

**Assessment of the standing of KGHM Polska Miedź S.A. for the year ended 31 December 2019, including an evaluation of the internal control, risk management and compliance systems and the internal audit function**

*(Adopted by Resolution No. 26/X/20 of the Supervisory Board of KGHM Polska Miedź S.A. dated 6 May 2020)*

April, 2020

## **Table of contents**

1. Introduction .....	2
2. Economic results of KGHM Polska Miedź S.A. in 2019 .....	2
3. Key events in 2019 and selected issues requiring attention .....	4
4. Assessment of the risk management system in the Company in 2019 .....	10
5. Evaluation of the compliance system in the Company in 2019 .....	12
6. Evaluation of the internal audit and internal control systems .....	12

## **1. Introduction**

In accordance with section II.Z.10.1 of the „Best Practice for GPW 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 2019, 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 activities of KGHM Polska Miedź S.A. and of the KGHM Polska Miedź S.A. Group, and based on the conclusions from the audit of the Company's accounts by a Certified Auditor.

## **2. Economic results of KGHM Polska Miedź S.A. in 2019**

### **2.1 Mine and metallurgical production**

In 2019 extraction of ore (dry weight) amounted to 29.9 million tonnes, which was 0.4 million tonnes less than in 2018. The average copper content in extracted ore amounted to 1.50% and was higher than the amount recorded in 2018 due to mining in regions with a higher copper ore content. In the case of silver in ore, content was at a similar level and amounted to 48.7 g/t.

As a result the amount of copper in extracted ore was lower than in 2018 by 2.7 thousand tonnes of Cu and amounted to 449.3 thousand tonnes. The volume of silver in ore decreased by 15.5 tonnes and amounted to 1 455.9 tonnes.

In 2019, 29.9 million tonnes of ore (dry weight) were processed (or 364 thousand tonnes less than in 2018). The lower amount of ore extracted by the mines directly affected the amount of copper in concentrate, which amounted to 398.9 thousand tonnes.

The production of concentrate (dry weight) increased as compared to 2018 by 2.2 thousand tonnes, while silver in concentrate was lower than the amount produced in 2018 by 1%.

In consequence of the above the Company produced 565.5 thousand tonnes of electrolytic copper, of which 418.3 thousand tonnes (74%) was from own concentrate. This means an increase as compared to metallurgical production in 2018 by 13%, which was due to the on-going optimisation of charge materials, the higher availability of production lines and the improved operation of the copper concentrate roasting installation. By supplementing own concentrate with purchased metal-bearing materials in the form of scrap, copper blister and imported concentrate, existing technological capacity was effectively used.

The production of other metallurgical products (silver, wire rod, OFE rod and round billets) derives from the level of electrolytic copper production and depends on the type of raw material used, and above all on market demand.

The production of metallic silver in 2019 amounted to 1 400.2 tonnes, or an increase by 211.4 tonnes (+18%) as compared to 2018. Production of metallic gold was also higher, with production by the Company of 103.7 thousand troy ounces (an increase by 20.5 thousand troy ounces, or 25%).

### **2.2 Macroeconomic conditions in 2019**

In 2019, the average annual price of copper was 6 000 USD/t, or an increase compared to the prior year by 8%. The price of silver, which averaged 16.21 USD/ounce, increased by 3%.

The average annual USD/PLN exchange rate (per the NBP) in 2019 amounted to 3.84 USD/PLN and was 6% higher than in 2018 (3.61 USD/PLN).

### **2.3 Revenues from sales**

In 2019, the volume of copper sales by KGHM Polska Miedź S.A. amounted to 557.0 thousand tonnes and was 8% higher than in 2018. This increase was mainly with respect to cathode sales (+29%). In 2019, there were no sales of copper in concentrate.

Sales of metallic silver by KGHM Polska Miedź S.A. in 2019 amounted to 1 393 tonnes and were higher than the level of sales in 2018 by 246 tonnes (21%). In 2019 there were no sales of silver in concentrate.

The volume of gold sales in 2019 amounted to 101.4 thousand troy ounces, or an increase by 21% as compared to 2018 (83.8 thousand troy ounces).

Total revenues from contracts with customers of KGHM Polska Miedź S.A. in 2019 amounted to PLN 17 683 million and were 12% higher as compared to revenues achieved in 2018 (PLN 15 757 million).

Revenues from copper sales in 2019 amounted to PLN 13 474 million, or a difference of +9% compared to the level of sales revenue in the prior year (PLN 12 342 million).

