

**Assessment of the standing of KGHM Polska Miedź S.A. for financial year 2015, including an evaluation of the internal control, risk management and compliance systems and the internal audit function**

*(Approved by Resolution No. 40/IX/16 of the Supervisory Board of KGHM Polska Miedź S.A. dated 17 May 2016)*

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# **Assessment of the standing of KGHM Polska Miedź S.A. for financial year 2015, including an evaluation of the internal control, risk management and compliance systems and the internal audit function**

## **Introduction**

In accordance with section II.Z.10. of the „Code of Best Practice for WSE Listed Companies” the Supervisory Board of KGHM Polska Miedź S.A. hereby presents an „Assessment of the standing of KGHM Polska Miedź S.A. for financial year 2015, including an evaluation of the internal control, risk management and compliance systems and the internal audit function”. This assessment was prepared based on documents submitted by the Management Board, discussions held with the participation of the Management Board and other individuals invited to attend meetings of the Supervisory Board, and also takes into account the financial statements and the reports of the Management Board on the Company's activities, and based on the conclusions from the audit of the Company's accounts by a Certified Auditor.

## **1. Economic results of KGHM Polska Miedź S.A. in 2015**

### **1.1 Mine and metallurgical production**

Mine production in the Company, in comparison to 2014, was higher by 1% (425.9 thousand tonnes of Cu in concentrate), while the deterioration of copper content in ore (caused by mining in areas with a lower copper ore grade) was offset by higher ore extraction. Electrolytic copper production volume was maintained at the level of 2014 and amounted to 574.3 thousand tonnes, with copper production from own concentrates maintained at a level above 420 thousand tonnes. Production was maintained thanks to processing a higher amount of own concentrate as well as purchased metal-bearing materials in the form of scrap, blister copper and imported concentrate, which enabled the efficient utilisation of existing technology.

In comparison to 2014, the production of metallic gold increased by 128 kg, or by 5.0% and for the first time in KGHM's history reached the level of 2 703 kg. Metallic silver production was higher by 27 tonnes and amounted to 1 283 tonnes.

### **1.2 2015 macroeconomic environment**

In 2015 the average annual price of copper was 5 495 USD/t, which was 20% lower as compared to the prior year. Silver decreased by a similar amount (18%), and averaged 15.68 USD/ounce.

The average annual USD/PLN exchange rate (per the NBP) in 2015 amounted to 3.77 USD/PLN and was nearly 20% higher than the rate in 2014 (3.15 USD/PLN).

### **1.3 Sales revenue**

In 2015 the Company recorded a slight decrease (1.9 thousand tonnes, or 0.3%) in copper sales volume, reflecting the change in the volume of electrolytic copper production. There was a change in the structure of sales of copper products towards more highly-processed products – sales of copper wire rod and OFE rod increased by 2.8% (7.3 thousand tonnes) alongside lower sales of cathodes by 3.1% (9.5 thousand tonnes).

Silver sales amounted to 1 245 tonnes and were lower by 1.4% (17 tonnes) as compared to the prior year, while gold sales increased by 5.1% (130 kg) and amounted to 2 660 kg. The increase in gold sales was due to the higher production of this metal by 5.0% (128 kg) due to the processing of purchased copper-bearing materials which among others contained a high level of gold.

Total revenues from sales in 2015 amounted to PLN 15 939 million and were lower by 4.2% than revenues achieved in 2014, mainly as a result of the decrease in metals prices expressed in the Polish zloty and to a decrease in copper sales volume by 1.9 thousand tonnes.

The value of revenues from sales in 2015 reflects the positive result from the settlement of hedging instruments in the amount of nearly PLN 482 million (in the prior year PLN 531 million).

### **1.4 Cost of sales, selling costs and administrative expenses**

The Company's cost of sales, selling costs and administrative expenses in 2015 amounted to PLN 12 655 million and were 3.5% lower as compared to 2014, mainly due to the fall in metals prices, which resulted in lower costs of purchased metal-bearing materials and a lower minerals extraction tax.

