

**Assessment of the standing of KGHM Polska Miedź S.A. for
financial year 2016,
including an evaluation of the internal control, risk management
and compliance systems and the internal audit function**

*(Approved by Resolution No. 18/IX/17 of the Supervisory Board of KGHM Polska Miedź S.A.
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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 2016, 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 2016

2.1 Mine and metallurgical production

Mine production in the Company was at a similar level to that of the prior year (424 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 7% lower than in 2015 and amounted to 536 thousand tonnes alongside a decrease in copper production from own concentrates by 11% to the level of 376 thousand tonnes, due to the three-month shutdown at the Głogów I Copper Smelter and Refinery, during which there was a change from shaft furnace technology to flash furnace technology.

In comparison to 2015, the production of metallic gold increased by 26.9 thousand troy ounces, or by 31% and for the first time in KGHM’s history reached the level of 114 thousand troy ounces, while metallic silver production was lower by 92 tonnes, ending the year at 1 191 tonnes.

2.2 2016 macroeconomic environment

In 2016 the average annual price of copper was 4 863 USD/t, which was 12% lower as compared to the prior year. The price of silver, which averaged 17.14 USD/ounce, increased by 9%.

The average annual USD/PLN exchange rate (per the NBP) in 2016 amounted to 3.94 USD/PLN and was 5% higher than the rate in 2015 (3.77 USD/PLN).

2.3 Sales revenue

In 2016, as compared to the prior year, KGHM Polska Miedź S.A. recorded a decrease in the sales volume of copper products by 47 thousand tonnes (8%), due to a decrease in electrolytic copper production. Due to the shutdown at the Głogów I Copper Smelter and Refinery related to the change in production technology, in 2016 the Company achieved additional sales of 169 thousand tonnes of copper concentrate (35 thousand tonnes of Cu and 91 t of Ag).

Silver sales amounted to 1 189 tonnes and were lower by 4% (56 t) as compared to 2015. Gold sales increased by 32% (27.0 thousand troy ounces) i amounted to 112.5 thousand troy ounces, due to higher production by 31% or 26.9 thousand troy ounces (due to the processing of purchased copper-bearing materials which among others contained a high level of gold).

Total revenues from sales in 2016 amounted to PLN 15 112 million and were lower by 5% than revenues achieved in 2015, mainly as a result of the decrease in the price of copper expressed in the Polish zloty and to a decrease in copper sales volume.

The production shutdown at Głogów I in 2016 resulted in lower production of electrolytic cathodes and, as a result, to lower revenues from sales of copper and copper products copper as compared to 2015 by 16%.

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This decrease was partially offset by sales of copper concentrate in the amount of approximately PLN 776 million.

Revenues from silver sales as compared to their level in 2015 were higher by 8%, while revenues from gold sales were higher by approx. 49%. The increase in revenues from gold sales was caused both by the increase in the price of this metal expressed in the Polish zloty as well as the increase in the volume of production and sales as compared to 2015.

The value of revenues from sales in 2016 reflects the positive result from the settlement of hedging instruments in the amount of PLN 3 million (in the prior year PLN 482 million).

2.4 Cost of sales, selling costs and administrative expenses

The Company's cost of sales, selling costs and administrative expenses in 2016 amounted to PLN 12 517 million PLN and were 1% lower as compared to the comparable period of 2015, mainly due to the minerals extraction tax.

Expenses by nature for 2016 were at the level of 2015 and amounted to PLN 12 776 million and had a similar structure.

In 2016, the C1 cost of producing copper in concentrate amounted to 1.30 USD/pound, as compared to 1.47 USD/pound in 2015. The decrease in this cost by 12% was due to: the weakening of the PLN as compared to the USD and to the 4.6% higher content of silver in own concentrates.

2.5 Financial result

In 2016, the Company recorded a loss for the period of PLN 4 085 million, which was higher as compared to 2015 by PLN 1 297 million.

The decrease in the financial result was mainly due to the higher by PLN 937 million impairment recorded on assets, including mainly due to impairment of the value of loans granted to subsidiaries, including to the KGHM INTERNATIONAL LTD Group (and indirectly to Sierra Gorda).

