Polskie Górnictwo Naftowe i Gazownictwo S.A.

Interim Report of the PGNiG Group

for the six months ended June 30th 2019

PGNiG

CONSOLIDATED INTERIM REPORT OF THE PGNIG GROUP FOR THE SIX MONTHS ENDED JUNE 30TH 2019 CONTAINS:

1. AUDITOR'S REVIEW REPORT OF INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR SIX MONTHS ENDED JUNE 30TH 2019.
2. AUDITOR'S REVIEW REPORT OF INTERIM CONDENSED SEPARATE FINANCIAL STATEMENTS OF PGNiG S.A. FOR SIX MONTHS ENDED JUNE 30TH 2019.
3. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF THE PGNIG GROUP AND INTERIM CONDENSED FINANCIAL STATEMENTS OF PGNIG S.A. FOR SIX MONTHS ENDED JUNE 30TH 2019.
4. DIRECTORS' REPORT ON THE OPERATIONS OF PGNIG S.A. AND THE PGNIG GROUP FOR SIX MONTHS ENDED JUNE 30TH 2019.

Auditor's report

passion

teamwork

quality

clarity

PKF

Accountants &
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Independent Auditor's Review Report

on the condensed interim consolidated
financial statements of The PGNiG Group
with the registered office in Warsaw at Marcina Kasprzaka 25 Street
for the period from 01.01.2019 to 30.06.2019

This document is a free translation of the review report issued in Polish. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to enhance understanding. The binding Polish original should be referred to in matters of interpretation.

INDEPENDENT AUDITOR'S REVIEW REPORT

on condensed interim consolidated financial statements for the 6-month period from 1 January till 30 June 2019

To the General Meeting of Polskie Górnictwo Naftowe i Gazownictwo S.A.

Introduction

We have reviewed the accompanying condensed interim consolidated financial statements of PGNiG Group, in which the Parent Company is Polskie Górnictwo Naftowe I Gazownictwo S.A. with its registered office in Warsaw at Marcina Kasprzaka 25 Street, which comprise the introduction, consolidated statement of financial position as of 30 June 2019, consolidated income statement, consolidated statement of other comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows for the period from 1 January 2019 to 30 June 2019 and selected explanatory notes.

Financial statements have been prepared in electronic format as a file titled Raport_okresowy_GKPGNiG_1H2019_PL and have been signed with qualified electronic signatures by the Management Board on 20 August 2019.

Responsibility of the Management Board

The Management Board of Polskie Górnictwo Naftowe I Gazownictwo S.A. is responsible for the preparation and presentation of these condensed interim consolidated financial statements in accordance with the International Accounting Standard 34 *Interim financial reporting* as adopted by the European Union, hereinafter referred to as IAS 34.

Auditor's Responsibility

Our responsibility is to express a conclusion on these condensed interim consolidated financial statements based on our review.

Scope of Review

We conducted our review in accordance with National Standard on Review Engagements 2410 being International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* applicable to reviews of interim financial statements for periods ended 30 June 2019. A review of condensed interim consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with National Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed interim consolidated financial statements of PGNiG Group for 6-month period ended 30 June 2019 are not prepared, in all material respects, in accordance with IAS 34.

Qualified electronic signature on the Polish original

Cezary Bąkiewicz
Statutory Auditor No. 12 232

on behalf of PKF Consult Spółka z ograniczoną odpowiedzialnością Sp. k.
the audit firm number 477

ul. Orzycka 6 lok. 1B
02 – 695 Warsaw
Warsaw, 20 August 2019

Auditor's report

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Independent Auditor's Review Report

on the condensed interim separate
financial statements of Polskie Górnictwo Naftowe I Gazownictwo S.A.
with the registered office in Warsaw at Marcina Kasprzaka 25 Street
for the period from 01.01.2019 to 30.06.2019

This document is a free translation of the review report issued in Polish. Terminology current in Anglo-Saxon countries has been used where practicable for the purposes of this translation in order to enhance understanding. The binding Polish original should be referred to in matters of interpretation.

INDEPENDENT AUDITOR'S REVIEW REPORT

on condensed interim separate financial statements for the 6-month period from 1 January till 30 June 2019

To the General Meeting of Polskie Górnictwo Naftowe i Gazownictwo S.A.

Introduction

We have reviewed the accompanying condensed interim separate financial statements of Polskie Górnictwo Naftowe I Gazownictwo S.A. with its registered office in Warsaw at Marcina Kasprzaka 25 Street, hereinafter referred to as the Company, which comprise the introduction, separate statement of financial position as of 30 June 2019, separate income statement, separate statement of other comprehensive income, separate statement of changes in equity, separate statement of cash flows for the period from 1January 2019 to 30 June 2019 and selected explanatory notes.

Financial statements have been prepared in electronic format as a file titled Raport_okresowy_GKPGNiG_1H2019_PL and have been signed with qualified electronic signatures by the Management Board on 20 August 2019.

Responsibility of the Management Board

The Management Board of Company is responsible for the preparation and presentation of these financial statements in accordance with the International Accounting Standard 34 Interim financial reporting as adopted by the European Union, hereinafter referred to as IAS 34.

Auditor's Responsibility

Our responsibility is to express a conclusion on these condensed interim separate financial statements based on our review.

Scope of Review

We conducted our review in accordance with National Standard on Review Engagements 2410 being International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity* applicable to reviews of interim financial statements for periods ended 30 June 2019. A review of condensed interim separate financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with National Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed interim separate financial statements of Polskie Górnictwo Naftowe i Gazownictwo S.A. for 6-month period ended 30 June 2019 are not prepared, in all material respects, in accordance with IAS 34.

Qualified electronic signature on the Polish original

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Cezary Bąkiewicz
Statutory Auditor No. 12 232

on behalf of PKF Consult Spółka z ograniczoną odpowiedzialnością Sp. k.
the audit firm number 477

ul. Orzycka 6 lok. 1B
02 – 695 Warsaw

Warsaw, 20 August 2019

Polskie Górnictwo Naftowe i Gazownictwo S.A.

INTERIM REPORT
for the six months
ended June 30th 2019

prepared in accordance with
International Financial Reporting Standards
as endorsed by the European Union

PGNiG

Financial highlights

Key data from the interim condensed consolidated financial statements	PLNm		EURm	
	6 months ended Jun 30 2019	6 months ended Jun 30 2018	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Revenue	22,624	20,886	5,276	4,927
Operating profit before depreciation and amortisation (EBITDA)	3,126	4,300	729	1,014
Operating profit (EBIT)	1,675	2,974	391	701
Profit before tax	1,732	3,087	404	728
Net profit attributable to owners of the parent	1,312	2,270	306	535
Net profit	1,311	2,270	306	535
Total comprehensive income attributable to owners of the parent	1,600	2,284	373	539
Total comprehensive income	1,599	2,284	373	539
Net cash flow from operating activities	3,988	4,596	930	1,084
Net cash flow from investing activities	(2,280)	(1,741)	(532)	(411)
Net cash flow from financing activities	(2,527)	(2,376)	(589)	(560)
Net cash flow	(819)	479	(191)	113
Basic and diluted earnings per share (PLN and EUR)	0.23	0.39	0.05	0.09
	As at Jun 30 2019	As at Dec 31 2018	As at Jun 30 2019	As at Dec 31 2018
Total assets	53,312	53,271	12,538	12,389
Total liabilities	15,705	16,639	3,694	3,870
Total non-current liabilities	8,400	7,255	1,976	1,687
Total current liabilities	7,305	9,384	1,718	2,183
Total equity	37,607	36,632	8,844	8,519
Share capital	5,778	5,778	1,359	1,344
Weighted average number of ordinary shares (million)	5,778	5,778	5,778	5,778
Book value per share and diluted book value per share (PLN/EUR)	6.51	6.34	1.53	1.47
Dividend per share declared (PLN/EUR)*	0.18	0.00	0.04	0.00

**For detailed information, see Note 5.2.*

Key data from the interim condensed separate financial statements	PLNm		EURm	
	6 months ended Jun 30 2019	6 months ended Jun 30 2018	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Revenue	12,035	10,915	2,807	2,575
Operating profit before depreciation and amortisation (EBITDA)	864	1,637	201	386
Operating profit (EBIT)	447	1,249	104	295
Profit before tax	1,895	3,080	442	727
Net profit	1,772	2,791	413	658
Total comprehensive income	2,067	2,782	482	656
Net cash flow from operating activities	846	1,279	197	302
Net cash flow from investing activities	(241)	(575)	(56)	(136)
Net cash flow from financing activities	(2,387)	(1,563)	(557)	(369)
Net cash flow	(1,782)	(859)	(416)	(203)
Earnings and diluted earnings per share attributable to holders of ordinary shares (PLN and EUR)	0.31	0.48	0.07	0.11
	As at Jun 30 2019	As at Dec 31 2018	As at Jun 30 2019	As at Dec 31 2018
Total assets	36,433	36,993	8,569	8,604
Total liabilities	6,254	8,160	1,471	1,899
Total non-current liabilities	2,972	2,551	699	594
Total current liabilities	3,282	5,609	772	1,304
Equity	30,179	28,833	7,098	6,706
Share capital and share premium	7,518	7,518	1,768	1,748
Weighted average number of shares (million) in the period	5,778	5,778	5,778	5,778
Book value per share and diluted book value per share (PLN/EUR)	5.22	4.99	1.23	1.16
Dividend per share declared (PLN and EUR)*	0.18	0.00	0.04	0.00

**For detailed information, see Note 5.2.*

Average EUR/PLN exchange rates quoted by the NBP	Jun 30 2019	Jun 30 2018	Dec 31 2018
Average exchange rate for period	4.2880	4.2395	4.2669
Exchange rate at end of period	4.2520	4.3616	4.3000

Items of the statement of profit or loss, statement of comprehensive income, and statement of cash flows were translated at the EUR/PLN exchange rate computed as the arithmetic mean of the mid rates quoted by the National Bank of Poland (NBP) for the last day of each calendar month in the reporting period.
Items of the statement of financial position were translated at the mid rate for EUR/PLN quoted by the NBP at the end of the reporting period.

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1. Interim condensed consolidated financial statements

Consolidated statement of profit or loss	3 months ended Jun 30 2019	6 months ended Jun 30 2019	3 months ended Jun 30 2018	6 months ended Jun 30 2018	
	unaudited	unaudited	unaudited	unaudited	
Revenue from sale of gas	5,751	16,825	5,192	14,754	*Note 4.4.1.*
Other revenue	2,533	5,799	2,447	6,132	*Note 4.4.1.*
Revenue	**8,284**	**22,624**	**7,639**	**20,886**	
Cost of gas sold	(4,846)	(14,777)	(4,066)	(12,281)	*Note 4.5*
Other raw materials and consumables used	(628)	(1,427)	(545)	(1,338)	*Note 4.5*
Employee benefits expense	(834)	(1,547)	(723)	(1,392)	*Note 4.5*
Transmission services	(258)	(519)	(259)	(528)	
Other services	(441)	(849)	(445)	(837)	*Note 4.5*
Taxes and charges	(46)	(599)	(41)	(598)	
Other income and expenses	(265)	(17)	(114)	(2)	*Note 4.6*
Work performed by the entity and capitalised	246	483	240	454	
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	(251)	(246)	(60)	(64)	*Note 4.5*
Operating profit before depreciation and amortisation (EBITDA)	**961**	**3,126**	**1,626**	**4,300**	
Depreciation and amortisation expense	(669)	(1,451)	(657)	(1,326)	
Operating profit (EBIT)	**292**	**1,675**	**969**	**2,974**	
Net finance costs	16	31	11	51	*Note 4.7*
Profit/(loss) on equity-accounted investees	14	26	27	62	
Profit before tax	**322**	**1,732**	**1,007**	**3,087**	
Income tax	(74)	(421)	(303)	(817)	*Note 4.8*
Net profit	**248**	**1,311**	**704**	**2,270**	
Net profit attributable to:					
Owners of the parent	248	1,312	704	2,270	
Non-controlling interests	-	(1)	-	-	
Weighted average number of ordinary shares (million)	5,778	5,778	5,778	5,778	
Basic and diluted earnings per share (PLN)	0.04	0.23	0.12	0.39	

Consolidated statement of comprehensive income	3 months ended Jun 30 2019	6 months ended Jun 30 2019	3 months ended Jun 30 2018	6 months ended Jun 30 2018
	unaudited	unaudited	unaudited	unaudited
Net profit	**248**	**1,311**	**704**	**2,270**
Exchange differences on translating foreign operations	(20)	2	30	26
Hedge accounting	25	345	43	(15)
Deferred tax	(2)	(45)	1	9
Share of other comprehensive income of equity-accounted investees	-	-	-	4
Other comprehensive income subject to reclassification to profit or loss	**3**	**302**	**74**	**24**
Actuarial losses on employee benefits	(15)	(15)	(14)	(14)
Deferred tax	3	3	3	3
Share of other comprehensive income of equity-accounted investees	(2)	(2)	1	1
Other comprehensive income not subject to reclassification to profit or loss	**(14)**	**(14)**	**(10)**	**(10)**
Other comprehensive income, net	**(11)**	**288**	**64**	**14**
Total comprehensive income	**237**	**1,599**	**768**	**2,284**
Total comprehensive income attributable to:				
Owners of the parent	236	1,600	768	2,284
Non-controlling interests	1	(1)	-	-

(in PLN million, unless stated otherwise)

Consolidated statement of cash flows	6 months ended Jun 30 2019	6 months ended Jun 30 2018
	unaudited	unaudited
Cash flows from operating activities		
Net profit	1,311	2,270
Depreciation and amortisation expense	1,451	1,326
Current tax expense	421	817
Net gain/(loss) on investing activities	235	(248)
Other non-monetary adjustments	(222)	232
Income tax paid	(549)	(664)
Movements in working capital	1,341	863
Net cash from operating activities	**3,988**	**4,596**
Cash flows from investing activities		
Expenditure for acquisition of tangible exploration and evaluation assets under construction	(388)	(408)
Payments for other property, plant and equipment and intangible assets	(1,827)	(1,204)
Payments for shares in related entities	-	(90)
Other items, net	(65)	(39)
Net cash from investing activities	**(2,280)**	**(1,741)**
Cash flows from financing activities		
Increase in debt	103	4
Decrease in debt	(2,630)	(2,390)
Other items, net	-	10
Net cash from financing activities	**(2,527)**	**(2,376)**
Net cash flows	**(819)**	**479**
Cash and cash equivalents at beginning of period	3,928	2,581
Foreign exchange differences on cash and cash equivalents	5	22
Cash and cash equivalents at end of period	**3,109**	**3,060**

(in PLN million, unless stated otherwise)

Consolidated statement of financial position	As at Jun 30 2019	As at Dec 31 2018	
	unaudited	audited	
ASSETS			
Property, plant and equipment	36,713	34,236	*Note 4.9*
Intangible assets	444	1,173	
Deferred tax	32	94	
Equity-accounted investees	1,831	1,806	
Derivative financial instruments	149	226	
Other assets	1,421	1,363	
Non-current assets	**40,590**	**38,898**	
Inventories	3,178	3,364	
Receivables	4,189	5,742	
Derivative financial instruments	1,590	1,092	*Note 4.10*
Other assets	614	204	
Cash and cash equivalents	3,109	3,925	
Assets held for sale	42	46	
Current assets	**12,722**	**14,373**	
TOTAL	**53,312**	**53,271**	
EQUITY AND LIABILITIES			
Share capital	7,518	7,518	
Hedging reserve	266	73	
Accumulated other comprehensive income	(212)	(203)	
Retained earnings	30,038	29,246	
Equity attributable to owners of the parent	37,610	36,634	
Equity attributable to non-controlling interests	(3)	(2)	
TOTAL EQUITY	**37,607**	**36,632**	
Financing liabilities	2,115	1,178	
Derivative financial instruments	57	105	
Employee benefit obligations	860	808	
Provision for well decommissioning costs	2,110	1,917	*Note 4.3*
Other provisions	204	197	*Note 4.3*
Grants	701	720	
Deferred tax liabilities	2,121	2,066	
Other liabilities	232	264	
Non-current liabilities	**8,400**	**7,255**	
Financing liabilities	215	2,524	
Derivative financial instruments	1,125	1,055	*Note 4.10*
Trade and tax payables*	3,050	3,748	
Employee benefit obligations	405	347	
Provision for well decommissioning costs	59	91	*Note 4.3*
Other provisions	769	675	*Note 4.3*
Other liabilities	1,682	944	
Current liabilities	**7,305**	**9,384**	
TOTAL LIABILITIES	**15,705**	**16,639**	
TOTAL	**53,312**	**53,271**	

*Including income tax of PLN 321m (2018: PLN 418m).

(in PLN million, unless stated otherwise)

Consolidated statement of changes in equity

	Equity attributable to owners of the parent										
	Share capital and share premium, including:		Hedging reserve	Accumulated other comprehensive income:				Retained earnings	Total	Equity attributable to non-controlling interests	Total equity
	Share capital	Share premium		Exchange differences on translating foreign operations	Revaluation of financial assets available for sale	Actuarial gains/(losses) on employee benefits	Share of other comprehensive income of equity-accounted investees				
As at Jan 1 2018 (audited)	**5,778**	**1,740**	**7**	**(93)**	**(3)**	**(64)**	**(5)**	**26,266**	**33,626**	**1**	**33,627**
Impact of IFRS 9 and IFRS 15*	-	-	-	-	3	-	-	172	**175**	-	175
Net profit	-	-	-	-	-	-	-	2,270	**2,270**	-	**2,270**
Other comprehensive income, net	-	-	(6)	26	-	(11)	5	-	**14**	-	**14**
Total comprehensive income	**-**	**-**	**(6)**	**26**	**-**	**(11)**	**5**	**2,270**	**2,284**	**-**	**2,284**
Change in equity recognised in inventories	-	-	(32)	-	-	-	-	-	(32)	-	(32)
As at Jun 30 2018 (unaudited)	**5,778**	**1,740**	**(31)**	**(67)**	**-**	**(75)**	**-**	**28,708**	**36,053**	**1**	**36,054**
As at Jan 1 2019 (audited)	**5,778**	**1,740**	**73**	**(112)**	**-**	**(91)**	**-**	**29,246**	**36,634**	**(2)**	**36,632**
Impact of IFRS 16	-	-	-	-	-	-	-	121	**121**	**-**	**121**
Net profit	-	-	-	-	-	-	-	1,312	**1,312**	(1)	**1,311**
Other comprehensive income, net	-	-	300	2	-	(12)	(2)	-	**288**	-	**288**
Total comprehensive income	**-**	**-**	**300**	**2**	**-**	**(12)**	**(2)**	**1,312**	**1,600**	**(1)**	**1,599**
Change in equity recognised in inventories	-	-	(107)	-	-	-	-	-	**(107)**	-	**(107)**
Dividend	-	-	-	-	-	-	-	(636)	**(636)**	-	**(636)**
Changes in the Group	-	-	-	3	-	-	-	(5)	**(2)**	-	**(2)**
As at Jun 30 2019 (unaudited)	**5,778**	**1,740**	**266**	**(107)**	**-**	**(103)**	**(2)**	**30,038**	**37,610**	**(3)**	**37,607**

*Retained earnings changed following a review, performed at the end of 2018, of the impact of implementation of IFRS 15 as of January 1st 2018 (retained earnings before the change: -113).

2. General information

2.1. Basic information about the Group

Parent's name	Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna
Registered office	ul. Marcina Kasprzaka 25, 01-224 Warsaw, Poland
Court of registration	District Court for the Capital City of Warsaw, 16th Commercial Division
NATIONAL COURT REGISTER (KRS) NO.	0000059492
Industry Identification Number (REGON)	012216736
Tax Identification Number (NIP)	525-000-80-28
Description of business	The Company's principal business activity is exploration for and production of crude oil and natural gas; import, storage and sale of gas and liquid fuels; and trade in electricity.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna is the Parent of the PGNiG Group (the "PGNiG Group", the "Group"). The shares of PGNiG S.A. („PGNiG", the „Company", the „Parent") have been listed on the Warsaw Stock Exchange (WSE) since September 2005.

As at the date of issue of this interim report for H1 2019, the State Treasury, represented by the Minister of Energy, was the only shareholder holding 5% or more of total voting rights at the PGNiG General Meeting. For more information on the PGNiG S.A. shareholding structure, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in H1 2019.

The PGNiG Group is the only vertically integrated company in the Polish gas sector, holding the leading position in all segments of the country's gas industry. It is also a significant domestic producer of heat and electricity. The PGNiG Group's business comprises exploration for hydrocarbon deposits; production of oil and natural gas; and import, storage and distribution of and trade in gas fuels. The PGNiG Group imports gas fuel, and is the largest producer of natural gas from Polish deposits. The Group's upstream business is one of the key factors ensuring PGNiG's competitive position on the Polish gas market.

For further information on the Group's operating segments and consolidated entities, see **Note** 3.

2.2. Basis for preparation of the financial statements included in the report

These interim condensed consolidated financial statements and interim condensed separate financial statements for H1 2019 have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting (IAS 34) as endorsed by the European Union and the Regulation of the Minister of Finance on current and periodic information to be published by issuers of securities and conditions for recognition as equivalent of information whose disclosure is required under the laws of a non-member state, dated March 29th 2018 (consolidated text: Dz.U. of 2018, item 757).

These consolidated financial statements have been prepared on the assumption that the Group entities, with the exception of the subsidiary Geofizyka Kraków S.A. w likwidacji (in liquidation), will continue as going concerns in the foreseeable future. As at the date of authorisation of these financial statements for issue, no circumstances were identified which would indicate any threat to the Group's continuing as a going concern.

The Polish zloty (PLN) is the functional currency of PGNiG S.A. and the presentation currency of these consolidated financial statements. The method of translation of items denominated in foreign currencies is presented in the full-year consolidated financial statements for the year ended December 31st 2018, issued on March 14th 2019.

Unless otherwise stated, all amounts in this report are given in millions of Polish zloty.

The issue date of this interim report for H1 2019 is August 22nd 2019.

2.3. Applied accounting policies

The accounting policies applied in preparing these interim condensed consolidated and separate financial statements were consistent with the policies applied to prepare the consolidated financial statements for 2018, except for the accounting policies arising from the implementation of the new standard IFRS 16 *Leases*.

The Group applies the new IFRS 16 to recognise, measure and present lease contracts, using a modified retrospective method, with effect from January 1st 2019. The impact of the amendments to IFRS 16 on the consolidated financial statements is presented in **Note 2.5**

2.4. Effect of new standards on the financial statements of the PGNiG Group

In these financial statements, the Group did not opt to early apply any standards, interpretations or amendments to the existing standards which have been issued.

2.5. Presentation changes in the financial statements

The Group applied the new IFRS 16 in accordance with the principles set out in paragraph C5.b), i.e. retrospectively with the cumulative effect of the initial application of the standard recognised as at January 1st 2019, as an adjustment to the opening balance of retained earnings. In line with the selected implementation option, the Group did not restate the comparative data.

The new standard establishes principles for the recognition, measurement, presentation and disclosure of leases. All lease transactions result in the lessee acquiring a right-of-use asset and incurring a lease liability. Thus, IFRS 16 abolishes the operating and finance lease classification under IFRS 17 and provides a single lessee accounting model.

<u>The Group as a lessee</u>

The key changes resulting from the application of IFRS 16 at the PGNiG Group are those relating to records of land and perpetual usufruct rights to land. Starting from January 1st 2019, perpetual usufruct rights acquired free of charge are initially recognised by the Group at the present value of lease payments outstanding at the date of initial application of IFRS 16. Perpetual usufruct rights acquired for consideration are measured on initial recognition at the present value of lease payments outstanding as at January 1st 2019, increased by:

- The excess of the first payment over the annual perpetual usufruct charge in the case of perpetual usufruct agreements made with the State Treasury or a local government unit;
- The cost of acquisition of the perpetual usufruct rights to land if the agreement was made with an entity other than the State Treasury or a local government unit.

As at January 1st 2019, the Group applied IFRS 16 to contracts previously classified as operating leases under IAS 17, in the amount equal to the present value of the lease liability adjusted for any prepaid or accrued lease payments that were recognised in the statement of financial position as at December 31st 2018. The lease liability was measured at the present value of the lease payments outstanding as at January 1st 2019, discounted using the lessee's incremental borrowing rate as at January 1st 2019. The incremental borrowing rate is the interest rate at inception of the lease which the lessee would have to pay to borrow funds necessary to purchase a given asset over a similar term and with a similar security. Depending on the lease term, the Group applies an incremental borrowing rate ranging from 0.9% to 5.5%.

In the case of leases previously classified as finance leases under IAS 17, the Group recognises the right-of-use asset and the lease liability at the carrying amount of the leased asset and the lease liability directly before the day of their measurement in accordance with IAS 17.

<u>The Group as a lessor</u>

In accordance with IFRS 16, the Group did not make any changes to the existing and recognised operating and finance leases in which it was a lessor as at January 1st 2019.

IFRS 16's approach to lessor accounting is substantially unchanged from its predecessor, IAS 17. Lessors continue to classify leases as operating or finance leases, with each of them subject to different accounting treatment.

(in PLN million, unless stated otherwise)

Group companies applied the following exemptions and did not apply IFRS 16 to the measurement of the lease liability and the right-of-use asset with respect to:

- Leases of intangible assets;
- Short-term leases (with a term below 12 months);
- Leases where the underlying asset is of a low value and is not sub-leased. New assets whose initial value, regardless of the age of the leased asset, does not exceed PLN 20,000 are considered as low-value assets (even if their aggregated value is material).

Furthermore, the Group did not recognise any lease contracts or lease decisions related to underground infrastructure. Since no uniform market practice has been established in this respect, the presentation may change during the year. According to the Group's estimates, if leases had been recognised under those contracts, assets and liabilities would have increased by approximately PLN 760m as at the date of these financial statements.

The effect on the consolidated statement of financial position as at the date of initial application of IFRS 16 is presented below.

Consolidated statement of financial position	As at Dec 31 2018 before restatement	Effect of IFRS 16 on consolidated statement of financial position	As at Jan 1 2019 after restatement
ASSETS			
Non-current assets including:	**38,898**	**1,160**	**40,058**
Property, plant and equipment	34,236	1,783	36,019
Intangible assets *	1,173	(623)	550
Deferred tax	94	(5)	89
Other assets	1,363	5	1,368
Current assets including:	**14,373**	**1**	**14,374**
Assets held for sale	46	1	47
TOTAL	**53,271**	**1,161**	**54,432**
EQUITY AND LIABILITIES			
TOTAL EQUITY including:	**36,632**	**121**	**36,753**
Retained earnings	29,246	121	29,367
		-	-
Non-current liabilities including:	**7,255**	**792**	**8,047**
Financing liabilities	1,178	785	1,963
Other provisions	197	(17)	180
Deferred tax liabilities	2,066	24	2,090
Current liabilities including:	**9,384**	**248**	**9,632**
Financing liabilities	2,524	250	2,774
Other provisions	675	(2)	673
TOTAL LIABILITIES	**16,639**	**1,040**	**17,679**
TOTAL	**53,271**	**1,161**	**54,432**

* The effect of IFRS 16, i.e. a decrease in intangible assets, is related to the transfer of perpetual usufruct rights to land to property, plant and equipment (as right-of-use assets).

In the period ended June 30th 2019, the Group adjusted the effect of the implementation of IFRS 16, particularly with respect to the recognised amounts of property, plant and equipment and finance lease liabilities.

3. The Group and its reporting segments

The Group identifies five reporting segments.

Below is presented a classification of the Group's fully-consolidated entities by reporting segment. For more information on the Group structure, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in the first half of 2019.

[Country] – country of registration (if different from Poland)
** Principal place of business (if other than country of registration)*
*** On April 4th 2019, the company's liquidation process was completed.*

Figure 1 ***Group structure by reportable segments (as at June 30th 2019)***

The reporting segments were identified based on the type of business conducted by the Group companies. The individual operating segments were aggregated into reporting segments according to the aggregation criteria presented in the table below. The Parent's Management Board is the chief operating decision maker (CODM).

Segment	Description	Operating segments and aggregation criteria
Exploration and Production	The segment's business focuses on extracting hydrocarbons from deposits and preparing them for sale. It involves the process of exploration for and production of natural gas and crude oil, from geological surveys and geophysical research, through to drilling, development of gas and oil fields, and production of hydrocarbons. The segment sells natural gas to customers outside the Group and to other segments of the PGNiG Group. It also sells crude oil and other products in Poland and abroad.	This reporting segment comprises the following operating segments: exploration and production business of PGNiG S.A. as well as the Group companies specified in ***Figure 1***. The key aggregation criteria were similarity of products and services; similar characteristics of the production process and of the customer base; and economic similarities (exposure to the same market risks, as reflected in the correlation of results (margins) generated by the aggregated operating segments).
Trade and Storage	The segment's principal business activities are sale of natural gas (imported, produced or purchased on gas exchanges), operation of underground gas storage facilities for trading purposes (Mogilno, Wierzchowice, Kosakowo, Husów, Brzeźnica, Strachocina and Swarzów), and electricity trading.	This reporting segment comprises the following operating segments: PGNiG S.A.'s gas fuel and electricity trading business as well as the Group companies specified in ***Figure 1***. The segment operates seven underground gas storage facilities to ensure Poland's energy security and to build a gas portfolio that meets the market demand, which is subject to seasonal fluctuations. The key aggregation criteria were similarity of products and services, similarity of the customer base, and similar economic characteristics.
Distribution	The segment's principal business activity consists in distribution of natural gas via distribution networks to retail, industrial and wholesale customers, as well as operation, maintenance (repairs) and expansion of gas distribution networks.	This operating segment overlaps with the reporting segment Distribution, and comprises Polska Spółka Gazownictwa Sp. z o.o. and its subsidiaries specified in ***Figure 1***.
Generation	The segment's principal business activities consist in generation and sale of electricity and heat.	This reporting segment comprises the following operating segments: PGNiG TERMIKA S.A. and its subsidiary PGNiG TERMIKA Energetyka Przemysłowa S.A. The key aggregation criteria were similarity of products and services, similarity of the customer base, and similar economic characteristics.
Other Activities	This segment comprises operations which cannot be classified into any of the segments listed above, i.e. the functions performed by the PGNiG Corporate Centre, engineering design and construction of structures, machinery and equipment for the extraction and energy sectors, as well as catering and hospitality and insurance services.	This reporting segment comprises the following operating segments: PGNiG S.A.'s activities related to corporate support for other reporting segments, and the Group entities which do not qualify for inclusion in the other reporting segments, specified under Other Activities in ***Figure 1.***

(in PLN million, unless stated otherwise)

3.1. Key data on the reporting segments

6 months ended Jun 30 2019	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation expense	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) on equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	1,564	1,428	2,992	1,990	(540)	1,450	(213)	27	(655)	13,512	6,714
Trade and Storage	17,688	189	17,877	(233)	(99)	(332)	(2)	-	(27)	3,217	3,074
Distribution	2,449	23	2,472	1,070	(477)	593	5	-	(1,074)	14,809	11,768
Generation	873	537	1,410	462	(304)	158	-	-	(386)	4,630	1,841
Other segments	50	153	203	(160)	(31)	(191)	(36)	(1)	(73)	767	1,644
Total	**22,624**	**2,330**	**24,954**	**3,129**	**(1,451)**	**1,678**	**(246)**	**26**	**(2,215)**	**36,935**	**25,041**
Reconciliation with consolidated data			(2,330)	(3)	-	(3)	-	-	-	(222)	
Total			**22,624**	**3,126**	**(1,451)**	**1,675**	**(246)**	**26**	**(2,215)**	**36,713**	

*Excluding employees of equity-accounted investees.

6 months ended Jun 30 2018	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation expense	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) on equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	1,831	1,829	3,660	2,567	(521)	2,046	(65)	55	(588)	12,525	6,893
Trade and Storage	15,528	242	15,770	(29)	(93)	(122)	-	-	(26)	3,249	3,002
Distribution	2,547	140	2,687	1,384	(457)	927	1	-	(769)	13,275	11,600
Generation	888	377	1,265	466	(220)	246	-	-	(163)	3,491	1,821
Other segments	92	151	243	(80)	(35)	(115)	-	7	(62)	461	1,533
Total	**20,886**	**2,739**	**23,625**	**4,308**	**(1,326)**	**2,982**	**(64)**	**62**	**(1,608)**	**33,001**	**24,849**
Reconciliation with consolidated data			(2,739)	(8)	-	(8)	-	-	(4)	(191)	
Total			**20,886**	**4,300**	**(1,326)**	**2,974**	**(64)**	**62**	**(1,612)**	**32,810**	

*Excluding employees of equity-accounted investees.

For discussion of the Group's financial results, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in the first half of 2019.

(in PLN million, unless stated otherwise)

4. Notes to the interim condensed consolidated financial statements

4.1. Deferred tax

	Deferred tax	Deferred tax liabilities	Set-off of assets and liabilities	Assets after set-off	Liabilities after set-off	Net effect of changes in the period
As at Jan 1 2018	**1,001**	**2,879**	**(860)**	**141**	**2,019**	
Impact of IFRS 9 and IFRS 15	(44)	-				**(44)**
Increase	167	155				**12**
Decrease	(199)	(138)				**(61)**
Currency translation differences	5	31				**(26)**
Other changes	-	(25)				**25**
As at Dec 31 2018	**930**	**2,902**	**(836)**	**94**	**2,066**	**(94)**
As at Jan 1 2019	**930**	**2,902**	**(836)**	**94**	**2,066**	
Impact of IFRS 16	(5)	24				**(29)**
Increase	88	128				**(40)**
Decrease	(37)	(3)				**(34)**
Currency translation differences	-	17				**(17)**
Other changes	-	(3)				**3**
As at Jun 30 2019	**976**	**3,065**	**(944)**	**32**	**2,121**	**(117)**

4.2. Impairment losses/write-downs

	Property, plant and equipment	Intangible assets	Assets held for sale	Equity-accounted investees	Other (non-current) assets	Inventories	Receivables	Other (current) assets	Total
As at Jan 1 2018	**4,038**	**84**	**17**	**844**	**30**	**191**	**759**	**-**	**5,963**
Impact of IFRS 9	-	-	-	-	-	-	68	-	**68**
Recognised provision taken to profit or loss	743	8	4	49	-	136	466	1	**1,407**
Provision reversal taken to profit or loss	(969)	(10)	-	-	-	(125)	(339)	-	**(1,443)**
Used	(32)	(1)	-	-	-	(2)	(31)	-	**(66)**
Transferred	-	-	(15)	-	25	-	(10)	-	**-**
Other changes	18	3	(1)	-	7	-	(3)	-	**24**
As at Dec 31 2018	**3,798**	**84**	**5**	**893**	**62**	**200**	**910**	**1**	**5,953**
As at Jan 1 2019	**3,798**	**84**	**5**	**893**	**62**	**200**	**910**	**1**	**5,953**
Impact of IFRS 16	21	(22)	-	-	-	-	-	-	**(1)**
Recognised provision taken to profit or loss	486	7	-	12	-	183	119	-	**807**
Provision reversal taken to profit or loss	(270)	(1)	-	-	-	(108)	(135)	-	**(514)**
Used	(39)	-	(1)	-	-	-	(29)	-	**(69)**
Transferred	-	-	-	-	-	-	-	-	**-**
Other changes	(4)	1	-	-	-	(1)	(2)	-	**(6)**
As at Jun 30 2019	**3,992**	**69**	**4**	**905**	**62**	**274**	**863**	**1**	**6,170**

(in PLN million, unless stated otherwise)

4.3. Provisions

	Provision for well decommissioning costs	Provision for certificates of origin and energy efficiency certificates	Provision for liabilities associated with exploration work abroad	Provisions for environmental liabilities	Provision for UOKiK fine	Provision for claims under extra-contractual use of land	Other provisions	Total	
As at Jan 1 2018	**1,770**	**155**	**163**	**124**	**10**	**31**	**319**	**2,572**	
Impact of IFRS 9	-	-	-	-	-	-	18	**18**	
Recognised provision capitalised in cost of property, plant and equipment	237	-	-	-	-	-	-	**237**	
Recognised provision taken to profit or loss	55	134	-	5	-	4	178	**376**	
Provision reversal taken to profit or loss	(35)	(54)	-	(14)	-	(12)	(107)	**(222)**	
Used	(28)	(114)	-	-	(10)	-	(3)	**(155)**	
Other changes	9	30	12	-	-	-	3	**54**	
As at Dec 31 2018	**2,008**	**151**	**175**	**115**	**-**	**23**	**408**	**2,880**	
As at Jan 1 2019	**2,008**	**151**	**175**	**115**	**-**	**23**	**408**	**2,880**	
Impact of IFRS 16	-	-	-	(19)	-	-	-	**(19)**	
Recognised provision capitalised in cost of property, plant and equipment	184	-	-	-	-	-	-	**184**	
Recognised provision taken to profit or loss	23	138	-	20	-	1	128	**310**	*Note 4.6*
Provision reversal taken to profit or loss	(39)	(34)	-	(5)	-	(3)	(60)	**(141)**	*Note 4.6*
Used	(13)	(54)	-	-	-	-	(11)	**(78)**	
Other changes	6	(1)	(2)	-	-	-	3	**6**	
As at Jun 30 2019	**2,169**	**200**	**173**	**111**	**-**	**21**	**468**	**3,142**	

(in PLN million, unless stated otherwise)

4.4. Revenue

The Group's revenue comes primarily from trade in high-methane and nitrogen-rich natural gas, generation and sale of electricity and heat, as well as sale of produced crude oil.

The Group's business includes services, such as distribution of gas fuels, storage of gas fuels, geophysical and geological services, gas service connection, drilling and oilfield services, and other services.

The Group sells its products to both retail and business customers.