Expenses by nature as compared to 2014 were lower by 2.4% (-PLN 311 million) and had a similar structure.

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After excluding the cost of purchased metal-bearing materials and the minerals extraction tax, expenses by nature were higher by PLN 106 million, mainly due to higher depreciation/amortisation by PLN 92 million due to advancement of the investment program.

The **cost of producing copper in concentrate - C1** in 2015 amounted to 1.47 USD/lb, compared to 1.82 USD/lb in 2014. The decrease in this cost by 19% was due to:

- the weakening of the PLN as compared to the USD (C1 cost achieved in 2015, using the USD/PLN exchange rate and metals prices from 2014, would have amounted to 1.75 USD/lb),
- the 1.2% higher production of copper in concentrates, and
- the 2.1% higher content of silver in own concentrates.

### **1.5 Financial results**

The Company recorded a loss for 2015 in the amount of PLN 2 788 million. The decrease by PLN 5 202 million as compared to earned profit for 2014 was mainly due to the impact of higher impairment losses on non-current assets (-PLN 5 236 million), including mainly impairment losses on shares in a holding company (Fermat 1 S.ar.l.) which indirectly owns 100% of the shares of KGHM INTERNATIONAL LTD. (-PLN 4 854 million).

The aforementioned impairment loss was the result of impairment testing of assets, in respect of which a key impairment indicator was the decrease in the market price of copper, silver, molybdenum and other commodities. In order to assess the risk of impairment of shares in Fermat 1, the fair value of the investment in KGHM INTERNATIONAL LTD. was estimated based on the sum of the fair values of individual CGUs within KGHM INTERNATIONAL LTD., decreased by liabilities and increased by other assets.

Other significant factors impacting the result as compared to 2014 were:

- the decrease in revenues from the sale of basic products (Cu, Ag, Au) by PLN 645 million, including due to lower metals prices (-PLN 3 670 million), a lower volume of copper and silver sales (-PLN 59 million) alongside a more favourable USD/PLN exchange rate (+PLN 3 029 million) and higher revenues from the sale of other products (+PLN 55 million),
- a decrease in the cost of sales, selling costs and administrative expenses by PLN 465 million, including a decrease in the minerals extraction tax by PLN 143 million and a decrease in other costs, mainly due to lower consumption of purchased metal-bearing materials,
- a change in the balance of income and costs due to interest on borrowings, including fees and commissions (+PLN 121 million),
- the impact of exchange differences (+PLN 97 million),
- the impact of hedging transactions (-PLN 85 million), of which due to the measurement and realisation of derivatives (-PLN 36 million) and to adjustments to revenues (-PLN 49 million), and
- lower income tax by PLN 98 million due to the lower tax base.

### **1.6 Company assets, equity and liabilities**

At the end of 2015, total assets amounted to PLN 33 120 million, an increase by PLN 808 million (+2.5%) as compared to the end of 2014.

The increase in assets resulting from realised tangible investments (+PLN 1 570 million) and loans granted (+PLN 4 709 million, related to refinancing the debt of KGHM INTERNATIONAL LTD.) was limited by the decrease in investments in subsidiaries (-PLN 4 920 million) mainly due to impairment losses.

The main changes in equity and liabilities were as follows:

- equity (-PLN 3 998 million) due to the loss for the period of PLN 2 788 million,
- liabilities due to borrowings (PLN 4 714 million), which increase was caused by the debt consolidation in the Group at the Parent Entity level.

