Polish Energy Partners Capital Group

DIRECTORS' REPORT
ON THE ACTIVITIES OF
POLISH ENERGY PARTNERS CAPITAL GROUP
FOR THE YEAR ENDED 31 DECEMBER 2012

Warsaw, 26 February 2013

The parent company of the Polish Energy Partners S.A. Capital Group is Polish Energy Partners S.A., hereinafter referred to as the 'Issuer', which was entered in the Register of Entrepreneurs kept by the District Court for the capital city of Warsaw, XIII Commercial Department of the National Court Register on 17 July 1997 under number KRS 26545.

1. Organisation of the issuer's capital group and identification of entities covered by consolidation and changes in the group's organisation, including reasons for the changes

Organisation of the issuer's capital group is presented in Note 3 to the consolidated financial statements.

2. Basic economic and financial data disclosed in the annual financial statements, including a description of factors and events (including unusual ones) having a significant effect on the issuer's operations and profits earned or losses incurred for the year. Outlook for the development of the issuer's operations within at least the next financial year.

The Issuer's key economic and financial data is presented in the table below (in PLN million):

Basic economic and financial data	**For the period from 1 January to 31 December 2012**	**For the period from 1 January to 31 December 2011***	**Change**
Revenue from sales	131.8	147.5	(15.7)
EBITDA on continuing operations	45.7	59.8	(14.1)
Adjusted EBITDA including interest on leased property and minority interest in the profits of wind farms on continuing operations	45.7	59.8	(14.1)
Net profit/loss from continuing operations	17.2	27.9	(10.7)
Net profit/loss from continuing operations after elimination of the effect of exchange differences arising on balance sheet valuation	13.5	33.2	(19.7)
Net profit/loss from discontinued operations	76.2	41.9	34.3
Net profit/loss from discontinued operations after elimination of the effect of exchange differences arising on balance sheet valuation	76.2	35.8	40.4
Net profit/loss attributable to equity holders of the parent	93.4	69.6	23.8
Net profit after elimination of the effect of exchange differences arising on balance sheet valuation	89.7	69.0	20.7
Net profit after elimination of the effect of exchange differences arising on balance sheet valuation and excluding sales of wind farms and discount valuation	82.5	32.8	49.7

**) restated figures*

The following factors had an effect on the results for the year ended 31 December 2012 compared with the results for the year 2011:

a) At the level of EBITDA (on continuing operations)

- The effect of the commissioning of the Łukaszów Wind Farm (Łukaszów WF) and Modlikowice Wind Farm (Modkowice WF) (a total increase by approx. PLN 44 million),
- Lack of sales of wind farm projects (an effect of PLN 51.8 million in 2011),
- The effect of the settlement for sale of a developed wind farm under the business cooperation agreement with EPA (PLN 4.2 million),
- The recovery of written-off receivables of PLN 4.3 million by the Wizów CHP Plant in the period from 1 January to 31 December 2011 (a non-recurring event in 2011),
- The recovery of written-off receivables of PLN 1.2 million by EPEP Jeziorna in the period from 1 January to 31 December 2012,
- Negative effect of the write-down recognized in 2012 against revenue from JI emission reduction units (ERUs) accrued in 2009 at an amount of PLN 1.1 million in the Dipol Wind Farm,
- Lower EBITDA of the Biomasa Energetyczna Północ and Biomasa Energetyczna Południe Projects due to the rise of straw purchase prices and the increase of operating expenses due to decreased performance of plant and equipment as a result of using straw with greater humidity,
- The effect of the commissioning of the Biomasa Energetyczna Wschód Project starting from September 2012 (a total increase by PLN 0.5 million),
- Lower costs of the management option scheme,
- Higher headquarters expenses due to higher costs of purchase of third party services.

b) At the level of Net Profit:

- The effect of EBITDA,
- Higher interest on cash deposits (net increase by PLN 6.8 million),
- The effect of higher revenue from the discount on sale of wind farms (net increase by PLN 9.5 million),
- Negative effect of interest on bank loans taken out by the Modlikowice WF and Łukaszów WF commissioned in 2012 and positive effect of the measurement of these loans at amortised cost (a decrease of net profit by PLN 15.1 million),
- The effect of unrealised exchange differences (net increase by PLN 9.1 million),
- The effect of an income tax decrease by PLN 9.8 million.

POWER GENERATION OUTSOURCING

- Saturn CHP Plant

On 2 May 2012, Mondi Świecie S.A., in accordance with the General Agreement of 29 April 2002, exercised the so-called call option under which Mondi Świecie S.A. called for the sale of all of PEP's rights and obligations as a limited partner of Saturn Management Sp. z o.o. i Wspólnicy Spółka Komandytowa and the purchase of 100% of shares in Saturn Management Sp. z o.o. In accordance with the settlement dated 19 July 2012, this sale had a significant impact on the results reported by the Group. The details of the sale transaction are presented on pages 6-7 of the consolidated financial statements.

In the income statement for 2012, profit from operations of the Saturn CH Plant and gain on the disposal of the Saturn CHP Plant are presented as discontinued operations. Comparative figures for 2011 have been restated as appropriate.

- Zakrzów CHP Plant

Operating profit for the period under review was at the level of the prior year profit.

- Mercury Power Plant

Operating profit for the period under review was lower than the prior year profit due to lack of JI revenues in 2012 (full utilisation of the purchases cap granted by the World Bank) and lower valuation of the balance of JI certificates (decrease of the EUR exchange rate compared with the year-end exchange rate).

Revenue from sale of electricity and operating expenses are at the same level as in the prior year.

- EPEP Jeziorna

In the period under review, EPEP Jeziorna – that did not conduct operations – under an agreement signed with the contractor, recovered part of written-off trade receivables (amounting to PLN 1.2 million).

BIOMASS POWER PLANTS

Within the area of outsourcing and generation of power generated using biomass, the PEP Group is preparing for the implementation of a project of construction and operation of a 30 MW biomass power plant connected to the power grid.

The location of the facility has been selected, a tender procedure related to the acquisition of a plot of land has been started, and the environmental decision and terms for connection to the power grid have been obtained. Currently the connection agreement is being negotiated and the detailed design of the facility is being developed. A legally valid building permit has already been obtained. The facility is planned to be commissioned at the turn of 2014/2015. Debt financing terms have been tentatively agreed with the banks.

In addition, negotiations are currently in progress with three significant industrial enterprises on the implementation of projects for the construction and operation of further 85MWt/30MWe biomass power plants or combined heat and power ('CHP') plants.

Construction of biomass-only facilities for industrial customers is aimed to increase their independence in power generation and implement the strategy for generation of energy using renewable sources, which will lead to a reduction of the cost of electricity.

As a result of implementing the above projects, PEP will obtain benefits from the following outsourcing projects based on green energy.

WIND POWER PRODUCTION

- Puck Wind Farm

Electricity production in 2012 was lower than budgeted due to unfavourable wind conditions. In 2012, a one-off write-down was recognised against revenue from JI ERUs in 2012 which was accrued in 2009 at an amount of PLN 1.1 million. Nonetheless, the net result for 2012 was higher than that for 2011 due to the positive effect of unrealised exchange differences on the balance sheet valuation of an investment loan denominated in EUR.

- Łukaszów and Modlikowice Wind Farms

The construction of the Łukaszów Wind Farm (34MW) and Modlikowice Wind Farm (24MW) was completed in December 2011. At the beginning of 2012, commissioning procedures were finalised and the wind farms achieved their intended performance. Electricity generation in 2012 was higher than budgeted.

Under the Operational Programme Infrastructure and Environment, Measure 9.4 Energy Production from Renewable Sources (bid 1/PO IiŚ/9.4/2009), each of the projects obtained a funding of PLN 40 million (a total of PLN 80 million). Grant agreements were signed in 2010. Under these agreements, both companies received a total of PLN 25.4 million until the end of 2011, PLN 49.9 million until the end of 2012 (the amount of PLN 50.2 million that had been received in the first 6 months of 2012 was decreased by an adjustment of PLN 0.3 million) and another PLN 2.4 million in February 2013. The last application for an amount of approx. PLN 2.0 million is awaiting acceptance by the Ministry of Economy. As at the date of issue of the report, the Company has received a confirmation of compliance with all recommendations issued as a result of the final audit of the project.

- Development of Wind Farm Projects

Like in the previous years, in 2012 the Company focused its efforts on expanding its wind farm portfolio. The total portfolio of projects under development currently amounts to about 1.000 MW, and they are expected to be finalised in years 2013-2016. Currently projects with a total capacity of 134 MW already have a local development plan, environmental decision, connection terms and building permits, projects with a total capacity of 102 MW have a local development plan, environmental decision and connection terms, projects with a total capacity of 168 MW have a local development plan and connection terms, projects with a total capacity of 88 MW – a local development plan and environmental decision, projects with a total capacity of 106 MW – a local development plan, and project with a capacity of 47 MW – connection terms.

- Wind Farms under Implementation

Negotiations are currently in progress with suppliers and contractors engaged in the construction of the following wind farms with a total capacity of 134 MW. Construction is planned to be carried out in 2013 and 2014.

