



ENERGA SA
Management Board
report on the activity
of ENERGA SA
for the year ended 31
December
2016

Gdańsk,

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Key information about the Company



1. KEY INFORMATION ON THE COMPANY AND THE ENERGA GROUP

1.1. Role of the Company in the Group

ENERGA SA (Company, ENERGA) is a parent company of the ENERGA Group (Group, ENERGA Group). It was established on 6 December 2006 as part of the Power Sector Program by the State Treasury, Koncern Energetyczny ENERGA SA (currently: ENERGA-Operator SA) and Zespół Elektrowni Ostrołęka SA (currently: ENERGA Elektrownie Ostrołęka SA). The company was registered in the National Court Register (KRS) on 8 January 2007 under file number 0000271591. Since 2013, the principal document of the ENERGA Group defining general principles of its governance has been the ENERGA Group's Corporate Governance.

1.2. Activities of the ENERGA Group

The core business of the ENERGA Group entails distribution, generation and sales of electricity and heat and concentrates on the following key operating segments:

The **Distribution Segment** – operating segment of key importance for the Group's operating profitability, involving distribution of electricity which in Poland is a regulated activity conducted on the basis of tariffs approved by the President of the Energy Regulatory Office (ERO). The ENERGA Group has a natural monopoly position in the northern and central part of Poland, where its distribution assets are located, through which it supplies electricity to 3 million customers, approx. 2.8 million of which are customers with comprehensive agreements and 205 thousand are TPA customers. A breakdown of ENERGA-OPERATOR SA's customer by energy group is presented in the *Key operational data* section. As at 31 December 2016, the total length of the power lines was over 184 thousand km and covered almost 75 thousand km², i.e. about 24% of the country's landmass. ENERGA-OPERATOR SA acts as the leader of this Segment.

Generation Segment operates on the basis of four business lines: the Ostrołęka Power Plant, Hydro, Wind and Other (including cogeneration – CHP). At the end of 2016, the total installed generation capacity in the Group's power plants was approximately 1.3 GW. In 2016 the Group's gross electricity production was 3.9 TWh, of which 1.2 TWh was energy produced from renewable sources. The ENERGA Group owes its leading position in terms of the percentage of electricity from renewable energy sources in the total energy generated, primarily to the generation of energy in hydro power plants and wind power plants. Green energy is produced in 46 hydro power plants, 5 wind farms and in biomass-fired installations (mainly in ENERGA Kogeneracja) and in photovoltaic installations. The leader in this segment is ENERGA Wytwarzanie SA.

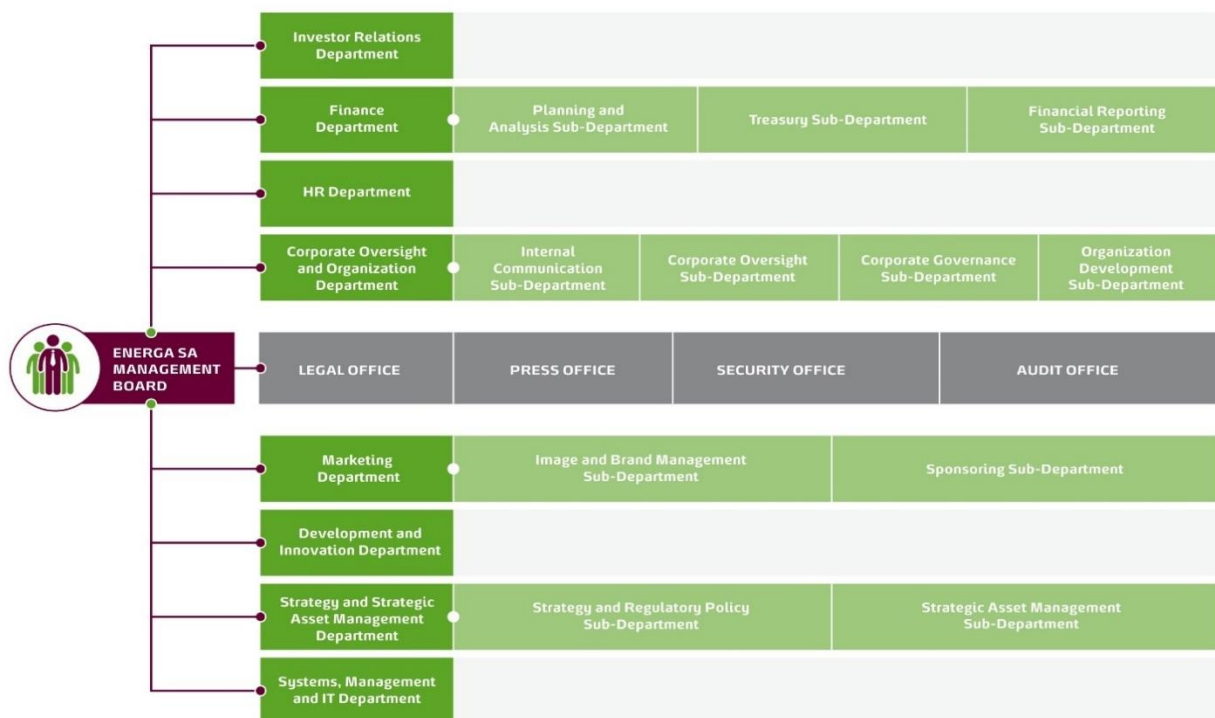
Sales Segment, with ENERGA-OBRÓT SA as its leader, conducts sale of electricity, gas and additional services both as separate products and in packages to all customer segments – from industry, through big, medium-sized and small business, to households. At the end of 2016, the ENERGA Group supplied 3 million customers, out of which over 2.7 million were G tariff customers and the remainder were customers from tariff groups: C, B and A, in a decreasing order.

1.3. Key changes to the Group's and ENERGA SA's management rules

In managing the Group, it is ENERGA SA that determines the Segments and defines their objectives. The leader manages the Segment, defines the objectives of the Segment Companies and evaluates their attainment, is responsible for the Segment's performance and the Segment's capability to generate dividends. The leader is obligated to cooperate with other Segments and ENERGA SA in the areas in which the Group may reduce costs and improve efficiency.

In 2016 the Company's structure was subject to dynamic changes. The current ENERGA SA Organizational Bylaws together with the organizational structure was approved in December 2016. The chart below shows the structure of ENERGA SA up to the level of organizational units directly reporting to Management Board members, as at 31 December 2016.

Figure 1: ENERGA's organizational structure chart as at 31 December 2016



The key organizational changes relative to 2015 are as follows:

- eliminating the function of Managing Director – the powers to issue decrees were handed over to the Corporate Oversight and Organization Department Director,
- direct reporting of organizational units to Management Board Members in accordance with the functional division,
- increasing the powers through establishing separate Departments in the following areas: Legal, IT, R&D and HR.

The standing advisory bodies supporting the ENERGA SA Management Board in making strategic decisions, have not changed relative to 2015. These include: the Group Council for Counteracting Mobbing and Discrimination, Risk Committee, Ethics Council, Financial Risk Management Committee, IT Coordination Council, Program Council, and Security and Critical Infrastructure Council.

1.4. Key events and achievements of ENERGA

Adoption of the ENERGA Group's Strategy for 2016-2025

On 15 November 2016 the ENERGA SA Supervisory Board adopted a resolution accepting the “Strategy of the ENERGA Group for 2016-2025” (“Strategy”) and “Long-Term Plan of Strategic Investments of the ENERGA Group for 2016–2025”. In accordance with the adopted documents, the Group's objective is to increase EBITDA to PLN 2.4 bn in 2020 and PLN 3.0 bn in 2025, with stable market conditions. Total expenditures on core and non-core investments of the Group planned for 2016-2025 as part of the implementation the Strategy are approx. PLN 20.6 bn, of which PLN 9.5 bn is expected to be spent in 2016-2020. The assumptions and objectives of the strategy are described in more detail in chapter 1.5. *ENERGA Group's Strategy for 2016-2025* [...] this Report.

Signing of an Investment Agreement with Enea S.A. regarding execution of the Ostrołęka C Project

On 24 May 2016, ENERGA SA's Management Board adopted a resolution repealing the resolution halting the execution of the project to build a new power unit in Ostrołęka, adopted on 14 September 2012 (Current Report No. 19/2016). On 8 December 2016 the Company entered into an Investment Agreement with Enea S.A. and Elektrownia Ostrołęka SA regarding the execution of the Ostrołęka C project, i.e. preparation, construction and operation of a 1,000 MW class coal-fired power unit. The execution of the Agreement was preceded by entering into a letter of intent on 19 September 2016 (Current Report No. 33/2016). According to the Agreement, in principle the cooperation will be structured around three stages: Development Stage – until an instruction is issued to the general contractor to commence the work; Construction Stage – until Ostrołęka C is commissioned for commercial operations; and Operation Stage – commercial operation of Ostrołęka C. Upon completion of the Development Stage the Parties are obligated to participate in the Construction Stage provided that the Project is profitable and the Project funding does not breach the Parties' covenants. It is estimated that ENERGA's capital expenditures until the completion of the Development Stage will be approx. PLN 27 m. For the execution of the Investment Project, ENERGA SA disposed of the shares in Elektrownia Ostrołęka SA, constituting 50% in the share capital, to Enea S.A. after obtaining the approval by the President of UOKiK for a concentration involving the acquisition of a stake in the special purpose vehicle for the execution of the Project. Based on specific assumptions (including appropriate participation of ENERGA, Enea and Financial Investors, if any) and assuming that the Capacity Market or other support mechanisms are introduced, Elektrownia Ostrołęka SA will be able to undertake the comprehensive execution of the Project (Current Report No. 49/2016). On 14 October 2016, the impairment loss on the fixed assets under construction in the amount of PLN 110 m in Elektrownia Ostrołęka SA was reversed. The above amount improved the ENERGA Group's operating result for Q3 in the Generation Segment and according to the prevailing definition did not affect its EBITDA. The PLN 122.6 m impairment loss was recognized in 2012 when the Ostrołęka C power plant was put on hold. The reason for reversing the impairment was the progress of work under the Ostrołęka C project (Current Report No. 37/2016). In December 2016 Elektrownia Ostrołęka SA entered into an agreement on coal supply to the planned power plant in Ostrołęka, and ENERGA Elektrownie Ostrołęka SA signed an agreement on raw material supplies to the existing Ostrołęka B power plant (these agreements were described in more detail in chapter 2.7. “Information on material agreements and transactions” of this Report). On 19 December 2016 a tender was announced to select a general contractor for the power generation unit in order to complete the Investment Project in the second half of 2023.

Capital investment in Polimex Mostostal S.A.

On 6 December 2016, directional talks were started between the Company and ENEA S.A., PGE S.A., PGNiG S.A. (Investors) and between the Investors and Polimex-Mostostal S.A. (Polimex). The negotiations were aimed at developing the structure of the Investors' potential capital investment in

Polimex and at developing a potential model of cooperation between the Investors in executing the Investment Project (Current Report No. 48/2016).

As the next step, on 27 December 2016 the Company signed a letter of intent with the Investors and Polimex in which the Investors expressed their intent to consider the potential investment in Polimex and based on which they launched talks with Polimex to work out the detailed parameters of the transaction. On the same date, the Company and the Investors also filed a petition with the Office for Competition and Consumer Protection (UOKiK) to approve the concentration involving acquisition of joint control over Polimex by the Investors (Current Report No. 54/2016).

On 18 January 2017 the Company signed the following agreements:

1. The Investment Agreement with the Investors and Polimex-Mostostal S.A. under which, subject to the conditions precedent specified in the agreement (described in detail in Current Report No. 5/2017), the Investors undertook to make an investment in Polimex, i.e. subscribe to a total up to 150,000,000 series T common bearer shares with a par value of PLN 2 each, for the issue price of PLN 2 each issued by Polimex as part of the Polimex's share capital increase up to PLN 300,000,000. Pursuant to the Investment Agreement, the Company undertook to subscribe to 37,500,000 New Issue Shares for the total issue price of PLN 75,000,000.
2. Agreement between the Investors setting out the rules of cooperation and the mutual rights and duties of the Investors during the execution of the investment project contemplated in the Investment Agreement.
3. Agreement between the Investors and SPV Operator obligating the parties to the agreement, on the condition that the conditions precedent are satisfied, to conduct the transaction of selling a total of 6,000,001 Polimex shares by SPV Operator to the Investors, in which the Company undertook to purchase 1,500,000 Polimex shares;
4. Agreement between the Investors and TFS, under which TFS granted the Investors, against remuneration, an option to purchase Polimex shares from TFS if the TFS exercises its right to convert the convertible bonds issued by Polimex and undertook before the Investors not to convert its series A convertible bonds issued by Polimex without a prior written demand from the Investors.

On 18 January 2017, having examined the application the President of UOKiK issued his approval for the concentration involving acquisition of joint control over Polimex by the Investors.

On 20 January 2017, after the fulfillment of the conditions precedent set forth in the investment agreement signed on 18 January 2017, the Company accepted an offer made by the Polimex Mostostal S.A. management board to subscribe to 37,500,000 series T common bearer shares with a par value of PLN 2 each issued by Polimex at the issue price of PLN 2 each and for the total issue price of PLN 75,000,000 in private subscription. On the same day the Company purchased 1,500,000 shares of Polimex from SPV Operator (Current Report No. 6/2017).

Submission, together with partners, of a tentative proposal for the acquisition of EDF's assets in Poland and execution of a memorandum of understanding

On 16 September 2016, ENERGA SA along with Enea S.A., PGE S.A. and PGNiG Termika S.A. ("Business Partners") submitted a joint, tentative, non-binding offer to EDF International S.A.S. ("EDF") to purchase shares in EDF companies in Poland holding conventional generating assets and carrying out service activity (Current Report No. 31/2016).

On 26 October 2016, EDF announced in a press release that it conducts exclusive negotiations with IFM Investors in respect to the sale of heating assets in Poland and with EPH (Energetický a průmyslový holding) in respect to the sale of the Rybnik Power Plant. On 30 November 2016, in connection with the imminent expiry date of the offer submitted on 16 September 2016, ENERGA SA together with its partners submitted a new offer to EDF to purchase shares in EDF companies in Poland.

On 27 January 2017 the Company, together with its Business Partners, signed a Memorandum of Understanding with EDF concerning the negotiation of the acquisition of EDF's assets in Poland and due diligence in this respect.

The transaction involves:

(i) acquisition of all EDF's shares in EDF Polska S.A., which is the owner of, in particular, 4 CHP plants, i.e. Kraków, Gdańsk, Gdynia and Toruń and the heat distribution network in Toruń, Rybnik Power Plant and

(ii) acquisition of acquisition of all the shares held by EDF in ZEC "Kogeneracja" S.A., which owns 4 combined heat and power plants, i.e. in Wrocław, Zielona Góra, Czechnica and Zawidawie and heat distribution networks in Zielona Góra, Siechnice and Zawidawie.

The Business Partners have agreed that a binding proposal, if any, will be submitted following a due diligence exercise, which will form grounds for making further decisions about the transaction (Current Report No. 8/2017).

Payment of a dividend from the profit generated in 2015

On 24 June 2016, the Annual General Meeting of ENERGA SA adopted a resolution on the distribution of net profit for the financial year covering the period from 1 January 2015 to 31 December 2015 in the amount of PLN 841,165,914.38, with the following allocation:

- 1) payment of a dividend to shareholders in the amount of PLN 202,892,885.86, i.e. PLN 0.49 per share (24.1% of profit),
- 2) PLN 570,979,755.36 to reserve capital (67.9% of profit),
- 3) PLN 67,293,273.16 to supplementary capital (8.0% of profit).

The record date was set by a resolution at 4 July 2016 and the dividend payment date at 18 July 2016 (Current Report Nos. 18/2016, 20/2016 and 25/2016).

Purchase of bonds issued by ENERGA SA by its subsidiary ENERGA-OPERATOR SA

On 16 June 2016, in connection with completion of the negotiation process conducted by ENERGA SA's subsidiary ENERGA-OPERATOR SA (Subsidiary) and selected Bondholders with regard to the terms and conditions of purchase, by the Subsidiary, of series A bonds issued by ENERGA SA, on the same day a transaction was executed under which the Subsidiary acquired 55,795 series A bonds issued by ENERGA with the total par value of PLN 557.95 m.

The Bonds were purchased by ENERGA-OPERATOR SA at the price of PLN 102.85 on the basis of resolutions adopted by the ENERGA SA's and the Subsidiary's Management Board and Supervisory Board. The purchase of the Bonds was financed with cash and funds from available credit facilities.

The purchase of the bonds was associated with optimization of the financing structure and cash management in the ENERGA Group. The above actions have been taken in the context of the dynamic changes in the financial and legal environment of the ENERGA Group (Current Report No. 23/2016).

Capital investment in Polska Grupa Górnicza Sp. z o.o.

On 15 March 2016, the Company submitted a non-binding conditional proposal of its capital contribution to the investment in Polska Grupa Górnicza Sp. z o.o. in the amount of up to PLN 600 m. The submitted proposal was an expression of will for the Company to enter into good faith negotiations concerning the investment and to strive to complete the investment process smoothly giving consideration to the conditions presented in the proposal.

On 26 April 2016 ENERGA Kogeneracja Sp. z o.o. („ENERGA Kogeneracja”), an indirect subsidiary of ENERGA SA, signed the Memorandum of Agreement on commencing the operations of Polska Grupa Górnicza Sp. z o.o. (“PGG”). The investors declared in the Memorandum of Agreement that they plan

to purchase shares in PGG for a final amount of PLN 2,417 m. ENERGA Kogeneracja has declared that it will subscribe for shares in PGG for PLN 500 m.

To define the possible directions of, and grounds for, PGG's further operation and development, its business plan has been devised and it assumes the following in particular:

- a) sale to PGG of KW's enterprise consisting of 11 mines, 4 establishments and a set of support functions for mines and establishments currently termed the head office of Kompania Węglowa;
- b) PGG's achievement of certain levels of profitability;
- c) enhancement of PGG's operating efficiency giving consideration to the re-allocation of some assets.

PGG will operate on the basis of its business plan whose purpose is to keep coal production costs under strict control, achieve specific levels of profitability and enhance the company's operational efficiency (Current Report No. 16/2016). Implementation of the Memorandum of Agreement required the execution of specific agreements, including the investment agreement, which was executed on 28 April of this year ("Agreement"). The Agreement regulated how the investment will be conducted and how to join PGG, contains the rules for the operation of PGG and its corporate bodies as well as the rules for the parties to divest their investment in PGG. The Agreement called for the purchase of shares in PGG in 3 stages by ENERGA Kogeneracja:

1. To pay PLN 361.1 m for the newly issued shares in PGG during the first stage (payable within 4 business days after signing the Agreement). The first stage will enable ENERGA Kogeneracja to subscribe for 15.7% of PGG's share capital.
2. To pay PLN 83.3 m for the newly issued shares in PGG during the second stage (by 3 November 2016), which will translate into a total stake of 16.6% in PGG's share capital.
3. To pay PLN 55.6 m for the newly issued shares in PGG during the third stage (by 1 February 2017), which will translate into a total stake of 17.1% in PGG's share capital.

The Agreement included introduction of a number of ratios to monitor the implementation of the business plan, in particular pertaining to profitability, liquidity, the debt level and PGG's operating efficiency. The Agreement contained clauses pertaining to providing regular information to the Investors' representatives on the levels of the various ratios. Details on the Agreement are presented in Current Report No. 17/2016 of 28 April 2016.

Additionally, PGE Górnictwo i Energetyka Konwencjonalna S.A., ENERGA Kogeneracja Sp. z o.o., PGNiG TERMIKA S.A. and Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych [Polish Corporates Closed-End Mutual Fund] (hereinunder jointly referred to as "New Investors" signed a memorandum of agreement regarding PGG ("Memorandum of Agreement"). The purpose of the Memorandum of Agreement is to increase control of New Investors over PGG, since they jointly hold the majority of votes at PGG's Shareholder Meeting. The Memorandum of Agreement assumes, among others, that a joint position will be agreed upon when the key decisions are made by PGG's General Meeting and its Supervisory Board.

All the above described payments have been made. On 10 March 2017, the increase in PGG's share capital was registered in National Court Register, which means that ENERGA Kogeneracja Sp. z o.o. holds a 17.14% stake in the share capital of PGG.

Changes in the ENERGA SA Management Board and Supervisory Board

A detailed description of changes to the Company's governing bodies is presented in chapter 4.7. *Company's corporate bodies* of this Report.

1.5. ENERGA Group's Strategy for 2016–2025

On 15 November 2016 the Company's Supervisory Board adopted resolutions accepting the documents: "Strategy of the ENERGA Group for 2016-2025" and "Long-Term Plan of Strategic Investments of the ENERGA Group for 2016–2025".

Grounds for updating the Group's Strategy

The recent decline in profitability throughout the power sector has forced leading European and Polish utility groups to revise their strategies. The conduct of business activity based on the previous business model could result, in the medium term, in deteriorated performance and lower valuation of utility companies. Continuing operations solely on the basis of existing assets while preserving the previous business model could lead to a gradual decline in the ENERGA Group's earnings, both in the medium and long-term. Efforts aimed at maintaining or improving the financial results will require adaptation to new trends: development of distributed generation and renewable energy sources, attempts at improving energy efficiency and emergence of new technologies, players and business models in the market. Accordingly, it was necessary to adjust the ENERGA Group's business model to the new challenges.

Strategic objectives and programs

The ENERGA Group's objective is to increase EBITDA to PLN 2.4 bn in 2020 and PLN 3.0 bn in 2025, with stable market conditions.

In order to solidify the position of the ENERGA Group as an innovative customer-oriented utility group, taking into account a stable business foundation based on predictable regulations, the Strategy assumes two areas of business development and value creation, namely Infrastructure and Customer, within which the following strategic objectives and programs of the ENERGA Group have been identified:

Objective 1. Developing modern energy infrastructure in a way that makes it possible to have a stable revenue base, dependent mainly on the quality of services provided rather than on typical market drivers. The infrastructure will respond to the future requirements of the Polish electrical power system, and its development will enable to keep a balance between the interests of all stakeholders of the ENERGA Group.

Program 1 / Expansion of a smart and reliable electricity distribution grid affording opportunities to market energy storage and local management services.

Program 2 / Development of infrastructure for broadband web access.

Program 3 / Utilizing regulations to stabilize revenues in the Capacity Market and tariffs on heat.

Program 4 / Maintaining a solid position in the RES area through the execution of (1) a hydro power plant construction project as part of the development of the second step dam on the Vistula River and (2) other RES-related projects.