Revenues from metallic silver sales in 2019 amounted to PLN 2 789 million and were higher by 33% as compared to the level of sales revenue in 2018, mainly due to a higher sales volume as well as higher prices of this metal compared to 2018. Revenues from gold sales in 2019 amounted to PLN 543 million, and in 2018 to PLN 381 million. The difference was due to higher production of gold in 2019.

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

The Company's cost of sales, selling costs and administrative expenses (cost of products, merchandise and materials sold plus selling costs and administrative expenses) in 2019 amounted to PLN 15 291 million and was 14% higher as compared to 2018. The increase in the Company's cost of sales, selling costs and administrative expenses was due to the following: the utilisation of inventories resulting mainly from increased processing of own concentrate, higher consumption of purchased metal-bearing materials by 29 thousand tonnes Cu at a comparable purchase price and an increase in other expenses by nature.

**The cost of producing copper in concentrate - C1** was as follows: in 2018: 1.85 USD/lb and in 2019: 1.74 USD/lb. The decrease was due to a weakening of the PLN versus the USD, higher silver and gold prices and to a lower minerals extraction tax.

## **2.5 Financial results**

The Company recorded a profit for 2019 in the amount of PLN 1 264 million, which was lower by PLN 761 million (38%) than in the prior year.

The change in the result was mainly due to the following factors:

- an increase by PLN 1 806 million in revenues from contracts with customers (excluding the impact of hedging transactions), comprised of:
  - an increase in revenues by PLN 1 393 million due to a higher volume of sales of copper (+42.6 thousand tonnes, +8%), silver (+165 tonnes, +13%) and gold (+18 thousand troy ounces, +21%),
  - an increase in revenues by PLN 1 029 million from sales of basic products (Cu, Ag, Au) due to a more favourable average annual USD/PLN exchange rate (a change from 3.61 to 3.84 USD/PLN),
  - a decrease in revenues by PLN 717 million due to lower copper prices (-523 USD/t, -8%), alongside higher prices of silver (+0.50 USD/koz t, +3%) and gold (+125 USD/koz t, +10%),
  - an increase in other revenues from contracts with customers by PLN 101 million, including revenues from sales of goods and materials (+PLN 51 million) and the measurement to fair value of receivables from M+ sales (+PLN 17 million).
- an increase in cost of sales, selling costs and administrative expenses by PLN 1 831 million, including:
  - PLN 738 million due to higher consumption of purchased metal-bearing materials by 29 thousand tonnes of copper alongside a comparable purchase price,
  - higher costs of utilising inventories by PLN 605 million (change in 2019: +PLN 369 million; in 2018: -PLN 236 million) resulting mainly from increased processing of own concentrate,
  - an increase in other costs by PLN 488 million, including an increase in other expenses by nature by PLN 549 million, mainly due to a change in costs: employee benefits (-PLN 270 million), electrical and other energy (-PLN 136 million), depreciation/amortisation (-PLN 125 million) and external services (-PLN 118 million) alongside a lower minerals extraction tax (+PLN 151 million).
- a change in the balance of impairment losses recognised/reversed on shares in subsidiaries from +PLN 355 million in 2018 to -PLN 460 million in 2019 (-PLN 815 million),

- a change in the balance of impairment losses recognised/reversed on financial instruments from +PLN 270 million in 2018 to +PLN 102 million in 2019 (-PLN 168 million),
- a decrease in dividend income by PLN 202 million,
- the impact of exchange differences +PLN 165 million,
- an improvement in the result on a change in the fair value of financial assets measured at fair value through profit or loss, from -PLN 63 million to +PLN 84 million (+PLN 147 million),
- the impact of hedging transactions (+PLN 101 million),
- the recognition/release of provisions (+PLN 111 million),
- a change in the balance of income and costs due to interest on borrowings (-PLN 76 million).

## **2.6 Assets, equity and liabilities of the Company**

As at 31 December 2019, total assets amounted to PLN 35 989 million, or an increase as compared to the end of 2018 by PLN 1 739 million, or 5%, mainly due to increases in the following items:

- property, plant and equipment and intangible assets by PLN 1 805 million, including mining and metallurgical property, plant and equipment by PLN 1 710 million, arising from the realisation of investments – expenditures on property, plant and equipment and intangible assets in 2019 amounted to PLN 2 481 million,
- non-current financial instruments by PLN 747 million, including mainly loans granted (+PLN 955 million) alongside a lower value of derivatives (-PLN 196 million),
- tax assets by PLN 160 million,
- cash pooling receivables by PLN 88 million,

alongside a decrease in the value of investments in subsidiaries by PLN 564 million and of inventories by PLN 319 million, including mainly half-finished products and work in progress (-PLN 472 million) alongside an increase in finished products (+PLN 111 million).