4.4.1. Revenue by product

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Revenue from sale of gas, including:	**16,825**	**14,754**
High-methane gas	15,673	14,233
Nitrogen-rich gas	779	714
LNG	41	38
CNG	19	17
Propane-butane gas	33	32
Adjustment to gas sales due to hedging transactions	280	(280)
Other revenue, including:	**5,799**	**6,132**
Crude oil and natural gasoline	919	1,194
NGL	46	62
Sale of heat	741	744
Sale of electricity	1,195	1,046
Revenue from rendering of services:		
- drilling and oilfield services	61	83
- geophysical and geological services	38	40
- construction and assembly services	37	69
- distribution services	2,288	2,411
- connection charge	81	73
- other	131	184
Other	262	226
Total revenue	**22,624**	**20,886**

(in PLN million, unless stated otherwise)

4.4.2. Segment revenue by product

6 months ended Jun 30 2019	Exploration and Production	Trade and Storage	Distribution	Generation	Other segments	Reconciliation with consolidated data	Total
Revenue from sale of gas, including:	**1,805**	**16,577**	**-**	**-**	**-**	**(1,557)**	**16,825**
High-methane gas	1,101	15,762	-	-	-	(1,190)	**15,673**
Nitrogen-rich gas	654	487	-	-	-	(362)	**779**
LNG	17	29	-	-	-	(5)	**41**
CNG	-	19	-	-	-	-	**19**
Propane-butane gas	33	-	-	-	-	-	**33**
Adjustment to gas sales due to hedging transactions	-	280	-	-	-	-	**280**
Other revenue, including:	**1,187**	**1,300**	**2,472**	**1,410**	**203**	**(773)**	**5,799**
Crude oil and natural gasoline	919	-	-	-	-	-	**919**
NGL	46	-	-	-	-	-	**46**
Sale of heat	-	-	-	741	-	-	**741**
Sale of electricity	-	1,204	-	553	-	(562)	**1,195**
Revenue from rendering of services:							
- drilling and oilfield services	61	-	-	-	-	-	**61**
- geophysical and geological services	38	-	-	-	-	-	**38**
- construction and assembly services	26	-	-	-	34	(23)	**37**
- distribution services	-	-	2,262	40	-	(14)	**2,288**
- connection charge	-	-	81	-	-	-	**81**
- other	11	79	11	15	158	(143)	**131**
Other	86	17	118	61	11	(31)	**262**
Total revenue	**2,992**	**17,877**	**2,472**	**1,410**	**203**	**(2,330)**	**22,624**

6 months ended Jun 30 2018	Exploration and Production	Trade and Storage	Distribution	Generation	Other segments	Reconciliation with consolidated data	Total
Revenue from sale of gas, including:	**2,179**	**14,588**	**-**	**-**	**-**	**(2,013)**	**14,754**
High-methane gas	1,445	14,353	-	-	-	(1,565)	**14,233**
Nitrogen-rich gas	684	475	-	-	-	(445)	**714**
LNG	18	23	-	-	-	(3)	**38**
CNG	-	17	-	-	-	-	**17**
Propane-butane gas	32	-	-	-	-	-	**32**
Adjustment to gas sales due to hedging transactions	-	(280)	-	-	-	-	**(280)**
Other revenue, including:	**1,481**	**1,182**	**2,687**	**1,265**	**243**	**(726)**	**6,132**
Crude oil and natural gasoline	1,194	-	-	-	-	-	**1,194**
NGL	62	-	-	-	-	-	**62**
Sale of heat	-	-	1	743	-	-	**744**
Sale of electricity	-	1,061	-	393	-	(408)	**1,046**
Revenue from rendering of services:							
- drilling and oilfield services	87	-	-	-	-	(4)	**83**
- geophysical and geological services	40	-	-	-	-	-	**40**
- construction and assembly services	25	-	-	-	64	(20)	**69**
- distribution services	-	-	2,380	40	-	(9)	**2,411**
- connection charge	-	-	73	-	-	-	**73**
- other	18	112	18	14	170	(148)	**184**
Other	55	9	215	75	9	(137)	**226**
Total revenue:	**3,660**	**15,770**	**2,687**	**1,265**	**243**	**(2,739)**	**20,886**

(in PLN million, unless stated otherwise)

4.5. Operating expenses

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Cost of gas sold	**(14,777)**	**(12,281)**
Gas fuel	(14,778)	(12,290)
Cost of transactions hedging gas prices	1	9
Other raw materials and consumables used	**(1,427)**	**(1,338)**
Fuels for electricity and heat generation	(552)	(466)
Electricity for trading purposes	(639)	(657)
Other raw materials and consumables used	(236)	(215)
Employee benefits expense	**(1,547)**	**(1,392)**
Salaries and wages	(1,098)	(1,049)
Social security contributions	(248)	(235)
Cost of long-term employee benefits	(83)	2
Other employee benefits expense	(118)	(110)
Other services	**(849)**	**(837)**
Regasification services	(188)	(181)
Repair and construction services	(89)	(99)
Mineral resources production services	(109)	(119)
Rental services	(32)	(48)
Other services	(431)	(390)
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	**(246)**	**(64)**
Cost of exploration and evaluation assets written-off	(24)	(376)
Impairment losses on property, plant and equipment	(216)	312
Impairment losses on intangible assets	(6)	-
Total	**(18,846)**	**(15,912)**

4.6. Other income and expenses

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Compensations, penalties, and fines received	17	18
Exchange differences related to operating activities	5	114
Measurement and exercise of derivative financial instruments	64	(73)
Change in inventory write-downs	(75)	63
Change in impairment losses on trade and other receivables	16	(35)
Change in provision for well decommissioning costs	16	(4)
Change in provision for certificates of origin and energy efficiency certificates	(104)	(26)
Change in other provisions	(90)	(22)
Change in products	176	170
Change in underlift/ overlift	105	(92)
Other income and expenses	(147)	(115)
Total other income and expenses	**(17)**	**(2)**

(in PLN million, unless stated otherwise)

4.7. Net finance income/(costs)

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Interest on debt (including fees)	(37)	(28)
Foreign exchange differences	20	28
Measurement and exercise of derivative financial instruments not designated for hedge accounting	(2)	(9)
Fair value measurement of financial assets	1	21
Other net finance costs (income)	49	39
Total net finance costs	**31**	**51**

4.8. Income tax

Reconciliation of effective tax rate	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Profit before tax	1,732	3,087
Corporate income tax at the 19% statutory rate applicable in Poland	(329)	(587)
Deductible temporary differences with respect to which no deferred tax was recognised	(92)	(230)
Income tax expense disclosed in the statement of profit or loss	**(421)**	**(817)**
Including:		
Current tax expense	(390)	(722)
Deferred tax expense	(31)	(95)
Effective tax rate	24%	26%

Tax group

PGNIG S.A. is a company that represents the PGNiG Tax Group with respect to its obligations under the Act on Corporate Income Tax and the Tax Ordinance Act. The PGNiG Tax Group was established under an agreement of September 19th 2016, for a period from January 1st 2017 to December 31st 2020.

The PGNiG Tax Group comprises: PGNiG S.A., PGNiG Obrót Detaliczny Sp. z o.o., Polska Spółka Gazownictwa Sp. z o.o., PGNiG Termika S.A., Gas Storage Poland Sp. z o.o., PGNiG SPV 5 Sp. z o.o., PGNiG SPV 6 Sp. z o.o., PGNiG SPV 7 Sp. z o.o., Geofizyka Toruń S.A., PGNiG Technologie S.A., and PGNiG Serwis Sp. z o.o.

In accordance with the Act on Corporate Income Tax, the companies included in the PGNiG Tax Group have lost their status of tax payers under the Act on Corporate Income Tax and this status was acquired by the PGNiG Tax Group as a whole, which makes it possible to calculate corporate income tax jointly for all members of the PGNiG Tax Group. The PGNiG Tax Group is a separate entity only for corporate income tax purposes, and should not be viewed as a separate legal person. Its tax status does not extend to other types of taxes; in particular, each of the companies forming the PGNiG Tax Group is a separate payer of value-added tax and of tax on civil-law transactions, and a separate remitter of personal income tax withholdings. The other companies of the PGNiG Group are separate payers of corporate income tax.

The PGNiG Tax Group is a source of certain benefits for its member companies, including:

- ability to offset losses generated by individual members of the PGNiG Tax Group against profits earned by other member companies in the period when such losses are incurred,
- CIT settlement by one entity only.

(in PLN million, unless stated otherwise)

4.9. Property, plant and equipment

	As at Jun 30 2019	As at Dec 31 2018
Land	1,550	106
Buildings and structures	19,408	19,040
Plant and equipment	8,503	8,557
Vehicles and other	1,241	1,209
Total tangible assets	**30,702**	**28,912**
Tangible exploration and evaluation assets under construction	2,293	2,008
Other tangible assets under construction	3,718	3,316
Total property, plant and equipment	**36,713**	**34,236**

4.9.1. Material transactions to purchase or sell items of property, plant and equipment

In the reporting period, the Group did not execute any material transactions to purchase or sell items of property, plant and equipment.

4.9.2. Material liabilities related to purchase of property, plant and equipment

In the reporting period, the Group did not carry any material liabilities related to purchase of property, plant and equipment.

(in PLN million, unless stated otherwise)

4.10. Derivative financial instruments

The Group uses derivative financial instruments to hedge commodity, currency and interest rate risk exposures.

In the reporting period, the Parent accounted for all eligible transactions using cash-flow or fair-value hedge accounting. The Company was party to CCIRS transactions, which are not designated for hedge accounting, As the valuation of both the hedged item and the hedge (the derivative transaction) is recognised in profit or loss, which produces the same effect as if hedge accounting was applied.

In the current reporting period, in its trading activity, the Parent entered into transactions within the approved limits. The aggregate amount of hedging transactions does not exceed the amount of the hedged items.

The transactions in derivative financial instruments entered into by the Parent are based on the ISDA (International Swap & Derivatives Association) standards or Polish Master Agreements prepared in accordance with the guidelines of the Polish Banks Association.

The effect of the valuation of derivative instruments on profit or loss is presented in the table below.

Income and expenses related to assets and liabilities under derivative financial instruments			**6 months ended Jun 30 2019**		**6 months ended Jun 30 2018**	
Item of statement of profit or loss and statement of comprehensive income	**Item referenced in Note / additional explanations**	**Note**	**Derivative financial instruments not designated for hedge accounting**	**Derivative financial instruments designated for cash flow hedge accounting**	**Derivative financial instruments**	**Derivative financial instruments designated for cash flow hedge accounting**
Effect on statement of profit or loss						
Net finance costs	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 4.7*	(2)	-	(9)	-
Other income and expenses	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 4.6*	64	-	(73)	-
	Reclassification from other comprehensive income	*Note 4.6*	-	-	-	-
Revenue	Reclassification from other comprehensive income	*Note 4.4.1.*	-	280	-	(280)
Cost of gas sold	Reclassification from other comprehensive income	*Note 4.5*	-	1	-	9
			62	**281**	**(82)**	**(271)**
Effect on other comprehensive income						
Gains/(losses) on measurement of derivative instruments designated for cash flow hedge accounting [effective portion]				626		(286)
Reclassification of derivative instruments measurement to profit or loss upon exercise (cash flow hedges)				(281)		271
				345		**(15)**
Effect on comprehensive income			**62**	**626**	**(82)**	**(286)**
Change in equity recognised in inventories				**(107)**		**(32)**

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The tables below present derivative instruments held by the Group as at June 30th 2019.

Derivative instruments designated for hedge accounting	As at Jun 30 2019					As at Dec 31 2018		
Type of derivative instrument	Notional amount (million)	Period when cash flow will occur and affect the financial result	Exercise price (exercise price range)	Weighted average exercise price	Fair value of instruments for which cash flow hedge accounting is applied	Notional amount (million)	Period when cash flow will occur and affect the financial result	Fair value of instruments for which cash flow hedge accounting is applied
Derivative instruments used to hedge currency risk in gas purchase and sale contracts								
Forwards								
USD	619 USD	up to 3 years	3,34-3,73	3.57	96	901 USD	up to 3 years	216
USD	225 USD	1–3 months	3,73-3,83	3.78	(10)	77 USD	1–3 months	(1)
EUR	1,181 EUR	up to 3 years	4,37-4,49	4.44	141	1,354 EUR	up to 3 years	50
EUR	196 EUR	up to 12 months	4,33-4,41	4.39	(20)	438 EUR	up to 3 years	(18)
					207			**247**
Derivative instruments used to hedge gas purchase and selling prices								
TTF swap MA	3 MWh	1–3 months	9.8	9.80	4	-	-	-
TTF swap DA	30 MWh	up to 3 years	9,12-21,71	18.54	224	9 MWh	up to 3 years	67
TTF swap MA	2 MWh	1–3 months	11.47	11.47	(7)	2 MWh	1–3 months	(9)
TTF swap DA	18 MWh	up to 3 years	9,57-19,75	15.18	(157)	3 MWh	up to 3 years	(54)
GASPOOL Swap DA	10 MWh	up to 3 years	16,73-21,98	20.61	152	6 MWh	up to 3 years	57
GASPOOL Swap DA	4 MWh	up to 3 years	15,97-16,40	16.19	(39)	16 MWh	up to 3 years	(276)
HH NYMEX	4 MMBTU	up to 3 years	2,65-2,66	2.66	(3)			
					174			**(215)**
				Total	**381**		**Total**	**32**
			Including:	Assets	616	Including:	Assets	390
				Liabilities	235		Liabilities	358

TTF – Natural Gas at the Title Transfer Facility
IRS – Interest Rate Swap
MA – month-ahead; DA – day-ahead
MMBTU - a million of international British Thermal Units

Derivative instruments not designated for hedge accounting	As at Jun 30 2019		As at Dec 31 2018	
Type of derivative instrument	Notional amount (million)	Fair value of instruments not designated for hedge accounting	Notional amount	Fair value of instruments not designated for hedge accounting
Derivative instruments hedging interest rate risk and currency risk				
CCIRS				
NOK	2,318 NOK	96	2,318 NOK	94
Forwards				
EUR	17 EUR	-	573 EUR	16
EUR	289 EUR	30	97 EUR	(8)
EUR	1 EUR	-	336 EUR	(15)
		126		**87**
Derivative instruments used as economic hedges of electricity purchase prices				
Forwards				
Electricity	-	3	-	-
Electricity	9 MWh	(31)	-	-
electricity – PPX	-	-	0.3 MWh	12
electricity – PPX	-	-	8 MWh	(7)
electricity – OTC	1 MWh	35	1 MWh	75
electricity – OTC	1 MWh	(16)	2 MWh	(97)
Futures				
electricity – EEX AG	4 MWh	124	5 MWh	203
electricity – EEX AG	4 MWh	(113)	5 MWh	(180)
		2		**6**
Derivative instruments used to hedge gas purchase and selling prices				
Forwards				
Gas	1	-	-	-
Gas	249	(12)	30 MWh	305
gas - TGE	2 MWh	(26)	33 MWh	(342)
gas - TGE	-	1	-	-
gas – OTC	24 MWh	497	-	-
gas – OTC	22 MWh	(425)	-	-
Futures				
gas – ICE ENDEX B.V.	7 MWh	168	7 MWh	85
gas – ICE ENDEX B.V.	6 MWh	(132)	5 MWh	(63)
gas – POWERNEXT SA	4 MWh	61	6 MWh	74
gas – POWERNEXT SA	5 MWh	(104)	6 MWh	(59)
GASPOOL DA	4 MWh	59	-	-
GASPOOL DA	3 MWh	(26)	-	-
HH NYMEX	4 MMBTU	5	-	-
HH NYMEX	4 MMBTU	(8)	-	-
TTF swap DA	2 MWh	35	1 MWh	2
TTF swap MA	2 MWh	(11)	5 MWh	37
TTF swap DA	2 MWh	(37)	1 MWh	(11)
TTF swap DA	-	-	2 MWh	(7)
		45		**21**
Derivative instruments used to hedge oil prices				
Futures				
Crude oil – ICE Futures Europe	0.2 Bbl	1	0.3 Bbl	11
Crude oil – ICE Futures Europe	0.2 Bbl	(1)	0.3 Bbl	(11)
		-		**-**

(in PLN million, unless stated otherwise)

Derivative instruments used to hedge purchase prices of CO_2 emission allowances				
Forwards	72 EUR	(5)	2 EUR	-
Forwards	-	-	16 EUR	-
Forwards	-	-	16 EUR	-
Futures	8 t	(2)	1 t	-
		(7)		**-**
Derivative instruments used to hedge share purchase prices				
Options	9.125 million shares	10	9.125 million shares	12
	Total	**176**	**Total**	**126**
	Including:		Including:	
	Assets	1,123	Assets	928
	Liabilities	947	Liabilities	802

CCIRS – Cross Currency Interest Rate Swap
PPE – Towarowa Giełda Energii S.A. (Polish Power Exchange)
OTC – non-regulated over-the-counter market
EEX AG – European Energy Exchange AG
ICE ENDEX B.V. and POWERNEXT SA – leading energy exchanges in Europe

4.11. Contingent assets and liabilities

Contingent asset	As at Jun 30 2019	As at Dec 31 2018
	Estimated amount	
Promissory notes received	1	1
Grants awarded*	221	218
Other contingent assets	14	14
Total	**236**	**233**

* Under EU funding agreements executed by Polska Spółka Gazownictwa Sp. z o.o.

Contingent liabilities	As at Jun 30 2019	As at Dec 31 2018
	Estimated amount	
Guarantees and sureties	4,230	3,504
Promissory notes	553	784
Other	11	8
Total	**4,794**	**4,296**

The change in contingent liabilities under sureties and guarantees issued in the reporting period was principally due to new guarantees issued as security for gas supplies, totalling EUR 178m (PLN 759m at the exchange rate quoted by the NBP for June 30th 2019).

4.12. Fair value hierarchy

In the reporting period, the Group made no changes to the fair value measurement method used to measure financial instruments. There were also no transfers between fair value hierarchy levels.

	As at Jun 30 2019		As at Dec 31 2018	
	Level 1	Level 2	Level 1	Level 2
Financial assets				
Derivative instruments	925	814	763	555
	925	**814**	**763**	**555**
Financial liabilities				
Derivative instruments	871	311	819	341
	871	**311**	**819**	**341**

4.13. Classification of financial assets

In the reporting period, no changes were made to the classification of the Group's financial assets.

(in PLN million, unless stated otherwise)

5. Supplementary information to the report

5.1. Key events related to the issuer in the reporting period

Date	Company	Event
Jan 16 2019	PGNiG S.A.	The PGNiG Supervisory Board passed a resolution to remove Mr Radosław Bartosik from the position of Vice President of the PGNiG Management Board, Chief Operating Officer.
Jan 25 2019	Polska Spółka Gazownictwa sp. z o.o.	By a decision of January 25th 2019, the President of the Energy Regulatory Office ("President of ERO") approved new Tariff No. 7 for gas fuel distribution and liquefied natural gas regasification services provided by Polska Spółka Gazownictwa sp. z o.o. (the "Distribution Tariff"). The prices and rates of network fees used for settlements with customers, provided in the Distribution Tariff were reduced by an average of 5% in relation to the current tariff of Polska Spółka Gazownictwa sp. o.o. for all tariff groups with the exception of coke gas. The Distribution Tariff will be effective from February 15th to December 31st 2019. For detailed information on the approved Distribution Tariff, see www.ure.gov.pl and *Biuletyn Branżowy URE – Paliwa gazowe* (the ERO official gazette – Gas fuels).
Jan 25 2019	PGNiG Obrót Detaliczny Sp. z o.o.	On January 25th 2019, the President of URE approved new Gas Fuel Trading Tariff No. 7 of PGNiG Obrót Detaliczny Sp. z o.o. (the "Retail Tariff"). The new Retail Tariff provides for a 2.5% increase in gas fuel prices for all tariff groups relative to the previous tariff of PGNiG Obrót Detaliczny Sp. z o.o. Subscription fees were adjusted in tariff groups 2.2 (reduced by 1.3%) and 3.6 (increased by 0.3%), while in the other tariff groups they remained unchanged. Furthermore, new Retail Tariff groups were introduced for customers using prepaid metering systems. The Retail Tariff applies only to household consumers of gas fuels. The Retail Tariff will be effective from February 15th to December 31st 2019. For detailed information on the approved tariffs, see www.ure.gov.pl and Biuletyn Branżowy URE – Paliwa gazowe (the ERO official gazette – Gas fuels).
Mar 11 2019	PGNiG S.A. PGNiG TERMIKA S.A.	On March 11th 2019, the President of the Office of Competition and Consumer Protection (UOKiK) issued a notification to the effect that antitrust proceedings had been opened in a case of a suspected breach of the prohibitions laid down in Art. 6.1.1, 6.1.3 and 6.1.7 of the Act on Competition and Consumer Protection and Art. 101(1)(a) and (c) of the Treaty on the Functioning of the European Union regarding fixing heat prices, sharing the heat market and fixing bids in procurement procedures for the sale and delivery of heat, as a result of an agreement that was allegedly made in 2014, with Veolia Energia Warszawa S.A., Veolia Energia Polska S.A., PGNiG TERMIKA S.A. and PGNiG as the parties to the proceedings.
Mar 14 2019	PGNiG S.A.	The PGNiG Supervisory Board passed a resolution to appoint Robert Perkowski as a member of the PGNiG Management Board, Chief Operating Officer, with effect as of March 18th 2019.
Apr 1 2019	PGNiG S.A.	On April 1st 2019, PBG S.A. ("PBG") submitted a counterclaim against PGNiG with the Regional Court in Warsaw, 20th Commercial Division. In the counterclaim, PBG is pursuing against PGNiG a claim arising out of: • the contract concluded with PGNIG S.A. on November 19th 2008 to execute the investment project "Construction of the Wierzchowice Underground Gas Storage Facility, phase 3.5bn nm^3, sub-phase 1.2bn nm^3" (the "Contract"), i.e. the claim for payment by PGNiG of the remaining remuneration due to the Consortium (PBG S.A., Tecnimont S.P.A., TCM FR S.A., Plynostav Pardubice Holding a.s., Plynostav-Regulace Plynu a.s.) under the Contract; and • the contract of August 11th 2008 concluded with PGNIG S.A. for the execution of the LMG project – central facility, well areas, pipelines and other infrastructure (the "LMG Contract"), i.e. PGNiG's refund to PBG of the deposit securing warranty claims, which was offset under the LMG Contract against PGNiG's disputed claims against

(in PLN million, unless stated otherwise)

		the Consortium under the LMG Contract. The claims total PLN 118.1m, together with default interest accrued from the claim filing date to the actual payment date. As at the date of issue of this report, PGNiG is analysing whether a provision should be recognised for the cost of the claim
Apr 12 2019	PGNiG S.A.	On April 12th 2019, an agreement was signed with PKF Consult Sp. z o.o. Sp.k. for the audit of consolidated and separate financial statements of selected PGNiG Group companies for 2019–2020.
Apr 25 2019	Elektrociepłownia Stalowa Wola S.A. (entity jointly controlled by PGNiG (indirectly) – 50% owned by PGNiG TERMIKA S.A.)	The Court of Arbitration at the Polish Chamber of Commerce in Warsaw (the "Arbitration Court") issued the award in a case brought by Abener Energía S.A. of Campus Palmas Altas, Seville, ("Abener Energia") against Elektrociepłownia Stalowa Wola S.A. of Stalowa Wola ("ECSW"). The proceedings before the Arbitration Court concerned claims for payment, determination of the legal relationship and obligation to make a declaration of will in connection with the terminated contract between Abener Energia (general contractor) and ECSW (the contracting authority) for the construction of a ca. 400 MW CCGT unit with a heating unit at Elektrociepłownia Stalowa Wola S.A. The Court of Arbitration ordered ECSW to pay to Abener Energia PLN 334m plus default interest at the statutory rate and costs of arbitration. The Arbitration Court's award may be appealed against to a court of general jurisdiction. ECSW is analysing the award and its grounds with a view to filing a claim to vacate the award.
May 23 2019	PGNiG S.A.	Further to Current Report No. 31/2016 of April 13th 2016 and Current Report No. 52/2017 of June 21st 2017 concerning the conclusion of Individual Contracts with the Grupa Azoty Group, PGNiG received from five Grupa Azoty Group companies, namely Grupa Azoty S.A. of Tarnów, Grupa Azoty Zakłady Azotowe Puławy S.A., Grupa Azoty Zakłady Chemiczne Police S.A., Grupa Azoty Zakłady Azotowe Kędzierzyn S.A., and Grupa Azoty Kopalnie i Zakłady Chemiczne Siarki Siarkopol S.A. ("Customers"), representations confirming the extension by the Grupa Azoty Group companies of the term of the Individual Contracts executed under the Framework Agreement on sale of gas fuel of April 13th 2016 ("Individual Contracts"). As a result of the extension, PGNiG will remain the strategic supplier of gas to the Grupa Azoty Group companies listed above until September 30th 2022. The aggregate amount of the Individual Contracts may exceed PLN 8bn over the four years of the Contracts' term. The applied pricing formula is based on gas market price indices.
Jun 7 2019	PGNiG Upstream Norway AS	PGNiG Upstream Norway AS ("PUN") concluded an agreement for the purchase of interests in licences on the Norwegian Continental Shelf from Total E&P Norge AS (the "Agreement"). The Agreement provides for the acquisition from Total E&P Norge AS of a 22.2% interest in licence areas PL146 and PL333 (the "Licences"), including the King Lear gas field. The field operator is AkerBP, which holds a 77.8% interest purchased in 2018 from Equinor Energy AS. King Lear is an gas and oil field located in the North Sea. According to the Norwegian Petroleum Directorate data, the field has recoverable reserves of 9.2 bcm of natural gas and 6.5 mcm of crude oil. The parties agreed to treat the transaction value as a trade secret. Currently, work is under way on the field development concept for the Licence areas. The investment process is planned to span from 2021 to 2024 and production is to start in 2025. Based on the operator's current data, after the field goes on stream, gas production attributable to PUN is expected to be 0.25 bcm per annum. The Licences were purchased under the PGNiG Group Strategy for 2017–2022 (with an outlook until 2026). The Agreement provides for conditions precedent, including obtaining the required administrative approvals in Norway.
Jun 12 2019	PGNiG S.A.	On June 12th 2019, PGNiG executed an annex to the long-term contract of September 28th 2018 (the "Annex") for the supply of liquefied natural gas (LNG) signed with Venture Global

(in PLN million, unless stated otherwise)

		Plaquemines LNG, LLC. The Annex provides for an increase in the volume of LNG deliveries to PGNiG from the planned Plaquemines LNG liquefaction terminal in Plaquemines Parish, US from 1m tonnes to 2.5m tonnes per year, which corresponds to a total volume of nearly 3.4 bcm of natural gas after regasification. Following the execution of the Annex, the total volume of LNG deliveries to be made by Venture Global Plaquemines LNG, LLC and Venture Global Calcasieu Pass, LLC in 2023-2043 to PGNiG may reach 3.5 million tonnes of LNG per year, i.e. over 4.7 bcm of natural gas after regasification per year. The deliveries will be made on a free-on-board basis. In the opinion of the PGNiG Management Board, the negotiated terms and conditions of the Annex are satisfactory in the context of the PNGiG Group's strategy to expand LNG trading on global markets.
Jun 26 2019	PGNiG S.A.	On June 26th 2019, Moody's Investors Service ("Moody's", the "Agency") announced an upgrade of PGNiG's credit rating from Baa3 to Baa2 with a stable outlook. Moody's rating opinion emphasises PGNiG's current, significant financial flexibility, allowing it to absorb increased debt levels and maintain its conservative financial and dividend policy. According to Moody's, the key reasons for the rating upgrade are the Company's dominant position in the domestic gas market and the ability to retain its strong financial metrics over the next years despite substantial investments which are focused on the Exploration and Production segment, also taking into account the adverse effect of macroeconomic factors expected by the credit rating agency on future financial performance in the Exploration and Production and Trade and Storage segments. The stable rating outlook reflects Moody's expectation that PGNiG will be able to retain its strong liquidity profile despite substantial investments and will continue to build a sustainable hydrocarbon reserve base in Poland and Norway. At the same time, the Agency points out that the Company's rating is constrained by the following factors: (1) uncertainties regarding development of European gas market in terms of supply volumes and prices over the next years, (2) investment and execution risk in the E&P segment, and (3) potential pressure from the European Union to accelerate liberalisation and increase competition in the Polish gas market.

5.2. Dividend paid (declared)

On October 29th 2018, the Management Board of PGNiG S.A. resolved to distribute an interim dividend of PLN 404m from profit for 2018, with December 3rd 2018 set as the payment date.

On June 27th 2019, the Annual General Meeting of PGNiG S.A. passed a resolution to distribute PGNiG's net profit for 2018 and allocate PLN 1,040m (PLN 0.18 per share) to dividend payment. The dividend, paid on August 7th 2019, was reduced by the amount of interim dividend from the Company's 2018 profit.

No dividend was paid for 2017. On July 20th 2018, the PGNiG Annual General Meeting passed a resolution, based on a draft resolution proposed by a shareholder, to allocate PLN 867m from the net profit for 2017 to the capital reserve to be used for financing the expansion and modernisation of the Polish gas distribution network, and PLN 1,167m to increase the Company's statutory reserve funds.

5.3. Issue, redemption, and repayment of debt securities

In H1 2019, PGNiG S.A. redeemed PLN 2.3bn worth of domestic notes as part of the following programme:

					Utilisation (%) as at	Outstanding debt (PLN bn) as at	
Start date	End date	Programme	Participating banks as at the reporting date	Limit	Jun 30 2019	Jun 30 2019	Dec 31 2018
Jun 10 2010	Jul 31 2020	Note programme	Bank Pekao S.A., ING Bank Śląski S.A., PKO BP S.A., Bank Handlowy w Warszawie, BNP Paribas S.A. Oddział w Polsce, Societe Generale S.A., Bank Zachodni WBK S.A., mBank S.A.	PLN 7bn	-	-	2.3

On June 24th 2019, the Company entered into an agreement terminating the PLN 7bn and PLN 1bn Note Programmes, replacing them with a PLN 10bn syndicated loan agreement with a five-year availability period. The agreement was concluded with a syndicate of nine banks, comprising: Bank Gospodarstwa Krajowego, Bank Polska Kasa Opieki S.A., BNP Paribas Bank Polska S.A., Caixa Bank SA Branch in Poland, ING Bank Śląski S.A., Intesa Sanpaolo SpA S.A. Branch in Poland, Powszechna Kasa Oszczędności Bank Polski S.A., Santander Bank Polska S.A., and Société Générale S.A.

The loan will replace the financing in the form of two note programmes with a PLN 8bn subscription guarantee. The funds made available under the loan are intended to be used by the Company to e.g. finance the day-to-day operations and capital expenditure of PGNiG and the PGNiG Group companies.

PGNIG S.A. has also entered into an agreement on a debt securities programme (up to PLN 5bn). The agreement was not performed in the reporting period. For detailed information, see the full-year consolidated financial statements for the period ended December 31st 2018.

5.4. Seasonality

The sale, distribution and storage of gas fuels, as well as cogeneration of heat and electricity which, in addition to hydrocarbon exploration and production, is the Group's principal business activity, are subject to significant seasonal fluctuations.

Revenue from sale of natural gas and heat in the winter season (the first and fourth quarters of the year) is substantially higher than in summer (the second and third quarters of the year). This is due to the seasonal changes in weather conditions in Poland, with the extent of the fluctuations determined by air temperatures – low in winter and high in summer. Revenue from sales of gas and heat to households is subject to much greater seasonal fluctuations than in the case of sales to industrial customers as households use gas and heat for heating purposes.

To ensure uninterrupted gas supplies in periods of peak demand and for reasons of security of the supplies, the underground gas storage facilities must be restocked in summer, and higher transmission and distribution capacities must be reserved for the winter season.

5.5. Settlements from court proceedings

In the current reporting period, the Group entities reported no material settlements arising in connection with any court proceedings.

5.6. Changes in the economic environment and trading conditions with a material bearing on fair value of financial assets and liabilities

In the reporting period, the PGNiG Group recorded no changes in its economic environment or trading conditions which would have a material bearing on the fair value of its financial assets and liabilities.

(in PLN million, unless stated otherwise)

5.7. Credit default or breach of material credit covenants with respect to which no remedial action was taken before the end of the reporting period

In the reporting period, there were no events of credit default or breach of material credit covenants by the Parent or its subsidiaries.

5.8. Events subsequent to the reporting date

Date	Company	Event
Jul 12 2019	PGNiG Upstream Norway AS	On July 12th 2019, PGNiG Upstream Norway AS ("PUN") concluded an agreement for the purchase of interests in licences on the Norwegian Continental Shelf from Wellesley Petroleum AS (the "Agreement"). The Agreement provides for the acquisition of 20% interests in licences PL636 and PL636B (the "Licences") from Wellesley Petroleum AS, including the Duva field. The field operator is Neptune Energy Norge, which holds a 30% interest. The other partners are Idemitsu Petroleum Norge (30%) and Pandion Energy (20%). The parties agreed to treat the transaction value as a trade secret. Duva is a gas and oil field located in the North Sea, 6 km from the Gjøa field, operated by Neptune Energy Norge. The field is located within the PL636 licence area and its reserves were documented based on results of an exploration well in 2016. Since then, intensive work has been carried out to prepare a development concept for the field. According to data of the Norwegian Petroleum Directorate, the recoverable reserves of the Duva field are approximately 8.4 bcm of gas, 3.7 mcm of crude oil and 1m tonnes of NGL. Currently, the Duva field is in the pre-production phase. The Plan for Development and Operation of the field was approved by the Norwegian Ministry of Petroleum and Energy in June 2019. It assumes the drilling of at least three production wells and their connection to the Gjøa platform. The tie-in to existing production facilities will significantly reduce costs and shorten the project work, to be continued in 2019–2020. The launch of production is expected towards the end of 2020. According to the field operator's current data, maximum production is expected to reach 30,000 barrels of oil and gas equivalent. Gas production attributable to PUN is expected to be 0.13 bcm per annum. The Licences were purchased under the PGNiG Group Strategy for 2017–2022 (with an outlook until 2026), as announced in Current Report No. 19/2017. The agreement provides for conditions precedent, including obtaining the required corporate approvals and administrative approvals in Norway. On July 22nd 2019, the first of the conditions precedent to the purchase agreement was fulfilled when the PUN General Meeting approved the steps to be taken in order to enter into the Agreement.
Aug 5 2019	Elektrociepłownia Stalowa Wola S.A. (entity jointly controlled by PGNiG (indirectly) – 50% owned by PGNiG TERMIKA S.A.)	On August 5th 2019, the Court of Appeals in Rzeszów (the Court) issued a decision to postpone the examination of the application filed by Abener Energia S.A. of Campus Palmas Altas, Sevilla ("Abener Energia") for a declaration of enforceability of an award issued by the Arbitration Court at the National Chamber of Commerce in Warsaw on April 25th 2019 (the "Award") concerning Elektrociepłownia Stalowa Wola S.A. ("ECSW") of Stalowa Wola (a jointly-controlled entity of PGNiG). The Court decided to postpone the examination of the above application until ECSW's appeal to the Court for vacating the Award is examined. As a result of this decision, ECSW's liability to pay Abener Energia PLN 334m plus statutory default interest and costs of arbitration proceedings is postponed until the case for vacation of the arbitration court's award is examined (see Note 5.1 for more information).

5.9. Other information material to the assessment of assets, financial condition and results

Other than the information disclosed in this report, the PGNiG Group is not aware of any information which, in its opinion, could be material to the assessment of its assets, financial condition and results.

