

**REPORT OF THE SUPERVISORY BOARD OF IZOSTAL S.A.**  
**from assessment of the following documents**  
**submitted by the Management Board:**

- I. Financial statement of Izostal S.A. for the year 2016.
- II. Report of the Management Board on operations of the Company for the year 2016.
- III. Proposition of the Management Board concerning distribution of net profits for the year 2016.

I. The Supervisory Board assessed the financial statement of Izostal S.A. for 2016 upon becoming familiar with the opinion of the independent expert auditor and a report from examining the financial statement presented by the auditor - Kancelaria Porad Finansowo-Księgowych dr Piotr Rojek Sp. z o.o. [Piotr Rojek, PhD, Office for Financial and Accounting Counsel] based in Katowice. On this basis, the Supervisory Board states that the financial statement of Izostal S.A. drawn up for the financial year from January 1 to December 31, 2016 which consists of:

- introduction to the financial statement,
- the statement of the financial situation drawn up as at December 31, 2016, with total assets and total liabilities and equity of PLN 365,471,000 (in words: PLN three hundred and sixty five million four hundred and seventy one thousand),
- the statement of comprehensive income for the financial year from January 1 to December 31, 2016 showing comprehensive income in the amount of PLN 7,058,000 (in words: PLN seven million fifty-eight thousand),
- the statement of changes in equity for the financial year from January 1 to December 31, 2016, which presents an increase in equity by the amount of PLN 7,058,000 (in words: PLN seven million fifty-eight thousand),
- the cash flow statement for the financial year from January 1 to December 31, 2016 indicating an increase in cash by the amount of PLN 19,477,000 (in words: PLN nineteen million four hundred and seventy-seven thousand),
- notes to the financial statement,

in all crucial aspects, information significant for the assessment of the Company's material and financial situation as at December 31, 2016 and its financial result for the financial year from January 1 to December 31, 2016 is presented in a reliable and clear manner. The discussed report was drawn up according to International Financial Reporting Standards adopted by the European Union and related interpretations announced in the form of regulations of the European Commission, and in the scope not regulated by these standards – according to the requirements of the act on accounting and executive regulations issued on its basis as well as on the basis of correctly kept accounting books. The financial statement is consistent to the extent required by the Regulation of the Polish Minister of Finance dated February 19, 2009 on current and periodical information submitted by issuers of securities (Journal of Laws No 33, item 259 as amended) and covers the period from January 1 to December 31, 2016 and the comparable period from January 1 to December 31, 2015, and is also consistent with legal regulations and provisions of the Statute of Izostal S.A. affecting the content of the financial statement.

The presented financial statement corresponds to all requirements of IFRS adopted by the European Union and presents the Company's material and financial situation as at December 31, 2016 and December 31, 2015, its results as well as cash flows for the period from January 1, 2016 to December 31, 2016 and from January 1, 2015 to December 31, 2015 in a reliable manner.

The Supervisory Board expresses a positive opinion on the presented financial statement of Izostal S.A. for 2016 and proposes the General Meeting approve it.

- II. The Supervisory Board analyzed the Management's report from the Company's activities for 2016 and stated that the results of business activities in 2016 as well as the Company's material and financial situation are presented in a correct and reliable manner, and the presented facts supported by figures reflect the actual state of affairs.

The Supervisory Board expresses a positive opinion on the presented statement of the Management of Izostal S.A. for 2016 and proposes the General Meeting approve it.

- III. The Supervisory Board read and expressed a positive opinion on the Management's motion regarding the division of net profit for the period from January 1 to December 31, 2016 in the amount of PLN 7,093,995.45 (in words: PLN seven million ninety-three thousand nine hundred and ninety five 45/100) which will be submitted for approval to the Ordinary General Meeting, allocating the profit for:

- the Company's supplementary capital in the amount of: PLN 4,801,915.45 (in words: PLN four million eight hundred and one thousand nine hundred and fifteen 45/100);
- the payment of dividend for shareholders of the Company in the amount of: PLN 2,292,080.00 (in words: PLN two million two hundred and ninety-two thousand eighty 00/100), which gives PLN 0.07 ( PLN 7/100) of dividend for each share.

The proposal includes covering all shares issued by the Company, quantity 32,744,000 pieces, with the dividend. In addition, the Supervisory Board does not have any objections to the dividend right date proposed by the Board as at August 16, 2017 as well as the dividend payment date planned as at September 1, 2017.

#### **BRIEF ASSESSMENT OF THE COMPANY'S SITUATION.**

In 2016 the Company earned sales revenues at the level of PLN 379,878,000, namely 80.8% more as compared to the previous year. The sales of the Company's basic products – pipes insulated against corrosion, had the greatest impact on the increase in revenues. This range of products (along with insulation services) recorded a growth of 80.3% (namely by PLN 59,661,000). The execution of contracts for OGP Gaz-System S.A. had the biggest impact on this growth. In terms of quantities, 598,000 m<sup>2</sup> of insulation against corrosion was sold in 2016, with 385,000 m<sup>2</sup> sold in 2015 which gives an increase by 55.3%.