The process of acquiring funds for the construction of the above-mentioned wind farms is also well in progress (total capital expenditures of approx. PLN 1 billion).

BIOMASS USED IN POWER GENERATION

- Biomasa Energetyczna Północ

The plant in Sępólno Krajeńskie reported lower results in the period under review compared with the prior year, mainly due to low quality of straw (high humidity) and proportionately higher production costs (lower quality of raw materials affects equipment efficiency, which results in the increase of unit production costs).

- Biomasa Energetyczna Południe

In the period under review, the plant operated below the target performance level due to insufficient supply of raw materials for the production of pellets.

In 2012, the plant reported lower results compared with the previous year, mainly due to lower revenues, low quality of straw (high humidity) and proportionately higher production costs (lower quality of raw materials affects equipment efficiency, which results in the increase of unit production costs).

- Biomasa Energetyczna Wschód

In August 2012, the construction of the plant was completed and in September it commenced production of pellets under the contract with GDF Suez Bioenergia Sp. z o.o. The target capacity of the plant is 60,000 tonnes per year. GPBE Wschód operates in the Europark Mielec Special Economic Zone, the Zamość sub-zone.

Outlook for development

In the next financial year, like in the previous years, the Company will focus its efforts on the expansion of its wind farm and biomass power plant portfolio.

Currently, the total portfolio of wind farm projects under development is about 1,000 MW. They are planned to be finalised in 2013-2016. The development of 362 MW was completed until the end of 2012, of which 282 MW were sold (the Suwałki WF, Tychowo WF, Jarogniew/Mołtowo WF, Wartkowo WF, Pągów WF, Klukowo/Samborsko WF), while 80 MW operate as part of the PEP Group (the Puck WF, Łukaszów WF, Modlikowice WF). The development of the following wind farms with a total capacity of 106 MW is planned to be finalised in the first half of 2013.

In addition, the Issuer will work to acquire further biomass power plant projects for significant industrial enterprises as well as to be operated as independent facilities supplying electricity to transmission grids.

Construction of biomass-only facilities for industrial customers is aimed to increase their independence in power generation and implement the strategy for generation of energy using renewable sources, which will lead to a reduction of the cost of electricity.

In accordance with the communicated financing strategy for development, the objective of which is to ensure increased net earnings per share while retaining the shares in some wind farms and earning premium on the sale of shares in the remaining ones, in 2013, as it was the case in previous years, PEP plans to sell all of its shares in selected projects and to retain shares in the remaining projects. Decisions regarding individual projects are taken upon the completion of their development phase. PEP's Management analyses market situation on an on-going basis to ensure that the relationship between the aforementioned key components of its strategy is most favourable for the shareholders.

3. Description of the structure of consolidated assets and liabilities, including from the perspective of Group's liquidity

	Ratio	Details	Value
1	Return on equity	Net profit/loss / Average equity for the year	4.1%
2	Profit margin	Net profit/loss / Sales revenue	13.0%
3	Liquidity I	Current assets / Short-term creditors	2.9
4	Debtors days	Average trade debtors for the year x 365 days / Sales of finished goods, goods for resale and raw materials	343 days
5	Debt ratio	(Total liabilities and provisions) * 100 / Total assets	50.0%

High debtors days ratio is mainly due to the increase of trade receivables arising from sale of the Saturn CHP Plant project (discontinued operations) as well as high amount of receivables arising from the deferred payment for the Klukowo/Samborsko Wind Farm Project sold in December 2011.

4. Identification of significant risks and the extent of exposure

Risks associated with the business environment of the PEP S.A. Group

Competition risk

Considering the attractiveness of investing on this market, an increase is expected in the competition in this segment, including from strong foreign capital entities, which may affect both the PEP Group's ability to acquire new outsourcing contracts and the attractiveness of the terms of completion of the following projects.

Due to the systematic increase in the demand for power generated using renewable sources caused by the existing legal regulations, a small level of supply of this type of energy and the expected growth of its prices, the attractiveness of investing in the generation of power using renewable sources is increasing. As a result, it is expected that competition on this market will increase. The Issuer started to operate wind farms and is in the course of development of the following units. Due to atmospheric and environmental limitations in Poland, this is the source which, in addition to biomass combustion, is perceived as providing the largest opportunities for production of 'green' energy in Poland. It is likely that companies from Western Europe and the United States of America, which have gained experience in this area in other markets, will be interested in the construction of wind farms in Poland.

Proper location of the facilities is essential for the profitability of investments in wind power production. So far the Issuer has worked on the development of wind farms together with EPA Wind Sp. z o.o., Poland's leading wind farm project developer. Thanks to this collaboration, the Issuer had access to information on the best locations for wind farms, the results of wind measurements taken in Poland and practical experience resulting from construction of wind farms in Poland, thus gaining advantage over its potential competitors due to the fact that collection of such data is costly and time-consuming. On 21 January 2013, the aforementioned business cooperation agreement was terminated and the Issuer took over wind farm development projects with a total capacity of approx. 530 MW for individual implementation together with EPA Wind Sp. z o.o.'s experienced wind farm development team, which will enable it to maintain the competitive advantage acquired in the past.

In addition, the Issuer developed an in-house wind farm development team within its own organisational structure. The combined teams are currently carrying out 29 projects.

The PEP Group acquired a unique experience in Poland in the implementation of outsourcing projects, including both the development and implementation of optimal technological solutions as well as construction of appropriate legal, tax and financial structures, which gives it a significant competitive advantage. In addition, the PEP Group focuses on high quality of services rendered to clients, systematic improvement of competence in the area of advanced technologies as well as improvement of management techniques.

Risk associated with economic conditions in Poland

The achievement of the strategic goals set by the PEP Group and its budgeted financial results is affected, among others, by macroeconomic conditions, which are beyond the control of the Group companies. These factors include, for example, GDP growth, inflation index, general condition of Polish economy, changes in legislation. Any unfavourable changes in macroeconomic conditions may result in a decrease of the Issuer's budgeted revenues or an increase of its operating expenses.

Currency risk

Part of the contracts concluded by the PEP Group with energy consumers provide for payments in EUR. As a result, fluctuations of the EUR exchange rate may affect the amount of revenue earned by the Group after translation into PLN.

The PEP Group companies mitigate the impact of the currency risk on the profitability of their projects by using the so-called natural currency hedge, under which if a given project generates income which must be translated from a foreign currency, then majority of costs of construction, modernisation and day-to-day functioning of such facility (a combined heat and power plant or a wind farm) are incurred in the same currency. In addition, loans taken out to finance the project are also denominated in the currency of the future revenue.

On the other hand, the PEP Group companies do not apply hedging in order to eliminate non-monetary differences arising on the re-measurement of non-monetary assets and liabilities denominated in a foreign currency at the balance sheet date. The sensitivity of the Issuer's profit or loss before tax (due to changes in the fair value of non-monetary assets and liabilities) to reasonably possible changes in the EUR exchange rate, with all other variables held constant, is presented in Note 34 to the consolidated financial statements.

Interest rate risk

The share of debt in the financing structure of the Capital Group is high. In accordance with the PEP Group's strategy, which is aimed at maximisation of the rate of return on equity, the projects developed by the Group are financed by debt in more than 50%. According to the loan agreements concluded by the individual Capital Group entities, interest on loans is determined based on variable interest rates. A significant rise in the market interest rates above the values expected by the Issuer and included in project budgets may have an adverse effect on the PEP Group's results. The Issuer is aware of this risk and makes efforts to counteract it and to prevent any potential adverse effects by a continuous monitoring of the conditions on the money market, effective finance management and incorporation of clauses providing for client's participation in the interest rate risk in the contracts made with the clients. In addition, entering into hedging transactions to hedge the interest rates of long-term investment loans will be considered for new projects.

Risk of fluctuations of commodity prices and availability of commodities used in the production process

Currently, the Issuer and members of its Capital Group use the following commodities in the production of electricity and heat: natural gas, coke gas and agricultural biomass.

Until the end of 2010, the PEP Group used hard coal for generation of electricity and heat in the Saturn and Jeziorna CHP Plants, and starting from 2011, due to the sale of the Jeziorna CHP Plant, it used hard coal in the Saturn CHP Plant only. As of May 2012, due to the sale of the Saturn CHP Plant, the Group stopped using coal in its operations.

Natural gas is only used by the PEP Group for the production of heat at the Zakrzów CHP Plant. The main suppliers of gas fuel in Poland are the companies from the PGNiG group. The fuel is mainly imported from Russia and, to a lesser extent, is extracted by PGNiG. Any problems with the supply of gas by PGNiG in an amount necessary to satisfy the existing demand may result in the reduction of the supply of gas fuel to the customers. In such a case the PEP Group may be unable to fulfil its obligations relating to the supply of heat to its customers.

