DIRECTORS' REPORT
ON THE OPERATIONS OF THE RAFAKO GROUP
IN 2016

Racibórz, March 21st 2017

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I. General information

About us

RAFAKO S.A. (the "parent") is one of the largest Polish companies acting as general contractor for complete power generating units, engaged in designing, manufacturing, constructing and servicing of power equipment and facilities. Since November 2011, RAFAKO has been included in the PBG Group.

The RAFAKO Group's key products and services include:

Complete power generating units	Steam generators and heat generators	Air pollution control systems	Subassemblies and parts of power machinery and	Other
• consisting of a boiler (fired with fossil fuels or biomass) together with a turbine coupled with a generator and complete assembly necessary for proper operation of the unit.	• fired with fossil fuels, biomass and waste • with stoker-fired, fluidised bed- and pulverised fuel furnaces • sub- and supercritical • manufacture and delivery of heat recovery steam generators	• manufacture and delivery of wet and semi-dry flue gas desulfurisation units • manufacture and delivery of flue gas NOx reduction units, including SCR systems • manufacture and delivery of dust extraction equipment (electrostatic precipitators, bag filters)	• manufacture of components for steam generators and precipitators • diagnostics, repairs, and upgrades of boiler equipment • design, advisory and maintenance services • manufacture of steel structures and other parts for the power generation industry	• construction and process design, urban planning • engineering and technical advisory services • supervision services for the construction, industrial and environment protection sectors • equipment assembly in the power and chemical industries • property management

The Group delivers these products and services in the EPC model (end-to-end project management including design, procurement, manufacture, assembly/construction, and commissioning) or in a non-EPC model (design, procurement, manufacture, assembly/construction in various combinations, with procurement and manufacture as mandatory elements).

The parent operates its own production plants. The main plant, manufacturing mainly pressure equipment, is located in Racibórz, along with the plant management office, design and technology offices, as well as five production floors. Electrostatic precipitators and their components are manufactured in Wyry. The Group's total production capacity for 2016 was in excess of 1.1 million man-hours per year, with the potential to be increased to more than 1.35 million man-hours per year. The Group is currently Poland's and EU's leader in terms of the production capacity for pressure equipment.

RAFAKO S.A. has operated in the power sector since 1949. The parent's product offering, initially comprising mainly steam generators and their components, was gradually expanded to include complete flue gas desulfurisation units, dust extraction units, NOx control systems, etc. From a typical manufacturer, the parent was transformed into a general contractor for power construction projects. In 2014, the parent became one of the few companies offering and delivering power generation units under EPC contracts, when it launched, practically on a stand-alone basis, the construction of a 910 MW unit for the Jaworzno Power Plant (the "Jaworzno 910 MW Project").

Since its inception, the parent has been a leading supplier of steam generators for the country's power and industrial sectors. The combined capacity of RAFAKO-delivered steam generators accounts for a significant part of the total capacity installed in Polish commercial and industrial power plants. The most important facilities which use steam generators delivered by the parent include power plants in Bełchatów, Opole, Turów, Dolna Odra (all owned by PGE), Rybnik (EDF), Pątnów-Adamów-Konin, Kozienice (Enea), and power plants owned by Tauron Wytwarzanie, as well as Warsaw CHP Plants – Elektrociepłownie Warszawskie (PGNiG Termika), Wrocław CHP Plants – Zespół Elektrociepłowni Wrocławskich Kogeneracja, Łódź CHP Plants – Zespół Elektrociepłowni Łódź (Dalkia), and Zielona Góra CHP Plant – Elektrociepłownia Zielona Góra (EDF). The parent has also delivered circulating fluidised bed (CFB) steam generators to the Żerań CHP Plant and Bielsko-Biała II CHP Plant (Tauron Wytwarzanie), Siersza Power Plant (Tauron Wytwarzanie), and Zakłady Farmaceutyczne Polpharma Starogard Gdański.

In 2008, a 464 MW unit was commissioned at the Pątnów II Power Plant for which RAFAKO S.A., in cooperation with SNC Lavalin, had supplied the steam generator and flue gas delsulfurisation (FGD) unit. The supercritical power generating unit at the Pątnów II Power Plant was the first such project in Poland, both in terms of the capital expenditure incurred and generating capacity delivered. It is a high-efficiency unit, which helps significantly reduce harmful gas emissions.

In 2011, an 858 MW unit was commissioned at the Bełchatów Power Plant for which RAFAKO S.A. had been the supplier of the boiler island comprising a steam generator, electrostatic precipitator, and flue gas desulfurisation unit. The newly built unit in Bełchatów is the most powerful lignite-fired generating unit in Poland.

In 2014, a project was completed to increase the generation capacity of green electricity and heat at PGE Elektrociepłownia Kielce (a CHP plant) through the addition of a pass-out and condensing turbine generator (with a capacity of ca. 6.5 MW) and heat exchanger (with a capacity of ca. 14 MW), coupled with the existing biomass-fired OS-20 steam generator.

Foreign sales account for a significant part of RAFAKO S.A.'s total sales. The largest steam generators manufactured by RAFAKO S.A. operate in former Yugoslavia's power plants; a number of large units have also been delivered to the Czech Republic, China, Turkey, and India. RAFAKO S.A. is also an important player on the European market for steam-generator components. In 2016, RAFAKO products were sold to customers in Serbia, Finland, the United Kingdom, Germany and Hungary.

The parent is solidifying its position on the European market of waste incineration solutions. In 2011, RAFAKO S.A. supplied three heat recovery steam generators to a waste incineration facility in Turin, Italy, and further two heat recovery steam generators to Baku, Azerbaijan. In December 2013, a steam generator was placed in service at a municipal waste incineration plant in Roskilde, Denmark. In 2013, the Company began to perform a contract for delivery of the process section for two lines of the Thermal Waste Treatment Plant for the Szczecin Metropolitan Area. In 2014, we delivered a waste combustion boiler to Billingham, Cleveland County, UK. At the beginning of 2016, a contract providing for delivery of a boiler for a municipal waste incineration facility located in Calvert, Buckinghamshire, UK, was completed.

In 2012, a fluidised bed boiler was commissioned at the Jaworzno Power Plant (Tauron Group). The boiler burns only biomass, as opposed to coal-fired and biomass co-fired units already operated at the plant. In 2014, the construction of a biomass-fired boiler was completed in Wiesbaden, Germany. In the same year, a contract at the Stalowa Wola Power Plant for conversion of an existing PCC boiler into a biomass-fired unit was completed. These innovative projects highlight RAFAKO S.A.'s established position as a supplier of renewable power generation technologies. They are also aligned with Poland's strategy to increase the share of renewables in power generation, as well as with the Company's own pro-environmental strategy.

RAFAKO S.A. is also a leading manufacturer of large environmental protection facilities in Poland. Units of this type have been delivered by the parent to the Jaworzno III Power Plant, Bełchatów Power Plant, Pątnów Power Plant, Ostrołęka B Power Plant, Dolna Odra Power Plant, Siekierki CHP Plant, Łódź CHP Plant, Siersza Power Plant, Skawina Power Plant, Trzebowice Power Plant (for Dalkia, the Czech Republic), Kozienice Power Plant, and Połaniec Power Plant.

In 2012, RAFAKO S.A. delivered one of its largest projects, a wet flue gas desulfurisation unit at the Siekierki CHP Plant owned by PGNiG Termika S.A. The unit is also one of the largest environmental projects in Poland, and one of the largest stand-alone structures ever built by RAFAKO S.A. In 2014, RAFAKO S.A. completed an upgrade of the FGD systems on units 5 and 6 at the Bełchatów Power Plant. In 2015 and 2016, wet FGD units were placed in service at CHP plants owned by the EDF Group. The units were built in Gdańsk, Gdynia, Kraków and Wrocław, as part of the EDF Group's comprehensive plan of bringing its generation assets in line with new environmental requirements.

In 2007−2008, RAFAKO S.A. commissioned high-efficiency semi-dry flue gas desulfurisation units at the Łódź CHP Plant and Skawina Power Plant. The semi-dry system, which is a more cost-efficient solution than the wet method, was engineered exclusively by RAFAKO S.A.

In 2011, the parent entered a new area of pro-environmental projects for the power sector, i.e. the reduction of nitrogen oxides, as it commenced the manufacture of state-of-the-art SCR units on an EPC basis. Following construction of the first such unit on the K8 boiler at PKN Orlen, construction of a second SCR system has been under way since June 2011 at the Kozienice Power Plant. In 2012, a contract for delivery of Catalytic Flue Gas NOx Reduction Systems for six power generating units at Elektrownia Połaniec S.A. was signed with GDF SUEZ Energia Polska S.A. In 2014, a consortium formed by RAFAKO S.A. and OMIS S.A. signed a contract with ENERGA

Elektrownie Ostrołęka S.A. for the construction of flue gas NOx reduction systems on units 1, 2 and 3 at Elektrownia Ostrołęka S.A. In September 2016, RAFAKO S.A. and ENEA Wytwarzanie Sp. z o.o. signed a contract for delivery and installation of a catalytic flue gas NOx reduction system for AP-1650 boilers No. 9 and 10 and for upgrade of the electrostatic precipitators at ENEA Wytwarzanie Sp. z o.o.

In 2009, dust extraction equipment, including electrostatic precipitators and bag filters, was added to the parent's product offering. In 2010−2013, a number of electrostatic precipitators were put in operation, including on units 10, 4, 3 and 8 at the Kozienice Power Plant; on BB-1150 steam generator of unit 4 (in 2010) and units K5 and K6 (in 2011) at the Bełchatów Power Plant, as well as an electrostatic precipitator with a modernised slag and ash transport system on unit 6-215 MW at the Tuzla CHP Plant (in 2012). In 2014, two electrostatic precipitators were installed by RAFAKO at the Westfalen Power Plant in Germany and two at the Eemshaven Power Plant in the Netherlands.

2014 was a breakthrough year for RAFAKO S.A. A contract was signed for the construction of a 910 MW power generation unit at the Jaworzno III Power Plant, where RAFAKO will execute this turn-key project on a practically stand-alone basis and, in terms of technologies, will supply the entire boiler island.

In addition, in February 2014, the long-awaited contract for extension of the Opole Power Plant came into effect. Under the contract, two new supercritical 900 MW power generation units are being built, in what is the largest investment project in the Polish power sector since 1989. RAFAKO S.A.'s entire scope of work and services under the contract was subcontracted to Alstom Power Sp. z o.o.

The project designs are based on the state-of-the-art technology of electricity generation by means of supercritical steam generators and turbines, which pushes the efficiency of a generating unit up to 45% or more. The parent has long cooperated with Polish scientists on a concept of generating units with efficiencies in excess of 50% (ultra-supercritical units). Its implementation will mark another milestone in the history of both the Company and Polish power sector, which cannot afford to discontinue the use of domestically produced coal as the key fuel. In May 2014, RAFAKO signed another ECP contract, this one involving the construction of a new CHP plant in Kędzierzyn for Grupa Azoty Zakłady Azotowe Kędzierzyn S.A. The project provides for the construction of a coal-fired generating unit with a high-efficiency steam generator, state-of-the-art flue gas treatment technology and steam turbine.

The parent provides after-sale support and servicing for all products and equipment supplied. The parent also offers upgrades of existing equipment to enhance its operating parameters and mitigate negative environmental impacts.

Certificates held by RAFAKO S.A. (EMAS, AD 2000-Merkblatt HP0, ASME CODE, SVTI / ASIT, EN 1090 and EN 3834-2) confirm its compliance with the ISO 9001, ISO 14001, PN-N 18001 standards, Directive 97/23/EC and Regulation (EC) 1221/2009 of the European Parliament and of the Council. They also provide assurance to the parent's customers that RAFAKO-manufactured equipment complies with the technical safety requirements applicable in Poland, the EU, and the US.

In 2011, the RAFAKO Group was included in the PBG Group, whose parent is PBG S.A. PBG S.A. w upadłości układowej (in company voluntary arrangement) is the parent of a group of companies operating on the specialist construction market. The key segments of the Group's business currently include the construction of facilities and structures for the power, natural gas, crude oil and fuel sectors. From June 2012, PBG had had the status of a company 'w upadłości układowej' (in company voluntary arrangement). In August 2015, the meeting of PBG's creditors voted on and approved an arrangement. In October 2015, the arrangement was approved by the court. PBG's arrangement with its creditors became final on June 13th 2016.

For the shareholding structure of the parent as at December 31st 2016, see Appendix 9.

II. Organisation of the RAFAKO Group

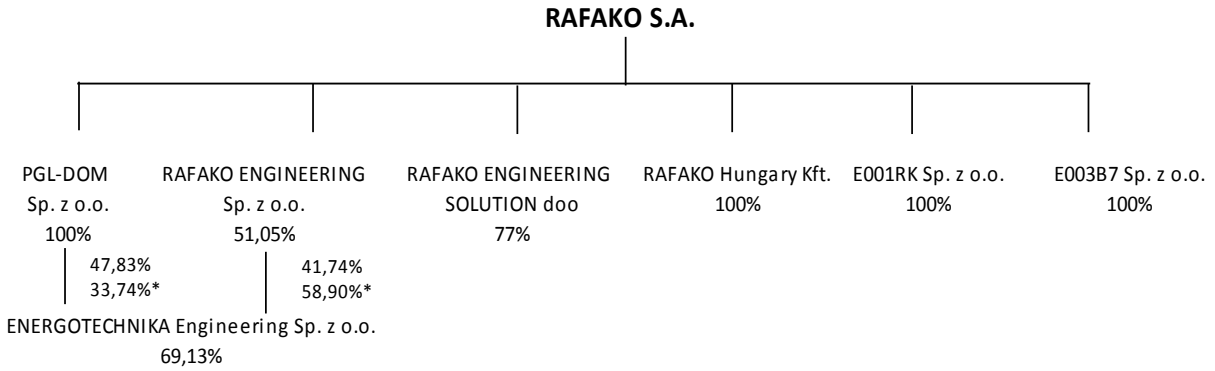
1. Structure of the Group and its consolidated subsidiaries

As at December 31st 2016, the RAFAKO Group comprised the parent and seven subsidiaries operating in the power construction, services and trade sectors.