Objective 2. Customer-focused business model facilitating effective customer value management based on a coherent product and service offering.

Program 5 / Rolling out a new customer-oriented business model and developing new business areas – the program will result in the creation of approx. 100 new products dedicated to three customer segments: individual customers, business customers and local government and public administration units.

A visualization of the strategy is presented in the chart below.

Figure 2. Chart illustrating the objectives and programs under the updated ENERGA Group's Strategy

Energa | ENERGA Group Strategy for 2016–2025

Objective no. 1

To develop a modern power infrastructure to enable a stable revenue base, relying mainly on the quality of services provided and not on typical market factors. The infrastructure will respond to the future requirements of the Polish power system, while its development will allow balancing the interests of stakeholders of the ENERGA Group.



Objective no. 2

Customer-oriented business model, enabling efficient customer value management based on a consistent product and service range.

Dividend

The dividend policy will be adapted to the financial needs of the investment process which assumes the cessation of key spending items by 2023. At the same time, the provisions included in the Company's Prospectus approved by the Polish Financial Supervision Authority on 15 November 2013 regarding declarative dividend payments have gone out of date.

1.6. Research and development

The ENERGA Group consistently implements innovations in key areas of its operations. The performed projects make it possible for the Group to improve effectiveness of operations and for its customers to gain measurable benefits. ENERGA has the ambition to be the most advanced energy group in Poland, both in implementing innovative technical, organizational and procedural solutions, and in shaping the market model and regulatory environment.

From the Group's perspective, the most prospective directions of development are associated with the smart grid, smart city, energy storage, electrical mobility areas, or new technologies in generation sources (including RES). In the aforementioned areas, projects associated with, among others, AMI, Demand Side Response (DSR), energy storage, eMobility or improving the effectiveness of energy conversion processes, were continued in 2016. In 2016, the ENERGA Group allocated in total PLN 189 m, i.e. approx. 1.9% of its consolidated operating expenses, for research and development and implementation of innovative solutions; PLN 62 m was allocated for investments in ENERGA SA itself.

Key projects in ENERGA Group's innovative activity

NEDO Project – the objective of the project is to gain expertise and experience on the possibility of using the energy storage technology to increase the flexibility of operation of the NPS, their impact on improving the operating reliability of the NPS and identification of the energy storage warehouse operating scenarios which stand an opportunity to develop in Poland with the existing and future legal and economic regulations. The planned completion date is 31 December 2020 (with possible extension of the duration of the project). In 2016, the project feasibility study was completed and presented to the Japanese governmental agency NEDO, which funds most of the project. The next step is to obtain the approval of all the parties involved in the project for the feasibility study and declaration of further cooperation on the project. The project will test the possibility of using an energy storage facility connected to the HV grid to increase the flexibility and reliability of the operation of the NPS and the SPS IT system making it possible to limit the capacity of generation sources (wind farms) to improve the security of electricity supplies and avoid failures in the NPS.

Pilot with 3City Electronics – project completed in 2016. As part of the commissioned research and development works, 4 controller prototypes were developed using state-of-the-art communication technology solutions to be applied in MV/LV stations.

LOB Project – the objective of the project is to build the first in Poland virtual power plant equipped with an energy storage facility, which will translate into gaining expertise and experience on the possibility of building local balancing areas, familiarization with the energy storage control technologies and the possibilities offered by solutions based on the Lithium-ion technology. In 2016 work associated with installation of energy storage facilities was completed. The expected project completion date is mid-2018. The next task to be performed is installation of software for controlling the energy storage facility and commencement of research and analyses.

“Energy for Saving” Project – project completed in 2016; it resulted in development and testing the effectiveness of soft management of the behaviors and habits of end users. Based on the information provided by the AMI system, personalized reports and analyses on energy consumption were prepared and delivered to selected customers together with the electricity bill. The analyses have confirmed the effectiveness of the methods used in the project.

Upgrid Project, i.e. municipal grid of the future – subsidized by the European Union under the Horizon 2020 program. The project is aimed at analyzing selected technologies in terms of the possibility of improvement of reliability and optimization of the operation of the MV and LV grids on the selected grid area, with special focus on development of new IT solutions and utilization of data from IT systems, in particular the AMI system. The project will be completed in 2018.

Construction of a local balancing area as an element enhancing security and energy efficiency of the operation of the distribution system – the project is aimed at developing and implementing the Local Balancing Area technology which, in a specified area of the electrical power system, allows for integrated management of its power resources. Implementation of the solution developed in the project will make it possible to increase the capability of connection to the distributed generation network based on RES, improve the efficiency of the use of electricity, reduce the costs of operation of the electrical power system and improve reliability and security of energy supplies, leading as a result to an environmental effect in the form of reduction of national CO₂ emissions. In August 2015 an agreement on subsidizing the project by Narodowe Centrum Badań i Rozwoju (National Centre for Research and Development) under the Gekon Program was signed. The project will be performed until the end of 2017.

Smart Grid Demonstration Project – the objective of the project is to develop grid management systems increasing the security of the work of the National Power System in a situation of significant

penetration of wind sources, through implementation of new solutions for TSO, DSO (SPS – Special Protection Scheme) and generation companies (BESS - Battery Energy Storage System).

Stage I of the project will deliver a Feasibility Study on the basis of which the stakeholders will be able to make a decision on continuation of the project at Stage II, i.e. demonstration (which requires concluding separate agreements).

Energa Living Lab – the essence of the Energa Living Lab project implemented by Enspirion is to demonstrate the effectiveness and to popularize demand-side response tools, using the formula of tests in a live laboratory consisting of 300 households in Gdynia. The project is co-financed by the European Commission (50%) and the National Fund for Environmental Protection and Water Management (45%) within the LIFE+ Instrument.

eMobility – in 2016 Enspirion continued the eMobility project which in the next decade is expected to bring about a significant increase in demand for electricity and development of new services associated with construction and operation of the required power infrastructure. In 2016, as part of the project, another fast charging terminal with the capacity of approx. 50 kW was built in the Tri-City for CHAdeMO and Combo 2 standard cars. In practice this means that the ENERGA network charging points support all mass production models of electric cars. In addition a fleet of electric vehicles accumulating energy in Lithium-ion batteries with the capacity from 16 to 30 kWh has been organized and an IT system for remote management of the terminals and accumulation of measurement data has been tested.

Cooperation with partners

As part of its research and development projects, the ENERGA Group cooperates with numerous scientific entities, including: the Energy Institute in Gdańsk, the University of Gdańsk, Gdańsk Technical University, Opole Technical University, the Fluid-Flow Machinery Institute of the Polish Academy of Sciences, the Warsaw University, the University of Varmia and Masuria, the Science and Technology Park in Gdańsk and the Pomeranian Science and Technology Park.

ENERGA SA, as the leader of one of two Partnerships affiliated within the Smart Specialization in Pomerania (Inteligentne Specjalizacje Pomorza, ISP3). entitled “Eco-efficient technologies in production, industry, distribution and consumption of energy and fuels and in construction” signed an agreement on development of ISP3 with the representatives of the Marshall’s Office.

Research findings and practical implementations in power engineering are presented in the Scientific Quarterly of Power Engineers “*Acta Energetica*”, published by ENERGA SA in cooperation with Gdańsk Technical University since 2009. The quarterly is one of the highest-ranking science magazines about power engineering in view of the Ministry of Science and Higher Education.

Research and development prospects

New development opportunities for ENERGA pertain in particular to the customer and comprise: response to demand, smart grids, provision of services and introduction of new technologies and significant development of distributed generation.

The main areas determining the development of the ENERGA Group also include R&D efforts focusing on the following areas:

- smart grid, active customers, RES and balancing clusters;
- energy storage;
- improvement of reliability and continuity of supply;
- customer service and marketing actions;
- production and sale of energy;
- system services for network operators;
- development of diagnostic systems;

- improvement of energy efficiency.

Development prospects and strategy implementation in 2017

ENERGA's overriding objective is to grow the goodwill in a way that guarantees return on the capital invested by the shareholders. In addition, the Group carries out tasks related to ensuring energy security of the Republic of Poland. Due to the large share of regulated activity in the business structure, the Group continues to be a low risk profile enterprise. As a result, it is relatively immune to unfavorable changes on the electricity market.

Distribution Segment

The ENERGA Group consistently strives to win the leader position among distribution system operators through improving its efficiency and reliability of the network, combined with top quality customer service. In 2017 the Distribution Segment is planning to spend capital expenditures in the amount of PLN 1.3 bn. The key directions for investments in 2017 are associated with execution of initiatives contributing to improvement of the SAIDI/SAIFI indicators, connection time, and continuation of implementation of the AMI smart metering system and the TETRA trunked communication system.

2017 will be another year of application of the "Distribution System Operator Regulation Strategy for 2016-2020". These principles introduced far-reaching changes, among others, in calculation of return on employed capital, amount of operating expenses included in the tariff and qualitative regulation. The actual level of the efficiency indicators will have impact on the allowed revenue in the next periods – the actuals in 2016 will be reflected in the 2018 tariff.

The Distribution Segment aspires to be a leader in implementing innovative technical, organizational and process solutions. The ENERGA Group introduces innovative solutions in such areas as: implementation of smart grid, smart metering, construction of a local balancing zone, international UPGRID project, whose main objective is development in a DSO these functionalities that serve integration of low- and medium-voltage networks with demand side management and dispersed generation.

Generation Segment

In the Generation Segment, capital expenditures planned to be incurred in 2017 amount to PLN 0.3 bn, however approx. one third of their level depends on the timing and outcomes of the RES energy auctions. In 2017 new projects are planned to be put to RES auctions and some existing RES generation sources are to migrate to the auction system. The remaining expenditures result from the necessity to modernize the existing assets.

In accordance with the prevailing ENERGA Group Strategy, the key investments in the generation area are: Ostrołęka C coal-fired power plants with the capacity of approx. 1,000 MWe and the plan to build a hydro power plant based on the second step dam on the Vistula River with the capacity of approx. 80 MWe. In 2017 efforts will be continued to execute the Ostrołęka C project. In addition, overhaul of unit no. 1 in the Ostrołęka B power plant will be conducted, comprising a general overhaul of the boiler and the turbine set and ancillary equipment. In the Vistula hydro power plant project issuance of the decision on the environmental conditions of the consent to perform the project is expected.

Sales Segment

In 2017 it is expected that the competitiveness of the energy market will continue to increase, stimulated both by competition between the largest sellers belonging to 4 vertically integrated capital groups as well as by new smaller entities entering the market, whose number keeps increasing and, as at the end of 2016, exceeded 160.

From among external factors in 2017, the biggest impact on the activity of the Sales Segment will be exerted by the regulations pertaining to the “Obligated Offtaker” discharged by ENERGA-OBRÓT. This is related to increase in the cost of purchase of electricity relative to market conditions. This results from the fact that a considerable part of the Polish generating capacity from wind sources is found within the area of DSO ENERGA-OPERATOR. This situation significantly impairs the competitiveness of the company’s offering in comparison to companies that are not subject to the above requirements.

ENERGA-OBRÓT takes actions aimed at improving the profit levels and increasing the number of customers in the portfolio. The most important internal development initiatives comprise:

- implementation of a new customer-focused business model and developing new business areas (in accordance with Program 5 of the new ENERGA Group Strategy for 2016-2025),
- development of an offering for end-users,
- localization and acquisition activities aimed at development of the customer portfolio,
- undertaking initiatives and implementing tools streamlining and enhancing customer service efficiency.

Construction of the customer portfolio is based both on acquisition activities outside the ENERGA DSO and loyalty-enhancing actions protecting the existing customer base against competitors. At the same time improvements are implemented to increase the effectiveness of sales activities and improvement of the quality of customer service, guaranteeing satisfaction of the main customer expectations at the lowest possible cost.

The new areas of activity will enable ENERGA-OBRÓT to diversify the profit sources, financial benefits and utilization of the potential of dynamically developing areas of economy. In 2017 development of the Indexed Offering Platform (launched in 2016) is planned - it is the first platform in Poland for big customers enabling them to independently manage their electricity purchases.

In the wholesale area ENERGA-OBRÓT is planning to increase the share in the so-called protrading on the products with physical supply of electricity and gas. In addition, undertaking activity in trading in financial contracts at EEX and ICE exchanges is assumed.

The next actions planned to increase the efficiency of the wholesale activity include: entering the Financial Instruments Market at the Polish Power Exchange, and undertaking activity in the Intersystem Exchange Market in IntraDay, on the Polish-German and Czech-Slovak borders.

The customer focus defined in the Strategy, together with ensuring top level services with simultaneous use of innovative solutions and tools will enable the Company to both expand the customer portfolio and effectively defend the existing consumer base. The aforementioned actions, combined with the effective policy reducing the Company’s financial burdens (through optimizing the customer service processes, implementation of modern IT solutions, regulatory dialogue aimed at eliminating unfavorable RES solutions) and launch of new activity areas are expected to increase profits and strengthen the position of ENERGA-OBRÓT in the market.

Material factors relating to development of the ENERGA Group

In the opinion of the ENERGA SA's Management Board, a factor material to the Company's development is the possibility of collecting dividends from subsidiaries, whose performance and activity in the perspective of at least 2017 will be affected by the following:

Figure 3: Material factors relating to ENERGA Group’s development at least for 2017

Change of the structure of distributed energy in relation to the structure set in the tariff	Incurring expenditures on the grid in connection with the quality regulation requirements in the Distribution Segment	Long-term contracts for purchase of “green” certificates based on the substitution fee in the environment of low market prices for such rights
Increasing competition in the electricity suppliers market	Impact of the function of the Obligated Offtaker and RES source balancing	Electricity prices on the spot and balancing markets
Must-run production level at ENERGA Elektrownie Ostrołęka	Expected increase of coal prices	Prices of CO ₂ emission allowances in the face of decreasing number of free allowances
Actual rate received and the operating reserve volume	Share in the net result of PGG and Polimex-Mostostal	Weather and hydrometeorological conditions

1.7. Risk management in the Company

Integrated Risk Management System in the ENERGA Group

The risk management in the ENERGA Group is aimed at obtaining comprehensive knowledge on the threats and opportunities following from individual areas of the Group’s operations and its environment, conscious responding to identified risks, and thus facilitating the planning and decision-making processes, and supporting the attainment of the Group’s strategic and operating objectives.

In 2016, no material changes were made to the Integrated Risk Management System (ERM) in place in the ENERGA Group. It still operates on the basis of commonly used risk management standards, such as COSO II, FERMA and ISO 31000. The system consists of: the Risk Management Policy in the ENERGA Group, the Risk Management Methodology in the ENERGA Group, and the risk management process presented in the chart below:

Figure 4: Risk-management process



In the Integrated Risk Management System, Risk Owners on an ongoing basis manage the risks allocated to them, among others, through implementation of new control mechanisms (security). In

connection with entry into force of the act on wind power plant investments the related risk has materialized and it was necessary to apply the predefined action plan aimed at mitigating the negative consequences of the risk. In addition, new risks have been identified, mainly associated with the investments, e.g. in Polska Grupa Górnicza, or re-launch of the project to build the new unit in Ostrołęka and the related risk of no implementation of the capacity market concept.

In accordance with the Risk Management Policy in the ENERGA Group, risk identification is based on a uniform risk model, i.e. a set of the main risk areas and categories, ensuring comprehensive risk identification in all areas of activity.

Below are presented the most important risks identified on the level of Segments and the Group, with specification of the control mechanisms and risk response.

Strategic area

Distribution Segment

In the Distribution Segment, incorrect handling of customer notifications is a material risk that may impair the Company's image or revenues. The risk is associated with complying with the customer service quality standards as regards provision of the distribution service. Problems with integration of the IT systems, in particular as regard implementation of new tools, may cause an increase in the number of queries from the ERO President regarding the errors and result in financial penalties. To mitigate this risk, actions are taken to improve the customer service process, among others through stabilizing the implemented functionalities, developing the system to include additional customer service quality mechanisms or temporary manual problem resolution in the system.

Generation Segment

For the Generation Segment, investor oversight over Polska Grupa Górnicza Sp. z o.o. is a key issue. The risk pertains to on-going monitoring and control of fulfillment of the investment conditions. The high valuation of the risk follows from the level of capital committed to the investment and catastrophic effects for ENERGA Kogeneracja Sp. z o.o. (direct investor), if any, if the business plan or restructuring plan PGG fails. In addition, deeming the capital involvement to amount to public aid by the European Commission may impair the return on investment and thus impair the Group's financial result. To mitigate the risk, ongoing monitoring of the fulfillment of investment conditions is conducted and ENERGA's representatives sit on the Investor Committee in accordance with the Investor Agreement, and in the Monitoring Committee at the PGG Supervisory Board.

The next risk pertains to strategic management in ENERGA Elektrownie Ostrołęka SA (planning the methods of the company's operations in the future, ensuring funding for implementation of the strategy) and operational management (ensuring correct operation of the processes and appropriate resources for their execution). Lack of a long-term strategy for the power sector affects the effectiveness of the company's management. The macroeconomic situation, electricity and fuel prices, and demand for electricity in the National Power System impact the current value of the company's assets. As part of the applied control mechanisms, among other things, analyses of the external environment and internal conditions are carried out to support flexible response and adaptation to changing environment (scenario-based analysis). The monitoring covers also quantitative risk measures, such as: indicators following from the adopted objectives, EBITDA, return on invested capital (ROIC), availability factor (AF), failure rate (FOR) or increase of capacity in relation to the base period, efficiency of generation or level of fixed costs excluding amortization and overhaul costs per 1 MW of installed capacity.

Sales Segment

The market risk factors associated with trading in electricity and fuels, such as: unexpected price volatility, lack of sufficient liquidity in the forward and spot market, volatility of RES generation, mismatch of the electricity and gas contracting strategy or incorrect forecasts of the buyers' demand for electricity and gas fuel are important from the standpoint of the Sales Segment, impacting the strategic objective associated with high financial efficiency. Materialization of this risk may lead to increase of operating expenses, because large volatility of wind generation, combined with the purchase obligation under the

“Offtaker of Last Resort” mechanism, is negatively correlated with the electricity price. The control mechanisms used in this respect comprise primarily all internal policies, rules and processes pertaining to purchase of electricity, which are aimed at management of global risk through its measurement and limitation of the value at risk (VaR). The quantitative measures used include primarily: financial and economic indicators, market ratios, VaR level, or levels of contracting for the needs of end buyers. With the existing safeguards, materialization of the risk is limited to the extent to which the company has influence on them. In the event of occurrence of signals pointing to the necessity to verify the adopted long-term and medium-term contracting strategy the actions are updated in order to adjust them to changing market conditions. In 2016 an audit with the participation of an external consultant was completed to provide a comprehensive analysis of the wholesale area, including the approach to market and credit risk management and control in the wholesale of electricity and related products. Based on completed analyses a report was prepared, outlining the directions of development of the area and recommending changes. The implementation of the recommendations is gradual; it will make it possible to update the adopted strategy to adapt the actions to the current conditions and good market practices in order to manage the risk in this area more effectively.

ENERGA Group

On the ENERGA Group level, material risk in the strategic area also pertain to: corporate governance system, supervision and coordination of the actions in the area of relations with the Group’s customers, image of the Group and development and operation of the Ostrołęka C unit.

The risk associated with the corporate governance system pertains to the process of issuing corporate authorizations in the ENERGA Group, including the policy for employing and remunerating members of the Group companies’ governing bodies and collecting information about material activities undertaken by the Group companies. Materialization of the risk impacts the effectiveness of operation of the Segments and the Group, and formal errors or delays may result in legal ineffectiveness of the decisions made and the possibility of suing them by the shareholders. The control mechanisms in place define the scopes of responsibilities in the corporate governance area, and ineffective internal communication and continuing works on the internal regulations in the Group may impair their effectiveness. Timeliness of execution of corporate decisions, completeness and up-to-dateness of basic information about the companies and materiality of formal defects in the corporate decisions made are monitored on an ongoing basis. To mitigate the risk the internal regulations are adjusted to ensure clear division of responsibilities in the corporate governance area, and in the transition period - there is enhanced activity of the staff of the ENERGA SA Corporate Governance Sub-Department.

The next risk is associated with supervision and coordination of the actions in the area of relations with the ENERGA Group’s customers. The number and structure of serviced customers, product offering, organization and structure of sales service points, or operation of the IT systems have a direct impact on the customer satisfaction level. The ongoing work on changes to the Group’s IT systems and the related transitional problems with issue of invoices cause an increase in the number of customer complaints and thus translate into high assessed probability of materialization of this risk. To mitigate the risk, actions are taken to identify any defects of the customer service systems by teams in ENERGA-OBRÓT SA and ENERGA-OPERATOR SA and jointly develop in the Group a package of customer service measures.

Customer service in the Group has direct impact on the next material risk associated with the image of the ENERGA Group. Use of inappropriate or ineffective marketing and communication actions, or conduct of actions by the Companies without estimating their impact on the image may lead to deterioration of the Group’s credibility and thus impair the Group’s value and its rating. Among the measures of this risk, the following may be listed: results of marketing research, results of promotional actions, or results of qualitative analysis of the brand’s presence in the media relative to other names in the industry. The plan of actions taken in response to the risk comprises, among others, update and adoption of a new marketing strategy and communication strategy, intensification of the communication efforts in response to negative image-related effects resulting from customer service problems, or development of a new customer-focused product offer.

These risk associated with development and operation of the Ostrołęka C unit concerns possible failure to achieve an appropriate level of project profitability, financing structure and unsatisfactory technical parameters of the unit as well as delays in project implementation. Due to scale of the investment project, materialization of the risk may translate into high debt levels in the Group and liquidity. To mitigate the risk optimal finance parties and contractors are sought, and deviations of the expenditures relative to the base assumptions are monitored.