The Issuer's subsidiaries: Grupa PEP Biomasa Energetyczna Północ (GPBE), Group PEP Biomasa Energetyczna Południe (GPBEP) and Grupa PEP Biomasa Energetyczna Wschód (GPBEW) make pellets for power industry using agricultural biomass. Pellets are produced using crop, corn and rapeseed straw. Main suppliers are farms located nearby production plants. The volume and price of straw supplies can be affected by the volume of harvested crops, corn and rapeseed as well as weather conditions.

The Issuer hedges against this risk by conducting an exhaustive research and analyses of the availability of straw on local agricultural markets. In addition, the Companies apply price formulas in the supplies of pellets to its customers, under which the price of the pellets depends on both the price of straw and the inflation index.

The Issuer and the Capital Group companies apply mechanisms to hedge against adverse effects of fluctuations in the prices of raw materials used in production. In principle, the prices of electricity and heat and the prices of biofuel sold by the Group are linked to the prices of natural gas and straw. However, it cannot be precluded that, despite the use of hedging mechanisms, fluctuations in the prices of raw materials may affect the results of the Issuer and of the Capital Group.

Risk associated with Polish energy market

The energy market in Poland is only partly regulated. While thermal energy and gas fuel markets are regulated, the market of electricity is only partly controlled by the relevant public authorities. These authorities include in particular the President of the Energy Regulatory Office (*Urząd Regulacji Energetyki* – URE), which is a central administrative body appointed by the Prime Minister. Under the Energy Law, this body is responsible for regulation of fuel and energy markets as well as promotion of competition in the power industry. The scope of competencies and responsibilities of the President of URE includes, among others, granting, amendment and withdrawal of concessions for production, storage, transmission and trade in fuel and energy as well as control of the fulfilment by the entities subject to Energy Law of their obligations under this law and the relevant executive regulations. The powers of the President of URE also include agreeing draft development plans for energy companies, resolving disputes between different energy companies and between energy companies and their customers as well as approval and control of the rates and charges used by energy companies for compliance with the principles set out in relevant regulations, in particular the principle of protecting consumers against unreasonable prices. The President of URE may also impose penalties on concession holders, including significant monetary penalties. As a result, the Issuer cannot eliminate altogether the risk that the President of URE will make an unfavourable use of his rights towards PEP and its Capital Group. Nonetheless, the Issuer mitigates this risk by taking all steps to ensure that it conducts its operations in conformity with the requirements of the Energy Law and the executive regulations issued based on this law.

Due to the considerable degree of implementation of competitive market mechanisms in the power industry, holders of concessions for generation of electricity are exempt from the obligation to submit their electricity rates and charges for approval, although they are still required to do so in respect of electricity provided to households. It must be, however, emphasised that the rates and charges for electricity generated by PEP are not subject to approval by the President of URE. Despite the fact that, in principle, the Energy Law does not require approval of electricity rates and charges by the President of URE, they should be set up in accordance with the principles and guidelines included in this law and in the relevant executive regulations. It must be emphasised that, in principle, the current provisions of the Energy Law ensure coverage of reasonable operating expenses.
Potential amendments may prove to be unfavourable for the Issuer, but the Issuer's influence on the decisions taken at the community and country-wide level is very limited.

<u>The risk of approval of heat rates and charges by the President of URE</u>

The PEP Group companies generating heat are required to submit their rates and charges for the sale of heat to the President of URE. In accordance with law, the table of rates and charges should ensure coverage of reasonable budgeted costs of generating heat in a given period plus a return on equity. The approval of the rates and charges by the President of URE is intended to protect consumers against unreasonable rises of the prices of heat. In practice, the rates and charges are calculated by the President of URE using certain assumptions which may differ from the actual level of operating expenses incurred by the PEP Group companies. Consequently, there is a risk that the President of URE will approve a table of rates and charges that will not ensure a sufficient return on equity for the heat generator, or even not cover the costs of generating heat. Additionally, there is a risk that the rates and charges for the next period will be approved with a delay, which means that the heat generator will have to apply the rates for the previous period, which may not ensure a sufficient return on equity. The realisation of such risk may result in the PEP Group achieving results below the expected ones.
The companies which are exposed to the risk relating to heat rates and charges are the Zakrzów CHP Plants. The impact of this risk on the PEP Group's results is limited due to the relatively small share of the revenue earned by this plant from the sale of heat in the total revenues of the Group.

<u>Risk of changes in legislation</u>

In the Issuer's opinion, certain risk may arise from the frequent changes in law or different, often contradictory, interpretations of legal regulations. Potential changes in legislation, including in particular laws governing business activity and taxes, labour law, commercial law (including law of commercial companies and capital markets) and environmental protection law may have an adverse effect on the business conducted by the Issuer and its Capital Group. It must be emphasised that Polish law is in the final phase of adjustment to EU law, which is not without an effect on the legal environment in which the PEP Group operates. Additionally, Polish law is being amended on an on-going basis to reflect the changes occurring in EU regulations. In particular, the implementation of the new regulations concerning business transactions may give rise to interpretation problems, inconsistent court judgments, or unfavourable interpretations adopted by public administration authorities.

It must also be emphasised that, in addition to general regulations applicable to each type of business activity, the Group's operations are subject to specific regulations resulting from the provisions of the Energy Law and the relevant executive regulations. Those regulations are often imprecise, resulting frequently in the lack of unambiguous interpretation. This in turn may give rise to problems with their application. Since those regulations are subject to frequent changes, the legal environment in which the Issuer operates is not fully stable. Accordingly, there is a risk that future changes in the state policy and the resulting changes in legal regulations may have an adverse effect on the business conducted by the Issuer and members of its Capital Group.

Risk of unstable taxation system

The Polish taxation system is characterised by frequent changes in tax regulations, many of which have not been formulated with a sufficient precision and consequently do not allow unambiguous interpretation. Interpretation of tax regulations is subject to frequent changes and both the practices applied by tax authorities and the case law regarding taxation continue to be inconsistent. One of the aspects of the insufficient precision of tax law is the lack of regulations setting out formal procedures for final verification of the accuracy of calculation of tax liabilities for a given period. Tax declarations and the amount of actual tax payments may be inspected by tax authorities within a period of five years of the end of the year in which the tax liability was payable.
As a result of Poland's accession to the European Union, Polish laws, including tax regulations, became subject to the process of adaptation to EU law and harmonisation with regulations binding in other EU countries. This process is still pending and creates an opportunity for further stabilisation of Polish tax regulations, which may considerably mitigate the risk of an unstable taxation system.

The risk of an unstable taxation system, including in particular the risk of the tax authorities adopting a different interpretation of tax regulations from the one adopted by the Issuer, does exist and may have an adverse effect on the operations, results, financial position and outlook for the Issuer's development.

Risk of non-compliance with regulations concerning environmental protection

The business activities conducted by the Issuer and the individual members of its Capital Group are subject to a number of legal regulations relating to environmental protection. In particular, an obligation exists or may arise to obtain integrated permits, allowances for the emission of gases or dust into the air. In addition, due to the EU system of trading in CO_2 allowances, it became necessary to obtain the relevant allowances for the installations used by the Issuer or members of its Capital Group in their operations.

The fulfilment of the requirements resulting from laws on environmental protection may entail expenditures for preparation of relevant applications as well as adaptation of installations to comply with such requirements. At the date of authorisation of this Prospectus, the Issuer and its subsidiaries obtained all permits and allowances required under environmental protection.

In addition, in accordance with the National Plan for Allocation of CO_2 Allowances for the years 2009-2012, the Issuer's subsidiaries and jointly controlled entities obtained allowances for specified amounts of annual CO_2 emissions which are necessarily entailed by their projects (ME: 35,605, and Zakrzów CHP Plant: 7,966 allowances). From verified reports of CO_2 Emission for the Facilities it follows that, in 2012, ME and the Zakrzów CHP Plant emitted 33,393 and 3,873 tonnes, respectively. Therefore, these facilities have surplus emission allowances.

In the new trading period of 2013-2020, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, amended by Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009, the Zakrzów CHP Plant received a preliminary annual allocation of free-of-charge emission allowances under Article '10a' amounting to 8,439 tonnes for the years 2013-2020. Under Article '10c' – as part of derogation – the Mercury Power Plant facility as an electricity generator received preliminary allocations of emission allowances amounting to 22,344 tonnes for 2013, and decreasing to zero in 2020.

Since 1 January 2013, both facilities have been operating under new CO_2 emission monitoring plans, approved by relevant bodies and complying with the requirements of: Commission Regulation (EU) No. 601/2012 of 21 June 2012 on the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Commission Regulation (EU) No. 600/2012 of 21 June 2012 on the verification of greenhouse gas emission reports and tonne-kilometre reports and the accreditation of verifiers pursuant to Directive 2003/87/EC of the European Parliament and of the Council.

Risks associated with the Issuer's business activities

Risk of lack of funding for investment projects

The Issuer seeks to achieve a project finance formula of 70%-80% share of external funding and 30%-20% own share. Construction of new wind farms, biomass power plants, upgrade of existing facilities and development of projects related to the outsourcing of production of electricity and heat will require substantial resources. New projects will be funded through bank loans, own funds, the issue of shares (only on condition that the share price reflects the fair value of the company) and the sale of stakes in selected projects.