As at December 31st 2016, in addition to the parent, the RAFAKO Group comprised:

- Przedsiębiorstwo Gospodarki Lokalami PGL-DOM Sp. z o.o., registered office at ul. Bukowa 1, Racibórz, Poland. Principal business activity: housing community management.
- RAFAKO ENGINEERING Sp. z o.o., registered office at ul. Łąkowa 33, Racibórz, Poland. The parent holds a 51.05% interest in the share capital of the company and the same percentage of voting rights at its general meeting. The company's business includes engineering activities and related technical consultancy.
- ENERGOTECHNIKA ENGINEERING Sp. z o.o. of Gliwice, a subsidiary of RAFAKO ENGINEERING Sp. z o.o. (which holds 58.90% of voting rights at the company's general meeting) and of PGL DOM Sp. z o.o. (which holds 33.74% of voting rights at its general meeting). Principal business activity: construction and process design, urban planning and engineering consultancy.
- RAFAKO ENGINEERING SOLUTION doo. of Belgrade; The parent holds a 77% interest in the share capital of the company and the same percentage of voting rights at its general meeting. Principal business activity: process design, construction, industry, and environmental protection consultancy and supervision.
- RAFAKO Hungary Kft. of Budapest, Hungary. The parent holds the entire share capital of the company and all voting rights at its general meeting. Principal business activity: equipment assembly for the power sector and the chemical industry.
- E001RK Sp. z o.o. of Racibórz, entered in the National Court Register on October 9th 2013. The parent holds 100% of the company shares. Principal business activity: development of building projects; construction of roads and highways, railways and subways, bridges and tunnels; engineering activities and technical and scientific consultancy; production, repair and maintenance of machinery and equipment, generation and transmission of and trading in electricity.
- E003B7 Sp. z o.o. of Racibórz (or "SPV Jaworzno"), entered in the National Court Register on November 22nd 2013. The parent holds 100% of the company shares. Principal business activity: development of construction projects, construction, engineering and process consultancy and design.

As at December 31st 2016, the following subsidiaries were consolidated in the Group's consolidated financial statements:



* % share of voting rights at GM.

The RAFAKO Group's parent is PBG S.A., with its registered office at ul. Skórzewska 35, Wysogotowo, Poland.

2. Significant changes of equity interests

As at December 31st 2016 and December 31st 2015, the Company's share in total voting rights held in the subsidiaries was equal to the Company's interest in the share capital of those entities, except for ENERGOTECHNIKA ENGINEERING Sp. z o.o., in which RAFAKO Engineering Sp. z o.o. holds 41.74% of preference shares (conferring the right to 58.90% of the total vote); 47.83% of the shares (conferring the right to 33.74% of the total vote) are held by PGL-DOM Sp. z o.o.

In the 12 months ended December 31st 2016, there was a number of changes in the Group's structure.

On April 29th 2016, the extraordinary general meeting of RAFAKO Engineering Sp. z o.o. passed a resolution to increase the share capital from PLN 1,959,000.00 to PLN 3,555,500.00, i.e. by PLN 1,596,500.00, through an issue of 3,193 new shares with a par value of PLN 500.00 per share. The new shares were acquired pro rata by the existing shareholders, i.e.:

- RAFAKO S.A. acquired 1,630 shares with a par value of PLN 500 per share, and a total value of PLN 815,000; the shares were acquired in return for a cash contribution of PLN 4,317 thousand;
- PBG Oil & Gas Sp. z o.o. acquired 1,563 shares with a par value of PLN 500 per share, and a total value of PLN 781,500; the shares were acquired for a non-cash contribution with a total value of PLN 4,140 thousand in the form of an organised part of business.

Since the registration of the share capital increase at RAFAKO Engineering Sp. z o.o. on January 5th 2017, the respective interests held in the company by RAFAKO S.A. and PBG oil and gas Sp. z o.o. have not changed and amount to 51.05% and 48.95%, respectively.

On June 30th 2016, PGL DOM Sp. z o.o., a subsidiary, acquired from a minority shareholder 100 shares in ENERGOTECHNIKA ENGINEERING Sp. z o.o., a subsidiary, for PLN 137 thousand, thus increasing its equity interest in the company to 47.83%.

On September 13th 2016, RENG-NANO Sp. z o.o., a new company, was incorporated. The company's share capital amounts to PLN 1,000,000 and is divided into 10,000 shares with a par value of PLN 100 per share. Interests in the company's share capital were acquired in return for cash contributions by the following shareholders:

- RAFAKO ENGINEERING Sp. z o.o., which acquired 6,000 shares with a total par value of PLN 600,000, representing 60% of the company's share capital;
- NANO Corp Ltd. of Seoul, which acquired 3,500 shares with a total par value of PLN 350,000, representing 35% of the company's share capital;
- Marek Buzanowski-Konakry, who acquired 500 shares with a total par value of PLN 50,000, representing 5% of the company's share capital.

On February 27th 2017, the District Court in Gliwice, 10th Commercial Division of the National Court Register, registered RENG-NANO Sp. z o.o. in the National Court Register under entry No. 0000663393.

On October 12th 2016, RAFAKO Engineering Sp. z o.o., a subsidiary, acquired from a minority shareholder 40 shares in ENERGOTECHNIKA ENGINEERING Sp. z o.o., a subsidiary, for PLN 20 thousand, thus increasing its equity interest in the company to 41.74%.

3. Parent's governing bodies

The governing bodies of RAFAKO S.A.:
the General Meeting;
the Supervisory Board;
the Management Board.

General Meeting

The Annual General Meeting of RAFAKO S.A. held on June 21st 2016 passed the following resolutions:

1. it reviewed and approved the Directors' Report on the parent's operations and the parent's financial statements for the financial year 2015,
2. it reviewed and approved the Directors' Report on the RAFAKO Group's operations and the RAFAKO Group's consolidated financial statements for the financial year 2015,
3. it approved the report on the activities of the parent's Supervisory Board in 2015,
4. it granted discharge to members of the parent's Management Board for performance of their duties in 2015,
5. it granted discharge to members of the parent's Supervisory Board for performance of their duties in 2015,
6. it decided that the parent's entire profit for the financial year from January 1st to December 31st 2015 will be applied towards the parent's statutory reserve funds.

Supervisory Board

The Supervisory Board exercises ongoing supervision over the parent's operations.

During the financial year, there were no changes in the composition of the parent's Supervisory Board.

As at the date of the financial statements, the composition of the supervisory body of RAFAKO S.A. was as follows:

Jerzy Wiśniewski	– Chairman of the Supervisory Board
Dariusz Sarnowski	– Deputy Chairman of the Supervisory Board
Krzysztof Gerula	– Member of the Supervisory Board (independent member)
Przemysław Schmidt	– Member of the Supervisory Board (independent member)
Dariusz Szymański	– Member of the Supervisory Board
Adam Szyszka	– Member of the Supervisory Board (independent member)
Małgorzata Wiśniewska	– Member of the Supervisory Board.

Management Board

During the financial year, there were no changes in the composition of the parent's Management Board.

As at the date of this Directors' Report on the operations of the RAFAKO Group, the composition of the management body of RAFAKO S.A. was as follows:

Agnieszka Wasilewska-Semail	– President of the Management Board,
Krzysztof Burek	– Vice President of the Management Board,
Jarosław Dusiło	– Vice President of the Management Board,
Edward Kasprzak	– Vice President of the Management Board,
Tomasz Tomczak	– Vice President of the Management Board.

III. Economic and financial standing

1. External and internal factors materially affecting the RAFAKO Group's financial performance and development prospects

A. External factors:

- domestic and global economic situation;
- situation in the domestic and global power industry;
- competition on the market on which the Group operates;
- financial standing and market position of the Group's customers, consortium partners, subcontractors and suppliers;
- timeliness of payments by the employers;
- market prices of materials used by the Group in manufacturing, market prices of services, and employee benefits expense;
- foreign exchange rates;
- financial institutions' willingness to provide financing and guarantees for contracts performed by the Company;
- financial condition of the Group's main shareholder;
- limited ability of the Group to obtain guarantee facilities in view of PBG's arrangement proceedings;
- technological progress;
- changes in tax regulations.

B. Internal factors:

- conclusion and performance of material contracts by the Group;
- maintaining financial liquidity of the Group;
- ability to capitalise on the effects of completed and planned investment projects designed to boost efficiency at the companies, particularly in manufacturing and management, and to increase their capacity to win and execute orders;
- improvement of management processes at the Group, including management of long-term contracts and operating costs (fixed costs);
- formation of large, multi-industry teams for coordination of work on comprehensive power sector facilities;
- maintaining and acquiring new highly-qualified staff for designing and production.

2. Key risks and threats

The RAFAKO Group has identified the following risks and threats to the Group's operations in the near future:

Risks relating to macroeconomic conditions and the sector in which the RAFAKO Group operates:

1. Risk factors relating to the macroeconomic situation, including the GDP growth rate, unemployment rate, salaries and wages, growth of the industrial and construction output, capital expenditure, and foreign exchange rates;
2. Risk relating to political environment, as well as energy policy and uncertainty over its future directions;
3. Currency risk;
4. Interest rate risk;
5. Risk of competition.

Risks specific to the RAFAKO Group:

1. Risk relating to non-performance or improper performance of contracts;
2. Risk related to non-payment or delayed payment of amounts due under contracts performed by the companies;
3. Risk associated with performance of high value contracts and limited number of customers;

4. Risk of increased operating costs of the RAFAKO Group resulting from higher prices of supplies and services and increased employee benefits expense;
5. Risk of underestimating project costs;
6. Risk related to winning new contracts;
7. Risks related to execution of certain projects in consortia;
8. Risk related to project acquisition and execution in cooperation with suppliers and subcontractors;
9. Risk of failure to obtain financial guarantees required to win and perform contracts;
10. Risk related to failure to secure external financing in assumed amounts and on expected terms;
11. Risk related to full or partial repayment of arrangement receivables by PBG;
12. Risk related to failure to maintain appropriate liquidity by the Group;
13. Risk of failure to implement the strategy;
14. Reputational risk;
15. Risk related to the use by the Group of complex and innovative manufacturing technologies;
16. The Group's IT systems may suffer a failure or security breach;
17. The Group's day-to-day operations and growth depend on its senior management and ability to hire and retain highly-qualified personnel, particularly specialist production staff and engineers;
18. Risk that the insurance cover maintained by the Group will prove insufficient;
19. Risk related to consequences of accidents at work and occupational diseases;
20. Risk related to plant failure or to destruction or loss of the companies' assets.

Regulatory risks:

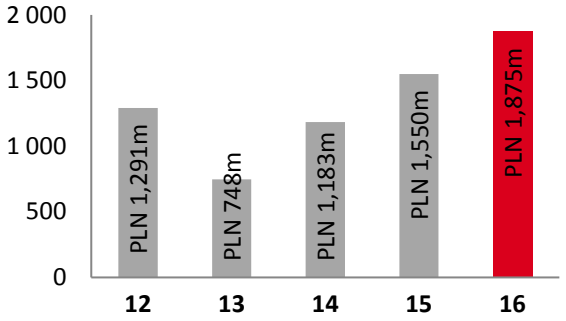
1. Risk related to changes in regulations concerning the power sector;
2. Risk related to environmental protection;
3. Risk of changes in tax laws or their interpretation and changes of private letter rulings;
4. Risk associated with related-party transactions.

For information on the objectives and rules of financial risk management, including the specification of the most material risks, see Note 52 to the Group's financial statements.

3. Analysis of key financial and economic data

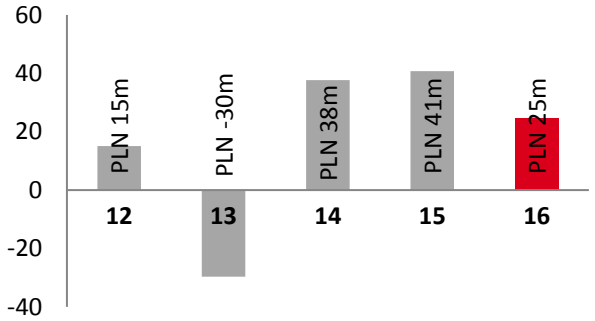
3.1. 2016 highlights

Revenue
PLN 1,875m



Definition: Total sales of products, merchandise and materials, net of VAT.
Relative to 2015: Revenue grew by 21.0%, mainly on increased (by PLN 604.5m) sales under the Jaworzno 910 MW Project.

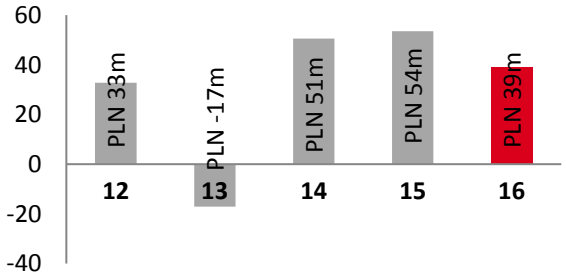
EBIT
PLN 25m



Definition: Profit (loss) from continuing operations

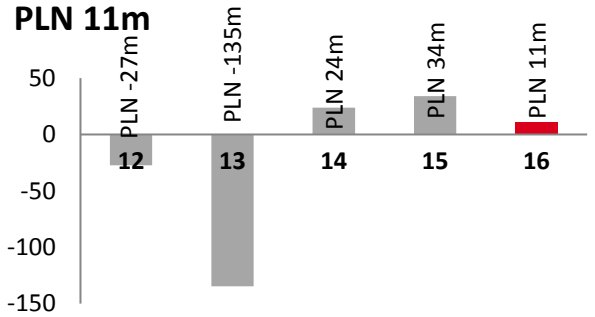
Relative to 2015: Profit from continuing operations amounted to PLN 25m, having declined PLN 16m year on year, mainly due to the parent's loss.

EBITDA
PLN 39m

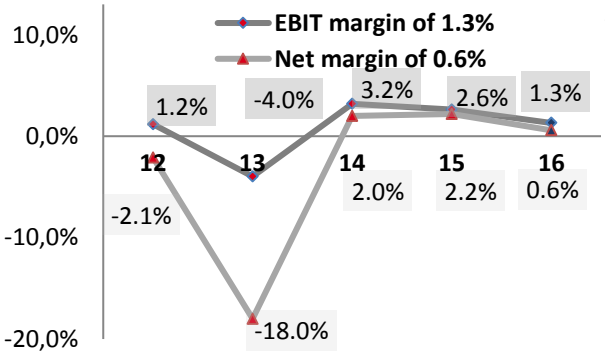


Definition: Sum of profit (loss) from continuing operations, depreciation and amortisation
Relative to 2015: EBITDA went down from PLN 54m to PLN 39m.

Net profit
PLN 11m

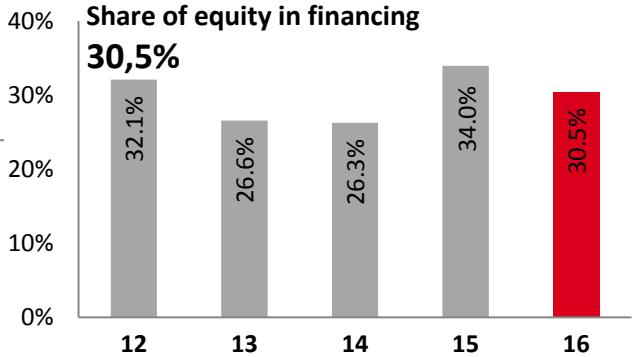


Definition: Excess that remains after deducting all costs. Difference between revenue and total costs.
Relative to 2015: The Group generated net profit of PLN 11m, compared with PLN 34m earned a year earlier.



Definition: EBIT margin: operating profit (loss) / net revenue from sale of products and merchandise; Net margin: net profit (loss) / net revenue from sale of products and merchandise.
Relative to 2015: EBIT margin was down by 1.3%, and net margin decreased by 1.6%.

Share of equity in financing
30,5%



Definition: Equity / total assets.

Relative to 2015: The share of equity in total sources of financing of assets was down by 3.5pp.

