

Evaluation of the situation of PROCHEM S.A. in 2017
including the assessment of the internal control system
and risk management system

Evaluation of the Company PROCHEM S.A. in 2017 was made in three aspects:

- results of operations,
- the Company's situation,
- functioning of the internal control and risk management system.

I. ASSESSMENT OF THE COMPANY'S RESULTS FOR 2017

The company in the scope of basic activity - sales of engineering and construction services - reached the level of PLN 49.2 million and this is the level of sales, one of the lowest in recent years. In comparison to the previous year, revenues were lower by PLN 60.5 million. Such a strong drop resulted from the ending of large contracts and the parallel unfavourable macroeconomic situation that lasted for the majority of 2017, manifesting itself, among others, in low level of investments of the enterprises.

Such a strong weakening in the level of sales despite measures aimed at reducing costs caused that in the field of basic activity the year of 2017 ended with a loss of PLN 3.7 million.

Despite the unfavourable result on basic activity, the final result of PROCHEM S.A. in 2017 was very good and amounted to PLN 12.7 million. This result was determined by a one-off event - a positive settling of a long-standing court dispute with PERN S.A.

The final assessment of the result achieved by PROCHEM S.A. for 2017 therefore is not unambiguous. On the one hand an unsatisfactory result on basic activity to a large extent resulting from the market situation and strong reactivity of engineering companies to adverse market condition, on the other a very good final result resulting from the won process, and such a winning is the kind of capitalized effect of the earlier professional activity of the company. Therefore, it can be concluded that the overall assessment of the company's results is positive and satisfactory for the shareholders.

Results of the PROCHEM SA Capital Group it is nearly 17 million net profit. The main source of this result, of course, apart from PROCHEM S.A., are the results of the

Irydion real estate development company responsible for the implementation of ASTRUM project. Other companies from the Capital Group in majority also had a positive impact on the final result.

II. COMPANY'S SITUATION

The macroeconomic situation in 2017, despite relatively high GDP growth (4.6%), was not favourable to engineering activity being the basic activity of PROCHEM S.A. The low level of investment was maintained for the majority of the year, it was only in the fourth quarter that we had to witness a rapid increase and as a result, the year ended with over 5% increase in investment. However, it did not affect the engineering activity of PROCHEM in 2017.

At the low turnover we had last year and after distortion of the liquidity in 2016 related to the settlement of the contract in Belarus, active measures were taken to reduce the company's current costs. They are mainly related to labour costs. However, the economizing in this area are limited by the need to maintain the basic engineering potential. Excessive reduction would result in a loss of competitive advantage which is ability to comprehensive performance of more complex projects. Such situation occurred in 2017, where the scale of sales reduction could not be balanced with the same reduction of costs.

The increase in investments in the last quarter of 2017, the continuing good level of these investments in the first months of 2018 should strengthen the engineering services market in the current year. In the first months of this year the Company recorded increase in number of inquiries and also an increase in signed contracts for the provision of services, in particular in the scope of design and engineering services.

The ASTRUM development project carried out jointly with the financial partner is a project having a significant impact on the Company. The size of the project - about 22 thousand m², a significant scale of own resources already involved, credit funds launched, but also a competitive situation on the office space market in Warsaw create a necessity for close supervision over the undertaking and ongoing evaluation of risks, which are related to its implementation, including primarily regarding the acquisition of reliable tenants. The year 2017 brought a significant revival in terms of

tenants' interest in the project. The company has changed the intermediary company in the search for tenants and signed a contract with a renowned agency Cushman & Wakefield. The council monitors on the ongoing basis the condition of the building's lease as well as the interest of potential tenants. The current situation indicates very good chances for successful commercialization of the building by the end of 2018.

III. EVALUATION OF THE INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT

The scope of control covers primarily:

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

In the company exist and are in use the planning and control systems of the undertakings executed. These systems do not operate in real time and the signals flowing from them are analysed with delay.

After negative experiences with the Belarusian contract regarding the operation of the control system, the Management Board undertook corrective actions. The "Service cost control" manual has been changed and a new manager of the "Cost control team" has been appointed responsible for the implementation of modifications and streamlined procedures. The year 2017 was the first year in which the system worked according to new rules.

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 working out of information on the activities of the organizational units of the company, selected economic issues and other issues that have been recognized by the Company's Management Board in the given period as are being the most essential. 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. Such managers perform the supervision over the employees subject to them, such control consists in the checking of the state of accomplishment of set tasks.

Checks 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 formal and substantive correctness and calculation correctness bears a signature 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.

There is no separate, organizationally separated risk management structure in PROCHEM S.A. Identification and assessment of risk areas are done by the respective services of the Company appropriate for relevant risk type. Their responsibilities also include to define the actions needed to reduce the risk.

Supervision, but also key decisions on the scale of risk exposures are taken by the Management Board of the Company. The risk analysis in PROCHEM S.A. has systemic nature, and is covered by various types of procedures, which are concerning the particular risk. In the opinion of the Supervisory Board, consideration should be given to appointment (merging) of the unit within the frame of organizational structure of the entity which will be responsible for this neuralgic area in the Company.

Negative experience with the Belarusian contract has led to the sealing and improvement of risk control. 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 process is based on the requirements of the international ISO-31000 standard. The procedure is valid in all organizational units of PROCHEM S.A. involved in preparing the offer and in executing of projects.

The following risks were identified in PROCHEM's activities:

1. The risk of economic fluctuations

The company is highly susceptible to fluctuations in the construction market and it strongly depends on the demand for engineering services, such demand is cyclical.

In order to reduce the impact of that risk on the Company's results and situation:

- is carried out monitoring of the macroeconomic situation and the situation in selected industries,

- the diversification of activities is continued (execution activity, developer's activity and the maintenance),
- the geographical diversification is being launched (through expanding of exports),
- 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, who are also an attractive recruitment target for the competitors.

In order to limit such a risk, the Company applies:

- monitoring of the labour market and monitoring of level of remuneration
- maintaining a 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 in PROCHEM S.A. - preparation and management of investment projects for clients - cause that it is a constantly occurring risk.

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

- realistic price calculation at the concluding of contracts,
- monitoring of the progress in the implementation of contracts and in the 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 financial consequences when executing contracts concluded under the crisis conditions, including under conditions of strong price competition.

4. The risk of payment unreliability

The instruments limiting this constantly occurring type of risk are:

- monitoring of the financial standing of clients before and during the execution of contracts,

- the use of specialized recovery procedures,
- optimization of payment structures.

5. The foreign currency risk

The instruments limiting this type of risk are:

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

6. The risk of dependence on significant buyers of services

The instruments limiting this type of risk are:

- monitoring of contracts with the significant suppliers
- contractual provisions containing the cushioning elements
- maintenance of the partner relations with recurring customers.

SUMMARY

Both in the scope of the control system and risk management, systemic and personnel changes have increased the level of security in the Company's functioning and reduced the risk of not being able to notice a significant threat in the area of the company's basic activity.

Signatures of the Members of the Supervisory Board:

1. Marek Garliński _____

2. Karol Żbikowski _____

3. Andrzej Karczykowski _____

4. Krzysztof Obłój _____

5. Marcin Pędziński _____