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**1.7 Selected financial ratios**

|                                       | 2014 | 2015  |
|---------------------------------------|------|-------|
| Return on assets (ROA) (%)            | 7.5  | -8.4  |
| Return on equity (ROE) (%)            | 9.9  | -13.7 |
| Quick liquidity                       | 0.6  | 0.4   |
| Current liquidity                     | 1.3  | 0.9   |
| Debt ratio (%)                        | 24.9 | 38.8  |
| Durability of financing structure (%) | 88.1 | 84.6  |
| Net debt / EBITDA of the Group*       | 0.9  | 1.4   |

\* adjusted EBITDA, excluding JV Sierra Gorda SCM

The loss in 2015, caused by the impairment losses on assets, resulted in the negative amounts of the profitability ratios - ROA and ROE.

The decrease in both the current quick and liquidity ratios as compared to 2014 was mainly due to an increase in current liabilities due to borrowings. The liquidity ratios are currently at a safe level.

In 2015, there was an increase in debt due to borrowings drawn, as well as an increase of current liabilities. As a result, at the end of 2015 current liabilities amounted to PLN 5 085 million and were higher than current assets by PLN 371 million. The Company uses working capital facilities and overdraft facilities with maturities of up to 2 years. As a result of the above, as well as of the successive extension of the financing available under these bilateral agreements for subsequent periods, the Company considers the liquidity risk related to short-term bank loans received as low.

As compared to the prior year the debt ratio increased, which on the separate level reflects an increase in the use of borrowing to finance activities due to the consolidation of debt in KGHM Polska Miedź S.A. (in accordance with the Group's financing strategy as well as best market practice for large international groups). The current level of debt is still lower than the average for the sector.

In light of the above, analysis of the Net debt/EBITDA ratio should primarily be based on the level of this ratio for the Group. The level of this ratio, both for the Company and the Group, demonstrates the safe financial condition of KGHM Polska Miedź S.A. – in accordance with the Company's Financial Liquidity Management Policy, it is assumed that this ratio will remain below the level 2.0.

The similar and high level of the financing structure durability ratio confirms the long-term nature of the Company's borrowing.

**2. Key events in 2015**

**2.1 Debt restructuring in the Group**

In 2015, the Company continued the process of debt consolidation in the Group at the Parent Entity level by refinancing the USD 700 million debt of KGHM INTERNATIONAL LTD. (a syndicated credit facility of USD 200 million and USD 500 million in senior notes). The consolidation of debt is the basic tenet of the Group's financing strategy and conforms with best market practice for large international groups. The adoption of such a financial strategy results in:

- lower borrowing costs of the Group,
- more efficient use of cash,
- enhanced transparency in the Group's borrowing structure,
- optimisation of the Group's financial and non-financial covenants, and
- the elimination of collateral established on the assets of KGHM INTERNATIONAL LTD.

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### **2.2 Sierra Gorda: start of commercial production and outlook for the mine**

Since September 2011 the Sierra Gorda project has been a joint venture (under the JV company Sierra Gorda S.C.M.) of KGHM INTERNATIONAL LTD. (55%) and companies of the Sumitomo Group and is a key development project of the KGHM Polska Miedź S.A. Group.

The Sierra Gorda mine commenced copper production on 30 July 2014, in April 2015 the molybdenum installation commenced production, and on 1 July 2015 the Sierra Gorda mine commenced commercial production (since then it has prepared operational statements of profit or loss).

The mine is still in the ramp-up phase aimed at achieving target processing capacity, during which work is underway to optimise and verify the technical assumptions of the existing infrastructure. As a result of these actions, at the end of 2015 the maximum daily amount of ore processed was recorded at the level of over 130 thousand tonnes of ore. Following the ramp-up phase, which will be completed in 2016, the mine will have annual production of 120 thousand tonnes of copper and 40-50 million pounds of molybdenum in its first years of operation.

In 2015, the process of optimising project assumptions was carried out aimed at reducing capital expenditures and improving the functional efficiency of the plant. The goal of the Sierra Gorda Oxide project is to process the oxide ore obtained during construction and development of the Sierra Gorda mine. Under consideration is the recovery of metal in an installation using SX/EW technology. The oxide ore is currently being stored separately for later heap leaching. In 2015, advanced engineering and design work aimed at selecting alternative concepts to maximise the project's economic value was performed. At the current stage the project is being advanced by KGHM INTERNATIONAL LTD. The base case scenario for this investment foresees inclusion of the Sierra Gorda Oxide project within the structure of Sierra Gorda S.C.M. and its joint advancement with Sumitomo. All of the expenditures related to the project, until Sumitomo joins the project, are incurred by KGHM INTERNATIONAL LTD.