There was an increase in equity and liabilities, mainly due to increases in the following items:

- equity by PLN 844 million, including with respect to the profit for 2019 in the amount of PLN 1 264 million,
- trade payables (+PLN 540 million),
- employee benefits liabilities (+PLN 235 million),
- higher provisions for decommissioning costs of mines and other technological facilities (+PLN 139 million)

alongside a decrease in liabilities due to borrowings, leases and debt securities by PLN 303 million, mainly due to the following: cash flow (-PLN 1 437 million), a change in accounting principles – implementation of IFRS 16 (+PLN 511 million), accrued interest (+PLN 381 million) and exchange differences (+PLN 214 million).

## **3. Key events in 2019 and selected issues requiring attention**

### **3.1 Changes in the manner of financing the Group in 2019**

In 2019, the Company achieved its primary strategic goal adopted in 2018, involving assuring long-term financial stability and developing mechanisms supporting further growth.

Following changes introduced in 2019, the average weighted maturity of the debt of KGHM Polska Miedź S.A. was substantially extended and exceeded the median for the copper mining and processing sector, significantly leading to achievement of the strategic goal of utilising long-term financial instruments.

In 2019, the key events which impacted the ability to ensure long-term financial stability were the basing of the financing structure of the KGHM Polska Miedź S.A. Group on diversified and long-term financing sources through implementation of the following financial instruments:

- The signing of an agreement for an unsecured syndicated credit facility in the amount of USD 1 500 million with a 5-year tenor with the option of extending for another 2 years. The credit facility replaced the

current revolving syndicated credit facility in the amount of USD 2 500 million dated 11 July 2014, whose availability would have expired on 9 July 2021;

- The opening of a renewable working capital facility in the amount of USD 450 million under an agreement with the Bank Gospodarstwa Krajowego, concluded for a period of 7 years;
- The issue of bonds, Series A, in the amount of PLN 400 million with a 5-year maturity, and Series B in the amount of PLN 1 600 million with a 10-year maturity;
- The drawing of two instalments from the EIB in the amount of USD 65 million and PLN 90 million, with maturity in 2031.

In 2019, the KGHM Polska Miedź S.A. Group was fully capable of meeting its obligations with respect to liabilities drawn. The cash and cash equivalents held by the Group along with the external financing obtained ensure that liquidity will be maintained and enable the achievement of investment goals.

KGHM Polska Miedź S.A. is engaged in a factoring program involving the purchase by factoring companies of trade receivables. Thanks to this money is received quickly, and at the same time the balance of receivables at the end of the settlement period is reduced. Receivables at the end of 2019 amounted to PLN 153 million. In 2019, a reverse factoring program was initiated. Under this program the obligations of customers to pay for goods and services are assumed by the factoring company based on statutory subrogation. This enables a substantial extension of the deadlines for payment of trade payables without negative consequences for suppliers, who receive their fees earlier for additional discounts or within the contractual deadline. As at 31 December 2019 the value of trade payables transferred to reverse factoring amounted to PLN 596 million.

### **3.2 Capital expenditures**

In 2019, capital expenditures amounted to PLN 2 481 million (including expenditures on property, plant and equipment of PLN 2 417 million, uncompleted development work of PLN 6 million, and capital expenditures due to leases as the right to use assets of PLN 58 million).

Around 67% of the capital expenditures incurred on property, plant and equipment were utilised for the advancement of projects involving the replacement of equipment and maintaining mine production in the core business, mainly aimed at maintaining mine production at the planned level.

The remaining capital expenditures involve development projects which affect the core business, production volume, the implementation of activities optimising the use of existing infrastructure, maintaining production costs and adaptation of the company's operations to changes in standards, laws and regulations.

