

MANAGEMENT BOARD REPORT
ON THE ACTIVITIES OF THE PROCHEM S.A.
CAPITAL GROUP IN THE FIRST HALF OF 2018

Warsaw, 31 August 2018

1. Principles of presentation of financial statements

Principles of preparation of the consolidated financial statements of the Prochem S.A. Capital Group for the first half of 2018 have been included in Explanatory notes to the financial statements.

2. Concise description of significant achievements or failures of the Issuer in the period covered by the report together with the list of the most important events related to the Issuer

In the first half of 2018 the Prochem S.A. Capital Group achieved revenues from basic activities in the amount of PLN 50.3 million. They are over 3 million lower than those achieved in the first half of 2017. Thanks to recently signed new contracts, the drop in revenue that has been recorded since more than a year has been stopped in the second quarter of 2018 and their systematic growth is planned in the subsequent periods. A similar reversal of the trend should also take place in the profitability of the basic activity of both the Issuer and the companies from the Capital Group.

3. Indicating of factors and events, including of untypical nature, having a significant impact on the condensed financial statements

As a result of the settlement, on 21 March 2018, of the transaction of purchase of own shares, the Company acquired a total of 960,000 (say: nine hundred sixty thousand) of own shares with a nominal value of PLN 1.00 each, which together constitute 24.65% of the share capital of the Company. These shares are equal to 960,000 votes at the Company's General Meeting, which constitutes 24.64% of votes at the General Meeting of the Company. The purchase price was PLN 25.00 (say: twenty five Zlotys) per share. The shares were purchased within the framework of being announced by the Company on February 28, 2018 (current report No. 14/2018 of 28 February 2018) the offer to purchase no more than 960,000 shares of the Company with a nominal value of PLN 1.00. The offer was announced on the basis of Resolution No. 4 of the Extraordinary General Meeting of the Company of January 26, 2018 regarding the consent to the acquisition by PROCHEM SA. of own shares for redemption and granting authorization to purchase own shares of PROCHEM S.A. Acquisition of shares took place outside the regulated market, through intermediary of mBank S.A. with headquarters in Warsaw - Dom Maklerski

mBanku. The shares were purchased with the aim of their redemption, what will be registered in September 2018.

4. Description of significant risk factors and threats to the activities of the Issuer's Capital Group

The companies from the Capital Group of Prochem S.A. in their activities are exposed to the following types of risk and threats:

Economic fluctuations on the investment market

Part of the companies included in the Capital Group provide services on the investment market, characterized by a large scale of fluctuations in demand that is strongly linked with the overall macroeconomic situation of the country. Methods used by the Group to restrict the negative impact of this factor on financial results (accumulation of financial reserves, diversification of services rendered) may not fully neutralize this risk.

Possibility of threat occurrence at the execution of contracts

Types of activity conducted by the companies from the Capital Group of PROCHEM S.A. in particular, the preparation and management of technically complex investment projects, that are often implemented on the basis of contracts concluded under conditions of strong price competition, cause that occurs a permanent risk of technical and financial problems.

Dependence on the staff

The risk of dependence on staff in particular occurs in the Parent Company. Raising the quality of services provided, undertaking the implementation of complicated technological projects, the use of modern information systems, and the work for the renowned clients require from workers the highest professional qualifications. Acquiring of such persons, especially in the situation of the liberalization of the European labour market can be difficult. The company is trying to minimize this threat by raising qualifications of the employed staff and using incentive programs binding employees with the company.

Exchange rate risk

Part of contracts for the sale of services is concluded with foreign companies in foreign currencies (EURO, USD). In the event of a significant strengthening of the exchange rate of the domestic currency, it may have a negative effect on the Group's results. This risk is partially mitigated in a natural way i.e. through the purchase of equipment and services necessary for the execution of these contracts abroad.