### **2.3 Advancement of the Victoria project**

In the fourth quarter of 2015 work on the Basic Engineering document was completed, comprising detailed technical documentation based on which the mine will be built. This document is the work of an interdisciplinary team of specialists from Canada as well as Poland (including representatives of the companies Cuprum and PeBeKa). In 2015 alternatives for accessing the deposit were analysed, comprised of a detailed technical and economic analysis. The result of this work was an optimised project for the future mine in terms of the most rapid development and the most economically and technically attractive plan.

In 2015, additional exploration work was performed aimed at confirming the potential continuity of the mineralisation below the currently identified orebody. As part of the work conducted, two multilateral drillholes were sunk to a depth of around 2200 meters below the surface. Analysis of the results obtained from this drilling for core samples gave positive preliminary results.

In 2015, work was carried out on preparing surface infrastructure – construction of the transformer station was completed, and work was performed aimed at connecting it to the high-voltage network. In addition, the terrain of the future mine was prepared in terms of necessary surface work, among others setting aside a site for storing barren rock. The infrastructure developed is necessary in terms of creating the possibility to commence work on sinking the shafts.

Due to the current macroeconomic environment, the Management Board of KGHM Polska Miedź S.A. decided to modify the previously adopted schedule for the project.

### **2.4 Tangible investments**

In 2015, expenditures on tangible investments amounted to PLN 2 673 million (including expenditures incurred on uncompleted development work -PLN 18 million, and borrowing costs of -PLN 57 million).

Around 40% of expenditures were incurred on advancement of projects involving replacing equipment and maintaining mine production in the core business, aimed at maintaining mine production at the planned level.

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The remaining expenditures in 2015 involved development projects which impact the production line, production volume, implementing activities to optimise the use of existing infrastructure, controlling production costs and adapting the company's operations to changes in standards, laws and regulations.

The following development projects were subjected to the detailed supervision of the Supervisory Board in 2015:

**Żelazny Most project, ensuring the ability to store flotation tailings after 2016-ŻM** (in 2015 expenditures incurred amounted to PLN 19 million)

Advancement of the ŻM project is important for the operations of the core business due to the need to ensure the ability to store flotation tailings after 2016.

The ŻM project is in the preparatory stage. Work related to obtaining administrative permits is proceeding in accordance with revised assumptions. At the present date, completion of the project within the planned schedule (2020) is realistic.

### **Metallurgy development**

To achieve the key goal of a comprehensive strategy of metallurgical modernisation, i.e. possessing infrastructure which will ensure cathode production at the planned level while maintaining an optimal and achievable structure to process both own concentrates and purchased metal-bearing materials, the following projects were carried out in 2015:

- **Pyrometallurgy Modernisation Program- PMP** (in 2015 expenditures incurred amounted to PLN 616 million)

The timely completion of this project is necessary in order to synchronise the start-up of the installation with the planned smelter shutdown, and will impact the financial results of the Company in 2016.

The project is in the main stage of advancement. Progress on the project to date indicates the possibility of completing required work necessary to connect the new installations to the smelter's production line in accordance with the adopted schedule and planned shutdown of the Głogów I smelter.

Nonetheless there are still risks which could affect the timely start-up of the Flash Furnace installation (the quality of project documentation, contractor potential, prototype risk, the impact of the scale of the technological start-up).

- **Metallurgy Development Program - MDP** (in 2015 expenditures incurred amounted to PLN 311 million)

Under this program, in 2015 projects were commenced related to adapting technical infrastructure to the change in smelting technology at the Głogów I smelter/refinery, based on taking technical-technological actions aimed at optimising the utilisation of the modernised metallurgical infrastructure in terms of investment projects currently underway at the Głogów smelter/refinery, and in particular the PMP program.