6. Interim condensed separate financial statements of PGNiG S.A.

Separate statement of profit or loss	3 months ended Jun 30 2019	6 months ended Jun 30 2019	3 months ended Jun 30 2018	6 months ended Jun 30 2018
Revenue from sale of gas	3,233	9,932	3,194	9,104
Other revenue	974	2,103	828	1,811
Revenue	**4,207**	**12,035**	**4,022**	**10,915**
Cost of gas sold	(2,815)	(8,537)	(2,540)	(7,223)
Other raw materials and consumables used	(415)	(957)	(265)	(649)
Employee benefits expense	(183)	(340)	(165)	(325)
Transmission, distribution and storage services	(234)	(464)	(244)	(483)
Other services	(209)	(415)	(317)	(723)
Depreciation and amortisation expense	(209)	(416)	(196)	(388)
Taxes and charges	(8)	(135)	(9)	(142)
Other income and expenses	(177)	(110)	(66)	7
Work performed by the entity and capitalised	3	6	2	3
Recognition and reversal of impairment losses on property, plant and equipment, intangible assets, rights-of-use assets	(244)	(227)	77	320
Dividends	1,344	1,344	1,726	1,726
Finance income	(2)	25	59	119
Interest income calculated using the effective interest rate	57	113	47	96
Finance costs	(4)	(44)	(62)	(108)
Gain/(loss) on derecognition of financial assets measured at amortised cost	-	10	-	-
Revaluation of financial assets	33	7	(26)	(65)
Total	**(3,063)**	**(10,140)**	**(1,979)**	**(7,835)**
Profit before tax	**1,144**	**1,895**	**2,043**	**3,080**
Income tax	27	(123)	(77)	(289)
Net profit	**1,171**	**1,772**	**1,966**	**2,791**
Weighted average number of ordinary shares (million)	5,778	5,778	5,778	5,778
Basic and diluted earnings per share (PLN)	0.20	0.31	0.34	0.48

Separate statement of comprehensive income	3 months ended Jun 30 2019	6 months ended Jun 30 2019	3 months ended Jun 30 2018	6 months ended Jun 30 2018
Net profit	**1,171**	**1,772**	**1,966**	**2,791**
Hedge accounting	25	345	43	(15)
Deferred tax	(2)	(45)	1	9
Other comprehensive income subject to reclassification to profit or loss	**23**	**300**	**44**	**(6)**
Actuarial losses on employee benefits	(6)	(6)	(4)	(4)
Deferred tax	1	1	1	1
Other comprehensive income not subject to reclassification to profit or loss	**(5)**	**(5)**	**(3)**	**(3)**
Other comprehensive income, net	**18**	**295**	**41**	**(9)**
Total comprehensive income	**1,189**	**2,067**	**2,007**	**2,782**

(in PLN million, unless stated otherwise)

Separate statement of cash flows	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Cash flows from operating activities		
Net profit	1,772	2,791
Depreciation and amortisation expense	416	388
Interest and dividends	(1,407)	(1,785)
Net gain/(loss) on investing activities	227	(256)
Other non-monetary adjustments	(47)	317
Income tax paid	(171)	(324)
Current tax expense	123	289
Movements in working capital	(67)	(141)
Net cash from operating activities	**846**	**1,279**
Cash flows from investing activities		
Payments for tangible exploration and evaluation assets	(366)	(372)
Payments for other property, plant and equipment and intangible assets	(188)	(170)
Loans advanced	(1,277)	(423)
Payments for derivative financial instruments	(34)	(62)
Payments for shares in related entities	(4)	(4)
Other cash used in investing activities	(14)	(4)
Repayments of loans advanced	177	323
Proceeds from derivative financial instruments	21	34
Interest received	74	84
Dividends received	1,344	1
Other cash generated by financing activities	26	18
Net cash from investing activities	**(241)**	**(575)**
Cash flows from financing activities		
Proceeds from issue of debt securities	-	450
Other cash generated by financing activities	-	2
Redemption of debt securities	(2,295)	(1,996)
Interest paid	(66)	(19)
Payment of principal and interest under lease liabilities	(26)	-
Net cash from financing activities	**(2,387)**	**(1,563)**
Net cash flows	**(1,782)**	**(859)**
Cash and cash equivalents at beginning of period	4,844	1,680
Cash and cash equivalents at end of period	**3,062**	**821**
including restricted cash	231	506

In the reporting period, selected PGNiG Group companies were parties to cash pooling agreements:

- A cash pooling agreement of July 16th 2014 between Bank Pekao S.A. and the following Group companies: PGNiG S.A., Polska Spółka Gazownictwa Sp. z o.o., Exalo Driling S.A., Geofizyka Kraków S.A. w likwidacji, Geofizyka Toruń S.A., Gas Storage Poland Sp. z o.o., PGNiG Serwis Sp. z o.o., PGNiG Termika S.A., PGNiG Obrót Detaliczny Sp. z o.o., Geovita S.A., PGNiG Gazoprojekt S.A., Gas-Trading S.A., PGNIG Supply & Trading GmbH Sp. z o.o. Poland Branch, and Termika Energetyka Przemysłowa S.A.;

(in PLN million, unless stated otherwise)

- A cash pooling agreement of December 22nd 2016, effective as of March 1st 2017, between PKO BP S.A. and the following Group companies: PGNiG S.A., Polska Spółka Gazownictwa Sp. z o.o., PGNiG Technologie S.A., Geofizyka Toruń S.A., Gas Storage Poland Sp. z o.o., PGNiG Serwis Sp. z o.o., PGNiG Termika S.A. and PGNiG Obrót Detaliczny Sp. z o.o.

The main objective of these agreements is to enhance the management of the Group's financial liquidity. The cash pooling arrangement facilitates liquidity planning within the PGNiG Group and has reduced dependency on borrowed funds. The improved and more efficient utilisation of free cash also enabled the Group to reduce its borrowing costs.

Cash flows under the cash pooling arrangement as well as exchange differences on translating cash and cash equivalents are presented in the statement of financial position under cash and cash equivalents, and as an adjustment to cash and cash equivalents in the statement of cash flows.

The table below presents reconciliation of cash and cash equivalents disclosed in the statement of cash flows with cash and cash equivalents disclosed in the statement of financial position.

Reconciliation of cash and cash equivalents disclosed in the statement of cash flows with cash and cash equivalents disclosed in the statement of financial position.	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Cash and cash equivalents at end of period in the statement of cash flows	**3,062**	**821**
Opening balance of net exchange differences	(3)	(2)
Opening balance of inflows/outflows of cash under cash pooling arrangement	(1,697)	306
Net exchange differences in period	5	21
Inflows/(outflows) of cash under cash pooling arrangement in period	750	1,031
Cash at end of period in the statement of financial position	**2,117**	**2,177**

(in PLN million, unless stated otherwise)

Separate statement of financial position	As at Jun 30 2019	As at Dec 31 2018
Assets		
Property, plant and equipment	12,506	12,116
Licences, mining rights and rights to geological information	139	120
Deferred tax	-	45
Shares	9,846	9,846
Derivative financial instruments	146	214
Loans advanced	4,250	2,881
Other assets	489	520
Non-current assets	**27,376**	**25,742**
Inventories	2,489	2,691
Receivables	2,067	2,365
Cash pooling receivables	1,093	1,825
Current income tax	58	-
Derivative financial instruments	772	453
Loans advanced	335	592
Other assets	126	181
Cash and cash equivalents	2,117	3,144
Current assets	**9,057**	**11,251**
TOTAL	**36,433**	**36,993**
Equity and liabilities		
Share capital and share premium	7,518	7,518
Capital reserve	1,867	867
Hedging reserve	265	72
Accumulated other comprehensive income	8	13
Retained earnings	20,521	20,363
Total equity	**30,179**	**28,833**
Lease liabilities	305	-
Derivative financial instruments	59	105
Employee benefit obligations	269	255
Provision for well decommissioning costs	1,756	1,569
Other provisions	11	28
Grants	501	519
Deferred tax liabilities	11	-
Other liabilities	60	75
Non-current liabilities	**2,972**	**2,551**
Financing liabilities	-	2,298
Lease liabilities	14	-
Derivative financial instruments	346	406
Trade and tax payables	2,291	2,194
Cash pooling liabilities	174	171
Employee benefit obligations	75	109
Provision for well decommissioning costs	59	91
Other provisions	244	287
Other liabilities	79	53
Current liabilities	**3,282**	**5,609**
TOTAL LIABILITIES	**6,254**	**8,160**
TOTAL	**36,433**	**36,993**

(in PLN million, unless stated otherwise)

Statement of changes in equity

	Share capital and share premium	Capital reserve*	Hedging reserve	Accumulated other comprehensive income	Retained earnings (deficit)	Total equity
As at Jan 1 2018	**7,518**	**-**	**7**	**23**	**18,485**	**26,033**
Effect of IFRS 9	-	-	-	-	(140)	(140)
As at Jan 1 2018 (restated)	**7,518**	**-**	**7**	**23**	**18,345**	**25,893**
Net profit	-	-	-	-	2,791	2,791
Other comprehensive income, net	-	-	(6)	(3)	-	(9)
Total comprehensive income	**-**	**-**	**(6)**	**(3)**	**2,791**	**2,782**
Change in equity recognised in inventories	-	-	(32)	-	-	(32)
As at Jun 30 2018	**7,518**	**-**	**(31)**	**20**	**21,137**	**28,644**
As at Jan 1 2019	**7,518**	**867**	**72**	**13**	**20,363**	**28,833**
Effect of IFRS 16	-	-	-	-	21	21
As at Jan 1 2019 (restated)	**7,518**	**867**	**72**	**13**	**20,384**	**28,854**
Net profit	-	-	-	-	1,772	1,772
Other comprehensive income, net	-	-	300	(5)	-	295
Total comprehensive income	**-**	**-**	**300**	**(5)**	**1,772**	**2,067**
Transferred	-	1,000	-	-	(1,000)	-
Dividend	-	-	-	-	(636)	(636)
Change in equity recognised in inventories	-	-	(107)	-	-	(107)
As at Jun 30 2019	**7,518**	**1,867**	**265**	**8**	**20,521**	**30,179**

* Pursuant to a resolution of the Annual General Meeting, PGNIG S.A. decided to allocate PLN 1bn to capital reserves (in the comparative period, the amount was PLN 867m). These funds are to be used to expand and modernise the national gas distribution network.

(in PLN million, unless stated otherwise)

7. Notes to the interim condensed separate financial statements

7.1. Presentation changes in the financial statements

PGNiG S.A. adopted the new IFRS 16 starting from January 1st 2019 (for more information, see **Note 2.5.**).

The impact of IFRS 16 on the financial statements is presented below.

	Carrying amount as at Dec 31 2018	Effect of IFRS 16 on the statement of financial position	Carrying amount as at Jan 1 2019
Assets			
Property, plant and equipment, including	12,116	368	12,484
land	38	(19)	19
Right-of-use assets, including:	-	387	387
land	-	349	349
buildings and structures	-	19	19
Plant and equipment	-	4	4
vehicles	-	15	15
Deferred tax on provision for environmental liabilities	5	(5)	-
Other assets, including:	520	(30)	490
perpetual usufruct rights to land	30	(30)	-
Non-current assets	**25,742**	**333**	**26,075**
TOTAL	**36,993**	**333**	**37,326**
Equity and liabilities			
Retained earnings	20,363	21	20,384
Total equity	**28,833**	**21**	**28,854**
Other provisions, including	28	(17)	11
provisions for environmental liabilities	24	(17)	7
Finance lease liabilities	-	331	331
Non-current liabilities	**2,551**	**314**	**2,865**
Other provisions, including	287	(2)	285
provisions for environmental liabilities	2	(2)	-
Current liabilities	**5,609**	**(2)**	**5,607**
TOTAL LIABILITIES	**8,160**	**312**	**8,472**
TOTAL	**36,993**	**333**	**37,326**

In the period ended June 30th 2019, the Company made a PLN 41m adjustment to the effect of implementation of IFRS 16 with respect to the recognised amounts of property, plant and equipment and finance lease liabilities.

(in PLN million, unless stated otherwise)

7.2. Deferred tax

	As at Jan 1 2018	Effect of implementation of IFRS 9 as at Jan 1 2018	Credited/Charged Net profit/(loss)	Credited/Charged Other comprehensive income	As at Dec 31 2018	Effect of implementation of IFRS 16 as at Jan 1 2019	Credited/Charged Net profit/(loss)	Credited/Charged Other comprehensive income	As at Jun 30 2019
Deferred tax assets									
Employee benefit obligation	49	-	4	2	55	-	-	1	56
Provision for well decommissioning costs	155	-	26	-	181	-	7	-	188
Other provisions	26	-	9	-	35	(5)	4	-	34
Valuation of derivatives	13	-	80	-	93	-	(25)	-	68
Useful lives of property, plant and equipment	174	-	(76)	-	98	-	5	-	103
Unused tax losses of the Pakistan Branch	-	-	50	-	50	-	17	-	67
Other	26	-	10	-	36	-	16	-	52
Total	**443**	**-**	**103**	**2**	**548**	**(5)**	**24**	**1**	**568**
Deferred tax liabilities									
Difference between depreciation rates for property, plant and equipment	292	-	86	-	378	-	17	-	395
Valuation of derivatives	34	-	58	15	107	-	14	45	166
Other	38	(4)	(16)	-	18	-	-	-	18
Total	**364**	**(4)**	**128**	**15**	**503**	**-**	**31**	**45**	**579**
Set-off of assets and liabilities	(364)	-	-	-	(503)		-	-	(568)
After set-off									
Assets	79	-	-	-	45	-	-	-	-
Liabilities	-	-	-	-	-	-	-	-	11
Net effect of changes in the period		**4**	**(25)**	**(13)**		**(5)**	**(7)**	**(44)**	

In the period ended June 30th 2019, the Company recognised the effect of IFRS 16 on deferred tax assets of PLN 5m. As deferred tax is presented in the statement of financial position on a net basis, the balance of deferred tax liabilities was adjusted by the identified amount of assets.

In the comparative period, the Company recognised the effect of IFRS 9 on deferred tax liabilities of PLN 4m. The balance of deferred tax assets was adjusted by the identified amount of liabilities.

(in PLN million, unless stated otherwise)

7.3. Impairment losses/write-downs

	Property, plant and equipment, licences, mining rights and rights to geological information	Right-of-use assets	Other assets	Loans advanced	Shares	Inventories	Receivables	Cash pooling receivables	Current financial assets	Total
As at Jan 1 2018	**3,597**	**N/A**	**20**	**50**	**2,669**	**103**	**320**	**-**	**39**	**6,798**
Effect of IFRS 9	-	N/A	-	81	-	-	13	6	-	100
As at Jan 1 2018 (restated)	**3,597**	**N/A**	**20**	**131**	**2,669**	**103**	**333**	**6**	**39**	**6,898**
Recognised provision taken to profit or loss	690	N/A	1	106	77	108	461	10	-	1,453
Transferred	-	N/A	(14)	-	15	-	(1)	-	-	-
Provision reversal taken to profit or loss	(945)	N/A	(1)	(159)	(1)	(81)	(306)	(6)	-	(1,499)
Other changes	(94)	N/A	-	-	-	-	-	-	-	(94)
As at Dec 31 2018	**3,248**	**N/A**	**6**	**78**	**2,760**	**130**	**487**	**10**	**39**	**6,758**
Recognised provision taken to profit or loss	444	48	-	18	4	192	137	3	-	846
Provision reversal taken to profit or loss	(265)	-	(1)	(13)	-	(108)	(151)	(8)	-	(546)
Other changes	(40)	-	-	-	-	-	-	-	-	(40)
As at Jun 30 2019	**3,387**	**48**	**5**	**83**	**2,764**	**214**	**473**	**5**	**39**	**7,018**

7.4. Provisions

	Provision for well decommissioning costs	Provision for certificates of origin and energy efficiency certificates	Provision for liabilities associated with exploration work abroad	Provisions for environmental liabilities	Provision for UOKiK fine	Provision for claims under extra-contractual use of land	Provision for financial guarantees	Other provisions	Total
As at Jan 1 2018	**1,429**	**38**	**162**	**26**	**10**	**6**	**-**	**15**	**1,686**
Effect of IFRS 9	-	-	-	-	-	-	18	-	18
As at Jan 1 2019 (restated)	**1,429**	**38**	**162**	**26**	**10**	**6**	**18**	**15**	**1,704**
Recognised provision capitalised in cost of property, plant and equipment	237	-	-	-	-	-	-	-	237
Recognised provision taken to profit or loss	56	34	13	-	-	1	-	15	119
Used	(28)	(1)	-	-	(10)	-	-	-	(39)
Provision reversal taken to profit or loss	(34)	(1)	-	-	-	(3)	(3)	(5)	(46)
As at Dec 31 2018	**1,660**	**70**	**175**	**26**	**-**	**4**	**15**	**25**	**1,975**
Effect of IFRS 16	-	-	-	(19)	-	-	-	-	(19)
As at Jan 1 2019 (restated)	**1,660**	**70**	**175**	**7**	**-**	**4**	**15**	**25**	**1,956**
Recognised provision capitalised in cost of property, plant and equipment	184	-	-	-	-	-	-	-	184
Recognised provision taken to profit or loss	24	20	-	-	-	-	2	29	75
Used	(13)	(48)	-	-	-	-	-	-	(61)
Provision reversal taken to profit or loss	(40)	(21)	(2)	-	-	-	(11)	(10)	(84)
As at Jun 30 2019	**1,815**	**21**	**173**	**7**	**-**	**4**	**6**	**44**	**2,070**

(in PLN million, unless stated otherwise)

7.5. Revenue

	Total		Domestic sales		Export sales	
	6 months ended Jun 30 2019	6 months ended Jun 30 2018	6 months ended Jun 30 2019	6 months ended Jun 30 2018	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Revenue from sale of gas, including:	**9,932**	**9,104**	**9,524**	**8,719**	**408**	**385**
Revenue from contracts with customers IFRS 15	9,652	9,384	9,244	8,999	408	385
High-methane gas	8,737	8,577	8,456	8,288	281	289
Nitrogen-rich gas	756	686	692	629	64	57
Propane-butane gas	33	32	33	32	-	-
LNG	48	42	48	42	-	-
Helium	78	47	15	8	63	39
Excluded from the scope of IFRS 15	280	(280)	280	(280)	-	-
Adjustment to gas sales due to hedging transactions - IFRS 9	280	(280)	280	(280)	-	-
Other revenue, including:	**2,103**	**1,811**	**1,903**	**1,481**	**200**	**330**
Revenue from contracts with customers IFRS 15	1,804	1,527	1,604	1,197	200	330
Crude oil and natural gasoline	717	717	543	504	174	213
Sale of electricity	944	624	942	553	2	71
CO_2 emission allowances	13	4	13	4	-	-
Other	130	182	106	136	24	46
Excluded from the scope of IFRS 15	299	284	299	284	-	-
Right to use storage facilities - IFRS 16	290	284	290	284	-	-
Other income from operating leases - IFRS 16	9	N/A	9	N/A	-	N/A
Total revenue	**12,035**	**10,915**	**11,427**	**10,200**	**608**	**715**

N/A – non applicable; the items did not exist in 2018 and are a result of implementation of new IFRS 16 *Leases*.

Sales are made directly to business customers and via the Polish Power Exchange. Generally, goods are transferred at a specific point in time. They are sold on the basis of individual short-term contracts, meeting the definition of a “contract” provided in IFRS 15. Such contracts are concluded under long-term framework agreements. Settlements are made on the basis of the contract price and the quantity of goods received by the customer. The Company did not identify any significant financing component in its contracts nor did it incur any significant incremental cost of obtaining a contract.

‘Adjustment to gas sales due to hedging transactions’ presents the effective portion of the hedge under cash flow hedge accounting. The Company uses a net open position basis for hedging. In line with the adopted methodology and given the level of sales generated in Poland in relation to sales generated outside Poland, the Company discloses the aggregate effect of adjustment to gas sales due to hedging transactions as adjustment to revenue earned in Poland.

(in PLN million, unless stated otherwise)

7.6. Operating expenses

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Cost of gas sold	**(8,537)**	**(7,223)**
Gas fuel	(8,538)	(7,232)
Net gain/(loss) on gas price hedges	1	9
Other raw materials and consumables used	**(957)**	**(649)**
Electricity for trading	(903)	(601)
Other raw materials and consumables used	(54)	(48)
Employee benefits expense	**(340)**	**(325)**
Salaries and wages	(261)	(242)
Social security contributions	(65)	(61)
Other employee benefits expense	(41)	(39)
Employee benefit obligations	27	17
Transmission, distribution and storage services	**(464)**	**(483)**
Other services	**(415)**	**(723)**
Regasification services	(188)	(181)
Cost of dry wells written off	(22)	(366)
Repair and construction services	(23)	(17)
Geological and exploration services	(16)	(17)
Mineral resources production services	(10)	(10)
Well abandonment services	(11)	(2)
Other services	(145)	(130)
Depreciation and amortisation	**(416)**	**(388)**
Depreciation of non-leased assets	(408)	(388)
Depreciation of leased assets	(8)	N/A
Recognition and reversal of impairment losses on property, plant and equipment, intangible assets, rights-of-use assets	**(227)**	**320**
Impairment losses on property, plant and equipment and rights-of-use assets	(221)	320
Impairment losses on intangible assets	(6)	-
Total	**(11,356)**	**(9,471)**

7.7. Other income and expenses

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Measurement and exercise of derivative financial instruments	40	(2)
Change in inventory write-downs	(84)	42
Change in provision for well decommissioning costs	16	(5)
Change in provision for certificates of origin and energy efficiency certificates	1	(17)
Cost of merchandise and materials sold	(18)	(9)
Change in other provisions	(19)	(20)
Other	(46)	18
Total other income and expenses	**(110)**	**7**

(in PLN million, unless stated otherwise)

7.8. Finance income and costs

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Finance income		
Foreign exchange gains	12	82
Fair value measurement of a loan	-	22
Other finance income	13	15
Total finance income	**25**	**119**
Finance costs		
Loss on measurement and exercise of forward contracts	(11)	(84)
Interest on debt, excluding leases, and commissions on debt	(22)	(22)
Interest on lease liabilities	(5)	N/A
Loss on modification of financial assets	(2)	-
Other	(4)	(2)
Total finance costs	**(44)**	**(108)**

7.9. Income tax

Reconciliation of effective tax rate	6 months ended Jun 30 2019	6 months ended Jun 30 2018
Profit before tax	**1,895**	**3,080**
Corporate income tax at the applicable 19% statutory rate	(360)	(585)
Dividends received	255	328
Other income not recognised as taxable income	4	74
Non-tax deductible expenses	(22)	(106)
Corporate income tax at the effective tax rate	**(123)**	**(289)**
Current tax expense	(115)	(220)
Deferred tax expense	(8)	(69)
Effective tax rate	**6%**	**9%**

7.10. Property, plant and equipment

	As at Jun 30 2019	As at Dec 31 2018
Land	19	38
Buildings and structures	7,001	7,130
Plant and equipment	2,228	2,306
Vehicles and other	100	104
Total tangible assets	**9,348**	**9,578**
Tangible exploration and evaluation assets under construction	2,255	1,974
Other tangible assets under construction	575	564
Total tangible assets under construction	**2,830**	**2,538**
Right-of-use asset – land	301	N/A
Right-of-use asset – buildings and structures	10	N/A
Right-of-use asset – machinery and equipment	4	N/A
Right-of-use asset – vehicles	13	N/A
Total right-of-use assets	**328**	**N/A**
Total property, plant and equipment	**12,506**	**12,116**

(in PLN million, unless stated otherwise)

7.11. Derivative financial instruments

Type of hedging instrument	Notional amount	Carrying amount as at Jun 30 2019		Name of statement of financial position item which includes hedging instrument	Change in fair value of hedging instrument used as basis for recognising hedge ineffectiveness in given period	Hedging gains or losses for reporting period, recognised in other comprehensive income	Hedge ineffectiveness amount taken to profit or loss	Statement of comprehensive income (statement of profit or loss) item in which ineffectiveness amount is included	Amount reclassified from cash flow hedging reserve to profit or loss as reclassification adjustment	Statement of comprehensive income (statement of profit or loss) item in which reclassification adjustment is included
		Assets	Liabilities							
CASH FLOW HEDGES										
CURRENCY RISK										
Forward contracts for currency purchase (USD)	3,149	96	10	Derivative financial instruments	86	31	-	Operating income / expenses	Not applicable	Not applicable
Average rate forwards (EUR)	5,853	140	20	Derivative financial instruments	136	95	-	Operating income / expenses	9	Revenue from sale of gas
COMMODITY PRICE RISK										
Basis swap contracts for gas price indices	206	24	10	Derivative financial instruments	14	132	-	Operating income / expenses	(143)	Revenue from sale of gas
Swap contracts for gas price indices	2,239	355	193	Derivative financial instruments	302	371	(21)	Operating income / expenses	(146)	Revenue from sale of gas
Swap contracts for HH price indices	36	-	3	Derivative financial instruments	(3)	(3)	-	Operating income / expenses	Not applicable	Not applicable
Total	**11,483**	**615**	**236**	**-**	**535**	**626**	**(21)**	**-**	**(280)**	**-**

Type of hedging instrument	Notional amount	Carrying amount as at Dec 31 2018		Name of statement of financial position item which includes hedging instrument	Change in fair value of hedging instrument used as basis for recognising hedge ineffectiveness in given period	Hedging gains or losses for reporting period, recognised in other comprehensive income	Hedge ineffectiveness amount taken to profit or loss	Statement of comprehensive income (statement of profit or loss) item in which ineffectiveness amount is included	Amount reclassified from cash flow hedging reserve to profit or loss as reclassification adjustment	Statement of comprehensive income (statement of profit or loss) item in which reclassification adjustment is included
		Assets	Liabilities							
CASH FLOW HEDGES										
CURRENCY RISK										
Forward contracts for currency purchase (USD)	3,678	216	1	Derivative financial instruments	215	418	-	Operating income / expenses	Not applicable	Not applicable
Average rate forwards (EUR)	7,707	50	18	Derivative financial instruments	26	29	-	Operating income / expenses	(3)	Revenue from sale of gas
COMMODITY PRICE RISK										
Basis swap contracts for gas price indices	208	34	9	Derivative financial instruments	26	(192)	-	Operating income / expenses	217	Revenue from sale of gas
Swap contracts for gas price indices	3,081	90	330	Derivative financial instruments	(189)	(359)	(10)	Operating income / expenses	164	Revenue from sale of gas
Swap contracts for petroleum product price indices	-	-	-	Derivative financial instruments	-	28	-	Operating income / expenses	Not applicable	Not applicable
FAIR VALUE HEDGES										
Total	**14,674**	**390**	**358**	**-**	**78**	**(76)**	**(10)**	**-**	**378**	**-**

(in PLN million, unless stated otherwise)

Hedged items as at Jun 30 2019	Change in value of hedged item used as basis for recognising hedge ineffectiveness in given period	Balance of cash flow hedging reserve for continuing hedges	Balance remaining in cash flow hedging reserve in respect of all hedging relationships for which hedge accounting is no longer applied
CURRENCY RISK			
Natural gas (USD)	(86)	86	-
Natural gas (EUR)	(136)	50	81
COMMODITY PRICE RISK			
Gas contracts indexed to monthly gas price indices	(14)	14	1
Gas contracts indexed to daily gas price indices	(391)	148	(50)
Gas contracts indexed to monthly petroleum product indices	4	(3)	-
TOTAL	**(623)**	**295**	**32**

Hedged items as at Dec 31 2018	Change in value of hedged item used as basis for recognising hedge ineffectiveness in given period	Balance of cash flow hedging reserve for continuing hedges	Balance remaining in cash flow hedging reserve in respect of all hedging relationships for which hedge accounting is no longer applied
CURRENCY RISK			
Natural gas (USD)	215	215	Not applicable
Natural gas (EUR)	(26)	31	(5)
COMMODITY PRICE RISK			
Gas contracts indexed to monthly gas price indices	(26)	25	1
Gas contracts indexed to daily gas price indices	179	(182)	2
Gas contracts indexed to monthly petroleum product indices	Not applicable	Not applicable	Not applicable
TOTAL	**342**	**89**	**(2)**

	6 months ended Jun 30 2019	6 months ended Jun 30 2018
At beginning of period	88	8
CURRENCY RISK		
Hedging gains or losses recognised in other comprehensive income during reporting period	126	448
Amount reclassified from cash flow hedging reserve to statement of profit or loss as reclassification adjustment	9	(3)
Amount transferred from cash flow hedging reserve and recognised as adjustment to carrying amount of inventories	(160)	(194)
COMMODITY PRICE RISK		
Hedging gains or losses recognised in other comprehensive income during reporting period	500	(524)
Part of loss taken to statement of profit or loss as hedged item was not expected to occur	-	(1)
Amount reclassified from cash flow hedging reserve to statement of profit or loss as reclassification adjustment	(289)	381
Amount transferred from cash flow hedging reserve and recognised as adjustment to carrying amount of inventories	53	(11)
Amount reclassified from cash flow hedging reserve to statement of profit or loss as reclassification adjustment for those hedging relationships to which hedge accounting is no longer applied	(1)	(16)
At end of period	**326**	**88**

8. Representation by the Management Board

We represent that, to the best of our knowledge, the interim condensed consolidated financial statements of the PGNiG Group and the interim condensed separate financial statements of PGNiG S.A. for the first half of 2019 and the comparative data have been prepared in compliance with the applicable accounting policies and give a true, clear and fair view of the assets, financial condition and financial results of the PGNiG Group and PGNiG S.A.

PGNiG Management Board:

President of the Management Board	Piotr Woźniak	----------
Vice President of the Management Board	Łukasz Kroplewski	----------
Vice President of the Management Board	Robert Perkowski	----------
Vice President of the Management Board	Michał Pietrzyk	----------
Vice President of the Management Board	Maciej Woźniak	----------
Vice President of the Management Board	Magdalena Zegarska	----------

Warsaw, August 20th 2019

This document is an English version of the original Polish version.
In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

Polskie Górnictwo Naftowe i Gazownictwo S.A.

Directors' Report on the Operations of PGNiG S.A. and the PGNiG Group

in the first half of 2019

PGNiG

Definitions

Whenever any of the following acronyms and terms appear in this Directors' Report and nothing to the contrary is stated herein, these acronyms and terms should be interpreted as follows:

Proper names of companies and branches: **PGNiG or Issuer** – PGNiG S.A. as the parent of the group; **PGNiG Group**, **Group** – the PGNiG Group, which includes PGNiG S.A. as the parent and the subsidiaries; **CLPB** – Oddział Centralne Laboratorium Pomiarowo-Badawcze PGNiG S.A.; **ECSW** – Elektrociepłownia Stalowa Wola S.A.; **EXALO** – EXALO Drilling S.A.; **Gazoprojekt** – PGNiG Gazoprojekt S.A.; **GEOFIZYKA Kraków** – GEOFIZYKA Kraków Sp. z o.o. w likwidacji; **GEOFIZYKA Toruń** – GEOFIZYKA Toruń Sp. z o.o.; **Geovita** – Geovita S.A.; **GSP** – Gas Storage Poland Sp. z o.o.; **PGG** – Polska Grupa Górnicza Sp. z o.o.; **PGNiG OD** – PGNiG Obrót Detaliczny Sp. z o.o.; **PGNiG Technologie** – PGNiG Technologie Sp. z o.o.; **PGNiG TERMIKA** – PGNiG TERMIKA S.A.; **PGNiG TERMIKA EP** – PGNiG TERMIKA Energetyka Przemysłowa S.A.; **PGNiG UN** – PGNiG Upstream Norway AS; **PGNiG UNA** – PGNiG UPSTREAM NORTH AFRICA B.V.; **Polski Gaz TUW** – Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych (mutual insurance company); **PSG** – Polska Spółka Gazownictwa Sp. z o.o.; **PST** – PGNiG Supply & Trading GmbH; **PST ES –** PST Europe Sales GmbH; **Polimex Mostostal** – Polimex Mostostal S.A.

Names of institutions, capital market entities and energy markets: **EEX** – European Energy Exchange (an energy exchange in Germany); **GASPOOL** – GASPOOL Balancing Services GmbH (a hub in Germany); **GAZ-SYSTEM** – Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A.; **WSE –** Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.); **National Court Register** – National Court Register; **NCG** – NetConnect Germany GmbH & Co. KG (a hub in Germany); **NBP** – National Balancing Point (a hub in the UK); **LNG Terminal** – the President Lech Kaczyński LNG Terminal in Świnoujście; **PPX** – Towarowa Giełda Energii S.A. (Polish Power Exchange); **TTF** – Title Transfer Facility; **URE** – Energy Regulatory Office.

With respect to units: **bbl** – one barrel of crude oil; **boe** – barrel of oil equivalent; **LNG** – liquefied natural gas; **Mg** – 1 megagram equal to 1 tonne, the unit used to measure the amount of waste; **MWt** – 1 megawatt thermal; **MWe** – 1 megawatt electrical; **NGL** – gas composed of molecules heavier than methane: ethane, propane, butane, isobutane, etc. (natural gas liquids); **PJ –** 1 petajoule; **TWh** – 1 terawatt hour.

With respect to economic and financial ratios: **EBIT** – earnings before interest and taxes; **EBITDA** – earnings before interest, taxes, depreciation and amortisation; **EV** – enterprise value; **P/BV** – price/book value; **P/E** – price/earnings; **ROA** – return on assets; **ROE** – return on equity.

Other abbreviations: **HP** – heat plant; **CHPP** – combined heat and power plant; **SFG** – Storage Facilities Group; **SF** − storage facilities; **CGSF** – cavern gas storage facility; **EGM** – Extraordinary General Meeting (of a joint-stock company); **EGM** − Extraordinary General Meeting (of a limited liability company); **UGSF** – underground gas storage facilities; **GM** – General Meeting (of a joint-stock company); **GM** − General Meeting.

With respect to currencies: amounts expressed in the złoty are designated with the acronym **PLN**; amounts expressed in the euro are designated with the acronym **EUR**; amounts expressed in the US dollars are designated with the acronym **USD**; amounts expressed in the Norwegian crown are designated with the acronym **NOK**; amounts expressed in the Swedish crown are designated with the acronym **SEK**; amounts expressed in the Ukrainian hryvnia are designated with the acronym **UAH**; amounts expressed in the Omani rial are designated with the acronym **OMR.**

Converters

Converters	1 bcm of natural gas	1m tonnes of crude oil	1m tonnes of LNG	1 PJ	1m boe	1 TWh
1 bcm of natural gas	1	0.90	0.73	38	6.45	10,972
1m tonnes of crude oil	1,113	1	0.81	42.7	7.5 - 7,8*	11.65
1m tonnes of LNG	1.38	1.23	1	55	8.68	14.34
1 PJ	0,026	0.23	0,019	1	0.17	0.28
1m boe	0.16	0,128 - 0,133*	0.12	6.04	1	1.70
1 TWh	0,091	0,086	0.07	3.6	0.59	1

** The converter is different for crude oil produced in Poland and Norway.*

CONTENT

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1. PGNiG Group in the first half of 2019

1.1. Key financial and operating metrics

PLN 22.6bn
Revenue

PLN 3.1bn
EBITDA

PLN 1.7bn
EBIT

PLN 1.3bn
Net profit

PLN 53.3bn
Total assets

5th
largest company listed on the WSE*

PLN 30.7bn
Market capitalisation*

25.0 thousand
Number of employees

3.5%
ROE

2.5%
ROA

9.6
EV/EBITDA

13.6
P/E

0.8
P/BV

PLN 28.5m
Average daily value of trading

0.6 m tonnes
Production of crude oil, condensate and NGL

2.2bn m^3
Production of natural gas

0.4 bcm
Sales of natural gas by the Exploration and Production segment

197
Number of production licences

54
Number of oil and gas production facilities in Poland

48
Number of hydrocarbon exploration and appraisal licences

15.5 bcm
Sales of natural gas by the Trade and Storage segment

3.1 bcm
Gas storage capacities

5.9 bcm
Volume of gas sold on energy exchanges

7.4 bcm
Volume of imported gas

7m
Number of customers

189 thousand km
Length of gas distribution network, including service lines

1,518
Number of municipalities connected to the gas grid

6.3 bcm
Volume of distributed gas

23.0 PJ
Heat output

2.3 TWh
Electricity output

5.3 GW
Thermal power

1.0 GW
Electric power

Market capitalisation as at June 30th 2019.

1.2. Calendar of corporate events

January 2019

- January 18th – Three new licences awarded to PGNiG UN by the Norwegian Ministry of Petroleum and Energy as part of the APA 2018 licensing round. › For more information, see 5.1.4
- January 25th – President of URE's decision to reduce the prices and rates of network fees under the PSG Distribution Tariff by 5%. › For more information, see 3.1.1
- January 25th – President of URE's decision to increase the price of gas fuel under the PGNiG OD Retail Tariff by 2.5%. › For more information, see 3.1.1

March 2019

- March 11th – Notification of antitrust proceedings initiated by the President of UOKiK against PGNiG TERMIKA and PGNiG. › For more information, see 6.4.2
- March 13th–18th – Completion by Grupa LOTOS and PGNiG of the first commercial LNG bunkering of sea vessels.

April 2019

- April 3rd – Start-up of a power generation unit fired with methane from coal beds in Gilowice.

May 2019

- May 20th – Drilling of the Rehman-6 production well in the Rehman field commenced by PGNiG Pakistan Branch. › For more information, see 5.1.4
- May 23rd – Submission by Grupa Azoty Group companies of a representation to extend the term of natural gas supply contracts until September 30th 2022. › For more information, see 5.2.3

June 2019

- June 7th – Execution by PGNiG UN of an agreement for purchase of interests in the King Lear field from Total E&P Norge AS. › For more information, see 5.1.4
- June 12th – Execution by PGNiG of an annex to the long-term contract with Venture Global Plaquemines LNG, LLC. › For more information, see 5.2.3
- June 24th – Execution by PGNiG of a syndicated loan agreement.
- June 26th – Upgrade of PGNiG's credit rating by Moody's Investors Service from Baa3 at Baa2.
- June 27th – Adoption by the PGNiG Annual General Meeting of a resolution on allocation of PGNiG's net profit for the financial year 2018. › For more information, see 7.2.

1.3. Events subsequent to the reporting date

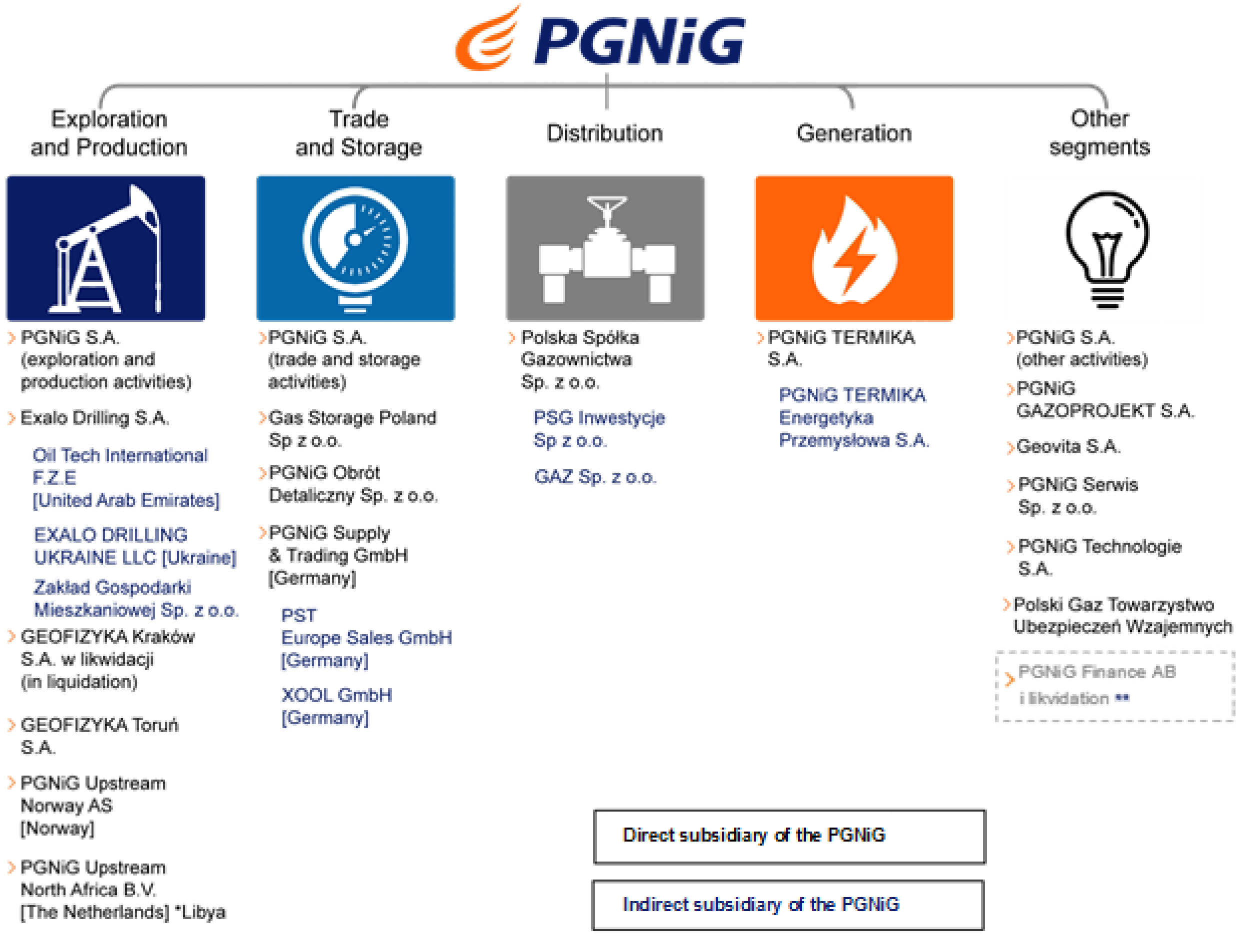
July 2019

- July 12th – Execution by PGNiG UN of an agreement to purchase interests in licences covering the Duva field from Wellesley Petroleum AS. › For more information, see 5.1.4
- July 17th – publication by PGNiG of estimated operating highlights for Q2 and H1 2019.
- July 29th – publication by PGNiG of estimated selected consolidated financial highlights for Q2 and H1 2019.
- July 31st – Approval by the PGNiG Extraordinary General Meeting of acquisition of shares in the increased share capital of PGNiG UN.

