

THE DIRECTORS' REPORT ON THE GROUP'S OPERATIONS

for 2016

**(including disclosures required for the Directors' Report in the
aforementioned period)**

Łomża, 17 March 2017

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Introduction

This Board of Directors’ report on the operations of PEPEES Group for 2016 provides disclosures whose scope was specified in § 91-92 of the Decree of the Polish Minister of Finance dated 19 February 2009 on Current and Periodic Information Published by Issuers of Securities [...] (“the Decree”).

The consolidated annual report, which comprises the aforementioned financial statements and this Directors’ report, has been prepared pursuant to § 91 and § 92 in connection with Clause 1 item 3 and Clause 2 § 82 of the Decree.

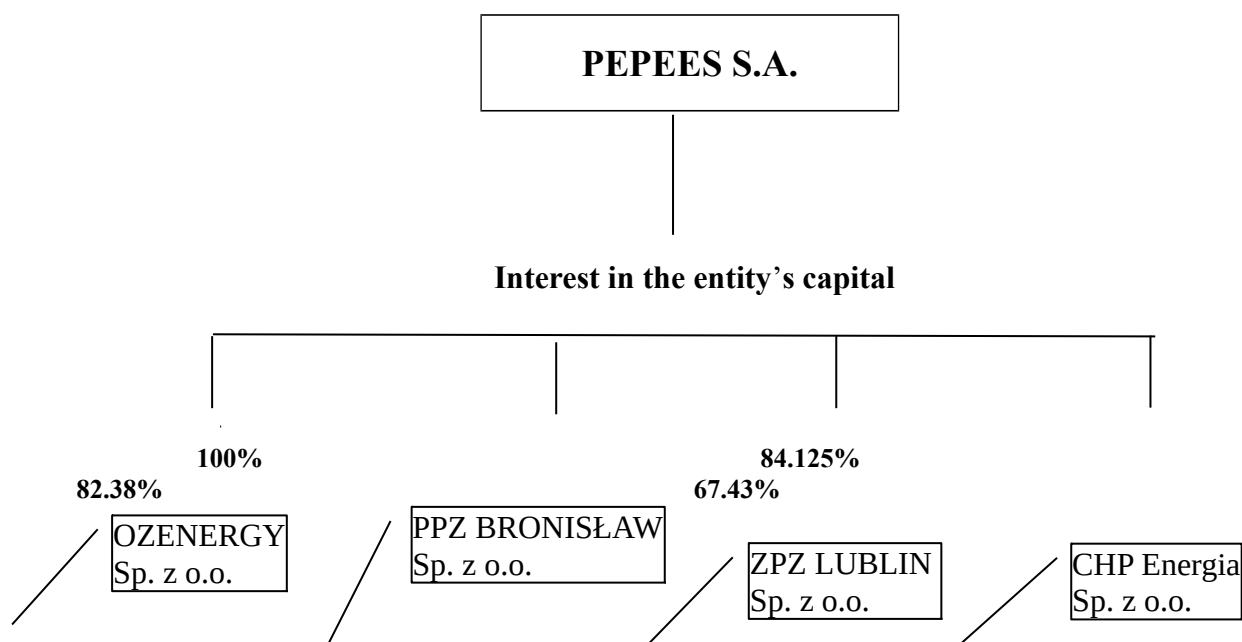
Pursuant to § 83 Clause 7 of the Decree, this report also comprises disclosures required for the Report on the Operations of the Parent Company referred to in § 91 Clause 1 item 4 of the Decree.

The principles of the preparation of financial statements have been presented in respective financial statements, i.e. in the financial statements of the Parent Company and in the financial statements of the Group for 2016.

I. The structure of PEPEES Group

Przedsiębiorstwo Przemysłu Spożywczego “PEPEES” S.A. is a parent company for Zakłady Przemysłu Ziemniaczanego „ZPZ Lublin” Sp. z o.o.; Przedsiębiorstwo Przemysłu Ziemniaczanego “BRONISŁAW” Sp. z o.o.; OZENERGY Sp. z o.o. and CHP Energia Sp. z o.o.

The composition of the Group as at 31 December 2016 was as follows:



All subsidiaries were consolidated with the full method.

1. **Przedsiębiorstwo Przemysłu Spożywczego “PEPEES” Spółka Akcyjna in Łomża – the parent company**

1.1 General information about the Company

The Company’s business name is: Przedsiębiorstwo Przemysłu Spożywczego “PEPEES” S.A. Its registered office is in Łomża, at the address: ul. Poznańska 121.

It operates as a joint stock company incorporated under a notarial deed on 21 June 1994 signed before the notary public Mr Paweł Błaszczuk in Warsaw (Notarial Record Book A No. 14126/94).

The Company is entered in the Register of Entrepreneurs kept by the District Court in Białystok, XII Economic Division of the National Court Register (KRS) in Białystok under No. KRS 000038455.

It has its Tax Identification Number (NIP): 718-10-05-512, assigned by the Tax Office in Łomża on 20 January 2000.

The statistical office assigned the following identification number (REGON) to the Company: 450096365.

The Company operates pursuant to the Polish Commercial Code. Is is a single-establishment company; it does not have any branches.

According to the Company’s Articles of Association, the Company's objects are as follows:

- processing of potatoes;
- manufacture of starches and starch products;
- services related to the processing and preserving of fruit and vegetables;
- manufacture of fruit and vegetable juice.

During the reporting period, the Company carried out activities related to the manufacture of starches and starch products, and the processing of potatoes.

The Company’s share capital as at 31 December 2016 amounted to PLN 5,700 thousand and was divided into:

- series A - 83,000 thousand ordinary bearer shares with the nominal value of PLN 0.06 each;
- series B - 12,000 thousand ordinary bearer shares with the nominal value of PLN 0.06 each.

To the best of our knowledge, as at 31.12.2016, the shareholding structure was as follows:

- Mr Maksymilian Maciej Skotnicki - the number of votes: 19,634,843; the share in the total number of votes at GMS – 20.67%
- Mr Michał Skotnicki - the number of votes: 10,700,011; the share in the total number of votes at GMS – 11.26%
- Mr Newth Jonathan Reginald - the number of votes: 7,995,200; the share in the total number of votes at GMS – 8.42%
- Mr Krzysztof Borkowski (indirectly through affiliates, including Mazowiecka Korporacja Finansowa Sp. z o.o., which holds 5,397,343 shares/votes, representing 5.68% of the share capital/total number of votes) – the total number of votes: 7,923,409; the total share in the total number of votes at GMS – 8.34%
- Epsilon Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych - the number of votes: 9,931,499; the share in the total number of votes at GMS – 10.45%

- Richie Holding Ltd - the number of votes: 6,133,100; the share in the total number of votes at GMS – 6.46%

To the best of the Company’s knowledge, none of the remaining shareholders informed about the holding of at least 5% of the share capital and total votes at the GMS. To the best of the Company’s knowledge, until the date of this report, there had been no changes in the structure of major shareholders.

1.2 The Company’s authorities

Board of Directors

In the period from 1 January 2016 to 1 June 2016, the composition of the Board of Directors of PEPEES S.A. was as follows:

Mr Wojciech Faszczeński – President

Mr Krzysztof Homenda – Member / Chief Financial Officer

As of 1 June 2016, Mr Krzysztof Homenda resigned from his membership of the Board of Directors.

In the period from 2 June 2016 to 30 November 2016, the Board of Directors had a sole member, namely:

Mr Wojciech Faszczeński – President

The Supervisory Board, at its meeting held on 14 October 2016, adopted the resolution on the appointment of Mr Tomasz Rogala as a Member of the Board of Directors of PEPEES S.A.; he began his work on 1 December 2016.

In the period from 1 December 2016 to 31 December 2016, the composition of the Board of Directors of PEPEES S.A. was as follows:

Mr Wojciech Faszczeński – President

Mr Tomasz Rogala – Member

After the end of the reporting period, there have been no changes in the composition of the Company’s Board of Directors.

The Board of Directors is composed of one to five members. The Supervisory Board appoints the President of the Board of Directors and, upon the motion of the President of the Board of Directors, also other members of the Board of Directors. Members of the Board of Directors are dismissed by the Supervisory Board. The Board of Directors exercises all management powers in the Company, except for the powers reserved for the Supervisory Board or the General Meeting of Shareholders. The decision on the issue or redemption of shares is made by the General Meeting of Shareholders by way of a resolution.

The Issuer’s Board of Directors does not have any powers to issue shares – the Company has not established any target capital.

Supervisory Board

In the period from 1 January 2016 to 19 May 2016, the composition of the Supervisory Board of PEPEES S.A. was as follows:

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- | | |
|----------------------------|-----------------|
| 1. Mr Maciej Kaliński | – Chairman |
| 2. Mr Piotr Marian Taracha | – Vice-Chairman |
| 3. Mr Krzysztof Stankowski | – Secretary |
| 4. Mr Piotr Łuniewski | – Member |
| 5. Mr Robert Malinowski | – Member |

On 19 May 2016, the Annual General Meeting of Shareholders appointed Ms Agata Czerniakowska as a Member of the Supervisory Board.

On 29 December 2016, Mr Piotr Łuniewski resigned from his membership of the Supervisory Board.

The composition of the Supervisory Board as at 31 December 2016:

- | | |
|----------------------------|-----------------|
| 1. Mr Maciej Kaliński | – Chairman |
| 2. Mr Piotr Marian Taracha | – Vice-Chairman |
| 3. Mr Krzysztof Stankowski | – Secretary |
| 4. Ms Agata Czerniakowska | – Member |
| 5. Mr Robert Malinowski | – Member |

Until the date of this report, there had been no changes in the composition of the Company’s Supervisory Board.

Members of the Supervisory Board are appointed and dismissed by the General Meeting of Shareholders.

2. Zakłady Przemysłu Ziemniaczanego „LUBLIN” Spółka z ograniczoną odpowiedzialnością in Lublin – a subsidiary

2.1 General information about the Company

The Company's registered office is in Lublin, at the address: ul. Betonowa 9. The Company is a limited liability company established by virtue of a notarial deed on 8 November 1996 signed in the notary public's firm run by Ms Antonina Renata Bednara in Lublin, at ul. Spokojna 8, Notarial Record Book A No. 6437/96, for an indefinite lifetime. The Company is entered in the Register of Entrepreneurs kept by the District Court in Lublin, XI Economic Division of the National Court Register (KRS) in Białystok under No. KRS 0000050886.

The Company has its Tax Identification Number (NIP): 946-15-80-419.
The Company operates pursuant to the Polish Commercial Code.

The Company’s objects are mainly the processing of potatoes and the production and sales of glucose syrup.

The Company’s share capital as at 31 December 2016 amounted to PLN 2,761,200, and its shareholders were as follows:

- | | | |
|---|-------------|--|
| - | PEPEES S.A. | - 22,748 shares with the value of PLN 2,274,800, i.e. 82.38% |
|---|-------------|--|

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- The Company’s employees - 3,244 shares with the value of PLN 324,400, i.e. 11.75%
- Farmers - 1,620 shares with the value of PLN 162,000, i.e. 5.87%

2.2 The Company's authorities

Board of Directors

In the period from 1 January 2016 to 1 June 2016, the composition of the Company’s Board of Directors was as follows:

Mr Krzysztof Homenda – President
Ms Małgorzata Dudzic – Member/Chief Financial Officer

As of 1 June 2016, Mr Krzysztof Homenda resigned from his position of the President of the Board of Directors. From 2 June 2016 until 19 July 2016, the Board of Directors had only one member, i.e. Ms Małgorzata Dudzic, who was the Member of the Board of Directors and the Chief Financial Officer.

On 19 August 2016, the Supervisory Board appointed Mr Piotr Kaniowski as President of the Board of Directors.

The composition of the Board of Directors as at 31.12.2016 was as follows:

Mr Piotr Kaniowski – President
Ms Małgorzata Dudzic – Member/Chief Financial Officer

Supervisory Board

The composition of the Supervisory Board as at 31.12.2016 was as follows:

- Mr Wojciech Faszczeniowski – Chairman
- Mr Piotr Taracha – Vice-Chairman
- Mr Piotr Łojko – Secretary
- Mr Mariusz Świątlicki – Member
- Ms Agata Czerniakowska – Member

3. OZEnergy Spółka z ograniczoną odpowiedzialnością in Łomża – a subsidiary

The Company’s registered office is in Łomża, at the address: ul. Poznańska 121. The Company was established by virtue of a notarial deed (Notarial Record Book A No. 12369/2010) on 18 October 2010 signed before a notary public Tomasz Poreda in Łomża.

