S.A. and Autostrada Wielkopolska S.A. A detailed description of financial instruments held by PGE S.A., in particular bonds, is included in note 38 to the standalone financial statements.

As at 31 December 2012 and as at 31 December 2011 PGE's total equity equalled PLN 29,296.5 million and PLN 31,935.1 million, respectively, which constituted 96.4% and 96.1% of total equity and liabilities, respectively. Treasury shares are described in more detail in item 7.10.

The change in total equity was caused mainly by the payout of dividends for 2011. A detailed description of changes in PGE's share capital and other capitals is included in note 23 to the standalone financial statements.

The level of current liabilities decreased by PLN 225.6 million in comparison to that of 2011, mainly in consequence of the payment of income tax liabilities in the amount of PLN 248.6 million.

4.3. Statement of cash flows

Cash and cash equivalents as at 31 December 2012 equalled PLN 953.0 million and were PLN 65.2 million higher than at the end of the corresponding period of 2011.

Total net cash flows from operating activities for the 12-month period ended 31 December 2012 amounted to PLN (-) 411.8 million as compared to PLN (-) 50.9 million for the 12-month period ended 31 December 2011.

Negative cash flows from operating activities comprised a PLN 3,974.2 million fall in gross profit on continued activities in the 12-month period ended 31 December 2012 as compared to the 12-month period ended 31 December 2011. This fall resulted to a considerable extent from the absence of dividends from the Capital Group's companies and lower profit on disposal of investments. Additionally, negative cash flows from operating activities in the analysed period resulted from the higher levels of inventories and receivables as well as the payment of corporate income tax.

Positive net cash flows from investing activities for the reporting period ended 31 December 2012 amounted to PLN 3,631.3 million versus PLN 4,120.2 million in 2011.

The balance of cash flows from investing activities for the 12-month period of 2012 comprises first of all net cash flows related to the sale and acquisition of financial assets for PLN 3,046.7 million, received interest in the amount of PLN 344.8 million as well as inflows related to the repayment of granted loans and the refund of a down payment for transmission fees in the amount of PLN 202.1 million.

Net cash flows from financial activities in 2012 amounted to PLN (-) 3,284.8 million versus PLN (-) 3,309.4 million of net cash flows from financial activities in 2011.

The aforementioned result for the year 2012 was determined mainly by the payout of dividends in the amount of PLN (-) 3,421.7 million and the inflows related to acquired credits in the amount of PLN 142.8 million.

4.4. Financial resources management

As at the end of the year 2012 the Company had considerable financial surpluses.

In 2012 PGE Polska Grupa Energetyczna S.A. generated funds from the issue of bonds and from interest on cash and cash equivalents, deposits and granted loans. Such funds were allocated by the Company for the financing of investments in the PGE Capital Group.

As the parent company of the PGE Capital Group, PGE Polska Grupa Energetyczna S.A. provides the particular companies within the Group with funds for the financing of their investment projects and current activities. Such funds are provided by way of selling zero-coupon and coupon bonds. For this purpose, the companies of the PGE Capital Group entered into agency agreements with banks for the provision of services related to bond issues.

As at 31 December 2012 PGE Górnictwo i Energetyka Konwencjonalna S.A. had issued bonds for the combined nominal amount of PLN 3,459.8 million; the bonds were acquired by PGE S.A. under the following bond issue programmes:

- The Agency agreement with ING Bank Śląski S.A. entered into on 13 September 2010
- The Agency agreement entered into on 30 November 2009 between PGE Elektrownia Bełchatów S.A. and PKO Bank Polski S.A.
- The bond issue programme entered into with ING Bank Śląski S.A. of 20 June 2011.

As at 31 December 2012 PGE Energia Odnawialna S.A. had issued bonds acquired by PGE S.A. under the following bond issue programmes:

- The bond issue programme entered into with ING Bank Śląski S.A. of 20 June 2011.

The present and future investment projects are being and will be financed with funds coming from the PGE Capital Group's core activity, funds coming from the issue of securities and internal financing procedures. The PGE Capital Group's financial results and the debt level for 2012 confirm that the Group is in possession of sufficient funds for the implementation of its investment plans, including capital investments.

5. Description of significant agreements

The section below describes agreements which, according to PGE S.A., are agreements entered into within the scope of ordinary business activities and are of significant importance for the Company's activities.

5.1. Agreement for sales of electricity to PGE Obrót S.A.

In 2012 PGE S.A. continued sales of electricity to PGE Obrót S.A. on the basis of the framework agreement for the sales of electricity concluded in 2007.

Sold energy is to meet the demand of the end-users of PGE Obrót S.A. Energy is sold on the basis of transaction arrangements covering demand reported by PGE Obrót S.A.

In 2012 sales revenues under this agreement amounted to PLN 6,557.6 million, which represented 61.8% of total sales revenues.