1.4. Companies of the PGNiG Group

As at June 30th 2019, PGNiG as the parent and 23 subsidiaries (including 16 direct and 7 indirect subsidiaries) were fully consolidated.

Fig. 1 Fully consolidated companies of the PGNiG Group



[country] – country of registration (if different from Poland)
* Principal place of business (if other than country of registration)
** On April 4th 2019, the company's liquidation process was completed.

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2. Strategy of the PGNiG Group

2.1. Mission, vision, overriding objective

Mission statement: We are a trusted supplier of energy for households and businesses.

Vision: We deliver innovative energy solutions in a responsible and efficient manner.

Overriding objective: Increase the PGNiG Group's value and ensure its financial stability.

2.2. Challenges

The PGNiG Group's activities largely depend on external factors. The key challenges facing the PGNiG Group include:

- Developments in the global fuel and energy markets, especially **fluctuations in oil and gas prices,** the weakening correlation between market prices of gas and petroleum products as well as the dynamic **development of the LNG market** driven by rapid expansion of LNG infrastructure globally, which creates an oversupply in global LNG markets, leading to price declines;
- **Further deregulation**, particularly with respect to contracts with customers, procedures for switching gas suppliers, and the exchange sale requirement (i.e. the requirement to sell high-methane gas on commodity exchanges or other regulated markets) pose a risk of significant customer loss and reduced revenue from storage operations;
- **The need to change the mix of gas import sources** and to diversify supply sources considering the expiry of the Yamal contract after 2022;
- **Policy and legislative changes**, particularly with respect to taxation of hydrocarbon production, fulfilment of the exchange sale requirement, and uncertainty surrounding the support model for gas-fired cogeneration, all of which may adversely affect the PGNiG Group's revenues.

2.3. PGNiG Group Strategy

The Strategy defines the overriding goal of the PGNiG Group, which is to increase the Group's value and ensure its financial stability. It will be pursued through sustainable development of the Group driven by parallel investments in riskier business areas yielding relatively high rates of return (upstream projects – ca. 45% of total planned capex) and in regulated areas offering considerable safety of the investments (gas distribution, power and heat generation – ca. 42% of total capex). Additionally, ca. PLN 4bn of capex will be allocated to other growth projects, primarily in distribution, trading, power and heat generation.

The total capex has been assumed to exceed PLN 34bn 2017−2022. The investment programme should deliver cumulative 2017−2022 EBITDA of ca. PLN 33.7bn, driving long-term growth of the Group's EBITDA in 2023−2026 to the annual average of ca. PLN 9.2bn. At the same time, the net debt to EBITDA ratio should stay below 2.0 over the Strategy term, with the current dividend policy providing for distribution of up to 50% of the Group's consolidated net profit upheld.

The new Strategy identifies seven key business areas, with the following strategic objectives and ambitions for 2017−2022:

1. Exploration and Production – increase the current base of documented hydrocarbon reserves by ca. 35%, increase hydrocarbon production by ca. 41%, significantly reduce unit costs of exploration for and appraisal of deposits, and maintain unit cost of field development and hydrocarbon production;
2. Wholesale – build a diversified and competitive gas supply portfolio beyond 2022 and increase the overall volume of natural gas sales by ca. 7%;
3. Retail – maximise retail margins, while maintaining the total volume of retail gas sales at ca. 67–69 TWh/year;
4. Storage – secure access to storage capacities adjusted to actual demand and improve storage efficiency;
5. Distribution – build more than 300 thousand new service lines and increase the volume of distributed gas by ca. 16%;
6. Power and Heat Generation – increase power and heat sales volumes by ca. 20%;
7. Corporate Centre – increase involvement in and effective execution of R&D&I projects (target outlay of ca. PLN 680m), improve operational efficiency across the PGNiG Group and enhance the Group's image.

For further information on the strategic objectives in the individual business areas and a review of their implementation in the first half of 2019, see Sections 5.1–5.4.

2.4. Risks

In the first half of 2019, there were no material changes in the nature, magnitude or probability of materialization of the risks affecting the PGNiG Group's business. For further information on the risks affecting the individual segments, see Section 8 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2018. › www.pgnig.pl

The PGNiG Group monitors and assesses its risk exposures on an ongoing basis and takes steps to minimise their effect on its financial position. The key financial risks to which the PGNiG Group is exposed include:

- market risk: commodity price risk, currency risk and interest rate risk,
- credit risk,

- liquidity risk.

For a detailed description of the above risk, see Section 7.3 of the PGNiG Group's consolidated financial statements for 2018. › www.pgnig.pl

2.5. Research, development and innovation (R&D&I)

In the first half of 2019, PGNiG and the PGNiG Group continued their research, development and innovation activities, carried out through two departments and the Central Measurement and Testing Laboratory. In the previous reporting period, the main objective in this area was to streamline processes and improve products and services supporting innovation at the PGNiG Group.

2.5.1. Innovation and Business Development Department

Innovation Portfolio

In the first half of 2019, acting through the Innovation Project Management Office, the PGNiG Innovation and Business Development Department supervised and monitored the progress of and expenditure on 106 innovation projects, 89 of which were in the implementation phase, including:

- 15 projects implemented and/or financed by the Innovation and Business Development Department: Geo Metan II, InnVento Startup Centre, SORGE, Kelvin, Norwegian Funds, PMEF (energy efficiency property rights), PGNiG Ventures, Helios, Digital Field, Trigonostoma, Concept for the Development and Construction of a Mobile LNG Sampling Facility, Smok 3D, Smok 4P, Microcoiled tubing ¼', Upgrade of the GMVH-12 gas engine.
- 74 projects implemented and financed by Group companies (Exalo Drilling – 3 projects, Gas Storage Poland – 14 projects, Gas Trading – 2 projects, Geofizyka Toruń – 3 projects, Gazoprojekt – 4 projects, PGNiG OD – 16 projects, PGNiG Serwis – 2 projects, PGNiG Technologie – 1 project, PGNiG Termika – 6 projects, and PSG – 23 projects).

In the first half of 2019, 17 projects were completed, including:

- 2 projects implemented and/or financed by the Innovation and Business Development Department: 'VPP Prąd', automatic foaming stick injector;
- 15 projects implemented and financed by Group companies (Exalo Drilling – 5 projects, Gas Storage Poland – 4 projects, PGNiG OD – 5 projects, and PSG – 1 project).

More than PLN 1m was spent on innovative projects implemented at PGNiG.

In the first half of 2019, the Innovative Portfolio Board recommended seven new projects for implementation (PGNiG Ventures, Smok 3D, Smok 4P, Upgrade of the GMVH-12 gas engine, Easy UnPack, IMOD, and Helios). The Company's Management Board approved the launch of the 'PGNiG Ventures' innovative project, the primary objective of which is to establish, within the PGNiG Group, an entity capable of investing in innovative projects with a high growth potential. On the one hand, this will contribute to strengthening PGNiG's core business segments (exploration, production, trading, storage, distribution, and generation) and, on the other, it will enable entering new business areas using tools for indirect and direct investment in the venture market. The time required to establish an investment vehicle is estimated at approximately six months.

InnVento

In the first half of 2019, the activities of the Startup Centre focused around the following three pillars:

1. Collaboration with professional partners specialising in the search for startups:

   The first half of 2019 saw continued pilot implementation of six startups selected as part of cooperation with MIT Enterprise Forum Poland, among other entities. Together with the Lesław A. Paga Foundation, the Energy Academy and Young Innovators programmes were implemented. A platform for sharing knowledge between energy practitioners with long experience and those beginning their careers in the energy sector was launched. Cooperation was established with new partners: the Polish Association of the Oil and Gas Industry Engineers and Technicians (SITPNiG) and the Coalition for Polish Innovation, which will contribute to exchanging best practices in innovation and expand opportunities for international cooperation.

   The Department formalised cooperation with the Startup Hub Poland (SHP) Foundation, which submitted an application in the Poland Prize competition organised by the Polish Industrial Development Agency. As one of the six selected applications, the Foundation's application received funding of approximately PLN 5m to implement the programme. PGNiG and SHP jointly conducted the first round of the Programme, under which eight foreign startups were invited to Poland and their establishment was accelerated. The UK-based Spottitt startup, assessed as the best one, is in the process of preparing to pilot implementation of its solution at the PGNiG Group.

2. Cooperation with startups in implementing innovative ideas across the PGNiG Group:
   - PROA Technology (lease and personalisation of virtual workforce to swiftly and efficiently handle customers' business processes using its RPA (Robotic Process Automation) platform;
   - InnoMesh Sp. z o.o. (a service including power banks, a charging station and an online/mobile application, operating under the Access Economy model);

- Solutions 4 Tomorrow Sp. z o.o. (a company providing drone solutions; use of drones for mapping air pollution; the startup offers a docking station which enables a UAV to take off, land and replace batteries completely autonomously on a mobile platform, such as a boat or a car);
- IC Solutions (a solution which optimises document handling processes by eliminating scanning and automating document processing in IT systems);
- Lesss (a smart external lighting control system, controlled by HD cameras detecting human presence; the system regulates the light intensity in the range 10–100%);
- Elastic Cloud Solutions – Elastic Intranet.

In the reporting period, approximately 40 startups were reviewed under the InnVento programme. For the most interesting solutions, a pitch day was organised for wider presentation of the proposed solutions.

3. Promoting the culture of innovation at the PGNiG Group and building the Startup Centre brand:

In the first half of 2019, workshops were held with representatives of the Group companies, on 'Updating growth-related needs for the PGNiG Group', which enabled knowledge exchange and identification of business areas with the largest potential to use innovation. Under the InnVento programme, 12 open events were also organised, intended for PGNiG Group employees, as well as for individuals and organisations operating in the oil and gas sector or interested in the innovations for this sector.

Efforts were also continued to promote PGNiG on the innovation market through active participation in and giving lectures during industry events, such as Infoshare 2019 in Gdańsk, European Startup Days in Katowice, and Impact2019 in Kraków.

In the first half of 2019, PGNiG joined the Innovation Manager Academy (IMA) training and advisory programme organised by the Polish Agency for Enterprise Development (PARP). The IMA programme covers six thematic areas, which define the subject of thematic congresses and individual employees' work at the Company: Culture of Innovation, Understanding Business, Strategy, Organisational Structure, Potential and Resources, Processes. The IMA programme will be carried out for approximately nine months. It is intended to provide the participants with knowledge of and skills in the management of innovation at an enterprise. During the training part (lectures and workshops), participants will gain knowledge of how enterprises which effectively use innovation to grow are organised and how they operate. During the advisory part, with the support from an adviser and expert on the subject, participants will transfer this knowledge into the practices of the support recipient. The objective of the IMA programme is to increase the innovation potential of an enterprise by enhancing staff competence.

Geo Methane II

The "Pre-mining extraction of coal bed methane by stimulating the productivity of methane in directional drilling wells" project was among the winners of the 12th edition of the 'Teraz Polska' competition in the Innovation Projects category. A plan of geological operations, which envisages the drilling of the Bielszowice-1K test well together with the Bielszowice-2H directional well to evaluate the pre-mining extraction of coal bed methane as part of Phase II of the Geo Methane Research Programme, has been submitted with the Ministry of the Environment.

Energy Efficiency

PGNiG settled its obligation under the Energy Efficiency Act for Q4 2016 and 2017–2018 through cancellation of its energy efficiency certificates. Implementation of the Energy Management System compliant with the ISO:50001 standard was launched at PGNIG S.A. As part of the implementation, more than 1,370 employees of the Sanok, Zielona Góra and Odolanów Branches received training in the period from March to June.

Growth prospects

New innovation projects are planned to be launched in the second half of 2019, which will help increase competitiveness in key business areas, generate savings, and enhance the offering for customers. Start of operations by PGNiG Ventures, ready to make the first equity investments, will be of key importance in expanding the ability to develop the innovation area. This will be coupled with active market penetration to identify the most promising projects.

Two more rounds are planned to be run under the Poland Prize programme in partnership with the Start Hub Poland Foundation. Eight best projects will be selected in each round (24 in total under the Programme). In Poland, the selected start-ups will take part in the acceleration programme; after that, PGNiG will be able to cooperate with them under pilot implementation of the PGNiG Group's projects. The finale of the programme is to take place in December 2019.

Other efforts undertaken as part of the InnVento incubator will also be compounded: more Pitch Day rounds, regular meetings with experts, and workshops designed to build innovation capabilities are to be organised. Steps are being taken to prepare a market report on innovation in the oil and gas industry and to present it during key events this autumn. A procedure is under way to select accelerators which have already received grants from the Polish Agency for Enterprise Development (PARP) under the second ScaleUp programme. This will increase the number of interested start-ups, and the PARP funds will be applied towards their acceleration.

As regards the implementation of the Geo Metan II project, cooperation agreements with Tauron Wydobycie and Jastrzębska Spółka Węglowa, as well as another agreement with Polska Grupa Górnicza on KWK Murcki-Staszic are to be signed. Plans also include carrying out appropriate procedures, selecting the contractor for site preparation, as well as drilling wells and commencing the drilling of the Bielszowice-1K and Bielszowice-2H boreholes.

As far as Energy Efficiency is concerned, the Company also plans to launch the Helios project to confirm its commitment to achieving the national target related to increasing the share of RES in energy output and developing electromobility by creating a complete chain, from hydrogen generation to refuelling hydrogen-powered vehicles.

Requests for energy efficiency certificates are prepared and submitted to the President of URE on a regular basis in connection with energy efficiency improvement projects implemented by the Company.

PGNiG will also step up its efforts to deploy the Energy Management System. New energy efficiency initiatives are also to be undertaken, including the launch of a mechanism to report and reward initiatives improving energy efficiency.

2.5.2. Research and Development (R&D) Department

The Research and Development Department, through the Dedicated R&D Project Management Office, supervised the progress and monitored expenditure under 46 R&D projects, of which 23 were in the implementation phase, including:

- 35 projects implemented and financed/co-financed by the Research and Development Department, including the INGA programme comprising nine projects co-financed by PGNiG;
- 11 projects implemented and financed by PGNiG Group companies (PSG – 6 projects, Geofizyka Toruń – 3 projects, PGNiG Termika – 2 projects).

In the first half of 2019, 5 projects were completed, including:

- 3 R&D projects implemented and financed by the Research and Development Department: "Use of spectrometric gamma measurements on low radioactivity cores for calibration of natural gamma-ray profiles not standardised in API units", "Comparison of LoRa and Sigfox technologies, technical analysis, elements of business plan", "Measuring the operating parameters of prototype modules based on the Sigfox technology for the purpose of remote readings".
- 2 R&D projects implemented and financed by PGNiG Group companies (Geofizyka Toruń): Development of a package of competitive GT modules in production processing software I – the '3D Dataset Projection' programme, Development of a package of competitive GT modules in processing production software II – the '3D Spatial Residual Amplitude Corrections' programme.

More than PLN 3m was spent on R&D projects implemented by the PGNiG Group. The outcome of the efforts undertaken by the Research and Development Department was 35 proposals received by PGNiG to cooperate in the implementation of R&D projects; 17 of those proposals were registered as R&D offers and reviewed. In the first half of 2019, six meetings of the Research and Development Project Assessment Committee were held, during which 19 offers submitted by Polish research institutes and universities were presented and discussed, including: The Oil and Gas Institute − National Research Institute (INIG-PIB), the Catholic University of Lublin (KUL), the Warsaw University of Technology, the Kielce University of Technology) and private businesses, such asSAM Polska Sp. z o.o., GoodWay Sp. z o.o., and Every European Digital Poland Sp. z o.o. From among the presented proposals, seven offers received approval and recommendation from the Research and Development Project Assessment Committee to be implemented as research and development projects. These include:

- Cement slurries of increased mechanical strength with the addition of nanoparticles – stage II, INIG-PIB.
- Development of an algorithm to support the decision-making process for selecting a commercialisation model − dedicated to PGNiG and KUL.
- HYDRA-Tank – Construction of a hydrogen refuelling research and development station at ul. Prądzyńskiego in Warsaw, the PGNiG Research and Development Department.
- Investigating the possibility of storing hydrogen and natural gas mixtures in selected underground geological structures, INIG-Chemkop.
- Activating an increase in the calorific value of coal, Good Way Sp. z o.o.
- Construction of a power-to-gas (PtG) plant and analysis of the impact of hydrogen presence on gas network operating parameters (PtG Ciechanów), the Warsaw University of Technology – State Higher Vocational School in Ciechanów.
- Development of a methodology for environmental footprint assessment at selected facilities of PGNIG S.A., INIG–PIB.

In the first half of 2019, seven offers were selected for implementation as research projects, and one R&D project proposal was recommended for implementation. In the same period, PGNiG signed seven contracts for the implementation of R&D projects, for a total amount of approximately PLN 16.5m, including contracts signed as part of the ongoing competition held as part of Joint Venture INGA I.

The INGA Joint Venture (INGA)

In the first half of 2019, the first competition held as part of INGA ended with the closing of an appeal handling procedure following which two further projects with a total budget of PLN 17.9m were accepted for implementation. Consultations were also held with the National Centre for Research and Development and GAZ-SYSTEM to agree on the organisational details of the second competition (preparations for its launch are currently under way; the agreed date for announcing the competition is September 30th 2019).

Hydrogen

To modify area targets for the R&D area, a new area target was proposed: 'Developing the PGNiG Group's hydrogen competencies as a potential new line of business'. The Department commenced work designed to look into the possibility of utilising hydrogen at the PGNiG Group, as confirmed by, *inter alia*, the launch of the Hydra Tank project related to the construction of a pilot hydrogen filling station.

The Department's efforts are undertaken in view of market's growing interest in hydrogen technologies, including in particular from the rapidly growing automotive industry, and the growing production of vehicles powered by alternative fuels. As part of the project, a letter of intent was signed with Toyota Motors Poland as the selected supplier of hydrogen-powered vehicles.

Interest in hydrogen as an alternative fuel is also confirmed by the implementation of other research projects in partnership with research institutions. The recommended projects included the construction of a demonstration PtG plant for production of hydrogen from renewable sources in Ciechanów and a research investigating the possibility of storing hydrogen and natural gas mixtures in selected underground geological structures.

Other key projects

The department supervised on a regular basis approximately 30 R&D projects commissioned for execution to external partners. With respect to projects which are of key importance for the area, research work on testing remote reading of gas and heat meters using the Sigfox and LoRa transmission protocols was completed. Positive results of the tests led to a decision to continue implementation work through pilot schemes carried out by the PGNiG Group companies interested in using the technology (PSG and PGNiG TERMIKA). As part of the subportfolio of projects for the Exploration and Production segment, the second phase of the MiniDrill project began. The project consists in drilling small-diameter horizontal wells in which the hydrofracturing technology is then used. Under the contract signed with the AGH-EUROTECH science and industry consortium, the parties will work to develop the prototype technology and carry out well testing at a borehole indicated by PGNiG.

Major projects continued or completed in the first half of 2019 also included:

- Day-to-day efforts and project work on intellectual property protection and management, on connection with the implementation of an intellectual property protection model in the R&D area at PGNiG.
- As continuation of the efforts commenced in 2018, further steps were taken with a view to obtaining patent protection for the results of the R&D projects in which PGNiG participated. These steps prevented a potential loss of PGNiG's patent rights. The patent award procedures will be continued in the second half of 2019 and in the following years.
- A complete application to the Patent Office of the Republic of Poland was prepared to obtain protection for the 'SMOK' trademark.
- Rules for the award of rights to PGNiG trademarks at the PGNiG Group were defined.
- As a result of cooperation with the HR Department with respect to Implementation Doctorates, at the moment there are seven PGNiG employees working on such doctorates.
- Cooperation was undertaken with the Norwegian SINTEF research institute as part of the Hydrogen for Europe project, whose partners include 10 international oil and gas companies, such as TOTAL S.A., Shell, EQUINOR Energy Belgium NV, The UK Oil and Gas Industry Assocation Ltd., Norsk Olje og Gas, and others. The aim of the project was to carry out analyses necessary to evaluate the feasibility of introducing hydrogen to the market, and to investigate the related legal, formal, economic, environmental, technological and investment aspects. The completed study was presented to the European Commission as a proposal of regulatory changes relating to the greenhouse gas emission reduction targets. It is consistent with the R&D programme carried out by the Research and Development Department and aimed at development and implementation at PGNiG of hydrogen technologies as alternative energy sources (energy storage facilities) and an alternative fuel for electric vehicles.
- Active participation in the working group for Strategic Analysis of Development of Hydrogen Management in Poland, established by the Ministry of Energy. Other members of the working group include representatives of Polska Grupa Energetyczna, Jastrzębska Spółka Węglowa, Institute of Power Engineering, GAZ-SYSTEM, PKN Orlen, Grupa LOTOS, and PKP Energetyka.
- Continued active participation in the Scientific Advisory Group. New, outstanding scientists representing various areas of knowledge and specialisms were appointed to the Scientific Advisory Group to actively support PGNiG's R&D activities.

Growth prospects

To improve its organisational model for R&D activities, the PGNiG Group intends to:

- Complete the project related to the implementation of an intellectual property protection model for the R&D area at PGNiG.
- Continue the process to secure the intellectual property rights as part of the ongoing R&D projects. The main steps to be taken in this process include ongoing collection and analysis of data on intellectual property created as part of R&D projects, as well as monitoring of patent proceedings relating to the inventions and other industrial property rights created as a result of the Company's R&D projects and taking the relevant procedural and legal steps as part of such proceedings.
- Update the relevant documentation, including the Rules of Procedure for the Research and Development Project Assessment Committee.
- Intensify the request for proposal activities aimed at broadening the cooperation between the business and the academic world and also with private parties. The purpose of entering into cooperation with new external partners is to gain direct business benefits for the Company, boost innovation and competitiveness, and to commercialise the effects of joint work.
- Complete the process of agreement execution and start the project work as part of the First Edition of the INGA Programme (nine agreements in total). The projects relate to issues which are relevant to the business of the Group's internal stakeholders – the PGNiG Branches and Groups companies. New areas of interest include exploration for coalbed methane and optimisation of coalbed methane production at pre- and post-mining stages, as well as the launch of a smart customer service system using voice recognition, voice biometrics, and big data analysis.
- Work on the launch of the Second INGA competition to identify new R&D projects for the PGNiG Group companies, which are to be implemented in 2020-2023 and 50% financed by the National Centre for Research and Development.

As part of further work on a new business area – hydrogen technologies, the Group plans to build a "Roadmap for Hydrogen Competence," which will set out the opportunities for expanding into new business areas. The issues to be addressed include, among other things, the storage of hydrogen using the underground gas storage infrastructure and the distribution network, hydrogen-based electromobility, and distributed generation, especially fuel cell technologies.

2.5.3. The Central Measurement and Testing Laboratory Branch

The main projects carried out or completed by the Central Measurement and Testing Laboratory in the first half of 2019 included:

- Metrological inspection of the metering systems on the Polish section of the Yamal-Europe transit pipeline – service performed since 1999.
- Metrological inspection of measurement systems at large gas customers' (industrial customers) billing stations − about 30 measurement systems.
- Review and evaluation of natural gas measurement systems for the purpose of assessment of CO_2 emissions by large industrial emitters.
- Metrological supervision over process analyser systems for assessing natural gas quality at GAZ-SYSTEM's transmission network, PSG's networks, PGNiG's gas production and gas storage facilities, and at the LNG Terminal.
- Investigations into the feasibility of using Coriolis and ultrasonic mass flow meters in the distribution segment.
- Examination of the LNG sample collection systems used at small LNG facilities.
- Supervision of liquefied gas consignment billing processes at the LNG Terminal.
- Commercialisation of the SMOK measurement systems.
- Tests of hythane mixture (natural gas+H2) quality control systems – tests of the Japanese Riken Keiki correlation analyser).

Growth prospects

As regards the development of its activities in the second half of 2019 and in the following periods, the Central Measurement and Testing Laboratory's plans are as follows:

- To maintain its position as the leading research laboratory and verification centre for measurement systems and devices used in the natural gas industry, including with respect to liquefied gases and LNG.
- To achieve the position of the leading laboratory in Poland for hydrogen analysis (in the future – an accredited laboratory).
- To maintain the position of the leading natural gas quality control laboratory with respect to all types and forms of natural gas (CNG, LNG) as well as biogas/biomethane.
- Growing numbers of gas quality analysers which must be subject to metrological and analytical supervision – at the moment only the Central Measurement and Testing Laboratory is capable of performing such supervision for the entire industry as a laboratory accredited in this respect, in particular with regard to settlements made in energy units.
- The trend to implement and equip gas (including LNG) billing systems with ultrasonic and mass gas meters – in the first half of 2019 commercialisation of the SMOK systems for PSG commenced.
- The need to supervise large scale (sea terminal) and small scale (transport by tankers) LNG settlements.
- To maintain the position of the leading provider of industry specific and technical training services.
- To maintain the position of the PGNiG Group leader with respect to cooperation with international inspection bodies and international technical organisations, such as GERG or IGU.
- To leverage the Laboratory's experience with respect to the settlement of supplies and technical support when executing new LNG purchase contracts (both delivery-ex-ship (DES) and free-on-board (FOB) delivery).

3. Regulatory and market environment

3.1. Regulatory environment

Except as discussed below, there were no significant changes in the regulatory environment of the PGNiG Group in the first half of 2019. A detailed description of the regulatory environment is presented in Section 4.1 of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2018. › www.pgnig.pl

3.1.1. Changes in the regulatory environment in Poland

Energy Law

The first half of 2019 saw the entry into force of amendments introduced by the following acts:

- The Act Amending the Energy Law and Certain Other Acts of November 9th 2018 (Dz.U. of 2018, item 2348) – amendments concerning identification in contracts of a reserve supplier and introducing the obligation to publicly sell all electricity output;
- The Act on Promotion of Electricity from High-Efficiency Cogeneration of December 14th 2018 (Dz.U. of 2019, item 42) – amendments made to ensure consistency of the provisions of this Act with the new systemic solutions introduced to support cogeneration.

Moreover, on June 7th 2019 an Act Amending the Energy Law was passed, which defined the obligations of gas system operators (including the transmission, distribution or the entire connected gas system) and clarified the competence of the President of URE in defining the relationship between the gas network owner and its operator.

None of the above changes will affect the PGNiG Group's business.

Energy Efficiency Act

In the first half of 2019, the Act of June 13th 2019 Amending: the Act Amending the Act on Excise Duty and Certain Other Acts, the Energy Efficiency Act and the Act on Biocomponents and Liquid Biofuels (Dz.U. item 1210), extended the time limit by which the energy efficiency obligation may be discharged using the energy efficiency certificates issued under the regime of the previous Act.

Thus, the validity of the energy efficiency certificates ("white certificates") was extended until June 30th 2021. The changes will not affect the PGNiG Group's business.

Act on the Promotion of Electricity from High-Efficiency Cogeneration

In the first half of 2019, the Act on the Promotion of Electricity from High-Efficiency Cogeneration was amended by the Act of February 21st 2019 Amending: the Act Amending the Excise Duty Act and Certain Other Acts, the Environmental Protection Law, the Act on the System for the Management of Emissions of Greenhouse Gases and Other Substances, the Act Amending the Act on Biocomponents and Liquid Biofuels and Certain Other Acts, and the Act on the Promotion of Electricity from High-Efficiency Cogeneration (Dz.U. item 412). The amendments were made to align the rules for the provision of support to new entities with the EU law.

The changes will not affect the PGNiG Group's business.

Act on Special Hydrocarbon Tax

In the first half of 2019, legislative work continued on the draft act on the abolition of the special hydrocarbon tax and amendment of certain other acts, the purpose of which is to abolish the special hydrocarbon tax and accelerate the collection of the tax on production of certain minerals with respect to the production of natural gas. The proposed changes have a positive effect on the PGNiG Group's business.

Tariff Regulation

In the first half of 2019, PGNiG OD applied the following gas fuel trading tariffs:

- Amendment No. 2 to PGNiG OD Gas Fuel Trading Tariff No. 6 – in the period from August 10th 2018 to February 14th 2019. In relation to the previous tariff, gas fuel prices rose by 5.9%.

- PGNiG OD Gas Fuel Trading Tariff No. 7, approved by decision of the President of URE of January 25th 2019. Relative to the previous tariff, this new tariff raised gas fuel prices by 2.5% for all tariff groups. Subscription fees were adjusted in the 2.2 and 3.6 tariff groups by -1.3% and 0.3%, respectively, while in the other tariff groups they remained unchanged. Furthermore, new retail tariff groups were introduced for customers using prepaid metering systems. Tariff term: from February 15th 2019 to December 31st 2019.

In the first half of 2019, GSP made settlements with storage service customers in line with the following tariffs:

- Amendment to Gas Fuel Storage Tariff No. 1/2018, approved by the President of URE on July 26th 2018 for the period from August 11th 2018. In relation to the previous tariff (Tariff No. 1/2018), the average fee for storage services was increased by 0.4%. GSP made the settlements with storage service customers on the basis of the above tariff until April 14th 2019.
- Gas Fuel Storage Tariff No. 1/2019, approved by the President of URE on March 29th 2019. The tariff is effective from April 15th 2019 to March 31st 2020 and reduces the average rates by 6.3% relative to the previous tariff. The change follows from the average rates determined on the basis of the storage capacity reservations for the long-term service, made for the 2019-2020 storage year.

In the first half of 2019, PSG applied the following tariffs:

- Tariff No. 6 for Gas Fuel Distribution Services and LNG Regasification Services. The Tariff, effective as of March 1st 2018, reduced the average fee for distribution services by 7.37% in relation to the previous tariff. Tariff No. 6 was amended to harmonise its provisions with the Tariff Regulation of March 15th 2018. The amendment took effect on October 1st 2018 and did not change the fees for distribution and regasification services provided. PSG carried out settlements based on the tariff until February 14th 2019.
- Tariff No. 7 for Gas Fuel Distribution Services and LNG Regasification Services provided by PSG, approved by decision of the President of URE on January 25th 2019; The average reduction of prices and rates of network fees used for settlements with customers in the Distribution Tariff in relation to the previous tariff of PSG for all tariff groups with the exception of coke gas is 5%. Tariff term: from February 15th 2019 to December 31st 2019.

In the first half of 2019, PGNiG TERMIKA applied the tariff approved by decision of the President of URE on July 27th 2018 for heat generated at the following heat generating sources: the Żerań CHP plant, Siekierki CHP plant, Pruszków CHP plant, Wola heating plant and Kawęczyn heating plant, and for transmission and distribution of heat via the heating networks in the Pruszków area (supplied from the company's own heat generating source: Pruszków CHP plant), as well as in the Annopol, Chełmżyńska, Jana Kazimierza, Marsa, and Marynarska areas: PGNiG TERMIKA filed a new tariff application with URE on May 31st 2019. Proceedings concerning the application are pending.

In the first half of 2019, the tariffs applied by PGNiG TERMIKA EP included:

1. For electricity:
   - Electricity Tariff No. 19/18, approved by resolution of the PGNiG TERMIKA EP Management Board on January 16th 2018,
   - Tariff for electricity distribution services of PGNiG TERMIKA EP, approved by decision of the President of URE on October 17th 2017.
   - From May 1st 2019 – a new tariff for electricity distribution services, approved on April 11th 2019
2. For heat:
   - The heat tariff approved by decision of the President of URE on March 12th 2018 along with the heat tariff amendment approved by decision of the President of URE on October 15th 2018. The tariff and the amendment were effective until June 30th 2019.
   - A new heat tariff, approved by decision of the President of URE on June 5th 2019 The tariff came into force on July 1st 2019. The new tariff set the following price increases: 3.51% for heat generation, and 2.29% for heat transmission.

3.1.2. Changes in the European regulatory environment

Third Energy Package

On April 17th 2019, the European Parliament and the Council of the European Union adopted Directive amending Directive 2009/73/EC concerning common rules for the internal market in natural gas (Directive 2019/692), the purpose of which is to make Directive 2009/73/EC applicable to gas pipelines with third countries, in the territorial seas of the EU. The final text of the Directive substantially imposes the obligation to ensure compliance of gas pipeline operation in accordance with the EU law on the Member State where the first interconnection point with the Union network is located. The Directive also gave the Commission powers to verify the compliance of granted derogations or exemptions from the obligations arising under the newly adopted regulations.

Directive on the Promotion of Clean and Energy Efficient Road Transport Vehicles

In June 2019, the European Parliament and the Council of the European Union adopted the Directive on the promotion of clean and energy-efficient road transport vehicles (CVD), which is now awaiting publication in the Official Journal of the European Union. In accordance with the adopted regulations, Member States should ensure that public contracts for vehicles are awarded in such a way as to reach a minimum percentage of clean vehicles in the total number of road vehicles covered by all contracts awarded two years after the CVD enters into force. The target shares of clean vehicles are divided into targets for passenger vehicles, trucks (above 3.5 tonnes) and buses. For Poland, the target for 2025 in the first category is 22%, for trucks – 7%, and 32% for buses. Vehicles fuelled with natural gas may be included in these targets in the case of the latter two vehicle groups. For 2026-2030, the target for trucks is to be increased to 9% and for buses to 46%.

SoS Regulation

In the first half of 2019, efforts to adapt procedures to the requirements of the new SoS Regulation were continued. To this end, steps were taken to confirm the portfolio of customers eligible for the category of protected customers within the meaning of the SoS Regulation.

NC CAM Regulation

PGNiG participated in public consultations to indicate the auction platform preferred by market participants for the interconnection point between the Polish and German gas systems. Following an appeal filed by one of the market participants with a higher level institution, PGNiG also submitted its position as part of the appeal procedure.

EU ETS

On February 26th 2019, the European Commission adopted a delegated regulation with respect to the operation of the Innovation Fund. The Innovation Fund, set up under the EU ETS Directive, aims to promote the development of renewable energy sources, CCS/CCU technologies and forms of energy storage. To this end, 450 million CO_2 emission allowances were issued, with an estimated value of EUR 10bn (depending on the market price of the allowances).

Also in February 2019, the European Commission adopted a delegated decision identifying the sectors and subsectors deemed at risk of carbon leakage for 2021-2030. The European Commission adopted the new decision in view of the beginning of a new financial framework for the EU ETS mechanism in 2021 and the amendment of the EU ETS Directive.

3.2. Fuel prices and currency exchange rates

3.2.1. Trends on natural gas market

The first half of 2019 saw a decline in natural gas prices across European markets. Prices in month-ahead contracts were on average 25% lower than the average price for the corresponding period of the previous year. This was due, among other things, to mild winter weather and higher LNG deliveries to terminals in Europe. The downward trend in prices continued for the first two quarters of 2019. Spot prices were below contract prices at the time of exercise.

Global prices of natural gas

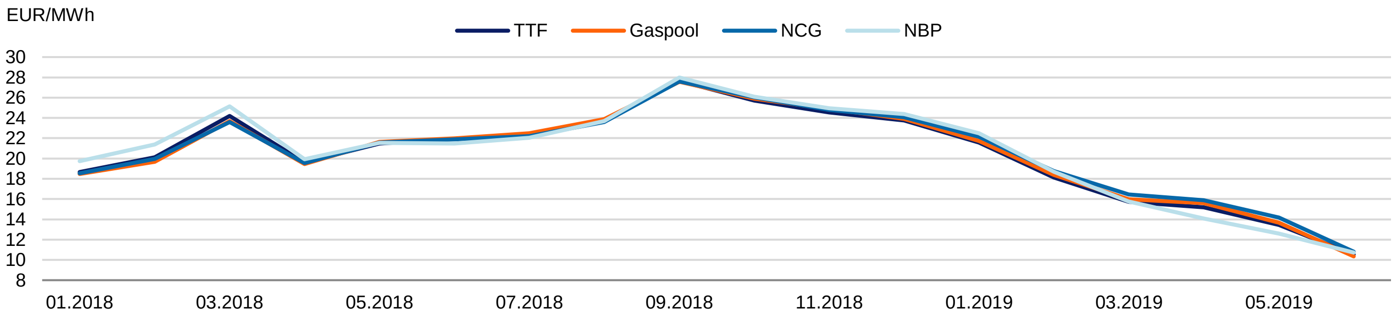
In the first half of 2019, natural gas prices at PPX fell on average by 20.8% year on year. For this period, it was the smallest decline among the European markets under analysis. The strongest decrease was seen at the UK NBP hub: 27% y/y. The average price of gas on key European markets was EUR 16.30 per MWh, compared with EUR 21.31 per MWh in the first half of 2018. At the beginning of 2019, European countries held high volumes of gas in storage. Mild winter conditions lowered the demand for gas in the heating period, deepening the downward price trend, especially in the first quarter of 2019.