The Company is entered in the Register of Entrepreneurs kept by the District Court in Białystok, XII Economic Division of the National Court Register (KRS) in Białystok under No. KRS 0000370060.

The Company has its Tax Identification Number (NIP): 7182123627.

The Company operates pursuant to the Polish Commercial Code.

The Company’s objects, according to its Articles of Association, are as follows: electric power generation and supply; sewerage and waste management; remediation activities; growing of

crops; production, trade, rendering of services, including export and import. The Company had not commenced operations until the balance sheet date.

The Company’s share capital as at 31 December 2016 amounted to PLN 95,000 and was divided into 1,900 equal and indivisible shares, each with the value of PLN 50.

The composition of the Board of Directors as at 31.12.2016:
Mr Roman Minierski – President

4. Przedsiębiorstwo Przemysłu Ziemniaczanego BRONISŁAW Spółka z ograniczoną odpowiedzialnością in Bronisław – a subsidiary

4.1 General information about the Company

The Company’s registered office is in Bronisław 41, 88-320 Strzelno. The Company is a limited liability company established by virtue of a notarial deed on 23 November 2001, Notarial Record Book A No. 8625/2001, for an indefinite lifetime. The Company is entered in the Register of Entrepreneurs kept by the District Court in Bydgoszcz, XIII Economic Division of the National Court Register (KRS) in Bydgoszcz under No. KRS 0000099072.

The Company has its Tax Identification Number (NIP): 557-15-95-182.
The Company operates pursuant to the Polish Commercial Code.

The Company’s objects are as follows:

- manufacture of starches and starch products;
- sales of potato-based products in Poland and abroad;
- agricultural services.

The Company’s share capital as at 31 December 2016 amounted to PLN 800,000 and was divided into 1,600 equal and indivisible shares, each with the nominal value of PLN 500. PEPEES is the major shareholder; it holds 84.125% of the share capital. Other shareholders are natural persons.

4.2 The Company’s authorities

Board of Directors

The composition of the Board of Directors as at 31.12.2016:

- Mr Wojciech Faszczeński – President
- Mr Roman Minierski – Vice-President

Supervisory Board

The composition of the Supervisory Board as at 31.12.2016:

- Mr Piotr Taracha – Chairman
- Mr Piotr Łuniewski – Vice-Chairman

- Mr Grzegorz Dobrowolski – Member
- Mr Stanisław Bukowski – Member

5. CHP Energia Sp. z o.o. - a subsidiary

5.1 General information about the Company

The Company with its registered office in Wojny-Wawrzyńce was established on 27 April 2011 on the basis of the notarial deed, Notarial Record Book A No. 1163/2011. The Company operates in the form of a limited liability company. The Company is entered in the Register of Entrepreneurs kept by the District Court in Białystok, XII Economic Division of the National Court Register (KRS) under No. KRS 0000390180.

The Company has its Tax Identification Number (NIP): 772-162-44-70
The Company operates pursuant to the Polish Commercial Code.

The Company’s objects are as follows:

- power generation
- electricity transmission and distribution

The Company’s share capital as at 31 December 2016 amounted to PLN 5,298,000 and was divided into 10,596 equal and indivisible shares, each with the nominal value of PLN 500.

PEPEES is the major shareholder; it holds 67.43% of the share capital. Other shareholders are natural persons.

5.2 The Company's authorities

Board of Directors

The composition of the Board of Directors as at 31.12.2016:

- Mr Andrzej Wszyński – President
- Mr Mirosław Siemieniako – Vice-President

Supervisory Board

The composition of the Supervisory Board as at 31.12.2016:

- Mr Wojciech Faszczewski – Chairman
- Mr Tomasz Rogala – Member
- Mr Wojciech Zagdański – Member

6. Changes in the organisation of PEPEES Group

On 24 October 2016, the Extraordinary General Meeting of Shareholders of CHP Energia sp. z o.o. (“CHP Energia”) decided to increase the share capital of this company by issuing 6,000 new shares which were subscribed for by the Issuer. The said shares were subscribed for at PLN 850 per share, i.e.

for the total amount of PLN 5.1 million. As a result of the shares subscription, the Issuer’s share in the share capital of/total number of votes in CHP Energia has increased from the present 24.91% to 67.43% and, hence, CHP Energia will become the Issuer’s subsidiary. The biogas plant run by CHP Energia uses agricultural raw materials in its production and, as a result, owing to the inclusion of this asset in the Issuer’s Group, the production process for basic products in the Group’s offer will be expanded with another link of the production chain. This is related to a need to dispose of by-products (potato pulp) created in the aforementioned production process. Notwithstanding the foregoing, the increased interest in CHP Energia is also associated with the expected development of this entity’s core business related to the production of electricity and heat. The aforementioned investment was financed with own funds. The increase in the share capital referred to above was registered by the competent registry court on 13 January 2017.

II. Factors and events affecting the Group's operations

1. The market

Production, trade and rendering of services related mainly to the processing of potatoes and power generation were the main revenue-generating activities of PEPEES Group in the reporting period. In PEPEES Group, the Parent Company conducts manufacturing and trading activities related to products and goods from the starch industry.

Until the time of taking control of the subsidiary CHP Energia, the Group had been operating in a single, main reporting segment covering the processing of potatoes to obtain starch, dried potato-based products and starch hydrolysates. Hence, from that time, both at the level of the Group and of the Parent Company, a single segment is identified in the daily records and internal reports, i.e. “processing of potatoes”.

At the same time, due to taking control of CHP Energia, the “power generation” segment was separated in the consolidated financial statements for 2016, which comprises the activities of the aforementioned subsidiary.

In the “processing of potatoes” segment, the Company produces:

- potato starch;
- a few varieties of glucose;
- a wide range of starch syrups;
- potato grits;
- potato flakes.

The Group processes both starch potatoes and table potatoes. Potatoes are the primary source of starch, not only in Poland, but throughout Europe. Starch potatoes are potatoes containing at least 13% of starch. One can obtain starch from such potatoes, for food-related and technical purposes, by its mechanical separation from other potato components, washing out, purifying, drying and screening.

Europe is the largest manufacturer of potato starch in the world. In the EU, in recent years, the output amounted to ca. 1.85 million tonnes p.a.; 92% of that amount were produced by EU-15 states and almost 8% by new Member States. Poland’s share in the potato starch production in the EU amounts to ca. 6%.

Table potatoes are processed in the subsidiary ZPZ Lublin, mainly to obtain potato grits and potato flakes, and partially in PPZ BRONISŁAW, to obtain potato flakes.

CHP Energia Sp. z o.o. is an enterprise which, in its strategy, provides for the running of a biogas plant and of the integrated plant producing solid fuel from biomass, and power generation in green co-generation. The generated excess heat is used to dry the biomass used as a fertiliser in agriculture. In addition, the Company carries out trading activities related to the purchase and bailing of pulp. The establishment of agricultural biogas plants is part of the

implementation of commitments towards the European Union. New legal regulations already implemented and the support system will accelerate the development of this sector in Poland.

2. Basic products, trade goods and services sold by the Group

In the “processing of potatoes” segment, the Company produces:

- potato starch, used for many applications in the food, pharmaceutical, paper, textile and chemical industries;
- a few varieties of glucose used by the food industry, confectionery industry and pharmaceutical industry;
- maltodextrin, which is an essential ingredient of powdered products (ice cream, sauces, soups, fruit extracts, flavoured sprinkles) and vitamin and mineral preparations and supplements for children and athletes;
- a wide range of starch syrups used in confectionery and baking industries;
- potato grits used by the food industry;
- potato flakes used in the food industry.

Potato starch

Potato starch is obtained through mechanical crushing of potatoes, extraction, refining, dehydration, drying and sifting.

Starch is one of the most multifunctional raw materials in the food industry. In some applications, its natural properties enabling the production of gels and thickening are exploited (food, chemical, textile, paper industries).

In the food and pharmaceutical industries, starch is used to give products proper texture, appearance (form), moisture, consistence and durability during their storing.

Starch hydrolysates

• Crystalline glucose

Crystalline glucose is the end product of the hydrolysis of potato starch. It is a white, fine-crystalline powder with sweet taste. Its microbiological purity is very high and it contains ca. 99.5% of pure glucose. Crystalline glucose is a high-calorie monosaccharide, easily absorbed by human organism. It is a valuable and natural source of energy. Glucose is often used in the production of pharmaceutical and dietary products (drugs, dietary supplements). Its consumption is particularly important during intense physical workout and recovery.

The food industry takes advantage primarily of the following glucose properties: sweet flavour, and enhancing the flavour of products. It is used in the production of confectionery, ice-cream, desserts, dry food mixes, non-alcoholic beverages, fruit and vegetable products. In addition, crystalline glucose is applied in the brewing, baking, wine and meat industries.

• Anhydrous glucose

Anhydrous glucose is a product obtained in the process of the fluidized bed drying of crystalline glucose until its moisture content is below 1 %. The product meets high microbiological requirements. The entire production of anhydrous glucose is used by the pharmaceutical industry. It is used mainly in the production of infusion liquids.

• Maltodextrin

Maltodextrin is a product of the depolymerization of potato starch produced as a result of enzymatic hydrolysis. It is a white powder with a slightly sweet flavour. Maltodextrin

properties depend on the degree of starch hydrolysis. An increase in DE (dextrose equivalent) results in greater sweetness, which is accompanied by increased solubility and hygroscopicity, and the reduction of viscosity, bonding power and resistance to crystallization. Due to its binding and filling properties, and its ability to improve texture and stabilise flavour and aroma, maltodextrin is applied in food production. It is an essential ingredient of powdered products (ice cream, sauces, soups, fruit extracts, flavoured sprinkles) and vitamin and mineral preparations and supplements for children and athletes. Is an important carbohydrate ingredient of milk-based formulas and nutritional powders for infants. The share of maltodextrin in the reduced-calorie food production is substantial.

- Glucose syrups

Glucose syrups are concentrated, aqueous solutions of monosaccharides (glucose, maltose) and low molecular weight polysaccharides obtained in the process of the enzymatic hydrolysis of starch. They are temperature and chemically stable, and are characterised with high osmotic pressure. Glucose syrups are used in the production of hard and soft caramel drops, chewing gums, fruit jellies, ice cream, desserts, confectionery. Glucose syrup increases plasticity, affects the durability of the colour and flavour, and provides transparency and gloss. The syrup ensures the appropriate structure and delicate sweetness, improves structural properties, inhibits sugar crystallization, preserves the natural colour of fruit, adds delicate flavour, enhances the aroma.

- Potato protein

This product is obtained from potato intracellular fluid in the process of coagulation, separation and drying. Final product is a loose grey powder with the aroma typical for dried potato protein and moisture content not higher than 10%. The product is characterised with a high total protein content (over 80%), and the digestible protein constitutes over 70% of dry substance. It is a high quality, easily digestible, vegetable protein; therefore, it is a valuable ingredient of feedstuff mixes for animals and an excellent substitute for animal protein.

- Food starch

Food starch is obtained from pulped cells of potato bulbs in the process of rinsing and then purifying, drying and sifting. Commercial product contains ca. 40% of water. Food starch is produced from potatoes for industrial use with appropriate quality properties, i.e. high starch content with the highest possible percentage of large starch grains, small quantities of non-starch substances, low protein content, round potato bulbs, crisp pulp, shallow “eyes”.

- Hydrol

Hydrol is a waste product. This is an intercrystalline juice remaining after the separation of glucose crystals from the concentrated glucose syrup – massecuite. It is a dense, dark brown liquid with a characteristic aroma. Due to its high content of carbohydrates, hydrol is used in the spirits, feed-producing and chemical industries (e.g. for tanning).

- Grits

Grits are a waste product from the food starch-producing unit. These are lumps of lumpy and gruelled starch separated from dried potato starch.