5.2. Agreements with power plants within the PGE Group

In view of the amendment to the Energy Law effective as of 9 August 2010 and regulating, through article 49a, the procedure of selling energy by entities which generate energy (the so-called "power exchange obligation"), in 2012 the agreement entered into between PGE S.A. and PGE Górnictwo i Energetyka Konwencjonalna S.A. for the purchase of electricity not covered by the aforementioned obligation remained in force. Concluded for an indefinite period of time, the agreement provides for the purchase of electricity on the basis of transaction arrangements.

The sale of electricity generated by power plants operated by PGE Górnictwo i Energetyka Konwencjonalna S.A. and by PGE Elektrownia Opole S.A. was conducted on the organised markets pursuant to Article 49a of the Energy Law.

Additionally, PGE Górnictwo i Energetyka Konwencjonalna S.A. and PGE Elektrownia Opole S.A. could purchase energy under the EFET agreement entered into with PGE S.A.

5.3. Agreements for the delivery of hard coal

2012 was another year of centralized purchases of hard coal for the power plants and cogeneration plants belonging to the PGE Capital Group.

In 2012 these plants were supplied with coal by PGE Polska Grupa Energetyczna S.A. on the basis of agreements entered into mainly with domestic producers of coal. The group of hard coal suppliers comprised Kompania Węglowa S.A., Jastrzębska Spółka Węglowa S.A., Katowicki Holding Węglowy S.A., SUEK Polska Sp. z o. o., HAWEX Sp. z o.o., EKO ENERGIA Szczecin Sp. z o.o., and, with respect to outstanding deliveries for 2011, PHU Energokrak Sp. z o.o. and Carbo Proces Recykling Sp. z o.o.

The major hard coal supplier is Kompania Węglowa S.A., with a 65% share in annual hard coal deliveries to PGE. Kompania Węglowa S.A. is the largest producer of hard coal in Poland. It has a 50% share in the hard coal production market, and a 56% share in the market of hard coal used power generation. In view of the dominant position of Kompania Węglowa S.A. in the supply of hard coal, its absence would result in the necessity to enter into new hard coal delivery agreements.

6. Factors significant for the development of PGE S.A. and the PGE Capital Group

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

- the volume of demand for electricity and heat;
- the prices of electricity on the wholesale and retail markets;
- the prices of property rights;
- 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;
- the availability of trans-border transmission capacities,
- increased power generation capacities in the national power system, including those based on renewable energy sources;
- changes in the macroeconomic environment of the Group, particularly in interest rates and currency exchange rates, which influence the evaluation of the Group's assets and liabilities;
- the availability and prices of CO₂ emission allowances;
- the termination of the process of allocating free emission allowances to the power plants of the PGE Capital Group for the years 2013-2020;
- the European Commission's decision to move the sale of some emission allowances from the period 2013-2015 to the period 2018-2020 (so-called "backloading") or to remove a part of emission allowances from the market (so-called "setaside");
- amendments to the Energy Law and other acts;
- the results of the explanatory proceedings conducted by the President of the Energy Regulatory Office with respect to the issue of certificates of origin for energy generated from biomass in some branches of PGE GiEK S.A.;
- the decisions of the President of the Energy Regulatory Office concerning the implementation of the Power Purchase Agreements Act and the court's ruling on the disputes between the President of the Energy Regulatory Office and the energy producers from the PGE Capital Group entitled to receive compensations under the PPA Act with regard to the annual adjustments of the stranded costs for 2008 and annual adjustments of the stranded costs and annual adjustments of costs incurred by gas-fired units in 2009, 2010 and 2011;
- decision determining environmental constraints for the construction of power generation units no. 5 and 6 in PGE GiEK S.A., the Opole Power Plant Branch;
- the implementation of efficiency improvement programmes in the PGE Capital Group;

- seasonality and weather conditions;
- possible adverse settlements of legal and tax disputes or other contingent liabilities.

7. Risks and threats to PGE Polska Grupa Energetyczna S.A. and the PGE Capital Group

The business activities of PGE Polska Grupa Energetyczna S.A. and other major companies belonging to the PGE Capital Group, for which PGE Polska Grupa Energetyczna 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 the PGE Capital Group 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 an inconsistent political environment,
- the risk of changes to the system of support for cogeneration and renewable energy sources,
- the risk related to the requirement to hold a licence,
- the risk connected with a potential breach of anti-monopoly regulations,
- 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 fuel supplies and insufficient fuel stocks,
- the risk related to the atmospheric factors,
- the risk related to the acquisition and costs of external financing,
- the risk of transfer prices,
- the risk of insufficient insurance coverage,
- the risk related to court, arbitration and administrative proceedings.

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 to 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 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;
- 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 2012 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 standalone and consolidated financial statements of PGE. 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 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. for the year 2012.

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

Marcin Zieliński

Vice Chairperson of the Supervisory Board:

Małgorzata Dec

Members of the Supervisory Board:

Maciej Bałtowski

Jacek Barylski

Czesław Grzesiak

Grzegorz Krystek

Katarzyna Prus