Legal and regulatory area

Since the State Treasury is the majority shareholder of ENERGA SA, the decisions taken by the Polish authorities and administrative bodies may have a material impact on the operations of the entire Group. Increase of the investment or acquisition plans in the face of decreasing energy prices and increasing CO₂ prices may lead to failure to attain the expected financial results and operational benefits. Political decisions taken by the state and EU administrative bodies shape also the amendments of legal regulations. Unstable legal environment as regards the operation of the power sector is a material threat to the ENERGA Group. Adoption of regulations by legislative bodies at the domestic and EU level that materially change the thus far energy policy or introduction of changes to the tariff system, in Poland's climate policy and other regulations related to environmental protection for generation entities, may have negative impact on the activity of individual Group companies and result in suspension of financing of the investments by banks and the necessity to reformulate the investment plans. The new legal regulation pertaining to investments in wind power plants significantly impacted the profitability of this area of operations. The ENERGA Group has a leading position in Poland in terms of the share of electricity from renewable sources in total generated energy, hence changes to the interpretation of the RES Act by the ERO President or Ministry of Energy in matters associated with supporting and operation of RES in Poland may lead to decline of the rates of return on executed investments. The planned amendments to the Water Law assume introduction of additional fees associated with RES operations, which will also have impact on the financial, operating and strategic activity of the Generation Segment. The involvement of ENERGA SA and Segments in the legislative process for the legal acts and work of industry organizations is a security mechanism in this respect. A qualitative analysis of the proposed changes to the law is carried out on an ongoing basis and their impact on the Group's financial result is measured, however due to the significant exposure of this risk to external factors, the Company has very limited possibility of mitigating it.

The claims put forward against ENERGA Group companies, in particular those following from the unsettled legal status of real properties used for the power installations are other elements of legal risk. The decisions of the public authorities imposing significant obligations on the companies (in particular as regards protection of competition and consumers) may lead to increase in the number of disputes and entail a requirement to pay compensations or penalties. Due to the continuing nature of the risk and the value of currently pending litigations, the risk score is high. Coordination of court, arbitration and administrative proceedings at the Group level, monitoring and reporting of values of subjects of litigation as well as other actions taken by ENERGA SA and the companies which are part to such proceedings, are aimed at mitigation of risk. Last year the Group implemented appropriate internal regulations pertaining to coordination of legal aid. In addition work is under way to implement new IT solutions and roll out the Compliance system aiming at ensuring even more effective and comprehensive compliance with internal and external regulations, ethical standards and organizational culture, as well as compliance with other regulations required of the Group.

Absence of a comprehensive regulation of the Compliance area in the ENERGA Group may affect the loyalty and motivation of the employees, impair the Group's credibility among its business partners, and result in financial losses as a result of abuse. Internal and external audits have not shown any Compliance incidents, however one may not rule them out completely. To mitigate the risk, the Group plans to review the existing procedures and supplement shortcomings, if any, in the context of management of abuse risk.

Operating area

Due to the large size of ENERGA Group's assets and the age of some facilities, the activity of the Group companies is exposed to such fortuitous events as: breakdowns, weather anomalies, atmospheric

factors or acts of third parties, which may affect security or continuity of generation and supplies to customers of electricity of sufficient quality parameters. Interrupted operations of generation or distribution units lower their performance and involves disturbances to attainment of strategic objectives and entails, among others, danger to safety of people and property as well as the necessity to incur additional costs of repair/replacement of damaged components or activities connected with the buyers' disaster recovery. The risk in the distribution area is measured by the SAIDI and SAIFI ratios. In the generation area, the key data include, in turn, data on deviations from the production plans, and indicators pertaining to the number of failures / events impairing the availability or duration of the failure / events impairing the availability. To prevent the materialization of these risks, extensive regulation of this area has been introduced. In addition, ongoing reviews, maintenance, monitoring of technical condition and failure rates of equipment. Also, the technical emergency service is available. All Segments and selected companies, such as ENERGA SA, ENERGA Elektrownie Ostrołęka SA or ENERGA Informatyka i Technologie Sp. z o.o. perform tasks to ensure continuity of their operation in the event of occurrence of an emergency.

The advanced age of the production equipment operated by ENERGA Kogeneracja Sp. z o.o. may generate the risk of non-performance of certain sales contracts and production plans while failing to satisfy the requirements specified by the integrated permit and environmental regulations, e.g. emission norms. Monitored in the context of this risk are deviations from the adopted plans and deviations from the parameters agreed upon in the contracts. To mitigate this risk, it is planned that IT systems will be rolled out to support production management, accompanied by modernization expenditures on basic production equipment.

The efficiency of production equipment is also a significant aspect in the operation of wind farms. The risk is associated with ensuring the proper production process and turbine availability at a level of 96.5%. Significant risk factors include: weather conditions, decisions issued by local governments as well as legal and environmental circumstances that may affect the operation of the facility and auxiliary infrastructure. The risk assessment depends on the number of wind turbines in operation, the frequency of failures, the cost of their removal and the cost of foregone production.

Also potential failures and unreliability of ICT infrastructure are extremely important, because their occurrence translates into serious difficulties or even inability to pursue the basic tasks of individual companies. The risk associated with ensuring the availability, integrity and confidentiality of ICT systems, including their integration, has increased recently as a consequence of problems arising from the operation of the sales service system. The absence of operational continuity of IT systems in this area may also cause inefficient management of measurement data and complaints handling and improper processing of seller requests. Due to the absence of invoices for purchasers caused by the migration of billing systems, there is a risk that the ERO President may initiate administrative proceedings aimed at clarifying the matter or, possibly, punishing the ENERGA Group. Efforts aimed at managing this risk include measures taken to stabilize the system and the implemented functionalities and to create an ICT security roadmap. The manner of communication between consultants and sellers has also changed. Also planned is the implementation of new control mechanisms and creation of new functionalities.

Another risk is related to the management of the central portfolio of projects, including IT projects in the ENERGA Group, which may lead to the emergence of redundant IT solutions in Group companies and a greater complexity of integration causing an increase in IT spending throughout the Group. Among the planned measures aimed at mitigating this risk is the development of a new IT Strategy at Group level and IT Action Plans for the Segments.

Finance area

The macroeconomic situation impacts the conditions in which the ENERGA Group conducts its activity. Variations in business conditions measured by GDP change rates, inflation or unemployment rates translate to electricity, heat and gas prices and shape demand for products supplied by Group companies.

Correct calculation of sales prices translates directly into the results attained by ENERGA-OBRÓT SA. As a result of the obligation to obtain the ERO President's approval for the tariff rates, in the event a negative decision is issued and the procedure closed, customers cannot be invoiced for the completed sales and, as a consequence, no revenues are earned. As far as this risk is concerned, there may be a situation where the rates approved by the ERO President in the tariff will not guarantee profitable sales. Risk control mechanisms include, among others, the current market benchmark and ongoing analysis of the impact of the adopted rules for the calculation of electricity and gas prices on the financial performance and selected ratios. In 2016, new internal regulations were developed to govern the rules of shaping the pricing policy and a number of other control mechanisms were implemented to minimize the materialization of risks arising from shaping the pricing policy. The risk measures applied include, among others, the number of accepted offers, financial and economic ratios, including the level of contracted margins, and market ratios such as market value, market share or market growth.

Another significant financial risk is the absence of continuity or incorrect invoicing of sales and distribution services caused by gaps or errors in actual metering data on electricity consumption. This risk may result in the inability of invoicing revenues and, as a consequence, the absence of cash inflows and potential penal and fiscal penalties. A large number of customers subject to settlement translates into a high probability of this risk. In order to mitigate this risk, ongoing work is underway aimed at creating a solution which would enable automatic (partially manual) reconciliation of system differences and filling the gaps in metering data. The current settlement rules applicable to distribution services permit monitoring of settlements on a monthly basis, whereas the full launch of data collection from the Central Metering Database will enable settlement of distribution services on an ongoing basis. In respect of the risk of tax settlements, it is planned that the Tax Risk Management Policy will be implemented to the full extent and that close cooperation will be established with tax advisors aimed at minimizing the Company's risks in this area.

The product price levels (electricity, property rights, CO₂) also has a decisive impact on the Generation Segment. The significant fluctuations observed in the market may translate into failures in the implementation of the Strategy in respect of the achievement of the target values of financial ratios, because they result in deviations of sales revenues. They may also cause the need to post impairment losses on the value of fixed assets in the Segment. To secure against the risk, the Group constantly monitors the price levels in the market and transaction execution is planned in such a way as to avoid accumulation of negative trends of price changes of all products at the same time.

Implementing the provisions of the ENERGA Group Financial Policy, the Group companies conclude different kinds of financial agreements which entail financial and market risks. The most important ones include the interest rate risk, FX risk, credit risk and liquidity risk. The above risk categories determine the financial results of individual companies and the ENERGA Group.

Interest rate risk

The ENERGA Group companies finance their operating or investing activity with debt liabilities bearing interest at a floating or fixed interest rate. Interest rates are also associated with investment of surplus cash in floating or fixed interest rate assets.

The floating interest rate risk resulting from concluded debt liabilities applies to WIBOR-based rates only. In respect to liabilities denominated in EUR, the ENERGA Group has contracted financial debt under issued fixed-coupon Eurobonds.

According to the interest rate risk policy, risk of variation in interest rates is mitigated by maintaining a portion of debt with fixed interest rate. Under these assumptions, IRS floating interest rate hedging transactions are executed.

In connection with implementation of hedge accounting, the ENERGA Group also identifies interest rate risk related to the concluded CCIRS and IRS hedging transactions, which however has no effect on the Group's financial result.

Moreover, the level of interest rates has a direct effect on the WACC stated by the ERO President to calculate the return on RAB, which is included in the tariffs of ENERGA-OPERATOR SA. Low interest rates result in a lower return on RAB and an increase in actuarial provisions.

Foreign exchange risk

In the financial area the FX risk is associated mainly with incurring and servicing ENERGA Group's debt liabilities in foreign currencies under the EMTN Eurobond Issue Program. Additionally, selected ENERGA Group companies had foreign currency surpluses resulting from their operating activity or investing activity. The ENERGA Group monitors the foreign exchange risk and manages it primarily through contracted CCIRS hedge transactions and implemented hedge accounting.

Credit risk

Credit risk is associated with the counterparty's potential permanent or temporary insolvency with regard to financial assets such as cash and cash equivalents and financial assets available for sale. The risk arises due to the contractual counterparty's inability to make the payment and the maximum exposure to this risk equals the carrying amount of acquired instruments.

In this respect, the ratings of financial institutions with which the ENERGA Group cooperates are monitored on a regular basis to minimize credit risk. Credit risk is also incurred in the case of funds involved in participation units in the ENERGA Trading SFIO fund dedicated to the ENERGA Group. According to the adopted investment policy, the fund invests in assets such as treasury bills and bonds and commercial debt instruments. Credit risk associated with investments in treasury bills and bonds is referred to the solvency risk of the State Treasury. Credit risk associated with investments in commercial debt instruments is mitigated through the fund's properly defined investment policy. The fund may invest its monies only in assets characterized by an investment rating awarded by rating agencies or internally by the fund manager.

Liquidity risk

Risk of loss of financial liquidity – associated with the possibility of losing the ability to pay liabilities on time or losing possible benefits resulting from over-liquidity.

ENERGA Group companies monitor the liquidity risk using a regular liquidity planning tool. The tool takes into account the payment due/maturity dates both for investment liabilities and financial assets and liabilities and projected cash flows from operating activity. The Group aims at maintaining the balance between continuity and flexibility of financing through use of various sources of financing, such as working capital and investment loans, local bonds and Eurobonds. Since the Group's debt is centralized in ENERGA, this company monitors the fulfillment of covenants on an ongoing basis and their forecasts in the long term, which allows it to determine the ENERGA Group's debt capacity, its capability to conduct capital expenditures and affects its capacity to pay liabilities on a timely basis in the longer term.

To efficiently manage the liquidity of Group companies, the ENERGA Group used the mechanism of issuing short-term bonds offered by the issuer – a Group company – only to other Group companies. The procedure was coordinated by ENERGA, which made it possible to optimize the entire process in terms of its organization. As of January 2016, the ENERGA Group implemented the zero-balancing cash pooling service, which comprises functions associated with issue of short-term bonds, and additionally maximizes the possibility of using the Group's cash surpluses to finance the current operations of individual Group companies.

Moreover, ENERGA has concluded loan agreements with several financial institutions, which represent an immediate liquidity reserve in case of any liquidity needs.

1.8. Information on material agreements and transactions

Material contracts

Information about material contracts entered into by the Company in 2016 is provided in Section 1.4 of this Report. *Key events and achievements of the Company*

Agreements for loans and borrowings

Loan agreements with multilateral financial institutions

Loans to finance the capital expenditure program at ENERGA-OPERATOR SA for the years 2009-2012

In the years 2009-2010 ENERGA SA together with its subsidiary ENERGA-OPERATOR SA entered into the following loan agreements to finance the expansion and modernization of the distribution grid in 2009-2012:

- with the European Investment Bank (EIB) with the limit of PLN 1,050 m;
- with the European Bank for Reconstruction and Development (EBRD) with the limit of PLN 800 m;
in 2014, ENERGA SA with ENERGA-OPERATOR SA and EBRD amended the above loan agreement, as a result of which, among others, the available loan amount increased by PLN 276 m and is to be used to fund ENERGA-OPERATOR SA's capital expenditures, with the funds available for drawdown by the end of 2016.
- with the Nordic Investment Bank (NIB) with the limit of PLN 200 m.

The above funding has been fully utilized by the Company, of which the following amounts are still outstanding and remain to be repaid to:

- EIB – PLN 720 m with final maturity of 15 December 2025,
- EBRD – PLN 741 m with final maturity of 18 December 2024,
- NIB – PLN 119 m with final maturity of 15 June 2022.

Loans to finance the investment program at ENERGA-OPERATOR SA for the years 2012-2015

In 2013 ENERGA SA together with its subsidiary ENERGA-OPERATOR SA entered into the following loan agreements to finance the capital expenditure program of ENERGA-OPERATOR SA for the period of 2012-2015 associated with the expansion and modernization of the distribution grid:

- agreement with EBRD with a limit of PLN 800 m – as at 31 December 2016, PLN 762 m of the loan was utilized (of which PLN 302 m by ENERGA SA and PLN 460 m by ENERGA-OPERATOR SA). The final maturity of the loan is 18 December 2024;
- agreement with EIB with a limit of PLN 1,000 m – as at 31 December 2016, PLN 1,000 m of the loan was utilized (of which PLN 800 m by ENERGA SA and PLN 200 m by ENERGA-OPERATOR SA). The final maturity of the loan is 15 September 2031.

Nordic Investment Bank

On 23 October 2014, ENERGA SA signed a loan agreement with a limit of PLN 67.5 m with the Nordic Investment Bank to finance a wind farm construction project in Myślino. The aggregate use of the loan as at 31 December 2016 was PLN 61 m. The final maturity of the loan is 15 September 2026.

Loans granted

No loans were granted in the ENERGA Group in 2016. Only two loans from 2013 for a total amount of EUR 499 m were continued; they were granted to ENERGA by the Group's special purpose vehicle, ENERGA Finance AB (publ), using the funds raised under an Eurobond (EMTN) issue carried out in March 2013.

Moreover, during the reporting period, the ENERGA Group used the short-term bond issue facility, in which, to achieve efficient liquidity management, the Group company issuing the debt securities offered their purchase only to other Group companies.

Acting on the basis of the Financial Policy adopted by the ENERGA Group and under the terms and conditions of internal bond issue facilities, in 2016 ENERGA purchased bonds issued by Group companies. The main purpose of the issues was for the issuers, ENERGA Group companies, to raise funds to execute their capital expenditure programs.

The table below presents the nominal value of bonds subscribed by ENERGA and outstanding, broken down into individual issuers from the ENERGA Group, as at 31 December 2016.

Table 1: Nominal value of bonds subscribed by ENERGA SA and outstanding, by issuer, as at 31 December 2016

No.	Company name	Nominal value of subscribed bonds (PLN 000s)
1.	ENERGA-OPERATOR SA	4,124,606.5
2.	ENERGA Wytwarzanie SA	842,200.0
3.	ENERGA Kogeneracja Sp. z o.o.	50,512.5
4.	ENERGA Elektrownie Ostrołęka SA	114,000.0
TOTAL		5,131,319.0

Domestic bond issue program

No changes in respect of the issue volume were made in the domestic bond issue program established in September 2012, in which the first issue of PLN 1,000 m was executed in October of that year. As part of the actions taken in 2016, the subsidiary ENERGA-OPERATOR SA purchased on the secondary market 55,812 bonds issued by ENERGA with a total par value of PLN 558.12 m (in June ENERGA-OPERATOR purchased a majority of those bonds, i.e. 55,795 with a total par value of PLN 557.95 m).

Eurobond issue program

In Q1 2017, a subsidiary ENERGA Finance AB (publ) carried out a public subscription for the Eurobonds issued under the updated EMTN Program (the bookbuilding process was closed on 1 March 2017). It was an EUR 300 m bond issue with the issue price of 98.892% and 10-year maturity. The 2.125% coupon will be payable annually, after the discount rate is taken into account, the yield for bondholders is 2.25%. The Eurobonds are listed on the Luxembourg stock exchange. The final settlement of the transaction was effected on 7 March 2017. ENERGA SA acts as the guarantor of the issue. The funds raised through the bond issue will be applied to general corporate purposes.

Insurance contracts

The Group has in place a joint insurance policy, which ensures insurance cover for the companies and their activities against risks, with sums insured at levels typical for the profile of energy sector companies in Poland. In cooperation with insurance brokers, a joint property and liability insurance scheme has been concluded for the period from 1 July 2014 to 30 June 2017. The Scheme allows for a standardized insurance cover for relevant risks with customized extensions negotiated for unique needs of individual companies.

Insurance contracts are concluded with the leading insurance companies operating in Poland. As a principles, the key insurance contracts for critical risks and with the highest sums insured are concluded with insurance consortiums underwritten by two or more insurance companies.

Guarantees and sureties given

Table 2: Information on sureties and guarantees extended by ENERGA as at 31 December 2016

No.	Extension date of the surety or guarantee	Term of the surety or guarantee	Entity for which the surety or guarantee was granted	Entity in favor of which the surety or guarantee was granted	Form of the surety or guarantee	Surety or guarantee amount (PLN m)	Amount of liability secured by the surety or guarantee as at 31 December 2016 (PLN m)
1	2012-11-15	2024-12-31	ENERGA Finance AB	bondholders	surety agreement*	5,530.0	2,110.8
2	2015-04-03	2019-05-02	ENERGA Invest SA	PKO BP SA	surety** - agreement to extend a guarantee	89.4	62.5
3	2015-01-08	2024-12-31	ENERGA Wytwarzanie SA	WFOŚiGW Gdańsk	surety - loan agreement	15.0	8.9
4			Other ENERGA Group Companies		surety** - agreement to extend a guarantee	28.0	16.4
TOTAL						5,662.4	2,198.6

* On 15 November 2012, an EMTN Eurobond issue program was established for the amount up to EUR 1 bn. Under the program, ENERGA Finance AB (publ) registered under the Swedish law, acting as a subsidiary of ENERGA SA, may issue Eurobonds with maturities from 1 year to 10 years. Pursuant to the surety agreement, ENERGA SA undertook, unconditionally and irrevocably to guarantee liabilities of ENERGA Finance AB (publ) resulting from Eurobonds up to EUR 1,250 m until 31 December 2024 inclusive. On 19 March 2013, ENERGA Finance AB (publ) issued one series of Eurobonds of EUR 500 m and maturing on 19 March 2020.

** Civil law sureties extended by ENERGA SA for liabilities of Group companies arising from bank guarantees granted by PKO BP SA under guarantee facilities dedicated to Group companies. The facility may be used until 19 September 2017. Terms of validity of the guarantees granted under the facility limit may extend beyond this date. Repayment of liabilities is secured by a civil law surety.

Other guarantees granted at the request of the Group's companies included the following:

- bank guarantees totaling PLN 176.9 m granted by Pekao SA, ING Bank Śląski SA and mBank SA to ENERGA-OBRÓT SA,
- bank guarantee of PLN 17.7 m granted by PKO BP SA to ENERGA-OPERATOR SA.

Information on transactions of material importance with related parties on terms other than an arm's length basis

All the transactions within the ENERGA Group are made on the basis of the market prices of goods, products or services based on their manufacturing costs. Detailed information on this subject is presented in note 22 to the financial statements for the year ended 31 December 2016.

Evaluation of financial resources management

During the financial year, ENERGA Group had at its disposal cash guaranteeing timely service of all current and planned expenditures related to conducted operating and investing activity. Cash on hand as well as available credit facilities ensure that the liquidity management policy may be conducted in a flexible manner.

The execution of investment projects was based on the use of own funds and debt financing. The structuring of projects assumes the maintenance of financial security for the ENERGA Group manifesting itself in the use of long-term debt financing, pursuit of a dividend policy consistent with the adopted strategy, maintenance of financial covenants at levels agreed upon with debt financing providers and maintenance of investment-grade ratings.

The Company monitors the liquidity risk using a periodic liquidity planning tool. The tool takes into account the payment due/maturity dates both for investment liabilities and financial assets and liabilities and projected cash flows from operating activity.

The objective is to maintain balance between continuity and flexibility of financing through the use of various sources of financing, such as current account overdrafts, working capital loans, investment loans, local bonds and Eurobonds.

To improve the quality of management of the financial surpluses of the Group companies as of 4 January 2016 the zero-balancing cash pooling service was implemented. It is a tool for optimum utilization of the surpluses generated by the ENERGA Group to fund the current activities of the companies in the structure.

1.9. Proceedings pending before the court, arbitration bodies or public administration bodies

As at 31 December 2016, ENERGA SA was party to 9 court proceedings. The Company acted as a plaintiff in 2 cases where the aggregated value of the disputed matters was approx. PLN 1.22 m. The Company acted as a defendant in 5 cases with the aggregated value of the disputed matters of approx. PLN 762 thousand.

None of the aforementioned proceedings pertaining to the liabilities or receivables of the Issuer exceeded the minimum of 10% of the Issuer's equity. Also, no pecuniary penalty, fine or other financial liability measures were imposed that would be equivalent to at least 5% of the consolidated EBITDA for the last financial year.

1.10. HR and payroll situation

Headcount in the ENERGA Group

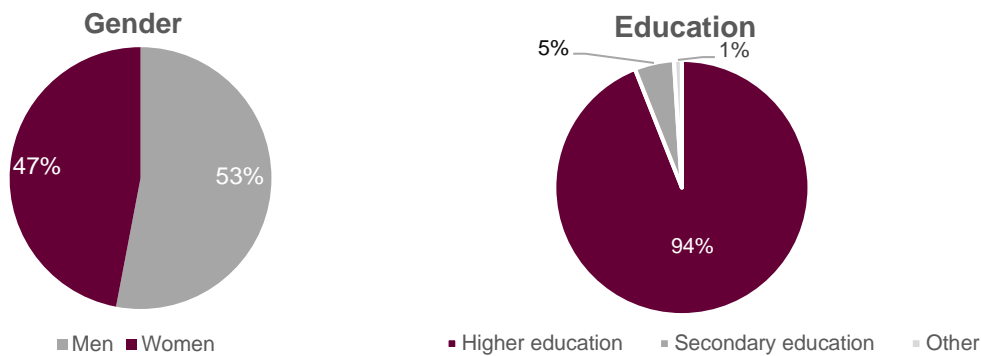
Table 3 : Headcount in ENERGA SA as at 31 December 2013-2016*

Headcount as at 31 December 2013 persons	Headcount as at 31 December 2014 persons	Headcount as at 31 December 2015 persons	Headcount as at 31 December 2016 persons	Average headcount in 2013	Average headcount in 2014	Average headcount in 2015	Average headcount in 2016
135	104	108	148	137.24	114.8	100.18	122.02

*Average headcount including persons on unpaid leaves, parental leaves and rehabilitation leaves.