The Issuer's historical experience in the preparation of investments and securing funding indicates that professionally designed business plans and good relations maintained with financial institutions will ensure appropriate funding for the individual projects.

In case of difficulties with the acquisition of entities interested in buying shares, ineffective issue of shares, difficulties in obtaining bank loans, the PEP Group may postpone the implementation of individual investment projects. In such circumstances, the Issuer will consider other forms of financing for the proposed projects, including a temporary reversal of the ratio between the shares sold and retained.

Risk of new projects being unsuccessful

The PEP Group carries out an intensive development plan and implements a significant number of investments in the segment of power generation outsourcing, development and construction of wind farms and production of pellets using agricultural biomass. The projects carried out by the Issuer entail significant capital expenditures. The expenditures are particularly high in the area of development and construction of wind farms, which is the area in which the Issuer plans further development and is currently conducting a number of projects. The Issuer's decisions on commencing development phase are based on detailed financial models, expert studies and technical analyses which are prepared by a specialised Business Development Department. The above-mentioned analyses take into account a number of assumptions, including assumptions relating to the volume of generated electricity, sales revenue, production costs, the size of the required investment and costs of its financing. There is a risk that the Issuer adopts assumptions that are more favourable than the actual ones, which will result in the PEP Group achieving a lower than expected return on the investment in a given project. In addition, the costs of preparing the project before entering into the development phase are also significant, especially in the segment of construction of wind farms. Unsuccessful implementation of a project means that these expenses will not be recoverable.

The Business Development Department has an extensive experience in all aspects of project preparation and implementation, such as development, facilities' operations or funding. The Issuer systematically improves its project management techniques and carefully selects locations for wind farm investments, so as to minimise the risk of achieving an unsatisfactory return on the investment and the risk of incurring significant expenses for preparation of a project which is not probable of implementation. In addition, in January 2013 the Issuer took over from EPA Wind Sp. z o.o., Poland's leading wind farm project developer, a team of employees with a broad experience in the development of wind farm projects. As a result it gained access to information on the best locations for wind farms, the results of wind measurements taken in Poland as well as practical experience resulting from construction of wind farms in Poland.

Risk of inability to complete or delayed implementation of investment plans

Investments in industrial power generation outsourcing and renewable energy production are one of the key elements of the PEP Group's development strategy.

In the event of delays in implementation or inability to complete investment projects, there is a risk that the operating targets are not achieved within the specified deadline, as a result of which the Issuer's financial performance will be worse that it would have been had the project been completed in accordance with the plan.

In its efforts to realise its investment plans, the Group takes steps to minimise the above risk (among others, by precise planning and analysis of factors that may affect its ability to achieve targets, on-going monitoring of results and immediate response to signals indicating that the achievement of the targets may be endangered). The Company's management carefully prepares the process of implementation of particular projects, by planning in detail all technological aspects and ensuring sufficient funding.

Risk of competition in acquiring locations for wind farm projects

Due to enhanced support for renewable energy production in the EU and in Poland, the financial attractiveness of wind farm projects has increased, which results in an increased competition in acquiring locations for such projects. However, due to the fact that the Company commenced its operations in the area of wind farm development as early as in 2003, it has an experience in acquiring locations as well as a wide portfolio of defined wind farm projects. In addition, the Issuer has a large team of in-house employees experienced in wind farm project development who are currently working on 29 projects. Therefore, the Company believes that it will be able to complete the assumed development of approx. 1.500 MW by 2016 (including the wind farms that have been sold and developed to date).

Risk of dependence on key customers

Each of the industrial power outsourcing projects developed and implemented by the Issuer is addressed, in practice, to one or several customers, which are manufacturing companies. As the Group's activity grows, new outsourcing projects are implemented and the Group expands into the renewable energy market, the share of individual customers in the structure of revenue will be gradually reduced. Currently, the shares of only three customers in the structure of total sales of the Group have exceeded 10%.

Risk associated with financial condition of customers

Within the segment of industrial power generation outsourcing, the PEP Group earns revenue based on long-term agreements for the supply of electricity and heat concluded with one or several customers. The financial condition of the customers and their ability to pay their liabilities to PEP is, therefore, of key importance for successful implementation of the projects, the results achieved by the PEP Group as well as its financial condition. Additionally, a rapid decrease in the customer's power consumption may affect the efficiency of energy production.

Before entering into outsourcing contracts and setting to implementation of projects, the Issuer performs a comprehensive review of potential customers, sometimes with the support of external consultants, for their ability to meet their liabilities to PEP, as well as a review of the outlook for future developments in the industries in which they operate. The PEP Group carefully selects customers out of industries with a good market potential. The Issuer conducts a detailed analysis of the customer's technological process and electricity and heat requirements, and the commencement of any project is preceded by a several months' cooperation with the customer.

Risk of seasonality

The wind conditions determining production of electricity by wind farms are characterised by an uneven distribution over a year. In autumn and wintertime they are significantly better than in spring or summertime. The Issuer decided to construct wind farms in the indicated locations based on professional wind measurements confirmed by independent and renowned experts. However, it cannot be precluded that the actual wind conditions will vary from those adopted in the models prepared for the particular investment projects.

Risk of temporary suspension of production due to break down, destruction or loss of assets

A serious breakdown, damage, loss of part or all of the property, plant and equipment held by the PEP Group may result in a temporary suspension of production. In such a case the Group may experience difficulties in timely performance of contracts, which may in turn result in contractual penalties. Such a situation may not only result in the decrease of the quality of client service, but may additionally lead to significant deterioration of financial performance.
The Group holds an insurance against loss of gross margin as well as property insurance; hence a potential damage, destruction or breakdown will be at least partly compensated by the compensation received under the insurance contracts.

The Issuer and members of its Capital Group believe that their insurance contracts provide them with a sufficient coverage against the risks associated with their business activities. However, it cannot be precluded that the amount of losses caused by the events covered by the insurance policy may exceed the limits stated therein. In addition, one cannot preclude occurrence of other events that have not been covered by the insurance, which may result in the Company incurring significant expenses to cover the loss.

Risk of loss of key personnel

Both the Issuer and the Capital Group companies conduct their operations mainly based on the knowledge and experience of their highly qualified staff. Due to the deficit of specialists in the area of industrial power generation outsourcing as well as possible activities taken by both the current and future competitors to take them over by offering them competitive terms of employment and remuneration, there is a risk of loss of personnel that is of key importance for the development of the Issuer and the Capital Group. This might affect the Issuer's performance and strategy implementation.

The risk of loss of key personnel is mitigated by the following:
- the Issuer's high internal corporate culture ensuring employees' identification with the Company,
- appropriate structuring of the remuneration system, fostering incentive and loyalty,
- a share option incentive scheme for key personnel,
- knowledge management and an extensive training programme.

Risk associated with operations conducted in the facilities

Industrial facilities are subject to the risk of not achieving the expected performance and availability of the facilities as well as the risk of non-compliance with the terms of power supply contracts. The Issuer's experience shows that the risk of unexpected breakdowns resulting in the exceeding of facilities' operating budgets is low. To mitigate this risk, PEP S.A. improves procedures for operating facilities and enters into insurance contracts, or applies contractual clauses which enable it to transfer any potential additional costs to sub-contractors.

Risk of cash flow hedges

As at 31 December 2012, the Group did not have any financial instruments that were designated as hedging instruments in cash flow hedges.

During 2012, the Group realised a forward contract with a value of EUR 4,198 thousand. The result on the forward contracts was taken to assets under construction and will be amortised to profit or loss over the expected period of depreciation of the underlying fixed asset which is approx. 20 years.

5. Statement of compliance with corporate governance rules

a) Identification of the Issuer's set of corporate governance rules and the place in which it is publicly available

The Code of Best Practices for WSE Listed Companies. Available at the following WWW address: http://corp-gov.gpw.pl/

b) Departures from the set of corporate governance rules referred to under letter a), including identification of those rules and reasons for non-compliance

The Company does not conduct on-line broadcasts of General Meetings, nor does it record such meetings. Due to considerable costs entailed by such activities, the Company does not intend to enable on-line broadcasts or to record General Meetings. The Company believes that the existing method of communicating the progress of General Meetings to the shareholders, i.e. publishing the contents of the resolutions adopted by the General Meeting, is sufficient.

The determination of the composition of the Supervisory Board is an independent decision of the Company's shareholders. Due to the fact that they did not appoint women to the Supervisory Board, the Company has not complied with the recommendation included in section I.9 and does not publish the information referred to in section II.1.2a.

As the Company's Statutes do not provide for participation in General Meetings over the Internet, the recommendation included in section IV.10. has not been complied with.

c) Main features of the Issuer's internal control and risk management systems used in preparing separate and consolidated financial statements

The Company's Management Board is responsible for the effectiveness of the internal control and risk management systems in the process of preparation of financial statements.

Periodical financial statements and management reports are prepared by the Accounting Department and the Department of Internal Control, Reporting, Modelling and Analyses, under the technical supervision of the Director for Finance and Administration – Management Board Member.

