

# **Assessment of the situation of PROCHEM S.A. in 2022 including the assessment of the internal control system and the risk management system**

Assessment of PROCHEM S.A. for 2022 was made in three aspects:

- results of operating activities,
- situation of the Company,
- functioning of the internal control and risk management system.

## **I. ASSESSMENT OF THE COMPANY'S RESULTS FOR 2022**

The Company in the scope of its basic activity – sales of engineering and construction services – achieved PLN 149.3 million and this is the sales level more than 20% lower than in 2021. This drop in sales resulted primarily from the slowdown in implementation projects. At the same time, it should be noted that in the field of design activities, the sale of the company in 2022 increased significantly, by as much as 49%, compared to the previous year, reaching PLN 41.5 million.

The decrease in turnover, and above all, the sharp increase in the costs of investment projects, related to high inflation resulting from the war in Ukraine, caused in terms of operating activities the Company to close the year 2022 a loss of PLN 5.9 million.

The loss was incurred only on implementation services, design services were in 2022 definitely profitable business.

The final level of Prochem's net profit of approximately PLN 26.25 million was affected by a one-off event, namely the sale of the Astrum office building and the amount of high dividend due to this, which was paid to Prochem S.A.

The Prochem Capital Group also achieved lower sales and a lower result compared to 2022. Sales amounted to almost PLN 222 million, net profit PLN 526 thousand.

Summing up the results, it should be said that 2022 was a difficult year, which was caused by a number of mainly external conditions affecting the company's business situation. Nevertheless, thanks to the success of the development project prepared and carried out professionally, the final result of the Company is very good and guarantees

more than a stable financial situation of Prochem, even in the event of unfavourable market developments.

## **II. THE COMPANY'S SITUATION**

The Company's situation in 2022 was shaped by both macroeconomic factors and incidental factors.

In 2022, there was a high, despite unfavorable conditions, GDP growth of 4.9%, but it must be remembered that the GDP growth rate during the year was clearly declining, the best was the first quarter with an increase of 8.6%, while the last quarter was only 2.3% increase. The investment rate in 2022 was only 16.8% and it was the lowest level in many years.

From the point of view of Prochem's areas of activity, the structure of sources of GDP growth - an increase in inventories and high consumption did not have a positive impact in 2022.

A factor that began to materially reveal itself in 2021 and exploded in 2022 there was inflation. As a result of the war, its level in the area of goods, investment materials and energy was very high and reached several dozen percent. The new situation - the war in Ukraine not only contributed to a further increase in inflation, but also generated an increase in the short- and medium-term volatility of the prices of products and investment materials. The consequence of this situation was and still is the difficulty for both investors and companies undertaking investments in determining the budget of investment projects, assessing their effectiveness, as well as the actual costs of carrying out the investment.

We believe that this factor had the greatest impact on the Company's negative results in terms of basic activity in 2022. In the current year, and perhaps also in the following years, this factor will have a negative impact on investment decisions, and will encourage abandonment of development projects or their significant postponement.

Rising inflation caused a change in the policy of interest rates set by the NBP. Their significant growth in a short time triggered necessity to make a number of changes on the part of investors - first of all, to prepare a new calculation of financial costs of intended or implemented investment projects. We estimate that in the current year and in the following years the factor of rising credit costs, as well as high inflation, will have a negative impact

on the investment climate in Poland, and thus will worsen the market situation of companies such as Prochem.

The outbreak of war in Ukraine is another factor that affected the company's situation not only last year, but also this year, and perhaps in the years to come.

Negative consequences are obvious, in addition to the already mentioned - increase in raw material prices, high price volatility, limited supplies, there is a sense of uncertainty and risk associated with being a in neighborhood to war country, which will obviously negatively affect the level of involvement of investors, both Polish and perhaps even more foreign.

Another, also negative factor affecting the investment market is the uncertainty of obtaining EU funds, either from the KPO (National Reconstruction Plan) or from the basic budget of the European Union.