In 2019, the Supervisory Board gave particular attention to overseeing the following development projects:

<p>Development of the <b>Żelazny Most</b> Tailings Storage Facility (in 2019 expenditures incurred amounted to PLN 448 million)</p>	<p>Construction of the Southern Quarter</p> <ul style="list-style-type: none"> <li>- Based on the current building permit, work continued on construction of the Southern Quarter. Commencement of the consecutive storage of tailings is planned for March 2021, and completion of construction by June 2022.</li> </ul> <p>Construction of the Tailings Segregation and Thickening Station (TSTS)</p> <ul style="list-style-type: none"> <li>- The TSTS project was advanced in that part related to hydrocyclone technology, with 70% of that part related to thickening technology being completed.</li> <li>- The foundations and technical hall of the TSTS were built along with 97% of the power building using reinforced concrete.</li> <li>- Construction was carried out involving architecture and internal installations for the hall and power building, as well as on the installation of power lines. Technological equipment for the TSTS was purchased.</li> </ul>
<p><b>Outfitting of the mines</b> (in 2019 expenditures incurred amounted to PLN 244 million, including</p>	<p>Investments being carried out in the mines are related to developing the infrastructure of the mining regions, ventilation and air conditioning equipment and investments in conveyor belt and pipe transport.</p>

<p>PLN 46 million on the Deposit Access Program)</p>	
<p><b>Replacement of the machinery park in the mines</b> (expenditures incurred amounted to PLN 285 million)</p>	<p>With respect to modernisation and replacement of mining machinery, 223 pieces of mining equipment were purchased (in the replacement category), including the accelerated purchase in 2019 of 31 pieces of mining equipment.</p>
<p><b>Deposit Access Program – DAP (formerly Deep Głogów)</b> (in 2019, the total expenditures on the project amounted to PLN 455 million, including PLN 46 million on outfitting of the mines as well as PLN 409 million on development projects)</p>	<p>Construction of the GG-1 shaft</p> <ul style="list-style-type: none"> <li>- The injection process was completed and sinking of the shaft reached a depth of 1099.3 m. Completion of the sinking of the shaft in the main dolomite layer (Stage IV); Stage V is underway – final stage sinking.</li> </ul> <p>Construction of the GG-2 „Odra” shaft</p> <ul style="list-style-type: none"> <li>- An Area Planning Concept for the GG-2 „Odra” shaft was developed. Procedures were carried out related to the amendment of planning documentation (Study on Spatial Development Conditions and Directions and Local Zoning Plan) with a planned publication date of 15 February 2021. The inventorisation of buildings in the villages of Kamiona and Stone was carried out.</li> </ul> <p>Access and development tunnels</p> <ul style="list-style-type: none"> <li>- 48.1 kilometers of tunneling were excavated (versus a planned 46.6 km) along with added infrastructure in the Rudna and Polkowice-Sieroszowice mines.</li> <li>- Progress on the excavation of tunnels in the main directions towards the GG-1 shaft, as compared to the yearly plan, amounts to 97% (for directions D-1,2,3,4) and 95.3% (for directions T,W-169).</li> </ul> <p>Surface-based Central Air Conditioning System (SCA)</p> <ul style="list-style-type: none"> <li>- Construction continued on the SCA at the GG-1 shaft. Assembly of the hall’s steel elements was completed along with construction of the power building.</li> <li>- Cooling aggregates were delivered to the construction site: compressors, absorbers.</li> <li>- 90% of the cooling tower’s supporting structure was assembled.</li> </ul> <p>Ice Water Transportation System (IWTS)</p> <ul style="list-style-type: none"> <li>- Construction-mining work in feeder unit no. 1 was completed.</li> <li>- Drilling of technical openings TK-5 and TK-6 was completed.</li> <li>- 90% of the tri-unit feeder was assembled.</li> <li>- 15% of the surface-based piping was laid.</li> </ul>
<p><b>Metallurgy Development Program</b> (expenditures incurred amounted to PLN 24 million)</p>	<p>In 2019, the steam drier and the concentrate roasting installation were brought on-line. Basic work was completed under projects related to adapting technical infrastructure to the changes in smelting technology at the Głogów I Copper Smelter and Refinery. The process of concluding the project commenced.</p>
<p><b>Program to adapt the technological installations of KGHM to the requirements of BAT Conclusions for the nonferrous metals industry and to restrict emissions of arsenic (BATAs)</b> (expenditures</p>	<p>In 2019, under the BATAs Program, 22 projects were advanced (16 in the Głogów Copper Smelter and Refinery and 6 in the Legnica Copper Smelter and Refinery). As a result of preparatory work conducted under these projects, the decision was made to exclude six projects from the BATAs Program.</p> <p>In 2019, in the Głogów Copper Smelter and Refinery work was completed involving the sealing of conveyor belts and belt pulling stations for carrying copper concentrate, and construction of a gas desulphurisation installation for the Kaldo furnace was completed.</p>