**Ore Access Program - OAP (formerly Deep Głogów)** (in 2015 expenditures incurred amounted to PLN 366 million)

Under this program, projects related to the development of mine infrastructure (preparatory drifts and mining sections as well as mining work and infrastructure required to equip these areas) are being advanced.

The scope of program work in 2015 was reviewed based on current technical and economic assumptions (TEA 2015) assuming operations to the year 2055.

Expenditures incurred in 2015 on hubs and mine work were comparable to expenditures incurred in prior years, which guarantees an appropriate lead time for mining operations.

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**3. Assessment of the risk management system in the Company in 2015**

The KGHM Polska Miedź S.A. Group defines risk as uncertainty, being an integral part of the activities conducted and having the potential to result in both opportunities and threats to achievement of the business goals. The current, future, actual and potential impact of risk on the Group's activities is assessed. Based on this assessment, management practices are reviewed and adjusted in terms of responses to individual risk factors.

Under the Corporate Risk Management Policy and Procedure approved in 2013 and the Rules of the Corporate Risk Committee, the process of corporate risk management in the KGHM Polska Miedź S.A. Group is consistently performed. Risk factors in various areas of the Group's operations are continuously identified, assessed and analysed in terms of their possible limitation.

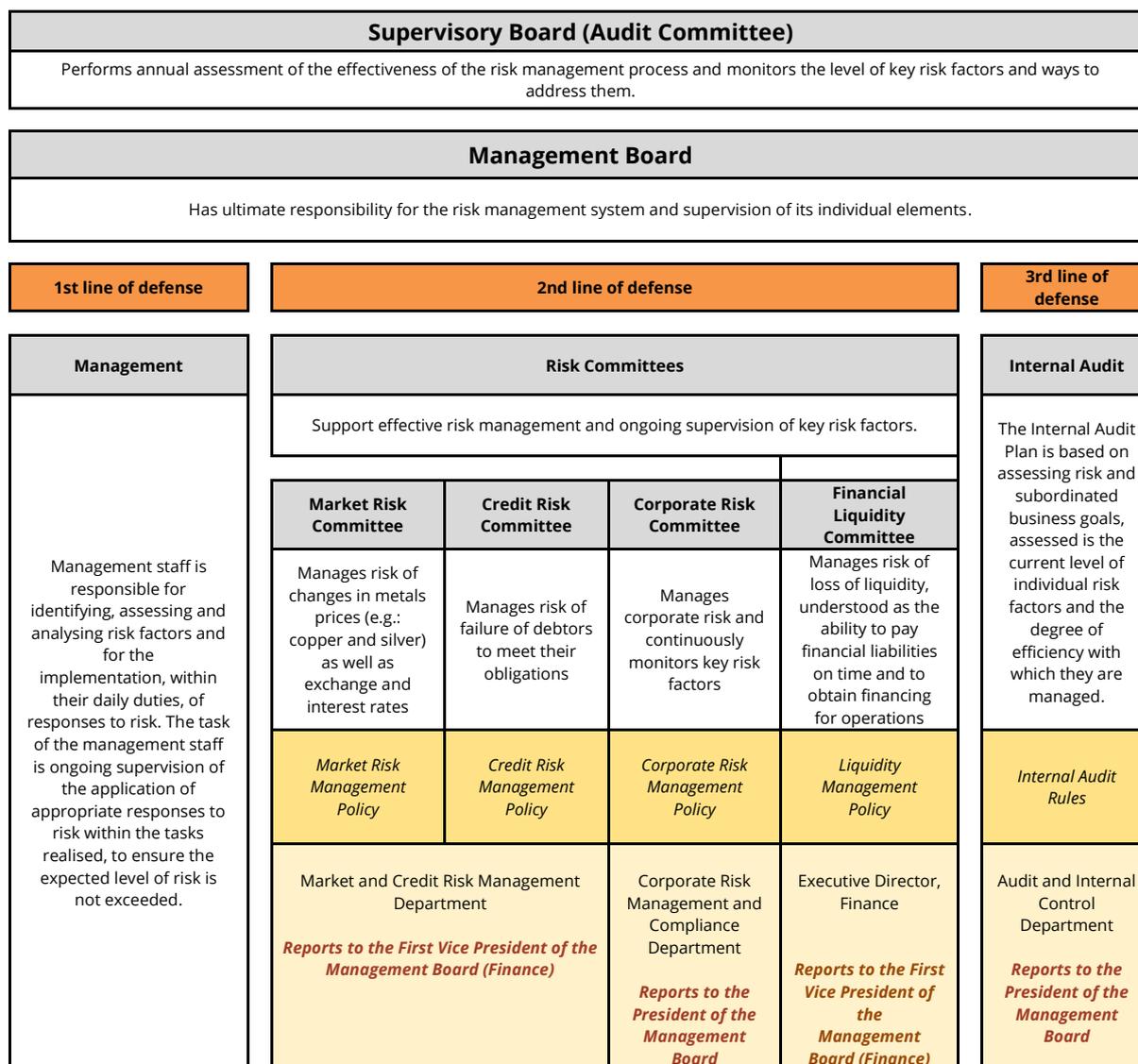
Key risk factors undergo in-depth analysis in order to develop a Risk Response Plan and Corrective Actions. Other risk factors undergo constant monitoring by the Corporate Risk Management and Compliance Department, and in terms of financial risk by the Executive Director for Finance and the Market and Credit Risk Management Department.