The lack of these funds or a clear postponement of the possibility of using them results in an even greater weakening of the investment market.

There is also a new factor associated with the risk of weakening Poland's ties with the European Union. For many investors, especially foreign ones, Poland is attractive, among other things, because it is in the European Union and has access to the huge market of developed countries. The emergence of doubts as to the long-term sustainability of Poland's participation in the EU may discourage foreign investors from locating investments in Poland, especially those with a long payback period.

The direction and dynamics of changes on the European market, including the Polish market, also bring certain opportunities favorable to the development of Prochem.

The need to gradually free ourselves from fossil energy resources will generate an increase in interest in various types of projects generating clean energy from unconventional sources, free from political blackmail of suppliers.

Large projects in the field of nuclear energy are also awaiting implementation.

The end of the war in Ukraine may also generate new contracts related to the reconstruction of its economy after war damage.

What should be noted is the different time horizon of the impact of factors that favor and hinder Prochem's development opportunities.

In the short period of the current and next year, unfortunately, negative factors predominate:

- high inflation,
- high cost of investment money,
- ongoing war,
- inhibition in obtaining EU funds.

This means that the supply of new investment projects will be clearly smaller, and therefore the competition in obtaining them will increase, which will weaken the ability to optimally fill the portfolio of companies from the engineering and construction industry.

In the long-term horizon, there are chances of weakening the impact of the above-mentioned negative factors and the emergence of the already mentioned pro-growth factors.

Despite the dominance of negative factors shaping the market this year, Prochem's business situation in 2023 should be assessed as satisfactory. Already acquired long-term contracts, with simultaneous marketing activity maintained at a high level, should allow the Company to achieve satisfactory results.

The awareness of Prochem's strong dependence on the changing investment situation prompted the company's management to look for activities that would stabilize the company's position also in less favorable periods.

Undertaking projects that cushion difficulties in periods of economic downturn has become a permanent element of the company's strategy.

This function, in relation to the basic activity, was fulfilled by sporadic, though with some regularity, development activity. Recently, the large office project Astrum Business Park, implemented with a financial partner, has found its market confirmation in the effective leasing of nearly 100% of office space to reputable tenants. After this commercialization, the sale of the facility was completed last year and the cycle of development activity was closed.

Obtaining significant financial resources creates a relatively comfortable liquidity situation and guarantees either surviving crisis situations or, if it is not necessary, increases the company's development opportunities.

### **III. ASSESSMENT OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM**

The scope of the control covers primarily:

- business activity of the company - basic and auxiliary,
- financial reporting and accounting settlements,
- compliance of the company's operations with applicable laws and internal regulations,
- employment and wages.

Specificity of PROCHEM S.A. activity is related to the implementation of complex investment projects for clients.

The company has and uses systems for planning and controlling the projects being implemented. After the not-so-good experience from previous years regarding the operation of the control system, the Management Board took corrective measures in 2017. In the same year, the "Service cost control" instruction was changed and a new manager of the "Cost Control Team" was appointed, responsible for the implementation of modifications and improved procedures. The year 2018 was the second year in which the system operated according to the new rules. In 2018, further modifications were made to the "Service cost control" system with regard to the presentation of budgets and they have been applied to new topics since January 1, 2019.

The main task of institutional control is to carry out comprehensive control in the scope of the most important issues for the company and to collect and elaborate information on the activities of the organizational units of the company, selected economic issues and other issues being recognized by the Company's Management Board as the most essential in the given period. Apart from the institutional internal control, there is also the so-called functional control in the Company, which is exercised by managers at various ranks. These managers exercise supervision over the employees subordinate to them, consisting in checking the status of the implementation of the tasks set.

Control activities are carried out in all phases of activity in the form of the preliminary control, current and next. Financial and accounting documents are subject to substantive, formal and accounting control. Information on the formal and substantive and accounting correctness bears a signature made in an identifiable manner (full name and surname),

or bears the personal stamp of the authorized person and the date of approval of the document.