3.2. Revenue and its structure

In 2016, revenue from sales of products, merchandise and materials was PLN 1,875,312 thousand, having increased year on year by PLN 325,222 thousand (or 21.0%). Sales of products and services amounted to PLN 1,870,559 thousand, while revenue from sales of materials was PLN 4,753 thousand.

The sales growth reported in 2016 was driven mainly by higher revenue from sales of power generation units and steam generators. Strong sales generated by this segment are chiefly attributable to the implementation of the Jaworzno 910 MW Project, worth PLN 4.5bn, revenue from which reached PLN 1,274,220 thousand in 2016 (PLN 669,723 thousand in 2015). Revenue from other sales of power generation units and steam generators on the domestic market fell in 2016 year on year, from PLN 313,275 thousand to PLN 195,725 thousand. The decrease was mainly attributable to the parent's having completed the contract for construction of a fluidised bed boiler with a particle collection system for Synthos Dwory (value of PLN 151.6m; sales in 2016: PLN 8,559 thousand, sales in 2015: PLN 93,466 thousand).

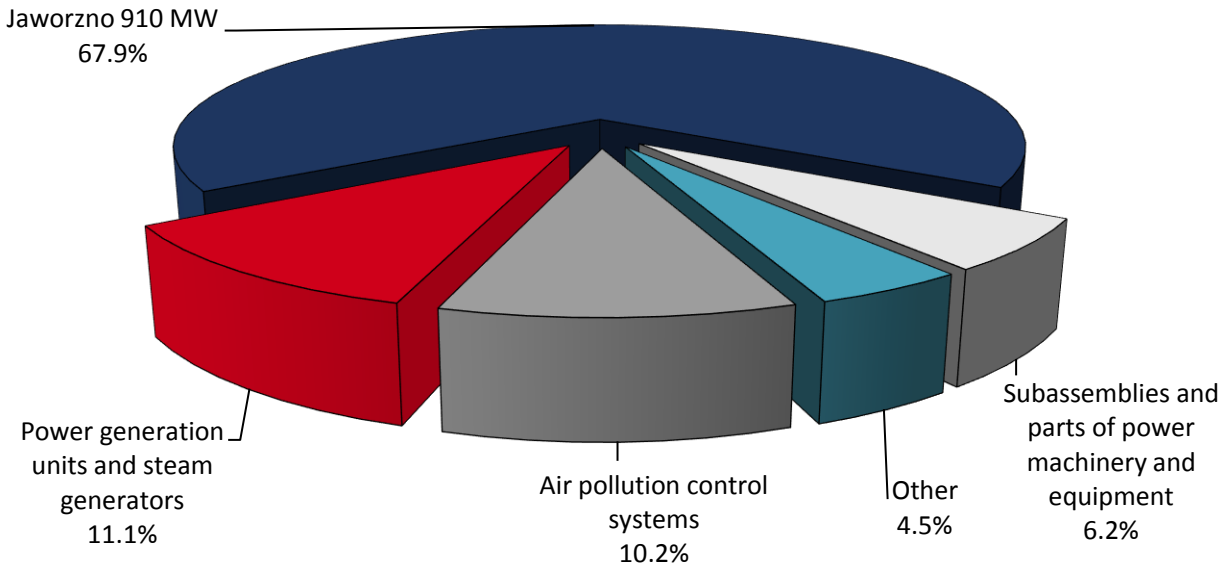
On the other hand, in the air pollution control product group, revenue fell: in 2016 sales of air pollution control systems on the domestic market amounted to PLN 174,341 thousand and were 52.1% lower year on year. The decline in sales of air pollution control systems is related to the completion of projects performed for the EDF Polska Group (with a value of approximately PLN 770m) and lack of new orders of considerable value.

Sales of subassemblies and parts of power machinery and equipment on the domestic market reached PLN 21,006 thousand, having dropped by 64.2% relative to 2015, when they amounted to PLN 58,642 thousand.

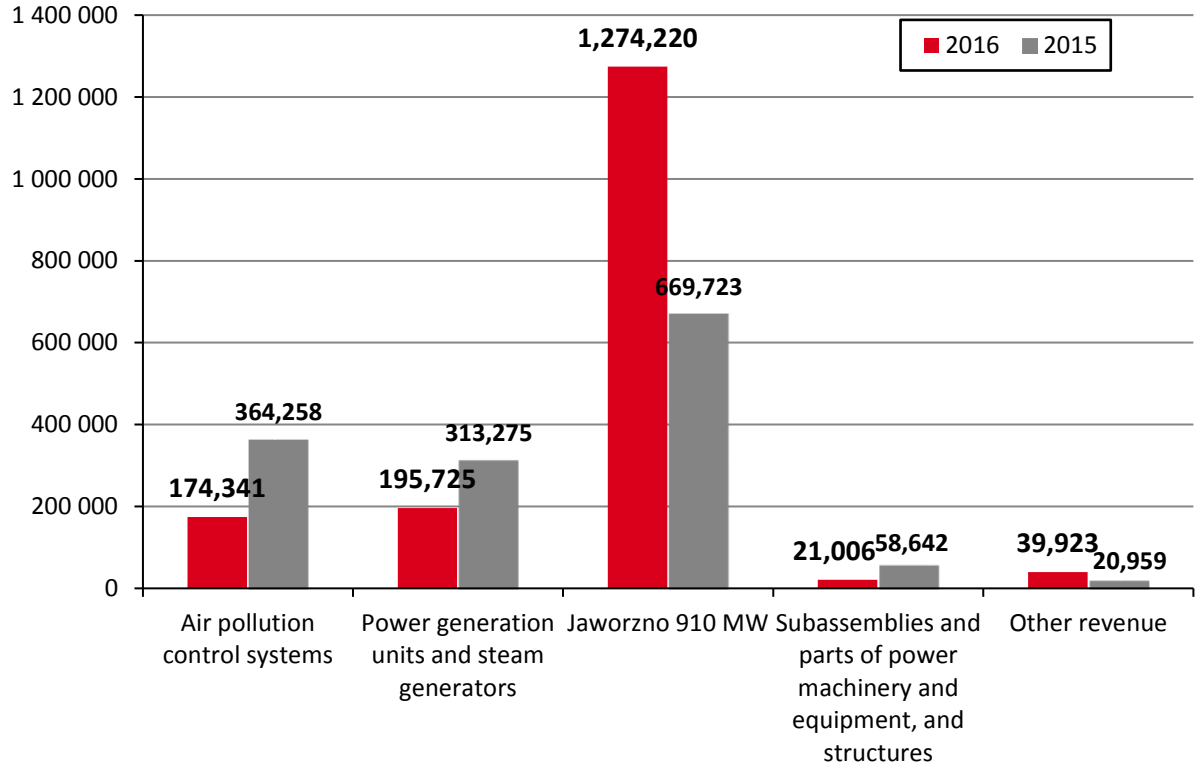
The share of export sales in total sales was 9.1%, having increased year on year by 1.1pp. In 2016, export sales amounted to PLN 170,097 thousand, up by 38.0% from PLN 123,233 thousand reported in 2015. Export sales increased in all product groups except for power generation units and steam generators. Sales of subassemblies and parts of power machinery and equipment totalled PLN 95,075 thousand, up by 306.7% on 2015, primarily thanks to execution of a contract on the Serbian market. Exports of air pollution control systems amounted to PLN 17,661 thousand (2015: PLN 5,197 thousand), having increased by PLN 12,464 thousand (or 239.8%). In the other product groups, exports grew to PLN 45,225 thousand.

A decline in exports of power generation units and steam generators (to PLN 12,136 thousand in 2016 from PLN 59,064 thousand in 2015) was mainly attributable to lower sales under the contract for the supply, installation and start-up of a municipal waste incineration boiler for the Hereford & Worcestershire thermal waste treatment plant in the United Kingdom; the contract execution was nearing completion in 2016.

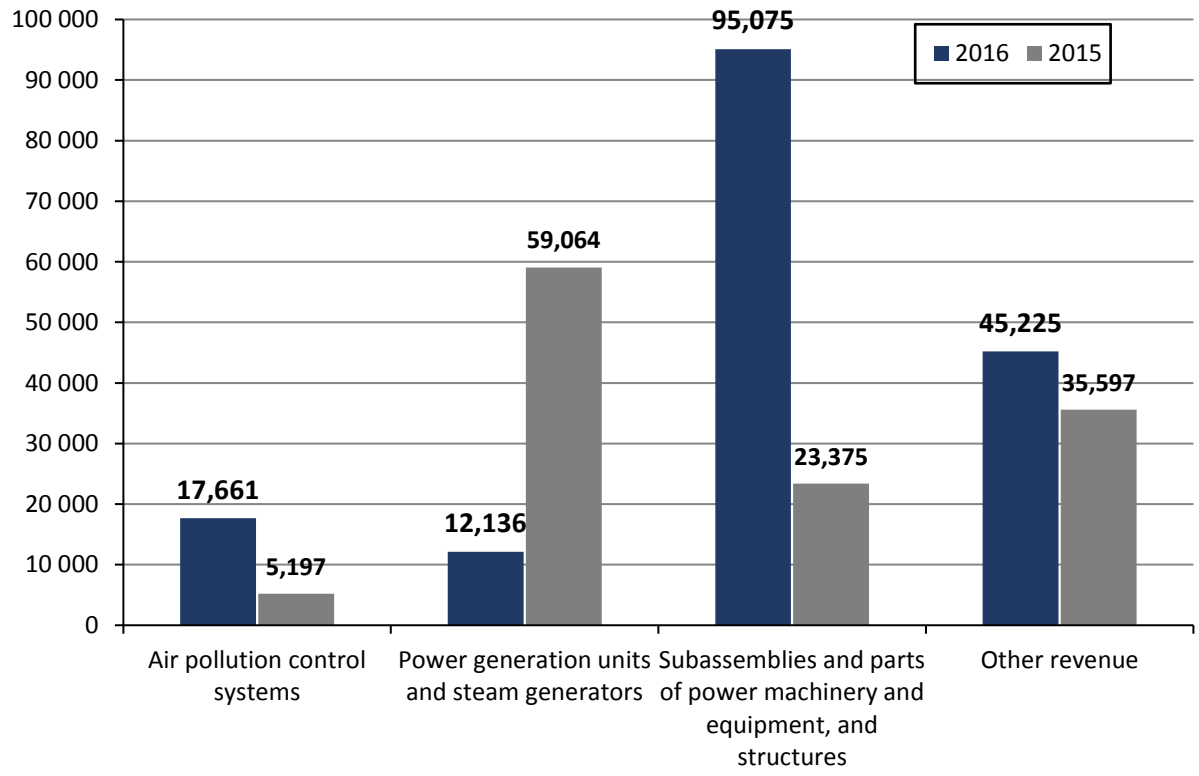
In 2016, the Group's sales structure was as follows:



Sales by market:
Domestic market (2016: PLN 1,705,215 thousand; 2015: PLN 1,426,857 thousand)

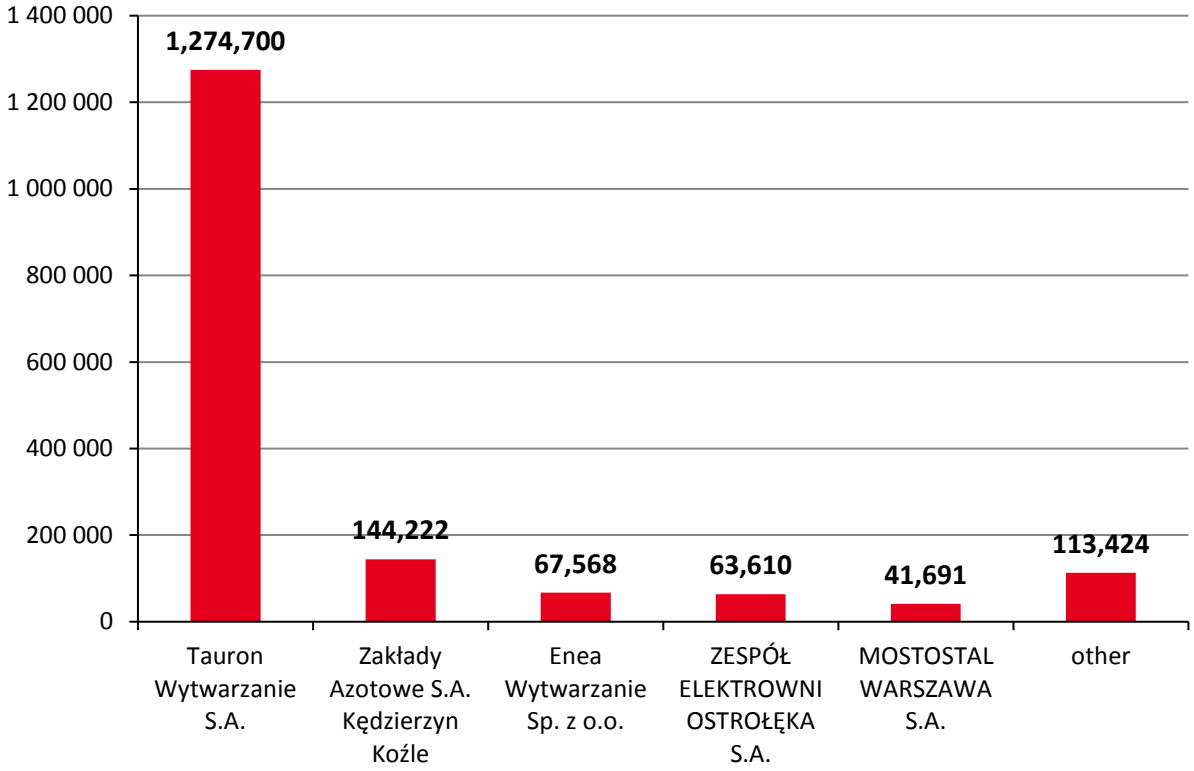


Foreign markets (2016: PLN 170,097 thousand; 2015: PLN 123,233 thousand)



In 2016, the RAFAKO Group's major customers included:

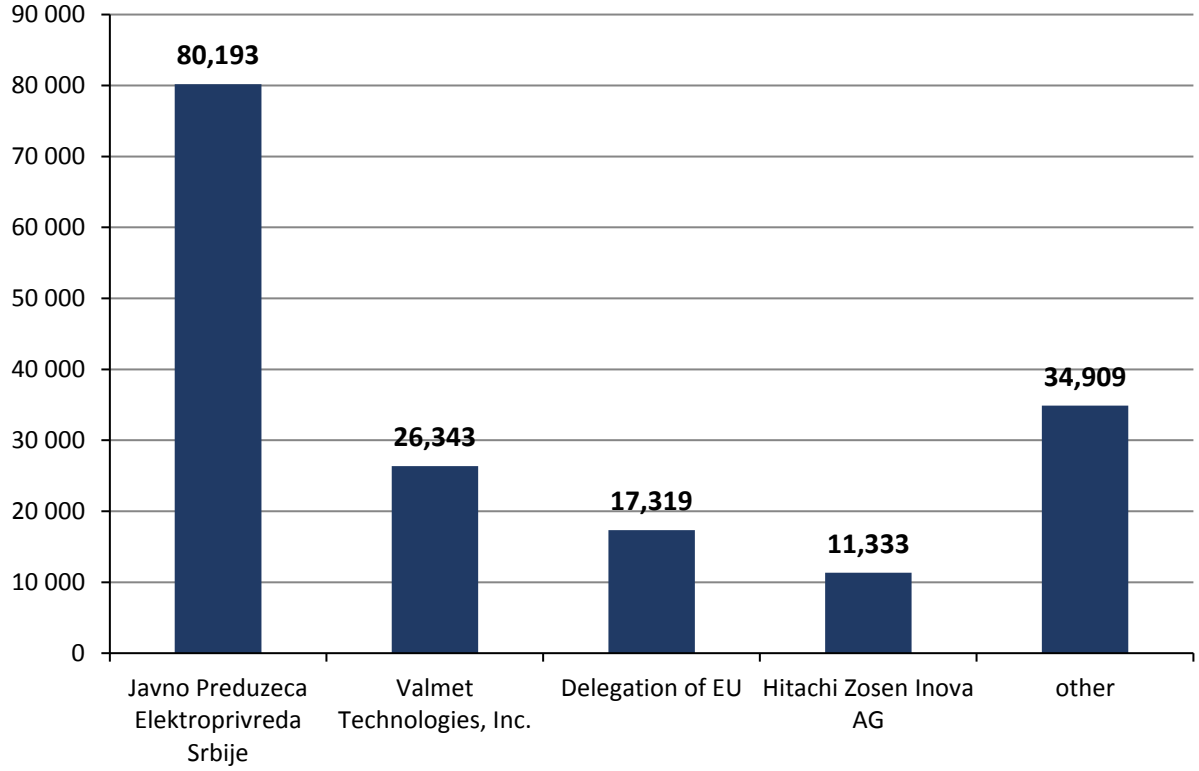
on the domestic market (PLN 1,705,215 thousand in total):



In 2016, the Group's main customer was Tauron Wytwarzanie S.A., which accounted for 68.0% of total sales (43.3% in 2015). Revenue attributable to this customer was generated mostly in connection with the construction of a 910MW supercritical power generating unit at the Jaworzno Power Plant.