In winter, the demand for LNG supplies in Eastern Asia (Japan, South Korea, China) was lower than expected, leading to a 46% decrease in spot prices, from EUR 26.66 per MWh at the beginning of the year to approximately EUR 14.37 per MWh in June. This also had an impact on natural gas prices in European markets. The spot price of gas at the Dutch TTF hub fell from EUR 21.56 per MWh to EUR 10.53 per MWh over the period. The average price of gas was EUR 15.76 per MWh, down 25% year on year. The shrinking price spread between Asia and Europe, averaging at EUR 2.2 per MWh compared with EUR 4.64 per MWh a year ago, made LNG sales to Europe more attractive. In the period, the volume of liquefied gas supplies to Europe grew by 90.5%.

A material factor with a bearing on gas prices in Europe in the first half of 2019 was the storage level at European gas storage facilities. In Germany, the country with the largest storage capacity in Western Europe, the storage level at the end of the 2019 winter season was 52.3%, compared with 15.2% the year before. The demand for gas for heating purposes was lower than a year ago due to mild winter conditions. In addition, increased LNG supplies played an important role in balancing demand. Gas storage levels were high when the gas injection season in Europe began, which weakened the gas injection rate in May and June.

Prices of other energy commodities also had an impact on gas prices in Europe. The average price of coal and crude oil fell in the first half of 2019 by 25% and 7%, respectively, from the average level seen in the same period of the previous year.

Average monthly spot prices of natural gas at selected European hubs in 2018 and H1 2019



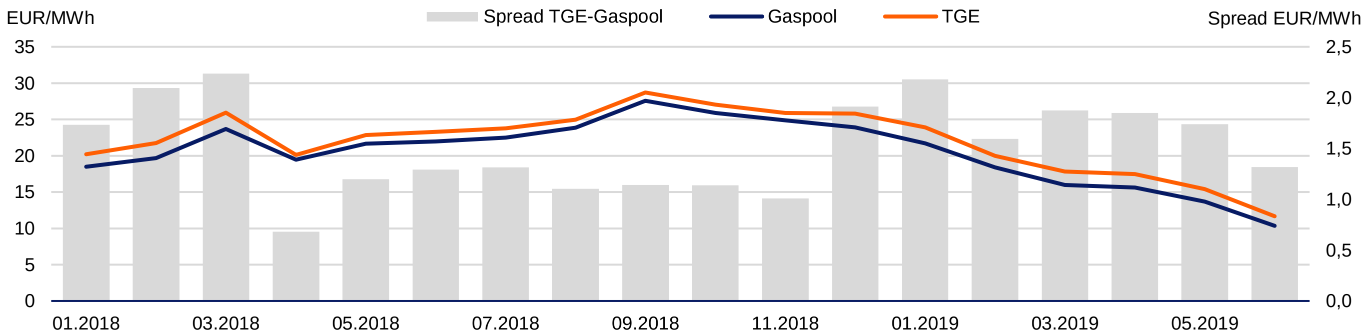
Source: ICE – Intercontinental Exchange, EEX – European Energy Exchange.

Natural gas market in Poland

In the first half of 2019, high-methane grid gas consumption was approximately 8.63 bcm (excluding gas fuel transmitted on the OTC and PPX markets), compared with 8.55 bcm n the corresponding period of 2018 (increase of 0.9% year on year). February and March saw a year-on-year decline in consumption due to relatively high average monthly temperatures during those months (temperature higher by 6.1°C and 5.4°C, respectively, than in 2018).

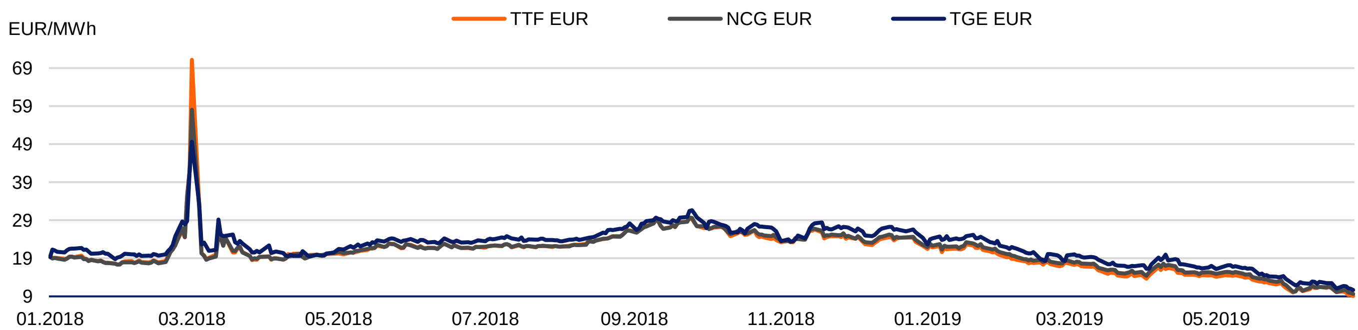
In the first half of 2019, the average spot price of gas in Poland was PLN 76 per MWh, down 19.5% year on year. Gas prices in Poland were correlated with those in European gas markets. The spread between spot prices on PPX and GASPOOL rose from EUR 1.54 per MWh in the first half of 2018 to EUR 1.76 per MWh in the first half of 2019, due to, *inter alia*, the three-times higher volumes of gas remaining in German storage facilities after the end of the 2018/2019 winter season and a decline in the rate of gas injection into German storage facilities in Q2 2019. The operational plan for storage facilities in Poland was better adapted to the prevailing weather conditions and did not differ significantly from the operating cycles observed in previous storage years.

Average monthly natural gas spot prices in Poland and Germany in 2018 and H1 2019



Source: In-house analysis based on PPX data and EEX data.

Spot price of gas at PPX, TTF and NCG in 2018 and H1 2019.

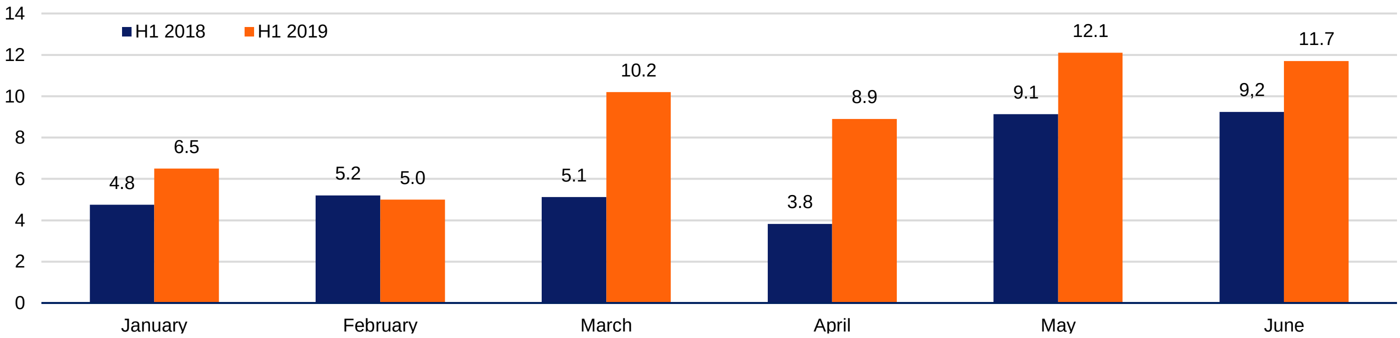


Source: In-house analysis based on PPX data and EEX data.

According to PPX data, in the first half of 2019 the total gas trading volume was 65.8 TWh, compared with PLN 51.8 TWh in the corresponding period of 2018. The volume of gas traded on the Day-Ahead Market and Intraday Market (spot contracts) was 11.5

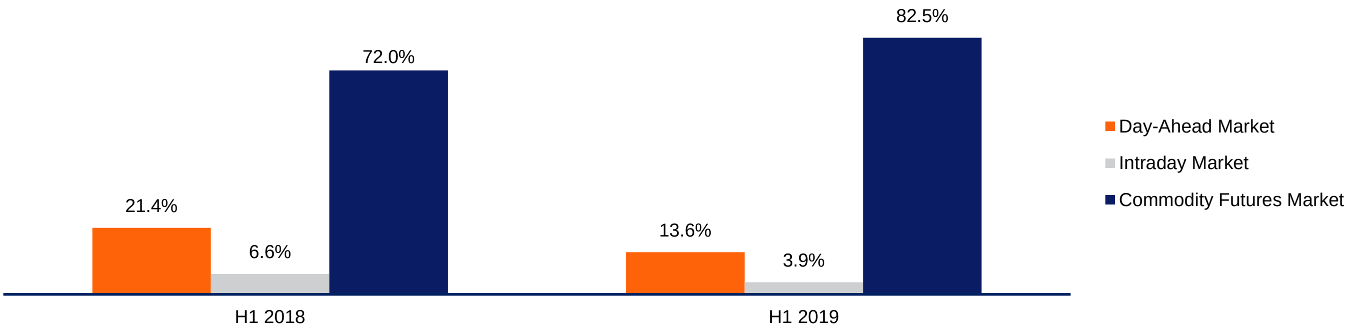
TWh, compared with 14.5 TWh in the first half of 2018. On the Commodity Forward Instruments Market, the trading volume was 54.3 TWh, up 45.6% year on year. This means that almost 82.51% of gas trades in the first six months of 2019 were executed under annual, seasonal, quarterly, monthly, and weekly contracts. The share of spot contracts reached 17.49% and was lower than in the first of 2018.

Trading volume in forward contracts (Commodity Forward Instruments Market) on the PPX in H1 2018 and H1 2019 (TWh)



Source: In-house analysis based on PPX data.

Contracts traded on the PPX in H1 2018 and H1 2019



Source: In-house analysis based on PPX data.

Global LNG market

The global LNG trading volume grew by more than 15% year on year, to over 238 bcm after regasification (preliminary data for delivered LNG volumes). This strong increase from the level observed in the first half of 2018 (by 31 bcm) was caused by launch of new liquefaction capacities, including in Australia, the United States and Russia. In the first half of 2019, the largest year-on-year increase in exports was recorded in Australia (by almost 7.4 bcm). Asia is the world region recording the most rapid growth in exports (by 11 bcm year on year).

The increase in supply was absorbed by the European markets. In the first half of 2019, 61 bcm of LNG reached Europe, up 29 bcm year on year. In Asia (particularly in China), the demand for LNG was low due to mild winter weather. Considering the three major regional importers of liquefied gas in the first half of 2019, demand increased year on year only in China, where the environmental policy reform created favourable conditions for the use of gas as a fuel in transport. Imports to South Korea and Japan decreased.

Global LNG supply [TWh]

LNG supply [TWh]	H1 2019	H1 2018	Y/y change (H1 2019 vs H1 2018)
Europe	4.69	5.04	-7%
including Norway	3.27	3.14	4%
Asia and Pacific	108.00	89.60	21%
including Australia	50.70	42.81	18%
Americas	33.35	24.75	35%
including United States	21.54	13.47	60%
Africa	29.37	26.56	11%
Middle East	63.35	61.82	3%
including Qatar	53.01	52.20	2%
TOTAL	238.76	207.77	15%

Source: Thomson Reuters.

Global demand for LNG [TWh]

LNG demand [TWh]	H1 2019	H1 2018	Y/y change (H1 2019 vs H1 2018)
Americas	12.01	11.90	1%
Europe	61.02	32.03	91%
Middle East	3.57	4.25	-16%
North-East Asia	128.77	131.47	-3%
including China	38.84	31.95	22%
TOTAL	205.37	179.65	14%

Source: Thomson Reuters.

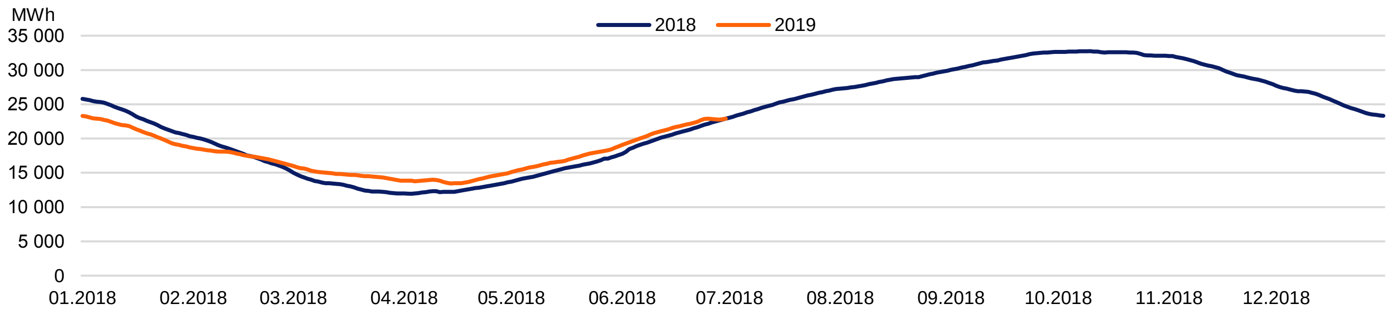
In the first of 2019, prices of natural gas in Europe fell significantly relative to prices quoted at the US Henry Hub. During that period, the average price of natural gas at TTF was EUR 15.75 per MWh, down by about 20% yoy. Year on year, the prices of natural gas at the Henry Hub rose by EUR 0.11 per MWh to the average of EUR 8.11 per MWh. The spread between these two trading points shrank by almost 35%, by EUR 4.09 per MWh to an average of EUR 7.64 per MWh in the first half of 2019. The highest price spread of EUR 12.43 per MWh was recorded in January.

Gas storage facilities

The mild winter contributed to a slower-than-expected rate of gas extraction from underground storage facilities in Western Europe. As at March 31st 2019, the average gas storage level in the EU was 40%. Gas storage levels on the European gas markets at the end of March 2019 were as follows: the United Kingdom – 43%, the Netherlands – 49%, Germany – 52%, and Poland – 42%. The gas storage levels at the end of the winter season in individual countries were higher than in the previous year: in the United Kingdom – by 31 pp, the Netherlands – by 43 pp, and Germany – by 37 pp. Poland was one of few countries where the gas storage level was lower year on year (by 2 pp).

The average daily withdrawal of gas from Polish storage facilities over the withdrawal period (the first quarter of the calendar year) amounted to 106.3 GWh in 2019, down 32% on the previous year. In the first half of the summer season (Q2) of 2019, gas was injected into storage at an average daily rate of 120.7 GWh, down 1.2 GWh on Q2 2018.

Average gas storage level at gas storage facilities in Poland



Source: In-house analysis based on Gas Infrastructure Europe and Gas Storage Europe data.

Transmission infrastructure

Baltic Pipe and transmission system in Poland

The Baltic Pipe project is a strategic infrastructure project aimed at creating a new gas supply corridor on the European market. It is to enable the transmission of gas, with a transmission capacity of up to 10 bcm, from deposits located in Norway to markets in Denmark and Poland, as well as to consumers in the neighbouring countries. The progress of work on the Baltic Pipe project since January 1st 2018 was as follows:

- In January 2018, PGNiG entered into a 15-year agreement with the Polish operator GAZ-SYSTEM and the Danish operator Energinet, concerning reservation of transmission capacity of the planned gas pipeline in the period from October 1st 2022 to September 30th 2037.
- In June 2018, GAZ-SYSTEM approved the recommended subsea route of the Baltic Pipe through the Baltic Sea. The selected route crosses the Swedish Exclusive Economic Zone and the Polish and Danish offshore areas.
- In November 2018, GAZ-SYSTEM and Energinet adopted Investment Decisions to implement the Baltic Pipe project.
- In January 2019, under the Connecting Europe Facility (CEF), the European Commission granted financing for construction work under the project (the maximum amount of the financing granted is close to EUR 215m).
- By April 2019, all the three countries whose offshore areas are to be crossed by the Baltic Pipe submitted the environmental impact reports (in line with the timetable, the report in Poland was submitted on March 28th, on March 19th in Sweden, and on January 25th in Denmark).
- In July 2019, an environmental decision was issued for the Baltic Pipe gas pipeline landfall in Denmark. Thus, the Baltic Pipe project obtained the first administrative decisions relating to its implementation in Denmark.

For more information on the progress of work on the Baltic Pipe project, visit the baltic-pipe.eu website.

Poland-Slovakia Interconnector

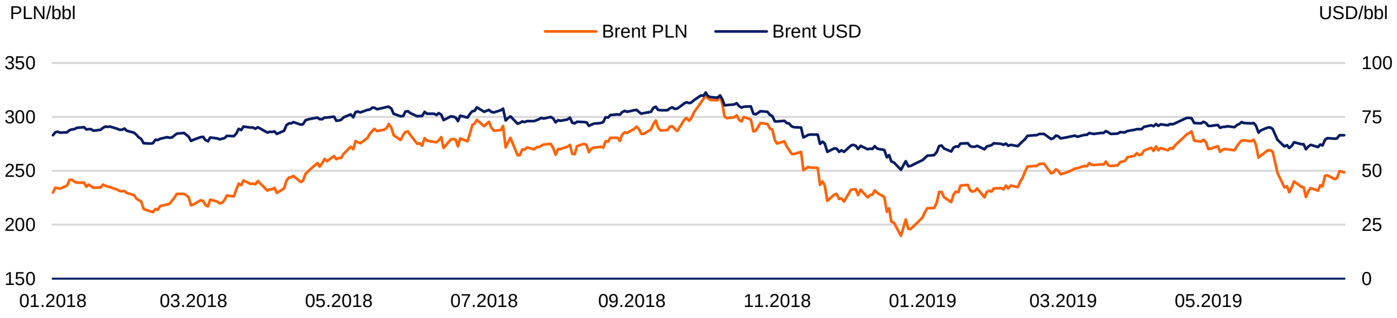
In April 2018, the Polish gas transmission system operator (OGP Gaz-System) and the Slovakian gas transmission system operator (Eustream) signed a Connection Agreement whereby they adopted investment decisions to build the gas interconnector between Poland and Slovakia.The construction work on the Slovak side began in September 2018.The construction work in Poland is scheduled to commence in mid-2019. The project completion is scheduled for 2021. The maximum annual transmission capacity is planned at 5 bcm.

For more information on the progress of work on the project, visit gaz-system.pl website.

3.2.2. Trends on the crude oil market

The first half of 2019 saw an increase in prices of crude oil and petroleum products relative to the end of 2018. However, the average Brent price in the first half of 2019 was 7% lower than the average price in the same period of 2018, mainly due to the low price at the beginning of the year, when it stood at USD 54.72 per barrel. Until the end of the first quarter, the price had gradually risen to USD 69.19. The key driver behind this price increase was reduced oil output by both OPEC and cooperating non-OPEC countries (e.g. Russia). The upward trend was only halted in the second half of May when investors started to fear the economic consequences of the trade war between the United States and China and the continuation of the oil output cut by OPEC+ countries was no longer certain. The prices rebounded due to the growing tension between the United States and Iran.

Brent oil price in 2018 and H1 2019 (USD and PLN, month ahead contract)



Source: ICE – Intercontinental Exchange.

In the first half of 2019, the average demand for crude oil rose by 0.67% compared with the previous year, to 100.3 million barrels per day. Among the world's largest consumers outside the OECD, the most pronounced increase (3.8%) was observed in China. Other Asian countries also recorded a demand increase, on average by 1.8%. The global oil supply rose in 2019 by 0.8% year on year. The strongest oil output increase was recorded in the United States – by 10%, or approximately 1.5 million barrels per day. Canada also recorded an increase, by 4.7%, or approximately 0.24 million barrels per day. In OPEC countries, daily output declined by 1.5m barrels, in line with the arrangement of December 2018, mainly due to production cut by Saudi Arabia and Venezuela.

3.2.3. Outlook for crude oil and natural gas market

According to analysts, the most recent arrangements between OPEC+ members to cut oil supply by more than 1% of global output may have a limited impact on the oil price level which ensures a global supply and demand balance due to growing production in North America. In the second quarter of 2019, the US average output was 19.59 million barrels per day, and 17.39 million barrels per day in the same period of 2018. Oil prices may be affected by political factors, such as difficult passage through the Strait of Hormuz due to Iran's conflict with the United States and Saudi Arabia, the customs war between the United States and China, or new climate regulations.

The price of natural gas in Europe largely depends on the demand for gas from North-East Asia. As the demand for natural gas in the first half of 2019 was weak, the volume of LNG imported to Europe almost doubled compared with the year before. Combined with high gas storage levels, this reduces the price of natural gas. Analysts believe that the price of natural gas in Europe in the coming years will be largely driven by the development of renewable energy sources, the EU's and China's climate policies, the size of gas volumes supplied by the largest exporters, and the expansion of the import infrastructure in Europe.

3.2.4. EUR/PLN and USD/PLN exchange rates

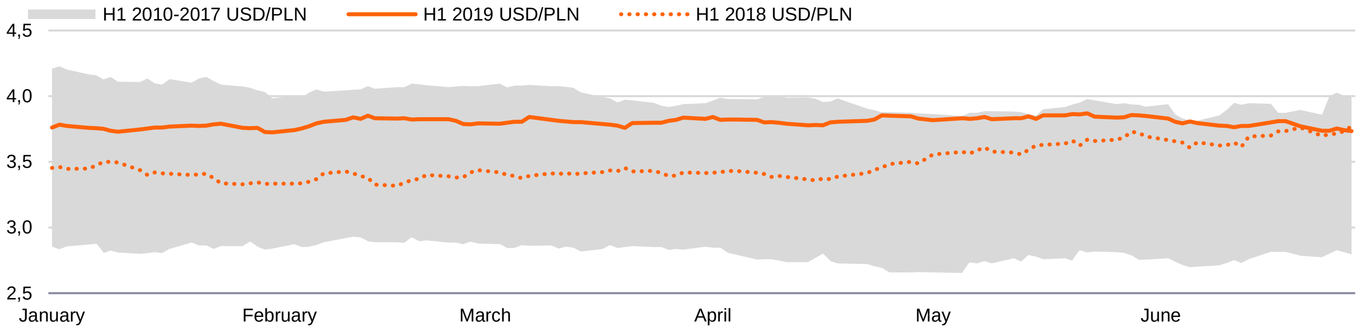
The USD/PLN exchange rate at the end of the first half of 2019 did not change significantly year on year (USD 1/PLN 3.73 on June 28th 2019 vs USD 1/PLN 3.74 on June 29th 2018). The main difference was the trend direction. In the first half of 2018, after several months of stabilisation at about USD 1/PLN 3.40, the US dollar strengthened by over 10% and its price peaked at USD 1/PLN 3.78 at the end of H1 2018. In 2019, the USD/PLN exchange rate fluctuated within the narrowest range in many years, between USD 1/PLN 3.72–PLN 3.86. In the first half of 2019, the highest exchange rate increase was recorded in the first two weeks of February, when the US dollar appreciated against PLN by more than 3%on the back of the surprisingly strong performance of the US economy, particularly with respect to the labour market.

Analysts expect the USD/PLN exchange rate to decline in the second half of 2019. As the key reasons behind the weakening of the US currency they cite the expected interest rate cuts by the FED and the uncertainty caused by the trade war between the US and China.

After a tranquil January, in February 2019 the EUR/PLN exchange rate rose markedly reaching its high of EUR 1/PLN 4.34. Then, the euro gradually depreciated against the Polish złoty and at the end of the first half of 2019 it reached its annual low (EUR 1/PLN 4.24 on June 28th 2019). In 2019, the situation is vastly different from what it was a year before when volatility was much stronger, with the EUR/PLN exchange rate soaring in the second quarter of 2018 to EUR 1/PLN 4.40.

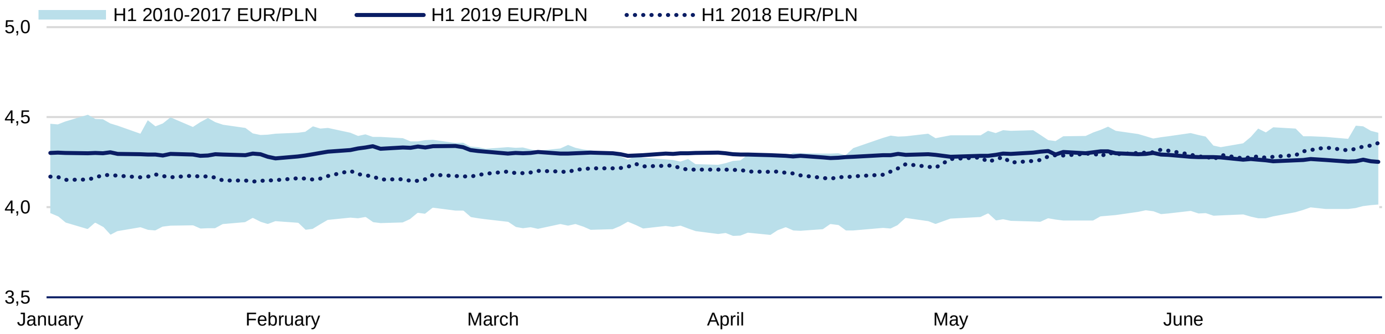
Analysts expect the EUR/PLN exchange rate to remain stable until the end of the year, with the Polish złoty likely to appreciate, which is directly attributable to the sound economic situation in Poland and the lowest unemployment rate in nearly 30 years.

USD/PLN exchange rates in H1 2019, H1 2018, and H1 2010–2017



Source: National Bank of Poland.

EUR/PLN exchange rates in H1 2019, H1 2018, and H1 2010–2017



Source: National Bank of Poland.

4. Financial results for the first half of 2019

Summary information on the financial results of the PGNiG Group and the Parent in the first half of 2019 is presented below.

4.1. Financial highlights of PGNiG

Financial highlights of PGNiG (PLNm)

	H1 2019	H1 2018	Change y/y
Revenue	12,035	10,915	1,120
Total operating expenses, including	(11,588)	(9,666)	(1,922)
Depreciation and amortisation expense	(416)	(388)	(28)
Operating profit (EBIT)	447	1,249	(802)
Profit before tax	1,895	3,080	(1,185)
Net profit	1,772	2,791	(1,019)
Net cash flow from operating activities	846	1,279	(433)
Net cash flows from investing activities	(241)	(575)	334
Net cash flow from financing activities	(2,387)	(1,563)	(824)
Net cash flow	(1,782)	(859)	(923)
	Jun 30 2019	**Dec 31 2018**	
Total assets	36,433	36,993	(560)
Non-current assets	27,376	25,742	1,634
Current assets, including	9,057	11,251	(2,194)
Inventories	2,489	2,691	(202)
Total equity and liabilities	36,433	36,993	(560)
Total equity	30,179	28,833	1,346
Total non-current liabilities	2,972	2,551	421
Total current liabilities	3,282	5,609	(2,327)
Total liabilities	6,254	8,160	(1,906)

Profitability

	Jun 30 2019	Jun 30 2018	Dec 31 2018
EBIT operating profit	447	1,249	1,839
EBITDA operating profit + depreciation/amortisation	864	1,637	2,637
ROE net profit to equity at end of period	5.9%	9.7%	11.4%
Net margin net profit to revenue	14.7%	25.6%	14.7%
ROA net profit to assets at end of period	4.9%	7.9%	8.9%

Liquidity

	Jun 30 2019	Jun 30 2018	Dec 31 2018
Current ratio current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	3.2	2.8	2.2
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.3	2.2	1.7

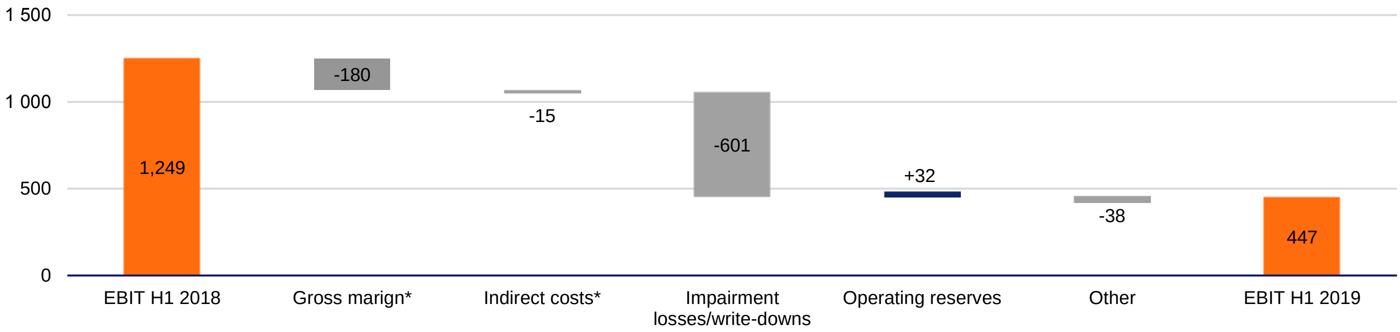
Debt

	Jun 30 2018	Jun 30 2018	Dec 31 2018
Debt ratio total liabilities to total equity and liabilities	17.2%	18.9%	22.1%
Debt to equity ratio total liabilities to equity	20.7%	23.3%	28.3%

Financial performance of PGNiG

In the first half of 2019, PGNiG's operating profit (EBIT) came in at PLN 447m, down PLN 802m year on year. The chart below presents the EBIT bridge between the first half of 2019 and the first half of 2018.

Changes in EBIT between H1 2018 and H1 2019



Including the provision for certificates of origin and energy efficiency certificates.

The PLN 802m yoy decrease in operating profit (EBIT) came primarily as a result of:

- lower margin on sales of high-methane gas, resulting primarily from a higher purchase price of imported gas;
- higher impairment losses/write-downs, in particular on tangible assets, tangible assets under construction and gas inventories.

The margin's decrease was partially offset by:

- higher margin on sales of nitrogen-rich gas, driven mainly by a higher selling price of nitrogen-rich gas;
- higher margin on sales of crude oil as a result of lower exploration costs;
- higher margin on sales of other products, particularly helium and electricity;
- recognition of lower operating reserves in 2019.

In the first half of 2019, net finance income/(costs) was PLN 1,447m as a result of PLN 1,344m in dividends received from the subsidiaries.

4.2. Financial highlights of the PGNiG Group

Financial highlights of the PGNiG Group (PLNm)

	H1 2019	H1 2018	Change y/y
Revenue	22,624	20,886	1,738
Total operating expenses, including	(20,949)	(17,912)	(3,037)
Depreciation and amortisation expense	(1,451)	(1,326)	(168)
Operating profit (EBIT)	1,675	2,974	(1,299)
Profit before tax	1,732	3,087	(1,355)
Net profit	1,311	2,270	(959)
Net cash flow from operating activities	3,988	4,596	(565)
Net cash flows from investing activities	(2,280)	(1,741)	(582)
Net cash flow from financing activities	(2,527)	(2,376)	(151)
Net cash flow	(819)	479	(1,298)
	Jun 30 2019	**Dec 31 2018**	**Change**
Total assets	53,312	53,271	41
Non-current assets	40,590	38,898	1,692
Current assets, including	12,722	14,373	(1,651)
Inventories	3,178	3,364	(186)
Other assets	9,544	11,009	(1,465)
Total equity and liabilities	53,312	53,271	41
Total equity	37,607	36,632	975
Total non-current liabilities	8,400	7,255	1,145
Total current liabilities	**7,305**	**9,384**	(2,079)
Total liabilities	**15,705**	**16,639**	(934)

Profitability

	Jun 30 2019	Jun 30 2018	Dec 31 2018
EBIT operating profit	1,675	2,974	4,395
EBITDA operating profit + depreciation/amortisation	3,126	4,300	7,115
Adjusted EBITDA operating profit + depreciation/amortisation + impairment losses on property, plant and equipment	3,348	3,988	6,891
ROE net profit to equity at end of period	3.5%	6.3%	8.8%
Net margin net profit to revenue	5.8%	10.9%	7.8%
ROA net profit to assets at end of period	2.5%	4.7%	6.0%

Liquidity

	Jun 30 2019	Jun 30 2018	Dec 31 2018
Current ratio current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	2.2	2.4	1.8
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.6	1.9	1.3

Debt

	Jun 30 2019	Jun 30 2018	Dec 31 2018
Debt ratio total liabilities to total equity and liabilities	29.4%	26.4%	31.2%
Debt to equity ratio total liabilities to equity	41.8%	35.9%	45.4%

4.3. Financial performance of the PGNiG Group

Change in presentation of the PGNiG Group's financial data

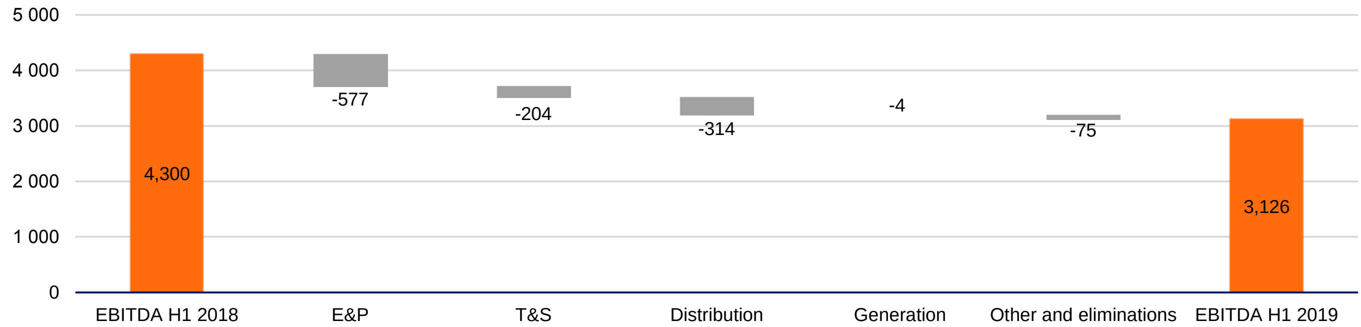
As of January 1st 2019, the PGNiG Group applies IFRS 16 to recognise, measure and present lease contracts. The Group applied the requirements of the standard using a modified retrospective method, with effect as of January 1st 2019 (without restating the comparative period figures).

For a detailed description of the effect of IFRS 16 on the PGNiG Group's consolidated financial statements, see Section 2.5 of the PGNiG Group's financial statements for the first half of 2019. > www.pgnig.pl

Financial performance of the PGNiG Group

In the first half of 2019, the PGNiG Group posted revenue of PLN 22,624m, up by PLN 1,738m (8.3%) on the corresponding period of the previous year, when revenue was at PLN 20,886m. With a 17.0% increase in operating expenses, to PLN 20,949m, the Group earned consolidated operating profit (EBIT) of PLN 1,675m (down 43.7% year on year). Operating profit before depreciation and amortisation (EBITDA) came in at PLN 3,126m, down by PLN 1,174m (27.3%) on the previous year. Net profit, which amounted to PLN 1,311m, was lower by PLN 959m (42.2%) year on year, reflecting the effect of macroeconomic conditions in the first half of 2019 relative to the same period of the previous year, including a decline in crude oil prices on global markets and gas prices in Central Europe by 7% and 25%, respectively. The combination of sales efforts and higher temperatures compared with the previous year (up by 0.7°C) drove the gas volumes sold by the PGNiG Group up from 15.4 bcm in the first half of 2018 to 15.9 bcm in the first half of 2019.

PGNiG Group's EBITDA bridge from H1 2018 to H1 2019 (PLNm)



Exploration and Production (E&P)

At the end of the first half of 2019, the Exploration and Production segment reported an operating profit of PLN 1,450m, down by PLN 596m year on year. At PLN 1,990m, EBITDA was lower than the year before, by PLN 577m (-22.5%). The segment's revenue fell by PLN 668m (down 18.3%) year on year, to PLN 2,992m.

In the first half of 2019, lower volumes of crude oil were produced (down 9% year on year) and sold (down 23% year on year), which translated into a PLN 291m (-23%) decrease in revenue from sale of crude oil in the segment. The segment's revenue from sale of gas fell 18% year on year due to lower gas prices and slightly lower production volumes. The segment's total costs dropped by 4% year on year, to PLN 1,542m. The change in impairment losses/inventory write-downs in the first half of 2019 reduced earnings by PLN 189m.

Trade and Storage (T&S)

In the first half of 2019, the Trade and Storage segment reported an operating loss of PLN 332m. The loss in the first half of 2018 was PLN 210m lower. At the EBITDA level, the segment recorded a loss of PLN 233m, a result lower by PLN 204m on the first half of 2018, when the Group generated EBITDA of PLN -29m. The segment's revenue reached PLN 17,877m, having increased by PLN 2,107m year on year.

In the first half of 2019, the segment's costs rose by 15% year on year, to PLN 18,210m, driven chiefly by a 14% year-on-year increase in gas procurement costs, to PLN 18,110m. The segment's result was additionally affected by a PLN -115m increase in gas inventory write-down and a PLN 280m gain on hedging instruments designated for hedge accounting, compared with a PLN -271m loss in the first half of 2018.

Distribution

In the first half of 2019, the Distribution segment's operating profit fell by PLN 334m year on year to PLN 593m, while EBITDA came in at PLN 1,070m, down by PLN 314m year on year.

In the first half of 2019, revenue fell by PLN 215m (mainly revenue from distribution services, which went down by PLN 118m, or -5%, year on year) due to lower tariff prices and slightly lower gas distribution volumes reaching 6.3 bcm. The segment's total expenses in the first half of 2019 increased by PLN 119m (7% year on year), mainly due to higher employee benefit expense.

Generation

The segment's operating profit for the first half of 2019 came in at PLN 158m, down by PLN 88m year on year. EBITDA was PLN 462m, close to that reported in the first half of 2018 (PLN 466m). The segment's revenue was PLN 1,410m, up by PLN 145m year on year.