The information included in the financial statements is derived from the financial and accounting system, in which accounting entries are made based on documents prepared in accordance with the Company's Accounting Policy, which has been approved by the Management Board and is based on the International Financial Reporting Standards. Such documents are first reviewed by eligible individuals for formal, accounting and technical accuracy.

The effectiveness of the internal control system is assured by a number of regulations and internal procedures approved by the Company's Management Board, including those relating to the flow of accounting documentation, description of vouchers, making purchases on behalf of the Company, incurring liabilities by the Company, conducting physical counts, sale of fixed assets and other items held by the Company, decision-taking process, budgeting process etc.

Data security is ensured by an on-going verification and updating of access restrictions and passwords to the financial and accounting system as well as by the procedures for the creation and storage of back-ups.

Annual and semi-annual reports (separate and consolidated) are subject to independent audits (annual reports) or reviews (semi-annual reports) by a statutory auditor selected by the Supervisory Board on the basis of authorisation included in the Company's Statutes.

Prior to publication, the audited annual reports of the Company are approved by the Management Board and the Supervisory Board.

After the hard close, each month the Company prepares management reports which include, among others, an analysis of key financial data and operating ratios and a comparison of current results with the budget, along with explanations for any significant variances from the budget. Such reports are distributed on a monthly basis among the members of the Management Board and Supervisory Board.

The Company's internal controls enable early identification, assessment and minimisation of risk and ensure accuracy of the information included in financial statements.

As a result, the financial statements prepared by the Company are true and fair, which is confirmed by auditors' reports.

d) Shareholders holding, either directly or indirectly, significant stakes, including the number of shares held, their percentage share in the issued capital, number of voting rights attached and their percentage share in the total vote at the General Meeting

The details of shareholders holding, either directly or indirectly, significant stakes are presented in Note 18.2 to the consolidated financial statements.

e) Holders of all securities giving special control powers, including a description of such powers

The Company did not issue any securities giving special control powers.

f) Restrictions on exercising voting rights, such as a restriction on the exercise of voting rights by the holders of a specified portion or number of votes, timing restrictions on the exercise of voting rights, or provisions according to which, with the entity's involvement, the equity rights attached to securities are separated from the ownership of such securities

There are no restrictions on the exercise of voting rights such as a restriction on the exercise of voting rights by the holders of a specified portion or number of votes, timing restrictions on the exercise of voting rights, or provisions according to which, with the entity's involvement, the equity rights attached to securities are separated from the ownership of such securities.

g) Restrictions on the transfer of ownership of the Issuer's securities

There are no restrictions on the transfer of ownership of the Issuer's securities.

h) Rules for appointing and dismissing members of executive bodies and their powers, including the right to take decisions on the issue or redemption of shares

The Company's Management Board consists of one to five members, including the President and Vice-president of the Board. The term of office is 3 (three) consecutive years. Board members are not appointed for a joint term of office.

The Management Board is appointed by the Supervisory Board, which also specifies the number of Board members for each term of office.

The Management Board manages the Company and represents it towards external parties.

Any matters connected with the running of the Company which have not been reserved by the Law or the Statutes for the General Meeting or Supervisory Board are within the scope of competence of the Management Board.

The Management Board has no power to take decisions on the issue of shares.

i) Amendments to the Issuer’s Statutes or Articles of Association

Any amendments to the Statutes require resolution of the General Meeting passed by the majority of ¾ of votes cast.

j) Procedure and main powers of the General Meeting and a description of shareholder rights and exercise of shareholder rights, including rules arising from the Rules of Procedure of the General Meeting, if any such document has been enacted, unless they result directly from the provisions of law

Description of procedure

The General Meeting acts on the basis of: (i) Code of Commercial Companies, (ii) other generally accepted regulations, (iii) the Statutes and (iv) the Rules of Procedure of the General Meeting.

Depository certificates give a right to participate in the General Meeting. The certificate should indicate the number of shares and include a clause that the shares will not be issued before the end of the General Meeting. In order to participate in a General Meeting, a shareholder must submit his or her certificate at the Company’s head office, at least one week in advance of the date of the General Meeting. Shareholders may participate in a General Meeting either personally or by proxy. A proxy for participation in a General Meeting should be executed in writing. In addition, in the case of proxies granted by corporate entities or commercial partnerships, the proxy should be accompanied by a document confirming the powers of the individuals appointing the proxy to represent the shareholder.

Voting at a General Meeting is public. Secret ballot is held if it is required by law (e.g. for voting on personnel-related matters) or at the request of a shareholder.

General Meetings are convened by placing an announcement on the company’s web site and in the manner set out for communicating current information under the laws on public offering, conditions governing the introduction of financial instruments to organised trading, and public companies. The announcement should be made at least twenty six days in advance of the date of the General Meeting.

Main powers of the General Meeting

The powers of the General Meeting are specified in Article 20.1 of the Company’s Statutes and include:

a) reviewing and approving the Directors' Report and the financial statements of the Company;

b) accepting performance of the Supervisory Board and the Management Board;

c) deciding on allocation of profits or absorption of losses;

d) setting up and cancelling specific funds;

e) setting up the basis for and the amount of remuneration for Supervisory Board members;

f) amending the scope of the Company's activities;

g) amending the Company's Statutes;

h) increasing or decreasing issued capital;

i) deciding on business combination or transformation of the Company;

j) dissolving the Company and winding it up;

k) issue of debentures, including convertible debentures;

l) selection of liquidators;

m) all decisions regarding claims for damages caused at the Company's incorporation or during the course of administration or supervision;

n) disposal of the Company's enterprise or its substantial part;

o) considering and deciding on matters raised by the Supervisory Board, Management Board or shareholders.

The General Meeting is also empowered to appoint and dismiss members of the Supervisory Board (under Article 10.2 of the Statutes). In addition, under Article 368 § 1 of the Code of Commercial Companies ('CCC'), the General Meeting may dismiss members of the Management Board.

Shareholder rights and their exercise

The main shareholder right is the right to take part in a General Meeting and to exercise voting rights.

In addition, a shareholder or shareholders representing at least 10% of the issued capital may request that a General Meeting be convened and that specific matters are included on its agenda (Article 400 § 1 CCC).

In addition, shareholders have the right to file a claim with a court of law against the Company for repealing a resolution or a claim for declaring invalidity of a General Meeting resolution.

k) Composition of the issuer's executive, supervisory or administrative bodies and their committees and changes therein during the last financial year, and description of the scope of their activities

<u>Supervisory Board</u>

Composition

	Name and surname	**Position**
1.	Dariusz Mioduski	President of the Supervisory Board
2.	Jacek Głowacki	Vice-president of the Supervisory Board
3.	Marek Gabryjelski	Member of the Supervisory Board
4.	Mariusz Nowak	Member of the Supervisory Board
5.	Tomasz Mikołajczak	Member of the Supervisory Board
6.	Arkadiusz Jastrzębski	Member of the Supervisory Board

The Supervisory Board consists of five or six members. The number of members of a Supervisory Board of a given term of office is set by the General Meeting. The term of office is 3 (three) years, except for the term of office of the first Supervisory Board, which lasts 1 (one) year. Members of the Supervisory Board are not appointed for a joint term of office.

Members of the Supervisory Board are appointed and dismissed as follows:

a) a shareholder holding shares which represent at least 33% of the Company's issued capital has the right to appoint and dismiss 2 members of the Supervisory Board, including the President. If more than one shareholder holds shares representing at least 33% of the Company's issued capital, the President is appointed by the shareholder who holds the greatest number of the Company's shares;

b) the remaining members of the Supervisory Board are appointed and dismissed by the General Meeting.

Scope of activities

The Supervisory Board acts on the basis of: (i) Code of Commercial Companies, (ii) other generally accepted regulations, (iii) the Statutes and (iv) Rules & Regulations of the Supervisory Board.

An Audit Committee has been appointed in the Supervisory Board, with the following members: (i) Mariusz Nowak – President, (ii) Jacek Głowacki – Member and (iii) Marek Gabryjelski – Member.