- Potato flakes

Potato flakes are produced from edible varieties of potatoes. These are ca. 0.2-0.5mm flakes first hydrated with steam and then dehydrated.

In 2016, apart from the above products, the Group also generated sales revenue in the following lines:

- seed potatoes;
- pesticides;
- the sales of heat;
- the sales of materials.

In the “power generation” segment, the Company produces:

- electricity from agricultural biogas;
- heat for its own needs used e.g. to dry animal feeds.

3. Sales volume and structure

The structure of sales revenue in the period from 01.01.2016 to 31.12.2016, against the corresponding period of 2015, is shown in Table 1.

Table 1:

Range of products	2016	Structure	2015	Structure	Growth rate
potato-based products	165,939	89.37%	125,271	88.50%	132.46%
- including the sales of the Parent Company	119,902	83.40%	87,725	81.28%	136.68%
heat	3,429	1.85%	3,537	2.50%	96.95%
electricity	1,054	0.57%			
animal feeds	112	0.06%			
other sales, including:	15,141	8.15%	12,745	9.00%	118.80%
a) services	1,014	0.55%	944	0.67%	107.42%
b) trade goods and materials	14,127	7.61%	11,801	8.34%	119.71%
Total net sales revenue	185,675	100.00%	141,553	100.00%	131.17%

Table 2:

Products sales volume in 2016 and 2015

Range of products	Unit	2016	2015	Growth rate in %
potato-based products	tonne	61,952	52,393	118.24
- including for the Parent Company	tonne	45,859	36,672	125.05

In 2016, the revenue from the sale of products increased by 33.84%, while volume growth was at the level of 18.24%. The difference between the growth rates results from the increase in the selling prices of starch in 2016.

4. Polish and foreign markets for the Group’s products

Table 3:

Net sales revenue	2016	Sales structure in 2016	2015	Sales structure in 2015
Poland, including	121,325	65.34%	107,357	75.84%
- products	108,403	58.38%	95,852	67.71%
- trade goods	11,908	6.41%	10,561	7.46%
- services	1,014	0.55%	944	0.67%
EU countries - intra-Community supplies, including:	15,160	8.16%	11,166	7.89%
- products	14,212	7.65%	11,142	7.87%
- trade goods	948	0.51%	24	0.02%
Other countries – export, including:	49,190	26.49%	23,030	16.27%
- products	47,919	25.81%	21,814	15.41%
- trade goods	1,271	0.68%	1,216	0.86%
Total	185,675	100.00%	141,553	100.00%

1) Sales in Poland by industries and geographical regions

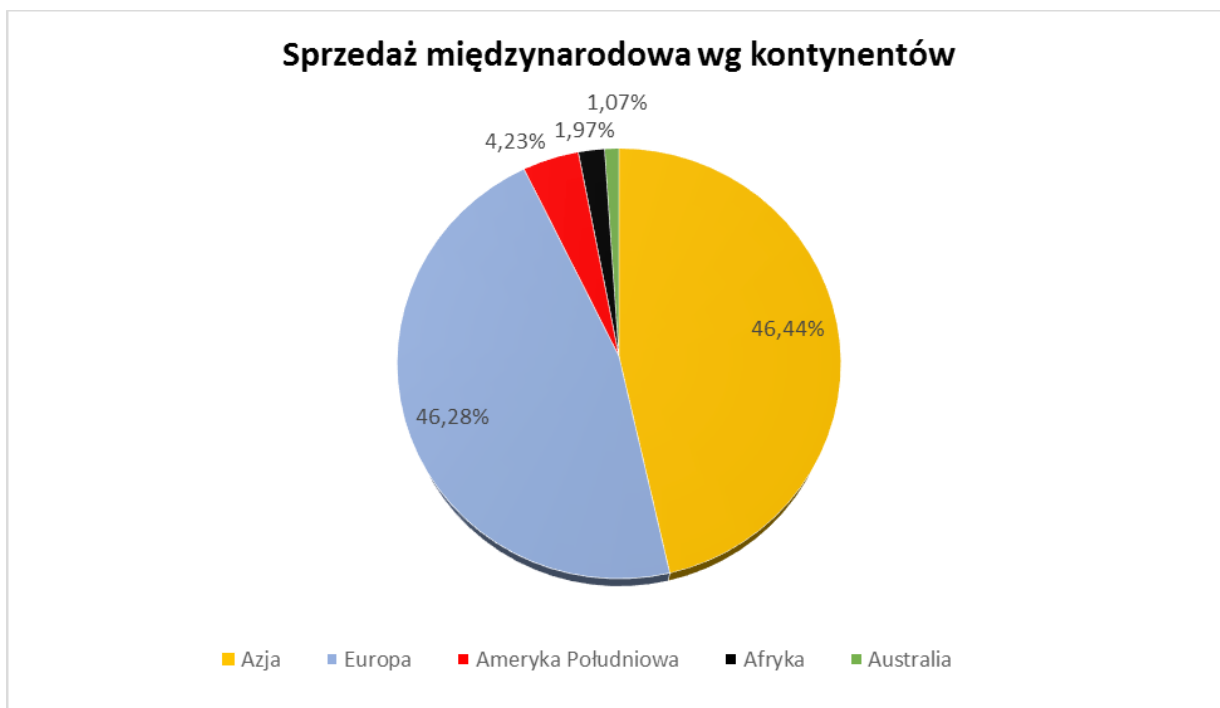
The products from the potato industry were sold in 2016 throughout Poland, and the biggest sale was recorded in the following provinces: lubelskie, wielkopolskie, podlaskie, mazowieckie, kujawsko – pomorskie, opolskie, dolnośląskie and śląskie.

The Group distributed its products both through the network of wholesalers and trading companies making deliveries to the food industry; and it supplied its products directly to production plants, mainly from the food, confectionery, meat and pharmaceutical industries, for which starch products are the raw material for further processing or a component in the manufacturing process. None of the customers exceeded 10% of sales revenue of both the Group and the Parent Company.

In the period, the largest share in the sales on the Polish market was recorded for potato starch, which accounts for 57.6% (in terms of value) of all products manufactured by the Group, and the next product is maltodextrin - 8.0%.

2) Export and intra-Community sales

In 2016, the value of export and intra-Community sales amounted to PLN 64,350 thousand, i.e. it increased by 88% as compared to the previous year’s figures. The main markets are in Asia and Eastern Europe, i.e. in Russia, Latvia and Lithuania. In 2016, the biggest number of products were sold to South Korea.



5. The sources of supplies of production materials, trade goods and services

Table potatoes and potatoes for industrial use are the main production material in “PEPEES” S.A. Group; they are purchased in the autumn on the basis of procurement contracts concluded in the spring. Since the beginning of the 1990’s, a downward trend in potato production in Poland has been observed. At the end of the 1990’s, their share in the crop structure exceeded 10% and now it is only 3%. Ca. 400,000 ha are used in Poland to grow potatoes; however, the cultivation area for starch potatoes is less than 25,000 ha, i.e. only 6% of the total potato cultivation area.

The main raw material for power generation in CHP Energia is biomass produced primarily from plant waste bought from farmers and from PEPEES—waste from the production of starch (potato pulp).

In addition, the following raw materials are purchased for the production process: paper packaging, enzymes, starch, glucose syrup, industrial gases, electrical materials, fine coal, metal parts, bags, sulphur dioxide, shrink film, hydrochloric acid, labels, cardboard boxes, diatomaceous earth, glues and adhesives, varnishes, thinners, enamels, steel strip, pesticides, etc.

The basic raw material, i.e. potatoes for industrial use, is purchased from individual farmers who are not affiliated with any organisations which are important from the Company's point of view.

In 2016, materials, trade goods and services were purchased mainly from Polish companies or agencies of foreign companies. Dependence on a single supplier was recorded in the case of:

- enzymes;
- filtering materials;

as these are the only Polish agencies of foreign companies manufacturing the raw materials needed by the Group.

None of the suppliers had a 10-percent or bigger share in the Group's revenue.

6. **Agreements material for the Group’s business**

Business agreements

In 2016, the Group did not enter into any business agreements of substantial value, and did not enter into any important cooperation/collaboration agreements.

Loan agreements

In 2016, the Group entered into and made annexes to the following loan agreements:

a) with BGŻ BNP Paribas S.A.:

- Amendment dated 29.08.2016 to the multi-purpose line of credit agreement dated 19.08.2015 between “PEPEES” S.A. in Łomża and BGŻ BNP Paribas S.A. The amendment was related to the renewal of the multi-purpose line. The total value of the multi-purpose line of credit amounts to PLN 45,500 thousand. The repayment date is 31.08.2017.

b) with BZ WBK S.A.:

- Annex dated 31.05.2016 to the multi-line agreement dated 7 October 2014 between “PEPEES” S.A. in Łomża and BZ WBK S.A. The subject of the annex is an increase in the value of the available revolving loan for PPZ Bronisław Sp. z o.o. The total value of the multi-line is PLN 40,500 thousand.

- Annex dated 01.07.2016 to the multi-line agreement dated 7 October 2014 between “PEPEES” S.A. in Łomża and BZ WBK S.A. The subject of the annex is a change in the repayment schedule of the working capital loan of ZPZ Lublin Sp. z o.o.
- Annex dated 29.08.2016 to the multi-line agreement dated 7 October 2014 between “PEPEES” S.A. in Łomża and BZ WBK S.A. The annex provides for the renewal of the multi-line for the companies of PEPEES Group for the next marketing year. The value of the multi-line is PLN 45,500 thousand. The repayment date is 31.08.2017.

c) with BOŚ S.A.:

- An agreement of a non-revolving loan with interest-rate subsidies with the Voivodship Fund for Environmental Protection and Water Management (WFOŚiGW) dated 18.02.2016 concluded between “PEPEES” S.A. in Łomża and BOŚ S.A. The agreement provides for the investment financing for PEPEES S.A. for the total amount of PLN 1.2 million for the period from 18.02.2016 to 31.12.2020. The multi-line interest rate is based on WIBOR 3M rate plus the bank’s fixed margin.

No loan agreements of the companies from PEPEES Group were terminated in 2016.

Cash loan agreements

A cash loan agreement of 09.06.2016 between “PEPEES” S.A. in Łomża and BNP Paribas Leasing Solutions Sp. z o.o. The subject of the agreement is to provide financing to purchase an agricultural tractor Deutz-Fahr Agrottron TTV 9340. The cash loan was granted in the amount of PLN 533 thousand for the period from 09.06.2016 until 13.06.2018. The interest rate of the cash loan is 0% (zero percent).

Insurance contracts

The companies concluded the following insurance contracts:

- 1) All-risk property insurance
- 2) business interruption insurance
- 3) electronic equipment insurance
- 4) liability insurance, including:
 - tort liability insurance
 - contractual liability insurance
 - product liability insurance
 - directors and officers liability insurance
- 5) motor vehicle insurance (liability insurance, auto accident and theft insurance)

Leases

- Two leases concerning three passenger cars with the value of PLN 250 thousand concluded for the period of 60 months with BGŻ BNP Paribas S.A.
- A lease concerning a passenger car with the value of PLN 239 thousand concluded for the period of 36 months with BGŻ BNP Paribas S.A.
- Two leases for the period of 36 months concerning agricultural machines with the net value of EUR 272 thousand and EUR 205 thousand concluded with BZ WBK Leasing.
- A lease concerning a combine harvester with the value of PLN 272 thousand concluded for the period of 36 months with BGŻ BNP Paribas S.A.
- A lease concerning a passenger car with the value of PLN 112,195.12 concluded for the period of 48 months with BGŻ BNP Paribas S.A.

Agreements between shareholders

As at the date of this report, the Group is not aware of any agreements between its shareholders.

7. Organisational or equity links between the Issuer and other entities; its major investments in Poland and abroad

As at 31.12.2016, major investments of “PEPEES” S.A. comprised interests in subsidiaries that are subject to consolidation and 3,000 shares of Warszawski Rolno-Spożywczy Rynek Hurtowy S.A. with the value of PLN 2,550 thousand.