This comprehensive approach to risk analysis also comprises the identification of risk factors related to achieving postulated strategic goals.

Following is the organisational structure of risk management in the Company. The breakdown of rights and responsibilities applies best practice principles for Corporate Governance and the generally recognised model of three lines of defense.

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**Diagram 1. Organisational structure of risk management in KGHM Polska Miedź S.A.**



**Market, credit and liquidity risk**

The management of individual market, credit and liquidity risks is regulated by individual, detailed regulations in KGHM Polska Miedź S.A. as set forth in the following documents:

- Market Risk Management Policy and the Rules of the Market Risk Committee,
- Credit Risk Management Policy and the Rules of the Credit Risk Committee, and
- Financial Liquidity Management Policy and the Rules of the Financial Liquidity Committee.

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The goal of market, credit and liquidity risk management in KGHM Polska Miedź S.A. is to restrict the undesired impact of financial factors on cash flow and Company results in the short and medium terms and creating a Company's value over the long term. The management of these risk factors includes both the processes of risk identification and measurement as well as its restriction to acceptable levels. The process of risk management is supported by an appropriate policy, organisational structure and procedures in the Company.

The Management Board is responsible for managing financial liquidity in the Company and for adherence to the Liquidity Management Policy adopted in this regard. The Financial Liquidity Committee, which was created in 2015, supports the Management Board in carrying out this policy.

In March 2014, a new Market Risk Management Policy in the KGHM Polska Miedź S.A. Group was approved, and representatives of KGHM INTERNATIONAL LTD. were added to the composition of the Market Risk Committee. These changes were aimed at setting principles and procedures with respect to market risk management in selected mining companies of the Group (KGHM Polska Miedź S.A., KGHM INTERNATIONAL LTD., FNX Mining Company inc., Robinson Nevada Mining Company, KGHM Ajax Mining Inc., Sociedad Contractual Minera Franke). The Policy concerns exposure to the following market risks: volatility in metals prices, volatility in exchange rates, volatility in interest rates and volatility in prices of commodities other than metals.