The scope of competence of the Supervisory Board includes:

a) evaluation of the Company's financial statements for the preceding financial year;

b) providing comments on the Directors' report and their motions on appropriation of profits (including distribution of dividends) or absorption of losses as well as draft resolutions proposed for the General Meeting and any other significant material presented to the shareholders in connection with General Meeting;

c) auditing and approving annual operating and financial plans for the Company ('the Company's Budget') and for the Projects in which the Company invests ('Project Budget') as well as any significant amendments thereto, and requesting the Directors to submit detailed reports on their performance;

   'A Project' means a company, activity or an undertaking related to generation, transmission or distribution of electricity or heat, or supply, trading in or distribution of fuel, in which the Company is a shareholder, investor, developer or administrator;

d) auditing and approving strategic plans for the Company's development;

e) providing the General Meeting with a written report on the results of the activities referred to under letters a), b) above;

f) appointing, dismissing and suspending a member of the Company's Management Board, including the President, Vice-president or the whole Management Board;

g) determining the number of members of the Management Board for the next term;

h) determining salaries and other emoluments to the Directors;

i) delegating its member(s) to temporarily perform the activities of the Company's Management Board in the event of dismissing or suspending the entire Management Board or where the Management Board is unable to act due to other reasons;

j) giving consent for disposal, lease, exchange or other disposal of the Company's assets, including the Company's shares in any Project, either as part of a single transaction or several related transactions, whose market value exceeds the equivalent of USD 100,000 (one hundred thousand), calculated using the average rate announced by the President of the National Bank of Poland on the date of the transaction ('the Exchange Rate');

k) giving consent for incurring a bank loan, incurring or extending other loans by the Company or incurring other type of debt except for: (i) trade payables incurred in the course of normal business operations, (ii) taxes that are not yet due and payable, (iii) short-term debt arising from other items, where the portion that has not been provided for in the Company's approved budget does not exceed in total the PLN equivalent of USD 250,000 (two hundred and fifty thousand) according to the Exchange Rate;

l) giving consent for the Company's expenditures exceeding the PLN equivalent of USD 250,000 (two hundred and fifty thousand) according to the Exchange Rate, incurred either as part of a single transaction or a number of related transactions, except for expenditures approved and specified in the Company's approved annual budget or incurred by the Company in the course of its normal operations, with a proviso that capital expenditures are not deemed to be incurred in the course of normal business operations;

m) giving consent for the Company's participation in legal transactions with any of the following entities:

   i) an entity in which the Company holds shares, either directly or indirectly, unless the Company holds, either directly or indirectly, 100% (one hundred percent) of the entity's issued capital;

   ii) member of the Company's Management Board;

   iii) member of the Supervisory Board;

n) giving consent for the Company's entering into a partnership, registered partnership or limited partnership agreement, agreement for participation in profits or revenues or any other similar agreement under which the Company's revenues or profits are or may be shared with other individuals or entities;

o) giving consent for the setting up of branches and subsidiaries by the Company, for the purchase or take-up of shares in other entities as well as for entering into commercial partnership agreements with entities other than those in which the Company holds, either directly or indirectly, 100% (one hundred percent) of the issued capital;

p) giving consent for issuing suretyships or guarantees by the Company and for any encumbrances of the Company's assets in each case where the total amount of such suretyships, guarantees or other encumbrances would exceed or exceeds the PLN equivalent of USD 100,000.00 (one hundred thousand) according to the Exchange Rate, unless such an encumbrance have been provided for in the Company's approved budget;

r) selecting or changing the Company's auditor;

s) giving consent for establishing proxies and for the amount of their remuneration;

t) giving consent for a conclusion, a significant amendment to or termination of a contract the value of which exceeds the PLN equivalent of USD 500,000 (five hundred thousand) according to the Exchange Rate, relating to the rendering of energy services, power purchases, facilities management, lease, turn-key deliveries and works, maintenance and operation of equipment, the incurring of loans, supply of fuels and other contracts relating to the Projects in which the Company is engaged, including any amendments to the orders placed under turn-key agreements, unless the given activity has been provided for in the Company's approved budget;

u) giving consent for the terms of financing Projects and for any significant amendments thereto;

v) giving consent for any significant changes to the accounting policies applied by the Company;

w) giving consent for the Company's purchase or disposal of a real estate, perpetual usufruct or property interest, unless the given activity has been provided for in the Company's approved budget or in the Project budget.

<u>Management Board</u>

Composition

	Name and surname	Function
1.	Zbigniew Prokopowicz	President of the Management Board
2.	Anna Kwarcińska	Vice-president of the Management Board
3.	Michał Kozłowski	Vice-president of the Management Board

The scope of activities of the Management Board has been described in paragraph 5 h) above.

6. Proceedings pending before a court, a body competent for arbitration proceedings or a public administration body, including information on:

a) proceedings concerning the issuer's or its subsidiary's liabilities or receivables whose value equals at least 10% of the issuer's equity, indicating: subject of proceedings and the issuer's standpoint

There were no proceedings concerning the issuer's or its subsidiary's liabilities or receivables whose value equals at least 10% of the issuer's equity.

b) two or more proceedings concerning liabilities and receivables whose total value equals, respectively, at least 10% of the issuer's equity, indicating the total value of proceedings concerning liabilities and receivables separately, the issuer's standpoint in the case and, with respect to major proceedings concerning liabilities and receivables - with an indication of their subject, the disputed amount, the date of instituting of proceedings and the parties involved

There were no proceedings concerning liabilities and receivables whose total value equals, respectively, at least 10% of the issuer's equity.

c) other proceedings

Under two decisions issued by the District Governor (*Starosta*) of Złotoryja, Amon Sp. z o.o. (the Company's subsidiary) had been obliged to make the so-called increased payment for excluding land from agricultural production, amounting in total to approx. PLN 620 thousand. Amon Sp. z o.o. filed an appeal against the above-mentioned decisions. The decisions have been reversed by the Local Board of Appeal.

Under the decision of the District Governor (*Starosta*) of Złotoryja, Talia Sp. z o.o. (the Company's subsidiary) had been obliged to make the so-called increased payment for excluding land from agricultural production, amounting to approx. PLN 310 thousand. Talia Sp. z o.o. filed an appeal against the above-mentioned decision. The decision has been reversed by the Local Board of Appeal.

7. Information on main goods or services along with their value and volume and share of individual products, goods and services (if significant) or of their groups in the issuer's total sales, as well as on movements in this respect in a given financial year

NET REVENUE FROM SALE (BY TYPE OF ACTIVITY) [PLNm]		**31.12.2012**	**31.12.2012**
Net revenue from sale of electricity		37.2	28.22%
Volume of electricity sold	[MWh]	210 090	
Net revenue from sale of heat		6.2	4.70%
Volume of heat sold	[GJ]	65 710	
Net revenue from consulting projects		0.9	0.68%
Revenue from leases and operator's activities		0.5	0.38%
Revenue from sale of goods for resale		4.2	3.19%
Revenue from sale of straw		0.1	0.08%
Revenue from sale of pellets		38.3	29.06%
Net revenue from certificates of origins		39.2	29.74%
Accrued net revenue from reduced CO_2 emission (Joint Implementation Mechanism)		-0.4	-0.30%
Revenue from sale of wind farms development		5.6	4.25%
Net revenue from sale of CO_2 emission allowances		0.0	0.00%
Total net revenue from sale		**131.8**	**100.00%**

8. Information about markets, including a breakdown into domestic and foreign markets, and information about sources of supply of materials for production of goods and services, identifying concentration on one or more customers and suppliers and, where the share of one customer or supplier reaches a least 10% of total sales - the name of the supplier or customer, its participation in the sales or supplies, and its formal relationship with the issuer

In the course of 2012, all goods and services were provided to domestic customers. Because of the nature of the business conducted, which involves production of heat and electricity for a specific customer, each of the industrial power outsourcing projects developed and implemented by the Issuer is addressed, in practice, to one or several customers, which are manufacturing companies. As the Capital Group's activity grows, new outsourcing projects are implemented and the Group expands into the renewable energy market, the share of individual customers in the structure of revenue will be gradually reduced. Currently, the shares of only three customers in the structure of total sales of the Group have exceeded 10%.

Customer	**Item sold**	**Relationships with the Capital Group**	**2012**
Grupa Tauron S.A.	Sale of certificates of origin and electricity	none	43%
GDF Suez Bioenergia Sp. z o.o.	Sale of pellets	none	13%
EDF Paliwa Sp. z o.o	Sale of pellets	none	11%

The main raw materials used by the Group to produce heat and electricity and pellets from biomass are natural gas and straw.
The Group does not depend on one supplier of straw. It buys gas from PGNiG SA, but has possibilities to purchase fuel gas on the market. However, the Group is dependent on the transmission networks of the PGNiG SA Group.
Below are presented other suppliers of goods and services, whose share in 2012 amounted to at least 10% of total sales revenue.

Supplier	Item sold	Relationships with the Capital Group	2012
EPA Wind – Sp. z o.o. Sp. K.	Purchase of the remaining shares of Wind Farms	none	44%
Vestas Poland – Sp. z o.o.	Purchase of turbines for wind farm projects	none	12%

9. Information about significant contracts signed by the issuer, including any shareholders (partners) agreements, insurance contracts or cooperation agreements known to the issuer

In line with the requirements set out in the Minister of Finance's decree dated 19 February 2009 on current and periodic information provided by issuers of securities and conditions for recognising information required under the laws of a non-EU member state as equivalent, the Issuer provides information on significant contracts in the form of current reports.

10. Information about organisational or capital relationships between the issuer and other entities and identification of its major domestic and foreign investments (securities, financial instruments, intangible assets and property), including equity investments made outside its capital group and description of their funding, and a description of the structure of major equity investments or major investments made within the issuer's capital group in the financial year

The Group's capital structure has been described in the financial statements. The Issuer's capital relationships have been presented in Note 3 to the consolidated financial statements.