Basic financial figures of subsidiaries

Subsidiary	Equity	Assets	Liabilities	Sales revenue	Profit/Loss
2015					
Zakłady Przemysłu Ziemniaczanego ZPZ LUBLIN Sp. z o.o.	2,709	14,579	11,870	13,818	(187)
PPZ BRONISŁAW	1,518	24,355	22,837	29,863	548
CHP Energia Sp. z o.o.	(2,906)	26,820	29,736	4,437	(3,163)
OZENERGY Sp. z o.o.	4	9	5	0	(1)
2016					

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Zakłady Przemysłu Ziemniaczanego ZPZ LUBLIN Sp. z o.o.	2,525	14,427	11,902	17815	(183)
PPZ BRONISŁAW	3,953	32,012	28,059	32,848	2,435
CHP Energia Sp. z o.o.	(470)	28,360	28,830	5,047	(2,664)
OZENERGY Sp. z o.o.	4	8	5	0	(1)

In 2016, PPZ BRONISŁAW improved its results significantly as compared to the previous year. Sales revenue and net profit increased.

In 2016, ZPZ LUBLIN recorded results similar to the previous year’s figures; however, financial projections for 2017 provide for much better results due to a higher revenue, also from export.

OZENERGY did not carry out any activities in 2016.

CHP Energia improved its results slightly as compared to the previous year. Agricultural biogas plants, following the amendment to the RES Act of 1.07.2016, have generated stable revenue due to the creation for them PMOZE-Bio support certificates. Global trends concerning the development of renewable sources of energy at the expense of coal and nuclear power plants bode well for this industry and ensure high profits from such activities.

In addition, the Group, through its Parent Company, holds interests in three other entities which ensure less than 5% of the total number of votes at the General Meeting of Shareholders of these entities, and they are not material in terms of their value and the Group’s investment policy.

8. Related party transactions

All related party transactions were an arm’s length transactions.

The Issuer’s transactions with its subsidiaries:

Transactions between “PEPEES” S.A. in Łomża and ZPZ “LUBLIN” Sp. z o.o. in Lublin

Transactions between “PEPEES” S.A. in Łomża with its subsidiary ZPZ “LUBLIN” Sp. z o.o. in Lublin consisted in the purchase from the subsidiary of potato grits and flakes for PLN 18 thousand, and of trade goods for PLN 699 thousand.

In 2016, PEPEES sold to ZPZ Lublin starch for PLN 314 thousand and a service for PLN 238 thousand.

The selling price is determined using the cost-plus pricing method or on the basis of price lists applicable in transactions with unrelated parties.

In addition, ZPZ “LUBLIN” paid to the Issuer interest on the cash loan granted in previous years amounting to PLN 127.8 thousand. The amount of the outstanding loan as at the balance sheet date was PLN 3,011 thousand.

*Transactions between “PEPEES” S.A. in Łomża and PPZ Bronisław Sp. z o.o. in
Bronisław*

In the reporting period, the Issuer purchased from the subsidiary starch and potato flakes for PLN 6,528 thousand, and services for PLN 85 thousand. The total value of purchases from PPZ “BRONISŁAW” Sp. z o.o. amounted to PLN 6,613 thousand.

In 2016, PEPEES sold to PPZ BRONISŁAW potatoes with the value of PLN 1,818 thousand, and starch for PLN 142 thousand. The total value of sales to PPZ “BRONISŁAW” Sp. z o.o. amounted to PLN 1,962 thousand.

The selling price is determined using the cost-plus pricing method or on the basis of price lists applicable in transactions with unrelated parties.

In addition, PPZ Bronisław paid to the Issuer interest on the cash loan granted in the previous year amounting to PLN 224.3 thousand. The amount of the outstanding loan as at the balance sheet date was PLN 4,673 thousand.

Transactions between “PEPEES” S.A. in Łomża and CHP Energia Sp. z o.o.
PEPEES sold to CHP Energia potato pulp with the value of PLN 184 thousand.
As at the balance sheet date, there is an outstanding loan amounting to PLN 700 thousand, the interest of PLN 10 thousand, and trade receivables of PLN 199 thousand.

Transactions with shareholders, and members of the management personnel and their family members in the reporting period:

In the reporting period, the Group did not enter into any transactions with shareholders, or members of the management personnel and their family members.

9. Borrowings

As at 31.12.2016, the Group had borrowings, which are presented in the table below:

Table 4:

Borrowings as at 31.12.2016

(amounts in PLN 000s)

Loan type /Agreement/	Lending bank	Contractual loan value	Debt as at 31.12.2016	Repayment date
1	2	3	4	5
Overdraft facility (Pepees)	Bank Zachodni WBK S.A.	4,000	0	31.08.2017
Revolving working capital loan in a credit account (Pepees)	Bank Zachodni WBK S.A.	10,000	6,338	31.08.2017
Non-revolving working capital loan in a credit account (Pepees)	Bank Zachodni WBK S.A.	15,000	15,000	31.08.2017
Overdraft facility (ZPZ Lublin)	Bank Zachodni WBK S.A.	500	0	31.08.2017
Revolving working capital loan in a credit account (ZPZ Lublin)	Bank Zachodni WBK S.A.	3,000	1,935	31.08.2017
Non-revolving working capital loan in a credit account (ZPZ Lublin)	Bank Zachodni WBK S.A.	1,500	1,500	31.08.2017
Overdraft facility (PPZ Bronisław)	Bank Zachodni WBK S.A.	500	0	31.08.2017
Revolving working capital loan in a credit account (PPZ Bronisław)	Bank Zachodni WBK S.A.	3,000	3,000	31.08.2017
Non-revolving working capital loan in a credit account (PPZ Bronisław)	Bank Zachodni WBK S.A.	8,000	7,783	31.08.2017
Overdraft facility (Pepees)	BGŻ BNP Paribas	4,000	0	31.08.2017
Revolving working capital loan in a credit account (Pepees)	BGŻ BNP Paribas	10,000	10,000	31.08.2017
Non-revolving working capital loan in a credit account	BGŻ BNP Paribas	15,000	15,000	31.08.2017

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(Pepees)				
Overdraft facility (ZPZ Lublin)	BGŻ BNP Paribas	500	0	31.08.2017
Revolving working capital loan in a credit account (ZPZ Lublin)	BGŻ BNP Paribas	3,000	1,887	31.08.2017
Non-revolving working capital loan in a credit account (ZPZ Lublin)	BGŻ BNP Paribas	1,500	1,500	31.08.2017
Overdraft facility (PPZ Bronisław)	BGŻ BNP Paribas	500	75	31.08.2017
Revolving working capital loan in a credit account (PPZ Bronisław)	BGŻ BNP Paribas	3,000	1,721	31.08.2017
Non-revolving working capital loan in a credit account (PPZ Bronisław)	BGŻ BNP Paribas	8,000	4,564	31.08.2017
Working capital loan to finance current liabilities associated with business activities (CHP Energia)	Spółdzielczy Bank Rozwoju Branch in Szepietowo	3,000	2,890	31.05.2017
The overdraft facility to cover payment obligations related to the business activities (CHP Energia)	Spółdzielczy Bank Rozwoju Branch in Szepietowo	1,000	987	23.02.2017
Subsidised investment loan (Pepees)	Bank Spółdzielczy S.A./Bank Polskiej Spółdzielczości S.A.	3,465	330	30.06.2017
Subsidised investment loan (Pepees)	Bank Polskiej Spółdzielczości S.A.	1,295	471	30.11.2018
Investment loan (Pepees)	BNP Paribas	9,822	7,157	25.02.2022
Loan with subsidies from WFOŚiGW (Pepees)	BOŚ	1,200	826	31.12.2020
Loan (Pepees)	BNP Paribas Lease Group	533	533	13.06.2018
Syndicated investment loan to implement the investment project “The Construction of a Biogas Plant in Szepietowo District” (CHP Energia)	1. Spółdzielczy Bank Rozwoju Branch in Szepietowo 2. Bank Spółdzielczy in Brańsk 3. Bank Spółdzielczy Branch in Andrzejów	12,830	12,464	31.12.2023

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Working capital loan associated with business activities (CHP Energia)	Spółdzielczy Bank Rozwoju Branch in Szepietowo	800	755	31.12.2019
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The interest rates on short-term loans are based on WIBOR 1M rate plus the banks' margins. The annual interest rate on subsidized loans is 2 %.
In 2016, none of the Group’s loan agreements were terminated.

10. Cash loans, guarantees and sureties granted

Sureties granted by the parent company “PEPEES” S.A. as at 31.12.2016:

The agreement of 9 June 2014 concerning the conditions of granting a security for a loan repayment concluded between PEPEES S.A. in Łomża and CHP Energia Sp. z o.o. Pursuant to the agreement, PEPEES S.A. grants the security for the repayment of the investment loan taken out by CHP Energia Sp. z o.o. The value of the investment loan taken by CHP Energia Sp. z o.o. amounts to PLN 12,830 thousand. The security granted by PEPEES S.A. is in the form of an endorsement on bills of exchange up to the amount of PLN **6,000 thousand** for the period until **25.05.2024**.

Sureties granted to the parent company “PEPEES” S.A. as at 31.12.2016:

Short-term loans are secured with e.g. mortgages on the assets of the subsidiaries: ZPZ „LUBLIN” Sp. z o.o. and PPZ „BRONISŁAW” Sp. z o.o.

11. Off-balance sheet items in PEPEES Group

Off-balance sheet assets	2016	2015
Value of land used under the right of perpetual usufruct	13,603	13,603
Receivables in litigation	121	
Off-balance sheet liabilities		
Mortgages on the assets of companies	178,940	135,029
Pledge on assets	102,716	102,663
Loan surety	6,000	6,000
An assignment of receivables under an insurance policy	224,548	210,318
Possible damages related to non-competition agreements	818	1,205
Disputed obligations	32	

12. The use of proceeds from shares issued or the acquisition of treasury shares

In 2016, the Group did not issue any shares and did not acquire treasury shares.

13. Explanation of differences between the financial results disclosed in the annual report and previously published forecasts for the year

The Company and the Group did not publish financial forecasts for 2016.

14. Financial resources management assessment

In 2016, the Parent Company and the Group were fully capable of meeting their obligations towards both suppliers and financial institutions. There was no risk of default. Also, in the next reporting period, there should be no risk of losing financial liquidity by the Group. Any cash surpluses were placed in short-term deposits.

15. Risk-related financial instruments, and the objectives and methods of financial risk management

The information on used financial instruments and the financial risk are the same for both the Group and the Parent Company, which coordinates the process of managing the aforementioned risk at the Group level.

The main financial instruments used by the Group comprised bank loans, lease agreements, short-term deposits, and cash.

In the reporting period, the Group did not conclude transactions involving derivatives. It also did not apply hedge accounting.

Other instruments arising directly in the course of business comprised trade receivables and payables.

The main financial risks in 2016 include the risk of changes in market prices of products manufactured by the Group, and the currency risk. The Company's main objective in the area of the management of these risks is their elimination or mitigation.

The Group's business risk is closely related to changes in product prices on the Polish market and foreign exchange rates, whose fluctuations affect the revenue from export sales. Also, the purchase prices of imported materials for the production process depend on the level of currency risk.

Due to the financing of operating and investing activities with bank loans, the Group is exposed to the interest rate risk.

The liquidity risk in the Group is not deemed high. This is due to the proper implementation of the trade credit management policy. KUKE S.A. evaluates counterparties and insures receivables.

Any cash surpluses are placed in short-term deposits, which make it possible to pay obligations when due. In periods of greater demand for working capital, i.e. during the “potato campaign”, the short-term bank loan for the purchase of potatoes, whose individual tranches are closely correlated with the schedule of the purchases of the raw material for the production process, is the main financial instrument used by the companies in the Group.

Boards of Directors of the companies verify and agree on the management policies for each of the risks. They monitor the market price risk for all financial instruments held by them.

16. **Completed and planned investment projects**

1) Investment projects completed in 2016

Apart from the increase in the interest in the subsidiary CHP Energia, in 2016 the Group implemented several investment projects, including but not limited to:

- the assembly of a compressed air station;
- the construction of a water softening station to meet the production needs of the food starch-producing unit;
- the assembly of the station to pack potato protein into Big-Bag bags;
- the renovation of the pipeline used to discharge production wastewater;
- the upgrading of several machines and production equipment;
- the modernisation of the dust removal system of coal boilers.

