

Assessment of the situation of PROCHEM S.A. in 2024 including the assessment of the internal control system and the risk management system

Assessment of PROCHEM S.A. for 2024 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 2024

The Company in the scope of its basic activity – sales of engineering and construction services – achieved PLN 63.8 million and this is 70% lower than in 2023. This decline in sales is primarily due to the smaller number of lump-sum projects in-progress. At the same time, it should be noted that in terms of design activities, the company's sales in 2024 also dropped by 40% compared to the previous year, reaching PLN 25.4 million.

First of all, the sharp increase in the costs of implemented investment projects, related to high inflation and difficulties with the indexation of contracts resulted in the Company closing 2024 in terms of operating activities with a loss of PLN 25.1 million, and the net loss amounted to PLN 28.5 million.

The PROCHEM Capital Group also achieved lower sales compared to 2023. Sales amounted to PLN 140 million, and net loss amounted to PLN 25,746 thousand.

To sum up the results, it should be stated that 2024 was a very difficult year, which was caused by a number of conditions, mainly external, affecting the business situation of the Company, and the achieved financial results are very unsatisfactory. The finalization in 2024 of large implementation contracts concluded in 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 2024 was influenced by both macroeconomic factors and also factors resulting from the specificity of the company's portfolio of implemented contracts.

In 2024, the Polish construction industry experienced a significant slowdown. Construction and assembly production in December 2024 was 8% lower than a year earlier. The investment rate also dropped in 2024 to 17.4%, with the European average being 22.4%.

This 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 has persisted in recent years has been high inflation. The consequence of this situation was and is the difficulty, both for investors and companies undertaking the implementation of investments, 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 principal activity in 2024.

High inflation led to 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 influenced the company's situation not only last year but will also, obviously, 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 frontline country, which will obviously have a negative impact on the level of involvement of both Polish and perhaps even more so foreign investors.

Another negative factor affecting the investment market in 2024 was the slow launch of EU funds, whether from the KPO (National Reconstruction Plan) or from the basic budget of the European Union in order to stimulate investment.

There are many indications that this threat will be eliminated in 2025.

To sum up this part of the assessment, it should be stated that in 2024 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 2024.

First of all, it should be noted that in 2024, similarly to 2023, PROCHEM implemented large, multi-year implementation contracts with a determined level of remuneration.

In the conditions of unfavourable factors, especially inflation, supply chain disruption in 2024, this type of projects was obviously the 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, extension of delivery times) caused a significant deterioration in the profitability of the contracts implemented, which resulted in a large loss on the principal activity.

An additional factor was the stiffening of investors during negotiations regarding price indexation.

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 principal activity, was fulfilled by developer's 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 financial buffer that allowed the company to survive the crisis in its principal activities.

The situation in 2025 will not be easy either. The expected lower but still variable level of inflation, ongoing geopolitical tensions, and the delayed impact of the inflow of EU funds mean that the supply of investment projects remains low on the market. This means that competition in acquiring them will continue to be strong, which will weaken the ability to optimally fill the portfolio of companies in the engineering and construction industry.

A certain opportunity for PROCHEM in the coming years is the need of gradually withdrawal 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.

PROCHEM has the competences and capabilities to operate in the above fields, which creates a chance to regain profitability in 2025.

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 implementing 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 development of 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 managers supervise the employees subject to them, which involves 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 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 reviewed and analyzed, as part of its annual assessment, current information on the company's internal control, risk management and internal audit systems.

The following risks have been identified in Prochem's operations:

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, 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 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

Instruments, that mitigate 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 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. Jarosław Stępniewski | _____ |
| 2. Karol Żbikowski | _____ |
| 3. Marek Garliński | _____ |
| 4. Wiesław Kiepiel | _____ |
| 5. Steven Tappan | _____ |