Also Grupa Azoty Zakłady Azotowe Kędzierzyn S.A. had a significant share in the Company's total sales: 7.7% in 2016 (9.5% in 2015). Revenue from sales to this customer was generated on the construction of a new CHP plant.

on foreign markets (PLN 170,097 thousand in total):



The RAFAKO Group's main customer on foreign markets was the Serbian company Javno Preduzece Elektroprivreda Srbije, whose share in total sales was 4.3% (2015: 0.02%). The subject matter of the contract with this customer was replacement of component parts of a combustion chamber in Boiler B2 at TENT B Obrenovac (Phase 1) and installation of membrane walls in Boiler OP-380b at TE Morava (Phase 2).

Given the nature of the Group's sales, the shares of major customers in total sales exceed 10% at times when large projects are being executed.

The presented revenue data includes construction contract revenue accounted for using the percentage of completion method.

3.3. Deliveries, procurement and purchase of production materials

In 2016, the Group's main supply sources included:

	PLN '000			
Source	*2016*		*2015*	
	value	*share in total purchases*	*value*	*share in total purchases*
Domestic purchases	1,113,116	69.0%	1,047,455	75.4%
Foreign purchases	500,145	31.0%	340,981	24.6%
TOTAL	**1,613,261**	**100.0%**	**1,388,436**	**100.0%**

In 2016, the share of one of the suppliers – Siemens AG – exceeded 10% of the Group's total purchases, amounting to 19.1% of total purchases (PLN 308,721 thousand). Purchases from Siemens AG comprise mainly the manufacture, delivery and installation of a turbine island system for the Jaworzno 910MW Project. The RAFAKO Group companies are not related to Siemens AG. The structure of the RAFAKO Group's other suppliers was highly fragmented.

The Group relies on external suppliers for various services, delivery and assembly of machines and equipment, construction and installation services and transport, as well as pipes, metal sheets, shaped materials, welding materials and specialist equipment. The range of purchases depends heavily on the nature and requirements of

running contracts (customised production). The Group's operations are not affected by limited availability of production materials, supplies or procurement services. Suppliers are chosen based on their ability to provide materials and equipment meeting the relevant technical and quality standards within specified deadlines and in the most cost-effective manner. The procurement process is based on market analysis, with the pool of suppliers including only manufacturers recognised for the quality of their products and compliance with safety, environmental and other relevant standards.

With some contracts, the list of potential manufacturers and service providers must be approved by the Group's employers.

3.4. Related-party transactions

In 2016, the parent and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms. The values of related-party transactions are disclosed in Note 45 to the consolidated financial statements of the RAFAKO Group for the 12 months ended December 31st 2016.

3.5. Operating expenses, structure of operating expenses and gross profit (loss)

In 2016, cost of sales of products, services and materials was PLN 1,750,999 thousand, with revenue of PLN 1,875,312 thousand. Thus, the Group posted gross profit of PLN 124,313 thousand (down 2.2% year on year).

Gross profit fell mainly due to:

- the parent Management Board's decision to adjust the valuation of long-term contracts as at December 31st 2016 following a periodic analysis of costs incurred to perform the contracts and a revision of assumptions regarding future revenue and costs relating to the contracts,
- increase in provisions related to warranties under the parent's completed sale contracts.

Gross profit was positively affected by a 21% year-on-year increase in sales, primarily attributable to higher sales under the Jaworzno 910 MW Project.

Gross profit margin fell year on year, to 6.6% (2015: 8.2%).

Administrative expenses totalled PLN 57,750 thousand, having risen by PLN 4,696 thousand year on year, driven, among other things, by higher costs of legal and advisory services, including costs of business support services and reorganisation of the parent.

In 2016, distribution costs were PLN 31,962 thousand, having increased by PLN 2,546 thousand year on year. The main drivers of distribution costs included the contract acquisition cost (PLN 26,263 thousand) and cost of promotion and advertising (PLN 4,954 thousand).

After accounting for distribution costs and administrative expenses, the Group generated profit on sales of PLN 34,601 thousand in 2016, compared with PLN 44,605 thousand in 2015.

3.6. Other income and expenses and net finance income/costs

3.6.1. Net other income/expenses

In 2016, the Group recorded net other expenses of PLN 9,904 thousand (2015: net other expenses of PLN 3,886 thousand), attributable to:

		PLN '000
1.	recognition of employee benefit obligations related to Voluntary Redundancy Programme	(7,622)
2.	recognition of provisions for future costs	(1,066)
3.	cost of scrapping	(536)
4.	organisation of the Power Engineer's Day	(509)
5.	donations and subsidies	(413)
6.	gain on sale of property, plant and equipment	758
7.	materials recovered from retirement of property, plant and equipment	461
8.	negative net balance of other items of other income and expenses	(977)

Recognition of employee benefit obligations resulted from the parent's conclusion of the Voluntary Redundancy Programme (VRP), with 128 employees opting for voluntary redundancy. The VRP aims to adjust the level and costs of employment at the parent to current market conditions, while supporting the leaving employees through financial and non-financial measures.

3.6.2. Net finance income/costs

In 2016, the Group recorded net finance costs of PLN 2,204 thousand (2015: net finance income of PLN 5,360 thousand), attributable to:

		PLN '000
1.	interest on financial instruments	(1,905)
2.	bank commissions paid on bank borrowings	(887)
3.	other interest	(760)
4.	recognition of provision for finance costs	(522)
5.	net foreign exchange gains	1,007
6.	interest on security deposits provided	782
7.	positive net balance of other finance income and costs	81

3.7. Income and its structure

The main source of the Group's pre-tax profit, which amounted to PLN 22,493 thousand in 2016 (PLN 46,079 thousand in 2015), was gross profit generated by the Group on its principal operations, of PLN 34,601 thousand.

After accounting for net other expenses (PLN 9,904 thousand), net finance costs (PLN 2,204 thousand) and income tax (PLN 11,553 thousand), the Group achieved net profit of PLN 10,940 thousand, compared with profit of PLN 33,950 thousand reported in 2015.

The Group did not publish any financial forecasts or profit guidance for 2016.

For the structure and change of consolidated pre-tax profit (loss) in 2016 and 2015, see Appendix 4.

3.8. Margins and ROE

In 2016, the Group reported a deterioration in its operating profit margin compared with a year earlier. Gross profit margin fell to 6.6% and was 1.6pp lower than in 2015, while operating profit margin amounted to 1.3% (compared with 2.6% in 2015).

With its net profit at PLN 10,940 thousand, the Group's return on equity (ROE) amounted to 2.5% (in 2015: 8.0%).

The deterioration in net profit, coupled with a 14.1% increase in the Group's total assets (up by PLN 175,851 thousand), brought down its return on assets to 0.8% (ROA in 2015: 2.7%).

The 2016 and 2015 profitability ratios are presented in Appendix 1.

3.9. Financial liquidity

The ratios measuring the RAFAKO Group's financial liquidity as at the end of 2016 are presented below. The current ratio (current assets to current liabilities) remained at its previous year's level of 1.2. Similarly, the quick ratio (current assets net of inventories to current liabilities) remained at the level of 1.2 at the end of 2016.

In 2016, the average collection period lengthened by 45 days (to 113 days), while the inventory cycle shortened by 28 days (to 39 days) and the average payment period lengthened by 2 days (to 106 days). The working capital cycle (average collection period + inventory cycle - average payment period) lengthened by 15 days year on year, to 46 days.

In 2016, liabilities to the Social Security Institution (ZUS), State Treasury and employees were settled in a timely manner, although there were delays in payments to suppliers.

The parent continued its multi-purpose credit facility agreement with PKO BP S.A. Several annexes to the agreement were signed, the most recent one extending the availability period until June 30th 2017 and amending certain provisions of the agreement. For detailed information on the amendments, see Section IV.4 'Other material events' on page 29.

Changes in the facility's interest rate affected the parent's finance costs. Further, the use of the credit facility bearing interest at a variable rate of 1M WIBOR plus margin exposed the parent to the risk of higher interest expenses typical of such financing instruments.

In terms of financial liquidity, the need to engage substantial cash to secure contract bonds (performance bonds and advance payment guarantees), provided mainly by financial institutions, is a significant burden on the parent.

A factor of key importance from the point of view of financial liquidity will be the Company's access to new bank/insurance guarantees requiring no security in the form of cash collateral, that would enable the Company to free some of the cash serving as performance bonds provided in respect of contracts which are already being performed. Unavailability of a satisfactory amount of guarantee limits may restrict the Group's ability to conclude revenue-generating contracts.

In 2016, significant guarantees issued to the RAFAKO Group included an advance payment guarantee of PLN 48m issued by mBank and a bank performance bond of PLN 126.3m related to the Jaworzno 910 MW Project.

In 2015, the parent carried out a share issue with the main objective of raising funds to finance contract bonds to help the parent build its order book, and to finance working capital requirements to enable the performance of contracts in the future. The parent is planning to allocate 85-90% of the issue proceeds for this purpose.

On August 25th 2015, the Judge Commissioner declared that an arrangement was made between PBG S.A. (parent of the PBG Group, of which RAFAKO S.A. is also a member) and its creditors. PBG's arrangement with its creditors became final on June 13th 2016. The arrangement should have a positive effect on the Group's ability to obtain financial guarantees, and thus on its capacity to win and perform contracts.

The Group is also exposed to currency risk. Changes in PLN exchange rates, especially if frequent and significant, may materially affect both the profitability of contracts and the amount of currency translation differences on assets and liabilities denominated in foreign currencies and translated into PLN.

The strategy of currency risk management followed by the parent is to use natural hedging to the extent possible. The parent seeks to achieve the highest possible level of structural matching of income and expenses denominated in the same currency and related to running contracts. Apart from natural hedging, the parent may hedge between 30% and 70% of its net exposure to foreign exchange risk by means of approved derivative instruments (e.g. FX forwards) available on the market.

As at December 31st 2016, the Group did not carry any unsettled FX hedging transactions.

For the objectives and rules of financial risk management, see Note 52 to the RAFAKO Group's consolidated financial statements for 2016.

3.10. Debt

In 2016, the RAFAKO Group's liabilities towards its creditors increased by PLN 161,766 thousand. As at December 31st 2016, total non-current and current liabilities were PLN 983,218 thousand, compared with PLN 821,452 thousand as at December 31st 2015.

Under current liabilities, the greatest increase was recorded in trade payables, which went up to PLN 473,476 thousand from PLN 400,842 thousand in 2015. Significant increases were also recorded in the current portion of interest-bearing borrowings, which grew by PLN 37,899 thousand, to PLN 147,107 thousand, and in other current liabilities, which increased to PLN 101,804 thousand from PLN 64,038 thousand in 2015.

Non-current liabilities increased by PLN 6,185 thousand, to PLN 73,849 thousand, and the increase was mainly due to trade payables, which rose by PLN 5,369 thousand.

As at December 31st 2016, the Group's assets not encumbered with on-balance-sheet (non-current and current) liabilities were PLN 443,851 thousand, having risen 3.3% from PLN 429,766 thousand as at December 31st 2015.

Debt (including non-current and current liabilities) to assets ratio, measuring the Group's ability to secure repayment of debt with assets, grew by 3.3pp year on year, to 68.9%.

Debt to assets ratio does not take account of the Group's liabilities under bank and insurance guarantees (mainly performance bonds and advance payment guarantees granted on the Group's instructions; such guarantees are typical for the RAFAKO Group's business and the market of power generation equipment), letters of credit and promissory notes issued as security.

The 2016 and 2015 liquidity and debt ratios are presented in Appendix 1.

