

# **Assessment of the situation of PROCHEM S.A. in 2023 including the assessment of the internal control system and the risk management system**

Assessment of PROCHEM S.A. for 2023 was made in three aspects:

- results of operating activities,
- situation of the Company,
- functioning of the internal control and risk management system.

## **I. ASSESSMENT OF THE COMPANY'S RESULTS FOR 2023**

The Company in the scope of its basic activity – sales of engineering and construction services – achieved PLN 218.2 million, which is over 45% higher than in 2022. This increase in sales is primarily due to a 66% increase in sales in the implementation topics segment. At the same time, it should be noted that in terms of design activities, the company's sales in 2023 also increased slightly, by almost 5% compared to the previous year, reaching PLN 43.3 million.

First of all, the sharp increase in the costs of implemented investment projects, related to high inflation resulting from the war in Ukraine and difficulties with indexation of contracts, caused the Company to close 2023 at the operating level with a loss of PLN 29.3 million, and the net loss amounted to PLN 19.6 million.

The PROCHEM Capital Group also achieved higher sales compared to 2022. Sales amounted to PLN 281 million, and net loss to PLN 24,348 thousand.

To sum up the results, it should be stated that 2023 was a very difficult year, which was caused by a number of conditions, mainly external, affecting the business situation of the Company, and the financial results achieved are very unsatisfactory. The finalization in 2023 of large implementation contracts concluded in 2019 and 2021 and the cumulative materialization of risks of these multi-year contracts had a decisive impact on Prochem's financial results.

## **II. THE COMPANY'S SITUATION**

The Company's situation in 2023 was influenced by both macroeconomic factors and also factors resulting from the specificity of the company's portfolio of implemented contracts.

Macroeconomic factors in its vast majority had a negative impact on the Company's situation. In 2023 there was a strong economic slowdown. GDP growth of 0.2% in practice meant stagnation. For the first time since joining the European Union, national GDP growth was slower than the average growth in the European Union.

Not only the pace of economic growth did not favour the emergence of new investment projects, the implementation of which is the main domain of PROCHEM S.A.'s activity. An unfavourable factor that persisted throughout 2023 was high inflation - the average increase was 11.4%. The consequence of this situation was and is the difficulty, both for investors and companies undertaking the investment implementation, in determining the budget for investment projects, assessing the effectiveness, as well as the actual costs of implementing the investment. We estimate that this factor had the greatest impact on the Company's negative results in terms of basic business in 2023.

High inflation has caused a change in the interest rate policy set by the National Bank of Poland. Their significant increase in a short period of time resulted in the need to make a number of changes on the part of investors - primarily the preparation of a new calculation of the financial costs of intended or implemented investment projects. Last year, the factor of high credit costs, as well as high inflation, had a negative impact on the investment climate in Poland, and thus worsened the market situation of companies such as PROCHEM.

The war in Ukraine is another factor that has had an impact on the company's situation not only last year but will also, which is obvious, have an impact this year and perhaps in the following years.

The war causes a sense of uncertainty and the risk associated with being a near frontline country, which will obviously have a negative impact on the level of involvement of both Polish and perhaps even more foreign investors.

Another negative factor influencing the investment market in 2023 was the uncertainty about obtaining EU funds, either from the KPO (National Reconstruction Plan) or from the basic budget of the European Union.

Everything indicates that this threat will be eliminated with the change of government in 2024. To sum up this part of the assessment, it should be stated that in 2023 external factors were not favourable and did not create business opportunities for companies operating in the investment services sector.

In the context of the analysis of the factors described above, it is necessary to additionally assess what impact they had on the current situation of PROCHEM in 2023.

First of all, it should be noted that in 2023, similarly to 2022, PROCHEM implemented large, multi-year implementation contracts with a determined level of remuneration.

In the conditions of unfavourable factors, especially inflation, which manifested itself in 2022 in strong cost volatility, and then in 2023 in stabilization of these costs at a very high level, this type of projects was obviously most affected by the decline in their efficiency.

The implementation of large, multi-year contracts, instead of stabilising the Company's situation (which would have occurred in a standard average environment), in a situation where several strong, unpredictable factors occurred (pandemic, war in Ukraine, high inflation) caused a significant deterioration in the profitability of the contracts implemented, which resulted in a large loss on the basic business.

An additional factor was the stiffening position at negotiations by the investors for whom PROCHEM implemented investment projects.

In conditions of such strong, unexpected negative factors, a more open negotiating attitude should have been expected.