The aforementioned impairment loss arose from the impairment testing conducted on assets, for which the key indicator was the change in parameters for the mine assets of the KGHM INTERNATIONAL LTD Group with respect to long-term mine life, copper production volume, forecasted operating costs and the level of capital expenditures during the life of a given mine. To assess the amount of the impairment loss, the fair value of the investment in KGHM INTERNATIONAL LTD. was estimated based on the sum of the fair values of individual CGUs in KGHM INTERNATIONAL LTD., less liabilities and including other assets.

Other significant factors impacting the result as compared to 2015 were:

- the decrease in sales revenues by PLN 348 million excluding the impact of hedging transactions, comprised of:
 - a decrease in revenues by PLN 975 million due to a lower volume of copper and silver sales alongside an increase in gold sales,
 - a decrease in revenues by PLN 794 million due to lower copper prices, alongside more favourable silver and gold prices,
 - revenues from the sale of copper concentrate in the amount of PLN 776 million from inventories which were created as a result of the shutdown at Głogów I,
 - an increase by PLN 624 million in revenues from the sale of basic products of the Company (Cu, Ag, Au) due to a more favourable exchange rate, and
 - higher by PLN 21 million revenues from the sale of merchandise and other products and services.

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- a decrease in the cost of sales, selling costs and administrative expenses (excluding impairment losses) by PLN 146 million, including a lower by PLN 117 million minerals extraction tax,
- the impact of hedging transactions (-PLN 324 million), including an adjustment to revenues (-PLN 479 million) and the measurement and realisation of derivatives (+PLN 155 million),
- a change in the balance of income and costs due to interest on borrowings, including fees and commissions (+PLN 108 million),
- the impact of exchange differences (-PLN 46 million), and
- lower income tax by PLN 140 million due to the lower tax base.

2.6 Company assets, equity and liabilities

At the end of 2015, total assets amounted to PLN 30 100 million, a decrease by PLN 3 020 million, or by 9%, compared to the end of 2015. This decrease in assets was mainly due to:

- a decrease in the value of investments in subsidiaries and joint ventures (-PLN 4 856 million) due to the impairment losses on the value of shares held in subsidiaries, including mainly: Future 1 Sp. z o.o. (-PLN 4 770 million),
- an increase in the value of tangible and intangible assets by PLN 1 344 million, due to investments carried out,
- an increase in receivables due to loans granted by PLN 575 million, mainly comprised of: cash transferred +PLN 834 million, exchange differences +PLN 506 million and accrued interest +PLN 374 million, alongside an adjustment in the value of loans in the amount of -PLN 1 130 million.

The main changes in equity and liabilities were as follows:

- a decrease in equity by PLN 4 379 million, including due to the loss for the period of 2016 in the amount of -PLN 4 085 million,
- an increase in liabilities due to borrowings by PLN 1 110 million, mainly comprised of net inflow due to borrowings (PLN 597 million) and exchange differences on borrowings in foreign currencies (PLN 398 million), and
- higher tax liabilities by PLN 186 million.

3. Key events in 2016

3.1 Tangible investments

In 2016, capital expenditures amounted to PLN 2 630 million (including expenditures incurred on uncompleted development work of PLN 6 million and borrowing of PLN 91 million).

Around 30% of expenditures were incurred on the advancement of projects related to the replacement of equipment and to maintaining mine production in the core business, aimed at maintaining mine production at the planned level.

Other expenditures in 2016 relate to development projects which impact the core business, production volume, the implementation of activities optimizing the use of existing infrastructure, utrzymanie kosztów produkcji and maintaining production costs and adaptation of 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 2016:

- The **Żelazny Most project**, ensuring the ability to store flotation tailings after 2016 (in 2016 expenditures incurred amounted to PLN 14 million)

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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. Permits were acquired to expend the Main Facility to a crown height of 195m a.s.l.

The process of receiving a decision on the environmental conditions of the investment continues - construction of the Southern Quarter. A tender is being prepared to advance the base project called An Installation for the Segregation and Thickening of Tailings as part of the expansion of the Żelazny Most Tailings Storage Facility.