The goals of market risk management at the Group level are achieved through their implementation in individual Group companies, through the coordination of these activities at the Parent Entity level, i.e. KGHM Polska Miedź S.A. Key tasks were centralised in the Company related to the process of market risk management in the Group (such as coordination of the identification of sources of exposure to market risk, proposing hedging strategies, contacting financial institutions in order to sign, confirm and settle derivatives transactions, and calculating measurement to fair value).

Starting from 2016, the market risk management system will be assessed annually in terms of its effectiveness by the internal audit function, pursuant to the principles set forth in the document „Best Practice of GPW Listed Companies 2016” adopted by the Supervisory Board of Warsaw Stock Exchange.

### **4. Evaluation of the compliance system in the Company in 2015**

KGHM Polska Miedź S.A. defines compliance as adherence to laws generally in force and to voluntarily adopted legal regulations (e.g. ISO standards). The Company recognises that compliance is an important element in its effective functioning, which requires that decisive actions to be taken to ensure that this goal is achieved.

For this reason as well, despite the functioning of certain elements of the compliance management system (such as access by employees to a legal acts data base, formal internal procedures for requesting interpretations of laws, and processes to identify legal requirements and to assess their compliance with the ISO standards in force in the Company), in 2013 a Corporate Risk Management and Compliance Department was created, whose task is among others to create, implement and maintain the process of management compliance in the Company throughout its business operations.

In 2014 the Corporate Risk Management and Compliance Department analysed the structural, organisational, technical and methodological possibilities of necessary elements of the process and the organisation of compliance management. As a result of this work, a compliance management process inspired by the ISO 19600 standard was created, which is uniform and integrated with the remaining key elements to ensure compliance, including among others the process of corporate risk management, the audit and internal control processes, management systems based on ISO standards, legal service processes and the function of corporate social responsibility and business ethics.

In 2015 pilot work was carried out to implement the compliance management process in the Company, based on whose results the process will be formally approved (by confirming among others compliance management Policy and Procedures).

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This process complies with the specific principles of the updated „Best Practice of GPW Listed Companies 2016” adopted by the Supervisory Board of the Warsaw Stock Exchange and will be assessed annually in terms of its functional effectiveness by the internal audit function.

### **5. Evaluation of the internal audit and internal control systems**

The functions of internal audit and internal control are performed by a separate organisational unit in the structure of KGHM Polska Miedź S.A. – the Audit and Internal Control Department. This unit was established on 1 July 2013 through the combination of the former Department of Internal Auditing and Department of Internal Control.

This joint Department systematically evaluates and monitors the control mechanisms and identifies potential risks in individual processes occurring in the Company and in the entire Group, as well as uncovers irregularities and violations of existing procedures.

Auditing activities focus on assessing risk and evaluating and monitoring the functioning of the internal control systems in individual processes occurring in the Company and Group. Control activities focus in particular on uncovering irregularities and violations of existing procedures.

The work of auditing and internal control in KGHM Polska Miedź S.A. is based on the principle of independence, and may encompass virtually all areas of the Company's and Group's operations. In cases where the employees of the Audit and Internal Control Department do not possess sufficient competence in an area which is to be assessed, the Department makes use of independent internal or external experts.

In 2015, the Audit and Internal Control Department performed assessments in 54 various subject areas. Most of these assessments in specific areas were performed in several, or a dozen or so, Group subsidiaries simultaneously. Controls and audits were performed both in the divisions as well as in companies of the KGHM Polska Miedź Group, including those outside Poland.

As a result of audits performed in 2015, recommendations were formulated for implementation which eliminated ineffective controls mechanisms and minimised potential risks in analysed processes. The observations, results and recommendations from the comprehensive work were described in the Report on the implementation of the audit and internal control Plan of the KGHM Polska Miedź S.A. Group for 2015.

The projects carried out uncovered irregularities and violations most often of a procedural nature (improper execution of internal regulations), improper operation of equipment, violation of employee obligations, and also irregularities in the execution of services by contractors on behalf of the divisions of KGHM Polska Miedź S.A. The post-control recommendations made in respect of the controlled units were aimed at eliminating the identified irregularities and implementing mitigative procedures.