The provision for CO_2 emission allowances had an effect on the results for the first half of 2019 (in the second quarter of 2019, the provision amounted to PLN 43m). The provision was recognised in net other expenses and subsequent redemption of purchased emission allowances will be charged to depreciation and amortisation. The segment's depreciation and amortisation was PLN 304m, up 38% year on year. EBITDA adjusted for the provision for CO_2 emission allowances was PLN 505m, up PLN 39m (8.4%) year on year.

Despite relatively higher temperatures in the period, especially in the first quarter of 2019 when a year-on-year increase of 3.0^{O}C was recorded, revenue from sales of heat amounted to PLN 741m, close to the previous year's figure, while the volume of generated heat went down 2%. Electricity output increased by 6% year on year which, given the rising prices, translated into a 44% increase in revenue from sales of electricity, to PLN 538m. Costs of coal rose to PLN 502m (up 16% y/y) due to growing purchase prices, increasing the segment's operating expenses by PLN 105m. The segment's depreciation and amortisation reached PLN 304m and was higher by PLN 84m year on year.

For detailed information of the segments' financial results and volume figures, see Sections 5.1-5.4.

Statement of financial position

As at June 30th 2019, total assets were PLN 53,312m (taking into account the impact of IFRS 16), having increased slightly on the end of 2018 (up PLN 41m).

Assets

Property, plant and equipment represent the largest item of the PGNiG Group's assets. As at the end of the first half of 2019, property, plant and equipment amounted to PLN 36,713m, up by PLN 2,477m (7.2%) relative to December 31st 2018. As regards non-current assets, the largest increase (of PLN 1,444m, or 9.8%) was reported in the case of land, which came mainly as a result of applying IFRS 16 *Leases* with respect to perpetual usufruct rights to land. For a detailed description of the effect of IFRS 16 on the PGNiG Group's consolidated financial statements, see Section 2.5 of the PGNiG Group's financial statements for the first half of 2019. › www.pgnig.pl

As at the end of the first half of 2019, the Group's current assets amounted to PLN 12,722m, down by PLN 1,651m (-11.5% year on year) relative to the end of 2018. Receivables were the largest contributing item, having decreased by PLN 1,553m (27.0%) from the end of 2018 due to the seasonal nature of sales of gas fuels (the highest sales volumes are reported in the winter season).

Equity and liabilities

Equity is the main source of financing of the PGNiG Group's assets. At the end of the first half of 2019, the Group's equity was PLN 37,607m, up by PLN 975m (2.7%) relative to the end of 2018. The change in equity was attributable, among others, to the net profit of PLN 1,312m earned in the reporting period, less the dividend of PLN 636m.

As at June 30th 2019, non-current liabilities totalled PLN 8,400m, up PLN 1,145m on December 31st 2018, mainly on the back of an increase in liabilities resulting from the application of IFRS 16. At the reporting date, the Group carried current liabilities of PLN 7,305m, down PLN 2,079m (22.2%) on the end of 2018.

In connection with decrease in current liabilities and increase in equity and non-current liabilities, the Group's debt to equity ratio and debt ratio went up year on year, having changed respectively from 26.4% to 29.4% and from 35.9% to 41.8%.

As a result of a decrease in current liabilities and current assets, the current ratio fell to 2.2 from 2.4 at the end of June 2018, and the quick ratio went down to 1.6 from 1.9 in the comparative period.

Material related-party transactions on non-arm's length terms

In the reporting period, the Group did not execute any material transactions to purchase or sell items of property, plant and equipment other than on arm's length terms.

Group's ability to deliver forecast results

The PGNiG Management Board did not publish any forecasts of the PGNiG Group's financial performance in 2019.

Guarantees and sureties

In the reporting period, the Group companies did not execute any material suretyship agreements relating to bank and non-bank borrowings or guarantees.

Investments in H1 2019

In the first half of 2019, the PGNiG Group's capital expenditure on property, plant and equipment and intangible assets was PLN 2.0bn, having gone up by 44.9% year on year. The tables below present the Company's and the Group's expenditure in each segment.

Capital expenditure[1] on property, plant and equipment made by PGNiG in H1 2018

		H1 2019	H1 2018	Performance vs updated CAPEX plan H1 2019
I.	Exploration and Production, including:	474	384	66%
1	Exploration *(including expenditure on dry wells)*	322	279	82%
2	Production	152	105	47%
II.	Trade and Storage	45	65	54%
1	Trade	32	37	46%
2	Storage facilities used by the Trade and Storage segment	12	28	100%
III.	Total capital expenditure (I+II)	519	449	65%

1) Including capitalised borrowing costs.

Capital expenditure[1] on property, plant and equipment made by the PGNiG Group in H1 2018

		H1 2019	H1 2018	Performance vs updated CAPEX plan[2] H1 2019
I.	Exploration and Production, including:	687	560	62%
1	Norway	164	142	79%
2	Pakistan	35	30	23%
3	Libya	2	4	100%
II.	Trade and Storage	37	32	57%
III.	Distribution	904	609	104%
IV.	Generation	374	165	40%
V.	Other Activities	34	39	48%
VI.	Total capital expenditure (I-V)	2,036	1,405	67%

1) Including capitalised borrowing costs.
2) In relation to the updated projected capital expenditure on property, plant and equipment of the PGNiG Group in the first half of 2019, including expenditure on acquisitions in Norway.

4.4. Expected future financial condition

In the coming periods, the financial standing of the PGNiG Group will be materially affected by changes in the prices of hydrocarbons on global commodity markets and fluctuations in foreign exchange rates. These factors will be of particular importance for the PGNiG Group's performance in the Exploration and Production and Trade and Storage segments.

Any changes in hydrocarbon prices affect revenues of the Group entities engaged in production, and determine the demand for seismic and exploration services offered by the Group companies. Rising gas and crude oil prices have a positive effect on performance generated by the Exploration and Production segment. Long-term forecasts of hydrocarbon prices strongly influence projected cash flows from production assets, and as a consequence entail the necessity of revaluation of property, plant and equipment.

On the other hand, in view of the fact that the prices of gas purchased by PGNiG under the Yamal and Qatar contracts are linked to prices of crude oil, the effect of rising oil prices on the performance of the Trade and Storage segment is opposite to the effect that rising oil prices have on the performance of the Exploration and Production segment. Any increase of crude oil prices translates into higher cost of gas purchased by PGNiG. This correlation may change following a ruling by the Stockholm Arbitration Tribunal regarding the price formula used in the Yamal contract. › For more information, see 6.4.3

The PGNiG Group's financial results will also be materially affected by situation on the domestic currency market. Any strengthening of the złoty against foreign currencies (primarily the US dollar) will have a positive effect on performance of the Trade and Storage segment by driving down PGNiG's gas procurement costs, although it must be noted that the effect of exchange rate fluctuations is mitigated by the PGNiG Group's hedging policy.

The PGNiG Group's financial results will also be affected by the President of URE's position regarding the level of gas fuel sale and distribution tariffs and heat sale tariffs. In addition, the progressing deregulation of the gas market in Poland will continue to put pressure on the performance of the PGNiG Group's Trade and Storage companies engaged in the provision of gas sale services. Competition for customers has prompted the launch of a number of discount schemes dedicated to customers buying gas from the

Group and the change in pricing terms to reflect market prices. These factors may have an adverse effect on the profitability of the Trade and Storage segment by eroding its margins.

In the Generation segment, financial results will also be considerably affected by electricity prices, prices of CO_2 emission allowances and the support programmes for electricity produced from high-efficiency cogeneration sources and renewable sources. Legislative changes in this area and fluctuations in market prices of certificates of origin (both red and green) will have a bearing on the segment's financial position. Prices of fuels used to produce heat and electricity will be another key factor impacting the segment's performance.

In the coming quarters, the Group intends to maintain a high level of capital expenditure, spending primarily on projects to maintain hydrocarbon production rates, exploration for and appraisal of crude oil and natural gas deposits, extension and modernisation of gas distribution network, and investments in the power sector.

5. Operating activities in H1 2019

Operating data	H1 2019	H1 2018
Production of natural gas by the PGNiG Group (mcm)*		
High-methane gas (E)	916	925
Nitrogen-rich gas (Ls/Lw as E equivalent)	1,305	1,330
Total (as E equivalent)	2,221	2,255
Sales of natural gas by the PGNiG Group (mcm)*		
High-methane gas (E)	15,146	14,548
Nitrogen-rich gas (Ls/Lw as E equivalent)	801	799
Total (as E equivalent)	15,947	15,347
Volume of distributed gas (mcm)**		
High-methane gas, nitrogen-rich gas, propane-butane, coke gas	6,314	6,356
Crude oil, condensate and NGL ('000 tonnes)		
Production	614	673
Sale	554	723
Heat and electricity (from own generation sources)		
Heat sales outside the PGNiG Group (TJ)	23,010	23,463
Sales of electricity from own generation sources (TWh)	2,257	2,137

* Converted to gas with a calorific value of 39.5 mJ/m^3.
** In natural units.

5.1. Exploration and Production

The segment's principal business activity is extraction of hydrocarbons from deposits and preparation of produced hydrocarbons for sale. This involves exploring for and extracting natural gas and crude oil from deposits, and includes geological surveys, analysis of geophysical data, drilling, and development of and production of hydrocarbons from gas and oil fields. The work is conducted by the segment on its own or jointly with partners, under joint operations agreements. The segment also relies on storage capacities available at the Bonikowo and Daszewo UGSFs.

5.1.1. Segment's key data

Financial highlights	H1 2019	H1 2018	2018	2017	2016[2]	2015[1]
Total revenue	2,992	3,660	7,671	6,118	5,289	4,855
Revenue from sales outside the Group, including:	1,564	1,831	3,794	3,092	2,776	3,148
- high-methane and nitrogen-rich gas,	332	311	681	602	517	553
- crude oil, condensate, and NGL	965	1,256	2,554	1,862	1,606	1,945
- geophysical, geological and drilling services	99	122	262	358	429	382
Inter-segment revenue	1,428	1,829	3,877	3,026	2,513	1,707
EBITDA	1,990	2,567	5,019	3,865	2,206	2,426

1) Data not restated, as reported.
2) Data restated according to the new segmentation of the PGNiG Group's operations.

Natural gas production by the PGNiG Group mcm	H1 2019	H1 2018	2018	2017	2016	2015
High-methane gas (E)	916	925	1,834	1,863	1,918	2,027
in Poland	653	637	1,296	1,315	1,401	1,454
in Norway*	263	288	538	548	517	573
Nitrogen-rich gas (Ls/Lw as E equivalent)	1,305	1,330	2,712	2,674	2,540	2,564
in Poland	1,217	1,232	2,512	2,524	2,481	2,513
in Pakistan – PGNiG Pakistan Branch	88	98	200	150	59	52
TOTAL (measured as E equivalent)	2,221	2,255	4,546	4,537	4,458	4,591

*Converted to gas with calorific value of 39.5 MJ/m^3.

Segment's sale of natural gas outside the PGNiG Group mcm	H1 2019	H1 2018	2018	2017	2016	2015
High-methane gas (E)	13	14	26	31	77	54
in Poland	13	14	26	31	53	52
in Norway	-	-	-	-	24	1
Nitrogen-rich gas (Ls/Lw as E equivalent)	400	416	857	795	703	684
in Poland	312	319	658	646	645	633
in Pakistan – PGNiG Pakistan Branch	88	97	199	149	58	51
TOTAL (measured as E equivalent)	413	430	883	825	780	738

Crude oil* at the PGNiG Group thousand tonnes	H1 2019	H1 2018	2018	2017	2016	2015
Crude oil production*	614	673	1,345	1,257	1,318	1,428
in Poland	385	398	818	787	763	765
in Norway	229	275	527	470	555	664
Sales of crude oil*	554	723	1,410	1,269	1,347	1,391
including oil produced in Poland	387	398	817	791	754	772
including oil produced in Norway	167	325	593	479	593	619

* including condensate and NGL.

Production of other products thousand tonnes	H1 2019	H1 2018	2018	2017	2016	2015
Propane-butane	20	19	39	38	37	35
LNG	10	11	21	22	26	25
mcm						
Helium	2	2	3	3	3	3

5.1.2. Segment's strategy

Exploration and Production – the Group is delivering a strategy focused on increasing its existing base of proven hydrocarbon reserves by ca. 35%, increasing hydrocarbon production by ca. 41% by 2022, significantly reducing unit costs of exploration for and appraisal of deposits, and maintaining unit costs of field development and hydrocarbon production in order to improve profitability of its exploration and production operations. This objective will be attained mainly through:

- expanding the base of proven reserves and increasing annual hydrocarbon production volumes in Poland by carrying out investment plans relating to work on exploration, test and appraisal wells, and cooperation under licences with other entities;
- more intensive hydrocarbon exploration work in Poland, including through partnership with the Polish Geological Institute − National Research Institute under the Geo-Metan research project to use the fracturing technology to extract coal bed methane in Gilowice;
- increasing the base of proven reserves and doubling the annual production volume abroad, as well as increasing production in Norway to 2.5 bcm per annum for the Norwegian Corridor.
- accelerating exploration for and acquisition of hydrocarbon deposits abroad.

5.1.3. Segment's activities in Poland

Licences in Poland

As at January 1st 2019, PGNiG held 20 licences for exploration and appraisal of crude oil and natural gas deposits and 27 combined (exploration, appraisal and production) licences. As at June 30th 2019, PGNiG held 48 licences, including:

- 29 combined licences,
- 17 exploration and appraisal licences,
- 2 licences that expired on May 6th 2019, but are to be converted (suspended licences).

In the first half of 2019, the following decisions were obtained:

- 3 decisions approving additional geological information to plans of geological operations,
- 1 decision approving a plan of geological operations in an unlicensed area,
- 6 decisions amending the licences,
- following the second tender round – decisions for two licence areas: Szamotuły-Poznań Północ and Złotów-Zabartowo.

In addition, a total of 21 applications to amend (or convert) a licence as well as additional geological information to plans of geological operations have been submitted with the licensing authority and are awaiting decision. In addition, the following have been submitted with the licensing authority:

- 1 offer in the third tender round in the Sierpowo area,
- 1 application for granting a licence in the open-door procedure,
- 1 application to relinquish a licence - block 456.

As at June 30th 2019, PGNiG held a total of 197 production licences in Poland, down by 6 compared with the end of 2018. In the reporting period, no new licences were granted to PGNiG, 16 licences were amended, and 6 licences expired. The number of licences for storage of gas in underground gas storage facilities (9) remained unchanged.

At present, PGNiG holds two licences for waste storage. The licence for waste storage in the VII and VIIa reservoirs of the Husów-Albigowa-Krasne gas field expired on May 19th 2019, and on June 3rd 2019 an application for a new licence was submitted.

As at June 30th 2019, recoverable reserves in Poland were 15,740 thousand tonnes of crude oil and 83,097 mcm of natural gas (at high-methane gas equivalent), net of resources included in geological prospecting documentation and deposit utilisation documentation.

Work performed

In the first half of 2019, PGNiG was involved in oil and gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills, Upper Silesian Coal Basin, Przedsudecka Monocline, and Szczecin Synclinorium, both on its own and jointly with partners.

In the first half of 2019, drilling was carried out on 18 boreholes with a total depth of 41,778 linear metres, including 4 test, 3 exploration, 4 appraisal and 7 production wells. The drilling of four wells (Czarna Dolna-1, Krobielewko-7, Kramarzówka-3H i Szczepanów-14 - upgrade) began already in 2018. To compare, in the first half of 2018, drilling work was performed on 23 wells with a total depth of 38,599 linear metres, including 9 exploration, 6 appraisal and 5 production wells.

In the first half of 2019, other drilling works, comprising formation tests, workovers and abandonment operations, were performed in ten wells.

Out of the 18 wells drilled in the first half of 2019, 13 reached their target depth, including 2 test, 2 exploration, 3 appraisal and 5 production wells. As at the end of June 2019, formation test results were obtained from nine boreholes (three exploration and six production wells), with all of them classified as positive.

In the first half of 2019, the following wells were brought on stream:

- in the new fields in Sanok: a well on the Olchowiec field (Olchowiec-2),
- in already producing fields in Sanok: two wells in the Zagorzyce field (Sędziszów-38K and Sędziszów-39K), a well in the Nosówka field (Słotwinka-1), a well in the Przemyśl field (Przemyśl-47), and a well in the Przeworsk field (Przeworsk-24).

In the first half of 2019, decisions were issued on the expiry of production licences for Jeżowe, Lipowiec E, Łazy and Jankowice fields.

Seismic surveys

In the first half of 2019, 381.525 km of 2D seismic surveys and 87.880 km^2 of 3D seismic surveys were carried out.

Exploration, appraisal and extraction of coal bed methane

In the first half of 2019, as part of the second phase (research and demonstration) of the Geo-Metan project, a cooperation agreement was signed between PGNiG and PGG to drill Bielszowice-1K and Bielszowice-2H test wells in the KWK Ruda Ruch Bielszowice mining area. Research is currently under way on the drilling of another system of wells in the KWK Murcki-Staszic mine, owned by PGG. No conclusion has been reached so far in the negotiations concerning the terms of the cooperation agreement with JSW. The planned work in the KWK Budryk mining area comprised drilling of three test wells: Budryk-1, Budryk-2H and Budryk-3H. At present, talks are under way with Tauron Wydobycie, on potential drilling of three more test wells: Brzeszcze-1, Brzeszcze-2H and Brzeszcze-3H.

At the end of 2018, as part of work on the Międzyrzecze licence area, a long-term production test was resumed in the Gilowice-1 well. Methane produced from the well is now used for electricity generation with a gas power generator, and transmitted to the local power grid. As Gilowice-3K and Gilowice-4H wells, connected by intersection, were drilled in 2018 and the reservoir stimulation works were completed, a production test was launched. At present, the test is at the initial stage of dewatering, that is withdrawal of flowback and formation liquids with a pump system installed in both wells. Międzyrzecze-4, a cored well drilled in 2018 in the performance of licence obligations, has been temporarily secured. In the first half of 2019, another well, Międzyrzecze-3, was drilled with prospective intervals cored. The well is to be connected by intersection with the Międzyrzecze-5 horizontal well. A separate plan of geological operations will be developed for another system of wells connected by intersection (Międzyrzecze-6H and Międzyrzecze-7). Work on the plan is underway.

For more information on operations relating to coal bed methane deposits, see Section 5.1.3. of The Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2018. > www.pgnig.pl

Sale of oil

PGNiG sells crude oil at market prices. As regards trading in crude oil extracted in Poland, in the first half of 2019 PGNiG continued its trading partnerships with major Polish and foreign players in the fuel sector. Rail deliveries of crude oil are made to the refinery of the LOTOS Group in Gdańsk and to Orlen Południe's Trzebinia Production Plant (the ORLEN Group).

5.1.4. Segment's activities abroad

Norway

PGNiG UN holds interests in exploration and production licences on the Norwegian Continental Shelf in the Norwegian Sea, in the North Sea, and in the Barents Sea. Jointly with partners, the company has been extracting hydrocarbons from the Skarv, Morvin, Vilje, Vale and Gina Krog fields and working on the development of the Ærfugl (formerly Snadd), Skogul (formerly Storklakken), and Duva (acquired in July 2019) fields. PGNiG UN is preparing to develop the Tommeliten Alpha (acquired in 2018) and King Lear (acquired in the first half of 2019) fields, and is also considering development of the Fogelberg field. In the other licence areas, the company is engaged in exploration projects.

As at June 30th 2019, PGNiG UN held interests in 23 exploration and production licences on the Norwegian Continental Shelf, in four of them as the operator. The transfer of rights to four subsequent further licences (connected with the King Lear and Duva fields) will take place once the required administrative approvals are obtained in Norway.

Producing fields

In the first half of 2019, the company produced a total of 229 thousand tonnes of crude oil with condensate and NGL (measured as tonnes of crude oil equivalent) and 263 mcm of natural gas from the Skarv, Morvin, Vilje, Vale, and Gina Krog fields, Production from the fields was close to the plan and 13% lower year on year due to natural depletion.

PGNiG UN takes steps to maintain production from the existing fields while delivering good operating performance – in the first half of 2019, production was launched from additional wells on the Gina Krog field.

For a detailed description of the producing fields, see Section 5.1.4 of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2018. › www.pgnig.pl

Fields under development

In the first half of 2019, the development of the Ærfugl i Skogul fields, in which PGNiG UN is a licence partner, continued. Drilling of production wells and installation of downhole equipment in both fields is planned for 2019/2020. Both fields, operated by Aker BP, are expected to commence producing hydrocarbons in 2020. Both investment projects will be financed with funds generated in the course of operations in Norway. Development of the Ærfugl gas field means a partial fulfilment of strategic objectives by significantly increasing the production of natural gas to be transferred from Norway to Poland. › For more information on the Baltic Pipe project, see Section 3.2.1.

In the first half of 2019, PGNiG UN and its partners continued to develop the Gina Krog field. The main work included drilling of additional gas injection wells to increase oil production. The injected gas will be withdrawn from the field at a later time.

In June 2019, PGNiG UN signed an agreement to acquire 22.2% interests in PL146 and PL333 licences covering the King Lear gas field. The operator of the PL146 and PL333 licences is AkerBP, which holds a 77.8% interest. King Lear is a gas and oil field located in the North Sea. According to the Norwegian Petroleum Directorate data, the field has recoverable reserves of 9.2 bcm of natural gas and 6.5 mcm of crude oil. Currently, work is under way on the field development concept. The investment process is planned to span from 2021 to 2024 and production is to be started in 2025. Based on the operator's current data, after the field goes on stream, gas production attributable to PGNiG UN is expected to be 0.25 bcm per annum.

In addition, in July 2019 PGNiG UN entered into an agreement for the acquisition of 20% interests in licences PL636 and PL636B (including the Duva field) from Wellesley Petroleum AS. The field operator is Neptune Energy Norge, which holds a 30% interest. Other partners are Idemitsu Petroleum Norge (30%) and Pandion Energy (20%). Duva is a gas and oil field located in the North Sea, 6 km from the Gjøa field, operated by Neptune Energy Norge. The field is located within the PL636 licence area and its reserves were documented based on the results of an exploration well in 2016. According to data of the Norwegian Petroleum Directorate, the recoverable reserves of the Duva field are approximately 8.4 bcm of gas, 3.7 mcm of crude oil and 1m tonnes of NGL. Currently, the Duva field is in the pre-production phase. The field development plan assumes the drilling of at least three production wells and their connection to the Gjøa platform. The tie-in to existing production facilities will significantly reduce costs and shorten the project work, to be continued in 2019–2020. The launch of production is expected towards the end of 2020. According to the field operator's current data, maximum production is expected to reach 30,000 barrels of oil and gas equivalent. Gas production attributable to PGNiG UN is expected to be 0.13 bcm per annum.

The agreements for the acquisition of licences covering the King Lear and Duva fields were concluded under certain conditions precedent. PGNiG UN is in the process of obtaining the required administrative approvals in Norway.

A detailed description of the other fields under development is presented in Section 5.1.4 of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2018. › www.pgnig.pl

Prospects being explored/appraised

In January 2019, another APA 2018 (Awards in Pre-defined Areas) round was concluded, with PGNiG UN awarded interests in three further new exploration licences – PL838B, PL1009 and PL1017:

- a 40% interest as an operator in the PL838B licence area, situated in the North Sea and being an extension of the PL838 licence area; under the new licence PGNiG UN intends to drill the operator's first exploration well in the second half of 2019;
- a 35% interest as a partner in the PL1009 (Warka) licence area in the Norwegian Sea. The licence area is located close to the Skarv field and is operated by ConocoPhilips (holding a 65% interest);
- a 50% interest as operator in the PL1017 (Copernicus) licence area in the Norwegian Sea, located east of the Aasta Hansteen field. The licence partner is Equinor (50%).

The obligations under licence PL1009 include exploration well drilling. As regards the other two licences, within two years, the licence partners are to carry out necessary geological and geophysical surveys to precisely estimate the oil production potential of the licence areas. After that period, drill-or-drop decisions will be made.

The new licences have significant gas potential. All three licence areas are located close to existing production and pipeline infrastructure, which will make their development, if any, simpler and faster. The PL838B and PL1009 licence areas are located near the Skarv field, the largest field in PGNiG UN's assets portfolio, and near the Åsgard field, allowing the PGNiG Group to leverage its extensive experience in oil and gas exploration in this region.

Jointly with its partners, PGNiG UN also continued work in the other exploration licence areas. As regards licence PL838, an exploration well is to be drilled in the second half of 2019. The potential of the remaining exploration licences held by the company was also evaluated. Based on the results of geological and economic analyses, the company decided to relinquish licence PL813.

Taxes – operations in Norway

As of January 2019, the corporate tax rate in Norway was reduced from 23% to 22%. At the same time, the lower tax rate was offset by an increase in the special petroleum tax from 55% to 56% and a reduction of the uplift tax incentive from 21.2% to 20.8%. The marginal tax rate on production activities remains at 78%, thus the changes have only a minor impact on the company's business.

Licences held at the end of June 2019

Licence	Operator	Interest	Type	Planned activities
PL029C (Gina Krog)	Equinor	29.63% (8% interest in the project)	Exploration/development	Development (production since 2017)/exploration
PL036D (Vilje)	AkerBP	24.243 %	Production	Production
PL044 (Tommeliten Alpha)	ConocoPhilips	42.38% for Tommeliten Alpha, 30% Exploration	Exploration/Development preparation	Preparation of a development concept
PL036 (Vale) **PL249 (Vale)**	Spirit	24.243 %	Production	Production
PL134B (Morvin) **PL134C (Morvin)**	Equinor	6%	Production	Production, Exploration
PL212 (Skarv) **PL212B (Skarv)** **PL262 (Skarv)**	AkerBP	15% (11.9175% interest in the project)	Exploration/Development/Production	Production, Ærfugl field development, production to commence in 2020
PL212E (Snadd Outer)	AkerBP	15%	Exploration	Possible tie-back to Ærfugl
PL433 (Fogelberg)	Spirit	20%	Exploration	Review of production testing results, launch of development possible
PL460 (Skogul)	AkerBP	35%	Development	Development (production scheduled to start in 2020)
Op. PL838 (Tunfisk/Shrek) **Op.PL838B**	PGNiG	40%	Exploration	Drilling decision Steps to be taken depend on the results of the drilling of the Shrek prospect well
PL839 (Nise/Storkobbe)	AkerBP	11.9175%	Exploration	Seismic data interpretation
PL850 (Ulv)	Edison	20%	Exploration	Drill or drop*: November 2019
PL887 (Novus East)	PGNiG	40%	Exploration	Drill or drop*: February 2020
PL891 (Tunfisk South)	ConocoPhilips	30%	Exploration	Drill or drop*: August 2019
PL939	Equinor	30%	Exploration	Drill or drop*: March 2020
PL941	AkerBP	20%	Exploration	Drill or drop*: March 2020
PL1009	ConocoPhilips	35%	Exploration	Obligation to drill a well by March 2021
PL1017	PGNiG	50%	Exploration	Drill or drop*: March 2021

**Drill-or-drop decision – a decision to either commit to drilling exploration wells or relinquish the licence*

Pakistan

PGNiG carries out exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area. The work is conducted jointly with Pakistan Petroleum Ltd. (PPL), with production and expenses shared proportionately to the parties' interests in the licence: PGNiG (operator) – 70%, PPL – 30%. So far, two gas fields, Rehman and Rizq, with initial recoverable reserves of 9.95 bcm and 3.48 bcm, respectively (with 6.96 bcm and 2.44 bcm, respectively, attributable to PGNiG) have been discovered in the area. Gas from the Rehman and Rizq fields is produced via facilities located in the Rehman field.

In the first half of 2019, production from the Rehman and Rizq fields was supported by seven wells, and as at June 30th 2019 the reserves attributable to PGNiG were approximately 8.69 bcm. By June 30th 2019, drilling and testing of positive well Rehman-5 had been completed, the Rehman-6 well had been spudded and the equipment had been mobilised to drill the Rizq-3 well.

Continuing exploration work in 2019, the Pakistani Branch completed the acquisition of seismic imaging initiated in 2018: 3D seismic imaging in the W1 prospect and 2D seismic imaging for the W2 prospect. Imaging for both prospects is currently being processed.

United Arab Emirates

In 2018, PGNiG participated in a tender round to acquire rights to hydrocarbon exploration, appraisal and production in the Ras Al Khaimah (RAK) emirate in the United Arab Emirates (UAE), organised by the Ras Al Khaimah Petroleum Authority (RAKPA). PGNiG's bid for Block 5 was found by RAKPA to be the best one, as a result of which on January 16th 2019 contracts between PGNiG and its partners (RAKPA and RAK Gas) were signed. As a result, PGNiG acquired a 90% interest in Block 5. For the purpose of performance of the contracts, a PGNiG Branch was registered in RAK and obtained the licence to conduct operations. Under the contracts, in the first exploration period PGNiG is obliged to perform 3D seismic surveys covering the area of Block 5. Preparatory work to fulfil this obligation is currently under way.

5.1.5. Growth prospects

Production forecasts for 2019-2021

On July 31st 2019, PGNiG published its oil and gas production forecasts for 2019–2021.

In line with the gas production forecasts, production of natural gas in Poland should remain stable owing to, among other things, the tie-in of new wells. The lower forecast gas production in Pakistan at the end of 2019 is attributable to delays in gas pipeline construction by the Pakistanis. On the other hand, production is expected to increase starting from 2020 as new wells are brought on stream. In Norway, gas output is projected to remain stable in 2019 and 2020, but the planned launch of production from the Ærfugl field will result in its increase in 2021.

Natural gas production forecast for 2019–2021, converted to high-methane gas with a calorific value of 39.5 MJ/m^3:

bcm	2019	2020	2021
Poland	**3.9**	**3.9**	**4.0**
Outside of Poland, including:	**0.7**	**0.9**	**1.2**
- Norway	*0.5*	*0.5*	*0.7*
- Pakistan	*0.2*	*0.4*	*0.5*
Total	**4.6**	**4.8**	**5.2**

In line with the oil production forecasts, crude oil production in Poland is expected to gradually decline over the forecast period due to natural depletion of reserves. For the same reason, oil production in Norway is expected to decline in 2019. On the other hand, the planned launch of production from the Skogul field in 2020 and from the Ærfugl and Duva fields in 2021 will significantly increase production volumes in 2020–2021.

Crude oil production forecast, including condensate and NGL, for 2019–2021

thousand tonnes	2019	2020	2021
Poland	**778**	**747**	**733**
Outside of Poland, including:	**475**	**611**	**671**
- Norway	*475*	*611*	*671*
Total	**1,253**	**1,358**	**1,404**

Poland

In the second half of 2019, the Company plans to conduct drilling operations on 14 new wells in Poland, including:

- 1 test well (Nowe Sady-1),
- 1 exploration well (Chałupczyn-1),
- 8 appraisal wells (Mirocin-66K, 67K, 68K, Ryszkowa Wola-8; Pruchnik-36, Gnojnica-4K, Pławce- 3/H, Sędziszów-40),
- 4 production wells (Zbąszyń-12, 11H; Przemyśl-292K, 317K).

Commencement of the planned drilling work depends on the progress of procurement procedures and receipt of relevant administrative/ legal permits.

Norway

PGNiG UN holds a diversified portfolio of production and exploration licences in the North Sea, the Norwegian Sea, and the Barents Sea, and maintaining this diversification is perceived as an important element of project portfolio management.

In the second half of 2019, on the Norwegian Continental Shelf PGNiG Upstream Norway will continue to produce, as a partner, hydrocarbons from the Skarv, Morvin, Vilje, Vale, and Gina Krog fields and will proceed with the development of the Skogul, Ærfugl and Duva fields. Development of the Tommeliten Alpha and King Lear fields is at the concept preparation phase.

PGNiG UN also intends to acquire new licence areas by participating in annual APA licence rounds and in regular licence rounds held every two to three years. The company may seek to acquire new licence areas through farm-in (purchase of interests from other companies), swap or farm-down (exchange of interests with other companies) arrangements.

Pakistan

With respect to appraisal and production work, plans for 2019 include completion of drilling and then testing and bringing on stream of the Rehman-5 production well, in parallel with the spudding of the Rehman-6 and Rizq-3 production wells, which will require mobilising a second drilling rig.

Drilling of the Rehman-7 and Rizq-4 wells is also scheduled to commence in 2019 (earthworks have already started at the Rehman-7 well site). In parallel with the drilling campaign, PGNiG will conduct work to expand the capacity of the production infrastructure and consecutively tie in new wells for commercial production. The Rehman-5 and Rehman-6 wells are expected to be brought on stream by the end of 2019.

5.2. Trade and Storage

The principal activity of the segment is trade in natural gas. In Poland, where the PGNiG Group is the largest natural gas supplier, the segment sells natural gas produced from domestic fields as well as imported gas. Through PGNiG Supply and Trading GmbH (wholesale) and PST Europe Sales GmbH (retail sale), the PGNiG Group is also developing its natural gas business in Germany, the Netherlands and Austria. The segment also trades in electricity, certificates of origin for electricity, CO_2 emission allowances, and crude oil (since 2018, through PST). The segment operates seven underground gas storage facilities and provides a ticketing service for gas storage to external customers.

5.2.1. Segment's key data

Financial highlights	H1 2019	H1 2018	2018	2017[3)]	2016[2)]	2015[1)]
Total revenue	17,877	15,770	31,704	26,540	28,180	31,742
Revenue from sales outside the Group, including:	17,688	15,528	31,038	26,045	27,733	31,274
- high-methane and nitrogen-rich gas,	16,385	14,337	29,094	23,869	25,615	29,413
Inter-segment revenue	189	242	666	495	454	468
EBITDA	(233)	(29)	(848)	(435)	614	623

1) Data not restated, as reported.
2) Data restated according to the new segmentation of the PGNiG Group's operations.
3) Data reflecting the potential impact of IFRS 15

Trade and Storage segment's natural gas sales outside the PGNiG Group (including gas exports from Poland) mcm	H1 2019	H1 2018	2018	2017	2016	2015
High-methane gas (E)	15,134	14,534	27,440	25,261	22,818	21,596
Nitrogen-rich gas (Ls/Lw as E equivalent)	401	383	721	701	671	611
TOTAL (measured as E equivalent)	15,535	14,917	28,161	25,962	23,489	22,207
including:						
PGNiG	*8,689*	*8,825*	*16,364*	*16,159*	*13,734*	*12,415*
PGNiG OD	*4,395*	*4,378*	*7,868*	*7,617*	*7,245*	*7,753*
PST	*2,451*	*1,714*	*3,929*	*2,186*	*2,510*	*2,039*

PGNiG Group's gas customer base in the Trade and Storage segment mcm	H1 2019	H1 2018	2018	2017
Households	2,428	2,349	4,107	4,065
Other industrial customers	1,162	1,570	1,859	1,764
Retail, services, wholesale	2,631	1,888	2,325	1,981
Nitrogen processing plants	1,169	1,253	1,836	900
Power and heat plants	1,096	954	2,111	2,795
Refineries and petrochemical plants	875	1,133	2,741	3,028
Exchange	5,868	5,549	8,802	8,515
Exports from Poland	306	221	451	728
Total Trade and Storage segment sales outside the PGNiG Group	15,535	14,917	24,232	23,776

5.2.2. Segment's strategy

In the Trade and Storage segment, the PGNiG Group is implementing a strategy covering three key areas: wholesale, retail trade, and storage.

Wholesale – the primary ambition is to build a diversified gas supply portfolio beyond 2022 and to increase the overall volume of gas sales by 7% by 2022, to be achieved through:

- Active interest and participation in infrastructure projects in order to diversify gas imports in view of the near expiry (in 2022) of the contract for gas supplies from east of Poland;
- Increased utilisation of the Świnoujście LNG Terminal capacity and development of trading presence on the global LNG market through a trading office in London;
- A significant increase in the overall volume of gas sales abroad (in particular on neighbouring markets) and maximising the volume of gas sales to strategic end users in Poland.

Retail – the primary objective is to maximise retail margins and maintain the total volume of retail gas sales at ca. 67–69 TWh/year from 2022 onwards, to be achieved through:

- Maximising the volume of retail gas sales while maintaining attractive margins and optimising costs of retail operations;
- Adapting the pricing policy to market expectations and competition environment;
- Offering new products and services in order to increase added value for customers and improve satisfaction and loyalty among the Group's existing customers.

Storage – the crucial issue is to secure storage capacities in keeping with actual demand and to improve storage efficiency, to be achieved through:

- Continued work on extending the Kosakowo CUGSF and implementing the model of long-term planning for storage infrastructure development, to be able to respond to changes in market demand;
- Streamlining the organisational model for the storage area and optimising the operating costs of regulated activities;
- Securing new revenue sources from non-regulated activities.

5.2.3. Segment's trading activities in Poland

The segment's principal activity is trade in natural gas in Poland. In Poland, where the PGNiG Group is the largest natural gas supplier, the segment sells natural gas produced from domestic fields as well as imported gas. On August 1st 2014, there was a change in the PGNiG Group's structure: retail sales were separated from the wholesale gas business, the latter remaining with PGNiG. The retail business was transferred to PGNiG OD.

Trade and Storage segment's natural gas sales in Poland outside the PGNiG Group (including gas exports from Poland) **mcm**	**H1 2019**	**H1 2018**	**2018**	**2017**	**2016**	**2015**
High-methane gas (E)	12,711	12,820	23,511	23,075	20,435	19,557
Nitrogen-rich gas (Ls/Lw as E equivalent)	401	383	721	701	671	611
TOTAL (measured as E equivalent)	13,112	13,203	24,232	23,776	21,106	20,168
including:						
PGNiG	*8,689*	*8,825*	*16,364*	*16,159*	*13,734*	*12,415*
PGNiG OD	*4,395*	*4,378*	*7,868*	*7,617*	*7,245*	*7,481*
PST	*28*	*-*	*-*	*-*	*127*	*272*

Wholesale market – PGNiG SA, PST

Gas imports

In the first half of 2019, imports of gas fuel into Poland rose to a total of 92.59 TWh (up by approximately 6.7 TWh, or 8%, yoy), with imports from the East down by 40%. Supplies from the European Union went up by over 200% compared with the first half of 2018. Supplies from the East accounted for the largest share of imported gas – approximately 47% of the total flow. The largest volumes of natural gas were delivered via the Mallnow point.