2) Investment projects planned for 2017

The Group intends to continue investment projects aiming at increasing the production of starch, reducing the production costs of products, and maintaining the existing technical infrastructure in a proper technical condition.

The main investment projects for 2017 are as follows:

- the modernisation of a starch drying room;
- the modernisation of a starch packing line;
- the implementation of the system of the automatic control of water level in the filter station;
- the modernisation of a biological wastewater treatment plant;
- the rebuilding of a transformer & switching station;
- Ethernet upgrade and expansion;
- the purchase and implementation of new integrated software;
- the purchase and assembly of other production plant and machinery.

The planned expenditure on these investment projects will amount to ca. PLN 22,000 thousand. The Group intends to finance them with its own funds and new long-term loans.

17. **Environmental issues**

The Issuer’s company is located in the region called “Poland's Green Lungs” covering areas in north-eastern Poland, which are the cleanest in Poland and offer the greatest value in terms of their natural environment.

When doing its business, the Group makes every effort to observe environmental requirements. The Company complies with all applicable legal regulations and laws, and holds all applicable permits related to emissions of pollutants, water intake, wastewater disposal or waste production.

Waste is managed in conditions which prevent the contamination of the environment and ensure human health and safety. The Group's companies maintain quantitative and qualitative waste management records in accordance with the adopted classification and model documents referred to in relevant regulations.

18. Employment in the Group

Table No. 5

Specification	Average number of employees in 2016	As at 31.12.2016		Average number of employees in the previous financial year - 2015
		Women	Men	
Administrative employees	129	69	62	117
Workers	290	46	232	274
Employees on unpaid leaves	4	1	1	4
Total	423	116	295	395

19. Major R&D accomplishments

In 2016, the Group carried out two R&D projects:

- The influence of water hardness on the viscosity of potato starch. The research was designed to determine the process parameters necessary to obtain a product with the viscosity consistent with customers’ requirements.
- Laboratory and industrial tests on closing the circulation of transport waters to reduce the use of water for the transport of potatoes, while eliminating odour nuisances and preserving high quality of the product—the continuation of works commenced in 2015.

20. Events with a significant impact on the result of the Group's business activities

In 2016, the parent company sold PMEF energy efficiency certificates (the so-called ‘white certificates’) granted to it, earning the income of PLN 1,153 thousand, which was recognised in the statement of comprehensive income in “other operating income”.

21. The structure of major equity investments

Amounts in PLN 000s

Equity investments	2016	2015
Short-term bank deposits in PLN	20,850	22,224

Investments held for trading (shares)	2,550	2,550
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22. Corrections of errors from previous periods and changes in accounting policies

In 2016, the Group did not change any accounting policies. There were also no corrections of errors from previous periods.

23. Changes of the basic principles of the Group management process

In 2016, there were no material changes of the principles of the Issuer’s and the Group’s management process.

24. Any agreements between the Issuer and the members of the Board of Directors providing for a compensation if they resign or are made redundant without a valid reason or if their employment ceases because of the Issuer’s merger through acquisition.

There are managerial contracts concluded between the Issuer and the members of the Board of Director, which provide for a compensation due to non-competition agreements for the period of 12 months from the date of their contract termination in the amount of 100% of the average monthly salary with bonuses for the past 12 months.

25. Remunerations, bonuses and other benefits paid and payable to members of the management and supervisory personnel in 2016

Board of Directors:

Mr Wojciech Faszczeński	PLN 833.4 thousand
Mr Tomasz Rogala	PLN 30.4 thousand
Mr Krzysztof Homenda	PLN 452.3 thousand
Total remuneration of the Members of the Board of Directors	PLN 1,316.1 thousand

Supervisory Board:

Mr	Maciej	PLN 67.6 thousand
Kaliński		
Mr	Piotr Taracha	PLN 64.0 thousand
Mr	Krzysztof	PLN 57.6 thousand
Stankowski		
Mr	Piotr Łuniewski	PLN 57.2 thousand
Mr	Robert	PLN 57.2 thousand
Malinowski		
Ms	Agata	PLN 34.7 thousand
Czerniakowska		
Total	remuneration of the	PLN 338,3 thousand
Supervisory Board		

Remunerations of the members of the Board of Directors and of the Supervisory Board paid for their work in the authorities of subsidiaries:

Mr Wojciech Faszczewski – President of the Board of Directors of PEPEES – PLN 52 thousand for working as a member of the Supervisory Board of Zakłady Przemysłu Ziemniaczanego „Lublin” Sp. z o.o.; PLN 48 thousand for working as President of the Board of Directors of PPZ BRONISŁAW Sp. z o.o.; PLN 6 thousand for working as a member of the Supervisory Board of CHP Energia;

Mr Krzysztof Homenda – a Member of the Board of Directors of PEPEES – PLN 116 thousand for working as President of the Board of Directors of ZPZ „LUBLIN” Sp. z o.o.; PLN 7 thousand for working as a member of the Supervisory Board of PPZ BRONISŁAW Sp. z o.o.; and PLN 19 thousand for working as a member of the Supervisory Board of CHP Energia;

Mr Piotr Taracha – PLN 47 thousand for working as a member of the Supervisory Board of Zakłady Przemysłu Ziemniaczanego “Lublin” Sp. z o.o.; and PLN 42 thousand for working as a member of the Supervisory Board of PPZ BRONISŁAW Sp. z o.o.

Mr Piotr Łuniewski – PLN 42 thousand for working as a member of the Supervisory Board of PPZ BRONISŁAW Sp. z o.o.

Mr Agata Czerniakowska – PLN 16 thousand for working as a member of the Supervisory Board of ZPZ „LUBLIN” Sp. z o.o.

There are no obligations arising from pensions and similar benefits payable to former members of the Board of Directors and the Supervisory Board.

26. Shares of “PEPEES” S.A. and of the Group's companies held by members of the management and supervisory personnel

As at 31.12.2016, the following members of the management and supervisory personnel of “PEPEES” S.A. in Łomża held the Company’s shares:

Mr Wojciech Faszczeński – President of the Board of Directors – holds 701,000 shares with the nominal value of PLN 0.06 each and with the total value of PLN 42,060.

None of the members of the management and supervisory personnel hold shares in the Issuer's subsidiaries.

27. The Company’s quotations in 2016

The Company’s shares have been listed on the Warsaw Stock Exchange since 22 May 1997. The share price at the beginning of 2016 amounted to PLN 0.54. The highest share price in 2016 was PLN 1.09 and the lowest share price was PLN 0.51.

Share price of PEPEES in 2016



28. Agreements, known to the Issuer, which may result in future changes in the proportions of the shares held by existing shareholders and bondholders

The Group does not possess any information about any agreements which may result in changes in the proportions of the shares held by existing shareholders.

The Company did not issue bonds.

29. The system of control of any employee share schemes

The Group does not have any system of control of employee share schemes or of any equity-based incentive schemes.

30. The entity authorised to audit and review the Issuer's financial statements

PEPEES and its subsidiaries concluded the agreement for the period of reviewing and auditing the financial statements for 2016 with **Mazars Audyt Sp. z o.o.** with its registered office in Warsaw, Poland. The agreement was entered into on 20 July 2016.

Remuneration in PLN 000s

Specification	2016	2015
Mandatory audit of the annual financial statements	34	41
<i>including: PEPEES</i>	23	26
Review of the semi-annual financial statements	21	23
<i>including: PEPEES</i>	13	15
Tax advisory services	-	-
Other services	-	-
Total remuneration	55	64

31. Proceedings pending before a court

There are no pending proceedings concerning commitments and debts of the Company or of its subsidiary with the value amounting to minimum 10% of the Issuer’s equity, and the Company or its subsidiary is not a party to two or more proceedings concerning either commitments or debts with the total value for particular groups amounting to minimum 10% of the Issuer’s equity.

The following litigations remain unresolved as at the balance sheet date:

- mutual claims between the subsidiary PPZ Bronisław and Przedsiębiorstwo Rolno-Produkcyjne in Rzadkwin;
- a lawsuit filed by PPZ Bronisław against the Director of the Water Management Authority in Poznań to revoke the decision concerning the reopening of the procedure to grant a permit required under the Water Law.

III. Assets and financial standing

3The Group's assets

Assets as at 31 December 2016 as compared to 31 December 2015 are shown in the table below.

Table 6:

Asset	As at		Changes in amounts + increases - decreases	Structure ratios in %	
	31.12.2016	31.12.2015		31.12.2016	31.12.2015
I. NON-CURRENT ASSETS (long-term)	138,339	102,971	35,368	50.8	46.62
1. Property, plant and equipment	119,315	89,196	30,119	43.8	40.38
2. Intangible assets	298	460	(162)	0.1	0.21
3. Goodwill	6,607	486	6,121	2.4	0.22
4. Investments in other entities	113	113	0	0.0	0.05
5. Cash loans			0	0.0	0.00
6. Advances	9,649	10,391	(742)	3.5	4.77
7. Deferred tax assets	2,357	2,325	32	0.9	1.05

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II. CURRENT ASSETS (short-term)	133,827	117,917	15,910	49.2	53.38
1. Inventories	77,283	64,111	13,172	28.4	29.02
2. Biological assets	158	172	(14)	0.1	0.08
3. Trade receivables	25,763	18,118	7,645	9.5	8.20
4. Current income tax receivables			0	0.0	
5. Other receivables	2,317	4,237	(1,920)	0.9	1.92
6. Advances	1,398	1,085	313	0.5	0.49
7. Cash loans	182	2,806	(2,624)	0.1	1.27
8. Investments held for trading	2,550	2,550	0	0.9	1.15
9. Cash and cash equivalents	24,176	24,838	(662)	8.9	11.25
III. Non-current and current assets held for sale					
Total assets	272,166	220,888	51,278	100.00	100.00

The total value of the Group’s assets as at 31.12.2016 increased by 23.22% as compared to the previous year, mainly due to the higher interest in the new subsidiary CHP Energia. In the case of non-current assets, there was an increase in the capital expenditure on property, plant and equipment. In the case of current assets, the highest increase was recorded for inventories due to a substantial increase in production, and for trade receivables due to higher sales.

4 Sources of financing for the Group

Sources of financing assets as at 31 December 2016 as compared to 31 December 2015 are shown in the table below.

Table 7:

Sources of financing	As at		Changes in amounts + increases - decreases	Structure ratios in %	
	31.12.2016	31.12.2015		31.12.2016	31.12.2015
I. Equity	129,119	109,854	19,265	47.4	49.73
<i>Equity attributable to equity holders of the parent</i>	<i>128,199</i>	<i>109,136</i>	19,063	47.1	49.40
1. Share capital	5,700	5,700	0	2.1	2.58
2. Reserve capital and other reserves	106,065	99,735	6,330	39.0	45.15
3. Revaluation reserve	(278)	(391)	113	(0.1)	(0.18)
4. Retained earnings/loss	(888)	(1,196)	308	(0.3)	(0.54)
5. Profit/loss for the year	17,600	5,288	12,312	6.5	2.39
<i>Non-controlling interests</i>	<i>920</i>	<i>718</i>	202	0.3	0.33
II. Non-current liabilities	42,696	23,417	19,279	15.7	10.60
1. Loans and borrowings	22,370	7,916	14,454	8.2	3.58
2. Liabilities related to leased assets	4,677	4,246	431	1.7	1.92

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3. Deferred tax liabilities	5,722	6,018	(296)	2.1	2.72
4. Retirement and similar benefits obligations	2,240	2,509	(269)	0.9	1.14
5. Grants	7,687	2,728	4,959	2.8	1.24
III. Current liabilities	100,351	87,617	12,734	36.9	39.67
1. Trade payables	11,956	7,511	4,445	4.4	3.40
2. Current income tax liabilities	3118	869	2,249	1.2	0.40
3. Other current liabilities	5,088	2,918	2,170	1.9	1.32
4. Loans and borrowings	76,080	73,114	2,966	27.9	33.10
6. Finance lease payables	1,901	1,243	658	0.7	0.56
7. Retirement benefits obligations	331	240	91	0.1	0.11
8. Provisions for other liabilities and other charges	1,877	1,722	(230)	0.7	0.78
Total equity and liabilities	272,166	220,888	51,278	100.0	100.00

The consolidation of CHP Energia exerts a substantial influence on the structure of financing. In the financing structure, the percentage of equity decreased, which caused the percentage of liabilities to increase. The percentage of non-current liabilities increased due to the loan taken out to build the starch drier, the unloading node and the water purification plant. Liabilities related to short-term loans, which were used to finance the purchase of potatoes and the current operations, also increased.

