

Evaluation of the situation of the Company PROCHEM S.A. in 2021 including the assessment of the internal control system and risk management system

The evaluation of PROCHEM SA for 2020 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 2021

The Company in the scope of its basic activity – sales of engineering and construction services – reached PLN 188.2 million and this is the sales level approximately 40% lower than in 2021. This drop in sales was mainly due to the completion of one of the company's two large implementation contracts. At the same time, it should be noted that in terms of design activities, the company's sales in 2021 remained at the level of sales achieved in 2020. The decrease in sales also affected the lower level of profit achieved in 2021 on operating activities in the amount of PLN 2.9 million.

At the level of net profit, the year 2021 ended with the result of PLN 2,713 thousand i.e. much lower than in the previous year.

Also, the Prochem Capital Group achieved lower sales and a lower result compared to 2021. Sales amounted to almost PLN 247.8 million, net profit was PLN 6,280 thousand.

Summarizing, the results, although lower than in 2021, should be assessed positively. The year was more difficult due to a number of conditions affecting the company's business situation.

II. COMPANY'S SITUATION

The Company's situation in 2021 was influenced by both macroeconomic factors and factors of an incidental nature.

In 2021, there was a significant increase in GDP by 5.7%, but one should remember about the lowered base - the recession that occurred in Poland in 2020 (GDP decrease by 2.5%) related to the Covid epidemic. The investment rate in the national economy was, similar to 2020, 16.6%.

From the point of view of the areas of Prochem's activity, the structure of sources of GDP growth - mainly consumption and the low investment rate did not have a positive impact in 2021.

Inflation was a factor that began to materialize in a significant way in 2021. The increase in this inflation is continued in 2022. Its level in the area of investment goods and materials is very high and reaches several dozen percent. The new situation - the war waged in Ukraine not only contributes to a further increase in inflation, but also generates an increased short and medium-term volatility of prices of investment products and materials. The consequence of this situation is the difficulty both for investors and companies implementing investments on request, correctly determining the budget of investment projects, assessing their effectiveness, etc.

We estimate that this factor will have a negative impact on investment decisions, both in the current year and in the coming years, and will lead to the resignation from projects or their significant postponement.

Rising inflation triggered a radical change in the interest rate policy set by the NBP. In a short time, their significant increase and further expectations for further moves necessitate changes on the part of investors - a new calculation of financial costs of planned or implemented investment projects. We estimate that this year and in the years to come, the factor of rising loan costs, as well as high inflation, will have a negative impact on the investment climate in Poland.

The situation in 2021, as well as this year, was and is influenced by incidental factors.

The first of them - the covid epidemic - in terms of the demand side - the demand for Prochem's services - contributed to the phenomenon described above, i.e. the resignation from investment projects or their postponement. On the supply side - contracting services by Prochem, there were also difficulties and limitations resulting from the need to work remotely, which obviously worsened the efficiency, and thus the efficiency of work.

The outbreak of the war in Ukraine has and will have an impact on the company's situation not only this year but also in the following years.

The negative consequences are obvious, an increase in commodity prices, high volatility of prices, limitations in supplies, combined with the general feeling of

uncertainty and the risk of being a frontier country will negatively affect the level of involvement of Polish investors, and perhaps even more foreign ones.

In the longer term, war may increase the demand for Prochem's services.

The necessity to gradually freed from fossil energy resources will generate increased interest in various types of projects generating clean energy from unconventional sources, free from political blackmailing of suppliers.

Another challenge, but also an opportunity, will be the reconstruction of the Ukrainian economy after the devastation of the war.

Summing up this synthetic analysis of the factors shaping the situation of Prochem, it must be stated that most of them are unfavorable and impede further development.

In addition to macro factors, important is, in the case of a company of our size, the investment activity of companies, industries in which Prochem has strong positions, such as chemicals, petrochemicals, industrial construction, energy.

In this respect, 2021 was satisfactory and the current year should be assessed similarly positively.

New investment projects announced by some companies from the petrochemical or chemical industry, combined with Prochem's strong marketing activity and its high engineering position, create an opportunity to fill the portfolio in 2022. In 2021, several long-term project contracts were won, which should significantly increase revenues in this service segment in 2022.

Despite the relatively good situation, the awareness of Prochem's strong dependence on the investment situation, which is threatened by a number of factors, prompts the company's management to seek activities that would help to stabilize the company's position also in less favorable periods.

The first group of these activities includes the activity of technical consulting, a service developed in recent years. PROCHEM includes technological themes 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 competences 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 competence position of companies and create a

strong basis for further cooperation. It should be noted, however, that in Poland awareness of the importance of this pre-investment stage is still low.

The second group, aimed at obtaining significant financial surpluses, fulfilling cushioning functions in relation to the basic activity, is performed sporadically, though with some regularity, by developer activity. The large office project Astrum Business Park, implemented with a financial partner, has been confirmed by the market in the effective lease of nearly 100% of office space to renowned tenants. In accordance with the adopted business model, after the commercialization of the building, it is assumed that the facility will be sold and the development cycle will be closed. Due to market conditions, in particular related to the epidemic, the process of searching for a client and concluding a contract was extended. Everything indicates that the transaction will be closed this year. - a preliminary contract for the sale of the building has been signed to date, and its finalization should take place within the next 3 months.

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. After the poor experiences of previous years regarding the operation of the control system, the Management Board undertook corrective actions in 2017. That 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 streamlined procedures. 2018 was the second year in which the system operated under the new rules. In 2018, further modifications

were made to the "Service Cost Control" system in terms of the presentation of budgets and they are applied to new topics from 01/01/2019.

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 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 got acquainted with and analyzed, as part of the annual assessment, the current information on the company's internal control, risk management and internal audit systems.

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 industry and is strongly dependent on the demand for engineering services, which is cyclical and subject to occasional events.

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

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

- form of contract performance adequate to the type of project and the scale of the risk,
- 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 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. Wiesław Kiepiel

5. Jarosław Stępniewski
