

Evaluation of the situation of the Company PROCHEM S.A. in 2019 including the assessment of the internal control system and risk management system

The Company PROCHEM S.A. evaluation for 2019 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 2019

The Company in the scope of its basic activity – sales of engineering and construction services – reached PLN 270,1 million and this is the level of sales almost three times higher than in 2018. The progress in sales also significantly improved the result on basic activities, what should be assessed very positively.

At the net profit level, the year 2019 ended with a profit of PLN 3,698 thousand, i. e. over three times higher than in the previous year.

What is the most important is the improvement of the result in the following quarters of 2019, as observed during the year. Also, the Prochem Capital Group achieved significantly higher sales and a higher result compared to 2018. Sales amounted to over PLN 323 million, net profit PLN 8 043 thousand.

So, the results of 2019. should be considered good, and the current trend and dynamics indicated the possibility of further growth in the current year, but the sudden development of the COVID-19 epidemic may not allow for the improvement of the Company's results in 2020 - today it is difficult to predict the consequences for the economy as well as for companies will bring an ongoing pandemic.

II. COMPANY'S SITUATION

Two groups of factors influence the situation of PROCHEM, 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 some progress in 2018, although we cannot talk about a breakthrough or an accelerated increase in investment activity.

The second group of factors important for the company' 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 from 2018 - 2019, where Bioagra, a company with which PROCHEM has been cooperating for many years, was an important ordering party with a very large share in the portfolio of orders last year. For this client, comprehensive services are provided on several specialized, technological projects for the expansion of the company with a total value exceeding PLN 200 million. In the current year, the main topics are contracts implemented for companies Bioagra SA. and Anwil SA.

Due to the strong dependence on the investment situation, PROCHEM, in order to strengthen and stabilize its position, additionally undertook and undertakes activities that go beyond the standard understanding of engineering services, including primarily investment projects using to a large extent the professional competences of the company's employees.

The first group includes the activity of technical consulting, a service developed in the last two years. PROCHEM joins the technological topics at their first stage, where the investor focuses on the recognition and preliminary assessment of the technical and economic feasibility of the project. Proprietary technological competencies of PROCHEM and scientific institutes cooperating with PROCHEM allow for the provision of technical advisory services for clients. Commencing cooperation at this early stage allows to build the company's competency position and create a strong foundation for further cooperation.

The second group, aimed at obtaining significant financial surpluses, fulfilling cushioning functions in relation to the basic activity, is carried out sporadically, though with some regularity, developer activity. A large office project Astrum Business Park, implemented with a financial partner, has been confirmed by the market in the effective lease of over 90% of office space to renowned tenants. In

2019 it was possible to sell the facility and close the development cycle. Due to market conditions, it was not possible to achieve such a transaction, but efforts in this regard will be continued this year.

So, in 2020 it looked promising both in basic engineering activities, supplemented with technical consulting services and in the area of development activity.

The company also expected to achieve good results this year.

The outbreak of the epidemic complicated the situation, both on the side of the Company's activity (remote work) and on the side of clients, some of whom are considering making a decision to postpone investment projects in time.

The scale of the pandemic's impact on the economy is difficult to predict. One thing is beyond doubt that it will be a negative impact, in the form of a slowdown, and most likely a recession. The high level of uncertainty and ambiguity in forecasts will rather induce companies to inhibit investment activity, postpone the decision to start an investment, or slow down the implementation of already started projects.

It will obviously have an impact on the weakening of the activity of the company Prochem, partly this year, but also next year.

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 comprehensive investment undertakings 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 analyzed 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 cost 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 has 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 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. Such the managers perform the supervision over the employees subject to them, consisting in the checking of the status of accomplishment of tasks set.

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. They are also responsible for defining the actions needed to mitigate the risks.

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 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.

In the current year the Supervisory Board has acquainted, reviewed and analyzed , as part of the annual assessment, actual 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 has cyclical nature.

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, technical consulting, 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 mitigate this risk, in Company the following are applied:

- monitoring of the labor market and 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 activity conducted in PROCHEM S.A. – preparation and management of investment projects for clients – cause that it is a constantly occurring risk.

In order to mitigate this risk PROCHEM S.A. applies:

- realistic price calculation at the concluding of contracts,
- 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 financial consequences when executing contracts concluded under the crisis conditions, including those under conditions of strong price competition.

4. The risk of payment unreliability

The instruments that mitigate 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 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 of 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
- 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.

Signatures of the Members of the Supervisory Board:

1. Marek Garliński _____

2. Karol Żbikowski _____

3. Andrzej Karczykowski _____

4. Krzysztof Oblój _____

5. Marcin Pędziński _____