5 The Group’s financial results

The financial results from the Group’s business activities for 2016 and 2015 are shown in the table below.

Table 8:

No.	Specification	Accomplish ment in 2016	Accomplish ment in 2015	Growth rate in %
1	Sales revenue	185,675	141,553	131.2
	- revenue from the sales of products	170,534	128,808	132.4
	- revenue from services	1,014	944	107.4
	- revenue from the sales of trade goods and materials	14,127	11,801	119.7
2	Costs of sold products, trade goods and materials	(135,147)	(109,675)	123.2
	- cost of products sold	(121,487)	(98,391)	123.5
	- cost of services sold	(435)	(298)	146.0
	- costs of trade goods and materials sold	(11,737)	(10,399)	112.9
	- profit/loss from agricultural production	(1,488)	(587)	253.5
3	Gross profit from sales	50,528	31,878	158.5
	- selling and marketing expenses	(8,920)	(7,081)	126.0
	- administrative expenses	(19,484)	(16,703)	116.6

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	- other operating income	1,896	991	191.3
	- other operating expenses	(436)	(478)	91.2
4	Profit on operating activities	23,584	8,607	274.0
	- finance costs	(1,515)	(1,411)	107.4
	- finance income	606	746	81.2
	- share of profit of an associate		(799)	0.0
5	Profit before tax	22,675	7,143	317.4
	- income tax expense	(4,777)	(1801)	265.2
6	Net profit, including:	17,898	5,342	335.0
	<i>Profit attributable to equity holders of the company</i>	<i>17,600</i>	<i>5,288</i>	<i>332.8</i>

In 2016, PEPEES Group generated sales of PLN 185.7 million, which denoted an increase by 31.2% as compared to the corresponding period in the previous year. The increase in sales revenue was particularly influenced by higher export sales outside the European Union.

Due to a lower growth rate for the costs of products sold (as compared to the growth rate for the revenue from the sales of products), in 2016, the Group generated gross profit from sales of PLN 50.6 million, which denoted an increase by 58.7% as compared to the same period in the previous year.

Selling and marketing expenses and administrative expenses in 2016 grew by 29% and 21% respectively as compared to the previous year.

The balance on other activities in 2016 closed at PLN 1.1 million as compared to the result of PLN 0.5 million in 2015.

In turn, in 2016 the result on financing activities (understood as the balance of finance income less finance costs) was lower than the corresponding item in 2015.

As a consequence, gross profit in 2016 amounted to PLN 22.7 million against PLN 7.14 million of operating profit generated in the comparative period, and net profit attributable to shareholders of PEPEES in 2016 amounted to PLN 17.6 million against PLN 5.29 million of net profit in 2015, i.e. it increased by 233%.

6Cash flows

In 2016, the balance of cash flows from operating activities was positive and amounted to PLN 14,080 thousand, owing to the generated operating profit. Cash flows from investing activities decreased by PLN 10,394 thousand, due to the expenditure on the acquisition of property, plant and equipment. The balance of cash flows from financing activities was positive and amounted to PLN 3,222 thousand due to the increase in loan debt. All in all, the balance of cash flows is positive and amounts to PLN 6,908 thousand.

7Economic ratios

The summary of ratios characterising the Group's business and situation is presented in the table below.

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Table 9:

Economic ratios

Ratio	Commercial substance	2016	2015
Return on Assets	$\frac{\text{net profit/loss attributable to equity holders of the Company} \times 100}{\text{total assets}}$	6.47%	2.39%
Return on Equity	$\frac{\text{net profit/loss attributable to equity holders of the Company} \times 100}{\text{equity}}$	13.73%	4.85%
Net Profit Margin	$\frac{\text{net profit/loss attributable to equity holders of the Company} \times 100}{\text{net revenue from the sales of products, services, trade goods and materials}}$	9.48%	3.74%
Return on Sales	$\frac{\text{gross profit/loss from sales} \times 100}{\text{net revenue from the sales of products, services, trade goods and materials}}$	27.21%	22.52%
Cash Ratio	$\frac{\text{total current assets}}{\text{current liabilities}}$	1.35	1.35
Quick Ratio	$\frac{\text{total current assets} - \text{inventories}}{\text{current liabilities}}$	0.57	0.61
Receivables Turnover**in days	$\frac{\text{average trade receivables} \times 365}{\text{net revenue from the sales of products, services, trade goods and materials}}$	43.13	40.83
Accounts Payable Turnover in days**	$\frac{\text{average trade payables} \times 365}{\text{costs of trade goods and services sold} + \text{value of trade goods and materials}}$	27.86	35.05
Inventory Turnover in days**	$\frac{\text{average inventories} \times 365}{\text{costs of products and services sold} + \text{value of trade goods and materials}}$	190.94	219.89
Equity to Fixed Assets Ratio	$\frac{\text{equity attributable to equity holders of the Company} \times 100}{\text{total fixed assets}}$	0.93	1.06
Gearing Ratio	$\frac{(\text{equity attributable to equity holders of the Company} + \text{non-current provisions} + \text{non-current liabilities}) \times 100}{\text{total equity and liabilities}}$	0.56	0.53

*To calculate turnover ratios, the Group used amounts as at the beginning and as at the end of each reporting period.

As demonstrated in the table above, profitability ratios increased in 2016, as the Group generated higher net profit as compared to the previous year. Liquidity ratios remained at the level recorded in the previous year. Trade payables turnover ratio decreased, so did the inventory turnover ratio, which is always high in the Group due to the seasonality of its production. Equity to fixed assets ratio decreased slightly.

IV. The development of the Issuer and of the Group

1. Description of underlying risks and threats and of external and internal drivers of the development of the Parent Company and PEPEES Group

1.1

Risks and threats

- **The dependence of the production on weather and seasonality**

Potatoes are the only raw material for the production process. As a result, the volume and quality of the production depends on the potatoes harvest. Adverse weather conditions contribute to the reduction of potatoes harvest and of the starch content.

- **Globalisation**

Globalisation is noticeable mainly in terms of competitiveness. At present, there is strong competition from substitutes. In the food industry, there are a lot of products that perform similar functions (fillers and thickeners) as potato starch, i.e. wheat starch, corn starch, imported natural hydrocolloids such as guar gum, xanthan gum, gum arabic, locust bean gum and gelatin.

In addition, there is a lot of competition on the internal starch market in the European Union.

- **Dependence on the profitability of potato production**

Due to high costs of potato production, it is being supplanted by other more profitable agricultural crops. In addition, the north-eastern part of Poland became a large production region for the dairy industry, which “steals” agricultural areas from other industries. For this reason, it is getting more and more difficult to find new growers in the areas near the plant. As a result, the Group is forced to purchase raw materials from remote regions of Poland, which results in reduced profitability.

- **Currency risk**

Such risk arises as a result of the international trade in currencies other than the Polish złoty. Substantial fluctuations of currency exchange rates adversely affect the profitability of foreign transactions.

- **Economic fluctuations**

The state of the economic activity in the world, in Poland and in a particular sectors, affects the operations of a company through a variety of indicators and ratios (GDP, prices, wages, employment).

- **Limited money supply**

Less and less available and more and more expensive money on the market is the effect of the global crisis. This hits manufacturers very hard. They are forced to grant trade credits to their customers and extend payment deadlines.

- **Too expensive instruments that increase sales safety**

Granting credits to customers increases the risk of the failure to get paid for deliveries. Financial products offered on the market are expensive and significantly prolong transactions.

- **The sale of a product posing a risk to consumer health and life**

The Group manufactures food. In the case of the sale of a product posing a risk to consumer health or life, the Group's image would be severely tarnished, and the Group would have the obligation to pay compensations to customers and consumers, and to cover the costs related to the product recall and disposal.

The risk is very limited due to the Corporate Food Quality and Safety Management System. The product recall procedure has been implemented, and recall simulations are carried out.

1.2 External drivers of the successful development of the Issuer and the Group

The development of the Issuer and its Group as regards the potato industry depends primarily on the agricultural policy of the European Union and of Poland, and on the creation of proper conditions for the operation of the agricultural and food industry.

The main drivers of the successful development are as follows:

- The development of the Polish potato industry. For many years now, the Polish potato industry has been undergoing thorough structural remodelling. These changes result in greater professionalism of the potato production, which, in the future, may contribute to greater competitiveness of the Polish potato industry. The total number of farms producing potatoes is on the decrease, while, at the same time, the production is more concentrated and specialised.
- the possibility of obtaining financial means from EU funds to finance investment projects;
- the market demand for modified potato starch products;
- the access to new and modern technologies;
- the development of markets in international trade;
- the development of specialised agricultural holdings;
- A wide range of the applications of starch and its derivatives.
- Area payments for starch potatoes.

1.3 Internal drivers of the successful development of the Issuer and the Group

The most vital internal drivers important for their further development are as follows:

- Regular investments in and gradual modernisation of production departments in order to boost the efficiency and innovation of products, and to reduce operating costs.
- Active response to market needs and requirements.
- Implemented Corporate Food Quality and Safety Management System with appropriate certificates.
- Implemented GMP (good manufacturing practice) system for manufacturers of active substances.
- The Company’s compliance with Smeta; the presence on SeDeX platform.
- Very good cooperation with growers throughout the year.
- The possibility of producing hydrolysates to meet specific customers’ needs.
- Low costs of the disposal of industrial wastewater.
- High production capabilities.
- The implementation of investment strategies and taking investment measures.
- The expansion of the product range.
- Employees’ expertise and experience.

2. Development prospects for the Issuer and the Group

The Parent Company and the Group link their development not only with the processing of potatoes, but also with power generation in a biogas plant located in a subsidiary CHP Energia. This company combines the generation of electricity and heat (the so-called “[co-generation](#)”), which is characterised with the highest efficiency of the conversion of primary energy into final energy. Moreover, the generation of biogas results in the production of digestate, which is a very good [fertiliser](#) for cultivation purposes. In addition, weather-independent efficiency of the production of this fuel is a great advantage of power generation from biogas. The present global situation poses new challenges in terms of the reduction of costs of heat and electricity consumption. Energy carriers are rapidly becoming more and more expensive. Investors must face an important issue of abandoning traditional sources and using instead, for example, renewable energy from biogas, which is becoming more and more popular with Polish investors and enterprises. In addition, in the area of ecological safety, the benefit lies in the disposal of waste in agricultural production and agricultural and food processing, e.g. of potato pulp, which is waste from the production of potato starch.

The processing of potatoes will still remain the Group’s most important line of business; last year, this segment recorded a major increase in its production and sales. The Group has begun to expand into new foreign markets, especially in East Asia, South-East Asia, South America and developing European countries. This objective is being accomplished through the implementation of the export growth programme as part of the announced strategy. The Group will continue its research and development works in the cooperation with research institutes which specialise in research on the processing of starch and its derivatives, both as regards issues related to the company’s current business and a new range of products.

The main objective of the Group is the maximum rate of return on investment while maintaining a moderate level of investment risk. As a result, the strategy of PEPEES Group assumes carrying out parallel development activities by increasing the efficiency of the operations of the Group companies and minimising the risks to which they are exposed as well as carrying out further investing activities. In the case of the emergence of attractive offers on the market, we will continue investing activities both in and outside the Group.

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V. THE APPLICATION OF THE CORPORATE GOVERNANCE PRINCIPLES

I. Corporate governance principles the Issuer is governed by and the place where the text of the set of principles is publicly available

1. Pursuant to § 29 of the Rules of Giełda Papierów Wartościowych w Warszawie S.A. (Warsaw Stock Exchange), the Company should comply with the corporate governance principles contained in the document titled **Best Practice of GPW Listed Companies 2016**, which is an Appendix to Resolution No. 26/1413/2015 of the Supervisory Board of the Warsaw Stock Exchange dated 13 October 2015 (“Best Practice”), available at:
https://static.gpw.pl/pub/files/PDF/RG/DPSN2016__GPW.pdf.
- 2.