- **Outfitting of the mines** (in 2016 expenditures incurred amounted to PLN 174 million)

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.

- **Replacement of the machinery park in the mines** (in 2016 expenditures incurred amounted to PLN 193 million)

With respect to modernisation and replacement of the machinery park in the mines, 149 pieces of mining machinery were purchased.

- **Change in the L-VI shaft's function to a material-transport shaft** (in 2016 expenditures incurred amounted to PLN 43 million)

Work on this project comprised construction of the L-VI shaft building for a transitory period, a water treatment station, a building for the heating network for heating inlet and shaft building air, the heating network for the L-VI shaft, the main transformer station building, and work ensuring that the steel construction of the shaft tower remains corrosion-free.

- **The Deposit Access Program – DAP (formerly GGP)** (in 2016 expenditures incurred amounted to PLN 371 million)

Work under the program includes projects related to the development of mine infrastructure (development and access works and mine work and infrastructure required to outfit these areas).

In 2016, 12 846 meters of mine tunnels were excavated in the Rudna and Polkowice-Sieroszowice mines.

Construction of the Surface-based Ventilation Station at the R-XI shaft was completed, which enabled an increase in the production of cooled air to the mine below the level of 1200 meters to 25 MW.

3.2 Modernisation of Pyrometallurgy

From 16 July to 15 October 2016, during the shutdown related to the change in technology at the Głogów I Copper Smelter and Refinery, all of the work required to prepare key units of the production line for start-up was carried out.

In accordance with the schedule, on the date the shutdown of Głogów I commenced, i.e. 16 July 2016, the final shaft furnace was extinguished and for the final time matte copper was processed in the convertor furnaces, thereby ending the production of raw copper at the Głogów I Copper Smelter and Refinery using the old technology.

During the shutdown all of the work required to prepare key units of the production line for start-up was carried out. Work was carried out which could not have been done during the normal operations of the metallurgical plant. This involved such areas as the convertor furnaces deduster, railway lines in the region of the furnaces hall, pumps and modernisation of the Sulphuric Acid Plant.

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The new production line at the Głogów I Copper Smelter and Refinery was brought on line in mid-August 2016.

On 15 October 2016, at 4:29 P.M., the first concentrate was charged to the flash furnace, meaning the date of start-up of the flash furnace was advanced by 5 days (planned date: 20 October 2016), and the total, initially-planned shutdown time was shortened by 22 working days (initially planned 114 days, as a result of optimisation of the schedule, the shutdown period was shortened to 96 days).

At the end of 2016, the PMP project was at the completion phase – the phase of starting up the Flash Furnace is underway, during which work includes the regulation of equipment, checking the proper functioning of individual parts of the installation along with their parameters (including productivity) and comparing designed project parameters with the required capacity parameters achieved for the whole installation for the appropriate concentrate mixes. Completion of other work, the acquisition of operating permits and hand-over for operation will be carried out successively during the final phase of the project by 30 June 2017.

As at 31 December 2016, since its start-up the installation has operated stably, with throughput of 90-100 tonnes/hour, or 75% of designed nominal capacity. Once nominal capacity has been achieved, guarantee tests will be conducted on the main production line equipment. The modernised production line will enable annual casting capacity of 1 050 thousand tonnes (dry weight) of concentrates.

As at 31 December 2016, expenditures incurred amounted to PLN 2 113 million, including PLN 585 million in 2016.

3.3 Review of development assumptions in the international assets

In 2016, work was carried out related to reviewing the key international assets of KGHM Polska Miedź S.A. The goal of the review process was to confirm the base technical and economic assumptions and to develop multi-year operating plans for the Company's key international assets. Engaged in the work were independent consultants with many years of international experience in their areas of expertise, i.e.:

- Martlet Consultants – review of block models, aimed at confirming the level of geological resources;
- AMC Consultants - technical and economic review, focused in particular on reviewing operating plans, and cost, geotechnical and metallurgical assumptions,;
- EY – preparation of assessment models based on technical and economic data obtained from AMC.