The headcount changed because of the reorganization of the Company, which was carried out to adjust its structure and staffing to the new tasks defined in the Organizational Bylaws of the Company and in connection with the Group's new Strategy.

Figure 5: Headcount structure in ENERGA SA as at 31 December 2016



Remuneration systems

The Company's remuneration system is described in the "Rules for remunerating ENERGA SA employees" approved by Resolution No. 46/II/2007 adopted by the ENERGA SA Management Board on 25 July 2007 and the September 2015 annex to the Remuneration Rules introducing a new classification table of positions and base salary rates in ENERGA SA.

Due to acquisition of employees through a trilateral agreement (agreement between work establishments), the following regulations are also applicable to certain remuneration components:

- 1) Multi-Company Collective Bargaining Agreement for Employees of the Utilities Sector,
- 2) Remuneration Rules of ENERGA-OPERATOR SA,
- 3) Company Collective Bargaining Agreement of ENERGA-OPERATOR SA Branch Office in Gdańsk,
- 4) Company Collective Bargaining Agreement of ENERGA Kogeneracja Sp. z o.o.

As at 31 December 2016, the Company's Management Board (5 persons) and 13 other managers were employed under management contracts. Their compensation is not part of the payroll fund.

Important information affecting the HR and payroll situation

Employee benefits

The Company has in place an extensive employee benefits system, of which the most important elements include:

- (1) Annual bonus constituting 8.5% of the annual payroll fund from last year, paid out pro rata to the length of employment,
- (2) 'Employee tariff' for electricity, available to employees with one year of professional experience in the utilities sector,
- (3) Holidays gift certificates issued to employees for the Easter Holiday, the Power Industry Employee's Day and Christmas,
- (4) The employer remits funds to the Employee Pension Plan in the amount of 7% of employees' remuneration,
- (5) Cash equivalent of coal allowance,
- (6) Benefit for work in hazardous conditions,
- (7) Addition to base salary depending on seniority,
- (8) Jubilee awards,
- (9) Additional Medical Care Program under the contract with AXA Życie Towarzystwo Ubezpieczeń SA. All employees are eligible for additional medical benefits under the Guaranteed Package funded by the employer,
- (10) The company social benefits fund authorizing charges in the amount three times higher than the basic charge defined in the Act on Company Social Benefit Fund ("ZFSS").

As of 31 December 2014, the Company withdrew from the Multi-Company Collective Bargaining Agreement. As a result of this change, employees newly hired after 1 January 2015 are not entitled to the benefits referred to in items 1, 2, 5, 6, 7 and 8 above.

The Company offers its employees training packages and other forms of development to prepare the employees to perform their duties, improve their knowledge and increase their efficiency, motivation and commitment to work.

Training activities executed in 2016 were focused mainly on increasing employee qualifications in specialized areas in the form of postgraduate studies, courses, training programs and conferences. Employees developed their managerial competencies (MBA studies and ICAN courses) and personal effectiveness (life energy management, communication, commitment) and improved their command of English. Additionally, the company delivered training courses on counteracting mobbing and discrimination.

Changes of the terms of remuneration

In 2016, there were no significant changes in the prevailing terms of remuneration.

Group layoffs

The Company did not effect any group layoffs in 2016.

Collective disputes

As at 31 December 2016, union membership in the Company was 22.2%. The following three union organizations operate in the Company:

1. Inter-Company Trade Union NSZZ Solidarność Energa-Operator SA Branch Office in Gdańsk,
2. Trade Union of Engineers and Technicians of MOZ in the ENERGA Group Branch Office in Gdańsk,
3. Independent Trade Union of the ENERGA Group Employees.

In 2016, there were no collective disputes in ENERGA SA.

1.11. Corporate social responsibility of the ENERGA Group

The ENERGA Group pursues its vision, mission and objectives and builds shareholder value in an ethical, transparent and open-to-dialog manner, while striving to maintain an appropriate balance between operational, ethical and environmental activities and the interests of its stakeholders: shareholders, customers, employees and local communities. Accordingly, our business objectives are supported by goals pursued in the area of sustainable development as laid down in the "Sustainable development and corporate social responsibility report" prepared by the ENERGA Group, which assumes the following:

- building responsible relationships with customers – development of relations with customers based on fair practices, transparency and openness, and ensuring the highest standards of service.
- reduction of environmental impact – improving energy efficiency, reducing harmful emissions, rational use of resources, environmental investments,
- development of distribution activity to improve the reliability and security of supplies
- care for employees and their safety – efforts aimed at reducing the number of accidents at work, ensuring a friendly and safe workplace, increasing satisfaction and commitment
- responsibility towards local communities – supporting local communities in consideration of their needs, building social partnerships and involvement in charitable activities
- national responsibility – contribution to the security of the country's power system and social development, support for strategic resources.

Every year, the Group publishes information about all its activities associated with corporate social responsibility in CSR reports. Such reports are prepared on the basis of the guidelines from Global Reporting Initiative G4.0 at the CORE level (giving consideration to the ratios included in the supplement

for utility sector companies). The basis for preparing such reports takes the form of a dialog with stakeholders, both internal and external. This year's document entitled "Our Responsibility 2016" will cover the whole calendar year 2016 and all ENERGA Group companies. Corporate social responsibility in the ENERGA Group also translates into our approach to environmental protection which forms one of the pillars of the Group's strategy for 2016-2025. Development of new and modernization of the existing generation and grid infrastructure, climate-related obligations and diversification of supplies are the tasks that have a direct impact on the business pursued by the Group companies. To support this business, since 2014 in the main companies of the Group's value chain an environmental management system compliant with the EMAS Regulation has been in place. In October 2015, the Group companies received an ISO 14001:2004 certificate, and in June 2016 they were entered in the EMAS register kept by the General Directorate for Environmental Protection. A simultaneous registration of such a large number of companies and installations in the EMAS register for a single group of companies (not only in the energy sector) is a precedent on a European scale. Due to the measurable benefits obtained as a result of the implementation of the system, work is underway on extending it to the other Group companies. Following the entry into force of new energy efficiency regulations in 2016, the Group companies launched the process of implementation of the ISO 50001 standard which defines the best practices in energy management.

In December 2016, ENERGA SA was included for the third time in the RESPECT index (which groups listed companies committed to social responsibility and managed according to the best standards) and in the FTSE4Good Emerging Index. This is an index grouping companies from more than 20 emerging economies that are selected on the basis of compliance of their operations with the environmental, social responsibility and corporate governance criteria.

ENERGA SA was also included in the "70 Emerging Markets" ranking compiled by the rating agency Vigeo Eiris. The ranking presents 70 companies from emerging markets with the highest environmental, social and corporate governance scores. The study included more than 850 companies from 37 sectors in 31 countries.

1.12. Awards and recognitions for the Company and the ENERGA Group

Table 4: Prizes, awards and certificates received in 2016

2016
<p>13.04.2016</p> <p>The title "Seller of the Year" awarded to ENERGA-OBRÓT by EuroPOWER for the Energa365 product, an innovative sales and loyalty offer.</p>
<p>18.04.2016</p> <p>ENERGA SA received an Eagle 2016 award from the "Wprost" weekly for a company with the highest average net profit in the Pomeranian region in 2012-2014.</p>
<p>22.04.2016</p> <p>ENERGA Elektrownie Ostrołęka SA received an Accreditation Certificate confirming compliance with the general requirements for testing and calibration laboratories. The certificate was granted by the Polish Center for Accreditation.</p>
<p>19.05.2016</p> <p>The CSR Golden Leaf Award granted to the ENERGA Group by the "Polityka" weekly for implementing the ISO 26000 guidelines as a key element of strategic actions in business and relationships with stakeholders.</p>

15.06.2016

The ENERGA Group received an EMAS Certificate confirming its registration in the Eco-Management and Audit Scheme. The certificate is granted by the Ministry of the Environment.

10.10.2016

The "Przetargi Publiczne" ["Public Procurement"] monthly granted the "Public procurement crystals" award to ENERGA Oświetlenie Sp. z o.o. for construction projects improving road and transportation infrastructure and for modernization of street lighting in Bydgoszcz.

27.10.2016

A Patron of Culture award granted to ENERGA SA by the Marshal's Office in Olsztyn for sponsoring the activity of the Warmia and Mazury Philharmonic Orchestra.

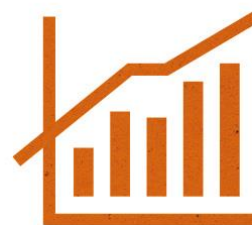
02.12.2016

A "Silver Paper Clip" award for the ENERGA Group in the Corporate PR category of the Golden Paper Clips contest organized by the Association of Public Relations Firms.

12.2016

The Federation of Consumers granted a Consumer Service Quality Certificate to ENERGA-OPERATOR SA for a positive result of the Consumer Audit conducted in November 2016 among employees of the Connection Service Centers and Consumer Service Departments.

Analysis of the financial situation and assets



2. ANALYSIS OF THE FINANCIAL STANDING AND ASSETS

2.1. Rules for preparing the annual financial statements

The financial statements of ENERGA SA for the twelve-month period ended 31 December 2016 were prepared:

- in accordance with the International Financial Reporting Standards and IFRS approved by the European Union;
- on the historical cost basis except for financial instruments measured at fair value through profit or loss and hedging derivatives;
- unless stated otherwise, in millions of Polish zloty (PLN m);
- under the assumption of ENERGA SA's being a going concern for the foreseeable future and there are no circumstances indicating a threat to the Company's continuing operations.

To the extent not regulated by the EU IFRS standards, ENERGA SA keeps its accounting ledgers in accordance with the accounting policy (principles) defined by the Accounting Act of 29 September 1994 (Journal of Laws of 2016 Item 1047) and the regulations issued on its basis ("Accounting Act", "Polish accounting standards", "PAS").

The accounting (policy) principles used to prepare the annual financial statements are presented in note 8 to the financial statements of ENERGA SA for the twelve-month period ended 31 December 2016.

2.2. Explanation of the economic and financial data disclosed in the Company's annual financial statements

Table 5: Statement of profit or loss

in PLN m	2015	2016	Change	Change (%)
Revenue	60	68	8	13%
Cost of sales	(55)	(51)	4	7%
Gross profit on sales	5	17	12	> 100%
Other operating income	13	12	(1)	-8%
General and administrative expenses	(86)	(81)	5	6%
Other operating expenses	(8)	(15)	(7)	-88%
Dividend income	914	874	(40)	-4%
Other financial income	233	224	(9)	-4%
Financial costs	(263)	(266)	(3)	-1%
Profit before tax	808	765	(43)	-5%
Income tax	33	19	(14)	-42%
Net profit	841	784	(57)	-7%

ENERGA SA's operating income is largely related to the services which the Company provides to other Group companies. The increase in revenues in 2016 was driven predominantly by growing revenues from marketing and IT activities.

The main source of the Company's financial income in 2016 was, as was the case in 2015, dividend income, which went down by PLN 40 m compared to the previous year.

The net result was significantly affected by a change in income tax. In 2015, a deferred tax asset was recognized in connection with the formation of the ENERGA Tax Group, whereas in 2016 no significant non-recurring events were recorded which would affect the amount of tax.

Accordingly, ENERGA SA's net result reached PLN 784 m, which was 7% less than the net profit earned during 2015.

Table 6: Statement of financial position

	Balance as at 31 December 2015	Balance as at 31 December 2016	Change	Change (%)
ASSETS				
Non-current assets				
Intangible assets	58	24	(34)	-59%
Shares in subsidiaries and associates	5,996	6,780	784	13%
Bonds	4,621	3,959	(662)	-14%
Deferred tax assets	24	5	(19)	-79%
Derivative financial instruments	48	147	99	> 100%
Other non-current assets	118	158	40	34%
	10,865	11,073	208	2%
Current assets				
Cash pooling receivables	-	577	577	-
Trade receivables and other current financial receivables	34	52	18	53%
Bonds	781	1,243	462	59%
Current tax receivables	37	102	65	> 100%
Portfolio of financial assets	314	-	(314)	-100%
Cash and cash equivalents	474	1,295	821	> 100%
Other current assets	38	38	-	-
	1,678	3,307	1,629	97%
TOTAL ASSETS	12,543	14,380	1,837	15%
EQUITY AND LIABILITIES				
Equity attributable to equity holders				
Share capital	4,522	4,522	-	-
Reserve capital	447	1,018	571	> 100%
Supplementary capital	661	728	67	10%
Cash flow hedge reserve	10	41	31	> 100%
Retained earnings	885	828	(57)	-6%

	6,525	7,137	612	9%
Non-current liabilities				-
Loans and borrowings	4,582	4,673	91	2%
Bonds issued	1,000	1,000	-	-
Non-current provisions	2	1	(1)	-50%
Deferred income and non-current grants	111	94	(17)	-15%
Derivative financial instruments	8	-	(8)	-100%
	5,703	5,768	65	1%
Current liabilities				
Cash pooling liabilities	-	1,009	1,009	-
Trade payables and other financial liabilities	22	19	(3)	-14%
Current loans and borrowings	207	290	83	40%
Bonds issued	16	20	4	25%
Deferred income and grants	27	23	(4)	-15%
Accruals	9	12	3	33%
Other current liabilities	34	102	68	> 100%
	315	1,475	1,160	> 100%
Total liabilities	6,018	7,243	1,225	20%
TOTAL EQUITY AND LIABILITIES	12,543	14,380	1,837	15%

As at 31 December 2016, total assets of ENERGA SA reached PLN 14,380 m and were PLN 1,837 m (15%) higher than as at 31 December 2015. Significant changes were related to the acquisition of stakes in subsidiaries (ENERGA Kogeneracja Sp. z o.o., Elektrownia Ostrołęka SA and ENERGA Invest SA), which was associated with ownership changes within the Group. At the same time, the value of investments in bonds issued by subsidiaries declined due to their redemption.

The increase in assets and liabilities was driven by the one-way zero-balancing cash pooling service launched in January 2016 for funds denominated in Polish zloty. According to the assumptions about the structure, at the end of each business day, cash owned by the Group's companies is consolidated on ENERGA SA's accounts and on the following day it may be used to finance payment liabilities of the individual participants.

The increase of liabilities on account of loans and borrowings was associated with the drawdown of financing from EBRD in the amount of PLN 276 m in 2016, which was partly offset by the repayment of liabilities incurred in previous years.

The settlement of the ENERGA SA 2015 result increased the reserve capital and supplementary capital in 2016 by PLN 571 m and PLN 67 m, respectively. The Company allocated PLN 203 m for dividends distributed to shareholders. As at 31 December 2016, equity covered 49.6% of the Company's assets, compared to 52.0% at yearend 2015.

Table 7: Statement of cash flows

in PLN m	2015	2016	Change	Change (%)
Net cash flow from operating activities	(26)	(22)	4	15%
Net cash flow from investing activities	933	752	(181)	-19%
Net cash flow from financing activities	(709)	88	797	> 100%
Net increase / (decrease) in cash	198	818	620	> 100%
Cash and cash equivalents at the end of the period	475	1,293	818	> 100%

The balance of ENERGA SA's cash as at 31 December 2016 was PLN 1,293 m. The total net cash flows from the Company's operating, investing and financing activities in 2016 were positive at PLN 818 m, compared to PLN 198 m in 2015.

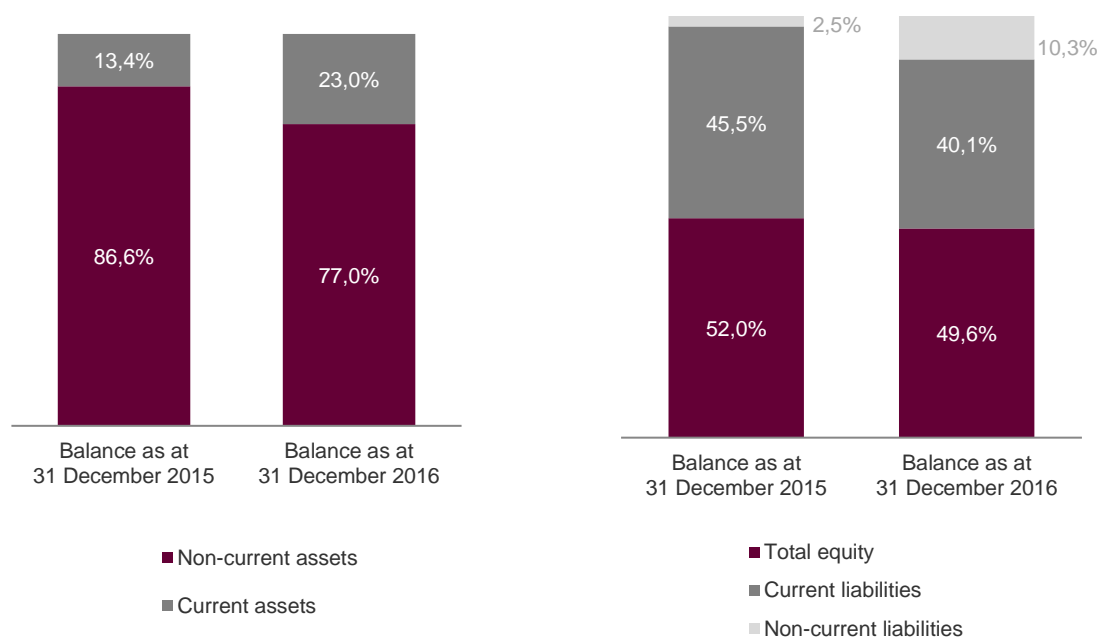
In terms of operating cash flows, an increase was recorded by PLN 4 m.

The decline in net proceeds from the Company's investing activities resulted from the acquisition of stakes in subsidiaries and lower dividend income, which was partly offset by positive cash flows associated with the resale of bonds issued by subsidiaries.

The increase in net cash flows from financing activities was predominantly driven by lower dividend payments and proceeds on account of the cash pooling service.

2.3. Structure of assets and liabilities in the statement of financial position

Figure 6: Structure of assets and liabilities



As at 31 December 2016, non-current assets represented 77% of total assets and current assets represented 23% of total assets. The increase in current assets in 2016 was driven primarily from the increase in cash, as described above. As at 31 December 2016, equity represented 49.6% of the sum of liabilities and equity. The remaining part of liabilities and equity was comprised of liabilities, with the highest portion attributable to financial liabilities.

2.4. Description of significant off-balance sheet items

There are no significant contingent assets and liabilities in the Company.

2.5. Projected financial results

The Management Board of ENERGA SA has not published projections of company or consolidated financial results for the financial year 2016.

2.6. Ratings

On 28 November 2016, Fitch Ratings affirmed the Company's long-term ratings at the previous level of BBB: the Company's long-term rating in local and foreign currencies and the rating for the Company's junior unsecured debt in the local and foreign currencies. The rating outlook remained stable (Current Report No. 43/2016).

On 9 February 2017, the Moody's Investors Service rating agency affirmed the Company's ratings at Baa1: the Company's long-term rating in domestic currency and rating for junior unsecured debt in domestic currency extended to the EMTN Program of the subsidiary ENERGA Finance AB (publ) with a total value of EUR 1 bn guaranteed by ENERGA. The rating outlook remained stable (Current Report No. 11/2017).

Table 8: Ratings awarded to ENERGA

	Moody's	Fitch
Company's long-term rating	Baa1	BBB
Rating outlook	Stable	Stable
Rating date	23 December 2011	19 January 2012
Last change of rating	-	12 October 2012
Last confirmation of rating	9 February 2017	28 November 2016

2.7. Dividend

On 24 June 2016, the Annual General Meeting adopted a resolution to distribute the 2015 profit, out of which PLN 203 m, i.e. PLN 0.49 per share, was allocated to a dividend for the Company's shareholders. The total declared dividend was paid out.

2.8. Information about the audit firm auditing the financial statements

The entity authorized to audit the Financial Statements of ENERGA SA and the ENERGA Group is PricewaterhouseCoopers Spółka z ograniczoną odpowiedzialnością ("PwC").

The agreement between ENERGA SA and PwC was entered into on 18 July 2016 and pertained to an audit of the Company's financial statements and the consolidated financial statements for 2016 and to a review of the financial statements for H1 2016.

Table 9: Auditor's fee for services provided to the Company (PLN 000s)

PLN 000s	Year ended 31 December 2015	Year ended 31 December 2016
Audit of the annual financial statements	59	59
Other assurance services, including a review of financial statements	74	84
Tax consulting services	-	-
Other services	225	190
Total	358	333

Shares and shareholding structure



3. SHARES AND SHAREHOLDING STRUCTURE

3.1. ENERGA's shareholding structure

Table 10: Issuer's shares by series and types

Series	Type of shares	Shares	(%)	Votes	(%)
AA	ordinary bearer shares	269,139,114	65.00	269,139,114	48.15
BB	registered preferred shares*	144,928,000	35.00	289,856,000	51.85
TOTAL		414,067,114	100.00	558,995,114	100.00

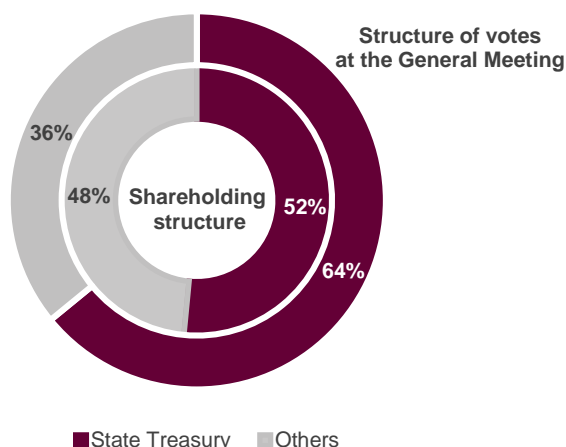
* One preferred share entitles its holder to 2 votes at the General Meeting. These shares are owned by the State Treasury.