Risk of becoming dependent on significant buyers of services

The implementation of the contracts of the significant value by the companies from the Group requires significant expenditure to purchase services and equipment that are then sold to the customer in the form of a finished object. Lack of appropriate correlation between expenses that are being incurred and inflows from the execution of the contract with the customer may result in the need for companies to use external financing, and in particular circumstances even may cause temporary loss of financial liquidity. Such a risk is to a large extent is secured by appropriate provisions in the contract with the client, by virtue of which the client is obliged to successively return the expenses incurred during the execution of the order.

5. Description of the organization of the capital group, with the indication of entities subject to consolidation

The Capital Group of Prochem S.A. (referred to as the "Capital Group", "Group"), in addition to data of the Parent Entity, includes the following subsidiaries directly and indirectly:

Subsidiaries covered by full consolidation:

- Prochem Inwestycje Sp. z o. o. seated in Warsaw – subsidiary directly (100.0%);
- PRO-INHUT Sp. z o. o. seated in Dąbrowa Górnicza – subsidiary indirectly (93.2%);
- Przedsiębiorstwo Konsultingowo-Inżynieryjne PREDOM Sp. z o. o. seated in Wrocław – subsidiary indirectly (80.7% of share in capital and profit, 71.1% of votes);
- Prochem Zachód Sp. z o. o. seated in Słubice – subsidiary indirectly (80.0%);
- ELPRO Sp. z o. o. seated in Krakow – subsidiary indirectly (92.7%, including 85.4% share in the 50% share of Elektromontaż Kraków);

- Elmont Inwestycje Sp. z o. o. seated in Krakow – subsidiary indirectly (92.7%, including 85.4% share in the 50% share of Elektromontaż Kraków);
 - Elektromontaż Kraków S.A. seated in Krakow – subsidiary indirectly (85.4%), including 73.0% share in capital and voting rights belongs to company Prochem Inwestycje subsidiary in 100%. Company Elektromontaż Kraków S.A. prepares consolidated financial statements, which includes data of subsidiary in 100%: ELMONT-POMIARY Sp. z o. o. seated in Krakow and two associated companies ELPRO Sp. z o. o. and Elmont-Inwestycje Sp. z o. o.;
 - IRYD Sp. z o. o. seated in Warsaw – subsidiary indirectly in 100%;
 - ATUTOR Integracja Cyfrowa Sp. z o. o. seated in Warsaw – subsidiary indirectly (87.3% of share holds company Prochem Inwestycje Sp. z o. o. subsidiary in 100%);
Prochem RPI Sp. z o. o. seated in Warsaw – subsidiary directly and indirectly in 100%;
- Associated entities and jointly-controlled entities consolidated with the equity method:
- IRYDION Sp. z o. o. seated in Warsaw – 50.0% of share in the voting rights and share capital,
 - ITEL Sp. z o. o. seated in Gdynia – 42.0% of share (18.7% of share in voting rights and capitals belong directly to Prochem S.A. and 23.3% holds Prochem RPI Sp. z o. o. subsidiary (in 100%).

The principle adopted in the consolidation consists in that entities not conducting activity are not included into consolidation - the financial data of these companies do not distort information on the financial results the Group of Prochem S.A.

Companies not covered by consolidation:

- Predom Projektowanie Sp. z o. o. seated in Wrocław – subsidiary

Subsidiaries, associated entities and jointly-controlled entities have been included in the consolidated financial statements from the date of including the control by the parent company.

6. Indication of the effects of changes in the structure of the capital group, including as a result of mergers, take over or sales of entities from the issuer's capital group, long-term investments, division, restructuring and discontinuing operations

There were no changes in the structure of the Capital Group in the first half of 2018.

7. Position of the Management Board regarding the possibility of meeting previously published forecasts of results for a given year in the light of the results presented in the interim report in relation to the forecasted results

Company Prochem S. A. did not publish any forecasts of financial results neither for the company nor for the Prochem S.A. capital group for 2018.