II. The extent to which the Issuer deviated from corporate governance principles, indicating such principles and explaining the reasons for such deviations

3. In 2016, PEPEES observed all the recommendations and principles of the Best Practice, except for the following recommendations and principles:

I. Disclosure policy, investor communications

I.Z.1. A company should operate a corporate website and publish on it, in a legible form and in a separate section, in addition to information required under the legislation:

4. I.Z.1.3 *“a chart showing the division of duties and responsibilities among members of the management board drawn up according to principle II.Z.1”*

5. The principle is not fully complied with. The division of duties is contained in the by-laws of the Board of Director available on the Company’s website.

6. I.Z.1.9 *“information about the planned dividend and the dividend paid out by the company in the last 5 financial years, including the dividend record date, the dividend payment date and the dividend amount, in aggregate and per share”*

7. The principle will be complied with if the General Meeting of Shareholders adopts the resolution on payment of dividend. In the last 5 years, no dividend has been paid.

8. I.Z.1.15 *“information about the company’s diversity policy applicable to the company’s governing bodies and key managers; the description should cover the following elements of the diversity policy: gender, education, age, professional experience, and specify the goals of the diversity policy and its implementation in the reporting period; where the company has not drafted and implemented a diversity policy, it should publish the explanation of its decision on its website”*

9. The Company has not developed and does not implement any diversity policy. When selecting members of the Board of Directors and of the Supervisory Board, the Company is invariably guided by the highest standards and, in this respect, does not discriminate against candidates because of their gender or other non-work-related traits. The authorities of the Company are selected taking into account primarily high competences, skills and professionalism of candidates.

10. I.Z.1.16. *“information about the planned transmission of a general meeting, not later than 7 days before the date of the general meeting”*

11. The Company is not planning any transmissions of the General Meeting of Shareholders.

I.Z.1.20. *“an audio or video recording of a general meeting”*

In accordance with applicable regulations, the Company draws up detailed records of general meetings of shareholders in the form of notarized minutes. In addition, by publishing required current reports and posting appropriate information on its website, the Company provides the shareholders with all relevant information concerning general meetings of shareholders. The Company believes that such principles ensure the transparency of general meetings of shareholders.

II. Management board, supervisory board

II.Z.2. *A company’s management board members may sit on the management board or supervisory board of companies other than members of its group subject to the approval of the supervisory board.*

Conflicts of interest are resolved in accordance with generally applicable laws, particularly pursuant to Article 380 of the Polish Commercial Code.

II.Z.3. At least two members of the supervisory board should meet the criteria of being independent referred to in principle II.Z.4.

Decisions concerning the selection of members of the Supervisory Board are made by the General Meeting of Shareholders. The Company’s Board of Directors do not have any influence on such appointments and do not have information on the independence of the members of the Supervisory Board. In the Company’s opinion, such a method of selecting members of the Supervisory Board properly protects the interests of the Company’s shareholders.

II.Z.4. Annex II to the European Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board applies to the independence criteria of supervisory board members. Irrespective of the provisions of point 1(b) of the said Annex, a person who is an employee of the company or its subsidiary or affiliate or has entered into a similar agreement with any of them cannot be deemed to meet the independence criteria. In addition, a relationship with a shareholder precluding the independence of a member of the supervisory board as understood in this principle is an actual and significant relationship with any shareholder who holds at least 5% of the total vote in the company.

The principle is not complied with. The Supervisory Board works primarily in accordance with applicable regulations, the Articles of Association and the By-laws of the Supervisory Board.

II.Z.5. Each supervisory board member should provide the other members of the supervisory board as well as the company’s management board with a statement of meeting the independence criteria referred to in principle II.Z.4.

The principle is not complied with. The Supervisory Board works primarily in accordance with applicable regulations, the Articles of Association and the By-laws of the Supervisory Board.

III. Internal systems and functions

III.R.1. The company’s structure should include separate units responsible for the performance of tasks in individual systems or functions, unless the separation of such units is not justified by the size or type of the company’s activity.

The separation of organisational units responsible for internal control, risk management, compliance and internal audit is not justified due to the scale of the Company’s activity.

III.Z.4. The person responsible for internal audit (if the function is separated in the company) and the management board should report to the supervisory board at least once per year with their assessment of the efficiency of the systems and functions referred to in principle III.Z.1 and table a relevant report.

In PEPEES, there is no separate internal audit function.

IV. General meeting, shareholder relations

IV.R.2. If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through:

- 1) real-life broadcast of General Meetings;*
- 2) real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting;*
- 3) exercise of the right to vote during a general meeting either in person or through a plenipotentiary.*

In the opinion of the Board of Directors, there is no need to broadcast General Meetings or ensure real-time bilateral communication. General Meetings of Shareholders are held in the Company's registered office at convenient times; therefore, the participation in them is not hindered in any way for shareholders interested in them, who want to take floor or exercise their voting rights (either in person or through a plenipotentiary). Extremely high attendance at General Meetings of Shareholders is proof of the same. In addition, the Company is of the opinion that, despite advanced technology, there is always the risk, for various reasons (including the reasons beyond the control of the Company, shareholders or third parties), of not being able to guarantee the technical and legal security of the real-time bilateral communication, or of exercising voting rights using electronic communication means, and any damage arising from related disruptions might result in an unreasonable increase in the costs of the Company's operations.

IV.Z.2. If justified by the structure of shareholders, companies should ensure publicly available real-time broadcasts of general meetings.

In the opinion of the Board of Directors, there is no need to broadcast General Meetings or ensure real-time bilateral communication. General Meetings of Shareholders are held in the Company's registered office at convenient times; therefore, the participation in them is not hindered in any way for shareholders interested in them, who want to take floor or exercise their voting rights (either in person or through a plenipotentiary). Extremely high attendance at General Meetings of Shareholders is proof of the same. In addition, the Company is of the opinion that, despite advanced technology, there is always the risk, for various reasons (including the reasons beyond the control of the Company, shareholders or third parties), of not being able to guarantee the technical and legal security of the real-time bilateral communication, or of exercising voting rights using electronic communication means, and any damage arising from related disruptions might result in an unreasonable increase in the costs of the Company's operations.

IV.Z.12. The management board should present to participants of an ordinary general meeting the financial results of the company and other relevant information contained in the financial statements to be approved by the general meeting.

12. In the opinion of the Board of Directors, there is no need to present and discuss results. Members of the Board of Directors are present at General Meetings of Shareholders and are ready to answer shareholders’ questions.

V. Conflict of interests, related party transactions

V.Z.6. In its internal regulations, the company should define the criteria and circumstances under which a conflict of interest may arise in the company, as well as the rules of conduct where a conflict of interest has arisen or may arise. The company’s internal regulations should among others provide for ways to prevent, identify and resolve conflicts of interest, as well as rules of excluding members of the management board or the supervisory board from participation in reviewing matters subject to a conflict of interest which has arisen or may arise.

The Company’s practice does not show that such regulations are necessary. In the case of conflicts of interest, the Company applies generally applicable laws.

VI. Remunerations

VI.R.1. The remuneration of members of the company’s governing bodies and key managers should follow the approved remuneration policy.

The Company adopted its remuneration policy, but members of the company’s authorities are not subject to it.

VI.Z.4. In this activity report, the company should report on the remuneration policy including at least the following:

- 1) general information about the company’s remuneration system;*
- 2) information about the conditions and amounts of remuneration of each management board member broken down by fixed and variable remuneration components, including the key parameters of setting the variable remuneration components and the terms of payment of severance allowances and other amounts due on termination of employment, contract or other similar legal relationship, separately for the company and each member of its group;*
- 3) information about non-financial remuneration components due to each management board member and key manager;*
- 4) significant amendments of the remuneration policy in the last financial year or information about their absence*

The aforementioned principle was not fully complied with by the Company. The reports disclose the remunerations of each member of the Board of Directors and of the Supervisory Board, but not broken down by fixed and variable remuneration components. The scope and form of disclosed information about the remuneration policy result, in particular, from generally applicable laws to be observed by issuers of securities.

III. Report on the remuneration policy

PEPEES has the remuneration policy which determines the form, structure and amounts of remunerations of the Company’s employees, including components depending on the Company’s results and the commitment of particular employees. Remunerations of members of the Company’s Board of Directors are determined by the Supervisory Board based on the qualifications, experience and responsibilities of a particular member of the Board of Directors. Remunerations of members of the Board of Directors include variable components, the

amounts of which depend on accomplished financial results and on the level of the accomplishment of objectives set by the Supervisory Board. Remunerations of members of the Board of Directors are paid by the Company and by subsidiaries, depending on the involvement of a given Board member in operating activities of individual subsidiaries. Remunerations of members of the Supervisory Board are determined by the General Meeting of Shareholders and they do not include variable components. In its Directors’ report, the Company discloses the total remuneration of members of the Board of Directors (not broken down into fixed and variable components) and of the Supervisory Board, broken down into amounts paid by the Company and jointly by the remaining entities from the Group.

In addition to their remuneration components, members of the Board of Directors and key employees use company cars and mobile phones, and participate in training courses financed by the Company. Last year, there were no significant amendments to the remuneration policy.

In the opinion of the Board of Directors, the remuneration policy is attuned to the achievement of the Company’s goals, in particular long-term shareholder value growth and the company’s stability.

IV. Sponsorship

PEPEES is a sponsor of many cultural, sporting and ecological events. In an effort to meet growing social, economic, cultural, educational and sports needs, principles have been adopted that may focus assistance on those areas where it can be used effectively. The sponsorship activities taken by the Company involve the financial and material support of regional and local initiatives. The primary direct goal of PEPEES sponsorship is to build and enhance brand awareness and to create a positive image of the initiatives in which PEPEES participates as a sponsor.

AREAS OF ACTIVITIES

The Company is committed to the following areas of life:

1. Sport and education
 - Promoting initiatives to support the development of science and education
 - Supporting the development of physical culture and sports education
2. Culture
 - Sponsoring local and regional events
3. Charity
 - Supporting organisations working for people in need

V. The description of the main features of any internal controls and risk management systems in relation to the process of preparing financial statements and consolidated financial statements

The effectiveness of the internal controls and risk management system in the process of preparing consolidated financial statements is ensured through the development, implementation and supervision of the application, in the companies of PEPEES Group, of consistent accounting policies. The Group’s companies submit required data in the form of reporting packets in order to prepare the consolidated financial statements of the Group. The scope of the disclosures in the Group is defined and results from disclosure requirements specified in IAS/IFRS. Changes in accounting standards are monitored on an ongoing basis in order to determine the need to update the scope of the reporting. All financial statements are verified by the Board of Directors of the parent company PEPEES. The Group’s companies have their financial statements reviewed every 6 months and audited on an annual basis by an independent certified auditor. Also, consolidated financial statements are subject to an audit. By the time of the publication of the financial statements and of the consolidated financial statements, the information is made available only to the employees involved in the process of their preparation, verification and authorisation, ensuring data confidentiality.

VI. Shareholders holding, directly or indirectly, qualifying holdings

To the best of our knowledge, as at 31.12.2016, the shareholding structure was as follows:

SHAREHOLDERS	Number of shares	Share in share capital %	Number of votes	Share in total number of votes at GMS %
Mr Maksymilian Maciej Skotnicki*	19,634,843	20.67	19,634,843	20.67
Mr Michał Skotnicki*	10,700,011	11.26	10,700,011	11.26
Mr Newth Jonathan Reginald	7,995,200	8.42	7,995,200	8.42
Mr Krzysztof Borkowski - indirectly	7,923,409	8.34	7,923,409	8.34
Epsilon Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych**	9,931,499	10.45	9,931,499	10.45
Richie Holding Ltd	6,133,100	6.45	6,133,100	6.45
Others	34,902,138	36.74	34,902,138	36.74
Total	95,000,000	100.00	95,000,000	100.00

* Mr Maksymilian Maciej Skotnicki and Mr Michał Skotnicki are persons referred to in Article 87 Clause 4 item 1 of the Act on Public Offering [...] and, thus, together they hold the total of 30,334,854 shares/votes representing 31.931% of the share capital of/the total number of votes in the Company.