Table 11: Shareholding structure of ENERGA as at 14 November 2016, 31 December 2016 and the date of preparing these financial statements

Shareholder's name	Company's shareholding structure			
	Shares	(%)	Votes	(%)
State Treasury*	213,326,317	51.52	358,254,317	64.09
others	200,740,797	48.48	200,740,797	35.91
TOTAL	414,067,114	100.00	558,995,114	100.00

* The State Treasury holds 144,928,000 series BB registered shares preferred in terms of voting at the General Meeting in such a way that one share entitles the holder to 2 votes at the General Meeting.

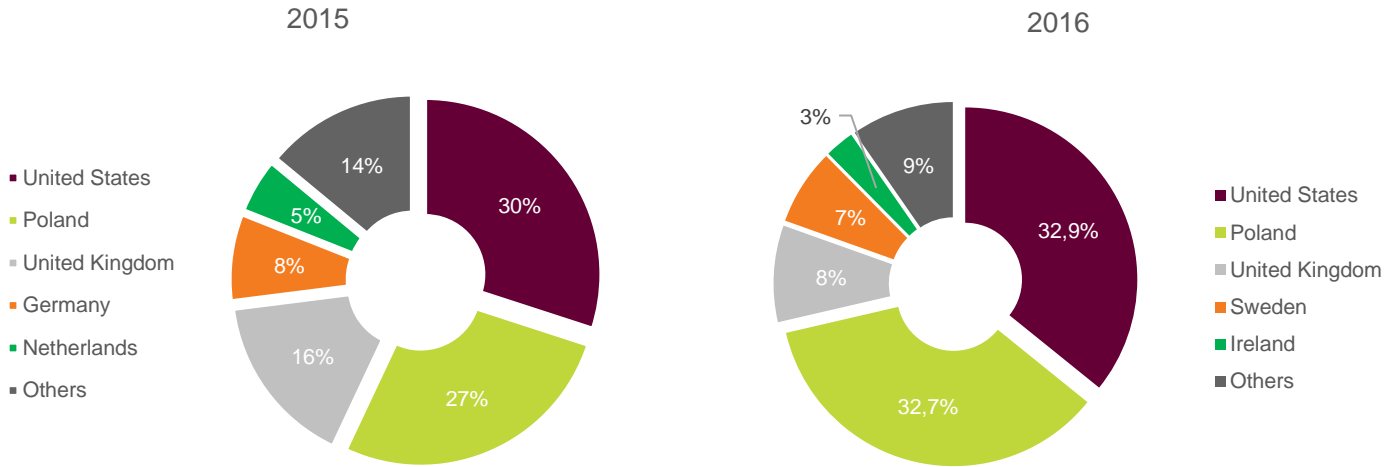
Figure 7: Shareholding structure of ENERGA and structure of votes at the General Meeting as at 14 November 2016, 31 December 2016 and the date of preparing these financial statements



The State Treasury is the Company's majority shareholder. As at the end of 2016, Open-End Pension Funds (OFEs) held 36,161 thousand shares, which represented a 8.7% stake in the Company. In relation to the last day of December of the year before, OFE's share increased by 1.2%.

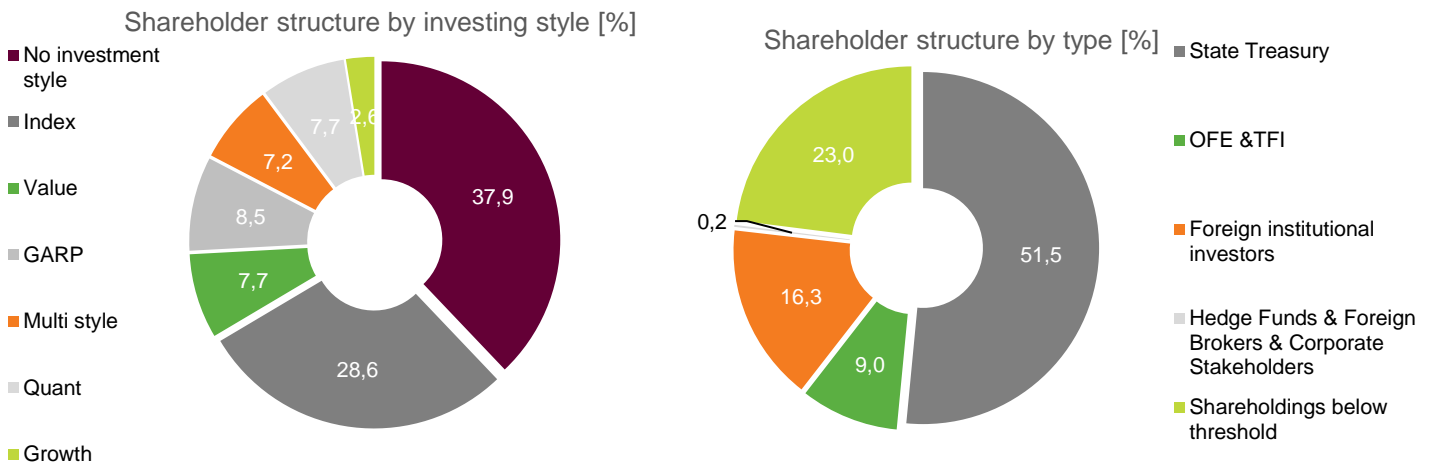
In 2016, the majority of the free float was held by international institutional shareholders, mostly from the United States (33%), UK (8%) and Sweden (6%).

Figure 8: Percentage of free float held by institutional investors in 2015 and 2016, by country of origin



Source: proprietary material based on Nasdaq and Orient Capital data

Figure 9: Shareholder structure in 2016, by investing styles and types



Source: proprietary material based on Orient Capital data

3.2. Other information on shares and shareholding structure of ENERGA SA

The Management Board is unaware of existence of any agreements (including any agreements which may have been concluded after the balance sheet date) which may result in future changes to the proportions of shares held by the current shareholders and bondholders.

Also, the Issuer is not aware of any significant agreements concluded between shareholders.

The Company does not have employee stock ownership programs.

In 2016, the Company and subsidiaries did not purchase any treasury stock of ENERGA. As at 31 December 2016, the Company and subsidiaries did not hold shares in ENERGA.

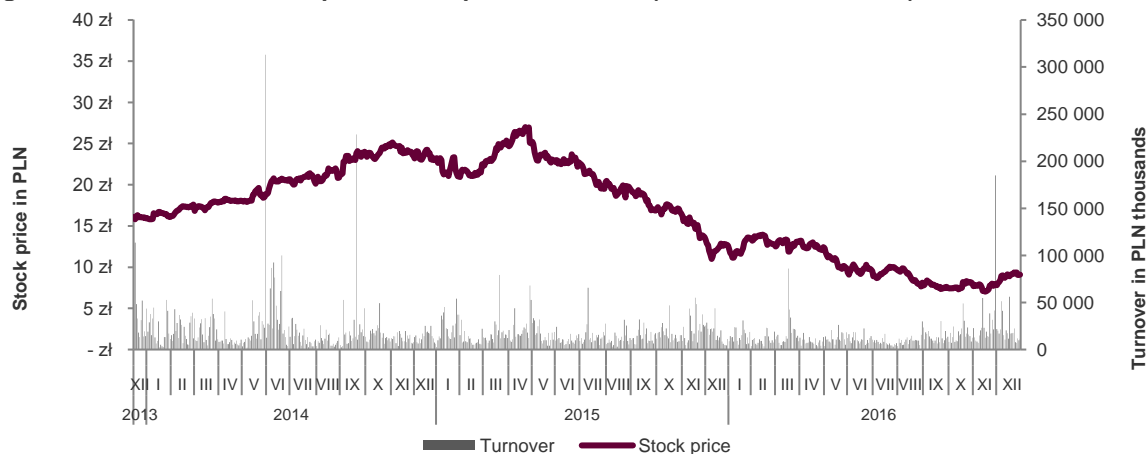
3.3. Company stock prices on the Warsaw Stock Exchange

Table 12: Data for ENERGA stock as at 31 December 2016

Data	Value
Issue price	PLN 17.00
Number of shares	414,067,114
Stock price at the end of the period	PLN 9.10
Capitalization at the end of the period	PLN 3.77 bn
Minimum at closing in Q4	PLN 7.03
Maximum at closing in Q4	PLN 9.37
Minimum at closing in 2016	PLN 7.03
Maximum at closing in 2016	PLN 13.94
Minimum in 2016	PLN 6.82
Maximum in 2016	PLN 14.30
Average trading value	PLN 14 m
Average trading volume	1,527 thous. shares
Average number of trades	2,357 trades

Source: Proprietary material based on data from www.gpwinfostrefa.pl

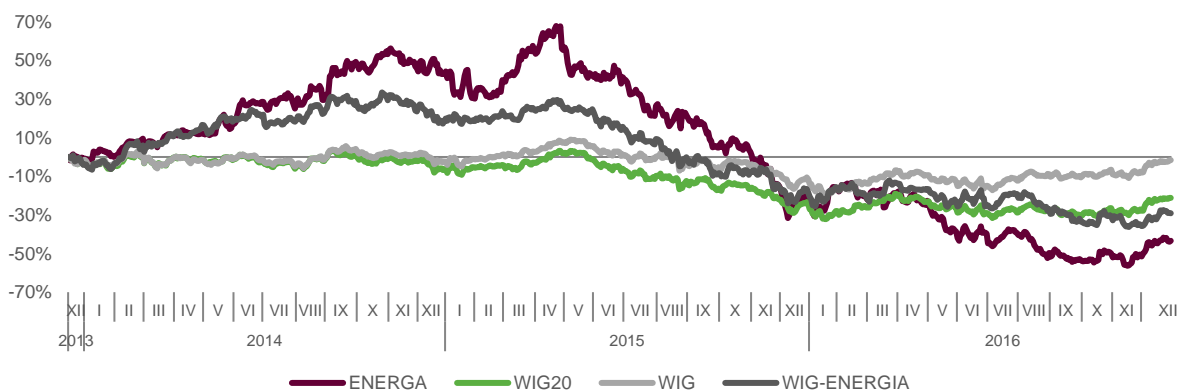
Figure 10: ENERGA SA stock price, in the period from IPO (i.e. 11 December 2013) to 31 December 2016



Source: Proprietary material based on data from gpwinfostrafa.pl

As at 31 December 2016, total shareholder return dividends for shareholders that acquired ENERGA SA shares at issue price was -29%.

Figure 11: Changes in ENERGA quotations in comparison with changes in WIG and WIG-ENERGIA indices



Source: Proprietary material based on data from gpwinfostrafa.pl

As at 31 December 2016, the Company formed part of the following stock market indices:

WIG – an index comprised of all companies listed on the Main Market of the Warsaw Stock Exchange, which meet the base criteria for participation in the indices.



WIG20 – a price index (meaning that only prices of concluded transactions are taken into account in its calculation) grouping 20 largest and most liquid companies from WSE’s Main Market.



WIG30 – a price index launched on 23 September 2013, comprising (30) companies with the highest position in the ranking determined on the basis of the data after the last session of January, April, July and October. The ranking is calculated on the basis of the trading volume for the past 12 months and the value of shares in free float as at the ranking date.



WIG-Energia – a sectoral index, which is comprised of companies which participate in the WIG index and are at the same time categorized as “power sector” companies.



WIGdiv – an index calculated since 2010, comprising up to 30 companies which in the index ranking were in a position not lower than 150 and are characterized by the highest dividend rate at the end of November each year and over the past 5 financial years paid out dividends at least 3 times.



WIG-Poland – an index comprised only of shares of domestic companies listed on the Main Market of WSE, which meet the base criteria for participation in the indices.



RESPECT Index – an index bringing together companies with the highest corporate social responsibility standards. It has existed on WSE since 2009 and is the only index of this type in Central European countries.



FTSE All World – an international index comprised of shares of medium and large companies from the FTSE Global Equity Index Series. It is calculated for mature and emerging markets and forms the basis for investment products such as e.g.



derivatives and the tracking passive fund portfolios. In addition to MSCI-Poland, this index is also an important measure for foreign funds investing in Polish equities.

FTSE4Good Emerging Index – an index grouping companies from more than 20 emerging economies that are selected on the basis of compliance of their operations with the environmental, corporate social responsibility and corporate governance criteria.

MSCI Global Sustainability Indexes is one of the indices calculated by MSCI ESG Research. The index has been developed for investors seeking companies with a profile focused on sustainable development.



3.4. Investor relations in ENERGA SA

In 2016 the Investor Relations Department executed tasks aimed at boosting the effectiveness of communication in the capital market, among others:

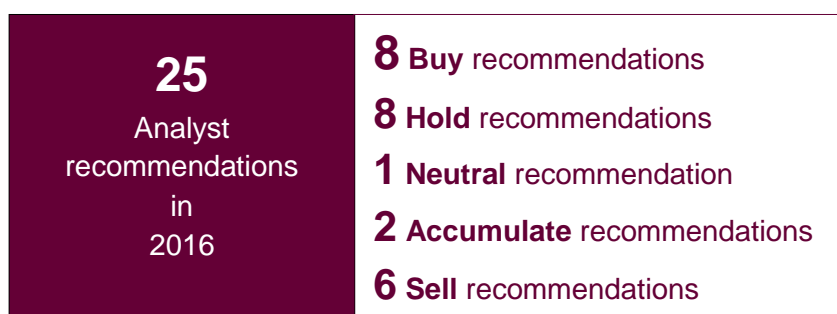
- (1) Publication of 55 current reports and 4 periodic reports,
- (2) More than 100 individual meetings with institutional investors (investor conferences or non-deal roadshows),
- (3) Online publication of the 2015 annual report,
- (4) 4 results conferences accompanied by online broadcast,
- (5) A “study tour” in Gdańsk for a group of analysts and institutional investors,
- (6) Investors chat with a Management Board members (addressed mainly to individual investors),
- (7) Constant communication with analysts issuing recommendations on companies to their customers.

In its activity, the Investor Relations Department uses a bilingual website, updated on an ongoing basis to include key information about the Group in the form of, among other things, quarterly results presentations or factual summaries, the so-called factsheets. Market participants may familiarize themselves with the rules applied by the Company in investor relations – the website includes the [Information policy](#).

3.5. Recommendations for the Company's stock

In 2016, the analysts of brokerage houses and investment banks issued 25 recommendations for ENERGA SA shares. A list of the recommendations can be found at [the Company's Investor Relations website](#).

Figure 12: Recommendations issued for ENERGA's shares in 2016



Representation on the application of Corporate governance principles



4. REPRESENTATION ON THE APPLICATION OF CORPORATE GOVERNANCE PRINCIPLES

In 2016, the Company and its authorities were subject to corporate governance rules, which are described in the set adopted by Resolution No. 26/1413/2015 of the Supervisory Board of the Warsaw Stock Exchange on 13 October 2015 as "Code of Best Practice for WSE Listed Companies 2016" ("Code of Best Practice", "DPSN") and were posted on the Warsaw Stock Exchange's website and the Company's website in the "Investor Relations" tab.

4.1. Corporate governance principles not applied in the Company

On 5 January 2016, ENERGA SA published information through the EBI system that the Company does not apply certain principles set out in the Best Practice, that is:

- Detailed principle I.Z.1.16 and IV.Z.2 concerning the transmission of general meetings and Principle I.Z.1.20 – the wording of the Company's Articles of Association in effect in 2016 did not envisage the use of the means of electronic communication during general meetings. On 15 December 2016, the Extraordinary General Meeting of ENERGA SA amended the Articles of Association, among others by introducing provisions that allow those principles set out in the Best Practice to be applied as of 2017.
- Principle III.Z.3 – the Company does not meet the requirement of standard 1110-1 only in respect to the organizational independence, that is appointment and dismissal of an Internal Audit Head and approval and changes of his/her remuneration.

The standard mentioned above is defined in the International Standards for the Professional Practice of Internal Auditing by the Institute of Internal Auditors.

Additionally the Internal Audit Head is not functionally subordinated to the Supervisory Board. Additionally, in 2016 the Company analyzed the following principles: I.Z.1.14, II.Z.1 (in conjunction with I.Z.1.3), II.Z.10.3, II.Z.10.4, V.Z.6, VI.Z.1, VI.Z.4. After the analyses are completed, the Company will update its position on the application of those principles. Since no decision on the publication of projections has been made, in light of the Finance Minister's regulation on current and periodic information of 19 February 2009, detailed principle I.Z.1.10 was also not be applied.

4.2. Major shareholders

Information on the shareholding structure is presented in chapter 5.1. *ENERGA SA's shareholding structure* of these financial statements.

4.3. Holders of securities giving special rights of control and description of these rights

According to the information presented in the previous sub-clause, the State Treasury is the holder of the majority block of shares and votes at the General Meeting. It held 144,928,000 series BB registered shares preferred in terms of voting at the General Meeting so that one series BB share entitles the holder to two votes at the General Meeting.

In addition, the State Treasury has the personal right to appoint and dismiss some members of the Company's Supervisory Board, and name the Supervisory Board Chairman, on the terms and conditions set forth in the Company's Articles of Association. Detailed information in that regard is included in the sub-section entitled Rules for appointing and dismissing Supervisory Board members.

At the same time, according to the Company's Articles of Association, the State Treasury has the right to receive:

- 1) information on the Company and the Group in the form of a quarterly report in accordance with the current guidelines, subject to relevant provisions on disclosure of confidential information,
- 2) copies of announcements, which must be published in the Court and Economic Monitor,
- 3) set of documents, which are to be examined at the Annual General Meeting pursuant to Article 395 § 2 of the Commercial Company Code ("CCC"), i.e. financial statements (consolidated financial statements of the Group), Management Board's report on the Company's activity (Management Board's report on the activity of the Group) for the previous financial year, auditor's opinion and report from the audit of the financial statements (consolidated financial statements of the Group), Supervisory Board's report, and the Management Board's motion on distribution of profit and coverage of loss,
- 4) consolidated version of the Articles of Association, within four weeks from the date of entering the amendments to the Articles of Association in the business register.

4.4. Restrictions regarding the exercise of voting rights

Provisions of § 27 of the Company's Articles of Association contain restrictions on the voting rights by shareholders, users and pledgees holding shares giving more than 10% of total number of votes at the General Meeting, as at the date of holding the General Meeting.

For the purposes of restricting the voting right, the votes of the shareholders connected by a parent or subsidiary relationship within the meaning of the following provisions are also accumulated by adding the votes held by those shareholders.

If as a result of accumulation it becomes necessary to restrict the voting rights, this will be done by pro rata reduction of the votes of all shareholders connected by a parent or subsidiary relationship, and the votes of the shareholder with the largest bundle of shares will be rounded up or down. If it is not possible to round up or down because two or more shareholders hold the same number of votes, the Management Board will randomly select a shareholder, whose votes will be rounded up or down. The reduction cannot lead to depriving the shareholder of the voting rights in their entirety.

The provisions governing the restriction on the voting rights do not apply to the State Treasury, which, pursuant to the Articles of Association, on the date of the restriction had entitlement under shares corresponding to more than 10% of the overall number of votes in the Company.

Moreover, the foregoing restrictions do not contravene the requirements concerning the purchase of significant blocks of shares according to the Act on Public Offerings and the Terms and Conditions for Introducing Financial Instruments into an Organized Trading System and on Public Companies of 29 July 2005 (i.e. Journal of Laws of 2013, item 1382) (hereinafter referred to as the "Act on Public Offering"). In a similar fashion, these provisions do not apply to the determination of obligations of the entities, which are purchasing or are to purchase significant blocks of shares.

In addition to the foregoing mechanism and those described in the generally applicable provisions of law, including the Commercial Company Code, there are no additional mechanisms that would specifically restrict the exercise of voting rights.

4.5. Restrictions on the transfer of ownership title to securities

As at the date of preparation of this Report, there are no restrictions on the transfer of title to Company's securities.

4.6. Rules for amending the Company's Articles of Association

The Company's Articles of Association are amended as set forth in the Commercial Company Code; in particular: Articles of Association are amended by way of a resolution adopted by the General Meeting by the majority of three quarters of the votes and then must be entered in the business register. The Company's General Meeting may authorize the Supervisory Board to agree upon the consolidated

version of the Company's amended Articles of Association or introduce such other editorial changes as may be specified in a resolution of the General Meeting.

Pursuant to § 27 section 8 and 9 of the Company's Articles of Association:

- 1) resolutions adopted by the General Meeting (which also require amendments to the Articles of Association) on the following subjects:
 - a) introduction of shares of various types, establishment of shares of a new type,
 - b) change of the preference of shares,
 - c) split-up of the Company, except for split-up through spinning-off,
 - d) moving of the Company's registered office,
 - e) transformation of the Company,
 - f) reduction of share capital through redemption of part of shares unless the reduction takes place simultaneously with increase of share capital, require the majority of four fifth of the votes cast.
- 2) a General Meeting resolution on a significant change of the Company's line of business may be adopted without buying up shares held by shareholders who oppose such change.

On 15 December 2016, the Extraordinary General Meeting of ENERGA SA among others amended the wording of the Company's Articles of Association, which remains in effect up to this date.

4.7. Company's corporate bodies

General Meeting

Rules of operation of the Company's General Meeting are regulated by the Commercial Company Code and the Company's Articles of Association. Additional issues related to the course of a General Meeting are defined in the General Meeting Bylaws (available on the Company's corporate website).

The Company's shareholders also have rights related to the General Meeting, which arise from the applicable provisions of law.

Manner of convening the General Meeting

The General Meeting is convened through announcement made on the Company's website and in the manner specified for publication of current information according to the Act on Public Offering, i.e. in the form of current reports. The announcement should be made at least twenty six days before the date of the General Meeting, according to the regulations set forth in the Commercial Company Code.

The Management Board convenes the General Meeting according to the Articles of Association.

- 1) at its own initiative,
- 2) at the written request the Supervisory Board, at the written request of a shareholder or shareholders representing at least one twentieth of the share capital or
- 3) at the written request of the State Treasury as long as the State Treasury remains a shareholder in the Company.

By principle, the properly convened General Meeting is valid irrespective of the number of shares represented thereat.

The General Meeting may be held in the Company's registered office (in Gdańsk) or in Warsaw.

Course of the General Meeting

The Supervisory Board Chairman or Deputy Chairman and if absent - the President of the Management Board or a person appointed by the Management Board opens the General Meeting. Then the Chairperson of the General Meeting is elected from among the persons authorized to participate in the General Meeting, in accordance with the provisions of the General Meeting Bylaws.