<p>incurred amounted to PLN 47 million)</p>	<p>At the Legnica Copper Smelter and Refinery, the modernised dedusting unit for three filters behind the shaft furnaces was brought on-line. In other projects, all planned agreements were signed for turn-key realisation and for the delivery of key equipment. In the case of most of the projects, work involving the preparation of opinions in respect of projects plans was either completed or is underway, and dismantling and re-assembly commenced. The process of receiving administrative decisions is underway.</p>
<p><b>Increasing cathode production at the Legnica Copper Smelter and Refinery to 160 kt/year (LCS160)</b> (expenditures incurred amounted to PLN 64 million)</p>	<p>Revolving-Casting-Refining (RCR) Furnace</p> <ul style="list-style-type: none"> <li>- In 2019, an RCR furnace was built and brought on-line at the Legnica Copper Smelter and Refinery with associated installations. Guarantee testing of the RCR furnace, Casting carousel and the Full Evaporation Tower with deduster was conducted with a positive result, and guarantee parameters were obtained. A scrap storage facility was constructed, thereby increasing scrap storage capacity by approx. 1500 tonnes of material.</li> </ul> <p>Permanent starter sheet technology</p> <ul style="list-style-type: none"> <li>- In 2019, an economic feasibility study was carried out on the possibility of implementing new technology based on permanent starter sheets for the production of electrolytic copper at the Legnica Copper Smelter and Refinery with capacity of 120 thousand tonnes of copper cathode annually. Assumptions were reviewed and verified and an economic feasibility study was developed along with a sensitivity analysis regarding the conversion to permanent starter sheet technology.</li> </ul>

### 3.3 Development of the Żelazny Most Tailings Storage Facility

Based on the permit received in 2016 to develop the Main Facility to a crown height of 195 meters a.s.l. and a permit to further operate the Tailings Storage Facility, the dam is being built up successively as part of the on-going operations of the Division. In March 2018, a building permit was issued for the Southern Quarter. Construction of the Southern Quarter will enable the additional deposition of waste tailings in the amount of around 170 million m<sup>3</sup>.

Following the signing of a contract for construction of the Southern Quarter with the company Budimex, construction is underway on Development of the Żelazny Most Tailings Storage Facility, ensuring the ability to deposit waste tailings to 2037. In 2019, expenditures incurred on advancing the Project to develop the Żelazny Most Tailings Storage Facility amounted to PLN 448 million, with 59% of the project to build the Southern Quarter completed. At the same time, as part of the project preparations for advancement of the following tasks was carried out: Construction of infrastructure related water and power management and construction of a slimes management system for the Southern Quarter - Phase 1.

The project's scope includes construction work related to advancement of the Tailings Segregation and Thickening Station, in respect of which 49% of the work was completed by the end of 2019. Construction work was completed on the assembly of the technical hall along with 97% of the TSTS power building using reinforced concrete. The design project for the TSTS was received, while handover of the remaining part is planned for June 2020. Installation of the power lines of the TSTS was carried out, a contract was signed for the purchase of technological equipment and construction began on architecture and internal installations for the hall and power building.

### 3.4 Situation in the international assets

#### Sierra Gorda mine in Chile

Production of copper in concentrate in 2019 amounted to 108.2 thousand tonnes, while production of molybdenum in concentrate amounted to 20.3 million pounds (on a 100% basis).

The improvement in copper production results compared to 2018 (an increase by 11.3 thousand tonnes, or 12%) was due to the higher extraction and processing of ore with a higher copper grade compared to the ore processed in 2018. Despite the higher processing of ore there was a drop in molybdenum production by 6.4 million pounds, or by 24% compared to 2018, as a result of lower molybdenum content in mined ore.

The level of ore processing in 2019 was higher compared to 2018 by 6%, while optimisation work currently underway is aimed at increasing the average daily processing of ore to 130 thousand tonnes in Q4 2020, and subsequently to 140 thousand tonnes in Q4 2022. During work on the Debottlenecking Program, the decision was taken to prepare an Integrated Plan. This is aimed at establishing optimal operational parameters which reflect additional processing machinery and equipment as well as ongoing optimisation activities in the processing plant of the Sierra Gorda mine. Required changes have also been introduced in the organisational structure of Sierra aimed at ensuring the efficient advancement of goals and tasks pursuant to the adopted schedule.

In 2019, work continued aimed at preparing the Oxide project for realisation. This work included verifying the block model for the heaped oxide ore (which has already been extracted from the mine and deposited at storage sites). Required changes for updating the project's environmental permits were reviewed. Additional work was carried out aimed at more precisely defining the technical solutions for the heaped ore's crushing and transport operations. Tests involving the leaching of the crushed ore in columns were completed and required analysis began of the post-leaching material.