8. Indication of shareholders having directly or indirectly through subsidiaries, at least 5% of the total number of votes at the General Meeting of the Issuer at the date of the quarterly report, including the number of shares owned by those entities, their percentage of the share capital, the number of votes resulted from them and their percentage share in the total number of votes at the general meeting, and changes in the ownership of large blocks of shares of the Issuer since the publication of previous report

In accordance with the information in the possession of the Company as at the date of this report, the following shareholders hold at least 5% of votes at the general meeting of shareholders:

Item No.	DESCRIPTION	NUMBER OF SHARES HELD (IN PCS)	NUMBER OF VOTES HELD	% OF VOTES IN TOTAL NUMBER OF VOTES	% OF SHARE IN SHARE CAPITAL
1	Steven Tappan	900,000	900,000	23.10	23.10
2	ESALIENS TFI S.A.	354,525	354,525	9.10	9.10
3	Otwarty Fundusz Emerytalny PZU S.A. „Złota Jesień“	387,521	387,521	9.95	9.95

4	Andrzej Karczykowski	201,882	201,882	5.18	5.18
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On June 22, 2018, received from the shareholder Mr. Steven Tappan a notice of a change in the share held so far as a result of the purchase of 176 226 shares of the company Prochem S.A. entitling to 176 226 votes at the General Meeting. Before the change Mr. Steven Tappan held a total of 723 774 shares of Prochem S.A., which constituted 18.58% of the share capital and entitled to 723 774 votes, constituting 18.58% of the total number of votes at the General Meeting of the Company. After the change Mr. Steven Tappan holds a total of 900 000 shares of Prochem S.A., which constitute 23.11% of the share capital and entitle to 900 000 votes constituting 23.10% of total number of votes at the Company's General Meeting.

The company Prochem S.A. holds 960,000 own shares purchased within an offer to purchase own shares for the purpose of redeeming no more than 960,000 shares of the Company with a nominal value of PLN 1 each which was announced under the Resolution No. 4 of the Extraordinary Meeting of January 26, 2018 by the Company on February 28, 2018. The transaction of purchase of own shares for redemption was settled on March 21, 2018. These shares constitute 24.65% of the share capital of the Company and correspond to 960,000 votes at the General Meeting of the Company, which constitutes 24.64% of votes at the General Meeting. As a result of their redemption, there will be changes in the proportions of shares held by the existing shareholders.

9. Statement of changes in the shareholding of the issuer's shares or rights to them (options) by the Management Board and the Supervisory Board, in accordance with the knowledge of the issuer, in the period since submission of the previous report

As at the date of publication of this report, the following members of the Management Board and of the Supervisory Board held shares of PROCHEM SA:

- Jarosław Stępniewski – 68,383 pcs
- Marek Kiersznicki – 59,474 pcs
- Krzysztof Marczak – 36,908 pcs
- Andrzej Karczykowski – 201,882 pcs
- Marek Garliński – 73,996 pcs.

In the period since the publication of the annual report for 2017 there was no change in the shareholding of the issuer's shares by members of the Management Board and the Supervisory Board.

10. Information on proceedings pending before the court, competent authority for arbitration proceedings or for public administration body, including information on:

- a) proceedings relating to liabilities or receivables of the issuer or of its subsidiary, which value is at least 10% of the equity of the issuer, with the specification of: the subject of the case, the amount in dispute, date of initiation of proceedings, the parties to the proceedings and the position of the issuer,
- b) of two or more proceedings relating to liabilities and receivables with a total value, respectively of at least 10% of the equity of the Issuer, with determining total value of proceedings separately in the group of liabilities and in the group of receivables, with the position of the issuer in this case, and in relation to the most significant proceedings in the group of liabilities and in the group of receivables – with an indication of their subject, the amount in dispute, date of initiation of proceedings, as well as parties participating in the such proceeding.

PROCHEM S.A. was a party to the proceedings before the court concerning the settlement of the contract in the formula of a Management Contracting (GRI) for an investment project under the name "Pipeline in a section from the ST-1 Adamowo - to raw material base Plebanka" which was concluded with PERN S.A. and interrupted on 10 November 2005. PROCHEM S.A. filed a lawsuit to the court for payment of PLN 41, 301 thousand under the final settlement of the contract. PERN S.A. filed a counter-claim from the cross action against the Company for the payment of PLN 129,444 thousand as the settlement of the contract.