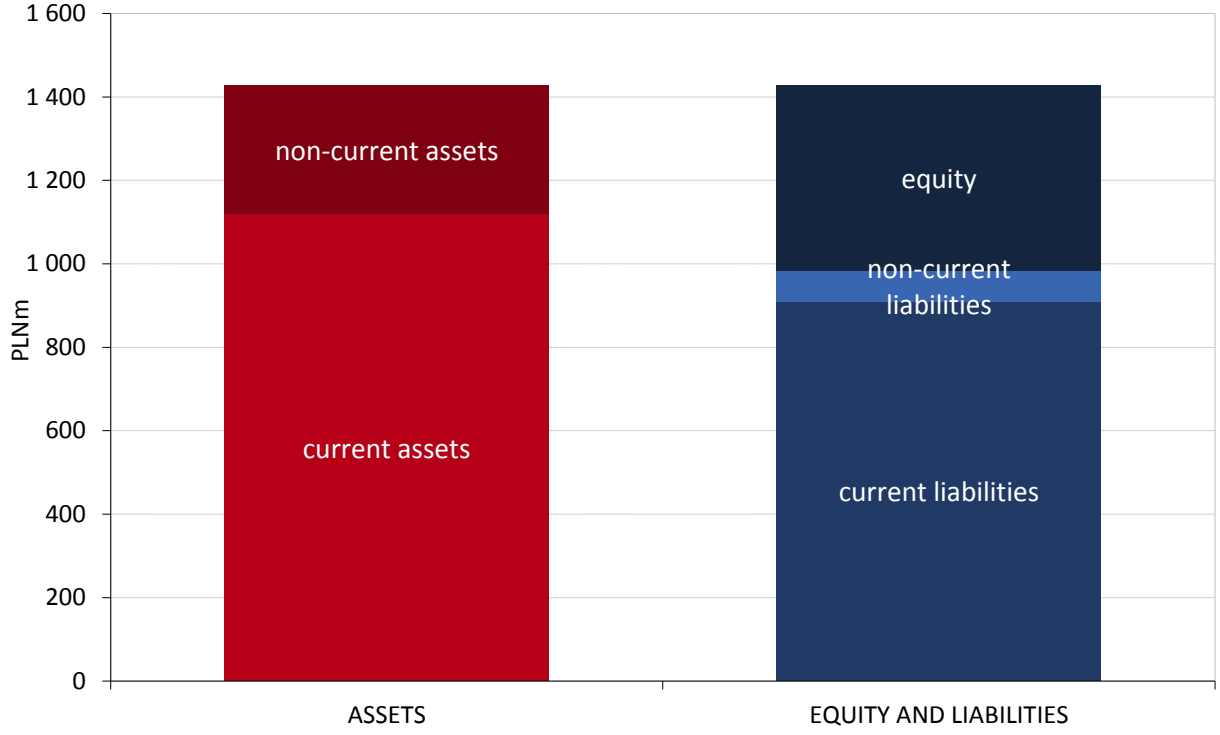
3.11. Off-balance-sheet items

As at December 31st 2016, the Group's contingent liabilities under bank and insurance guarantees, letters of credit and promissory notes issued as security stood at PLN 1,606,013 thousand (as at December 31st 2015: PLN 1,275,979 thousand). The main items of these liabilities were sureties issued for the benefit of financial institutions which provided financial security in respect of the Jaworzno 910 MW Project; the surety was provided to secure proper discharge of obligations by the Jaworzno project SPV in connection with financial guarantee agreements (PLN 1,395m). In the 12 months of 2016, guarantees (mainly performance bonds of PLN 107,950 thousand and bid bonds of PLN 45,745 thousand) were issued by banks and insurance companies to the Group's trading partners upon the parent's instructions. In this category of liabilities, the largest item was a performance bond of PLN 20,569 thousand.

In connection with its ongoing contracts, besides contingent (off-balance-sheet) liabilities, the Group also had contingent receivables, which amounted to PLN 692,181 thousand as at December 31st 2016 (PLN 614,825 thousand as at December 31st 2015). The increase of PLN 77,356 thousand included chiefly a PLN 82,251 thousand increase in receivables under bank and insurance guarantees and an increase of PLN 2,705 thousand in receivables under promissory notes.

For details of changes in contingent receivables and liabilities, see Note 40 to the consolidated financial statements for 2016.

3.12. Assets financing structure



As at December 31st 2016, total assets stood at PLN 1,427,069 thousand, having risen by PLN 175,851 thousand (or 14.1%) on December 31st 2015. The change was mainly driven by an increase of PLN 309 866 thousand in short-term trade receivables and a PLN 89,737 thousand decrease in cash and cash equivalents, to PLN 107,524 thousand.

The share of equity in the financing of assets decreased by 3.5pp relative to December 31st 2015, and was 30.5%.

Long-term capital (equity plus non-current liabilities) covered the full amount of non-current assets (excluding assets held for sale) and 18.8% of current assets.

As at December 31st 2016, the assets financing structure was as follows:

1. non-current assets of PLN 307,672 thousand were fully financed with equity,
2. current assets (and non-current assets held for sale) of PLN 1,119,397 thousand were financed with:

- long-term capital 18.8%,
- short-term borrowings 13.1%,
- trade payables 42.3%,
- gross amount due to customers for contract work 16.2%,
- other current liabilities 9.6%.

3.13. Non-current assets

3.13.1. Structure of non-current assets

The structure of non-current assets changed as a result of execution of investment projects, sale of assets, retirement or disposal of redundant property, plant and equipment, remeasurement of assets, and changes in the deferred tax asset. As at December 31st 2016 and December 31st 2015, it was as follows:

	Dec 31 2016		Dec 31 2015	
	Amount	Percentage	Amount	Percentage
1. Property, plant and equipment, including:	178,585	58.1%	183,439	58.8%
- land	23,754	7.7%	23,776	7.6%
- buildings	89,344	29.1%	91,832	29.4%
- plant and equipment	54,122	17.6%	56,489	18.1%
- vehicles	9,161	3.0%	8,389	2.7%
- property, plant and equipment under construction	1,409	0.5%	2,162	0.7%
- other	795	0.2%	793	0.3%
2. Intangible assets	18,782	6.1%	15,211	4.9%
3. Long-term trade receivables, other receivables and prepayments	34,007	11.0%	35,648	11.4%
4. Non-current financial assets	24,911	8.1%	30,129	9.6%
5. Deferred tax asset	51,387	16.7%	47,796	15.3%

The most important item of non-current assets was represented by land and buildings, which accounted for 36.8% of non-current assets and about 7.9% of total assets. Other significant items included plant and equipment and deferred tax assets. At the end of 2016, these accounted for 17.6% and 16.7%, respectively, of total assets. Plant and equipment includes mostly machinery, equipment and apparatuses used in the production process, as well as computer sets. Non-current financial assets included primarily receivables from PBG S.A., convertible into PBG bonds, related to the return of shares in ENERGOMONTAŻ-POŁUDNIE S.A. and a loan advanced to HYDROBUDOWA S.A. w upadłości likwidacyjnej (in liquidation bankruptcy) in the amount of PLN 24,071 thousand (the current portion of these receivables was disclosed under current assets in the amount of PLN 11,130 thousand).

In 2015, non-current assets decreased by PLN 5,162 thousand (1.5%) compared with the previous year. Increases were recorded in intangible assets (up PLN 3,571 thousand to PLN 18,782 thousand as at December 31st 2016) and in deferred tax assets (up PLN 3,591 thousand to PLN 51,387 thousand as at the end of 2016). Other non-current non-financial assets went down by PLN 5,829 thousand to PLN 24,071 thousand.

3.13.2. Key investments in property, plant and equipment

In 2016, the Group incurred capital expenditure on non-financial non-current assets of PLN 13,942 thousand, including:

- PLN 8,544 thousand on property, plant and equipment,
- PLN 5,398 thousand on intangible assets.

Capital expenditure on property, plant and equipment included primarily expenditure on the purchase and modernisation of plant and equipment, including IT hardware, and the purchase of vehicles.

Capital expenditure on intangible assets included mainly PBG Oil & Gas Sp. z o.o.'s non-cash contribution in the form of an organised part of business (with a value of PLN 4,041 thousand) in exchange for shares acquired in the subsidiary RAFAKO Engineering Sp. z o.o. Licences and computer software were also purchased.

The expenditure was financed with internally generated funds and through lease agreements.

3.14. Current assets

In 2016, current assets increased by PLN 180,530 thousand, to PLN 1,118,462 thousand. The change in current assets was chiefly driven by a PLN 309,866 thousand increase in trade receivables, to PLN 587,263 thousand. Cash and cash equivalents dropped significantly, to PLN 107,524 thousand as at December 31st 2016 from PLN 197,261 thousand as at the end of 2015. Other receivables and prepayments went down by PLN 39,713 thousand and to PLN 143,519 thousand.

Material receivables included deposits provided as security for contract guarantees (issued mainly by banks on the parent's instructions). At the end of December 2016, the amount of deposits provided as security for guarantees was PLN 68.3m (PLN 122.7m at the end of December 2015). The change in security deposits in the 12 months of 2016 was primarily attributable to a PLN 40m cash security deposit returned in connection with the construction of a power generation unit.

For the list of loans advanced in 2016, see Appendix 7.

3.15. Equity amount and structure

As at December 31st 2016, the RAFAKO Group's equity (including equity attributable to non-controlling interests) was PLN 443,851 thousand, up PLN 14,085 thousand year on year. Equity comprised:

1. Share capital of PLN 169,864 thousand, comprising 84,931,998 Series A, B, C, D, E, F, G, H, I and J ordinary shares; in 2016, there were no changes in the Group's share capital;
2. parent's share premium of PLN 95,340 thousand. In 2016, there were no changes in the Company's share premium;
3. Statutory reserve funds of PLN 175,365 thousand (a PLN 62,650 thousand increase was attributable to the allocation of retained earnings);
4. Retained earnings/accumulated losses of PLN (-)5,617 thousand;
5. Exchange differences on translating foreign operations of PLN (-)97 thousand;
6. Equity attributable to non-controlling interests of PLN 8,996 thousand.

In 2016, the Group companies did not acquire their own shares.

3.16. Use of proceeds from the issue of Series J shares

In 2015, based on a resolution passed by the Extraordinary General Meeting of RAFAKO S.A. on March 24th 2014, RAFAKO S.A. carried out an issue of new shares with the existing shareholders' pre-emptive rights waived. Following the issue of 15,331,998 Series J ordinary bearer shares with a par value of PLN 2 per share, the Company's share capital increased by PLN 30,664 thousand.

PLN 89,225 thousand of share issue proceeds were used in 2016, of which:

- PLN 29,187 thousand was used as security for new financial instruments,
- PLN 11,309 thousand was used as financing support for new contracts,
- PLN 5,129 thousand was used to finance R&D work in 2016.

A total of PLN 45,625 thousand was used from proceeds from the issue of Series J shares. The balance of approximately PLN 43,600 thousand is to be used:

a) to finance contract bonds in building the order book and to finance working capital requirements to enable the performance of contracts in the future. The parent plans to apply approximately 85-90% of the funds raised from the issue towards that purpose;

b) to increase its research and development spending with a view to advancing its technology portfolio and supplementing it with unique solutions to improve product efficiency and reliability. The parent's key focus in its research and development work financed with proceeds from the issue will be on environmental protection technologies. The Company plans to apply approximately 10–15% of the funds raised from the issue towards that purpose; The final allocation schedule will depend, among other things, on the results the R&D projects.

4. Human resources and workforce at the RAFAKO Group

In 2016, the average workforce at the Group was 2,413 employees, 32 more than in 2015.

	Dec 31 2016
Workforce structure at end of period	**2,411**
production	995
engineering design office	405
technology office	73
quality control	113
maintenance	85
other employees (financial and accounting, sales and procurement staff)	740

As at December 31st 2016, the Group's employees with university degree or secondary school diploma accounted for 70.9% of the personnel (69.4% as at December 31st 2015). The parent's Management Board recognises the importance of recruiting new, well-educated employees. As more than 90% of job positions at the Company require specialist knowledge, persons with specialist university degrees are given priority in the recruitment process. As at December 31st 2016, university graduates accounted for 45.4% of the personnel (up by 1.9% on December 31st 2015). The Group also attaches importance to continuous professional advancement, and many employees decide to enrol on part-time university courses.

Workforce structure at the Group at end of period	**2,411**
RAFAKO S.A.	1,993
ENERGOTECHNIKA ENGINEERING Sp. z o.o.	110
E003B7 Sp. z o.o.	123
RAFAKO ENGINEERING Sp. z o. o.	139
Przedsiębiorstwo Gospodarki Lokalami PGL-DOM Sp. z o.o.	26
RAFAKO ENGINEERING SOLUTION doo.	11
RAFAKO Hungary Kft.	7
E001RK Sp. z o.o.	2

The employee age structure slightly changed: the share of employees aged 30 or below was 16.2%, down 2.6% on 2015. Employees aged between 31 and 40 represented 24.6% (2015: 23.3%) of the total workforce, while the share of those aged between 41 and 50 increased slightly by 0.5% to 23.8%. The share of employees aged 51 or more was 35.3% (2015: 34.6%).

Over the last 12 months, minor changes were observed in the workforce structure in terms of their length of service. Employees with a length of service of up to 10 years represented 30.5% of the entire personnel (against 29.4% in 2015), while 18.5% of employees had worked for 11−20 years (down by 0.6% on 2015). The share of employees with 21−30 years of service remained unchanged at 17.4%. 33.6% of employees had been employed at the Group for more than 31 years. The Group has personnel with many years of unique professional experience.

5. Other information

For the statement of compliance with corporate governance rules by the parent in 2016, see Appendix 9.

For information on the amount of remuneration, awards and benefits for members of the Management and Supervisory Boards, see Note 49 to the consolidated financial statements of the RAFAKO Group.

The parent has entered into a management contract with each member of the Management Board, which includes provisions on compensation in the event of dismissal or resignation.

A member of the parent's Management Board who is dismissed or not re-appointed (except where such dismissal was caused by the member's failure to properly discharge their duties under the contract, or by wilful or negligent conduct adversely affecting the parent's business), or whose contract has been terminated or expired, is entitled to a one-off termination payment, equal to six months' remuneration.

Additionally, the parent is required to pay non-compete compensation to members of the Management Board, equal to 50% of their monthly remuneration, for six months following the date of dismissal, expiry of mandate or end of the notice period.

For information on the number of shares in RAFAKO S.A. and its related entities held by members of the Management and Supervisory Boards, see Note 47 to the Group's consolidated financial statements.

The parent is aware of the fact (which is publicly available) that on April 20th 2016 PBG S.A. w upadłości układowej (in company voluntary arrangement) and Multaros Trading Company Limited signed agreements with certain banks restricting the transferability of RAFAKO shares, which is connected with fulfilment of PBG's obligations towards some of its creditors. The agreements involve the creation of registered pledges over all RAFAKO shares held by PBG and Multaros.

In connection with the court's decision of June 13th 2016 approving the arrangement between PBG and its creditors, the ordinary pledge over RAFAKO shares held by these companies, created to secure the arrangement, became effective.

Moreover, on December 2nd 2016 RAFAKO S.A. was notified by PBG S.A. of the creation of a registered pledge over RAFAKO shares held by PBG and Multaros Trading Company Limited for the benefit of PBG's arrangement creditors acquiring bonds, in accordance with the arrangement. Shareholders of the parent may have up-to-date information on other such restrictions, if any.

IV. Key events and developments in 2016 and in the period from the end of the financial year to the date of the report

The key events and developments related to the activities of the RAFAKO Group are presented below.

1. Contract with TAURON (Jaworzno Power Plant)

On April 17th 2014, the parent, acting as the leader of a consortium with Mostostal Warszawa S.A., executed a contract with Tauron Wytwarzanie S.A. for the construction of a power generation unit at the Jaworzno III Power Plant - Power Plant II. The value of the contract is PLN 4.5bn. The subject matter of the contract is design and delivery, on a turn-key basis, of a supercritical 910 MW power generation unit consisting of a steam generator, turbine generator set, main building, electrical and I&C systems.

The coal-fired unit to be erected in Jaworzno will be one of the most advanced facilities of this kind.

Key parameters
Supercritical pulverised-fuel, tower-type, once-through steam generator, **U**nit's nominal output (gross) – 910 MW, **G**enerator's rated thermal input – 1,832 MWt, **R**ated capacity – 2,390 t/h, **T**emperature of steam at outlet (live/superheated) – 603/621°C, **P**ressure of live steam at outlet – 28.5 MPa, **P**ressure of superheated steam at outlet – 6.2 MPa, **E**fficiency in standard conditions >95%, **A**vailability > 95%, **N**et generation efficiency > 45.91 %.