### **Operating assets of KGHM International**

In 2019, the production assets of KGHM International (excluding Sierra Gorda) produced in total 76.5 thousand tonnes of copper, 0.7 thousand tonnes of nickel, 4.1 tonnes of silver and 85.2 thousand ounces of gold, palladium and platinum.

With respect to actions undertaken to date aimed at further development of the production assets of KGHM International, the basic technical and economic assumptions of the production assets were updated. As at the end of the first quarter of 2019, production was suspended from the Morrison deposit in the Sudbury Basin. It is currently expected that mining in the Robinson mine will involve extraction from the Liberty pit, which will extend the Life-of-Mine by 3 years, to 2028.

### **3.5 Occupational health and safety in KGHM Polska Miedź S.A. in 2019**

In 2019, the Company recorded a slight increase in the total number of workplace accidents (as defined by the Act dated 30 October 2002 on social insurance due to workplace accidents and occupational illnesses), with a year-on-year change from 297 to 299 injured (+2). At the same time, the number of workplace accidents in 2019 in KGHM Polska Miedź S.A. excluding accidents from natural causes (roof collapses, destressings, tremors, falling rocks) was lower by 31 (a decrease from 279 to 248). 51 workplace accidents, arising from natural workplace accidents in the mines of KGHM Polska Miedź S.A., represented 20% of all workplace accidents in the mines. The Company is continually improving in terms of safe mining of the copper ore deposits. The vast majority of workplace accidents (around 98%) qualified as light injuries, caused mainly by rock falls followed by loss of balance by employees, as well as contact (striking) with or by moveable/ immoveable objects.

The life and health of employees and workplace safety in general is the chief priority in the hierarchy of values of the KGHM Polska Miedź S.A. Group. For several years the Company has advanced its vision of „Zero accidents due to human and technical errors, zero occupational illnesses among our employees and contractors”. As a result of the adoption in December 2018 of a new strategy to the year 2023, in 2019 a conceptualisation of the strategy in the area of occupational safety was prepared through formulation of the Employee Safety Improvement Program – „Think About The Consequences” as well as a Program to prevent the most common hazards to workplace safety by utilising innovative technology. In the Company's Divisions a unified plan for communicating policies, the vision, mission and the golden principles of OHS was implemented. A concept for implementing the new OHS ISO 45001:2018 standard was prepared, and new organisational initiatives were implemented, as well as research aimed at improving workplace safety, especially in the Company's mines.

Despite the slight increase in the number of workplace accidents in 2019 compared to the prior year, due to the higher number of accidents from natural causes (from 17 to 50), the Company managed to maintain its LTIFR<sub>KGHM</sub> (Lost Time Injury Frequency Rate KGHM) rate in 2019, being the total number of workplace accidents (as defined by the Act dated 30 October 2002 on social insurance due to workplace accidents and occupational illnesses) in the Company, being the number of accidents per million hours worked for the entire core business of KGHM Polska Miedź S.A., at the same level as that achieved in 2018 – 10.3. At the same time this indicator was lower by 45% than the amount recorded in 2010.

### **3.6 Preparation of the Company and Group to the current situation in Poland and abroad**

The ongoing SARS-CoV-2 coronavirus pandemic, the cause of the COVID-19 illness, has led to the scenario of a global economic downturn. Due to the rapidly changing situation and the short timespan to date of this turbulence, at the present time it is difficult to assess the scope of negative consequences of the development of this disease, including for the commodities sector. The situation continues to require further monitoring and analysis in the coming months.

As of today, the risk of operational disruptions in the production-related companies of the KGHM Polska Miedź S.A. Group due to the coronavirus is estimated as low, which is due in large measure to the preparations by the organisation for operating in extreme conditions in terms of production as well the logistics of deliveries, supply and distribution.

In the current situation the most important actions for KGHM involve ensuring employee safety and maintaining uninterrupted operations as well as continuity of the supply chain, as well as systematic management of the risk of the negative impact of lower copper prices.

Since the start of the pandemic, KGHM has been undertaking a broad and intensive range of actions aimed at mitigating the risk of infections amongst the employees as well as persons with whom they come into contact (family, co-workers, customers).

The actions being taken within the Group's companies to protect the health of employees are on the one hand the result of the guidance issued and decisions taken by the government and national offices, while on the other hand they result from internal regulations and guidance aimed at the employees of the KGHM Group.

The KGHM Group has undertaken a variety of actions aimed at preventing the spread of the virus and protecting the Group's employees from the risk of infection, and has also joined local and national efforts to assist hospitals and other medical on a broad scale.