A resolution in matters not included in the agenda of the General Meeting may not be adopted, unless the Company's entire share capital is represented at the General Meeting and none of the persons present raises an objection to adopt a resolution.

Votes shall be cast in an open ballot. Secret ballot will be ordered during elections and when voting on motions to dismiss members of the Company's authorities or liquidators to hold them liable as well as in the case of personal matters. Furthermore, a secret ballot should be ordered at the request of at least one shareholder from among those present or represented at the General Meeting.

Pursuant to the Company's Articles of Association, the voting rights of the shareholders and the voting rights of the users and pledgees of shares is subject to restrictions described in detail in item Restrictions regarding the exercise of voting rights.

Resolutions of the General Meeting are adopted with the absolute majority of votes cast, unless the Commercial Company Code or the Articles of Association provide otherwise.

The General Meeting may request an adjournment in the meeting (by a two-thirds majority of votes) which may not last more than thirty days in aggregate.

Powers of the General Meeting

The most important powers of the General Meeting defined by the Commercial Company Code and the Articles of Association include:

- 1) reviewing and approving the Management Board report on the Company's activity and the financial statements for the completed financial year;
- 2) granting a discharge to members of the Company's corporate bodies on the performance of their duties,
- 3) distributing profit or covering a loss,
- 4) changing the Company's line of business,
- 5) amending the Company's Articles of Association,
- 6) increasing or decreasing the Company's share capital,
- 7) merging, splitting up or transforming the Company,
- 8) dissolving or liquidating the Company,
- 9) issuing convertible bonds or bonds with a pre-emptive right, and on issuing subscription warrants,
- 10) selling or leasing an enterprise or an organized part thereof and establishing a limited right in rem thereon,
- 11) creating, using and liquidating the Company's capitals and funds,
- 12) appointing or dismissing Supervisory Board members and setting their compensation levels,
- 13) depriving current Company shareholders of their pre-emptive rights, in whole or in part,
- 14) allowing the Company to purchase treasury stock and authorizing the Management Board to purchase treasury stock for retirement,
- 15) allowing the Company to enter into a credit facility, loan, surety agreement or some other similar agreement with a Management Board Member, a Supervisory Board member, a general proxy or a liquidator or in favor of any such person,
- 16) purchasing real property, perpetual usufruct or share in real property or in perpetual usufruct, worth more than PLN 20 m,
- 17) purchasing non-current assets, except for real estate or right of perpetual usufruct, and except for purchasing and subscribing for shares in other companies, worth more than PLN 20 m,
- 18) disposing of non-current assets, including real estate, right of perpetual usufruct, or share in real estate or right of perpetual usufruct, except for shares in other companies, worth more than PLN 20 m;
- 19) changing the record date, setting the record date or spreading the payment of dividend into installments.

Three General Meetings of the Company were held in 2016:

- 1) Extraordinary General Meeting on 7 January 2016. The wording of resolutions adopted during that Meeting was published in the Current Report No. 2/2016 of 7 January 2016;
- 2) Annual General Meeting on 24 June 2016. The wording of resolutions adopted during that Meeting was published in the Current Report No. 24/2016 of 24 June 2016;
- 3) Extraordinary General Meeting on 15 December 2016. The wording of resolutions adopted during that Meeting was published in the Current Report No. 50/2016 of 16 December 2016.

Supervisory Board

Composition

In the 2016 financial year and until the date of this Report the ENERGA SA Supervisory Board operated in the following composition:

- 1) in the period from 1 January to 3 January 2016:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Bogdan Skalski – Supervisory Board Secretary,
 - d) Jarosław Mioduszeński – Supervisory Board Member,
 - e) Mirosław Szreder – Supervisory Board Member,
 - f) Roman Pionkowski – Supervisory Board Member,
- 2) in the period from 3 January to 7 January 2016:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Bogdan Skalski – Supervisory Board Secretary,
 - d) Jarosław Mioduszeński – Supervisory Board Member,
 - e) Mirosław Szreder – Supervisory Board Member,
- 3) in the period from 7 January 2016 to 8 September 2016:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Bogdan Skalski – Supervisory Board Secretary,
 - d) Andrzej Powałowski – Supervisory Board Member,
 - e) Marek Szczepaniec – Supervisory Board Member,
 - f) Maciej Żótkiewicz – Supervisory Board Member.
- 4) in the period from 8 September 2016 to 30 December 2016:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Agnieszka Terlikowska-Kulesza – Supervisory Board Secretary,
 - d) Andrzej Powałowski – Supervisory Board Member,
 - e) Marek Szczepaniec – Supervisory Board member,
 - f) Maciej Żótkiewicz – Supervisory Board member.
- 5) in the period from 30 December 2016 to 10 February 2017:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Agnieszka Terlikowska-Kulesza – Supervisory Board Secretary,
 - d) Andrzej Powałowski – Supervisory Board Member,
 - e) Marek Szczepaniec – Supervisory Board Member,
 - f) Maciej Żótkiewicz – Supervisory Board Member,
 - g) Jacek Kościelniak – Supervisory Board Member.
- 6) in the period from 10 February 2017 until the date of preparing this Report:
 - a) Paula Ziemiecka-Księżak – Supervisory Board Chairwoman,
 - b) Zbigniew Wtulich – Supervisory Board Deputy Chairman,
 - c) Agnieszka Terlikowska-Kulesza – Supervisory Board Secretary,
 - d) Andrzej Powałowski – Supervisory Board Member,
 - e) Marek Szczepaniec – Supervisory Board Member,
 - f) Maciej Żótkiewicz – Supervisory Board Member,

In connection with his appointment to the Company's Management Board, Mr. Roman Pionkowski tendered his resignation from membership in the Supervisory Board as of 3 January 2016.

As of 7 January 2016 the Extraordinary General Meeting of ENERGA SA dismissed Mr. Jarosław Mioduszczyński and Mr. Mirosław Szreder from the ENERGA SA Supervisory Board and appointed three Supervisory Board Members for its fourth term of office, i.e. Mr. Andrzej Powalowski, Mr. Marek Szczepaniec and Mr. Maciej Żółtkiewicz.

As of 8 September 2016, Mr. Bogdan Skalski was dismissed from the Supervisory Board by a declaration of the Minister of Energy and Ms. Agnieszka Terlikowska-Kulesza was appointed.

As of 30 December 2016, Mr. Jacek Kościelniak was appointed to the Supervisory Board by a declaration of the Minister of Energy.

On 17 January 2017, Mr. Roman Pionkowski was delegated by the Company's Supervisory Board to act temporarily in the capacity of a Management Board Member responsible for managing the Company for a period of up to three months from the date of delegation. Then, in connection with his appointment to the Company's Management Board, Mr. Jacek Kościelniak tendered his resignation from membership in the Supervisory Board as of 10 February 2017.

Mr. Andrzej Powalowski and Mr. Marek Szczepaniec satisfy the criteria envisaged for independent supervisory board members within the meaning of the Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, taking into account the requirements following from the 2016 Code of Best Practice for WSE Listed Companies.

The current term of the Supervisory Board ends on 20 May 2017.

Paula Ziemiecka-Książak graduated from the Leon Koźmiński Entrepreneurship and Management College. In 1996 employed in the Ministry of the State Treasury. She worked in the oversight departments for State Treasury-owned companies. She supervised companies from the road transportation, marine shipping and power sectors. She currently is a sub-department head in the Supervision Department at the Ministry of Energy. Her scope of duties comprises supervision of overall economic and legal issues associated with the activity of State Treasury-owned companies from, among others, the black coal mining and power sector. In addition, she gathered experience associated with corporate governance since 2002 discharging functions in the supervisory bodies of such companies as SIP-MOT SA in Zamość, PKS Ostrołęka SA and Opakomet SA with its registered office in Płock. She has been acting in the capacity of the ENERGA SA Supervisory Board Chairperson since 12 November.

Agnieszka Terlikowska-Kulesza is a graduate of the Agricultural Faculty of the Warsaw University of Life Sciences and post-graduate studies in finance and European economic and legal relations at Warsaw School of Economics. In 1997 she joined the team of the State Treasury Ministry at the Commercialization and direct Privatization Department, the Tender Privatization Team. From September 1997 to June 2002 she worked for the Privatization Agency in the Tender Team as chief specialist and then as Section Manager. During that period, she participated in the organization of tenders for the selection of entities performing pre-privatization analyses of companies with State Treasury holdings, she oversaw and executed privatization projects, conducted mainly through the invitation to tender procedure, she verified economic and financial analyses and valuations of companies with State Treasury holdings slated for privatization. From July 2002 to June 2016, she was chief specialist in State Treasury corporate supervision departments at the State Treasury Ministry. She supervised companies from the ceramic, construction and motorized transportation industries. In 2009-2016 she supervised chemical sector companies, including companies such as CIECH S.A., Grupa Azoty S.A., Grupa Azoty Zakłady Azotowe "Puławy" S.A., Grupa Azoty Zakłady Chemiczne "Police" S.A., Grupa Azoty Kopalnie i Zakłady Chemiczne Siarki "Siarkopol" S.A., Zakłady Azotowe Chorzów S.A. Since July 2016, she has been chief specialist at the Control and Supervision Department at the Energy Ministry, where she is overseeing gas sector companies. She gathered additional experience by serving from 2001 to 2016 on the supervisory bodies of companies with State Treasury holdings, such as: "Chłodnia Szczecińska" Sp. z o.o., Zakłady Ceramiczne "Bolesławiec" w Bolesławcu Sp. z o.o., Przedsiębiorstwo Komunikacji Samochodowej w Białymstoku S.A.,

Przedsiębiorstwo Robót Drogowych Sp. o.o. in Mielec, Przedsiębiorstwo Elektryfikacji i Robót Instalacyjnych "ELTOR-Warszawa" Sp. z o.o. in Wołomin.

Zbigniew Wtulich graduated from the Faculty of Drainage and Water Engineering at the Warsaw University of Life Sciences. He started his professional career in 1984 as a Designer Assistant in the Water Drainage Design Department. Then he became a construction engineer in the Regional Drainage Projects Enterprise (in October 1984). He held this position until April 1988. From 1988 to 1991 he worked as an engineer in an international company doing business as "Amak" (construction industry) and from 1993 to 1997 he was employed by the State Treasury Agricultural Property Agency. Before appointment to the Company's Supervisory Board, Zbigniew Wtulich served as a chief specialist at the State Treasury Department of Assets Records at the State Treasury Ministry (1997-1998), a chief specialist - team coordinator at the State Treasury Restitution and Compensation Department at the State Treasury Ministry (1998-2001), sub-department head in the Restitution and Equity Allocation Department at the State Treasury Ministry (2002-2006), sub-department head in the Department of Records, Restitution, Compensation and Equity Allocation (2006-2010). He currently is a sub-department head in the Property Department at the State Treasury (since 2010). He also served as a Supervisory Board member in Zakłady Tworzyw Sztucznych "GAMRAT" SA (2011) and in Przedsiębiorstwo Gospodarki Wodnej i Rekultywacji S.A. (2002-2009).

Maciej Żółtkiewicz graduated from the Electrical Department of the Częstochowa University of Technology and completed post-graduate studies at the European University of Law and Administration in Warsaw. He started his career in 1979 as a technical specialist in the Eastern Power Region in Radom. He occupied this position until 1988. In 1988 – 1999 he was employed in Elektrociepłownia "Radom" S.A. as an Automation and Measurement Specialist, Corporate Governance and Restructuring Department Manager, Chief Specialist on Organizational and Employee Matters and Management Board Member. In 1999-2000 he was a Management Board Member of Zakład Maszyn do Szycia "Łucznik" Sp. z o.o. in Radom. In 2001-2005 he discharged the following functions: Receiver of "Putis" in Milanówek, Privatization Proxy of "Transdreg" in Warsaw, Vice-President of the Management Board of P.W. "Mediainstol" Sp. z o.o. in Radom. In 2006 – 2008 he discharged the function of President of the Management Board of Fabryka Łączników "Radom" S.A. From 2009 he was involved in internal control and audit in RTBS "Administrator" Sp. z o.o. in Radom, and from 2013 in "Radpec" S.A. in Radom. He gained experience related to overseeing the operations of State Treasury-owned companies by sitting in the supervisory boards of companies such as: Elektrociepłownia "Radom" S.A., Elektrownia Wodna Żarnowiec S.A., Fabryka Łączników "Radom" S.A. In 2009 – 2015 he sat in the supervisory board of PPUH "Radkom" Sp. z o.o. in Radom.

Marek Szczepaniec graduated from the University of Gdańsk. Currently, he is a professor at the University of Gdańsk (from 2008) and professor at the Kazimierz Wielki University in Bydgoszcz (from 2014). In 1993-2001 he worked as a consultant at the Polish-American Small Business Advisory Foundation. In 1992-2006 he was a consultant of the B.P.S. Consultants Poland. From 2006 he has been a co-owner and vice-president of a research firm called Qualifact. He specializes in research on entrepreneurship, human capital, economic growth, behavioral finance and corporate marketing strategies. He is the author of over 150 research reports, scientific articles and other publications. The following companies from the banking sector, among others, used his reports and studies: PKO Bank Polski, BZ WBK, Credit Agricole, BNP Paribas, Pekao SA, ING, mBank; from the insurance sector: PZU, Warta, Compensa, Allianz, Aviva; from the fuel sector: LOTOS Group, PKN Orlen, BP, Total. He managed market research for Elektrociepłownia Wybrzeże and the ENERGA Group and is the author of a study entitled "Energy company customer service models. Global trends".

Andrzej Powalowski studied from 1969 to 1973 at the Faculty of Law and Administration in the Nicolaus Copernicus University in Toruń. In 1973 he started to work as an assistant in the National Economy Management Law Section at the Faculty of Law and Administration in the University of Gdańsk. In 1980 he obtained the title of doctor of legal sciences and was employed at the position of assistant professor. From 1992 he worked on the position of senior lecturer at the Public Economic Law Faculty and from 1994 at the Public Economic Law and Environmental Protection Faculty. In 2009 he obtained the title of habilitated doctor of legal sciences in the area of public economic law. In 2010 he was nominated to the position of associate professor of Gdańsk University. At the Law and Administration Faculty in the

University of Gdańsk he is currently the head of the Public Economic Law Section and head of the post-graduate study programs entitled "Legal conditions for conduct of economic activity" and "Public procurement law and system". He is also a lecturer at the Off-Site Faculty of the Gdańsk School of Higher Education in Olsztyn. He was employed as an associate professor of the Baltic College of the Humanities and the Real Estate Management College. Author of numerous publications in the form of books and articles for scientific magazines; he is a member of the governing bodies of non-governmental organizations and scientific periodicals. He worked as a legal advisor and since 2010 he has been an advocate in his own law firm in Gdańsk. He discharges the function of arbitrator at the International Court of Arbitration at the Polish Chamber of Maritime Commerce.

None of the Company's aforementioned Supervisory Board Members is engaged in any business competitive to that of ENERGA SA, participates in a competitive entity as a partner in a civil law company or partnership or as a member of a corporate authority of a joint stock or limited liability company and does not participate in any other competitive legal person as a member of its corporate authority, or is listed in the Register of Insolvent Debtors kept pursuant to the National Court Register Act.

Supervisory Board's powers

The Supervisory Board's powers include in particular:

- 1) evaluation of the Management Board's reports on the Company's activity and the Group's activity and the financial statements for the previous financial year and the Group's consolidated financial statements in terms of their compliance with the accounting ledgers and documents as well as the actual state of affairs, and the evaluation of the Management Board's motion on the distribution of retained earnings,
- 2) submitting written reports to the General Meeting on the results of the activities referred to in item 1,
- 3) submitting the reports in connection with exercising the supervision over the Management Board's execution of investments, and the supervision over the correctness and effectiveness of spending funds on the investments,
- 4) preparing, at least once a year, along with a report from assessment of the annual financial statements and the consolidated financial statements of the group, the Supervisory Board's opinion on the issue of economic justification for the Company's capital exposure to other commercial companies, made in the given financial year,
- 5) once a year preparing and presenting to the Annual General Meeting a concise assessment of the Company's standing, including an evaluation of the internal audit system and the significant risk management system,
- 6) reviewing and opining the issues to be included in the resolutions of the General Meeting,
- 7) selecting a statutory auditor to audit the financial statements,
- 8) approving the strategy of the Company and its Group,
- 9) approving the annual/long-term material and financial plans and investing activity plans of the Company and its Group,
- 10) adopting bylaws defining in detail the Supervisory Board's functioning,
- 11) approving the Management Board bylaws,
- 12) approving the organizational bylaws of the Company's enterprise,
- 13) approving the rules for sponsorship activity conducted by the Company,
- 14) setting the rules and remuneration of the President and Members of the Management Board, subject to mandatory provisions of law,
- 15) delegating Supervisory Board members to temporarily perform the duties of Management Board Members who cannot perform their activities and setting their remuneration,
- 16) determining the manner in which the Company votes at general meetings of its subsidiaries.

A detailed description of the Supervisory Board's powers is included in the Company's Articles of Association posted on the corporate website.

Operation of the Supervisory Board

The Supervisory Board exercises permanent supervision over the Company's activity, in accordance with the Commercial Company Code and the Company's Articles of Association. The Supervisory Board Bylaws posted on the corporate website specify the detailed procedure for how it functions.

The Supervisory Board performs its activities as a collective body. Supervisory Board members participate in meetings, exercise their rights and perform their duties in person. Supervisory Board Members are obligated to maintain confidentiality of information related to the Company's activity, which they obtained when discharging their function or otherwise.

By principle, the Supervisory Board adopts resolutions at its meetings, which are held at least once every two months.

The Chairman or Deputy Chairman convenes Supervisory Board meetings presenting a detailed agenda. A meeting should also be convened at the request of any Supervisory Board member or at the request of the Management Board.

Supervisory Board meetings are chaired by the Supervisory Board Chairman, and during his/her absence by the Supervisory Board Deputy Chairman.

Supervisory Board members are allowed to participate in the meeting and vote on resolutions adopted during that meeting using remote means of direct communication, such as conference calls and video conference calls, with the reservation that there is at least one Supervisory Board member present at the location specified by the person convening the meeting and there is a technical possibility of ensuring a secure connection.

Pursuant to the Articles of Association, the Supervisory Board adopts resolutions in matters envisaged by the agenda if at least one-half of its members is in attendance at the meeting and all members have been invited to the meeting.

A change can be made to the proposed agenda if all Supervisory Board members are in attendance at the meeting and nobody raises an objection against the agenda. A matter not included in the agenda of the meeting, should be included in the agenda of the next meeting.

The Supervisory Board may adopt resolutions outside of meetings, by following a written procedure or via remote means of direct communication, including in particular via e-mail. Such a resolution will be valid if all Supervisory Board members have been notified of the content of the draft resolution.

Supervisory Board resolutions are adopted with the absolute majority of votes, and if the number of votes is equal, the vote cast by the Chairman will be decisive.

By principle, the Supervisory Board adopts resolutions in an open ballot, however a secret ballot will be ordered on the motion of a Supervisory Board member and in personal matters. If secret ballot is ordered, it will not be possible to adopt resolutions by following a written procedure or via remote means of direct communication.

The Supervisory Board may, for important reasons, delegate its specific members to perform specific oversight functions individually.

The Supervisory Board may delegate its members for a period no longer than three months, to perform temporarily the duties of Management Board Members, who were dismissed, resigned or who cannot perform their duties for any other reason;

A detailed description of the Supervisory Board's activity in the past financial year is provided in the Supervisory Board activity report submitted each year to the General Meeting and published on the Company's corporate website.

The Supervisory Board shall elect, from among its members, an Audit Committee and a Nomination and Compensation Committee.

In the period from 1 January to 31 December 2016, the ENERGA SA Supervisory Board held 17 meetings and adopted 107 resolutions. Two Supervisory Board meetings were held in 2016 with not all members in attendance.

In each case Supervisory Board members made a decisions in the form of a resolution to justify absences on the basis of information provided by the Supervisory Board members on the reasons for their absences.

The most important matters handled by the Supervisory Board in the 2016 financial year included, among others:

- 1) conducting executive search procedures for ENERGA SA Management Board members and determining the rules for and amount of compensation for ENERGA SA Management Board members,
- 2) approving the "Organizational Bylaws of the Enterprise of ENERGA Spółka Akcyjna",
- 3) analyzing the current economic and financial position of the Company and the Group and the execution and return on the investments conducted in the ENERGA Group.
- 4) issuing opinions on actions related to the implementation of investment projects in the ENERGA Group,
- 5) issuing opinions on amendments to the Articles of Association of ENERGA SA,
- 6) approving the Rules for sponsorship activity conducted by the ENERGA Group,
- 7) approving the ENERGA Group Strategy for 2016-2025, the Long-Term Plan of Strategic Investments of the ENERGA Group and the Long-Term Financial Model of the ENERGA Group.

Additionally, in 2016, the Supervisory Board decided on how to vote during general meetings of subsidiaries in the scope resulting from the Company's Articles of Association, approved the physical and financial plans of ENERGA SA and the ENERGA Group, evaluated financial statements and consolidated financial statements for the 2015 financial year with the motion to distribute profit and it monitored the Management Board's execution of the sponsoring activity plan.

Audit Committee

The principles of the Audit Committee's operation are set forth in the Articles of Association of ENERGA SA and the Supervisory Board Bylaws are available on the Company's website.

The Audit Committee operates as a collective body and serves as an advisory and opining body of the Supervisory Board.

The tasks of the Audit Committee include in particular the following:

- 1) monitoring the financial reporting process,
- 2) monitoring the reliability of financial information presented by the Company,
- 3) monitoring the effective operation of internal control, internal audit and risk management systems in place in the Company,
- 4) monitoring the performance of financial audit activities,
- 5) monitoring whether the auditor and the entity authorized to audit financial statements are independent and objective, including if they provide services other than financial review,
- 6) recommending an entity authorized to audit financial statements and to conduct financial review activities to the Supervisory Board.

Tasks of the Audit Committee are performed by providing the Supervisory Board with its conclusions, recommendations, opinions and reports within its tasks, in the form of resolutions.

The Audit Committee is independent from the Company's Management Board, which cannot give the Committee any binding instructions relating to its tasks.

The Audit Committee is composed of at least three Supervisory Board members, including at least one member who satisfies the independence criteria specified by the legal regulations and holds accounting or financial audit qualifications within the meaning of the Act on Statutory Auditors. According to the Articles of Association, this person should satisfy the requirements envisaged for independent

Supervisory Board members within the meaning of the Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162/EC), including the requirements following from the Code of Best Practice for WSE Listed Companies.