On 21 December 2016, at a meeting of the Supervisory Board of KGHM Polska Miedź S.A., a report was presented on the status of the international projects, including the results of the technical and economic review. Determination of development directions and policy and with respect to international equity investments is reflected in the revised Strategy.

4. Assessment of the risk management system in the Company in 2016

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. In 2016, the Enterprise Risk Management and Governance Standards Unit commenced work on updating the Corporate Risk Management Policy and Procedure and the Rules of the Corporate Risk Committee.

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Starting from 2016, the corporate risk management system is subject to annual evaluations of its operational effectiveness. In December 2016, the corporate risk management system in the KGHM Polska Miedź S.A. Group underwent an external audit by Deloitte Advisory Sp. z o. o. This audit of the efficiency of the risk management process (compliant with the guidelines of Best Practice for GPW Listed Companies 2016) indicated that the process functions properly.

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 constant monitoring by the Enterprise Risk Management and Governance Unit, and in terms of financial risk by the Executive Director for Finance and Risk Management.

This comprehensive approach to analysing risk factors also comprises the identification of risk factors related to achieving the strategic goals. In 2016 the process of revising risks associated with advancement of the strategic goals contained in the Main Strategy and in Executory and Supporting Strategies commenced.

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

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

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Supervisory Board (Audit Committee)				
Performs annual assessment of the effectiveness of the risk management process and monitors the level of key 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			Internal Audit
<p>Management staff is 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.</p>	Support effective risk management and ongoing supervision of key risk factors.			
	Corporate Risk 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 debtors 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>Liquidity Management Policy</i>
	Enterprise Risk Management and Governance Unit	Executive Director, Director for Finance and Risk Management		
Reports to the President of the Management Board	Reports to the Vice President of the Management Board (Finance)			<i>Internal Audit Rules</i>
				Audit and Internal Control Department
				Reports to the President of the Management Board

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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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 to the Company in a conscientious and responsible manner. 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 process of financial risk management in the Company is supported by the work of the Market Risk Committee, the Financial Liquidity Committee and the Credit Risk Committee.

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 financial results in the short and medium terms and to enhance the Group'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 policy by the Market Risk Committee and the Credit Risk Committee, entities which have functioned in the Company for many years, as well as by the Financial Liquidity Committee created in 2015. 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 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, KGHM Ajax Mining Inc. 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 estimates of fair value).

5. Evaluation of the compliance system in the Company in 2016

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 in KGHM Polska Miedź S.A., whose task is among others to create, implement and maintain the process of management compliance in the Company throughout its business operations.

As at the end of 2016, the process of management compliance in KGHM Polska Miedź S.A. was at the final stage of implementation. It was carried out as a pilot program by the Enterprise Risk Management and Governance Unit based on the Policies, Procedures and Compliance Management Methodology of KGHM Polska Miedź S.A., which after pre-testing during the pilot stage will be implemented in the Companies operations in 2017.

The process of management compliance satisfies the individual principles described in the updated collection of principles - Best Practice for GPW Listed Companies 2016, adopted by the Supervisory Board of the Warsaw Stock Exchange, as confirmed during an external audit conducted by Deloitte Advisory Sp. z o.

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o. in December 2016. In subsequent years this process will be reviewed annually in terms of its effectiveness by the internal audit function.

6. 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 2016, the Audit and Internal Control Department performed assessments in 52 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 2016, 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 2016.

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 ineffective management of resources and irregularities in the execution of services by contractors in various units of the KGHM Group. The 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.

7. Selected areas requiring attention

7.1 Strategy review

The „Strategy of KGHM Polska Miedź S.A. for the years 2015-2020 with an outlook to 2040” adopted by the Company in January 2015 was aimed at the achievement by the KGHM Polska Miedź S.A. Group to the year 2020 of production at the level of 1 million tonnes of copper equivalent. The basic factor determining achievement of this goal was the diversified portfolio of investment projects which was to increase the production capacity of KGHM Polska Miedź S.A. Achievement of the investment targets of KGHM Polska Miedź S.A.'s Strategy assumed carrying out projects with a total value of PLN 27 billion.