Apart from the production of Nitrosept liquid, masks and protective clothing, KGHM is engaged in the purchase of medical equipment designated to be used in the ongoing struggle with the effects of the pandemic, including respirators, protective medical aprons and protective masks as well as medical goggles. The purchased equipment is being delivered, via government agencies, to hospitals, clinics and other medical facilities.

In all of the KGHM Group's companies in Poland and abroad, a variety of internal actions and procedures of a protective and preventative nature are being implemented, such as:

- the creation of a special info line as well as email addresses where the employees can obtain full information on regarding the management, principles and manner of work under specific conditions, including in terms of organisational health and safety,
- all business trips abroad have been cancelled as well as employee participation in domestic conferences and training,
- the possibility of home-based remote work was introduced,
- body temperature measurement has been introduced utilising thermal cameras,
- decontamination of all common areas in the company's divisions has begun, including entrances, travel pathways, baths, lamp rooms, dressing rooms and restrooms,
- hand disinfectants have been provided at all entrances to buildings and sanitary spaces,
- additional equipment for industrial ozonisation in the divisions of KGHM Polska Miedź S.A. has been procured,
- In the mines of KGHM Polska Miedź S.A., the number of staff travelling in cages has been reduced and the frequency of trips into the mines has increased; barriers installed in the cages demarcate inter-person distances,
- On-line OHS training has been introduced,
- An informational campaign is underway using the company's existing means of communication: intranet, posters and billboards, enabling the on-going transmission of updated recommendations and announcements by the government and healthcare authorities,

- training for employees has been conducted on preventing and restricting the spread of the virus as well as mitigating the effects of the infection,
- all gastronomical establishments operating on company terrain have been restricted to solely providing take-out meals,
- we commenced collections, legal assistance, organisation of material and psychological support for employees – an Employee Assistance Program at the Robinson mine in the USA.

Thanks to the actions taken and continued, as of today all of the production assets of the KGHM Group are operating without interruption, there are no negative signals in terms of production or sales continuity.

Nonetheless, should the effects of the epidemic continue to impact the global economy, the situation may result in adverse financial and organisational consequences for the Group in the future.

#### **4. Assessment of the risk management system in the Company in 2019**

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 and future, actual and potential impact of risk on the KGHM Polska Miedź S.A. 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 and the Rules of the Corporate Risk and Compliance Committee updated in 2019, the process of corporate risk management in the Group is consistently performed. KGHM Polska Miedź S.A. oversees the process of managing corporate risk in the Group, while in the companies of the Group, documents regulating the management of corporate risk are consistent with those of the Parent Entity. Each year, the process of managing corporate risk is subjected to an efficiency audit (compliant with the guidelines of Best Practice for WSE Listed Companies 2016).

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 in the Group undergo in-depth analysis in order to develop a Risk Response Plan and Corrective Actions. Other risk factors undergo monitoring by the Department of Corporate Risk Management and Compliance, and in terms of financial risk by the division of the Executive Director for Treasury Operations - Corporate Treasurer.

The breakdown of rights and responsibilities applies best practice principles for Corporate Governance and the generally recognised model of three lines of defense.

## Organisational structure of risk management in KGHM Polska Miedź S.A.

Supervisory Board (Audit Committee)					
Performs annual assessment of the effectiveness of the risk management process and monitors the level of risk factors and ways to address them.					
Management Board					
Has ultimate responsibility for the risk management system and supervision of its individual elements.					
1st line of defense	2nd line of defense				3rd line of defense
Management	Risk Committees				Audit
Managers are responsible for identifying, assessing and analysing risk factors and for the implementation, within their daily duties, of responses to risk. The task of the management staff is ongoing supervision of the application of appropriate responses to risk within the tasks realised, to ensure the expected level of risk is not exceeded.	Support the effectiveness of the risk management process.				The Internal Audit Plan is based on assessing risk and subordinated business goals, assessed is the current level of risk factors and the degree of efficiency with which they are managed.  Internal Audit Rules  Executive Director for Audit and Control  <i>Reports to the President of the Management Board</i>
	Corporate Risk and Compliance Committee	Market Risk Committee	Credit Risk Committee	Financial Liquidity Committee	
	Manages corporate risk and continuously monitors key risk factors	Manages risk of changes in metals prices (e.g.: copper and silver) as well as exchange and interest rates	Manages risk of failure of customers to meet their obligations	Manages risk of loss of liquidity, understood as the ability to pay financial liabilities on time and to obtain financing for operations	
	<i>Corporate Risk Management Policy</i>	<i>Market Risk Management Policy</i>	<i>Credit Risk Management Policy</i>	<i>Financial liquidity Management Policy</i>	
	Department of Corporate Risk Management and Compliance	Executive Director for Treasury Operations - Corporate Treasurer			
<i>Reports to the Management Board</i>	<i>Reports to the Vice President of the Management Board (Finance)</i>				