In the 2016 financial year, the Audit Committee operated in the following composition:

- 1) in the period from 1 January 2016 to 7 January 2016:
 - a) Mirosław Szreder – Committee Chairman,
 - b) Jarosław Mioduszewski,
 - c) Zbigniew Wtulich;
- 2) in the period from 7 January to 22 January 2016 - in connection with the dismissal of Mr. Mirosław Szreder and Mr. Jarosław Mioduszewski from the Supervisory Board, only Mr. Zbigniew Wtulich was in the Audit Committee,
- 3) in the period from 22 January 2016 till the date of preparing this Report:
 - a) Marek Szczepaniec - Committee Chairman,
 - b) Zbigniew Wtulich,
 - c) Andrzej Powałowski.

On 22 January 2016, the Company's Supervisory Board filled the vacancies in the Audit Committee by appointing Mr. Marek Szczepaniec and Mr. Andrzej Powałowski.

Mr. Marek Szczepaniec has been acting in the capacity of the Audit Committee Chairman since 14 March 2016.

A description of the Audit Committee's activity in the past financial year including a detailed description of the actions taken by the Committee is provided in the Audit Committee Activity Report attached to the Supervisory Board Activity Report submitted each year to the General Meeting and published on the Company's corporate website.

In 2016, the Audit Committee held 5 meetings with all members in attendance.

Nomination and Compensation Committee

The ENERGA SA Supervisory Board Nomination and Compensation Committee has been operating since 27 February 2015, when the Company's Supervisory Board made a decision to appoint it and approve the ENERGA SA's new Supervisory Board Bylaws in which it framed how it is to operate.

The scope of the Nomination and Compensation Committee's operation covers giving opinions and conducting analyses to support the Supervisory Board in the performance of its duties defined by the Articles of Association in respect of the overall compensation policy for Management Board members, the Company's upper level management and in the other companies in the ENERGA Group and to articulate recommendations on appointing Management Board members.

The following tasks in particular fall among the powers and duties of the Nomination and Compensation Committee:

- 1) conducting activities to recruit the Company's Management Board members to the extent designated by the Supervisory Board,
- 2) preparing draft versions of contracts and other model documents in connection with serving as the Company's Management Board members and overseeing the performance of the contractual obligations taken by the parties,
- 3) overseeing the implementation of the Management Board's compensation system, in particular preparing billing documents concerning variable and bonus elements of compensation,
- 4) monitoring and analyzing the compensation system for the Management Boards and management of companies in the ENERGA Group,
- 5) overseeing the correct execution of perks for the Company's Management Board stemming from contracts, among others: personal and medical insurance, usage of company cars, apartment and others.

In the 2016 financial year, the Nomination and Compensation Committee operated in the following composition:

- 1) in the period from 1 January 2016 to 8 September 2016:
 - a) Paula Ziemecka-Księżak – Committee Chairwoman,
 - b) Bogdan Skalski,
 - c) Zbigniew Wtulich.
- 2) in the period from 8 September 2016 to 20 September 2016:
 - a) Paula Ziemecka-Księżak – Committee Chairwoman,
 - b) Zbigniew Wtulich.
- 3) in the period from 20 September 2016 till the date of preparing this Report:
 - a) Paula Ziemecka-Księżak – Committee Chairwoman,
 - b) Agnieszka Terlikowska-Kulesza,
 - c) Zbigniew Wtulich.

Six Nomination and Compensation Committee meetings were held in 2016 – all of them with all members in attendance.

A description of the activity of the Nomination and Compensation Committee last year has been presented in the Activity Report of the Nomination and Compensation Committee forming an Attachment to the Supervisory Board Activity Report.

Management Board

Rules for appointing and dismissing Management Board Members

The Management Board may be composed of one to five members, including the President of the Management Board and one to a few Vice-Presidents of the Management Board. The term of office of the Management Board is a joint term of three years.

According to the Articles of Association, Management Board Members are appointed and dismissed by the Supervisory Board, which designates one of them as President of the Management Board and one or more of them as Executive Vice-President of the Management Board.

A Management Board Member may be also:

- 1) dismissed or suspended by the General Meeting,
- 2) suspended by the Supervisory Board for important reasons.

For as long as more than one half of the shares in the Company is owned by the State Treasury, the Supervisory Board will appoint Management Board Members after completing an executive search procedure on the basis of the Council of Minister's regulation on qualification procedures for management board members in certain commercial companies of 18 March 2003 (Journal of Laws of 2003, No 55, item 476, as amended).

A Management Board Member submits his/her resignation to the Supervisory Board in writing.

Composition

In 2016 and up to the date of preparation of this Report, the Company's Management Board operated with the following composition:

- 1) in the period from 1 January 2016 to 3 January 2016:
 - a) Roman Pionkowski – ENERGA SA Supervisory Board member delegated to perform temporarily the duties of a Management Board member acting in the capacity of President of the Management Board,
 - b) Seweryn Kędra – Vice-President of the Management Board for Financial Matters,
- 2) in the period from 4 January 2016 to 1 February 2016:
 - a) Dariusz Kaśków – President of the Management Board,
 - b) Roman Pionkowski – Vice-President of the Management Board for Development Strategy,

- c) Mariusz Rędaszka – Vice-President of the Management Board for Financial Matters,
- 3) in the period from 1 February 2016 to 26 February 2016:
 - a) Dariusz Kaśków – President of the Management Board,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
 - c) Roman Pionkowski – Vice-President of the Management Board for Development Strategy,
 - d) Mariusz Rędaszka – Vice-President of the Management Board for Financial Matters,
- 4) in the period from 26 February to 21 March 2016:
 - a) Dariusz Kaśków – President of the Management Board,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
 - c) Mariusz Rędaszka – Vice-President of the Management Board for Financial Matters,
- 5) in the period from 21 March 2016 to 17 January 2017:
 - a) Dariusz Kaśków – President of the Management Board,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
 - c) Mariusz Rędaszka – Vice-President of the Management Board for Financial Matters,
 - d) Przemysław Piesiewicz – Vice-President of the Management Board for Development Strategy,
 - e) Mariola Anna Zmudzińska – Vice-President of the Management Board for Investor Relations,
- 6) in the period from 17 January 2017 to 10 February 2017:
 - a) Jacek Kościelniak – ENERGA SA Supervisory Board member delegated to perform temporarily the duties of a Management Board member acting in the capacity of President of the Management Board,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
 - c) Mariola Anna Zmudzińska – Vice-President of the Management Board for Investor Relations,
- 7) in the period from 11 February 2017 to 16 February 2017:
 - a) Jacek Kościelniak – Vice-President of the Management Board for Financial Matters,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
 - c) Mariola Anna Zmudzińska – Vice-President of the Management Board for Investor Relations,
- 8) in the period from 17 February 2017 to 1 March 2017:
 - a) Jacek Kościelniak – Vice-President of the Management Board for Financial Matters,
 - b) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
- 9) in the period from 1 March 2017 to 2 March 2017:
 - a) Jacek Kościelniak – Vice-President of the Management Board for Financial Matters,
 - b) Alicja Barbara Klimiuk – Vice-President of the Management Board for Operations,
 - c) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,
- 10) in the period from 2 March 2017 till the date of preparation of this Report:
 - a) Daniel Obajtek – President of the Management Board
 - b) Jacek Kościelniak – Vice-President of the Management Board for Financial Matters,
 - c) Alicja Barbara Klimiuk – Vice-President of the Management Board for Operations,
 - d) Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters,

On 29 December 2015, the Supervisory Board dismissed Mr. Seweryn Kędra serving as Executive Vice-President of the Management Board, Chief Financial Officer, from the Company's Management Board

as of 3 January 2016 and as a result of the completed executive search procedure appointed to the Management Board for its fifth term of office as of 4 January 2016:

- 1) President of the Management Board – Mr. Dariusz Kaśków,
- 2) Vice-President of the Management Board for Financial Matters – Mr. Mariusz Rędaszka,
- 3) Vice-President of the Management Board for Development Strategy – Mr. Roman Pionkowski.

The procedure to select the Vice-President of the Management Board for Corporate Matters was completed without selecting the best candidate.

Additionally, on 29 December 2015 the Supervisory Board launched an executive search for the Executive Vice-President of the Management Board for Corporate Matters and the Vice-President of the Management Board for Investor Relations that was completed on 1 February 2016.

The procedure to select the Vice-President of the Management Board for Investor Relations was completed without selecting the best candidate.

The procedure to select the Vice-President of the Management Board for Corporate Matters was completed by selecting Mr. Grzegorz Ksepko for this position.

On 26 February 2016, the Company's Supervisory Board adopted a resolution to dismiss Mr. Roman Pionkowski from the Company's Management Board who was serving as the Vice-President of the ENERGA SA Management Board for Development Strategy.

Also on 26 February 2016, the ENERGA SA Supervisory Board launched an executive search to recruit the Company's Management Board members for its fifth term of office, i.e.:

- 1) Vice-President of the Management Board for Development Strategy,
- 2) Vice-President of the Management Board for Investor Relations.

As a result of the executive search procedure, the ENERGA SA Supervisory Board chose the following persons as the best candidates for the position of:

- 1) Vice-President of the Management Board for Development Strategy – Mr. Zmysław Piesiewicz, appointing him to the ENERGA SA Management Board as of 21 March 2016,
- 2) Vice-President of the Management Board for Investor Relations – Ms. Mariola Anna Zmudzińska, appointing her to the ENERGA SA Management Board as of 21 March 2016.

On 17 January 2017, the Supervisory Board dismissed Mr. Dariusz Kaśków from the position of the President of the ENERGA SA Management Board, Mr. Przemysław Piesiewicz from the position of the Vice-President for Development Strategy and Mr. Mariusz Rędaszka from the position of the Vice-President for Financial Matters.

On 17 January 2017, Mr. Jacek Kościelniak was delegated by the Company's Supervisory Board to act temporarily in the capacity of a Management Board Member responsible for managing the Company for a period of up to three months from the date of delegation.

Also on 17 January 2017, the ENERGA SA Supervisory Board launched an executive search to recruit the Company's Management Board members for its fifth term of office, i.e.:

- 1) President of the Management Board,
- 2) Vice-President of the Management Board for Financial Matters,
- 3) Vice-President of the Management Board for Operations.

The executive search procedure was conducted on the basis of the Council of Minister's regulation on qualification procedures for management board members in certain commercial companies of 18 March 2003 (Journal of Laws of 2003, No 55, item 476, as amended).

As a result of the executive search procedure, the ENERGA SA Supervisory Board appointed the following to the position of:

- 1) President of the Management Board – Mr. Daniel Obajtek, appointing him to the ENERGA SA Management Board as of 2 March 2017,
- 2) Vice-President of the Management Board for Financial Matters – Mr. Jacek Kościelniak, appointing him to the ENERGA SA Management Board as of 11 February 2017,
- 3) Vice-President of the Management Board for Operations – Ms. Alicja Barbara Klimiuk, appointing her to the ENERGA SA Management Board as of 1 March 2017.

On 16 February 2017, the Company's Supervisory Board adopted a resolution to dismiss from the Company's Management Board Ms. Mariola Zmudzińska, who served as the Vice-President of the ENERGA SA Management Board for Investor Relations.

The current fifth term of office of the ENERGA SA Management Board will elapse on 4 January 2019.

Daniel Obajtek – President of the Management Board

Since 1999 he has been active in private companies where he served for 7 years in management and senior management roles; he also co-founded one of those companies. Local and self-government activist. From 2002 to 2006 he was a town council member in the Pcim Municipality and subsequently from 2006 to 2015 he was the head of the Municipality. During the 9 years in office, he undertook many successful development initiatives. He introduced solutions promoting equal standards of education in schools, implemented EU-funded projects to computerize households and organize training courses and workshops for less affluent households. He also successfully conducted numerous infrastructural investments. In 2015 he began his tenure as the President of the Agriculture Restructuring and Modernization Agency, the largest payment agency in Europe with more than 11 thousand employees in Poland's 16 regions. He streamlined the Agency's processes for spending approx. PLN 25 billion per annum in EU and domestic funds. He conducted an organizational reform of the Agency and optimized its operating expenses. He rationalized the Agency's employee salaries and he engaged in talks with the trade unions, thereby bringing to an end a collective labor dispute that had persisted for many years. In 2016 he set up the Offsite Sub-Department of the IT Department to cut IT expenses and thereby terminate the Agency's dependence on third party companies. Since 2016 he has also acted in the capacity of the Supervisory Board Chairman of LOTOS-Biopaliwa Sp. z o.o. and Supervisory Board member of DALMOR S.A. He has won many awards, including the first place in the EURO GMINA contest, the second place in the Best Municipality Head in Małopolska, he was also named the Personality of Myślenice Region and the Social Care Leader. In 2016 he took first place in Gazeta Bankowa's contest for Poland's Thriftiness Leader in the Newcomer of the Year category in 2016. He co-authored the publications: "Repolonization of Poland" and "European Union Funds as a factor improving competitiveness and quality of life in rural areas of the Podkarpacie region".

Alicja Barbara Klimiuk – Vice-President for Operations

She graduated from the Management Department of the University of Gdansk. She completed the Post-Graduate Course in Management at the Warsaw School of Economics and the Post-Graduate Course in Controlling in Corporate Management at the University of Gdańsk. She has many years of professional experience in commercial law companies with State Treasury holdings, including Energa SA as the President of the Management Board. In the period of consolidating the Energa Group with the Ostrołęka Power Plant Complex, she oversaw the process of separating the distribution system operator, establishing an electricity trading company and restructuring the Energa Group subsidiaries. In 2006-2007, she also served as a member of Supervisory Boards of companies such as: Towarowa Giełda Energii S.A. in Warsaw, Zespół Elektrowni Ostrołęka S.A. and Cergia Energetyka Toruńska S.A. In the period from 1992 to 1998, as the Vice-President of the city of Suwałki, she oversaw the areas of finance, infrastructure investments, geodesy, zoning management and public utility companies. From 1998 to 2006, she was the President and Vice-President of the Special Economic Zone in Suwałki responsible, among others, for overseeing infrastructure construction and development on the Special

Economic Zone site and monitoring compliance of the businesses with their permits. In the period from 2008 to 2013, she ran her own business, providing investment advice and consulting on the reports on the environmental impact of investment projects. Since 2014, she has been the Director of the Technology Transfer Center at the Higher Vocational School of prof. Edward F. Szczepanik in Suwałki, where she executed projects co-funded by the EU focusing on the research and development work for businesses and the transfer of technology from academic centers to the economy.

Jacek Kościelniak – Vice-President of the Management Board for Financial Matters

He graduated from the Economic Academy (currently University of Economics) in Katowice, specializing in finance and accounting. In 1989 he began his professional career as an accountant, finance specialist and Chief Accountant in private limited liability companies. Then, from 1992 to 1998, he provided accounting, tax and legal and economic advisory services running his business activity. He conducted training workshops on the subject of taxes, accounting and mandatory prevention of the introduction of funds originating from illegal or undisclosed sources into financial circulation. He also worked as an auditor for the National Cooperative Savings and Loans Organization (Krajowa Spółdzielcza Kasa Oszczędnościowo-Kredytowa). From 1998 to 2002 he served as the Finance Department Director at the Silesian Voivodship Office. He was also the Supervisory Board chairman of the Upper Silesia Regional Development Agency and a supervisory board member of the Upper Silesia Restructuring Fund. He was elected as Member of the Parliament of the 5th Term and, during that period, he served as a member of the Parliamentary Public Finance Committee. From January to November 2007 he was Secretary of the State in the Prime Minister's Office and Deputy Chairman of the Standing Committee of the Council of Ministers. From 2007 to 2011 he served as the Vice-President of the Supreme Audit Chamber. He acted as an expert in the twin cooperation project to strengthen the audit potential of the Audit Authority in Georgia and Albania. He has also worked for the EUROSTAT Working Group tasked with the preparation and development of European Public Sector Accounting Standards

Grzegorz Ksepko – Vice-President of the Management Board for Corporate Matters

Graduate of the Faculty of Law and Administration at the University of Gdansk (2001). In 2004 he completed his public prosecutor trainee program in the District Public Prosecution Office in Gdansk and he passed the public prosecutor examination. In November 2005 he was entered on the list of advocates. In July 2006 he became a partner (equity partner) in the law firm Kancelaria Radców Prawnych i Adwokatów Głuchowski Siemiątkowski Zwara i Partnerzy. In November 2010 he became a senior partner, thereby taking a senior management position. In his law practice he specialized above all in company law, business services, criminal law, criminal revenue law, civil law, administrative law and in issues related to the functioning of the oil and power sector. He also provided services to other businesses, including advisory services in the area of corporate governance. From 2003 to 2007 he sat in the Supervisory Board of Agencja Rozwoju Pomorza S.A. He was one of the principal authors of the vetting bill and the amendment of the Act on the Institute of National Remembrance drafted in 2006. He also participated in work on the consumer bankruptcy bill, the amendment of the State Treasury Solicitors' Office Act, the amendment of the Press Law, the amendment of the Weapons and Ammunition Act and the amendment of the Criminal Code and he prepared draft regulations for the Minister of Regional Development on public aid. In 1996 he completed the Fourth Annual Summer School for Young Social and Political Leaders under the Polish Robert Schuman Foundation and in 1997 the English language school at the University of California Los Angeles.

None of the Company's Management Board Members mentioned above engages in any business competitive to that of ENERGA SA, participates in a competitive entity as a partner in a civil law company or partnership or as a member of a corporate authority of a joint stock or limited liability company and does not participate in any other competitive legal person as a member of its corporate authority, or is listed in the Register of Insolvent Debtors kept pursuant to the National Court Register Act.

Management Board's powers

The Management Board operates in accordance with the Commercial Company Code and the Company's Articles of Association. The Management Board's organization and operation, including

detailed method of adopting resolutions, are determined by the Management Board Bylaws approved by the Supervisory Board and published on the Company's corporate website.

The Management Board runs the Company's affairs and represents it. Two Management Board Members acting jointly or one Management Board Member acting jointly with a general proxy are authorized to submit representations of will and sign them on the Company's behalf.

The powers of the Management Board comprise all the Company's matters which are not reserved by the regulations of law or the Company's Articles of Association to other corporate bodies. According to Articles of Association, without prejudice to exceptions indicated therein, each Management Board member may conduct the Company's matters in the scope of his/her powers set forth in the Management Board Bylaws without prior resolution of the Management Board. If, however, before handling such matter, at least one of the remaining Management Board Members objects to the handling thereof, a prior Management Board resolution will be required.

On the date of preparing this Report, the Management Board members have made a functional split of the specific areas of the Company's business for the purpose of individually handling the affairs in the range of their powers and have entrusted:

- 1) functional oversight over the following areas of the Company's business to the President of the Management Board:
 - a) press support,
 - b) audit and control,
 - c) strategic risk management,
 - d) legal support,
 - e) security,
 - f) Group's personnel policy, including the hiring of members of corporate bodies of ENERGA Group Companies,
 - g) marketing and sponsoring activity,
 - h) management of the Group's organization and corporate governance,
 - i) social dialogue,
- 2) functional oversight over the following areas of the Company's business to the Vice-President of the Management Board for Corporate Matters:
 - a) institutional relations,
 - b) the Group's corporate oversight and corporate governance, excluding the hiring and compensation of members of corporate bodies of ENERGA Group Companies,
 - c) management by objectives,
 - d) internal communication,
 - e) CSR and environmental policy,
- 3) functional oversight over the following areas of the Company's business to the Vice-President of the Management Board for Financial Matters:
 - a) financial planning and analyses,
 - b) financial reporting and consolidation,
 - c) financial policy,
 - d) management of the Group's financial risk,
 - e) business controlling,
 - f) compensation of members of corporate bodies of ENERGA Group companies,
 - g) investor relations,
 - h) stakeholder relations.
- 4) Functional oversight over the following areas of the Company's business to the Vice-President of the Management Board for Operations:
 - a) ENERGA Group's Strategy, regulatory policy,
 - b) strategic asset management,
 - c) market analyses and the Group's development,
 - d) research and development and innovation,

- e) mergers and acquisitions,
- f) IT.

Manner of the Management Board's functioning

In principle, Management Board resolutions are adopted at its meetings. The meetings are held on the set date as needed, but no less frequently than once every two weeks.

Management Board meetings are convened by the President of the Management Board or a Management Board Member. Meetings held according to a fixed schedule adopted by a Management Board resolution do not require notifications. In addition, the Management Board meeting convened at the written request of a Management Board Member or Supervisory Board member should be convened within four days from the date of submitting the request to the President of the Management Board.

In principle, the President of the Management Board presides over Management Board meetings. Management Board meetings are held in the Company's registered office or at another location indicated by the person convening the Management Board meeting. The Management Board Bylaws admit the possibility of Management Board Members' participation in the meeting and voting on resolutions adopted during a meeting using remote means of direct communication, such as conference and video conference calls, with the reservation that there is at least one Management Board Member present at the location specified by the person convening the meeting and there is a technical possibility of ensuring a connection.

Management Board resolutions are adopted by an absolute majority of votes. If an equal number of votes is cast, the Management Board President's vote will prevail. In order for the resolutions to be valid, all the Management Board Members must be correctly notified about the meeting, and more than one-half of the members must be in attendance if the Management Board is composed of at least three persons. If the Management Board is composed of two persons, all the Management Board Members must be in attendance in order for the resolutions to be valid. Voting, in principle, is by open ballot but at the request of Management Board member, a secret ballot may be called.

In urgent situations it is permitted to adopt resolutions following the written procedure or by using remote means of direct communication such as fax or e-mail on the condition that all Management Board Members express their consent for it. The resolution will be valid if all Management Board Members have been notified of the content of the draft resolution following the written procedure or by using remote means of direct communication.

In 2016 the ENERGA SA Management Board held 68 meetings and adopted 372 resolutions.

The Management Board's most important actions and decisions were as follows:

- 1) launch of a project involving the construction of a new power unit in Ostrołęka,
- 2) adoption of the ENERGA Group Strategy for 2016-2025, the Long-Term Plan of Strategic Investments of the ENERGA Group and the Long-Term Financial Model of the ENERGA Group,
- 3) engagement of the Company in projects of strategic importance for the Republic of Poland,
- 4) adoption of the "Organizational Bylaws of the Enterprise of ENERGA Spółka Akcyjna".

4.8. Compensation of persons in management and supervisory bodies

Management Board

In 2016, Members of the ENERGA SA Management Board provided Company management services based on management contracts entered into on condition that a Management Board member runs a business activity on the basis of an entry in business activity records and takes out management liability insurance at his/her own expense.