Unit's components
Superheated steam generator, **S**team turbine powering the electricity generator, **F**eed water pump system, **S**ystems designed to meet the sulfur dioxide, nitric oxide and dust emission standards specified in the Industrial Emissions Directive (IED), **S**ystems for disposal of combustion waste, as well as for delivery and preparation of various auxiliary media.

The Jaworzno unit will be a high-efficiency base-load electricity generation facility operating within the power system. The operating life of the unit will be at least 200 thousand hours or 30 years.

Environmental implications:

According to the project owner's estimates, once the project is complete, sulfur dioxide emissions will be sixteen times lower than from the 120 MW units which are to be decommissioned, nitric oxide emissions will be more than five times lower, and dust emissions will be reduced eleven times. In addition, carbon dioxide emissions will be cut by nearly two million tonnes a year.

Key events in 2016 and 2017

2016	
January	Construction of the groundslab for the steam generator.
February – April	Construction of the underground structures of the turbine house and the lower groundslab for the turbine generator set On February 24th 2016, SPV Jaworzno and Powszechna Kasa Oszczędności Bank Polski S.A., Powszechny Zakład Ubezpieczeń S.A., Bank Gospodarstwa Krajowego and mBank S.A., signed an annex to the agreement of April 16th 2014 for bank and insurance guarantees required for the Jaworzno 910 MW Project. Under the annex, mBank agreed to issue, in

February – April	favour of SPV Jaworzno, an advance payment bank guarantee of PLN 48m and a performance bond bank guarantee of PLN 126,334 thousand for the Jaworzno 910 MW Project. Under the annex, the PLN 40m amount which RAFAKO S.A. has contributed in cash as a performance bond for the main contract was returned to the parent. In addition, as part of the security interests, the parent also concluded an annex to the agreement of October 29th 2014 on the creation of a registered pledge over movables and rights of the Company, as announced by the Company in Current Report No. 47/2014. Under the annex, the scope of the pledge was extended so that, in addition to existing and future receivables of PKO, BGK and PZU, it also secures receivables of mBank, as providers of performance bonds and advance payment guarantees for the Company in connection with the Main Contract. Also, the maximum security amount was changed to PLN 1,300m (the previous value of the security was up to PLN 1,046m). In connection with the annex, in March and April the parent received decisions on the entry of the pledge in the register of pledges. Assembly of the external section of the cooling water system (pipelines from the turbine house to the cooling tower) was completed in March.
June	Construction of the reinforced concrete structure of pylons.
July	On July 13th 2016, SPV Jaworzno and POLIMEX Energetyka Sp. z o.o. executed a contract for erection of the boiler's pressurised section, performance of tests and participation in the start-up, in connection with the Jaworzno 910MW Project. The contract is worth PLN 118,750 thousand.
September	Construction of the reinforced concrete structure of the building accommodating the control room and electric devices. On September 14th 2016, SPV Jaworzno and the parent commenced negotiations with Tauron Wytwarzanie S.A. and Tauron Polska Energia S.A. regarding amendments to the contract. The Parties entered into the negotiations following detailed investigation of the ground designated to accommodate the planned generating unit, which was carried out by SPV Jaworzno after execution of the contract and handing over of the construction site to the parent. The investigation revealed that, contrary to the findings of earlier surveys conducted by the employer, the ground was not suitable for spread foundation of the planned structure. In order to avoid a construction disaster, it was necessary that SPV Jaworzno perform additional work, involving deep foundation of the generating unit's structure with piles and cavity walls. Moreover, after execution of the contract, it turned out that the contractor had to considerably increase the tonnage of steel elements in a number of structures compared with the tonnage assumed as at the contract date, which was the basis for determination of the contractor's remuneration under the contract. The increase was due to a change of the applicable technical standards following the transposition of European standards (Eurocodes) into the Polish regulatory environment. As a result, the parent and SPV Jaworzno approached the employer with a request to increase the contract price by PLN 127m and extend the deadline for completion of work under the contract by ten months.
December	Completion of erection of the load-bearing structure of the steam generator and delivery of the turbine island.
2017	
January	Delivery of the turbine island
March	On March 1st, the parent and Mostostal Warszawa signed annex 5 to the contract for the Jaworzno 910 MW Project with Tauron Wytwarzanie (the employer).

March	Under the annex, the contract price was increased by PLN 71.05m due to the need to change the design and place the structure accommodating the power generating unit on deep foundations, and also to account for the additional work commissioned from the contractor (i.e. the parent and Mostostal Warszawa S.A.) which involves laying the foundations in the fifth zone (the electrostatic precipitator zone) and extension of the electrostatic precipitator switchgear building. The additional works will enable the employer to bring the unit partly in line with future requirements of the BAT Conclusions. The employer did not acknowledge the claims arising from changes in the design standards (Eurocodes) as valid. Under the annex, the contract completion deadline was extended by eight months and five days, and therefore the unit commissioning report will be signed by November 2019. Execution of the annex will result in amendments to the project financing documentation, contract performance timetable, project budget and the subcontractor agreement between SPV Jaworzno and the parent. As at February 28th 2017, the percentage of project completion was 31.8%.

In its separate financial statements, RAFAKO S.A. recognises only revenue and expenses related to its own scope of work, i.e. 11.3% of the total scope of work to be performed on the Jaworzno 910 MW Project. In its separate financial statements, the parent does not recognise revenue and expenses related to the portion of work performed by E003B7 Sp. z o.o. – they are reported in the separate financial statements of E003B7 Sp. z o.o. and the consolidated financial statements of the RAFAKO Group.

For rules of accounting for the contract, see Note 11.1.1 to the consolidated financial statements.

2. Contract with PGE Elektrownia Opole

In February 2012, the parent, acting as the leader of a consortium comprising RAFAKO S.A., Polimex-Mostostal S.A. and Mostostal Warszawa S.A., executed a PLN 9.4bn contract with PGE Elektrownia Opole S.A. (currently PGE Górnictwo i Energetyka Konwencjonalna S.A. – the "employer") for turn-key design, delivery, construction, assembly, start-up and performance of all related services with respect to a facility consisting of power unit No. 5 and power unit No. 6 at PGE Elektrownia Opole S.A., together with equipment and devices as well as all related buildings and structures.

The units, each with a capacity of 900 MW, will be fired with hard coal. The project will be completed within 54 months from the notice to proceed for unit No. 5, and within 62 months from the notice to proceed for unit No. 6.

The subsidiary E001RK Sp. z o.o. ("SPV-RAFAKO") was appointed by RAFAKO S.A. as its subcontractor in charge of the entire scope of work and services related to the construction of the power generating units at Elektrownia Opole (Opole Power Plant). SPV-Rafako's remuneration for the performance of the works and services is PLN 3.96bn.

On October 26th 2013, E001RK Sp. z o.o. (a company dedicated to the Opole Project, wholly-owned of RAFAKO S.A.) entered into a subcontractor agreement with Alstom. Under the agreement, E001RK Sp. z o.o. appointed Alstom as its subcontractor responsible for 100% of the work and services making up the parent's scope of work under the Opole Project.

Presentation of revenue and expenses under the contract has no effect on the values disclosed in the Group's statement of comprehensive income.

For the rules of accounting for the contract, see Note 11.1.2 to the financial statements.

On January 31st 2014, the consortium received a notice to proceed for the Opole Project from the employer.

The project is on schedule: construction of the power generating units is half-way through, with invoices issued and payments made without any disruptions. As at December 31st 2016, PLN 2,098,544 thousand (65.1% of the contract's total value) was invoiced in relation to the Opole Project.

3. Events related to other significant contracts

I. On September 29th 2016, the parent signed a contract worth EUR 149,650 thousand with JSC Vilniaus Kogeneracinė Jėgainė. The contract provides for the construction of a biomass-fired co-generation unit consisting of boilers with fluidised beds, biomass storage and feeder systems, and a flue gas treatment system. The project will be executed as part of the process to construct a new CHP plant in Vilnius, Lithuania. The award of this project is an important step towards one of the parent's strategic objectives, which is to increase the Group-wide export revenues.

II. On September 30th 2016, RAFAKO S.A. and ENEA Wytwarzanie Sp. z o.o. signed a contract for delivery and installation of a catalytic flue gas NOx reduction system for AP-1650 boilers No. 9 and 10 and for upgrade of the electrostatic precipitators at ENEA Wytwarzanie Sp. z o.o., worth PLN 289,182.1 thousand.

III. On October 20th 2016, the parent signed an annex to the contract for execution of Phase 1 of the 'New CHP Plant at Grupa Azoty Zakłady Azotowe Kędzierzyn S.A.' project with Grupa Azoty Zakłady Azotowe Kędzierzyn S.A. Under the annex, the parties postponed the final deadline for completion of the contract until the end of Q1 2017. The annex also changed the aggregate limit of liquidated damages to 35%.

4. Other material events

a. Amendments to the parent's Articles of Association (consolidated text of the Articles of Association was published in Current Report No. 5/2016) of February 26th 2016.

b. In March 2016, the Management Board of RAFAKO S.A. passed a resolution to reorganise the parent. The purpose of the reorganisation is to adapt the parent's business model as well as its resources and key processes to the increasingly more demanding market in which it operates, and also to the new markets where the parent intends to purposefully and effectively operate in the forthcoming future.

Key objectives of the planned changes are as follows:

- to implement a CRM-based model and a system-based foreign markets management,
- to implement a system-based foreign markets management,
- to introduce uniform standards for bidding and project implementation,
- market orientation of production.

The parent's Management Board assumed that the most effective way to achieve these objectives would involve:

- adapting the organisational structure to challenges faced by the parent as well as building business awareness and responsibility for the implementation of strategic objectives at all levels of the organisation, and
- remodelling business processes (including the sale and manufacturing processes) as well as financial processes (mainly the controlling and accounting processes).

As at June 30th 2016, changes were made to the organisational structure, while work continued on the remodelling of business and financial processes.

c. On June 30th 2016, an annex to the Credit Facility Agreement with Powszechna Kasa Oszczędności Bank Polski S.A. of Warsaw was executed. Under the annex, the terms and conditions of the financing were changed as follows: as part of the multi-purpose credit facility (the "Facility"), the Bank provided the parent with:

- a current account overdraft facility of up to PLN 100m,
- a revolving working capital facility of up to PLN 50m (disbursements under the facility are to be made on the basis of the parent's instructions) for the financing of current liabilities as they arise in the course of day-to-day operations;

- a bank guarantee facility, on the terms and conditions specified in the Agreement, and a revolving working capital facility of up to PLN 100m for the financing of payments under bank guarantees issued by PKO BP, provided, however, that the aggregate amount drawn under the Facility may not exceed PLN 200m. The annex extended the availability and final repayment date of the Facility until June 30th 2017.

Furthermore, under the annex the parent agreed to change the existing security, i.e. a registered pledge over a set of movables and rights comprising the entire business of RAFAKO S.A., by extending the security to cover all liabilities which may arise under the Facility.

RAFAKO S.A. also undertook to make changes to the joint contractual mortgage of up to PLN 300m so that the mortgage secures all debts that may arise under the Facility.

Additionally, the annex includes a condition that if in 2016 RAFAKO does not acquire a new order book with a net value of PLN 900m, to be reviewed as at December 31st 2016, PKO BP will be entitled to reduce the amount of the PLN 100m overdraft facility available to the Company by the percentage by which the new order book falls short of the assumed value, rounded to the nearest million. In such a case, the next review of the order book for the previous 12 months, i.e. from April 1st 2016 to March 31st 2017, will be made as at March 31st 2017. Review of the planned value of the order book will be based on RAFAKO's representation submitted to PKO BP. The value of orders acquired in 2016 exceeded PLN 900m; see Section 3.

Furthermore, in the annex PKO BP reduced the level of security in the form of cash deposits from the sub-limit for guarantees granted.

The other terms and conditions of the Credit Facility Agreement were not materially amended under the annex. The Facility bears interest at 1M WIBOR + bank margin. The Agreement also provides for customary bank fees and commissions. Interest is payable on a monthly basis.

d. In May 2016, the Management Board of the parent updated the RAFAKO Group's Stable Growth Strategy for 2015−2018; the update was a result of the completed implementation of certain objectives, as well as changes in the market, competitive and legal environments. The parent's key strategic objectives are to:

- strengthen its R&D activity;
- consolidate the Group's position as a leader on the Polish market of technologically advanced and environmentally-friendly solutions for the power and industrial sectors;
- expand foreign sales;
- optimise management of the parent's and the Group's business, and in particular to expand the maintenance function.

e. Following the rescission by general contractor Mostostal Warszawa S.A. on June 14th 2016 of the contract for design, delivery and erection of a grid, boiler and flue gas treatment system for two lines of the Thermal Waste Treatment Plant in Szczecin, on July 7th 2016 RAFAKO S.A. rescinded the project subcontractor agreement, having previously found the rescission of the subcontractor agreement submitted by Mostostal Warszawa to be defective and invalid, and therefore legally ineffective.

On October 11th 2016, the parent filed a claim against Mostostal Warszawa S.A. with the Regional Court of Gliwice, demanding payment of PLN 8,042,475 plus statutory interest accrued from August 3rd 2016 as a refund of 70% of the amounts retained by Mostostal as a performance bond. The grounds for the claim were that the parties had effectively terminated their cooperation under the subcontractor agreement made on December 18th 2012. As cooperation on the project had been discontinued, Mostostal Warszawa S.A. was obliged to refund the amounts retained as a performance bond, because the contractual basis for providing a performance bond had ceased to exist.

For more details on these court proceedings, see Note 38 to the Group's financial statements.

f. On July 14th 2016, the parent and POLIMEX Energetyka Sp. z o.o. of Warsaw signed a letter of intent expressing the parties' intention to jointly participate in a potential tender for expansion of power generation capacities at the Ostrołęka Power Plant and perform works under the contract to be concluded if the consortium of Polimex Energetyka Sp. z o.o. and RAFAKO S.A. wins the project, on the terms and dates provided for therein.

The parties plan to participate in the project as a consortium. In the consortium agreement, the parties will specify the detailed scope of bid preparation and works for each Party, and the rules to be followed by each party in using its resources, granting credentials etc.