Due to signals which arose at the turn of 2015/2016 which supported the assertion that it would not be possible to achieve the goals set in 2015, in 2016 the Management Board of KGHM Polska Miedź S.A. decided to update the Company's Strategy.

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The main argument for an update to the Strategy was the change in the Company's macroeconomic environment, which made it impossible to reach the targeted goal (1 million tonnes of Cu equivalent). The goal of updating the Strategy became to focus on adapting the Company's goals to its expected financial capabilities, reflecting market conditions and the need to optimise costs.

The main factors indicating a need to revise the Strategy were:

- a decrease in the prices of key commodities versus the prices assumed in approved long-term strategic plans of Group companies for the years 2015-2020;
- higher-than-assumed capital expenditures on advancing international investment projects;
- lower-than-assumed operating and efficiency parameters in the international assets; and
- the impairment tests carried out at the end of 2015 on the carrying amounts of assets, which resulted in impairment losses being recorded in the net amount of PLN 5 220 million at the level of the Parent Entity KGHM Polska Miedź S.A. and PLN 5 048 million on production assets in the consolidated financial statements of the KGHM Polska Miedź S.A. Group.

In order to conduct the review and update of the Company's Strategy, by Official Order No. PR/8/2016 dated 29 April 2016, a Team was appointed to review and update the Strategy of KGHM Polska Miedź S.A. In July 2016, by Official Order No. PZ/40/2016 dated 11 July 2016 its composition was updated. The Team was composed of 14 persons, including most of the Executive Directors of the Head Office of KGHM Polska Miedź S.A. The main tasks of the Team was to review the Strategy of 2015 and to prepare proposals for its update.

The first meeting of the Team was in May 2016. In subsequent months the Team held cyclical meetings, during which subsequent areas of the Strategy were discussed. At the first meetings it was decided to remodel the pillars of the Strategy, selecting three executory strategies (Development of Domestic and International Assets, Production and Safety, Uniform Organisation) and three supporting strategies (Financial Stability, Corporate Social Responsibility, Innovation), which then underwent further detailed work reflecting the new market conditions and Company capabilities.

The results of the Team's work is the updated „Strategy of KGHM for the years 2017-2021 with an outlook to 2040” which was presented to the Supervisory Board of KGHM Polska Miedź S.A. on 31 March 2017 for its opinion. The expected date of publication of the updated Strategy of the Company is the second quarter of 2017.

7.2 Occupational safety and hygiene in KGHM Polska Miedź S.A. in 2016

In 2016, as compared to 2015, there was an increase in basic OSH indicators, i.e. the total number of workplace accidents rose from 298 to 370 (+24%), the frequency indicator from 16.4 to 20.4 (+24%) and LTIFR from 10.2 to 12.7 (+24%). The seriousness ratio reached a slightly lower amount, i.e. 64.8 versus 67.8 in 2015 (-3%). Most of the workplace accidents in KGHM Polska Miedź S.A. were in the mines (approx. 86%). In comparison to 2015, the number of accidents in the copper ore mines increased by 25% (from 255 to 318). The main increase was in the Rudna mine. In 2016, there were 8 group accidents in which a total of 58 injured mine employees took part. In seven of these group accidents, due to natural causes related to hazards associated with the rock mass (tremors, de-stressings, roof collapses, rock falls) a total of 54 injured mine employees took part. On 29 November 2016, in the Rudna mine there occurred a tragic group accident involving 29 injured mine employees (including 3 employees from contractors and 26 employees of the mine, of which 8 were fatalities).

The causes of all of these workplace accidents in KGHM Polska Miedź S.A. are in every case subjected to detailed analysis by post-accident teams. In the case of the tragic events of 29 November 2016, the President of the State Mining Authority on 7 December 2016 appointed a special Commission to evaluate the causes and circumstances of this event (Decree No. 36). According to the findings of the Commission (report dated 11 April 2017) the cause of the group accident involving persons employed in mining areas

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XXI/2 and XXI/1 of the G-23 section and in heavy machinery chamber C-23, was the dynamic impact on the injured resulting from a roof collapse caused by the independent rock mass tremor with an energy of 1×10^8 J.