A significant growth was also recorded in the sales of products (85% more as compared to 2015). The growth applies mostly to the sales of metallurgical products – hot-rolled strips for the production of pipes.

In 2016 the Company concluded 3 subsequent Partial Agreements with OGP Gaz-System S.A. from the Framework Agreement concluded in April 2015. The Company participates in the delivery of 280 km of pipes from among tenders settled so far, in total for 379 km of pipes, namely approx. 74%. This proves the Company's effectiveness in competing with the remaining 10 companies/consortiums from Europe and Asia. At the same time, it should be emphasized that previous deliveries have been completed without delays. The quality of delivered products, punctuality and attractive prices are the Company's strong attributes.

In connection with the execution of strategic contracts for Gaz-System S.A., the Company purchased hot-rolled steel sheets at ArcelorMittal Flat Carbon Europe S.A. in 2016. According to the adopted strategy, the Company supplies its domestic producers with steel sheet intended for the production of pipes, which are then purchased by Izostal S.A. This structure gives greater impact on the price of the final product and reliability with regard to punctuality and the quality of received pipes.

With regard to the costs of sold products, goods and materials, they increased by 82.6% which means a greater progression than in the case of sales revenues. This is related to a different range structure. Deliveries for OGP Gaz-System S.A. were completed in 2016. They included pipes DN1000, with thick walls, which are much more expensive than other pipes with smaller diameters used for the construction of distribution gas pipelines. The Company's Management consistently follows a restrictive cost policy. Particular cost items are subject to budgeting to organizational units and the analysis of current execution.

In 2016 net profit in the amount of PLN 7,093,000 was earned i.e. 188.8% more than in 2015. This is a very good result, in particular taking into account the fierce competition on the domestic gas market.

In the opinion of the Supervisory Board, the Company's situation is very good, and the financial results achieved by the Company in 2016 are satisfactory. The Company's Management correctly manages the property and the liabilities. Held capitals ensure the safety and stability of conducted business activities. The Supervisory Board acknowledges that the Company consistently pursues the adopted strategy and earns the assumed revenues.

The Supervisory Board also assessed significant risk factors and hazards resulting from them.

When assessing the system of managing risk significant for the Company, the Supervisory Board points out:

1. The risk related to the dependence on clients

Due to the structural characteristics of the Polish gas market, there is indirect dependence on the following companies: PGNiG S.A. (searching for, extracting, trading and distributing gas) and O.G.P. Gaz-System S.A. (operator of the transmission system), as well as on investment projects planned and executed by them. Apart from sales directly to O.G.P. Gaz-System S.A. and PGNiG S.A. The Company provides services for companies being the contractors or subcontractors of investment projects.

In order to minimize the risk, Izostal S.A. is additionally looking for new sales markets both in Poland (private gas companies) and abroad. One of the elements of minimizing risk is the Company's entering the market of casing strings and mining pipes. In addition, in connection with launching the Research and Development Center for Steel Technologies and Products, the Company's offer has been expanded by research and analyses of raw materials, developing new structural and technological solutions as well as introducing new products and services (DFBE coating) for companies from the following industries: gas, building and steel.

2. Risk related to ensuring the quality of offered services

The recipients of services and products offered by Izostal S.A. are entities operating in the gas and petrochemical industries which are characterized by high quality requirements.

The quality of services offered by the Company is ensured by implemented and observed principles of the Quality Management System according to the standard ISO 9001:2008 as well as obtained certificates of compliance for goods permitted for use in the building industry, issued and supervised by authorized certification units confirming the fulfillment of requirements. The Company has also implemented the standards ISO 14001:2004 and OHSAS 18001:2007. The insulation produced by the Company meets the requirements of the highest quality standards and are adjusted to new quality requirements on a current basis.

3. Risk related to the general macroeconomic situation of Poland

The Company's financial situation is correlated with the macroeconomic situation in Poland. The achieved financial results are affected by such general factors as the GDP growth rate, the investment growth rate, changes to the inflation level, exchange rates, the unemployment rate as well as the amount of the population's personal income. If the economic development rate in Poland and around the world deteriorates or if instruments of shaping the state's economic policy that may have negative impact on the Company's functioning are applied, the achieved financial results may change. The activities of Izostal S.A. may be particularly affected by a decrease in investment expenditures in the economy, a slowdown of the dynamics of GDP growth, an uncontrolled growth in inflation, an increase in restrictions of the state's fiscal and monetary policy.

This risk is minimized by the strategy of the diversification of the sources of gas supply adopted by Poland as well as restrictive regulations regarding environmental protection and CO<sub>2</sub> emission imposed by the European Union. New investments in the gas industry are confirmed by the "Development Plan with regard to satisfying the current and future demand for gas fuels for the years 2014-2023" adopted by OGP Gaz-System S.A.

