

Evaluation of the situation of the Company PROCHEM S.A. in 2018 including the assessment of the internal control system and risk management system

The Company PROCHEM S.A. evaluation for 2018 was made in three aspects:

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

I. ASSESSMENT OF THE COMPANY'S RESULTS FOR 2018

The company in the scope of its basic activity - sales of engineering and construction services - reached PLN 96.9 million and this means level of sales more than double as in 2017. However, it should be noted that 2017 was one of the weakest in recent years in terms of sales volume. Progress in sales had also an impact on the improving, however not yet fully satisfying, of the result on basic activity. Due to a one-off event that took place in 2017 (ending the process against PERN), the most adequate will be a comparison of the result on sales. In the year 2017 it was a loss of PLN 3 682 thousand, in 2018 it was a profit of PLN 5 935 thousand.

At the level of net profit, the year 2018 ended with a profit of PLN 1 089 thousand.

The most important is the observed during the year improvement of the result in the subsequent quarters, which allows us to assess the current year and the nearest future optimistically. The Prochem Capital Group also achieved higher sales and higher result. Sales amounted to over PLN 153 million, net profit PLN 1 839 thousand.

Results of 2018 should be considered to some extent as positive, at the current trend and dynamics indicating the chances of growth in the current, and perhaps also in the following year.

II. COMPANY'S SITUATION

Two groups of factors influence the situation of the PROCHEM company in the scope of its basic activity.

The first one has its source in the overall macroeconomic situation, and in particular is related to the level of investment in the economy, including in particular the level of enterprises' investments. In this regard, there has been progress in 2018, although one cannot talk about a breakthrough or an accelerated increase in investment activity.

The second group of factors important for the company's results is investment activity of companies from industries in which PROCHEM has a strong position (chemistry, petrochemistry, industrial building, power industry), and in particular investment activity of recurring customers.

This is confirmed by the situation in 2018, where the important ordering party with a large share in the portfolio of orders both in last year and in the current year is Bioagra - a company with which PROCHEM has been cooperating for many years. For this client, comprehensive services are provided at several specialist, technological projects for the expansion of the company with a total value exceeding PLN 200 million.

Due to the strong dependence on the investment climate, PROCHEM, to strengthen and stabilize its position, additionally undertook and undertakes activities that go beyond the standard understanding of engineering services, in particular investment projects that to a large extent use the professional competences of the employees of the company.

The first group includes the activity of technical consulting, a service being developed in the last two years. PROCHEM joins in technological topics at the first stage, when the investor focuses on the recognition and initial assessment of the technical and economic reasonability of the project. Own technological competences of PROCHEM and scientific institutes cooperating with PROCHEM allow for providing technical consultancy services for clients. Starting of cooperation at this early stage allows to build a company's competency position and create a strong basis for further cooperation.

The second group includes developer's activity carried out sporadically, although with a certain regularity, and which is aimed at obtaining significant financial surpluses which perform cushioning functions in relation to the base activity. In this respect, the year 2018 was important. Astrum Business Park's large office project, implemented

with a financial partner, has found its market confirmation in the effective leasing of over 90% of office space to renowned tenants. In 2019 are foreseen the transaction of sale of the facility and completion of the developer's cycle.

Thus 2019 both in the basic engineering activity, supplemented with technical consulting services and in the area of developer's activity, is promising and should allow to achieve much better results than in 2018.

III. EVALUATION OF THE INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT

The scope of control covers mainly:

- 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.

Specificity of the activity of PROCHEM S.A. is associated with the implementation of complex investment projects for clients.

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 the poor experiences of previous years regarding the operation of the control system, the Management Board undertook corrective actions in 2017. In the same year, the "Service costs control" manual was changed and a new manager of the "Cost control team" was appointed responsible for the implementation both of modifications and of streamlined procedures. The year 2018 was the second in which the system operated according to new rules. In 2018. further modifications were made to the "Service cost control" system in the area of budget presentation and they are applied to new topics from 1/01/2019.

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 elaboration 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 the managers perform the supervision over the employees subject to them, consisting in the checking of the status 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.

In PROCHEM S.A. no exists distinct, organizationally separated risk management structure. 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 limit 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 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 process 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.

In the current year, the Supervisory Board has acquainted and reviewed and analysed, as part of the annual assessment, information on internal control systems, risk management and internal audit which are functioning in the company.

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, technical consulting activities, developer's 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, 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 constantly occurring 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 constantly occurring 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, introduced 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.

Chairman of the Supervisory Board Marek Garliński