### 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

Based on the Market Risk Management Policy, Financial Liquidity Management Policy and Credit Risk Management Policy adopted by the Company, the Company's Management Board manages the identification of various types of financial risk. Understanding the threats arising from the Company's exposure to risk and maintaining an appropriate organisational structure and procedures enable an effective achievement of tasks. The Company identifies and measures financial risk on an ongoing basis, and also takes actions aimed at minimising their impact on the financial position.

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 the Company's results in the short and medium terms and to enhance the Company's value over the long term. The Management Board is responsible for the management of the types of risk described in the Company and for complying with the individual policies adopted in this regard. The Management Board is supported in the execution of risk management Policies by the Market Risk Committee, Credit Risk Committee and Financial Liquidity Committee, entities which have functioned in the Company for many years. The management of individual types of risk 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 organisational structure and procedures applied in the Company.

Since 2014, the Company has centralised the process of 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 and Sociedad Contractual Minera Franke). The goals of market risk management at the Group level are achieved by their realisation in individual Group companies, with coordination of these activities by the Parent Entity, 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, the proposal of hedging strategies, contacts with financial institutions aimed at concluding, confirming and settling derivatives transactions and calculating measurements to fair value).

## **5. Evaluation of the compliance system in the Company in 2019**

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, there exist in KGHM Polska Miedź S.A. a variety of organisational units (such as the Department of Corporate Risk Management and Compliance, the Department of Supply Chain Security, the Ethics and Anti-Corruption Procedures Unit, The Regulatory and Strategic Analysis Department and the Legal Department) as well as systemic solutions (such as employee access to legal databases, formalised internal procedures for legal interpretations, processes to identify legal requirements and to assess their compliance in terms of the ISO standards in force in the Company), which are aimed at ensuring compliance.

In 2019, a variety of new or updated normative acts were introduced in various operational areas of the KGHM Polska Miedź S.A. Group aimed at achieving the highest possible level of compliance of its activities with existing laws as well as the voluntary adoption of legal obligations.

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

The internal audit system is aimed at ensuring effective and efficient Company operations, the accuracy of financial reporting and the compliance of the Company's actions with laws in force and internal regulations.

The internal control system comprises the areas of oversight, all of the internal procedures, the function of compliance with laws, the financial reporting system, organisational structures, IT systems audits and other control mechanisms aiding in the achievement of the Company's goals as well as having an impact on its security and the stability of its functioning. The purpose of the internal control system is the rational realisation of effective and efficient operations, the accuracy of information disclosed, in particular as regards financial statements as well as the adequacy and operational efficiency of the audits conducted.

The internal control system is supervised in the Company by:

- the actions of the Company's Management Board, involving the establishment of an appropriate and effective internal control system,
- monitoring the efficiency of the internal control system by the Supervisory Board's Audit Committee, and
- oversight by the owners of individual business areas over their respective organisational units.

In addition, in terms of institutional control, actions are undertaken by specialised units, in particular in the Security and Preventing Losses division and the Audit and Control division, such as the Security Department, the Supply Chain Security Department and the Internal Control Department.

The internal audit function plays a special role, and is performed by a separate organisational unit in the structure of KGHM Polska Miedź S.A. – the Internal Audit Department, headed by the Executive Director for Audit and Control. The internal audit function is overseen by the Supervisory Board's Audit Committee, which issues opinions on internal audit regulations and the internal audit plan, and receives an annual report on the execution of audit plans.

The Internal Audit 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.

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

In 2019, the Department performed assessments in 33 various subject areas. Most of these assessments in specific areas were performed in several, or a dozen or so, Group entities simultaneously. These tasks 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 2019, recommendations were formulated for implementation. The observations, results and recommendations from the comprehensive work were described in the Report on the Implementation of the Internal Audit Plan for 2019 of the KGHM Polska Miedź S.A. Group.

The audits carried out uncovered irregularities and violations of, among others, a formal and legal nature, violations of employee duties, and also inefficient management of resources in various units of the KGHM Group. The recommendations made in respect of the controlled units were aimed at eliminating the identified irregularities and strengthening the internal control system by implementing corrective procedures. The implementation of recommendations is continuously monitored by the Internal Audit Department.