On 22 October 2015 the District Court in Warsaw, XXVI Commercial Division announced judgment in the above matter, in which:

- from a principal action, has adjudged from PERN jointly and severally for the benefit of the Issuer and a member of the consortium:
 - ✓ amount of PLN 35 086 589.26 with statutory interest from 23 March 2006 until the date of payment;

- ✓ amount of PLN 4 879 883.58 with statutory interest from 22 March 2006 until the date of payment;
- ✓ amount of PLN 126 400.44 with statutory interest from 16 January 2007 until the date of payment.
- from the cross action, dismissed the action of PERN in its entirety.

PERN S.A. lodged an appeal from the above judgment, on October 30, 2017 the appeal was dismissed by the Court of Appeal in Warsaw. Due to the dismissal of the appeal, the verdict of 22 October 2015 became final and the cash adjudged was transferred to the Issuer's account.

On April 5, 2018, was delivered to the Company's proxy a copy of the cassation complaint filed by PERN S.A. against the court sentence as above. Based on the legal opinion prepared by the Parent Company's proxy, the Management Board of the Parent Company is of the opinion that complaint lodged by PERN has no grounds, does not contain the necessary statutory premises, and is fraught with formal deficiencies, and being such the complaint should not be accepted by the Supreme Court for the considering. If, however, the complaint would be accepted for examination, the Supreme Court should dismiss it, due to the lack of justified basis. Therefore, the complaint creates a low risk to the stability of the judgments delivered in this case.

The value of this proceeding exceeds 10% of the equity of the Issuer.

Furthermore, the total value of other proceedings separately for the group of liabilities and for the group of receivables does not exceed 10% of the equity of the Capital Group.

11. Information on one or more transactions concluded by the issuer or by its subsidiary with related parties, if they are significant separately or jointly and were concluded on terms other than market terms:

- a) subject of the transaction,
- b) connections of the issuer or of its subsidiary with the entity which is the party to the transaction,
- c) the material terms of the transaction with particular emphasis on financial conditions and the indication of the specific conditions determined by the parties, characteristic of this agreement, in particular differing from conditions commonly applied for such contracts.

In the first half of 2018 there were no material transactions with related entities in the Prochem S.A. Capital Group concluded on other terms than market terms.

12. Information on granting of a surety of loan or borrowing or guarantee by the issuer or its subsidiary, jointly to one entity or its subsidiary, if the total value of existing sureties or guarantee is equivalent to at least 10% of the issuer's equity.

In the first half of 2018 the companies of the Capital Group did not grant sureties or guarantees.

13. Other information that in the issuer's opinion is material to the assessment of the human resources, financial position, financial results and changes in them, and information that is essential to assess the possibility of fulfilment the obligations by the companies from the issuer's capital group

The level of indebtedness and the financial liquidity ratio of companies from the Issuer's capital group indicate that there is no risk of the lack of possibility of fulfilment of obligations, which means that they are credible partners in the economic trade.

14. Factors which in the opinion of the issuer will have an impact on the financial performance achieved by the capital group in the prospect of at least the subsequent quarter

Macroeconomic surrounding will have the significant effect on the activities of the Capital Group of Prochem S.A. in 2018, in particular the condition of the Polish economy which in the significant way influences the undertaking of decisions on the starting of new investment objectives by the potential clients of the Capital Group of Prochem S.A. (in particular by industrial companies). After the slump in the investment in the last period, now take place slowly launching some the investment projects, which were previously suspended in the energy, chemical and environmental sectors. In many of them the companies from the Capital Group of Prochem S.A. have a chance to participate. This will be reflected in the number of orders obtained by the Group, and also in the financial results achieved in 2018. The Management Boards of

companies from the Capital Group of Prochem SA pay a particular attention is monitoring the current situation and, if necessary, are prepared to take appropriate actions aiming at increase of their potential to new opportunities.

Krzysztof Marczak
Vice President of
the Management Board

Marek Kiersznicki
Vice President of
the Management Board

Jarosław Stępniewski
President of
the Management Board