If the parties decide to conclude the consortium agreement, Polimex Energetyka Sp. z o.o. will be the consortium leader and will perform the assembly and construction works for the project. RAFAKO S.A. will be the consortium member and will perform the technology part of the project (excluding the turbine island), to be defined in detail in the agreement.

g. On August 2nd 2016, the parent received a debit note from ENERGA Elektrownia Ostrołęka S.A. (the "employer") for PLN 13,491 thousand, issued in connection with the contract for NOx emissions reduction on OP 650 boilers No. 1, 2, and 3 at the Ostrołęka B Power Plant, concluded on December 10th 2014 and performed in consortium with OMIS S.A. (with RAFAKO S.A. as the consortium leader (57.76% interest) and OMIS S.A. as the consortium member (42.24% interest)). ENERGA Elektrownia Ostrołęka S.A. charged liquidated damages for: i) delay in the completion of installation work, and ii) delay in the commissioning of the unit. Subsequently, as a result of negotiations held between the parties, ENERGA decided to waive the second claim for liquidated damages in whole, which reduced the debit note amount by PLN 899,400. On September 20th 2016, the consortium filed an action with the Regional Court of Białystok for determining non-existence of the liabilities towards ENERGA in connection with non-performance or improper performance of the contract. On October 27th 2016, ENERGA sent a letter to RAFAKO S.A. and OMIS S.A. in which it notified them of deducting PLN 6,453,698.68, representing part of the liquidated damages, from current payments due to the consortium under the contract. The consortium refuses to accept that set-off, which it deems groundless given the contested grounds for charging the liquidated damages, which are now under litigation.

For more details on these court proceedings, see Note 38 to the Group's financial statements.

h. On June 13th 2016, the Regional Court of Poznań dismissed creditors' complaints against the decision to approve the arrangement, whereupon the arrangement became final. PBG had the status of a company 'w upadłości układowej' (in company voluntary arrangement) from June 2012. In August 2015, the meeting of PBG's creditors voted on and approved the arrangement. In October 2015, the arrangement was approved by the court. PBG's Arrangement with its Creditors became final on June 13th 2016.

On February 10th 2017, the Management Board of RAFAKO S.A. effectively submitted a declaration of acceptance of the invitation to acquire secured ordinary bonds in book-entry form, issued in series from B1 to I1 by PBG S.A., with a nominal value of PLN 100 per bond, that is a total of 388,492 non-interest bearing bonds with a total nominal value of PLN 38,849.2 thousand.

The total issue price will be covered through a set-off of the debts owed to the parent under the arrangement concluded by PBG S.A. in the course of its arrangement proceedings.

On February 10th 2017, the bonds were allotted to the parent.

The bonds will be redeemed in individual series, as presented in Note 39 to the Group's financial statements.

The last series is to be redeemed on June 30th 2020.

i. On November 15th 2016, the Management Board of RAFAKO S.A. resolved to launch a Voluntary Redundancy Programme for the parent's employees. The VRP aims to adjust the level and costs of employment to the conditions prevailing in the market where the parent operates, while supporting the leaving employees through financial and non-financial measures. Ultimately, the programme is to cover around 200 employees. First and foremost, the programme is targeted at:

- employees who have reached the retirement age,

- employees who are entitled to pre-retirement protection,

- other employees who meet certain conditions.

The total number of the parent's employees who have benefited from the programme is 128, and the final amount of obligations arising in connection with the programme (for which a provision was set up affecting entirely the earnings for 2016) will be about PLN 7.7m.

j. On December 2nd 2016, the parent received from PBG S.A., a person closely associated with a person discharging managerial responsibilities at RAFAKO S.A. – Mr Jerzy Wiśniewski, Chairman of the Supervisory

Board of RAFAKO, a notification of a transaction creating a pledge over parent shares, executed on November 29th 2016.

In addition to the agreements specified in Section 4, partnership and cooperation agreements significant for the Group's business and executed in 2016 also include insurance agreements.

A list of insurance agreements in effect as at December 31st 2016 is presented in Appendix 5.

For information on the agreement with the qualified auditor of financials statements, see Note 51 to the Group's consolidated financial statements.

5. Research & development and quality improvement projects

Last year, the Group's research & development activity was focused primarily on developing new products intended for new markets. Key initiatives in this area rely on cooperation with a number of entities as part of projects commissioned by the National Centre for Research and Development, EIT through Knowledge & Innovation Community, or by the European Commission.

RAFAKO S.A. cooperates with institutions of science education, especially with the Wrocław University of Technology, Silesian University of Technology, Cracow University of Technology, AGH University of Science and Technology, Jagiellonian University, Stanislaw Staszic Institute for Ferrous Metallurgy, and the Polish Institute of Welding.

At the end of 2016, six patent applications were being reviewed by the Patent Office, and several more were being prepared.

The most significant research & development and quality improvement projects completed in 2016 included:

a. Work on innovative low-emission technologies (DUO-BIO) for reconstruction of coal-fired power plants with 200 MW generating units

b. Work related to a rotary air pre-heaters control system – development of a new control system featuring low-budget applications for small air pre-heaters

6. Projects related to management and deployment of computer-based processes

RAFAKO S.A. uses ERP Infor LN10 systems, communication software (Lotus Notes) as well as CAD/CAM/CAE tools for computer aided design, integrated at the level of basic elements of business (client, project, supplier). With this software package, the Company is able to perform a broad range of cross-sectional analyses and build reliable decision-support databases.

In 2016, the parent commenced work on the implementation of a new document flow system and a controlling system for planning and budgeting.

In 2016, there were no changes in the basic management policies applicable at the RAFAKO Group.

7. Other information

The companies of the Group did not launch any employee share option schemes.

The parent has a self-reporting branch in Turkey, which prepares its financial statements in accordance with Turkish law. The functional currency of the branch is EUR.

8. Disputes, pending litigation, arbitration or administrative proceedings

For information on material disputes and litigation, see Note 38 to the consolidated financial statements of the RAFAKO Group for 2016.

V. Growth prospects for 2017

1. Energy policy

Power market and environmental protection regulations

The power market, especially its commercial segment, is subject to extensive regulation governing both the way in which it operates and its future development and structure in the context of increasingly stringent environmental protection standards. The highly-regulated nature of the segment follows from the power market's strategic importance to the energy security of every country, with environmental protection and reduced CO_2 emissions becoming a global priority in international relations. Such regulations include both the legislative framework and general objectives of the national and EU-level energy policies concerning environmental protection.

Because of the introduction of more stringent environmental protection standards, businesses generating flue gases, such as CHP plants and power plants, are required to upgrade their existing units and install new equipment to reduce air emissions. This translates into more investment projects in the power segment, including construction of low-emission, high-efficiency power plants and upgrade of existing power plants to make them comply with the strict environmental requirements imposed under EU law, which may in turn boost demand for products and services offered by the Group.

Environmental protection regulatory environment in the EU

The EU's energy policy is formulated by Member States as well as EU institutions. The legal basis for the energy policy is the Treaty on the Functioning of the European Union. Under the Treaty of Lisbon, key objectives of the EU's energy policy are:

a. to ensure the functioning of the energy market;

b. to ensure security of energy supply in the Union;

c. to promote energy efficiency and saving and the development of new and renewable forms of energy;

d. to promote the interconnection of energy networks.

The current energy policy provides for a comprehensive and integrated approach to energy and climate policy. In 2014, the heads of EU Member States and governments set the following goals:

- greenhouse gas reduction by 2030 by at least 40% compared with 1990,
- increasing the share of renewable energy to at least 27% of the EU's energy consumption,
- increasing energy efficiency by at least 27% (indicative) in 2030.

On November 30th 2016, the European Commission presented a package of measures (Winter Package) to keep the European Union competitive as the clean energy transition is changing the energy markets.

The main goal of enacted regulations should be to put the European Union closer to fulfilling its commitments under the Paris Agreement, i.e. to cut CO_2 emissions, increase the share of renewables in energy consumption, improve energy efficiency and provide a fair deal for consumers. The package is still a proposal, which over the next year will be addressed by the European Parliament, the respective energy ministers of individual Member States, and other entities.

Regulatory environment in Poland

The key legal act regulating the operation of the Polish energy sector is the Energy Law. It lays down the rules governing development of the energy policy, rules and conditions for supply and use of fuels and energy, including heat, and operation of energy companies.

Poland's Energy Policy until 2030, prepared by the Ministry of Economy, plays a major role in setting the development directions for the energy sector. Its objectives include:

- improving electricity generation efficiency through the construction of high-efficiency generating units and a two-fold increase in the quantity of electricity from high-efficiency co-generation (by 2020);
- increasing the share of renewable energy sources in total energy consumption in Poland to 15% in 2020 and 20% in 2030.

The Policy also highlights the need to reduce the environmental impact of the energy sector (including the reduction of CO_2, SO_2 and NOx emissions), which would enable Poland to meet its international obligations. Among the objectives relating to electricity and heat supplies, the Policy lists the construction of new generating capacities to balance the domestic electricity demand and maintain an operationally available capacity surplus of at least 15% of the maximum domestic demand during the peak use of total capacity of the domestic generation sources. The Policy defines the key priorities and directions in which Poland's energy policy, and thus the Polish energy market, will develop.

The work on Poland's Energy Policy until 2050 has begun. The draft of August 2014 sets the following three operational objectives designed to support the main objective:

- to ensure national energy security;
- to increase the competitiveness and energy efficiency of Polish economy;
- to reduce the environmental impact of the heat and power sector.

The Polish energy strategy until 2050 should reflect the assumptions of EU's climate policy and the respective policies of individual Member States.

At the beginning of January 2016, a Transitional National Plan (TNP) was introduced in Poland in line with the Regulation of the Minister of Environment of July 2015. The plan is designed to implement into the Polish legal system the provisions of the directive of the European Parliament and of the Council of November 2010 on industrial emissions (IED). The directive introduces mechanisms that make it possible to postpone compliance with the obligation to apply new emission limits for sulfur dioxide, nitrogen oxides and dust (derogations). Derogations provide the operators of energy installations with time to complete investment projects designed to technically adapt them to the more stringent emission requirements. One of the mechanisms introduced under IED is the Transitional National Plan, which will be applicable in the period from January 1st 2016 to June 30th 2020. During that period, the installations covered by the Plan will have to meet the relevant emission ceilings set for each year.

In 2016, the Polish President signed the Energy Efficiency Act, which implements EU regulations into Polish law to further improve the energy efficiency of Polish economy. The Act came into force on October 1st 2016. Other bills signed into law in 2017 include the amended RES Act, whose purpose is to clarify the status of producers of electricity from renewable energy sources and the rules of granting staid aid to such producers, as well as the amended Energy Law, whose new regulations are expected, among other things, to improve the energy security of Poland.

2. Asset development plans of the power sector

According to the conclusions from forecast analyses performed for the purposes of Poland's Energy Policy until 2050, demand for electricity in Poland is expected to grow. According to Polskie Sieci Elektroenergetyczne, in 2016 electricity consumption totalled 165 TWh, compared with 161 TWh the year before. The estimated year-on-year growth in demand for electricity in Poland may reach 1.5-2%. The rising demand for electricity will translate into more investment projects in the power sector, which is where the RAFAKO Group's key customers operate.

In Poland, recent years have seen some slowdown in the execution of power generation projects (due, among other things, to the economic downturn in late 2012/early 2013). As a result, a number of ongoing investment projects have been delayed by about 2 years, and some projects have been suspended. The cost of both replacement and development projects in the power segment until 2020 is estimated at about PLN 129bn.

In 2017, work on the construction of three largest coal-fired units will be continued. First to be completed is the unit in Kozienice (1,075 MW), which is to be placed in operation in December 2017. The second most advanced project involves the construction of new generating units at the Opole Power Plant (2x900 MW), with unit No. 5 to be placed in service in July 2018 and unit No. 6 – in February 2019. The third project in terms of progress is the construction of a 910 MW unit at the Jaworzno Power Plant, which is scheduled to go online in the fourth quarter of 2019.

Among large gas-fired power units currently being built, the project that should be specifically mentioned is the construction of a 463 MWe CCGT unit at the Włocławek Power Plant for PKN Orlen. Built by the General Electric International and SNC-Lavalin Polska consortium, the unit is expected to be fully completed in the second quarter of 2017.

The second project involving a gas-fired unit is the construction of a 449 MW CCGT unit at the Stalowa Wola CHP Plant for Tauron/PGNiG, under a contract signed in 2012. The unit is expected to come online in 2019.

In 2013 and 2014, several smaller projects were launched, including:

- a 50 MW coal-fired unit at the Tychy plant, constructed for Tauron Ciepło by Elektrobudowa; the project was completed in June 2016;
- a 138 MW CCGT unit at the Gorzów plant, constructed for PGE by Siemens; the unit was placed in service in February 2017;
- a 75 MW coal-fired unit at the Zofiówka plant, constructed for Jastrzębska Spółka Węglowa by Energoinstal; under the construction contract the unit is to be ready for commercial operation at the end of April 2017;
- a 596 MW CCGT unit at the Płock plant, constructed for PKN Orlen by the consortium of Siemens AG and Siemens Spółka z o.o.; the unit is scheduled to come online in the fourth quarter of 2017;

2015 saw the inauguration of construction of a 450 MW lignite-fired unit at the Turów Power Plant. The unit will be constructed for PGE GiEK by the consortium of MHPSE, Budimex and Tecnicas Reunidas. In June 2015, work began on the construction of a new CHP plant in Zabrze. The 220 MW unit to be fired with hard coal, biomass and alternative fuel (RDF) is being built for Fortum by ILF Consulting Engineers Polska under an EPCM (Engineering, Procurement, Construction Management) contract.

Projects to be commenced in the near future include: construction of a 400-500 MW CCGT unit at the Żerań CHP Plant for PGNiG Termika (the submitted bids are currently being reviewed and evaluated), construction of an approximately 120 MW CCGT unit at the Konin Power Plant for ZE PAK, and construction of a 400 MW CCGT unit for Grupa Azoty Puławy.

Also, in June 2016 the project for the construction of a new 1,000 MW supercritical coal-fired unit in Ostrołęka for ENERGA S.A. was reactivated.

Apart from that, talks are under way to launch a contract award procedure for another 1,000 MW supercritical coal-fired unit at Kompania Węglowa. The project, which had been put on hold, is to be subject to further economic analyses. Another major coal-fired power plant construction project is Elektrownia Północ (target capacity of 2x800 MW). The project is to be executed by Polenergia of the Kulczyk Investments Group. In December 2015, the Governor of the Gdańsk Province revoked the building permit in whole and referred the case for re-examination. The Provincial Administrative Court of Gdańsk upheld the Gdańsk Province Governor's decision revoking the building permit for the Elektrownia Północ project. The Provincial Administrative Court's ruling is not final.

The programme for construction of municipal waste incineration facilities, launched in 2007 and included in the Indicative List of the Ministry of Regional Development under the Operational Programme Infrastructure and Environment, initially comprised 11 items. 12 municipal waste incineration facilities were to be built: in Szczecin, Koszalin, Poznań, Gdańsk, Olsztyn, Białystok, Bydgoszcz, Łódź, Warsaw,

Kraków and two facilities in Silesia. At present (at the end of 2016), six new waste incineration facilities are operated in Poland, and several more are under construction or specific plans have been made for their construction.

In 2001, the Municipal Solid Waste Disposal Plant in Warsaw was opened. 2015 saw the completion of projects in Białystok, Bydgoszcz, Konin and Kraków. In 2016, the operation of a municipal waste incineration facility in Poznań commenced. The initial deadline (December 2016) for commissioning of a thermal waste treatment plant in Szczecin will be postponed due to Mostostal Warszawa S.A.'s rescission of the contract in June 2016.

More local governments (e.g. from Gdańsk and Olsztyn) are contemplating the construction of waste incineration plants.