4. Risk of changes in the prices of production factors

The profitability of anti-corrosive insulation services provided by the Company depends on the changes in the prices of production factors, first of all, on the prices of chemical components, mainly polyethylene and polypropylene. The share of these factors in the structure of costs reaches the level of approx. 20%. The prices

of chemicals are characterized by high correlation with the prices of oil on global markets which, due to the current global political and economic situation, may be subject to strong fluctuations. The above cost factors may affect a temporary deterioration in the Company's financial results as well as the level of earned profitability.

In order to minimize the risk of changes in the prices of production factors, Izostal S.A. follows the strategy of the diversification of their sources in its activities by cooperating with several entities at every production stage. The Company's high financial potential also makes it possible to purchase materials to warehouses in periods when their prices are low.

#### 5. Risk related to the variability of the prices of steel pipes

The price of a steel pipe in the product "insulated steel pipe", depending on the conditions, is approx. 70% of the value. The high variability of prices on the market of steel pipes observed in recent years affects the revenue and margins earned by the Company. Izostal S.A., in order to avoid the risk related to the variability of the prices of steel pipes, optimizes its warehouse stock adapting it to the scope of conducted activities.

In special cases, steel pipes are purchased to warehouses at current prices to supplement the range in quantities making it possible to sell the goods with a profit.

When buying pipes for significant projects, the Company negotiates the prices with suppliers and concludes contracts making it possible to maintain the negotiated price regardless of the situation on the steel market. Changes in the prices of pipes may affect the Company's revenue and profitability both in the main segment of insulation and in trading goods. The Company is protected against the change of prices of particular contracts and the changes in the prices of pipes have a limited impact on the profitability of particular contracts in a short term. Nonetheless, the Company in the long term is favored by high prices of pipes (at the level of revenue and margins), while a decrease in the prices of pipes may affect a decrease in revenues and profit from the sales of pipes.

#### 6. Risk of changes in exchange rates

In connection with its export and import activities, the Company is exposed to the risk of changes in exchange rates. The dominating currency in commercial transactions (next to PLN) is EUR. The Company hedges currency risk by concluding adequate currency transactions with a deferred implementation date.

#### 7. Risk of a trade credit

The company makes sales with deferred payment deadlines which exposes it to the risk of the insolvency of its clients. The recent years have shown the financial difficulties of companies operating in the general building industry and in the road building industry. In order to reduce the risk to the maximum, the Company insures the receivables and makes sales within limits determined by the insurance corporation. The exception is sales for O.G.P. Gaz-System S.A. which the Company decided to exclude from the insurance policy. The stable situation of this recipient guarantees the lack of the risk of insolvency and the exclusion significantly reduces the cost of the insurance policy.

Both the Supervisory Board and the Management Board take measures to limit the risk factors to the minimum extent and identify new factors on an ongoing basis.

The Supervisory Board, when assessing management of risks that are crucial for the Company and the internal control, states that the actions taken by the Management Board, which consist in periodic inspections of rules for risk management and compliance of this process with the adopted standards, and also in constant analysis of risk management in order to develop improvement possibilities in this area, are appropriate and that they are taken in order to develop mechanisms which eliminate or minimise the risks. Identified main risk factors concerning the Company are constantly monitored to determine whether their identification and measures taken to minimise given risk areas are appropriate or if proper means and solutions are applied.

On the basis of the conducted analyses, the Supervisory Board considers that the risk management process within the Company, carried out by the Company's Management Board within the scope of its operations and the Company's directorship participating in the process of risk identification and preventing its consequences, is completed in a proper way. Moreover, the Supervisory Board issued a positive opinion on functioning of the internal control within the Company. In Izostal S.A. the internal control is conducted by the Management Board, directorship and the rest of the employees within the scope of their responsibilities. The Department of Investor Relations and Internal Audit has been separated in the Company. Mechanisms of the internal control ensure compliance of the performed activities with rules and procedures developed for particular areas.

The Supervisory Board also assessed the compliance system that is used by the Management Board and directorship of the Company. The Management Board, managers of the organisational units and experts have access to "Legalis" Legal Information System, specialised press and available professional analyses from where they get the information on changes of law, applicable standards and they familiarize themselves with the applicable legal interpretations. The cooperation with legal department is established on an ongoing basis and in special cases the Company makes use of the opinions of the external, specialised units. The Company has signed a contract with a Law firm for the current services.

The Supervisory Board has a positive view on the compliance system that is used in the Company.

Bearing in mind very good financial results of the Company in 2016 that show strong involvement of the Management Board in the current management, especially in the development processes, improving the Company's position on the market, the Supervisory Board considers a request to the Annual General Meeting on granting a discharge to the members of Izostal S.A. Management Board for performing their duties in 2016 as reasonable.

Kolonowskie, 23.03.2017

**Signatures of the Supervisory Board Members:**

Jerzy Bernhard	- Chairman of the Supervisory Board	.....
Andrzej Baranek	- Deputy Chairman of the Supervisory Board	.....
Jan Chebda	- Registrar of the Supervisory Board	.....
Jan Kruczak	- Member of the Supervisory Board	.....
Lech Majchrzak	- Member of the Supervisory Board	.....
Adam Matkowski	- Member of the Supervisory Board	.....