Gas flows at Polish borders (TWh)

Entry/exit point (in TWh)	**H1 2019**	**H2 2018**	**H1 2018**	**Y/y change (H1 2019 vs H1 2018)**
Supplies from EU	30.71	24.66	10.21	201%
including Lasów, Gubin (GCP)	2.98	2.29	2.07	44%
including Cieszyn	2.84	1.80	2.11	34%
including Mallnow	24.90	20.57	6.03	313%
Supplies from across Poland's eastern border	43.65	37.63	61.31	-29%
including Drozdovitse	19.81	17.92	24.68	-20%
including Teterovka	0.48	0.37	0.50	-3%
including Kondratki	9.33	5.81	16.25	-43%
including Vysokoye	14.03	13.54	19.88	-29%
LNG regasification	18.23	14.87	14.38	27%
Exports to Ukraine (mainly Hermanowice)	7.46	3.55	3.72	100%
Total flow	100.05	80.71	89.62	12%

Source: ENTSOG.

In the first half of 2019, PGNiG purchased natural gas mainly under the long-term agreements and contracts specified below:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until 2022 (the Yamal contract);
- Contract with Qatar Liquefied Gas Company Limited (3) for sale of liquefied natural gas, dated June 29th 2009, effective until 2034 (the Qatar contract), and supplementary agreement to the long-term agreement of March 2017 (effective from beginning of 2018 to June 2034).

PGNiG also received gas under medium- and short-term contracts for grid deliveries and LNG supply (e.g. the five-year contract which entered into force in 2018 for nine liquefied natural gas shipments from Centrica LNG Company Limited).

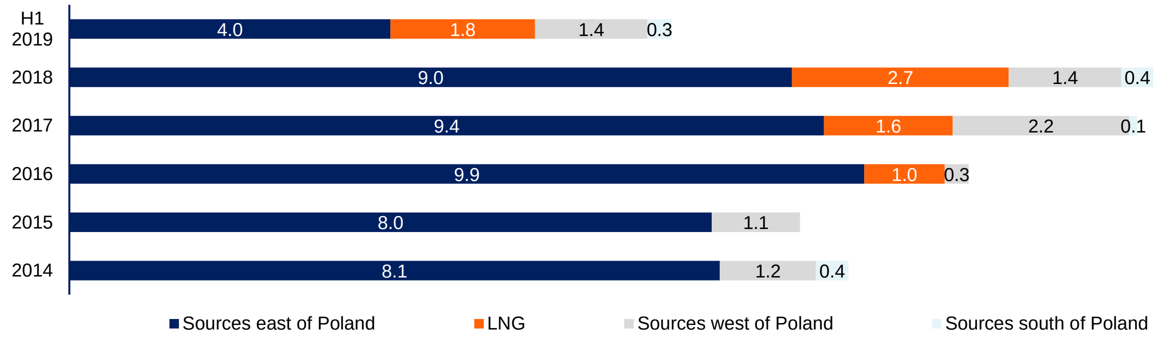
LNG supplies and purchase

In the first half of 2019, the deliveries of liquefied natural gas by sea to the LNG Terminal were continued. As a result, the volume of gas regasified at the LNG Terminal rose by 27% year on year. In the first half of 2019, PGNiG received a total of nine LNG shipments under the long-term contracts with Qatargas. The volume of LNG imported from Qatar reached 0.83m tonnes, i.e. about 12.6 TWh of natural gas after regasification. In the first half of 2019, PGNiG also purchased and imported to Świnoujście six shipments under spot contracts and one shipment under a medium-term contact between the PGNiG Group and Centrica, with a total volume of 0.45m tonnes, i.e. approximately 6.8 TWh of natural gas after regasification.

In the period under review, PGNiG took further significant steps to diversify its gas supply sources and build its LNG trading portfolio. On June 12th 2019, PGNiG executed an annex to the long-term contract for the supply of LNG signed with Venture Global

Plaquemines LNG, LLC on September 28th 2018. The annex provides for an increase in the volume of LNG deliveries to PGNiG from the planned Plaquemines LNG liquefaction terminal in Plaquemines Parish, US from 1m tonnes to 2.5m tonnes per year, which corresponds to a total volume of nearly 3.4 bcm of natural gas after regasification. Following the execution of the annex, the total volume of LNG deliveries to be made by Venture Global Plaquemines LNG, LLC and Venture Global Calcasieu Pass, LLC in 2023-2043 to PGNiG may reach 3.5 million tonnes of LNG per year, i.e. over 4.7 bcm of natural gas after regasification per year. The deliveries will be made on a free-on-board basis. Such terms of procurement give PGNiG, as the buyer, flexibility and ability to trade in LNG cargoes on a global scale.

Imports of natural gas to Poland in 2014–2018 and in H1 2019 (bcm)



Source: In-house analysis.

In the first half of 2019, imports reached 7.4 bcm, up 0.1 bcm year on year. The gas procurement structure changed – supplies from the East decreased by 1.6 bcm, which was offset by a 1.2 bcm increase in import volumes from the West and 0.5 bcm higher LNG supplies.

Renegotiation of price terms under the contract with OOO Gazprom Export

In the first half of 2019, PGNiG continued its efforts to revise the price terms under the Yamal Contract as part of the procedure formally launched on November 1st 2014. Since no agreement was reached with the supplier within the time limit provided for in the contract, on May 13th 2015 PGNiG instigated arbitration proceedings, in accordance with the contract. The dispute concerns bringing the price terms under the long-term Yamal Contract in line with the current conditions prevailing on the European natural gas market. On June 29th 2018, the Arbitration Court issued a partial award in which the Court:

- Found that in November 2014 PGNiG had filed a valid and effective request to renegotiate the contract price;
- Confirmed the satisfaction of the condition set forth in the Yamal Contract which entitles PGNiG to demand a reduction of the contract price for the gas supplied by Gazprom under the Yamal Contract, thus confirming that, in principle, PGNiG's request to determine a new, lower contract price is justified; and
- Found, contrary to Gazprom's claims, that PGNiG has the right to change the contract price within the limits of the claim, also declaring that PGNiG's initial demand regarding the new price formula is too far-reaching; the Court also decided ad hoc that the new contract price would be determined later on in the proceedings.

Under the Yamal Contract, the new contract price determined ad hoc by the Arbitration Court should apply with retroactive force as of November 1st 2014, i.e. the date of PGNiG's request for renegotiation of the contract price. On October 1st 2018, Gazprom filed a complaint with the Stockholm Court of Appeals seeking reversal of the partial award issued by the Arbitration Institute. In the Company's opinion, there are no grounds to demand reversal of the partial award. A relevant response by PGNiG concerning the matter was presented on December 20th 2018.

Notwithstanding the continuing arbitration proceedings, on November 1st 2017, PGNiG submitted another notice to PAO Gazprom/OOO Gazprom Export requesting renegotiation of the price terms of gas supplies. The Russians submitted their own renegotiation request on December 7th 2017, Which the Company believed to be groundless and ineffective as it failed to meet the formal requirements set out in the Yamal contract. So far, the parties have not reached an agreement on the terms of supply.

Sales of gas

PGNiG continues to apply a pricing policy based on market prices. The prices provided for in contracts executed by PGNiG are based on valuations prepared on a case-by-case basis using a uniform, objective pricing methodology. Settlements with customers are based on pricing formulas or fixed prices linked to exchange indices.

The largest amounts of gas in Poland were sold to industrial customers. The largest Polish customers in this category include Grupa Azoty and its subsidiaries, PKN Orlen S.A. and its subsidiaries, Grupa LOTOS, Polska Grupa Energetyczna, Arcelor Mittal Poland S.A., and KGHM Polska Miedź S.A.

In the first half of 2019, PGNiG successfully continued its sales strategy as a result of which it succeeded in retaining its customer base. The effectiveness of PGNiG's sales policy was confirmed by the submission by the Grupa Azoty Group companies of a representation on extension of the effective term of their natural gas supply contracts until September 30th 2022. The contracts, made on June 21st 2017 between PGNiG and five Grupa Azoty Group companies, provided for the possibility of extending their term by two years. The total value of the four-year contracts, i.e. covering the delivery period from October 1st 2018 to the end of September 2022, is estimated to exceed PLN 8bn.

In the first half of 2019, PGNiG placed on the market 27 thousand tonnes of LNG, of which 16.8 thousand tonnes was sourced through Świnoujście and 10.2 thousand tonnes came from the gas processing facilities in Odolanów and Grodzisk Wielkopolski. To compare, in the entire 2018 PGNiG placed on the market 52.7 thousand tonnes of LNG, of which 31.5 thousand tonnes was sourced through Świnoujście and 21.2 thousand tonnes was LNG produced in Odolanów and Grodzisk Wielkopolski.

Exports – PGNiG

In 2019, PGNiG continued to sell natural gas to the Ukrainian market. In the first half of 2019, the Company exported to Ukraine 306 mcm of natural gas. PGNiG's cumulative exports to the Ukrainian market from July 2016 reached 1.86 bcm. In Ukraine, PGNiG cooperates with ERU Trading. In October 2018, PGNiG and ERU Trading signed a contract for the supply of gas to Ukrtransgaz, the Ukrainian transmission network and gas storage facility operator. Moreover, in September 2018, PGNiG also signed a contract with Ukrtransgaz to use its underground gas storage facilities in Ukraine. The Company also has a contract with Ukrtransgaz concerning transmission of gas over the territory of Ukraine, under which PGNiG can use Ukrainian transmission networks.

Competition

In Poland, PGNiG competes with a number of companies engaged in natural gas trading in the industrial customers segment. For quite some time, competitors have been intensifying their efforts to win new customers. In a highly competitive environment, PGNiG successfully bid for new contracts, consolidating its market position in the gas sale business. In the first half of 2019, PGNiG's sales of high-methane grid gas in Poland amounted to 90.6 TWh. Compared with the first half of 2018, when sales were 93.4 TWh, the sales volume fell by 3%.

Sale of electricity

On the electricity market, PGNiG is engaged primarily in wholesale trading. Total sales of electricity to trading companies and on the PPX accounted for more than 92% of total electricity sales in the six months to June 2019.

PGNiG electricity sales	GWh	%
End users	0.0	0.0
Trading companies	297.2	7.6
Balancing market	200.9	5.1
Exchange	3,330.5	84.6
Producers	108.3	2.7
TOTAL	3,936.9	100.0

In the first half of 2019, PGNiG was engaged in wholesale trading in electricity and related products in Poland. The company traded on the OTC market and on PPX. PGNiG also provided services under a commercial balancing agreement to PGNiG TERMIKA, and to companies from the PGNiG TERMIKA Group: PGNIG EP and PGNiG TERMIKA Energetyka Rozproszona.

PST's trading activities

PST has established a branch in Poland to build relationships with customers within the segment assigned to PST. The purpose is to strengthen the company's relations with branches of international companies in order to present PST's offering of energy supplies across Poland and Europe.

As at June 30th 2019, PST's Polish branch successfully connected and started supplies to four customers (two connected on March 1st 2019, and two further customers on June 1st 2019).

Retail market – PGNiG OD

PGNiG OD's business is retail sale of natural gas (high-methane and nitrogen-rich gas), electricity, compressed natural gas (CNG) and liquefied natural gas (LNG).

Gas purchase

The largest share in the global volume of high-methane gas purchases was attributable to transactions on the PPX. PGNiG concluded bilateral EFET agreements for purchasing gas fuel with delivery to a physical and virtual trading point. In addition to natural gas, PGNiG's purchase portfolio also includes high-methane and nitrogen-rich gas and liquefied natural gas (LNG).

Sales of gas

Pursuant to the licence held, PGNiG OD's business consists in sale of gas fuel and electricity. In the first half of 2019, PGNiG OD continued its strategy to expand the gas fuel portfolio and improve its margin management. On February 15th 2019, PGNiG OD Gas Fuel Trading Tariff No. 7, approved by decision of the President of URE of January 25th 2019, took effect. Relative to the previous tariff, this new one raised gas fuel prices by 2.5% for all tariff groups.

In the first half of 2019, adding new solutions, such as the "PGNiG Fachowiec" service, to the basic offering, proved to be an effective improvement. Introduced in March 2019, the service was used by as many as 46.8 thousand customers by the end of the first half of 2019.

As at the end of June 2019, the volume of sales to all end-users was 47.0 TWh. According to URE, the number of customers who switched gas suppliers was approximately 13 thousand in January–March 2019, And approximately 54 thousand over the entire 2018.

Sale and supply of LNG and CNG

LNG is supplied to industrial and other customers across Poland. At the end of June 2019, PGNiG OD operated 18 small-scale LNG stations. The company intensified its LNG offering efforts, mainly addressed to industrial customers and commercial power plants using LNG as an alternative fuel to generate energy (mostly heat, but also electricity). In the first half of 2019, 3,859 tonnes of LNG were purchased to meet the needs of small-scale LNG customers, and 1,846 tonnes to meet the needs of B2B customers. In the first half of 2019, 15 LNG supply contracts were executed (a total of 20 such contracts were in effect).PGNiG OD also entered a new market for LNG sale: sea shipping. In the first half of 2019, sale of LNG as bunker fuel was launched. Customers supplied with bunker LNG are domestic and foreign ship owners, as well as bunker fuel brokers. A contract was also signed for the sale of LNG to two out of the three existing LNG service stations for land transport. The market potential for this product, estimated based on the volume of consumption at each service station, is high. Currently, PGNIG OD is seeking to build a customer base with a size justifying the construction of LNG service stations.

CNG is sold throughout Poland, at 17 CNG fueling stations. In individual cases, CNG can also be sold mobile fueling stations. Public transport companies remain the main customer group purchasing CNG. The development of this market segment is supported by the expected amendments to the Act on Electromobility and Alternative Fuels, which will allow CNG buses to be included in the calculation of the mandatory share of clean vehicles in the public transport fleet.

Sale of electricity

PGNiG OD sells electricity under comprehensive electricity supply agreements or under sale-only agreements. As at the end of June 2019, end users accounted for approximately 84% of PGNiG OD's electricity customer base, with non-end users representing the balance of around 16%. In the first half of 2019, PGNiG OD sold 260 GWh of electricity to end customers.

According to the URE data, approximately 37,500 customers in Poland switched electricity suppliers between January and June 2019, including 30,000 households (G tariff groups), and approximately 70,500 over the entire 2018, including 58,000 households (G tariff groups).

Trading policy

In the first half of 2019, PGNiG OD carried out promotional campaigns, including:

- 'Low Price All the Time, 4th Edition' and 'Low Price All the Time Plus' – in the first half of 2019, PGNiG OD launched further editions of the discount scheme. In both campaigns, customers could benefit from a special price offer on gas for 12 or 24 months, depending on the selected option.
- 'Subsidy of up to PLN 3,000', 2nd Edition – in the first half of 2019, PGNiG OD continued to offer customers holding the Large Family Card an opportunity to join the programme by May 31st 2019. The programme consisted in subsidysing households planning to switch from solid to gas fuel in their heating systems.

PGNiG OD customers are served by a network of 136 Customer Service Offices (BOK) located throughout Poland (including 7 BOK-Premium located in shopping malls). They may also use electronic (eBOK) and mobile (mBOK) customer service, or a call centre. Business customers are served by dedicated customer assistants. In the first half of 2019, the implementation of a single eBOK service was completed, providing a uniform customer service standard and enabling further development of both customer service and sale through remote channels. Contract conclusion via eBOK and remote identity verification service have already been launched. The remote identity verification service is available to the customers of PGNiG OD, PKO Bank Polski, ING and Inteligo.

Competition

Based on PGNiG OD estimates, in the first half of 2019 there were over 30 gas suppliers on the market who actively competed for domestic and business customers. In the retail segment, three companies are considered the most active competitors. In the business segment, in the first half of 2019 ten most active competitors were identified. On the LNG market, there are five particularly active operators. The number of entities holding licences to trade in gas fuels increased from 197 at the end of 2018 to 199 at the end of the first quarter of 2019. 100 entities actively traded in natural gas.

5.2.4. Segment's trading activities abroad – PST

Through PGNiG Supply and Trading GmbH (wholesale) and PST Europe Sales GmbH (retail sale), the PGNiG Group is also developing its natural gas business (both wholesale and sales to end users) in Germany and Austria.

Foreign sale of gas in the T&S segment, outside the PGNiG Group (excluding gas exports from Poland) mcm	H1 2019	H1 2018	2018	2017	2016	2015
High-methane gas (E)	2,423	1,714	3,929	2,186	2,384	2,039
Nitrogen-rich gas (Ls/Lw as E equivalent)	-	-		-	-	-
TOTAL (measured as E equivalent), including:	2,423	1,714	3,929	2,186	2,384	2,039
PST[1]	2,423	1,714	3,929	2,186	2,384	2,039

[1] *Gas sales by PST outside the PGNiG Group in the T&S segment, excluding domestic sales and gas exports from Poland.*

Foreign customer base structure

PST's foreign natural gas customers mcm	H1 2019	H1 2018	2018	2017
Households	20	23	38	48
Other industrial customers	10	15	32	35
Retail, services, wholesale	1,290	1,009	2,388	1,303
Exchange	1,103	668	1,471	800
TOTAL sales outside the Group[1]	2,423	1,714	3,929	2,186

[1] *Gas sales by PST outside the PGNiG Group in the T&S segment, excluding domestic sales and gas exports from Poland.*

Exchange and OTC wholesale trading

PST was actively involved in trading on organised (commodity exchange) and OTC markets with approximately 100 trading partners under EFET agreements or similar standard agreements. PST operates in Germany and its neighbouring countries (Austria, the Czech Republic, the Netherlands) and also in the UK gas market (NBP). The company also reached operational readiness in France and Poland.

In the first half of 2019, PST continued trading in two new commodities (launched in the second half of 2018): crude oil Brent futures on the ICE Futures Europe and on the ICE Futures U.S., where it was registered in order to secure LNG supplies related to the Henry Hub gas trading centre in Erath, Louisiana, US.

In the first half of 2019, PST sold 44.8 TWh of gas delivered by pipeline, 6.8 TWh of LNG, 2.8 TWh of electricity, and 0.6 TWh of crude oil in exchange and OTC transactions. Poland is PST's largest market, accounting for 46% of the sales volume (mainly sales within the PGNiG Group), with the Dutch and German markets accoutning for 28% and 25%, respectively, of total sales.

PST trading on the global LNG market

PST conducts its trading activities through a UK trading office. The sharp increase in transport costs in 2018 made Europe an attractive market for American LNG. In the first half of 2019, as many as seven deliveries were made to the LNG terminal, with five of them directly contracted by PST.

Retail sales

PST conducts retail sale of gas and electricity through its subsidiary PST ES. Target customers include small and medium-sized enterprises and households with standard consumption profiles (in Germany and Austria). XOOL GmbH is wholly owned by PST ES and holds a portfolio of natural gas for households.

The number of customers stabilised at 41,907 as at June 30th 2019 (compared with 43,902 customers as at December 31st 2018), and the sharp increase in commodity prices slowed down the process of new customer acquisition. Nevertheless, in the first half of 2019 PST signed almost 12,000 new contracts, with deliveries scheduled to begin in 2019 and the following years confirmed under about 46% of the contracts.

Under its strategy, PST is examining the possibilities of stepping up the PGNiG Group's gas trading activities in Western as well as Central and Eastern Europe, particularly in countries neighbouring Poland.

PST's customer base PST (gas and electricity combined)

Customers by country	Jun 30 2019	Dec 31 2018	Dec 31 2017	Dec 31 2016
Germany	41,562	43,673	44,168	31,432
Austria	345	229	303	580
TOTAL	41,907	43,902	44,471	32,012

Customers by market segment	Jun 30 2019	Dec 31 2018	Dec 31 2017	Dec 31 2016
Households	38,930	40,950	41,698	28,572
B2B	22	9	13	10
SMEs	2,955	2,943	2,760	3,430
TOTAL	41,907	43,902	44,471	32,012

5.2.5. Storage – GSP, PGNiG S.A.

The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno and Kosakowo underground cavern facilities. A part of the working capacity of the Mogilno facility which was made available to GAZ-SYSTEM is not a storage facility within the meaning of the Polish Energy Law. The capacities of gas storage facilities are managed by Gas Storage Poland (GSP), conducting activities in the following two core areas:

- Regulated activities comprising the provision of gas fuel storage services at storage facilities owned by PGNiG, as well as operation of the Mogilno and Kosakowo underground gas storage caverns;
- Non-regulated activities comprising the provision of services related to design, construction and extension of underground gas storage facilities.

Under an outsourcing agreement, GSP provides storage services at underground high-methane gas storage facilities owned by PGNiG. To ensure equal treatment of storage service users, standard storage service agreements are concluded based on GSP's Rules of Storage Services and the gas fuel storage tariff. GSP's services are provided using the following Storage Facilities (SF) and Groups of Storage Facilities (GSF):

- Kawerna GSF (comprising the Mogilno CGSF and Kosakowo CGSF, located in worked-out salt caverns),
- Sanok GSF (comprising the Husów UGSF, Strachocina UGSF, Swarzów UGSF and Brzeźnica UGSF, located in partly depleted gas reservoirs),
- SF (comprising Wierzchowice UGSF).

At the Kosakowo UGSF, the project 'Kosakowo GSF – Construction of Five Caverns, Cluster B' was continued in the first half of 2019. In January 2019, Caverns K-6, K- 8 and K-9 were delivered to PGNiG and placed in operation by GSP. Following analysis, the cavern leaching process was extended, which increased the geometric volume of the caverns and, consequently, the volume of gas stored by approximately 20% relative to the originally planned volume. In the first half of the year, the construction of Caverns K-7 and K-10 was continued.

For more information on gas storage in Poland, see Section 3.2.1.

Third-party access (TPA) storage capacities

As at June 30th 2019, the PGNiG Group's underground gas storage working capacities totalled 3,074.8 mcm of group E high-methane gas. As part of those storage capacities, GSP made available a total of 3,039.6 mcm of working storage capacities for third-party access (TPA) and for the gas transmission system operator under long-term services contracts. 29.99 mcm of Kawerna SFG's working capacity was made available on an interruptible basis under short-term services contracts. In addition, GSP allocated 5.22 mcm of working capacity for the needs of the Mogilno CUGSF's and Kosakowo CUGSF's technological units.

Total working capacities and TPA working capacities

	Working storage capacities (mcm)		TPA working storage capacities (mcm)		TPA working storage capacities (GWh)*	
	Jun 30 2019	Dec 31 2018	Jun 30 2019	Dec 31 2018	Jun 30 2019	Dec 31 2018
Kawerna SFG	825	735	820	730	8,992	8,011
Wierzchowice SF	1,200	1,200	1,200	1,200	13,166	13,166
Sanok SFG	1,050	1,050	1,050	1,050	11,521	11,520
Total	3,075	2,985	3,070	2,980	33,679	32,697

** Converted to gas with calorific value of 39.5 MJ/m³.*

Ticketing service

PGNiG offers a ticketing service which allows gas importers and traders to meet their gas-stocking obligations in accordance with the applicable Polish regulations. The Company performs ticketing service contracts concluded for the gas year 2018/2019 with 13 energy companies obliged to maintain emergency stocks of natural gas. The total volume of gas stocks maintained by PGNiG for other entities is over 385,000 MWh. In 2019, PGNiG continues to offer the ticketing service for subsequent periods.

As part of its ticketing service, PGNiG maintains gas stocks at GSP's storage facilities located in Poland which are covered by PGNiG's contracts for storage capacities and where PGNiG injected gas.

Storage in Ukraine

In March 2019, PGNiG signed a maintenance agreement with Ukrtransgaz for the submission of customs declarations for natural gas transported across the Ukrainian customs border. The agreement is in force until the end of 2019. The execution of such maintenance agreement is a necessary condition for storing natural gas in Ukraine's underground gas storage facilities operated as a customs warehouse for 1,095 days without the obligation to pay taxes and customs duties.

As at June 30th 2019, gas stocks owned by PGNiG and held in underground gas storage facilities in Ukraine exceeded 300 mcm of gas (measured as high-methane gas equivalent).

5.2.6. Segment's prospects

Import strategy

In the coming years, PGNiG will meet its obligations under the long-term contracts with Gazprom Export and Qatargas with respect to the minimum offtake volumes. If an unforeseen increase in demand occurs, the Company will purchase natural gas under short-term contracts from the neighbouring countries or on the LNG market, wherever more favourable prices are available. PGNiG also pursues its strategy of active participation in the international LNG market by entering into spot transactions to secure deliveries to the Świnoujście Terminal and by trading in LNG on the global market.

In the long term, with the near expiry (in 2022) of the Yamal contract and the expected rise in gas import capacities in mind, PGNiG will have the possibility of diversifying its gas sources. The elements essential for real diversification of gas supplies to Poland include further use of the LNG terminal in Świnoujście and building of the Norwegian Corridor. Therefore, the second half of 2019 will see the continuation of efforts to implement the Baltic Pipe project as well as commercial efforts to execute favourable contracts with gas producers and suppliers from countries north of Poland.

In the second half of 2019, the PGNiG Group will receive further LNG deliveries planned in the delivery schedule. In July 2019, the first delivery of natural gas under the long-term contract with Cheniere Marketing International, LLP was performed. In the second half of 2019 and the following quarters, further deliveries to the LNG Terminal will be made. In 2019–2022, the total volume of deliveries to be made under the contract with Cheniere Marketing International, LPP will be approximately 0.52m tonnes of LNG, or approximately 0.7 bcm of gas after regasification.

In the second half of the year, the LNG Terminal in Świnoujście may also receive further spot deliveries if additional demand arises. Efforts to develop competencies and strengthen the Company's presence on the global LNG market, including an analysis of the possibility of entering into contracts for LNG imports from new directions (e.g. from North America or Africa), the possibility of optimising supplies, as well as acquisition of new competencies in LNG transport by sea, will be continued.

Retail sales in Poland

The Company plans to further enhance its product offering, improve operational efficiency, as well as develop and streamline processes and tools in sale and customer service.

PGNiG OD's key growth objectives include:

1. Sale of gas:
   - Rational defence of the market share (maximising the margin on a stabilised volume portfolio), while managing the risk of loss of high-margin customers;
   - Development of the offering and the availability of CNG/LNG services.
2. Supplementing the electricity and gas offering:
   - Focus on solutions expanding the offering for various customer segments – added services (e.g. insurance, services for households);
   - Identifying opportunities to enhance the offering in cooperation with external partners (offering solutions complementary to PGNiG OD's core business);
   - Development of energy efficiency products/services.

The Company's key growth initiatives will focus on further optimisation of processes and tools designed to reduce operating expenses and ensure high customer satisfaction.

From the perspective of product portfolio development, implementation of products with a significant potential to boost PGNiG OD's margins is particularly important in 2019. Insurance/assistance packages sold to retail customers are among such products. Other services under partnership agreements with third parties are also being considered.

Foreign operations

PST intends to further expand its business of selling electricity and gas to end users and wholesale customers.

As part of its wholesale activities, in addition to the operations on the OTC and exchange markets, the company will expand its business to include services for municipal utilities and companies selling gas and electricity to end users. The extended portfolio would include standard and structured commercial products as well as services related to trading (e.g. balancing services). The company remains interested in the Dutch market (in connection with further hedging against price fluctuations) as it is the most liquid gas market in the continental Europe.

PST has reached its operational readiness in France, having secured all the required documentation. It is an interesting development direction, mainly due to its LNG receiving capacities and cross-border trade.

PST is also a registered supplier in Denmark, Slovakia and, since 2018, in Hungary. Presence on these markets will be useful if new business opportunities arise (e.g. supply of gas through Slovakia to Ukraine).

PST plans to use its experience on the LNG market in developing new services for new customers of the PGNiG Group, including by opening the market to oil companies. PST intends to continue using the LNG terminal in Świnoujście as a reliable source of LNG supply and in developing small scale LNG solutions (use of LNG as a fuel for lorries, for instance on the German market).

PST will continue to supply gas to industrial customers in Poland as part of its cooperation with PGNiG. Further takeovers of selected customers from PGNiG are also an option.

PST's retail segment is in the process of restructuring, with the primary objective of retaining customers and reducing the customer churn rate. The company focuses on improving the unit margin to regain business profitability and build a stable, loyal and profitable customer base. As regards its retail business, PST intends to:

- expand the base of end customers for gas and electricity,
- increase customer loyalty through measures aimed at retaining customers and through preventive measures, and to focus on pull channels,
- improve customer base quality, operational efficiency, and customer base profitability.

In the coming years, PST intends to continue stable acquisition of customers through traditional sales channels, such as telemarketing and door-to-door sales. Stable acquisition will be based on cooperation with existing trading partners. PST ES is also expanding exclusive sale channels to further improve its portfolio quality and sustainability.

Storage

In the second half of 2019, GSP will continue the construction of five Cluster B caverns in the Kosakowo UGSF. In 2019−2021, work on leaching and preparing for reinforcing and first gas injection in caverns K-7 and K-10 will be carried out. The contractual deadline for completion of all works related to the construction of the five Cluster B chambers falls in 2021.

In the second half of 2019, GSP will implement the Computerised Maintenance Management System (CMMS), a project important for maintaining the operation of UGSFs. It will help improve the efficiency of staff work by providing them with tools to comprehensively support the maintenance process – from the planning phase through implementation to billing.

As regards regulated activities, key tasks include the implementation of a project which is to enable offering storage services also through auctions, and streamlining of the contract execution process as it has been to date, i.e. on the basis of the rules of storage services.

5.3. Distribution

The segment's principal business activity consists in the delivery of high-methane and nitrogen-rich gas, as well as of small amounts of coke-oven gas, over the distribution network to retail and corporate customers. The segment is also engaged in extending and upgrading the gas network and connecting new customers. Natural gas distribution is the responsibility of PSG. As the Distribution System Operator, the company operates in all regions of Poland. Being the owner of the majority of Poland's gas distribution network and gas service lines, PSG enjoys a dominant market share.

5.3.1. Segment's key data

Financial highlights	H1 2019	H1 2018	2018	2017[1)]	2016	2015
Total revenue, including	2,472	2,687	4,927	4,937	4,915	4,585
- external sales of distribution services	2,248	2,371	4,604	4,753	729	363
- intra-group sales of distribution services	14	9	323	185	3,657	3,748
EBITDA	1,070	1,384	2,385	2,493	2,559	2,339

1) Data reflecting the potential impact of IFRS 15

Volume of distributed gas (high-methane, nitrogen-rich, propane-butane, and coke gas), mln m^3

	H1 2019	H1 2018	2018	2017	2016	2015
Total volume of distributed gas, including:	6,314	6,356	11,747	11,645	10,858	9,823
- high-methane gas	5,495	5,420	9,918	9,797	9,301	8,646
- nitrogen-rich gas	567	504	971	989	836	643
including outside the PGNiG Group	*1,372*	*1,644*	*3,101*	*3,110*	*3,081*	*1,793*

As at June 30th 2019, PSG provides gas fuel distribution services in 1,518 municipalities with a total area of 183,655 km^2. Relative to the total number of municipalities in Poland (2,447), PSG's gas distribution network roll-out is 61.28%.

5.3.2. Segment's strategy

In the Distribution Segment, the PGNiG Group is implementing a strategy designed to accelerate the development of the distribution system and increase the rate of connecting new customers to the grid. One of the key objectives is to increase the rate of connecting new customers to the distribution network from about 47 thousand new connections in 2017 to about 55 thousand new connections per year as a result of optimised connection processes and improved customer service quality. Connecting new customers to the gas network will enable PSG to increase the volume of natural gas distributed, from the 2017 target of approximately 10.6 bcm (117.8 TWh) to approximately 12.3 bcm (136.7 TWh) in 2022.

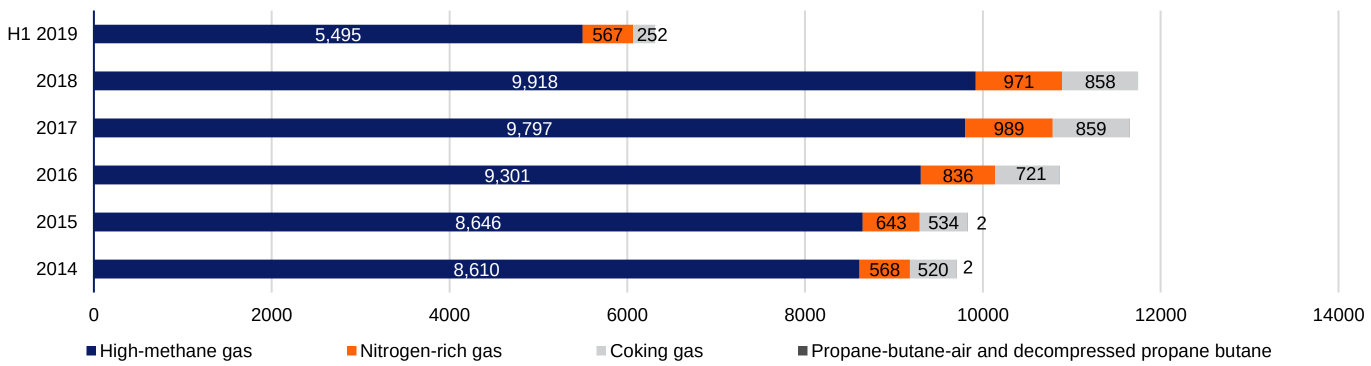
The increase in the volume of distributed gas will be achieved by connecting new customers to the existing distribution network, expanding the distribution network into unserved areas, and delivering gas to customers lacking access to the gas transmission and distribution network through roll-out of local gas delivery solutions.

5.3.3. Segment's activities

Since February 15th 2019, a new tariff for PSG's distribution services has been in force. The tariff rates were reduced on average by 5% in relation to the previously applicable tariff and will remain in force until December 31st 2019. PSG seeks to agree with the President of URE a long-term regulatory agreement setting out the rules for determining basic parameters used to calculate the tariff for another 3–5 years (i.e. the cost base, methods of its indexation in the regulatory period, distribution volume and calculation of return on capital). Regulatory agreements of this type are applied in setting distribution operators' tariffs in the power sector. In PSG's view, it is important that the terms of such agreement ensure stable, favourable conditions for investing in the distribution system.

In the first half of 2019, there was a slight year-on-year decrease in the volume of gas distributed by the segment.

Volume of gas transmitted via the distribution system in 2014–2018 and in the first half of 2019, in mcm (natural units)



The 41 mcm decrease in the volume of supplied gas in the first half of 2019 was mainly attributable to the weather conditions, in particular a 3^{O}C year-on-year increase in the average temperature in the first quarter of 2019.

As at June 30th 2019, the length of the PGS network (including service lines) was 189 thousand km, and the number of customers was 7m.

In the first half of 2019, PSG continued to pursue a number of strategic projects designed to implement technological and organisational solutions in customer service, meter reading and billing for distribution services. The new solutions will improve process handling efficiency, enable uniform process reporting and monitoring across the Company, facilitate introduction of changes into business processes and improve information flow. Such projects include:

- Implementation of the Customer Service Portal (e-bok);
- Implementation of the Customer Integrated System (CIS);
- implementation of the Customer Service System − Stos in Gdańsk;
- Setting up a countrywide contact centre;
- Extension and integration of the Edifact standard.

In addition, projects are being implemented to harmonise the SAP ERP system in the area of procurement, supply and investments, and to acquire from PGNiG its gas distribution pipelines. The project will enable PSG to streamline its distribution system and will improve the security of gas supplies to customers connected to the network.

As a distributor of the environmentally-friendly fuel, PSG takes a range of measures promoting the prevention of smog and air pollution. 2019 saw the continuation of environmental initiatives, including:

- "Activation of Inactive Connections" – a project aimed at encouraging customers with inactive gas connections to reconnect, especially in areas with a high level of low-stack emissions;
- "Connect, because every breath matters" – an education and promotion project intended to raise the awareness of the risks to human health presented by air pollution and to promote gas fuel as an environmentally-friendly alternative to solid fuels.

In the first half of 2019, PSG spent approximately PLN 500m (VAT exclusive) on network expansion and connection of new customers, and more than PLN 150m (VAT exclusive) on buying out network assets. 36,400 new service lines were built in the first half of 2019. To ensure the improvement and maintenance of the technical condition of gas pipelines and to guarantee their operational safety, PSG is constantly investing to upgrade its network assets. In the first half of 2019, more than PLN 280m (VAT exclusive) was spent on redevelopment and modernisation of the gas network, including approximately PLN 105m (VAT exclusive) on replacement and certification of diaphragm gas meters and metering system components. The amount spent in the reporting period in the delivery of the investment plan was more than PLN 1bn.

Under the investment plan, PSG is also carrying out the 'Programme for accelerating investment in Poland's gas network in 2018–2022'. The programme provides for the implementation of a number of projects, including:

- Construction of high- and medium-pressure networks the completion of which should make it possible to launch in the next four years distribution services at approximately 300 new municipalities in Poland;
- Proposal of specific legal solutions, including the wording of proposed provisions in selected legal acts the enactment of which will significantly facilitate gas network roll-out across Poland.

As part of the programme implementation, by June 30th 2019 PSG had launched distribution services in 36 municipalities and plans to start providing those services in 114 municipalities more by the end of 2019. Other initiatives undertaken in the programme:

- in the case of 43 municipalities, contracts were commissioned for the preparation of design documentation,
- in the case of 13 municipalities, construction work or project execution under the 'design and build' model were commissioned,
- in the case of 83 municipalities, analyses and concepts of extending the gas network were developed, confirming the viability of the projects,
- in the case of the remaining 11 municipalities, PSG is in carrying out multi-option technical and economic analyses to select the best extension of the gas network.

In addition, as part of the investment tasks included in the 'Programme for accelerating investment in Poland's gas network in 2018–2022', PSG is carrying out nine tasks related to eliminating transmission congestions. PSG intends to construct nearly 614 km of high-pressure gas network and to perform one task to construct a ca. two-kilometre long connection gas pipeline to the GAZ-SYSTEM transmission system in Zambrów. Total expenditure on those nine investment tasks included in the programme is estimated at approximately PLN 1.3bn, VAT exclusive.