Competitive environment

The Group operates on a market dominated by large, mainly international players. On this market, contracts are typically awarded through tenders announced by clients, and projects can take as much as several years to complete.

Given the significance of factors such as experience, credentials, technological capabilities and financial resources in bidding for new contracts, the Group faces a limited number of competitors, which are typically companies specialising in EPC projects. In line with market requirements, the majority of the Group's projects are also implemented under EPC contracts.

The Group operates on the Polish market (90.9% of revenue in 2016 came from domestic sales) and on foreign markets (9.1% of revenue in 2016). Given the limited number of projects and customers on each market, as well as specific contract requirements, contractors competing with the Group for projects in Poland (major foreign companies often have branches in Poland) usually also bid for foreign contracts.

There is considerable competition in terms of the products and services which are part of EPC projects. Each company which the Group believes to be a significant competitor has proprietary energy generation technologies, extensive credentials and many years of experience in delivering EPC contracts. While some of them specialise in specific types of steam generators, others offer a comparable range of products and have access to technologies allowing them to bid for contracts within the same product scope as the Group. Complete generating units are constructed by GE Power, Mitsubishi Hitachi Power Systems Europe, Doosan Power Systems, COVEC, CNEEC, SEC, Bilfinger Berger Power Systems, Amec Foster Wheeler, and CNIM, all of which have proprietary energy generation technologies, as well as organisational capacities necessary to pursue EPC contracts. These companies, as well as the Group, offer products necessary to construct complete generating units that can run on any kind of fuel.

On the Polish market, there are several companies, such as WARBUD, BUDIMEX and POLIMEX, which plan to enter the power construction industry by including EPC contracts into their offering or, at the very least, by offering assembly and construction services. Developing capabilities necessary to design and manufacture equipment for the power sector is complicated and requires considerable expenditures over long periods of time. In their competition with the Group, these companies rely solely on the technologies and products supplied by the Group's direct competitors, including GE Power, Mitsubishi Hitachi Power Systems Europe, Doosan Power Systems, Bilfinger Berger Power Systems, and CNIM.

With respect to specific products, such as steam generators, desulfurisation units, NOx reduction units and waste incineration facilities, the Group's major competitors again include GE Power, Mitsubishi Hitachi Power Systems Europe, Doosan Power Systems, Bilfinger Berger Power Systems, Amec Foster Wheeler, SES Tlmace, HZI, and CNIM, as well as Andritz, Valmet and Strabag.

The market is also seeing a number of Chinese companies, whose competitive edge consists primarily in lower prices and different − uncertain in the Group's opinion − technical specifications. The Group believes that customers on the Polish and European markets, including Turkey, perceive the offering of Chinese companies as unreliable, but the situation may well change if the Chinese competitors are able to maintain low prices while improving the technological quality of their products. Then those companies may become important players on the market of electricity generation technologies.

Furthermore, given the nature of large EPC contracts, it cannot be ruled out that the Group will partner with the above-mentioned companies for certain projects, especially those consisting in the supply of steam generators, their pressurised components or flue gas desulfurisation units.

3. Operational plans

The RAFAKO Group is prepared to face the challenges of the power market. The parent currently offers the widest selection of power technologies in Europe. In addition to all environmental protection facilities, which are constantly developed and upgraded, RAFAKO S.A. has capabilities necessary to construct power units for all parameters and fuel types. RAFAKO S.A. is one of Europe's four companies (the other being Alstom, Hitachi Power Europe and Doosan Babcock) offering the complete technology for the construction of supercritical power units.

In response to the shortage of new capacities, environmental requirements and insufficient energy resources, the Company's strategy meets the expectations of power sector clients by offering them high-efficiency power facilities and environmental protection systems.

In 2017, RAFAKO S.A. will continue to offer on the domestic and foreign markets:

- Complete thermal power stations, including:
  - supercritical power units,
  - municipal waste incineration facilities,
  - units with coal-fired and biomass-fired steam generators,
  - CCGT units;
- Deliveries of complete conventional 'technology islands', including:
  - subcritical steam generators and water boilers fired with various types of fuels: coal/gas/oil/biomass; stationary and circulating fluidised bed combustors, supercritical steam generators,
  - environmental solutions, including flue gas desulfurisation units (wet/semi-dry/dry technology), flue gas NOx reduction units and dust extraction equipment (electrostatic precipitators, bag filters), etc.;
- Comprehensive rehabilitation projects designed to improve efficiency and reduce emissions into the environment; complete power installations provided under EPC contracts;
- Manufacture of steam generator parts;
- Engineering and maintenance services, including diagnostics, modernisation and repair of steam generators and auxiliaries.

Given the need to comply with more exacting EU environmental standards, the RAFAKO Group should continue to increase its presence on the domestic market of environmental protection systems, where it currently offers technologies for the construction of complete flue gas desulfurisation units, industrial and municipal waste incineration systems and biomass-fired units, upgrading of boilers to reduce NOx emissions, as well as dust extraction equipment.

In 2017, the following factors and developments will have the greatest bearing on the Group's development and prospects:

- securing financial liquidity and obtaining access to new bank/insurance guarantees that will enable the Group to perform new contracts,
- making good progress on the construction of a 910 MW supercritical power generating unit at the Jaworzno Power Plant,
- performance of a large number of significant contracts in the Polish and European markets, including construction of modern steam generators, flue gas desulfurisation and NOx reduction units, municipal waste treatment and incineration systems, as well as pressurised parts of supercritical boilers,
- acquisition of new material contracts.

Capital expenditure planned for 2017 on property, plant and equipment will mainly be incurred on purchase of computer hardware, upgrade of buildings and structures, purchase or upgrade of plant and equipment, and purchase of vehicles. The most significant investment projects related to intangible assets will include purchase of a system for project budget planning, purchase of Microsoft licences, and

purchase of a system enabling real-time production monitoring. The investment projects will be financed primarily with the Group's own funds, but also using external sources (e.g. leases).

The parent's Management Board continues its efforts to win new contracts and believes that the key assumptions underlying its financial projections will materialise, ensuring the Group's liquidity in 2017.

4. Order book

As at December 31st 2016, the value of the Group's order book was in excess of PLN 4.0bn. The order book's largest item is the Jaworzno 910 MW Project – the amount outstanding under the contract is PLN 2.6bn, of which PLN 0.3bn is attributable to the parent and PLN 2.3bn to SPV Jaworzno. The order book does not include the Opole contract (the parent's outstanding share in the project, worth PLN 1.1bn, was subcontracted outside the RAFAKO Group). At present, the order book comprises only power construction projects.

ORDER BOOK	
Dec 31 2016	**Dec 31 2015**
~ PLN 4.0bn	**~ PLN 4.6bn**

	ORDER BOOK as at December 31st 2016	Due for execution in		
		2017	2018	after 2018
TOTAL	**~4.0bn**	**~1.8bn**	**~1.4bn**	**~0.9bn**
RAFAKO Group	**~1.7bn**	**~0.7bn**	**~0.6bn**	**~0.4bn**
SPV Jaworzno	**~2.3bn**	**~1.1bn**	**~0.75bn**	**~0.46bn**

As regards the value of the RAFAKO Group's order book, data presented in this document is based on the following assumptions:

a. the order book value is equal to the aggregate amount of the Group's remuneration under individual contracts executed by Group in the period to December 31st 2016; the figure does not take into account any planned contracts that have not yet been signed;
b. the order book value is disclosed as at December 31st 2016; actual revenue from contracts and performance periods depend on a number of factors, which may be outside the Group's control.

Key contracts for power generating units, boilers, power equipment, machinery and components

1) Construction of a 910 MW supercritical power generating unit at the Jaworzno Power Plant

On April 17th 2014, RAFAKO S.A., acting as the leader of a consortium with Mostostal Warszawa S.A., executed a contract with Tauron Wytwarzanie S.A. for the construction of a 910 MW supercritical power generation unit at the Jaworzno III Power Plant - Power Plant II. The value of the contract is PLN 4.5bn.

The consortium will construct the unit together with a complete set of key facilities, installations and external equipment required for its safe and proper operation. The unit will be fitted with a coal-fired supercritical pulverised-fuel once-through steam generator and a condensing steam turbine coupled with the power generator. The unit will be connected to a new 400 kV substation supplying electricity to the National Power Grid. The unit's gross capacity will be 910 MWe, with a net efficiency of 45.91% and design coal consumption of ca. 345 t/h at nominal capacity.

The unit will be a high-efficiency base-load electricity generation facility operating within the power system. It will be fitted with systems enabling compliance with the NOx, SO_2 and dust emission standards, i.e. an SCR unit, a desulfurisation unit and an electrostatic precipitator. The operating life of the unit will be at least 200 thousand hours or 30 years, and its output will increase the total capacities of the Polish electric utility sector by approximately 2.5%.

2) Construction of a biomass-fired co-generation unit in Vilnius

The contract provides for the construction of a biomass-fired co-generation unit consisting of boilers with fluidised beds, biomass storage and feeder systems, and a flue gas treatment system. The project will be executed as part of the process to construct a new CHP plant in Vilnius, Lithuania.

On September 29th 2016, a contract worth EUR 149,650 thousand was signed with JSC Vilniaus Kogeneracinė Jėgainė.

The project completion deadline is 28 months as of the date of the notice to proceed, which will be issued no later than nine months after the contract date. If the employer fails to issue the NTP within those nine months (condition), the contract will be null and void.

The award of this project is an important step towards one of the RAFAKO Group's strategic objectives, which is to increase Group-wide export revenues.

3) Execution of the first phase of the 'New CHP Plant at Grupa Azoty ZAK S.A.' project

On May 23rd 2014, RAFAKO S.A. and Grupa Azoty Zakłady Azotowe Kędzierzyn S.A executed a contract for approximately PLN 320m.

The contract provides for:

- construction and supply of equipment and services, as well as start-up of a boiler house with a coal-fired pulverised-fuel boiler, with a capacity of 140 Mg/h of steam with temperature of 495ºC and pressure of 7.5 MPa;
- construction and supply of equipment and services, as well as start-up of a 25 MWe pass-out and condensing turbine in the existing turbine house, to be fed inlet steam with temperature of 490ºC and pressure of 7.0 MPa;
- construction of a building (housing the central control room, DCS control system and social amenities), including equipment supply and start-up.

On October 20th 2016, the parent and Grupa Azoty Zakłady Azotowe Kędzierzyn S.A. signed an annex to the contract for execution of Phase 1 of the 'New CHP Plant at Grupa Azoty Zakłady Azotowe Kędzierzyn S.A.' project. Under the annex, the parties postponed the final deadline for completion of the contract to the end of Q1 2017. The annex also changed the aggregate limit of liquidated damages to 35%.

Key contracts for air pollution control systems

1) Installation of a catalytic flue gas NOx reduction unit at ENEA Wytwarzanie Sp. z o.o.

On September 30th 2016, the parent and ENEA Wytwarzanie Sp. z o.o. signed a contract for delivery and installation of a catalytic flue gas NOx reduction system for AP-1650 boilers No. 9 and 10 and for upgrade of the electrostatic precipitators at ENEA Wytwarzanie Sp. z o.o. for PLN 289,182.1 thousand.

The contract, to be executed on a turn-key basis, is divided into two tasks subject to separate acceptance procedures:

Task 1 – Preparation of a construction plan for the entire contract, construction of an SCR unit at boiler No. 9 with a DRiM II Station − entire scope, multidisciplinary approach (development of documentation, delivery, performance of construction, electrical, mechanical, and I&C works), replacement of flue gas ducts at the boiler outlet stub – LUVO 1÷3 inlet stub section, replacement of electrostatic precipitator with the ash removal system and the flue gas inlet and outlet ducts, replacement of flue gas fans, removal of REGAVO and auxiliary fans including the construction of new flue gas ducts in place of the removed REGAVO and auxiliary fans, and construction of protection system for flue gas ducts from the FGD I absorber outlet to stack No. 5.

Task 2 – Construction of an SCR unit at boiler No. 10 and connecting the unit to the DRiM II Station − entire scope, multidisciplinary approach (development of documentation, delivery, performance of construction, electrical, mechanical, and I&C works), replacement of flue gas ducts at the boiler outlet stub – LUVO 1÷3 inlet stub section, replacement of flue gas fans, and upgrade of electrostatic precipitator with flue gas ducts upstream and downstream of the electrostatic precipitator (adaptation to new pressures following the construction of the SCR unit).

The contract completion deadline is:

a) for Task 1 – May 18th 2018 (placing the SCR unit, DRiM II Station and EP 9 in service),

b) for Task 2 – August 25th 2018 (placing the SCR unit and upgraded EP 10 in service).

2) Construction of catalytic flue gas NOx reduction system at the Kozienice Power Plant

Since June 28th 2012, RAFAKO S.A. has carried out work at the Kozienice Power Plant under a contract executed with Enea Wytwarzanie S.A. for the turn-key delivery of complete, advanced catalytic (SCR) flue gas NOx reduction units. The total value of the contract is PLN 191m.

Thanks to the unit for OP-650 boilers, which is to be fitted on five biomass- and coal-fired 200 MW units (No. 4-8), the boilers will be able to operate in line with the environmental requirements.

3) SCR systems in Połaniec

On June 14th 2012, RAFAKO S.A. signed a contract for delivery of SCR Catalytic Flue Gas NOx Reduction Systems to the Połaniec Power Plant. The contract, providing for delivery of the systems for six units (No. 2−7), will be carried out in stages until 2017. The total value of the contract is PLN 240m. The contract also includes optional delivery of equipment with a value of PLN 26m.

4) Construction of a flue gas desulfurisation unit for boilers K7 and K8 at the Białystok CHP Plant

On October 23rd 2015, RAFAKO S.A. signed a PLN 78,500 thousand contract with ENEA Wytwarzanie Sp. z o.o. The contract provides for the construction of a flue gas desulfurisation unit for boilers K7 and K8 at the Białystok CHP Plant.

Management Board's statement

The Management Board of RAFAKO S.A., the parent of the RAFAKO Group, hereby represent that:

1) to the best of their knowledge, the consolidated financial statements for the year ended December 31st 2016, as well as comparative data for the year ended December 31st 2015, were drawn up in compliance with the applicable accounting standards and give a true, fair and clear view of the Group's assets, its financial condition and performance, and that the Directors' Report on the operations of the RAFAKO Group gives a true view of the Group's development, achievements and standing, including a description of key risks and threats;

2) the auditor of the full-year financial statements, being an entity qualified to audit financial statements, was appointed in compliance with the applicable laws, and the auditing firm and the auditors who conducted the audit satisfied the auditor independence criteria to deliver an unbiased and independent auditor's opinion on the audited full-year consolidated financial statements, in compliance with the applicable laws and professional standards.

Signatures of Management Board members

March 21st 2017	Agnieszka Wasilewska-Semail	President of the Management Board	.....
March 21st 2017	Krzysztof Burek	Vice President of the Management Board	.....
March 21st 2017	Jarosław Dusiło	Vice President of the Management Board	.....
March 21st 2017	Edward Kasprzak	Vice President of the Management Board	.....
March 21st 2017	Tomasz Tomczak	Vice President of the Management Board	.....