**Epsilon Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych, as a result of the invitation announced on 21 September 2016, acquired 3,532,768 shares.

None of the remaining shareholders informed about the holding of at least 5% of the share capital.

VII. The holders of any securities with special rights

The Company did not issue any securities with special rights.

VIII. Any restrictions on voting rights

The Company’s Articles of Association do not provide for such restrictions. However, the prohibition for a shareholder to exercise his voting rights may result from Article 89 of the Act of 29 July 2005 on Public Offering and the Conditions for Introducing Financial Instruments to an Organised Trading System, and on Public Companies (hereinafter referred to as the “Offering Act”), if the shareholder violates specific provisions of Chapter 4 of the Offering Act. In turn, pursuant to Article 6 § 1 of the Polish Commercial Code, if the parent company fails to notify its subsidiary of the

emergence of the relationship of control within two weeks from the date of the emergence of this relationship, the voting rights attached to the shares of the parent company representing more than 33% of the share capital of the subsidiary will be suspended.

IX. Any restrictions on the transfer of securities

The Company’s Articles of Association do not provide for such restrictions. However, they result from the law, including Articles 11 and 19 of Chapter 4 of the Offering Act referred to above; and Part VI of the Act of 29 July 2005 on Trading in Financial Instruments; the Act of 16 February 2007 on Competition and Consumer Protection; and Council Regulation (EC) No. 139/2004 of 20 January 2004 on Control of Concentrations Between Undertakings.

X. The rules governing the appointment and dismissal of board members, and their powers

1. The Board of Directors is composed of one to five members. The term of office of the Board of Directors is three years, except for the term of office of the first Board of Directors, which is two years. The Supervisory Board appoints the President of the Board of Directors and, upon the motion of the President of the Board of Directors, also other members of the Board of Directors. The Supervisory Board determines the number of the members of the Board of Directors. The Supervisory Board may dismiss the President of the Board of Directors, a member of the Board of Directors or all members of the Board of Directors prior to the expiration of the term of office of the Board of Directors. The Board of Directors exercises all the powers related to the management of the Company, except for the powers reserved by the law or the Articles of Association to other Company's authorities.
2. The operation of the Board of Directors, and the matters that can be assigned to its particular members, are determined in detail in the By-laws of the Board of Directors. The By-laws of the Board of Directors are adopted by the Company's Board of Directors and approved of by the Supervisory Board.
3. The following persons are authorised to make declarations and sign documents on behalf of the Company: (i) if the Board of Directors is composed of one member – President of the Board of Directors; (ii) if the Board of Directors is composed of more than one member – two members of the Board of Directors acting jointly or one member of the Board of Directors acting jointly with a proxy.
4. The Supervisory Board enters into, on behalf of the Company, agreements with the members of the Board of Directors and represents the Company in disputes with the members of the Board of Directors. The Supervisory Board may authorise, by virtue of its resolution, one or more its members to perform such legal acts.

5. The Company’s employees are subordinate to the Board of Directors. The Board of Directors enters into and terminates their contracts of employment and determines their remunerations.
6. The decision on the issue or redemption of shares is made by the General Meeting of Shareholders by way of its resolution.

XI. Amendments to the Company’s Articles of Association

Amendments to the Company's Articles of Association are made by virtue of a resolution of the General Meeting of Shareholders. Such resolutions are adopted with the majority of three-fourths of the votes cast. Resolutions regarding amendments to the Company’s Articles of Association, which increase the benefits of shareholders or reduce the rights bestowed personally upon individual shareholders, require the consent of all affected shareholders.

XII. The operation of the General Meeting of Shareholders and its powers

12.1. The basic principles of the operation of the General Meeting of Shareholders are as follows:

1. The Ordinary General Meeting of Shareholders is convened each year by the Board of Directors in June at the latest.
2. The agenda of the General Meeting of Shareholders is determined by the Board of Directors in consultation with the Supervisory Board.
3. The Supervisory Board and shareholders representing at least 5% of the share capital may demand to include particular items in the agenda of the General Meeting of Shareholders.
4. General Meetings of Shareholders are held in the Company’s registered office.
5. The General Meeting of Shareholders may adopt resolutions regardless of the number of shareholders present at the Meeting or shares represented at it.
6. Resolutions are adopted at the General Meeting of Shareholders in voting.
7. Resolutions of the General Meeting of Shareholders are adopted with a simple majority of the votes cast, unless the Articles of Association or the law provide for otherwise.
8. Resolutions of the General Meeting of Shareholders are adopted with the majority of 3/4 of the votes cast in the case of the following matters:
 - a) amendments to the Articles of Association, including issues of new shares;
 - b) issues of bonds;
 - c) the disposal of the Company's enterprise;
 - d) the Company's business combination with another company;

e) the Company's winding-up and dissolution.

9. The voting at the General Meeting of Shareholders is open. Confidential voting is ordered in the case of elections and motions concerning the dismissal of members of the Company’s authorities or liquidators, and on making them accountable, and on personal matters. Resolutions on amendments to the Company's objects are adopted by an open vote by roll call.

10. Shareholders entitled to participate in the General Meeting of Shareholders are the shareholders listed in the shareholders register drawn up by the Board of Directors in accordance with the principles resulting from applicable laws, particularly in accordance with Article 406 § 2 and Articles 406¹ – 406³ of the Polish Commercial Code.

11. The following persons may also be present at the General Meeting of Shareholders: each member of the Board of Directors; each member of the Supervisory Board; the notary public and his/her aides; the certified auditor; members of the organisational and technical support team for the General Meeting of Shareholders authorised by the Board of Directors; other persons designated by the authority convening the General Meeting of Shareholders. Persons other than those mentioned above may be present only with the consent of the Chairman of the General Meeting of Shareholders, who has the right, at all times and without justification, to order any such person to leave the room where the General Meeting of Shareholders is taking place.

12. The General Meeting of Shareholders is opened by the Chairman of the Supervisory Board or his deputy, and, in their absence, by the President of the Board of Directors or any other person designated by the Board of Directors. The person opening the General Meeting of Shareholders orders to put forward candidates for the Chairman of the General Meeting of Shareholders, and, when such candidates are proposed, to elect the Chairman.

13. The Chairman of the General Meeting of Shareholders presents to shareholders the agenda as proposed by the Board of Directors in the notice on the convening of the General Meeting of Shareholders and, in the absence of draft resolutions, formulates and presents draft resolutions. Any shareholder may submit a draft resolution concerning any matter included in the agenda.

12.2.

XIII. The composition and operation of the management and supervisory bodies

1. The composition of the Board of Directors of PEPEES as at 31.12.2016:

Mr Wojciech Faszczewski – President

Mr Tomasz Rogala – Member

The operation and powers of the Company’s Board of Directors are governed by the Company’s Articles of Association and the By-laws of the Board of Directors.

Basic principles of the operation of the Board of Directors are described in item X above.

2. The composition of the Supervisory Board of PEPEES as at 31.12.2016:

Mr Maciej Kaliński –Chairman

Mr Piotr Marian Taracha– Vice-Chairman

Mr Krzysztof Stankowski – Secretary

Ms Agata Czerniakowska – Member

Mr Robert Malinowski – Member

Basic principles of the operation of the Supervisory Board are defined in the Company's Articles of Association and the By-laws of the Supervisory Board. According to these regulations, the Supervisory Board is composed of five to nine members. The term of office of the Supervisory Board is three years. The Supervisory Board elects, from among its members, the Chairman and one or two vice-chairmen and a secretary. The Chairman of the Supervisory Board convenes the Board meetings and presides over them. The Chairman of the outgoing Supervisory Board convenes and opens the first meeting of the newly elected Supervisory Board and presides over it until the time of electing the new Chairman. The Supervisory Board holds its meetings at least once a quarter. The Chairman of the Supervisory Board or one of his/her deputies must convene the Board meeting upon a written request of at least two members of the Supervisory Board. The meeting should be convened within one week from the date of the request, on the day falling not later than the final day of the period of two weeks from the date of convening the meeting. For resolutions of the Supervisory Board to be valid, all its members must be invited to the meeting. The Supervisory Board adopts resolutions with an absolute majority of the votes present at the meeting of the members of the Supervisory Board, on condition that at least half of its members are present at the meeting. Resolutions of the Supervisory Board may also be adopted without a meeting by voting in writing if all members of the Supervisory Board agree in writing to adopting resolutions in such a manner. The Supervisory Board adopts its by-laws specifying in detail the operation of the Board. The Supervisory Board may delegate its members to perform specific supervisory activities on an individual basis. The General Meeting of Shareholders determines the remuneration of the members of the Supervisory Board.

Pursuant to the Company's Articles of Association, apart from the matters provided for in legal acts, in other provisions of the Articles of Association or in the resolutions of the General Meeting of Shareholders, the Supervisory Board has the following powers:

- 1) examining the annual balance sheet and income statement, and ensuring their verification by certified auditors chosen by it;
- 2) examining and evaluating the Board of Directors' report;
- 3) examining on an annual basis and approving of the Company's business, financial and marketing plans, and requesting the Board of Directors to present detailed reports on the implementation and accomplishment of such plans;
- 4) submitting to the General Meeting of Shareholders written reports on the results of the activities referred to in items 1-3;
- 5) expressing opinions on the proposals of the Company's Board of Directors regarding the distribution of profits, including amounts allocated to

dividend, dividend payment dates or the principles governing the covering of losses;

- 6) authorising transactions involving the disposal or acquisition of shares or other assets, or the taking out of a cash loan, if the value of a given transaction exceeds 15% of the Company’s net assets as per the most recent balance sheet;
- 7) appointing, suspending and dismissing members of the Board of Directors;
- 8) delegating Supervisory Board members to perform the duties of the Board of Directors in the event of the suspension or dismissal of the entire Board of Directors or when the Board of Directors is not capable of working for other reasons;
- 9) approving of the rules, adopted by the Board of Directors, governing the allocation of shares to eligible employees.

The following **Audit Committee** was appointed by virtue of the resolution of the Supervisory Board on 5 July 2016:

Mr Krzysztof Stankowski – Chairman

Mr Robert Malinowski – Vice-Chairman

Mr Piotr Łuniewski – Member

It had been the composition of the Audit Committee until 29 December 2016.

The main tasks of the Committee are as follows:

- Supervision in the form of the monitoring of financial reporting of the Company and of the Group, and financial auditing.
- Monitoring the effectiveness of internal control systems and internal audit.
- Reviewing financial statements of the Company.
- Monitoring the work and independence of the statutory auditor and of the entity authorised to audit financial statements.
- Recommending the selected entity authorised to audit financial statements to the Supervisory Board.
- Discussing the audit process with the auditor.
- Examining the Company’s documents.
- Submitting the annual report on its activities to the Supervisory Board.

The mode of the operation of the Audit Committee:

- The Audit Committee holds meetings as needed, at least twice a year.
- The meetings of the Committee are convened by its Chairman, either upon his own initiative or upon the request of any member of the Audit Committee, and also upon the request of the Board of Directors, internal or external auditor. A meeting of the Audit Committee may also be convened by the Chairman of the Supervisory Board.
- The agenda of the meeting of the Audit Committee is determined by the party convening the meeting, and it may be amended during the meeting.
- The Chairman of the Audit Committee may invite persons not being members of the Audit Committee to attend a given meeting.
- The meetings of the Audit Committee are recorded in the form of written minutes. The minutes are signed by the Chairman of the Audit Committee.
- The Audit Committee may adopt resolutions if at least half of its members participate in the meeting of the Audit Committee.

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- The Audit Committee may adopt resolutions in writing, provided that all members of the Audit Committee have been notified of the texts of draft resolutions.
- Resolutions of the Audit Committee are taken by a simple majority of the votes cast.
- The Company ensures the organisational and technical support for the Audit Committee.

12.3.

<i>Signatures of all Members of the Board of Directors of the Parent Company</i>			
<i>Date</i>	<i>Name</i>	<i>Title/Function</i>	<i>Signature</i>
17.03.2017	Wojciech Faszczeński	President of the Board of Directors	
17.03.2017	Tomasz Rogala	Member of the Board of Directors	

12.4.