In addition, PSG continued its R&D&I efforts, seeking solutions that would help it meet growing business and technological requirements. With regard to the R&D&I area, projects were implemented in partnership with scientific and research centres, PGNiG departments responsible for implementing innovation, and commercial entities.

5.3.4. Segment's prospects

In 2019, PSG continues its efforts to expand the network, increase the number of customers, maintain and improve the technical condition of gas pipelines, and guarantee operational safety. Investments in these areas include extension of the gas network and connection of new customers, redevelopment and modernisation of the gas network (including replacement and certification of diaphragm gas meters and metering system components, telemetry), and buying out assets.

PSG will continue to carry out tasks under the 'Programme for accelerating investment in Poland's gas network in 2018–2022' and several dozen tasks covered by the strategic investment programme.

In addition, PSG intends to gradually complete other tasks related to extending and upgrading the gas network and connecting new customers. Major tasks to be carried out as part of network extension include roll-out of the gas network in the Sośnicowice and Bierawa municipalities (the medium-pressure gas network planned to be constructed is over 70 km long).

Plans also include further development of PSG's LNG competence and continued work to connect new areas to the gas network using LNG regasification stations. The stations will be built and used both as stations feeding micro gas grids and supporting the roll-out of local gas delivery solutions. PSG's plans also include extending the ability to feed the distribution network through the LNG regasification points.

In the second half of 2019, PSG will also perform co-financing agreements concluded in 2017–2019 for nine investment projects carried out as part of the Operational Programme Infrastructure and Environment for 2014–2020. In addition, PSG has applied for co-financing for two more projects. The Ministry of Energy's 'List of Strategic Projects for Energy Infrastructure under OPI&E 2014–2020' includes 41 projects submitted by PSG. Despite meeting formal requirements, the projects did not qualify for co-financing as the amount of EU funds allocated to support the gas distribution segment was insufficient. If the Ministry of Energy increases the amount of EU funds allocated for the gas distribution segment, it will be possible to apply for co-financing for further projects.

PSG will continue to pursue projects related to ICT; project, process and information management (e.g. SAP development); gas transport and infrastructure (aimed at improving work safety and quality of gas networks), and innovation (e.g. construction of CNG and LCNG fueling stations).

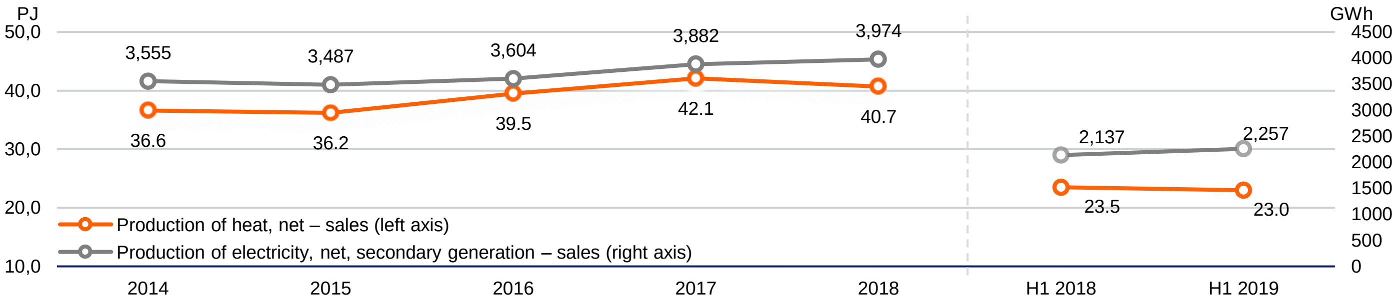
5.4. Generation

The segment's principal business consists in the production of heat and electricity, distribution of heat, and execution of large natural gas-fired projects in the power sector. In this field, the PGNiG Termika Group acts as the competence centre for the PGNiG Group. The PGNiG TERMIKA Group comprises PGNiG TERMIKA (with its subsidiaries), PGNiG TERMIKA EP (with its subsidiaries) and the non-consolidated PGNiG TERMIKA Energetyka Rozproszona Sp. z o.o.

5.4.1. Segment's key data

Financial highlights	H1 2019	H1 2018	2018	2017	2016	2015
Total revenue	1,410	1,265	2,387	2,251	2,195	1,887
Revenue from sales outside the Group, including:	873	888	1,617	1,655	1,472	1,215
- heat	741	743	1,323	1,346	1,262	1,126
- electricity	19	16	31	50	36	8
Inter-segment revenue	537	377	770	596	723	672
EBITDA	462	466	788	843	759	679
EBITDA adjusted for the provision for CO_2 emission allowances	505	466	788	843	759	679

Heat and electricity sales volumes from own generation sources



In the first half of 2019, net other expenses included the provision for CO_2 emission allowances of PLN 43m. In the following quarters, a provision for the shortage of emission allowances will be recognised, which will be reversed in the fourth quarter and the cost of redemption of purchased emission allowances will be charged to depreciation and amortisation. To ensure comparability of financial data, EBITDA adjusted for the provision for CO_2 emission allowances was PLN 505m, up PLN 39m (8.4%) year on year.

5.4.2. Segment's strategy

The PGNiG Group's strategy for the generation business is to expand its share in the heat generation and distribution market. In terms of electricity and heat generation, the Group's strategic ambition is to increase the electricity and heat sales volume from approximately 15 TWh in 2017 to around 18 TWh in 2022. This objective will be attained mainly through:

- upgrades to and development of the existing production facilities (new CCGT unit at the Żerań CHP plant);
- completed (in 2018) integration of acquired heating assets and an increase in electricity and heat production volumes at PGNiG TERMIKA EP following the launch of a new unit at the Zofiówka CHP plant in 2018;
- further acquisitions of local heating systems.

5.4.3. Segment's activities

PGNiG TERMIKA and Veolia Energia Warszawa S.A. sell and supply thermal capacity and heat to the Warsaw heating network under a Multi-Year Contract for the Sale of Heat from PGNiG TERMIKA S.A. Generating Facilities (MYC). The contract is effective until August 31th 2028, with an option to extend its validity for another 12 months unless both parties conclude a new contract to replace the MYC.

In the first half of 2019, PGNiG TERMIKA's key projects included:

- construction of a ca. 450 MW CCGT unit at the Żerań CHP plant,
- construction of a peak-load boiler house at the Żerań CHP plant,
- upgrade of the Pruszków CHP plant,
- construction of a multi-fuel unit at the Siekierki CHP plant.

As part of construction of a CCGT unit at the Żerań CHP plant, further unit components were installed, including the gas- and steam-turbine generator, primary heat exchanger, storage batteries, process water coolers, and a multi-tap transformer. Construction work and auxiliary work were also continued: upgrade of the cooling water system, discharge pipeline of cooling water from the unit, construction of a grid for the CCGT unit, adaptation and connection of the existing equipment of the Żerań CHP plant to the new switchgear of Polskie Sieci Elektroenergetyczne (PSE), upgrade of the water preparation station, and a system of gas pipelines connecting the GAZ-SYSTEM gas station with the unit. Work on sludge removal from the cooling water inlet channel to the Żerań CHP plant was also completed. The unit is planned to be placed in service in 2020.

As part of construction of the peak-load boiler house at the Żerań CHP plant, the boiler house structure and a communication pylon were erected in the first half of 2019. Finishing work on the roof and installation of external walls are in progress. All three boilers passed the pressure tests and were delivered and installed. Installation and connection of main equipment (pumps and fans) is under way. A contract was also signed with PGNiG TECHNOLOGIE for the construction of gas infrastructure for the new boiler house. The construction is planned to be completed in parallel with placing in service the peak-load boiler house (2020).

As part of the project to upgrade the Pruszków CHP plant, an alternative feasibility study to adapt the CHP plant for operation after 2022 was prepared. The study envisages, among others, preserving the existing boilers (the 29 MWt K-12 boiler and the 12.5 MWt K-13 boiler) and constructing a new gas engine house and two boiler houses (a coal-fired house and a peak load and reserve house with two oil-fired boilers). Plans also include alteration of the coal feeding system (plan to change fuel from pea coals to fine coal) and water boilers along with the construction of an environmental protection system. Completion of work on adapting the Pruszków CHP plant for 2022–2023. The project to construct a multi-fuel unit at the Siekierki CHP plant is in the process of obtaining an environmental permit. The multi-fuel unit is included in the Waste Management Plan for the Warsaw Province 2024, which was approved by the Provincial Parliament of the Warsaw Province on January 22nd 2019.

In the first half of 2019, PGNiG TERMIKA EP's key projects included:

- Growth projects: e.g. construction of heating networks and service lines in the area of PGNiG TERMIKA EP's operations. The purpose of the project is to increase contracted capacity, including to offset declines caused by thermal insulation improvements, and to increase sales of heat in the area of PGNiG TERMIKA EP's operations, as well as to reduce low-stack emissions and actively tackle the problem of air pollution (smog);
- Environmental projects: e.g. implementation of an investment programme to adapt flue gas treatment systems of generation units installed at PGNiG TERMIKA EP to the extent and level required by the BAT Conclusions for existing units;
- Modernisation projects: e.g. securing heat supplies to the part of Rybnik currently served by the Chwałowice CHP Plant in 2022 and beyond, upgrades and construction of networks in Jastrzębie-Zdrój, as well as upgrade of the WR 25 (K-2) boiler using the membrane wall technology at the Racibórz Branch.

In the first half of 2019, the special purpose vehicle ECSW carried out the construction of a ca. 450 MW CCGT unit at the Stalowa Wola CHP plant, in the following areas:

- Performance of an EPCM *(Engineering, Procurement, Construction Management)* contract by a consortium of Zakłady Pomiarowo – Badawcze Energetyki ENERGOPOMIAR sp. z o.o. and Biuro Studiów Projektów i Realizacji ENERGOPROJEKT – KATOWICE S.A.;
- Construction of, *inter alia*, a cooling water pipeline (performance of the contract is in progress), a back-up heat generator (design and construction work is under way).

On March 14th 2019, ECSW received a call for arbitration from Abener Energia S.A. › For more information, see Section 6.4.1.

5.4.4. Segment's prospects

In the second half of 2019, PGNiG TERMIKA will continue its key investment projects, including the construction of a CCGT unit and a peak-load boiler house at the Żerań CHP plant, upgrade of the Pruszków CHP plant designed to adapt it to operation after 2022, as well as modernisation of generation assets carried out to bring the plants into compliance with environmental requirements and as part of major overhauls.

In the coming quarters, PGNiG TERMIKA plans to pursue its strategy in the following areas:

- in the Warsaw market – maintaining the position of the leading heat producer; delivery of an investment plan to improve asset profitability and diversify the fuel portfolio (coal/gas/biomass/RDF) and adjust generation assets to the BAT Conclusions; providing regulatory support in the heat and cogeneration sector;
- nationwide – acquisitions of heating systems, development of generation activities outside Warsaw.

In the second half of 2019, PGNiG TERMIKA EP plans to commence further projects designed to adapt its generation plant to the BAT Conclusions. This will, in particular, involve expanding the flue gas treatment system at PGNiG TERMIKA EP Branches to achieve conformity with the extent and level of flue gas treatment required by the BAT Conclusions for existing units in order to continue generating and selling energy. In addition, PGNiG TERMIKA EP plans to further upgrade the Racibórz Branch boiler using the membrane wall and openwork grate technology, which will ultimately improve its efficiency from 79% to about 85%. The company also plans to continue projects co-financed with EU funds and already under way, such as construction and reconstruction of heating networks as part of effective heat distribution in the city of Jastrzębie-Zdrój, and construction of technical infrastructure supplying hot water for heating purposes to the town of Rybnik, starting from the 2022/23 heating season.

6. Additional information on the PGNiG Group

6.1. Structure of the PGNiG Group

As at June 30th 2019, the PGNiG Group comprised PGNiG (the Parent), 33 production, trade and service companies, and a mutual insurance company, including:

- 19 direct subsidiaries of PGNiG
- 14 indirect subsidiaries of PGNiG.

The table below presents the PGNiG Group companies as at June 30th 2019.

PGNiG Group companies as at June 30th 2019

No.	Company name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Subsidiaries – first tier				
1	PGNiG GAZOPROJEKT S.A.	4,000,000	3,485,500*	87.14%*	87.14%*
2	EXALO Drilling S.A.	981,500,000	981,500,000	100%	100%
3	GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	64,400,000	64,400,000	100%	100%
4	GEOFIZYKA Toruń S.A.	75,240,000	75,240,000	100%	100%
5	Geovita S.A.	113,407,782	113,407,782	100%	100%
6	Gas Storage Poland Sp. z o.o.	15,290,000	15,290,000	100%	100%
7	PGNiG Obrót Detaliczny Sp. z o.o.	625,307,815	625,307,815	100%	100%
8	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100%	100%
9	PGNiG Technologie S.A.	272,727,240	272,727,240	100%	100%
10	PGNiG TERMIKA S.A.	1,740,324,950	1,740,324,950	100%	100%
11	Polska Spółka Gazownictwa Sp. z o.o.	10,488,917,050	10,488,917,050	100%	100%
12	PGNiG Supply & Trading GmbH	10,000,000 EUR	10,000,000 EUR	100%	100%
13	PGNiG Upstream Norway AS	1,100,000,000 NOK	1,100,000,000 NOK	100%	100%
14	PGNiG Upstream North Africa B.V.	20,000 EUR	20,000 EUR	100%	100%
15	GAS-TRADING S.A.	2,975,000	1,291,350	43.41%	79.58%[2)]
16	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100%	100%
17	PGNiG SPV 6 Sp. z o.o.	51,381,000	51,381,000	100%	100%
18	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100%	100%
19	Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych	40,000,000	40,000,000	100%	100%
	Subsidiaries – second tier				
20	PGNiG TERMIKA Energetyka Przemysłowa S.A.	370,836,300	370,836,300	-	100%[9)]
21	GAZ Sp. z o.o.	300,000	300,000	-	100%[3)]
22	PSG Inwestycje Sp. z o.o.	81,131,000	81,131,000	-	100%[3)]
23	Oil Tech International F.Z.E.	20,000 USD	20,000 USD	-	100%[4)]
24	EXALO DRILLING UKRAINE LLC	20,000 EUR	20,000 EUR	-	100%[4)]
25	PST Europe Sales GmbH	1,000,000 EUR	1,000,000 EUR	-	100%[5)]
26	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	-	85.51%[6)]
27	CIFL Sp. z o.o. w likwidacji (in liquidation)	1,360,000	1,360,000	-	100%[7)]
28	Gas-Trading Podkarpacie Sp. z o.o.	6,670,627	5,257,523.51	-	78.82%[8)]
29	PGNiG Serwis Doradztwo Ubezpieczeniowe Sp. z o.o.	5,000	5,000	-	100%[1)]
30	PGNiG TERMIKA Energetyka Rozproszona Sp. z o.o.	13,550,000	13,550,000	-	100%[9)]
31	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	-	100%[4)]
	Subsidiaries – third tier				
32	XOOL GmbH	500,000 EUR	500,000 EUR	-	100%[10)]
33	SEJ-Serwis Sp. z o.o.	200,000	200,000	-	100%[11)]

1) PGNiG's interest held indirectly through PGNiG Serwis Sp. z o.o.
2) PGNiG's direct interest is 43.41%, with a 36.17% interest held indirectly through PGNiG SPV 6 Sp. z o.o.
3) PGNiG's interest held indirectly through Polska Spółka Gazownictwa Sp. z o.o.
4) PGNiG's interest held indirectly through EXALO Drilling S.A.
5) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH.
6) PGNiG's interest held indirectly through Gas Storage Poland Sp. z o.o.
7) PGNiG's indirect interest in the company is 100%: 99.98% is held through PGNiG SPV 6 Sp. z o.o. and 0.02% held through PGNiG SPV 5 Sp. z o.o.
8) PGNiG's interest held indirectly through GAS TRADING S.A.
9) PGNiG's interest held indirectly through PGNiG TERMIKA S.A.
10) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH and PST Europe Sales GmbH.
11) PGNiG's interest held indirectly through PGNiG TERMIKA S.A. and PGNiG TERMIKA Energetyka Przemysłowa S.A. (100%)
** As at August 12th 2019*

Changes in the Group structure in the six months to June 2019:

- On August 9th 2018, the Extraordinary General Meeting of PGNiG OD resolved to increase the company's share capital from PLN 600,050,000 to PLN 625,307,815, i.e. by PLN 25,257,815, through the creation of 459,233 new, equal and indivisible shares with a par value of PLN 55 per share. The new shares were acquired by PGNiG in exchange for a contribution in kind (CNG assets) with a total net value of PLN 25,257,842. The positive difference of PLN 27 between the contribution in kind and the par value of the acquired shares is to be transferred to PGNiG OD's share premium. The declaration of acquisition of the shares was submitted on the same day, i.e. August 9th 2018. The share capital increase was entered in the National Court Register on January 7th 2019.
- On December 21st 2018, the Extraordinary General Meeting of Geovita resolved to increase the company's share capital from PLN 102,176,575 to PLN 113,407,782, i.e. by PLN 11,231,207. The share capital was increased through the issue of 11,231,207 Series C ordinary (non-preference) registered shares with a par value of PLN 1 per share. The share capital

increase was covered by a contribution in kind in the form of assets of the Perła Bieszczadów hotel and resort complex. The declaration of acquisition of the 11,231,207 new Series C shares in the increased share capital was made on December 21st 2018. The share capital increase was entered in the National Court Register on March 22nd 2019.

- On April 4th 2019, the liquidation of PGNiG Finance AB i likvidation was closed.
- In June 2019 (pursuant to the PGNiG Management Board's decision of June 10th 2019), the process of acquisition of shares in PGNiG Gazoprojekt S.A. from its minority shareholders was launched in order to enable PGNiG to acquire full control of PGNiG Gazoprojekt S.A. The process was initiated by submitting an offer to the minority shareholders, which was published on the websites of PGNiG and PGNiG Gazoprojekt S.A., as well as at PGNiG Gazoprojekt S.A.'s registered office. As at August 12th 2019, 4,855 PGNiG Gazoprojekt shares were acquired, with a total par value of PLN 485,500.
- On November 19th 2018, the Extraordinary General Meeting of Polski Gaz TUW resolved to increase the company's share capital by a total of PLN 20m, to PLN 40m, by way of an issue of one million new shares with a par value of PLN 20 per share. The share capital increase was entered in the National Court Register on April 2nd 2019.
- On December 21st 2018, the General Meeting of CIFL sp. z o.o. passed a resolution to dissolve the company. The resolution took effect on January 1st 2019.

6.2. Other ownership interests and organisational links

The table below presents the PGNiG Group's associated companies as at June 30th 2019.

PGNiG Group's associated companies as at June 30th 2019

No.	Company name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Jointly-controlled and associated entities - first tier				
1	Sahara Petroleum Technology Llc w likwidacji) (in liquidation)	OMR 150,000	OMR 73,500	49.00%	49.00%
2	SGT EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	51.18%[1)]
3	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
4	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
5	Dewon ZSA	11,146,800.00 UAH	4,055,205.84 UAH	36.38%	36.38%
	Jointly-controlled and associated entities - second tier				
6	Zakład Separacji Popiołów Siekierki Sp. z o.o.	10,000,000.00	7,000,000.00	-	70%[2)]
7	Elektrociepłownia Stalowa Wola S.A.	28,200,000.00	14,100,000.00	-	50%[2)]
8	Polska Grupa Górnicza S.A.	3,916,718,200.00	800,000,000.00	-	20.43%[2)]
9	Polimex-Mostostal S.A.	473,237,604.00	78,000,048.00	-	16.48%[3)]
	Jointly-controlled and associated entities – third and fourth tier				
10	Śląskie Centrum Usług Wspólnych Sp. z o.o.	10,835,000.00	2,213,590.50	-	20.43%[4)]
11	Górnośląska Spółka Brokerska Sp. z o.o.	55,000.00	11,236.50	-	20.43%[4)]

1) PGNiG's direct interest is 48.00%, with a 3.18% interest held indirectly through GAS-TRADING S.A.
2) PGNiG's interest held indirectly through PGNiG TERMIKA S.A.
3) PGNiG's interest held indirectly through PGNiG Technologie S.A.
4) On April 1st 2017, Polska Grupa Górnicza S.A. acquired Śląskie Centrum Usług Wspólnych Sp. z o.o. (as part of the acquisition of selected mining assets from Katowicki Holding Węglowy S.A.); on October 26th 2018, Śląskie Centrum Usług Wspólna Sp. z o.o. acquired Górnośląska Spółka Brokerska Sp. z o.o. (from GSU S.A.).

Changes in other ownership interests within the PGNiG Group in the six months to June 2019:

- On May 13th 2019, a change in the share capital of Huta Stalowa Wola S.A. was registered in the National Court Register. The share capital was reduced from PLN 261,728,667 to PLN 261,454,801, i.e. by PLN 273,866. The value of PGNiG's equity interest remained unchanged.

6.3. Governing bodies

6.3.1. PGNiG Management Board

Composition of the PGNiG Management Board in the first half of 2019 was as follows:

- Piotr Woźniak − President of the Management Board
- Radosław Bartosik – Vice President, Chief Operating Officer (January 1st−January 16th 2019)
- Robert Perkowski – Vice President, Chief Operating Officer (March 18th−June 30th 2019)
- Łukasz Kroplewski – Vice President, Development
- Michał Pietrzyk – Vice President, Finance
- Maciej Woźniak – Vice President, Trade
- Magdalena Zegarska – Vice President

On January 16th 2019, the PGNiG Supervisory Board passed a resolution to remove Radosław Bartosik from the position of Vice President of the PGNiG Management Board, Chief Operating Officer. On March 18th 2019, the PGNiG Supervisory Board appointed Robert Perkowski to the position.

On June 27th 2019, the PGNiG Annual General Meeting resolved to grant discharge to all members of the PGNiG Management Board who served on the Board in the financial year 2018.

6.3.2. PGNiG Supervisory Board

In the first half of 2019, the composition of the PGNiG Supervisory Board was as follows:

- Bartłomiej Nowak – Chairman of the Supervisory Board
- Piotr Sprzączak – Deputy Chairman of the Supervisory Board
- Sławomir Borowiec – Secretary of the Supervisory Board
- Piotr Broda – Member of the Supervisory Board
- Andrzej Gonet – Member of the Supervisory Board
- Mieczysław Kawecki – Member of the Supervisory Board
- Stanisław Sieradzki – Member of the Supervisory Board
- Grzegorz Tchorek– Member of the Supervisory Board

On June 27th 2019, the PGNiG Annual General Meeting resolved to grant discharge to all members of the PGNiG Supervisory Board who served on the Supervisory Board in the financial year 2018.

6.4. Court proceedings

6.4.1. Pending court proceedings

A detailed description of pending court proceedings, including the proceedings with respect to the obligation of public sale of natural gas (no material events occurred with respect to these proceedings in the first half of 2019) is presented in Section 6.3.1 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2018. › www.pgnig.pl In the first half of 2019, the following changes occurred:

Legal action concerning claims of PBG S.A. (PBG)

On April 1st 2019, PBG submitted a counterclaim against PGNiG with the Regional Court in Warsaw, 20th Commercial Division. In the counterclaim, PBG is pursuing against PGNiG a claim arising out of

- the Contract concluded with PGNIG S.A. on November 19th 2008 to execute the investment project "Construction of the Wierzchowice Underground Gas Storage Facility, phase 3.5bn nm^3, sub-phase 1.2bn nm^3. PBG claims the payment by PGNiG of the remaining remuneration due to the Consortium (PBG, Tecnimont S.P.A., TCM FR S.A., Plynostav Pardubice Holding a.s., Plynostav-Regulace Plynu a.s.) under the Contract;
- The contract signed with PGNiG on August 11th 2008 to implement the 'LMG Project – Central Facility, Well Areas, Pipelines and Other Infrastructure'. PBG demands that PGNiG return PBG the security deposit securing warranty claims, which was offset under the contract against PGNiG's disputed receivables from the consortium, related to the contract.

The claims total PLN 118.1m, together with default interest accrued from the claim filing date to the payment date. After a review of the counterclaim and having analysed the facts, PGNiG decided to contest the claim and filed its response. To date, PGNiG has not identified any reasons for recognising a provision for the cost of the claim.

Call for arbitration submitted by Abener Energia S.A. (Abener Energia)

On March 14th 2019, ECSW received a call for arbitration submitted by Abener Energia with the Arbitration Court at the Polish Chamber of Commerce. The call concerns the amounts of PLN 147,241,239.98 and EUR 536,839.02 which, in Abener Energia's opinion, represent compensation payable to it for having groundlessly demanded and obtained, at Abener Energia's expense, payment from the insurance guarantee provided as a performance bond or, alternatively, the return of unjust enrichment obtained by ECSW. In March 2019, ECSW prepared the defendant's response to the call for arbitration.

On April 25th 2019, a ruling was issued in the case, whereby ECSW was obliged to pay Abener Energia PLN 333,793,359.31 plus statutory default interest. Such a ruling is legally equivalent to a court ruling or settlement made before the court only after it has been recognised by the court or after the court has determined its enforceability. On May 9th 2019, ECSW lodged a complaint against the ruling of the Arbitration Court at the Polish Chamber of Commerce dated April 25th 2019, and on May 14th 2019 ECSW submitted a request to exclude the arbitrators. Subsequently, on June 24th 2019 ECSW submitted with the Rzeszów Court of Appeals a complaint requesting that the Arbitration Court's ruling be reversed and its execution be suspended. On August 5th 2019, the Court of Appeals in Rzeszów issued a decision to postpone the examination of Abener Energia's application for a statement of enforceability of the award of the Court of Arbitration at the Polish Chamber of Commerce in Warsaw until ECSW's appeal for revocation of the award is examined. As a result of this decision, ECSW's liability to pay Abener Energia PLN 333,793,359.31m plus statutory default interest and costs of arbitration proceedings is postponed until the case for vacation of the arbitration court's award is examined.

6.4.2. Proceedings before the President of the Office of Competition and Consumer Protection (UOKiK)

In the first half of 2019, there were no material events relating to the antitrust proceedings initiated on December 28th 2010 and April 3rd 2010. A detailed description of the proceedings pending before the President of UOKiK is presented in Section 6.3.2 of the Directors' Report on the operations of PGNiG and the PGNiG Group in 2018.› www.pgnig.pl

In the first half of 2019, the following changes occurred in relation to the facts presented in Section 6.3.2:

Anti-trust proceedings initiated on March 11th 2019

On March 11th 2019, the President of UOKiK issued a notification to the effect that antitrust proceedings had been opened in a case of a suspected breach of the prohibitions laid down in Art. 6.1.1, 6.1.3 and 6.1.7 of the Act on Competition and Consumer Protection and Art. 101(1)(a) and (c) of the Treaty on the Functioning of the European Union regarding fixing heat prices, sharing the heat market and fixing bids in procurement procedures for the sale and delivery of heat, as a result of an agreement that was allegedly made in 2014, with Veolia Energia Warszawa S.A., Veolia Energia Polska S.A., PGNiG TERMIKA and PGNiG as the parties to the proceedings.

6.4.3. Renegotiation of price terms under the contract with OOO Gazprom Export

In 2018, PGNiG continued its efforts to revise the price terms under the Yamal contract as part of the procedure formally launched on November 1st 2014. Since no agreement was reached with the supplier within the time limit provided for in the contract, on May 13th 2015 PGNiG instigated arbitration proceedings, in accordance with the contract. The subject matter of the dispute is a revision of the price terms under the contract for gas supply to Poland. In the course of the arbitration proceedings, on February 1st 2016 PGNiG filed with the Arbitration Institute a claim against PAO Gazprom and OOO Gazprom Export. The arbitration proceedings are expected to end in the second half of 2019. The fact that the dispute was referred to arbitration does not preclude commercial negotiations and an amicable settlement with the supplier. Additionally, on November 1st 2017 PGNiG, PAO Gazprom and OOO Gazprom Export entered into another round of negotiations on the gas prices. On June 30th 2018, the Arbitration Institute of the Stockholm Chamber of Commerce ruled in a partial award that the contractual condition for the Company to demand a change in the price of gas supplied to Poland under the Yamal contract had been met.

6.4.4. Proceedings concerning the OPAL pipeline

Proceedings concerning the OPAL pipeline are pending before:

- The Court of Justice of the European Union – two appeals against the decision of the General Court of the European Union concerning inadmissibility of PST's complaint (PST submitted an appeal on February 13th 2018 and the Republic of Poland did so on March 5th 2018), and one appeal against the decision of the General Court of the European Union concerning inadmissibility of PGNiG's complaint, submitted on May 24th 2018;
- The Higher Regional Court in Düsseldorf (Oberlandesgericht Düsseldorf) where PGNiG and PST lodged complaints and requests for injunctive reliefs on December 15th 2016, subsequently extended on January 20th 2017.

The complaint and the request for injunctive relief filed with the General Court of the European Union are against the European Commission's decision of October 28th 2016 whereby the Commission allowed a revision to the exemption of the OPAL pipeline from the common gas market regulations (especially with respect to the Third Party Access (TPA) rule), in accordance with the text of the administrative decision issued by the German regulator – Federal Network Agency (Bundesnetzagentur), subject to modifications referred to in the Commission's decision. The complaint and the application for injunctive relief were submitted by PST. On December 23rd 2016, the President of the General Court of the European Union stayed execution of the challenged decision of the European Commission, temporarily granting PST's request for injunctive relief. The parties exchanged pleadings. No further decisions were issued on the case. On March 13th 2017, PST supplemented its complaint and request for injunctive relief due to the fact the European Commission's decision was not published until January 3rd 2017, while the complaint and the request were dated December 4th 2016. On May 29th 2017, PST filed its position on the plea of inadmissibility of the complaint raised by the European Commission.

A complaint against the Commission's decision together with a request for injunctive relief were also filed by PGNiG on March 1st 2017. On August 21st 2017, PGNiG replied to the plea of inadmissibility raised by the European Commission. On July 6th 2017, an application was filed to admit PGNiG as an intervener supporting the Ukrainian company Naftogaz in the case against the decision of the European Commission. On March 9th 2018, the General Court of the European Union issued a decision to declare inadmissibility of the complaint lodged by Naftogaz. On July 5th 2017, the President of the General Court of the European Union held hearings regarding the injunctive relief in the cases instigated by PST and PGNiG. On July 21st 2017, the President of the General Court of the European Union decided to revoke the injunctive relief in the PST case and dismiss the request for an injunctive relief in both cases.

On December 14th 2017 and March 15th 2018, the General Court of the European Union rejected complaints lodged by PST and PGNiG, respectively, on the grounds of inadmissibility and awarded the costs of the proceedings against the complaining parties. These were formal decisions, which were not based on examination of the validity of claims made in the complaint against the European Commission's decision. Two appeals were submitted to the Court of Justice of the European Union against the decision of December 14th 2017 concerning PST's complaint. Appeals were lodged by PST on February 13th 2018 and by the Republic of Poland on March 5th 2018. As regards PGNiG, an appeal was lodged on May 24th 2018.

The complaint and the request for an injunctive relief filed with the Higher Regional Court of Düsseldorf (Oberlandesgericht Düsseldorf) are primarily against the administrative settlement between the German regulator, OPAL Gastransport GmbH & Co. KG, OAO Gazprom and OOO Gazprom Export, specifying the revised conditions for exemption of the OPAL pipeline from the common gas market regulations (especially with respect to the Third Party Access (TPA) rule). On December 30th 2016, the Higher Regional Court of Düsseldorf issued an injunction whereby it obliged the German regulator to suspend the effects of the disputed administrative settlement by prohibiting OPAL Gastransport GmbH & Co. KG from holding any further daily, weekly, monthly and annual capacity auctions for the OPAL pipeline. Following the Court's ruling, on the same day the German regulator issued an immediately enforceable decision whereby it prohibited OPAL Gastransport GmbH & Co. KG from conducting such auctions.

On January 20th 2017, PGNiG and PST extended the earlier complaint by lodging a complaint against a decision of the German regulator – Federal Network Agency (Bundesnetzagentur), dated December 20th 2016, whereunder the regulator refused to instigate formal administrative proceedings concerning revised conditions for the pipeline's exemption from the common gas market regulations (especially with respect to the Third Party Access (TPA) rule) and allow the applicants, i.e. PGNiG and PST, to join the proceedings. The companies also extended the list of arguments contained in their earlier pleading. On March 31st 2017, a statement of reasons for the complaint against the administrative settlement was filed with the Higher Regional Court, containing an in-depth legal argument as a condition to pursuing any further legal remedies.

As no further rulings were issued on the case, the Court's decision of December 30th 2016 remains in force. After an exchange of pleadings, the Higher Regional Court in Düsseldorf, by a decision of July 27th 2017, overturned its decision of December 30th 2017, thus cancelling the previously granted injunctive relief. After a further exchange of pleadings, the Court dismissed the application for an injunctive relief during a hearing on October 11th 2017. A decision to dismiss the application, accompanied by a statement of reasons, was delivered on October 23rd 2017. On June 4th 2018, the companies filed their pleadings.

On January 9th 2019, the German Federal Network Agency (Bundesnetzagentur) resumed proceedings concerning a decision issued in 2009 on the terms of the regulatory exemption of the Opal gas pipeline, and at the same time it suspended the proceedings. On January 28th 2019, PGNiG and PST filed a request to join in the proceedings. In its reply of February 25th 2019, the German regulatory authority stated that the request would be examined after the pending court proceedings had been closed.

6.4.5. Other proceedings

Shareholder's action to void/revoke the General Meeting's resolution

In the first half of 2019, proceedings were pending for voiding/revoking the following resolutions:

- Resolution No. 1/IX/2017 of the Extraordinary General Meeting of PGNiG of September 13th 2017 – on June 26th 2019, the court of first instance issued a judgment dismissing the claim in its entirety;
- Resolution No. 7/VI/2016 of the Annual General Meeting of PGNiG of June 28th 2016 – by the end of the first half of 2019, the court of first instance did not issue any judgment in the case.

Neither PGNiG nor its subsidiaries were engaged in any other material proceedings before a court, arbitration court or administrative authority concerning liabilities or claims.

7. Shareholding structure. PGNiG at WSE

7.1. Shareholding structure

As at June 30th 2019, the share capital of PGNiG was approximately PLN 5.78bn, and comprised 5,778,314,857 shares with a par value of PLN 1 per share. Series A shares were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The State Treasury remains PGNiG's majority shareholder.

On June 26th 2008, the disposal by the Minister of State Treasury of one PGNiG share in accordance with general trading rules triggered the eligible employees' rights to acquire a total of up to 750,000,000 PGNiG shares free of charge. First share transfer agreements were executed on April 6th 2009 and the eligible employees' rights to acquire PGNiG shares free of charge expired on October 1st 2010. As at June 30th 2019, nearly 60 thousand eligible employees acquired 728,294 thousand shares. The Company shares acquired by eligible employees free of charge were subject to a lock-up until July 1st 2010, while trading in shares acquired free of charge by members of the Company's Management Board was restricted until July 1st 2011.

Shareholding structure as at June 30th 2019

Shareholders	Number of shares/voting rights attached to the shares as at Jun 30 2019	Percentage of share capital/total voting rights at the GM as at Jun 30 2019
State Treasury	4,153,706,157	71.88%
Other shareholders	1,624,608,700	28.12%
TOTAL	5,778,314,857	100.00%

PGNiG shares and shares in PGNiG's related entities held by management and supervisory personnel

Full name	Position	Number of shares as at Dec 31 2018	Par value of shares as at Dec 31 2018 (PLN)	Number of shares as at Jun 30 2019	Par value of shares as at Jun 30 2019 (PLN)
Mieczysław Kawecki	Member of the Supervisory Board	9,500	9,500	9,500	9,500
Stanisław Sieradzki	Member of the Supervisory Board	17,225	17,225	17,225	17,225

7.2. Dividend

The PGNiG Group's Strategy for 2017–2022 in effect as at the date of this Report provides for distribution of up to 50% of consolidated net profit as dividend, with the proviso that in recommending dividend payments the PGNiG Management Board must always take into account the PGNiG Group's current financial condition and investment plans. PGNiG recognises net profit of its subsidiaries in the consolidated accounts net of any dividends paid by the subsidiaries, which may result in such dividend payment being postponed by one year.

On May 20th 2019, On May 28th 2018, the PGNiG Management Board resolved to recommend that the Annual General Meeting of PGNiG allocate PLN 1,040,096,674.26 from the 2018 net profit to dividend payment (PLN 0.18 per share). The Annual General Meeting of PGNiG held on June 27th 2019 finally resolved to allocate PGNiG's net profit for 2018 of PLN 3,289,305,045.15 as follows:

- PLN 1,040,096,674.26 to dividend payment,
- PLN 1,000,000,000.00 to capital reserves to finance the extension and upgrade of the national gas distribution network; and
- PLN 1,249,208,370.89 to the PGNiG statutory reserve funds.

Following payment on December 3rd 2018 of interim dividend for 2018 of PLN 404,482,039.99, i.e. PLN 0.07 per share, the balance of the dividend for 2018, amounting to PLN 635,614,634.27, i.e. PLN 0.11 per share, was paid on August 7th 2019.

Dividend from 2013–2018 net profit

	2018	2017	2016	2015	2014	2013
Dividend for financial year (PLNbn)	1.04	-	1.16	1.06	1.18	0.89
Dividend per share (PLN)	0.18	-	0.20	0.18	0.20	0.15
Average annualised share price (PLN)	6.12	-	5.16	5.94	4.85	5.83
Dividend yield	2.94%	-	3.88%	3.03%	4.12%	2.57%

8. Representation by the PGNiG Management Board

The Management Board of PGNiG represents that to the best of its knowledge this Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in the first half of 2019 gives a true view of the Company's and the Group's growth, achievements and condition, and includes a description of key threats and risks.

PGNiG Management Board:

President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Robert Perkowski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

This document is an English version of the original Polish version.
In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

Warsaw, August 20th 2019