11. Information on significant non-arm's length transactions made by the issuer or its subsidiary with related parties, together with their amounts and details of their nature - the obligation is fulfilled by indicating the location of the disclosure in the financial statements

Details of related party transactions are presented in Note 38 to the consolidated financial statements.

12. Information about loan agreements made and terminated in a given financial year, providing at least their amounts, type and amount of the interest rate, currency and maturity dates

Details of loans taken out are presented in Notes 21, 22 and 23 to the consolidated financial statements.

13. Information about loans granted in a given financial year, with particular emphasis on loans to the issuer's related entities, indicating at least their amounts, type and amount of the interest rate, currency and maturity dates

Details of loans granted are presented in Note 35.2 to the separate financial statements and in Note 12 to the consolidated financial statements.

14. Information about suretyships and guarantees obtained and provided in a given financial year, with particular emphasis on suretyships and guarantees provided to the issuer's related entities

Details of suretyships or guarantees granted the issuer or its subsidiary to a single entity or its subsidiary are presented in Note 26.1 to the separate financial statements and in Note 25.1 to the consolidated financial statements.

Presented below are the details of suretyships and guarantees received:

Entity responsible / issuer of a guarantee or suretyship	Basis	Value	Period
Polenergia S.A./ Bank DnB NORD Polska SA	Agreement for the sale of property rights (green certificates)	1,000,000 PLN	03.10.2013
Vestas-Poland Sp. z o.o. / Vestas Northern Europe A/S	Contract for the supply of wind turbines for the Łukaszów Wind Farm	35,700,000 EUR	31.12.2013
Vestas-Poland Sp. z o.o. / Vestas Northern Europe A/S	Contract for the supply of wind turbines for the Modlikowice Wind Farm	25,200,000 EUR	31.12.2013
Beta Sp. z o.o. and Alfa Sp. z o.o. / Elektrownia Połaniec – GDF Suez Energia Polska S.A.	Rights to the Project Sale Agreement	80,000,000 PLN	31.12.2020 (or payment of the full amount guaranteed)
KSG Agro Polska Sp. z o.o . /KSG Agro SA	Contract for supply of biomass	-	30.06.2020
KSG Agro Polska Sp. z o.o. / KSG Agro SA	Licence agreement	-	31.12.2025

15. In the case of the issuing of securities during the period covered by the report – a description of how the issuer used proceeds until the report date

In the period covered by the report (i.e. in 2012) the Company did not issue any securities.

16. Explanation of differences between the financial results disclosed in the annual report and previously published forecasts (PLN m)

On 15 May 2012, in current report No. 24/2012 Polish Energy Partners S.A. cancelled the forecast for 2012 results that had been published in current report No. 40/2011.

The reason for the cancellation of the forecast was the acquisition by Mondi of all the rights and obligations of the limited partner of Saturn Management Spółka z ograniczoną odpowiedzialnością i Wspólnicy, Spółka Komandytowa as well as all of the shares in Saturn Management Spółka z ograniczoną odpowiedzialnością ('the Rights').

17. Assessment, together with justification, of the management of financial resources, with particular emphasis on the ability to meet obligations, and identification of potential risks and actions the issuer has taken or intends to take to address these risks

The most important part of the issuer's and its capital group's financial liabilities are bank loans, the details of which have been described in the financial statements. All liabilities of the issuer and its capital group are fulfilled without major delays. In the financial year 2012, there were no risks to the settlement of liabilities.

18. Feasibility assessment of investment projects, including equity investments, compared to the resources available, considering possible changes in the funding structure

PEP aims to finance individual projects in 70%-80% by loans and in 30%-20% by own resources (equity).

As at 31 December 2012, the Group plans to incur expenditures in 2013 on property, plant and equipment for an estimated total amount of about PLN 537 million. These amounts will mainly be used to purchase new machinery and equipment for the existing projects, and in particular to finance: construction of a biomass power plant in Southern Poland, development and commencement of construction of further wind farms.

19. Assessment of factors and unusual events affecting the results for the financial year, indicating the impact of such factors or unusual events on the achieved results, and major events having a significant impact on the business and financial results of the issuer's capital group in the financial year or whose effects are possible in subsequent years

Section 2 addresses in detail significant events affecting the Issuer's operations and results. All of them are typical of its business activity.

20. Description of external and internal factors important for the issuer's development and of the outlook for its development at least until the end of the financial year following the financial year for which the accounts have been included in the annual report, including market strategies developed, and policy for the issuer's capital group development

External factors important for the Capital Group's development

Poland's EU membership

Being a Member State, Poland must adapt its legislation on energy to the EU standards. The Community shapes the energy market in Member States by means of directives issued by the European Parliament. In relation to PEP SA's operations, the most important directives concern:

Power generation from renewable sources – Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 'on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC'. This Directive promotes 'green' energy so as to reduce dependence of the European markets on imported energy carriers as well as to reduce the exploitation and pollution of the environment. Unlike the repealed Directives, it takes a more comprehensive and extra-industrial approach to promotion of RES; it fosters changes in the legislation of Member States to increase the share of RES and mechanisms promoting green energy.

Reduction of emissions from large industrial facilities to the environment: Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (IED).

The Directive is not a new legal act as it results from the combination of existing directives (among others, 2008/1/EC – previously 96/61/EC – on the integrated pollution prevention and control (IPPC), 2001/80/EC on the limitation of emissions of certain pollutants into the air from large combustion plants (LCP). This directive has introduced more stringent emission requirements for both existing and new facilities, increased the role of BAT (best available techniques) in the planning of technological solutions for new large combustion plants and imposed a requirement on enterprises to monitor the emission of pollutants into water and soil.

Promotion of effective ways to produce energy – (Directive 2004/8/EC) – The EU believes that increasing the share of cogeneration, i.e. the generation of electricity in combination with heat, triggers reduction of greenhouse gas emissions into the atmosphere. Therefore, it introduced mechanisms to promote this technology.

Boosting competitiveness – (Directive 2003/54/EC) – The EU's strategic objective is to increase the competitiveness of energy market by enabling consumers to choose suppliers of energy. This creates a major opportunity for the development of power generation sources located close to the end-user.

Poland's share in the CO_2 emission allowances market. In 2003, the European Commission, based on the Kyoto Protocol, introduced, by way of Directive 2003/87/EC, CO2 emission allowances trading system (ETS). As part of the climate change and energy package, Directive 2009/29/EC of 23 April 2009 amending Directive 2003/87/EC was adopted in order to enhance and extend the common system of trading in greenhouse gas emission allowances. Poland participates in this trading system and Polish legislation complies with EU requirements.

Poland aligns legislation governing the energy market to European standards as laid down by the directives of the European Parliament. As a consequence, most of the industrial CHP plants that do not meet the environmental protection standards will have to be upgraded and energy production from renewable sources must increase. Also, energy consumption is expected to increase as it is currently lower by about 40% in Poland than in the 'old' European Union. Projected changes in the Polish energy market will create opportunities for development of the activities carried out by the Issuer. PEP's facilities already meet the European standards for environmental protection. PEP invests and intends to invest in power generation from renewable sources. Having assumed an increased market demand for 'green' energy from renewable energy sources resulting from the regulations, PEP intends to invest in facilities generating energy using wind power and biomass combustion. The Issuer uses cogeneration as the leading technology in industrial installations developed for end-users, making it possible to offer competitive price without the costs of energy transmission network. Furthermore, most power plants prepared and managed by the Issuer achieved a significant reduction in greenhouse gas emissions, using environmentally friendly technologies and solutions.

The consequence of Polish accession to the European Union is also the reduction of barriers to operating in other Member States. On the one hand, it offers the possibility to expand the Issuer's reach to the markets of other EU Member States, but on the other, especially in the context of projected growth in the demand for renewable energy in Poland, may bring foreign competitors.

Macro factors

Economic growth in Poland to a large extent influences the results of companies operating on the Polish market as well as their investment plans. The apparent economic upturn can be expected to increase investment, inter alia, in the modernisation of production processes, which may also be associated with the upgrade of industrial CHP plants. This allows the Issuer to expect a growing demand for its services.

Economic conditions, and thus the volume of investment and consumer demand, are important for the condition of current and future customers of the Issuer and its Capital Group. Therefore, it affects their ability to meet obligations towards the PEP Group.

Growth of the outsourcing services market

As part of their efforts to be more competitive on the Polish market, companies decide to separate support functions that are not directly related to the core activity and to outsource them to specialised organisations. This allows reducing costs of functions previously managed internally and allows focusing on the core business. Furthermore, it is possible – at least partially – to transfer operational risks associated with the support activities to the outsourcer. So far outsourcing has gained popularity in IT solutions and services, security, catering and cleaning services. It is expected that a growing number of areas will be outsourced and more businesses will decide on this step. Given the projected need for upgrade of industrial CHP plants, and due to increasing requirements related to environmental protection, it can be expected that many energy-intensive manufacturers will decide to hire specialised companies to design, implement and manage modern energy facilities, in particular those based on biomass fuel.