Given the present state of knowledge, there are no completely effective methods of predicting or preventing such events. In the mines of KGHM Polska Miedź S.A. systematic seismological observations are conducted using a well developed network of underground seismic stations and surface-based positions, encompassing all of the mines' active fields of excavation. Preventative actions are also carried out aimed at limiting the threat of tremors and roof collapses. These include for example on-going assessment of the rock mass, marking off areas of particular threat of roof collapse; selecting the size, shape and number of chambers and inter-chamber pillars; selecting the size of protective pillars; determining the most advantageous direction of mine work advance and the optimum order of ore selection to minimise local concentrations of stress in the rock mass; provoking dynamic events through mass blasting of mining faces and through blasting to release stress in the orebody or its roof.

It should at the same time be pointed out that in the long term perspective, i.e. since 2010, the number of work-related injuries in KGHM Polska Miedź S.A. decreased from 556 to 370, ... (LTIFR by approx. 32%).

7.3 Zapewnienie finansowania w Group

The volatile market conditions within which the KGHM Polska Miedź S.A. Group operates demand a balanced approach to liquidity management in the Group, mainly by ensuring stable sources of financing in such a manner as to ensure operational continuity and the possibility of continuing existing investment projects.

Currently the KGHM Polska Miedź S.A. Group makes use of three sources of financing, ensuring the availability of PLN 15.8 billion in external financing. These include an unsecured by KGHM, revolving syndicated credit facility in the amount of USD 2.5 billion with maturity of 9 July 2021, an investment loan from the European Investment Bank in the amount of PLN 2.0 billion with a financing period of 12 years and bilateral bank loans in the amount of up to PLN 3.3 billion with availability of up to 2 years.

As at 31 December 2016, 51% (PLN 8.1 billion) of the available lines of credit had been drawn. This level confirms the sustainability of the debt ratio at a safe level and guarantees continued liquidity.

At the end of 2016 the Net Debt/EBITDA ratio for the KGHM Group was at a safe level, i.e. 1.6.

7.4 Activities of the Sierra Gorda mine

The production and financial results of the mine for the year 2016 are not comparable with those of the prior year, as:

- in the first half of 2015 copper production remained at the ramp-up phase,
- the molybdenum processing plant commenced production in April 2015, and
- the financial results of 2015 comprise only the second half of the year – commercial production commenced on 1 July 2015 and only from this moment have operational statements of profit or loss been prepared.

In 2016 the Sierra Gorda mine concentrated on reaching full target production capacity by its processing plant and on improving its technological parameters. The production results of the processing plant were mainly impacted by the processing of relatively low quality ore from the so-called transition zone, which is characterised by increased hardness and the content of unwanted elements, which have a negative impact on the technological processing parameters.

In 2016, Sierra Gorda, with the support of teams of specialists employed by the partners and the support of external companies, took actions aimed at improving the stability of operations and improving the quality and efficiency parameters of the processing plant achieved to date, including above all the production of

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molybdenum. Work was also carried out related to modernisation of the tailings storage facility, overseen by a team of experts and specialised engineering firms

On 8 March 2016 the Chilean Environmental Enforcement Agency (SMA), publically indicated those areas in which the environmental permit held by Sierra Gorda may have been breached. In April 2016, Sierra Gorda submitted a program of compliance by the plant with the regulator's requirements, which was finally approved by the SMA in September 2016.

As a result of the review of the technical and economic assumptions for the Sierra Gorda mine carried out in 2016 and the start of 2017, there was a substantial change in the parameters for this asset as regards the mine's long-term operation, the volume of metals production, assumed operating costs and the level of capital expenditures during the life of the mine. The assumptions adopted do not include phase 2 of the mine's development, due to the assumed macroeconomic prices of molybdenum and copper and the current level of operational efficiency. The change in technical and economic assumptions, together with the change in macroeconomic assumptions, represented indicators to carry out testing for impairment of the value of non-current assets. The results of these tests are reflected in the report of KGHM Polska Miedź S.A. for 2016.

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