It should also be noted that in PROCHEM the awareness of strong dependence on the changing investment situation and the risk of the emergence of unfavourable incidental factors prompted the company's management to seek activities that would stabilise the company's position also in less favourable periods.

Undertaking projects that cushion difficulties during periods of recession is a permanent element of the company's strategy.

This function, in relation to the core activity, was fulfilled by developers activity conducted sporadically, although with some regularity. Recently, the large office project Astrum Business Park, implemented with a financial partner, has found market confirmation.

Obtaining significant financial resources from the sale of this project created a relatively comfortable liquidity situation at the beginning of 2023, which allowed the company to survive the crisis in its basic business activities.

The situation in 2024 will not be easy either. The expected lower but still variable level of inflation, ongoing geopolitical tensions related to the ongoing war, and the shifted in time effect of the inflow of EU funds mean that the supply of investment projects remains low on the market. This means that competition in obtaining them will increase, which will weaken the ability to optimally fill the portfolio of companies in the engineering and construction sector.

A certain opportunity for PROCHEM in the coming years is the need to gradually free itself from fossil energy resources, which will generate an increase in interest in various types of projects related to clean energy.

There are also large-scale nuclear energy projects waiting to be implemented.

In conditions of geopolitical tension, there will undoubtedly be an accelerated growth in the development of the arms sector.

A positive end to the war in Ukraine may also generate new contracts related to the reconstruction of its economy after the war damage.

However, it seems that 2024 will rather serve as a “soft” period for project preparation, and the engineering and construction phase will be launched in the following years.

### **III. ASSESSMENT OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM**

The scope of the control covers primarily:

- business activity of the company - basic and auxiliary,
- financial reporting and accounting settlements,

- compliance of the company's operations with applicable laws and internal regulations,
- employment and wages.

Specificity of PROCHEM S.A. activity is related to the implementation of complex investment projects for clients.

The company has and uses systems for planning and controlling the projects being implemented. After the not-so-good experience from previous years regarding the operation of the control system, the Management Board took corrective measures in 2017. In the same 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 improved procedures. The year 2018 was the second year in which the system operated according to the new rules. In 2018, further modifications were made to the "Service cost control" system with regard to the presentation of budgets and they have been applied to new topics since 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. These managers exercise supervision over the employees subordinate to them, consisting in checking the status of the implementation of the tasks set.

Control activities 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 the formal and substantive and accounting correctness bears a signature made 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. there is no separate, organizationally separated risk management structure. Risk areas are identified and assessed by the Company's services

appropriate for a given type of risk. They are also responsible for defining the actions necessary to mitigate the risk.

Supervision as well as key decisions regarding the scale of risk exposure are made by the Company's Management Board. Risk analysis has at PROCHEM S.A. has systemic character, included in various types of procedures regarding individual risks. 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.

Last year, the Supervisory Board got acquainted with and analyzed, as part of the annual assessment, the current information on the internal control, risk management and internal audit systems functioning in the company.

The following risks have been identified in the activities of Prochem:

### **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 also subject to occasional events.

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

- the macroeconomic situation and the situation in selected industries are monitored
- objective diversification is continued (executive activity, activities in the field of technical consulting, developers 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 of employees who are also an attractive target for recruitment by competitors.

In order to mitigate this risk, in Company the following are applied:

- monitoring of the labor market and of the level of remuneration,
- maintaining of the 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 at PROCHEM S.A. - preparation and management of investment projects for clients - make this a constant risk, which has recently become particularly important due to high inflation.

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

- form of contract performance adequate to the type of project and the scale of the risk,
- realistic price calculation when concluding contracts, taking into account the inflation forecast,
- monitoring the progress in execution of contracts and disclosure of threats,
- selection of reliable subcontractors,
- contract clauses restricting the maximum amount of contractual penalties.

### **4. The risk of payment unreliability**

Instruments, that mitigate this constantly occurring type of risk are:

- monitoring of the financial standing of clients before and during the execution of contracts,
- application of specialized debt collection-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
- maintaining of the partnership relations with repeat customers.

### **SUMMARY**

Both in terms of the control system and risk management, the systemic and personnel changes made in previous years allow for maintaining an appropriate level of security in the Company's operations and reduced the risk of failing to notice a significant threat to the Company's basic business.

Signatures of the Members of the Supervisory Board:

1. Marek Garliński

---

2. Karol Żbikowski

---

3. Paweł Bielski

---

4. Wiesław Kiepiel

---

5. Jarosław Stępniewski

---