The Supervisory Board sets forth the rules and amounts of compensation for the Company's Management Board members with whom an agreement on management (management contract) has been executed.

The compensation model for Management Board members includes a dual component compensation system consisting of the following:

- 1) the fixed part (basic monthly salary),
- 2) the variable part, which is conditional upon the satisfaction of specified criteria (successful execution of specified tasks or achievement of goals of special importance to the Company).

The basic monthly salary of Management Board members included all the compensation for discharging functions on supervisory authorities of the Companies from the ENERGA Group and compensation for copyright to all the works developed by the Manager within the framework of performing this agreement which constitute pieces of work as understood in the Act on Copyright and Related rights of 4 February 1994 and which are transferred to the Company pursuant to this agreement.

Variable components of compensation are set by the Company's Supervisory Board that may grant to a Management Board member:

- 1) annual bonus, granted within two months of the date of approving the Company's financial statements for the financial year to which the bonus refers, after assessment of the degree to which the economic conditions and parameters assumed by the Supervisory Board have been achieved,
- 2) additional bonus, in connection with the Management Board member's achievement of goals of special importance to the Company.

Agreements concluded between the Company and its managers provided for:

- 1) if the management contract expires because of the elapse of the term of office, the right to compensation for a period of three months after the date of the elapse of the term of office, with the proviso that the Management Board member remains in constant readiness to provide, at the Company's request, services to the extent making it possible to transfer the entire scope of his or her duties according to the Company's needs,
- 2) the right to compensation for refraining from conducting competitive activity (no-compete) for a period up to 12 months after the agreement termination date,
- 3) the right to severance pay in the amount of three times the basic monthly salary if the manager is dismissed from the function of a Management Board member.

On 15 December 2016, by the power of Resolution no. 27 adopted by the Extraordinary General Meeting, the rules for remunerating the Management Board Members to the provisions of the Act of 9 June 2016 on the Rules for Remunerating Persons Managing Certain Companies (Journal of Laws of 2016 Item 1202), As at the date of this report, the fixed part of compensation for work payable to the Members of the ENERGA SA Management Board was set within the range from 7 to 15 times the average salary in the corporate segment without profit-sharing awards in the fourth quarter of the previous year, as announced by the President of the Main Statistical Office.

Based on the new adopted rules of compensation, new management service contracts are signed with the managers, which provide for:

- 1) the right to compensation for refraining from conducting competitive activity (no-compete) for a period up to 6 months after the contract termination date,
- 2) the right to severance pay in the amount of three times the basic monthly salary if the manager is dismissed from the function of a Management Board member.

The compensation paid individually to each of the Company's Management Board members in 2016 is presented in the table below.

Figure 13: Compensation paid to the persons in the ENERGA SA Management Board in the period from 1 January to 31 December 2016 (PLN 000s)

Full name	In office	Compensation	Other benefits	Total*
Dariusz Kašków	from 4 January to 31 December 2016	833.2	63.1	896.3
Mariusz Rędaszka	from 4 January to 31 December 2016	773.7	44.3	818.1
Grzegorz Ksepko	from 1 February to 31 December 2016	715.0	37.5	752.5
Przemysław Piesiewicz	from 21 March to 31 December 2016	608.1	29.5	637.5
Mariola Anna Zmudzińska	from 21 March to 31 December 2016	606.0	2.3	608.3
Seweryn Kędra	from 1 January to 3 January 2016	195.0	8.7	203.7
Roman Pionkowski	from 1 January to 26 February 2016	191.3	8.6	199.9
TOTAL		3,922.2*	194.0	4,116.3

*the differences in sum are caused by rounding.

In the previous year, the Management Board Members were also entitled to non-financial compensation elements, such as:

- medical insurance for the Management Board member and his/her direct family and the right to select either life insurance or medical insurance,
- company apartment in justified cases or a reimbursement of rental expenses,
- covering or refinancing the costs of individual training related to the range of activities performed in favor of the Company,
- benefiting from the Company's asset items.

The compensation system for members of the ENERGA SA Management Board members is based on the objective management system. The objectives are set on the basis of the existing ENERGA Group Strategy, Long-Term Plan of Strategic Investments and the challenges, both internal and external, that the Group is facing. Payment of variable elements of compensation of ENERGA SA Management Board members is related to the extent and level to which the objectives have been fulfilled. Additionally, the objectives of Management Boards who are Segment leaders and the Company's management are related to the objectives for the ENERGA SA Management Board and cascaded in accordance with the "from top to bottom" methodology. The accepted model provides an incentive function and integrates the executive and management personnel around the objectives and gives them the sense of shared accountability for achieving them.

A system designed in such a way combines focus on the activities that are important from the Group's point of view, with effective achievement of its intentions. It is also important for the Company's shareholders, since it allows to build a long-term boost in ENERGA's value and ensures the Company's stable operation.

Supervisory Board

According to the Articles of Association, Supervisory Board members are entitled to monthly compensation in the amount set by the General Meeting.

The Company will also cover the costs incurred in connection with performance of the functions entrusted to Supervisory Board members, in particular the costs of transport to the Supervisory Board meeting, costs of exercise of personal oversight, and costs of food and lodging.

The compensation will not be due for the month in which the Supervisory Board member did not attend any of the formally convened meetings and failed to provide any formal justification. The compensation of ENERGA SA Supervisory Board members in 2016 is presented in the table below.

Table 13: Compensation paid to the persons sitting in the ENERGA SA Supervisory Board in the period from 1 January to 31 December 2016 (PLN 000s)

Full name	Period in office in 2016	Compensation	Other benefits	Total
Paula Ziemiecka-Książak	from 1 January to 31 December 2016	53.0	-	53.0
Jarosław Mioduszeński	from 1 January to 7 January 2016	1.0	-	1.0
Mirosław Szreder	from 1 January to 7 January 2016	1.0	-	1.0
Zbigniew Wtulich	from 1 January to 31 December 2016	52.5	-	52.5
Bogdan Skalski	from 1 January to 8 September 2016	35.4	-	35.4
Roman Pionkowski	from 1 January to 3 January 2016	-	-	-
Marek Szczepaniec	from 7 January to 31 December 2016	51.8	-	51.8
Jacek Kościelniak	from 30 December to 31 December 2016	-	-	-
Maciej Żółtkiewicz	from 7 January to 31 December 2016	51.8	-	51.8
Agnieszka Terlikowska-Kulesza	from 8 September to 31 December 2016	17.4	-	17.4
Andrzej Powalowski	from 1 January to 8 September 2016	51.8	-	51.8
TOTAL		315.6*		315.6*

*the differences in sum are caused by rounding.

Number and nominal value of the Company's shares and shares in the Company's related companies held by persons in management and supervisory bodies

No member of ENERGA SA's Management Board or Supervisory Board held shares in the Company as at 31 December 2016.

4.9. Diversity policy

No specific diversity policy has been developed in ENERGA SA to be applied to its administrative, management and supervisory bodies. Ultimately, ENERGA will do its utmost to prepare and implement such a policy and inform the stakeholders about its adoption.

4.10. Primary attributes of the internal control and risk management systems in reference to preparing financial statements

An important element of the internal control system is the internal audit function. The Company has an internal audit unit which carries out the audit and control tasks in the ENERGA Group. These tasks are carried out according to the Rules for conducting audits in the ENERGA Group. The internal audit function helps the organization maintain effective and efficient control mechanisms through their evaluation and promotion of constant improvements while following international standards of internal audit practices.

The purpose of an effective internal control system in the financial reporting process is to ensure adequacy and correctness of financial information contained in periodic reports. For this purpose, the Company designed and implemented the financial reporting process oversight matrices.

In 2016, employees of the Audit Department conducted an "Audit of effectiveness of internal control in respect to financial reporting" in the ENERGA Group, which covered all the control activities designed and defined in the matrices. The auditors believe that the control mechanism provided by the matrices is an effective and efficient protection for the Group against the effects of risk associated with this area. The control activities defined in matrices were pursued by the companies correctly; no material irregularities were found in respect to the effectiveness and efficiency of the financial reporting process. The financial reporting area is additionally an element of the annual Assessment of the Internal Control System, Risk Management and Compliance System in ENERGA SA, which in 2016 was effected with the participation of PricewaterhouseCoopers ("PwC") – in this case the work of the auditors pertaining to the Financial reporting process was positive

The financial data, which are the basis of financial reports and Management Board's reports as well as ENERGA SA's monthly management and operational reporting, come from the Company's financial and accounting system. After the performance of all the pre-determined ledger closing processes at the end of each month, detailed financial and operational managerial reports are prepared. These reports are drafted with co-participation of middle and senior management of the individual organizational cells. As far as closed reporting periods are concerned, the Company's financial results are analyzed in detail and compared to the budget assumptions, and the identified deviations are properly explained.

The financial reporting and the management reporting of the Company and the ENERGA Group are carried out on the basis of the accounting policy (according to International Financial Reporting Standards), which is adopted by a resolution of the Company's Management Board and updated as needed.

Annual reviews of strategies and economic and financial plans are carried out in the Company. The process of detailed planning and budgeting, which includes all the areas of the Company's functioning, involves middle and senior management. The economic and financial plan is accepted by the Company's Management Board and approved by the Supervisory Board.

The Supervisory Board is responsible for selecting a statutory auditor to audit the Company's financial statements and the Group's consolidated financial statements. The statutory auditor authorized to audit the Company's financial statements is the entity specified in the Act of 7 May 2009 on Auditors, their Self-Regulatory Authority, Entities Authorized to Audit Financial Statements and Public Oversight (Journal of Laws No. 77, item 649).

The Company does not have a specific rule regarding an entity authorized to audit financial statements. According to § 23a of the Company's Articles of Association, the Audit Committee recommends to the Supervisory Board the entity authorized to perform the financial review of the Company, and the Supervisory Board chooses and changes such entity. In the past, the Company did not cooperate with any of the three entities authorized to audit financial statements for more than five years in a row.

The entire statutory auditor selection procedure is conducted by the Supervisory Board's Audit Committee, and it encompasses determining the auditor selection criteria, conducting the selection procedure and authorizing the Management Board to conclude with it an agreement to audit the financial statements. The Supervisory Board selects the proposal for auditing the financial statements after carrying out the procedure, whose aim is to select an independent statutory auditor and the proposal whose price that takes into account the auditor's efforts, the auditor's position on the market of auditing services, and knowledge of the industry in which the Company operates.

In 2014, the Company's Supervisory Board (current report no. 42/2014 of 6 November 2014), having examined the recommendation of the Audit Committee, selected the authorized entity PriceWaterhouseCoopers Sp. z o.o. in Warsaw, to be the statutory auditor to audit the financial statements and consolidated financial statements of ENERGA SA and the ENERGA Group and to provide other affirmation services for the annual periods ended on 31 December 2015, 31 December 2016 and 31 December 2017, respectively. In connection with the entry into force of the Regulation of the European Parliament and of the Council (UE) on specific requirements regarding statutory audit of public-interest entities and the expected enactment, by the Polish parliament, of an act implementing the EU regulations providing for the minimum period of two years for which a statutory audit agreement should be signed, the Supervisory Board decided to carry out a procedure to elect an auditor for the years 2017-2018. Following the procedure, on 20 December 2016 the Company's Supervisory Board selected the authorized entity KPMG Audyt spółka z ograniczoną odpowiedzialnością sp.k. with its registered seat in Warsaw at ul. Inflancka 4A ("KPMG") as the statutory auditor to audit and review the financial statements and consolidated financial statements of ENERGA SA and the ENERGA Group for the annual periods ended on 31 December 2017 and 31 December 2018, respectively.

Opinion and report of the statutory auditor is presented to the Management Board, the Audit Committee and the Supervisory Board. After the annual audit, the statutory auditor sends to the Company the so-called Letter to the Management Board, which lists the failures and shortcomings found during the audit that have no material influence on the reliability and correctness of the financial statements prepared.

Within the framework of the Integrated Risk Management System in place in the ENERGA Group, the financial reporting risk is identified and managed to ensure timely and error-free preparation of the Company's and the Group's financial statements and the reporting and management information risk related, among others, with collection and preparation of management, operational and financial information needed to make management decisions. The mechanisms to control these risks, as described above, are registered in the Risk Card and subject to periodic evaluation in respect to adequacy, efficiency and effectiveness.

The risk management process, which is described in more detail in item 2.1 of this Report, encompasses all of the Group's operating segments and levels of organization. It assumes both ongoing and regular risk reviews as well as independent regular evaluation of the systems effectiveness and efficiency and continuous improvement based on the Deming cycle (PDCA).

The results of the risk identification and evaluation process, including reporting risks, are accepted each time by the Company's Management Board in the form of a Management Board Resolution, which sets the level of the organization's risk appetite, accepts the management strategy for the individual risks and obligates the Risk Owners to implement action plans as recorded in the Risk Cards. Additionally, as part of the effectiveness monitoring process for the risk management system in the ENERGA Group, a report summarizing risk reviews in the Group is delivered to the Audit Committee operating within the ENERGA SA Supervisory Board.

Management board's representation



5. MANAGEMENT BOARD'S REPRESENTATION

Gdańsk, 29 March 2017

The ENERGA SA Management Board hereby represents that:

- (1) according to the best knowledge, the annual financial statements and the comparative data were prepared in line with the accounting principles, and reflect, truly, reliably, and clearly, the asset and financial position of ENERGA SA and its financial result. The Management Board report on the activity of ENERGA SA contains a true presentation of developments, achievements and situation of the Company, including a description of key risks and threats;
- (2) PricewaterhouseCoopers Spółka z ograniczoną odpowiedzialnością, an entity authorized to audit the financial statements, which audited the financial statements of ENERGA SA for the financial year ended 31 December 2016, was selected in accordance with the applicable regulations. That entity as well as the auditors who audited the aforementioned financial statements satisfied the conditions for expressing an unbiased and independent opinion about the audit of the financial statements as required by the binding regulations and professional norms.

Signatures of ENERGA SA Management Board Members

Daniel Obajtek
President of the ENERGA SA Management Board

Alicja Klimiuk
Vice-President of the ENERGA SA Management Board for Operations

Jacek Kościelniak
Vice-President of the ENERGA SA Management Board for Financial Matters

Grzegorz Ksepko
Vice-President of the ENERGA SA Management Board for Corporate Matters

Marcin Biniś
Director of the Finance Department

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Glossary of terms and abbreviations

AMI, Advanced Metering Infrastructure	Integrated set of elements: intelligent electricity meters, communication modules and systems providing the possibility to collect data regarding electricity consumption by specific customers.
Billing	Itemized bill, statement of all fees for added services which a subscriber uses in a given billing period
Biomass	Solid or liquid, biodegradable substances of plant or animal origin, originating from products, waste and remnants of agricultural and forestry production, the industry

	processing their products, and also a portion of other biodegradable waste, and especially agricultural raw materials
CAPEX	Capital expenditures.
CIRS, CCIRS	Currency Interest Rate Swap and Cross-Currency Interest Rate Swap transactions, in which payments will be made over a specified period with a specified frequency, based on variable interest rates, in two different currencies (CIRS) or in more currencies (CCIRS).
CO ₂	Carbon dioxide
EIB	European Investment Bank
EBIDTA (Earnings Before Interest, Taxes, Depreciation and Amortization)	ENERGA SA defines EBITDA as operating profit/loss plus depreciation and amortization and impairment losses for non-financial non-current assets. Since the EBITDA definition changed as of 2016, EBITDA for comparative periods (2013-2015) was calculated using the new definition.
EBIT	Operating profit
EBRD	European Bank for Reconstruction and Development
ENERGA SA, ENERGA	Parent company in the ENERGA Group.
ENERGA-OPERATOR, EOP	ENERGA-OPERATOR SA – a subsidiary of ENERGA SA and the leader of the Distribution Segment in the ENERGA Group.
ENERGA-OBRÓT, EOB	ENERGA-OBRÓT SA – a subsidiary of ENERGA SA and the leader of the Sales Segment in the ENERGA Group
EMTN	Euro Medium Term Note issue program.
EU	European Union
EUA	Emission allowances
EU ETS	European Union Greenhouse Gas Emission Trading Scheme The rules governing its operation are stated in ETS Directive.
EUR	Euro, currency used in countries belonging to the European Union's Eurozone
WSE	Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.)
ENERGA Group, Group	A group distributing, selling and generating electricity and heat. It also conducts activity related to street lighting, design, procurement of materials, grid-related services, specialized transport, hotel and IT services.
Tariff group	Group of customers off-taking electricity or heat or using electricity or heat supply services with respect to which a single set of prices or fee rates along with their terms and conditions are applicable.
GUS	Główny Urząd Statystyczny (Central Statistical Office)
GW	Gigawatt, unit of power in the International System of Units, 1 GW = 10 ⁹ W
GWe	Gigawatt of electrical power
GWh	Gigawatt hour
IBnGR	Market Economy Research Institute (Instytut Badań nad Gospodarką Rynkową)
IPO	Initial Public Offering
IRS (Interest Rate Swap)	An interest rate swap agreement between two parties, under which the parties pay interest on the contractual nominal amount calculated according to a different interest rate.
Issuer	ENERGA SA
KNF	Komisja Nadzoru Finansowego (Polish Financial Supervision Authority)
Cogeneration, CHP	Technological process of simultaneous combustion of heat and electricity or mechanical energy in the course of the very same technological process
Covenants	Contractual clauses offering protection to lenders in loan agreements.
KRS	National Court Register
kWh	Kilowatt hour, unit of electricity generated or used by equipment with 1 kW of power in an hour; 1 kWh = 3,600,000 J = 3.6 MJ
MEW	Small hydro power plant
MoT	State Treasury Ministry
MW	Unit of power in the International System of Units, 1 MW = 10 ⁶ W
MWe	Megawatt of electrical power
MWh	Megawatt hour
MWt	Megawatt of thermal power
NBP	National Bank of Poland, central bank in Poland
NCBiR	National Centre for Research and Development (Narodowe Centrum Badań i Rozwoju)

NFOŚiGW	National Fund for Environmental Protection and Water Management
EGM	Extraordinary General Meeting of ENERGA SA
Renewable Energy Sources, RES	Sources converting the energy of the wind, solar radiation, geothermal energy, waves, currents and marine tides, run of rivers and energy obtained from biomass, garbage dump biogas as well as biogas ensuing from waste removal or treatment processes or the degeneration of stored plant and animal remains to generate electricity.
DSO, Distribution System Operator	Utility dealing with the distribution of gaseous fuels or electricity, responsible for grid operation in the gaseous distribution system or in the electricity distribution system, the current and long-term operational safety of this system, the operation, maintenance, refurbishment and required expansion of the distribution grid, including connections with other gaseous systems or other electrical energy systems.
TSO, Transmission System Operator	Utility dealing with the transmission of gaseous fuels or electrical energy, responsible for grid operation in the gaseous transmission system or in the electrical energy transmission system, the current and long-term operational safety of this system, the operation, maintenance, refurbishment and required expansion of the transmission grid, including connections with other gaseous systems or other electrical energy systems.
OZEX_A	Volume-weighted average price using all transactions pertaining to the PMOZE_A contract on an exchange session
PGE	PGE Polska Grupa Energetyczna SA
GDP	Gross Domestic Product
PLN	Polish zloty, national currency
PMOZE_A	Property rights to certificates of origin for electricity generated in RES whose period of generation, as specified in the certificate of origin, commenced after 1 March 2009
pp.	Percentage point
Property rights	Negotiable rights constituting a commodity arising from certificates of origin for energy generated from renewable energy sources and co-generation
Vertically-integrated utility	Utility or group of utilities whose reciprocal relationships are prescribed by Article 3 sec. 2 of the Regulation on the Control of Concentrations, dealing with (i) in respect of gaseous fuels: transmission or distribution, or storage, or condensation and generation or the sale of these fuels, or (ii) in respect of electricity: transmission or distribution and generation or the sale of this energy
PSE	Polskie Sieci Elektroenergetyczne Spółka Akcyjna with its registered office in Warsaw, entered in the register of entrepreneurs of the National Court Register under file number KRS 0000197596; company designated by ERO President decision No. DPE-47-58(5)/4988/2007/BT of 24 December 2007 to be the electrical power transmission system operator in the Republic of Poland for the period from 1 January 2008 until 1 July 2014
yoy	Year on year
SAIDI	System Average Interruption Duration Index
SAIFI	System Average Interruption Frequency Index
SFIO	Specialized Open-end Mutual Funds
Smart Grid	Electric power system intelligently integrating the actions of all the participants in the processes of generation, transmission, distribution and usage to deliver electricity in an economical, reliable and safe manner. It entails comprehensive energy solutions making it possible to combine, facilitate reciprocal communication and control in an optimum way elements of power grids that have been diverse to date
Spot	Day-Ahead Market (DAM) – energy market operating in the “day ahead” time interval (DA) providing for energy supply on day D
Certificate of origin	Certificate of origin from renewable sources and certificate of origin from co-generation
Certificate of origin from co-generation	Document issued by the ERO President pursuant to art. 9l of the Energy Law confirming the generation of electricity in highly-efficient co-generation generated in: <ul style="list-style-type: none"> (i) a co-generation unit fired with gaseous fuels or with the total installed electrical capacity at source being under 1 MW (known as a yellow certificate), (ii) (ii) a co-generation unit fired with methane released and drained in the course of underground mining activity in hard coal mines that are active, that are being shut down or that have been shut down or with gas obtained by processing biomass (known as a purple

	certificate), or (iii) some other co-generation unit (known as a red certificate)
Certificate of origin from renewable energy sources, green certificate	Document issued by the ERO President pursuant to art. 9e of the Energy Law confirming the generation of electricity in a renewable energy source (known as a green certificate)
Tariff G	Tariff group for individual customers – households
Polish Power Exchange, TGE	Polish Power Exchange S.A., a mercantile exchange on which commodities admitted to be traded on the exchange are traded, i.e. electricity, liquid and gaseous fuels, mine gas, pollution emission limits and property rights ensuing from certificates of origin whose price is directly or indirectly dependent on the price of electricity, liquid or gaseous fuels and the quantity of pollution emissions
TWh	Terawatt hour, a multiple unit of electricity in the International System of Units. 1 TWh is 10 ⁹ kWh
EU	European Union
ERO	Energy Regulatory Office
WACC	Weighted average cost of capital
WIBOR	Warsaw Interbank Offered Rate
Cofiring	Generation of electricity or heat using a process of simultaneous and joint combustion of biomass or biogas with other fuels in a single device; a portion of the energy generated in this manner may be deemed to be energy generated in a renewable energy source.