The implementation of recommendations is continuously monitored by the Audit and Internal Control Department.

### **6. Selected areas requiring attention**

#### **6.1 Strategy review**

In the medium term, the Strategy of KGHM Polska Miedź S.A. for the years 2015-2020 with an outlook to 2040 was aimed at the achievement by KGHM Polska Miedź S.A. of production capacity of 1 million tonnes of copper equivalent. The basic factor determining achievement of this medium term goal is the diversified portfolio of investment projects which will increase the production capacity of KGHM Polska Miedź S.A.

In 2015 the mining sector experienced a substantial decrease in the prices of commodities, due to the uncertainty about the sustainability of economic growth, in particular as concerns the economy of the People's Republic of China, which is the main consumer of commodities. Another factor impacting this trend was the substantial drop in the price of oil, with which commodities prices are strongly correlated.

The substantial drop in the prices of the primary commercial products of KGHM Polska Miedź S.A. and the uncertainty as to the short and medium term outlook for the commodities markets reduced the ability of KGHM Polska Miedź S.A. to generate free cash flow.

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Due to current challenges of the mining sector, KGHM Polska Miedź S.A. is reviewing its strategic assumptions and prioritising its investment portfolio in order to ensure a stable long-term increase in the company's value for its stakeholders and to ensure the security of its operations in a challenging macroeconomic environment.

### **6.2 Securing financing for the Group**

Due to the unfavourable situation on the metals market and to the substantial need for capital by the executed investment program of KGHM Polska Miedź S.A., it is particularly important in the current as well as the coming years to secure the availability of capital required to achieve the Company's business goals, while optimising financing costs.

Currently, KGHM Polska Miedź S.A. uses three sources of financing, which ensure the availability of PLN 15.6 billion in external financing and fully cover the medium and long-term liquidity needs of the Company and the Group. These sources of financing comprise: an unsecured, revolving syndicated credit facility in the amount of USD 2.5 billion with maturity of 10 July 2020 (with an option to extend for another year), an investment loan from the European Investment Bank for PLN 2.0 billion with a financing period of 12 years and bilateral bank loans in the amount of up to PLN 3.8 billion with availability up to 2 years.

### **6.3 Activities of the Sierra Gorda mine**

At present the Sierra Gorda mine is of key importance for the Group. The management board of Sierra Gorda is currently focused on completing the mine's ramp-up phase as quickly as possible.

Towards this end production installations are continuing to undergo required modernisation, which will enable unplanned shutdowns to be limited, as well as enhancement of asset productivity and improved production parameters, including above all molybdenum production.

Also of significance is the implementation of savings initiatives, whose goal is to achieve stable, positive operating cash flows.

At the same time, the mine has implemented post-control recommendations with respect to environmental protection and has assessed the financial impact, which was reflected in Sierra Gorda's financing plan.

### **6.4 Pyrometallurgy Modernisation**

The Company assumes that the newly-constructed flash furnace production line at the Głogów I smelter/refinery will be brought online in the fourth quarter of 2016, as part of the comprehensive Pyrometallurgy Modernisation Program.

This project involves replacing the shaft furnace technology currently in use by the Głogów I smelter/refinery and replacing it with a modern flash furnace technology with a processing capacity of 1 050 thousand tonnes of concentrate per year.

The goal of this project is to create a functionally integrated, cost effective and environmentally friendly smelting structure for KGHM Polska Miedź S.A. as well as technology which will ensure the capacity to continue processing concentrates (both our own as well as imported ones) to remain a functioning copper producer over the coming decades, among others by eliminating the risk factors associated with shaft furnace technology.

It is expected that the four-month shutdown of the Głogów I smelter/refinery, arising from the change in technology, will result in a production decrease of 49 thousand tonnes of electrolytic copper as compared to 2015 production, mainly from own concentrate.