Growth of renewable energy market

The need to adjust the Polish energy market to the requirements of EU membership creates potential for dynamic development of power generation from renewable sources. Even before the accession to the European Union, Poland undertook to fulfil the obligations regarding production of electricity from renewable sources. Under the Minister of Economy's decree of 18 October 2012 on the detailed scope of obligations to obtain and produce certificates of origin for redemption, payment of compensation fee and purchase of electricity and heat produced from renewable energy sources as well as the obligation to confirm the data relating to the amount of electricity generated using a renewable energy source (Journal of Laws item 1229 dated 9 November 2012), power companies are obliged to purchase renewable energy (in the form of the so-called green certificates) so that its share in the total electricity purchased be not less than:

1) 10.4 % - in 2012
2) 12.0 % - in 2013
3) 13.0 % - in 2014
4) 14.0 % - in 2015
5) 15.0 % - in 2016
6) 16.0 % - in 2017
7) 17.0% - in 2018
8) 18.0% - in 2019
9) 19.0% - in 2020
10) 20.0% - in 2021

PEP estimates that in 2012, given energy consumption in Poland of approx. 122,000 GWh, the demand for renewable energy arising from the above-mentioned obligation amounted to approx. 12,700 GWh. At the same time we estimate that generation of electricity using renewable energy sources amounted to approx. 14,000 GWh. This was the first year in which such a surplus was recorded. Failure to achieve the required share of renewable energy in the volume of sales by entities providing energy to the end-users triggers the obligation to pay a compensation fee determined in 2012 at PLN 286.74 per each MWh of undelivered green energy. However, given the oversupply of certificates, the compensation fee is not likely to be paid. In subsequent years, with the increase of the required share and increase of electricity consumption, the demand for certificates will be growing at a faster pace than their supply and there will again be a deficit of certificates on the market.

It is expected that due to the planned Renewable Energy Sources Act, (*Ustawa o Odnawialnych Źródłach Energii*) the rules for determining the amount of the compensation fee, and thus the income earned by companies generating electricity using renewable energy sources, will change. Pursuant to the draft Act presented, total income earned by companies generating electricity using renewable energy sources will be at the actual level of approx. PLN 470/MWh (on the assumption that the given facility will be granted one certificate for one unit of generated electricity).

The planned changes in legislation (determination of the level of income, guaranteed support for 15 years, increase of the required levels of certificate purchases) may have a positive impact on the development of the renewable energy market in Poland.

Given the existing climate and geological conditions in Poland, in practice the main sources of domestic production of 'green' energy may be combustion of biomass and wind power. High expectations are associated particularly with the development of wind power market – about 30% of the country features conditions allowing use of wind farms and 5% has very favourable conditions for the production of wind power. The best locations are along the Baltic Sea coast. According to URE, in 2012 the amount of installed power used for generation of such energy was about 2,500 MW, and its production in 2012 amounted to approx. 3,800 GWh.

Competitors

Market for outsourcing of industrial CHP plants does not feature much competition. Prospects for development of both the outsourcing of industrial CHP plant and the renewable energy market may help to increase competition in those segments of the energy market. Unique experience and competence of the Issuer in developing, financing and managing complex energy solutions should enable PEP to compete effectively.

Funding available for the developed projects

The Issuer seeks to achieve a project finance formula of 70%-80% share of external funding and 30%-20% own share. Construction of new wind farms, upgrade of existing facilities and development of projects related to the outsourcing of production of electricity and heat will require substantial resources. New projects will be funded through bank loans, own funds, the issue of shares (only on condition that the share price reflects the fair value of the company) and the sale of stakes in selected projects.

The Issuer's experience in the preparation of investments and securing funding indicates that professionally designed business plans and good relations maintained with financial institutions will ensure appropriate funding for the individual projects.

In case of difficulties with the acquisition of entities interested in buying shares, ineffective issue of shares, difficulties in obtaining bank loans, the PEP Group may postpone the implementation of individual investment projects. In such circumstances, the Issuer will consider other forms of financing for the proposed projects, including a temporary reversal of the ratio between the shares sold and retained.

Internal factors important for the Capital Group's development

Efficiency of facilities

PEP continuously monitors operations of the facilities it manages, which ensures quick response to potential threats to achieving their planned performance and availability and ensures performance under power supply contracts. Furthermore, the Group improves procedures for operating facilities and enters into insurance contracts or applies contractual clauses which enable it to transfer any additional operating costs to subcontractors.

Development of operations in the scope of new projects

The ability to create and manage new projects is crucial to be able to compete in the industrial power outsourcing market and the renewable energy market and thus is crucial for financial results that will be achieved in the future. PEP has a highly qualified and committed managers and engineers who are involved in implementing the strategy. During almost 10 years of its operations PEP has built an experienced Project Development Team that ensures continuity of works on new projects and their successful completion. The team has gained unique experience on the Polish market which ensures solutions customised to individual needs and abilities of customers thanks to using the most advanced energy technologies and legal structures. In addition, the Issuer systematically raises the Group's efficiency, among others by applying modern IT solutions for project budgeting and monitoring costs.

Outlook for the development of the Capital Group's activities

Detailed description of growth perspectives has been included in section 2 hereof.

The PEP Capital Group operates on the industrial power outsourcing market and the renewable energy market by using the facilities of the Zakrzów CHP Plant and the Mercury Power Plant, wind farms with a total capacity of 80 MW, and by producing biomass fuel which is supplied to industrial customers. The Issuer intends to further increase its share in the renewable energy market by generating wind power, biomass power in dedicated entities and producing fuel from biomass.

Growth factors:

- specialisation in the implementation and configuration of customised industrial power outsourcing projects based on biomass,
- focus on customers with good standing and operating in growth markets,
- developing qualified management, financial and engineering staff with competencies necessary to manage the existing and set up new projects,
- strengthening position on the renewable energy market – construction of wind farms and biomass-fuelled plants as well as further development of the development team,
- achieving a significant position on the biomass supplies market.

Please see sections 2, 18 and 20 hereof for a detailed description of the Issuer's capital group growth opportunities.

21. Changes in the basic management principles of the issuer and its capital group

There were no changes in the basic management principles of the issuer and its capital group in the financial year 2012.

22. Any agreements made between the issuer and members of its executive bodies providing for compensation in the event of resignation or dismissal from their positions without a valid reason or if their removal or dismissal is due to the issuer's acquisition

Board President, Zbigniew Prokopowicz, is a party to an employment contract with the Company. The contract was made for an indefinite period and may be terminated by either party with twelve months' notice.

Ms Anna Kwarcińska is a party to an employment contract with the Company. This contract is made for an indefinite period. The notice period is 12 months.

Mr Michał Kozłowski is a party to an employment contract with the Company. This contract is made for an indefinite period. The notice period is 12 months.

23. The amount of salaries, awards or benefits, including those resulting from incentive or bonus schemes based on the issuer's equity, including schemes based on bonds with pre-emptive rights, convertible bonds, subscription warrants (in cash, in kind or in any other form), paid, payable or potentially payable, separately for each of the members of the issuer's executive and supervisory personnel, irrespective of whether they were properly included in costs or resulted from the distribution of profits; if the issuer is the parent company, a partner in a jointly controlled entity or a significant investor – separate information about remuneration and awards received for performing their functions in the authorities of subordinated entities; if relevant disclosures were presented in the financial statements – the obligation is fulfilled by identifying their location in the financial statements

Salaries of executive and supervisory personnel are set out in Note 40 to the consolidated financial statements.

24. Total number and par value of all shares of the issuer and shares in the issuer's related entities, which are held by members of the issuer's executive and supervisory bodies (for each person separately)

As at 31 December 2012, no shares were held in the Company by the Issuer's executive or supervisory personnel.

25. Information about contracts known to the issuer (including those entered into after the balance sheet date) which may result in future changes in shareholding by existing shareholders and bondholders

The Issuer is not aware of any contracts that could result in future changes in shareholding by the existing shareholders.

26. Information about control of stock option schemes

The Company does not currently operate any employee stock option scheme.

27. Information about:

a) date when the issuer entered into a contract with an entity authorised to audit financial statements for an audit or review of separate or consolidated financial statements and term of the contract

Contract of 19 June 2012 between Polish Energy Partners S.A. and KPMG Audyt Sp. z o.o. seated in Warsaw, ul. Chłodna 51, 00-867 Warszawa for:

- review of the Company's financial statements for the 6-month period ended 30 June 2012,
- review of consolidated financial statements for the 6-month period ended 30 June 2012,
- audit of the Company's financial statements for the year ended 31 December 2012,
- audit of consolidated financial statements for the year ended 31 December 2012.

b) fee for the entity authorised to audit financial statements, paid or payable for the financial year

Total fee under the abovementioned contract is PLN 250 thousand.

28. Significant off-balance sheet items (indicating the entity involved, nature and value of the item)

A description of off-balance sheet items indicating the entity involved, nature and value of the item has been included in Note 25 to the consolidated financial statements.

Zbigniew Prokopowicz
– President of the Management Board

Anna Kwarcińska
– Vice-president of the Management Board

Michał Kozłowski
– Vice-president of the Management Board