In PROCHEM S.A. there is no separate, organizationally separated risk management structure. Risk areas are identified and assessed by the Company's services appropriate for a given type of risk. They are also responsible for defining the actions necessary to mitigate the risk.

Supervision as well as key decisions regarding the scale of risk exposure are made by the Company's Management Board. Risk analysis has at PROCHEM S.A. has systemic character, included in various types of procedures regarding individual risks.

In 2017 the risk management system was reviewed and improved during the execution of contracts under the „Integrated management system” process through the „Risk and opportunity management” sub-process. This procedure is based on the requirements of the international ISO-31000 standard. The procedure is obligatory in all organizational units of Prochem S.A. involved in preparing the offer and in executing of projects.

Last year, the Supervisory Board got acquainted with and analyzed, as part of the annual assessment, the current information on the internal control, risk management and internal audit systems functioning in the company.

The Supervisory Board analyzed and controlled the compliance of the company's internal regulations, including standards and practices, also regarding internal audit, with the Company's operations.

The following risks have been identified in the activities of Prochem:

### **1. The risk of economic fluctuations**

The company is highly susceptible to fluctuations in the construction industry and is strongly dependent on the demand for engineering services, which is cyclical and also subject to occasional events.

In order to limit the impact of this risk on the results and situation of the Company:

- the macroeconomic situation and the situation in selected industries are monitored

- objective diversification is continued (executive activity, activities in the field of technical consulting, developers activity),
- the level of financial reserves is being optimized.

## **2. The risk of loss of key employees**

The Company's activity is based on a well-educated and qualified staff of employees who are also an attractive target for recruitment by competitors.

In order to mitigate this risk, in Company the following are applied:

- monitoring of the labor market and of the level of remuneration,
- maintaining of the system of training and raising of qualifications
- incentive programs for the key employees
- active recruitment system through cooperation with universities

## **3. The risk of threats occurrence during the execution of contracts**

Types of activities conducted at PROCHEM S.A. - preparation and management of investment projects for clients - make this a constant risk, which has recently become particularly important due to high inflation.

In order to mitigate this risk, in PROCHEM S.A. the following are applied:

- form of contract performance adequate to the type of project and the scale of the risk,
- realistic price calculation when concluding contracts, taking into account the inflation forecast
- monitoring the progress in execution of contracts and disclosure of threats,
- selection of reliable subcontractors,
- contract clauses restricting the maximum amount of contractual penalties.

The application of these systemic instruments allowed to avoid or mitigate financial consequences when executing contracts concluded under the crisis conditions, including those under conditions of strong price competition.

#### **4. The risk of payment unreliability**

Instruments, that mitigate this constantly occurring type of risk are:

- monitoring of the financial standing of clients before and during the execution of contracts,
- use of specialized recovery procedures
- optimization of payment structures.

#### **5. The foreign currency risk**

The instruments that mitigate this type of risk are:

- monitoring and forecasting of currency exchange rates,
- forward type currency transactions,
- purchase of equipment and services in the currency the contracts

#### **6. The risk of dependence on significant buyers of services**

The instruments that mitigate this type of risk are:

- monitoring of contracts with the significant suppliers,
- contractual provisions containing the cushioning elements,
- maintaining of the partnership relations with repeat customers.

### **SUMMARY**

Both in terms of the control system, ensuring compliance of the Company's operations with the regulations applicable in the company, and in the area of risk



management, systemic and personal changes made in previous years increased the level of security in the Company's operations and reduced the risk of not noticing a significant threat in the basic activity of the company.

Signatures of the Members of the Supervisory Board:

1. Marek Garliński

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2. Karol Żbikowski

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3. Andrzej Karczykowski

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4. Wiesław Kiepiel

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5. Jarosław Stępniewski

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