PKPCARGO

PKP CARGO CAPITAL GROUP CONSOLIDATED ANNUAL REPORT FOR 2016

pkpcargo.com

Dear Investors!

It is my honor to convey to you the PKP Cargo Group's 2016 Annual Report. I am particularly pleased because our market share has been steadily rising since April, namely from the time when the new Management Board took over the helm in the Company. Our value and competitiveness at home and internationally have also been growing.

PKP CARGO is a dynamic brand with extensive growth potential. You will find the undeniable proof of that statement in this Annual Report and our results presented in it. As the saying goes: *Getting to know others and getting to know yourself is tantamount to victory without risk. Getting to know the environment and getting to know the situation at hand leads to total victory*. I am convinced that the Annual Report we present to you here will serve as the best confirmation of the fact that we know not just ourselves but also our business environment and the market context. Therefore, we can say that the success we have achieved is in fact total victory. The publication we are conveying to you also forms the best record of the hard work done with integrity by the more than 23 thousand employees of our group. They are the ones who on a daily basis are building our position as the unchallenged leader among domestic freight operators and as one of the largest in Europe.

Last year the PKP CARGO Group transported more than 111,5 million tons of freight and handled freight turnover to the tune of 28.5 billion tkm. At the same time, our market share measured by freight turnover was 51.6%. Five entities in our group handled that freight: PKP CARGO, PKP CARGO SERVICE and three operators in the AWT Group owned by PKP CARGO and operating in the Czech Republic, Slovakia and Hungary. The PKP CARGO Cargo's sales revenues were PLN 4,411 million while our EBITDA was PLN 562 million.

Our return to area management was an undoubtable success achieved in the most recent months. We cut out the level of managing directors from our organizational structure and we empowered our unit directors to a greater extent, thereby conferring greater powers to them in the measures they take. At the same time, we extended their accountability for results. Material changes have transpired in the Group and they have contributed to enhancing our collaboration with clients. We introduced a new sales model and we continue to expand our commercial structures aligned to the top standards for rendering comprehensive freight services. We are doing all this to be closer to our clients and to react to their needs and expectations more rapidly. Because of these efforts, we have been able to energize our commercial departments and we have won several important contracts.

The fact that despite the extremely challenging market environment we have stemmed the decline in the number of transports and we have reversed this adverse trend is something that deserves mention. *„A person who gives up – never wins,*

while a winner – never gives up". We want to win, and we are capable of winning. That is precisely why the PKP Cargo Group's market share is steadily growing from month to month and I am convinced that we have not yet said the last word.
Challenging macroeconomic conditions indubitably affected our results, though the circumstances in various cargo categories vary. The company diversified its sources of revenue by expanding, among others, intermodal and international transport. This business segment has gained strength recently with an additional growth impulse being generated by the New Silk Road and rail container transport from China to Europe. The PKP CARGO Group understands this trend and is taking great advantage of it, thereby becoming the unchallenged leader in this type of transport in Poland while becoming an ever more important player in Europe. The PKP CARGO Group's freight turnover outside Poland increased by 55% yoy and intermodal transport measured by weight increased by 25% yoy. Here I would like to highlight that the visit paid to PKP CARGO Group's intermodal terminal in Warsaw by the Presidents of Poland and China was an extraordinarily important event last year. During this meeting, the rail connection on the route from China to Europe under the brand of China Railway Express was opened symbolically and we are playing one of the leading roles in this project. We are presently already handling tens of train pairs per week on the New Silk Road and we hope that thanks to the agreements we signed and the contracts we executed with our Chinese partners this number will steadily grow in short order. I am convinced that this collaboration has great prospects, not just for our Company but for the overall Polish economy. We are also counting on Polish food exports to China to grow soon, thereby significantly driving up the amount of transport we handle.

We are steadfastly growing our market share in international transport. In Germany we launched our own shipping company to enable us to tap into the potential offered by western European markets better. In addition, we are looking for partners abroad to utilize our rolling stock outside Poland and on longer hauls more effectively. We are engaged in talks to extend collaboration with countries along the Adriatic Sea, the Baltic Sea and the Black Sea. Through our strategic cooperation with the AWT Group, we have become one of the key operators in the Czech Republic.

2016 was also a year in which we won tenders. Among others, we signed a long-term agreement with the Azoty Group and a coal supply contract to Enea's power plant in Kozienice. An important action we took was to announce the end of the price war that had brought operators to their knees. Freight rates in the most recent contracts are markedly higher than in previous corresponding contracts.

Renewing our rolling stock should also be appended to the list of objectives attained during the most recent twelve months. Whenever it is economically viable, we will continue to modernize our rolling stock as regular revitalization makes our offer more attractive. Additionally, we are taking receipt of the next multisystem locomotives we purchased to handle cross-border connections. We are also running proceedings to buy new specialist wagons.

I would also like to stress emphatically that a dynamic and successful company consists chiefly of people who every day, through their hard work, build its value and future. The success PKP CARGO can brag about would not have been possible without the staff's hard work and enormous commitment. I am glad that in w 2016 the Management Board and employees demonstrated that they want to do their best together to ensure the company's future. That is why I have no doubts that to this year's most important achievements one should add the understanding reached with the trade unions. In that way, we have returned to the path of dialogue; this always makes it possible to strike a compromise and it leads to social rest. Employees expect that and that also lies in the interest of every company and its shareholders.

After having depicted the PKP Cargo Group's most important events and accomplishments during the past year, there is nothing else left for me to do other than to assert boldly that we are a company with enormous growth potential. A company of which our shareholders, Management Board and employees can be proud. I am convinced that in 2017 we will once again manage to attain our ambitious objectives, and we have many of them before us. Keeping our Group on its growth path is merely one of them. I believe that we will raise our market share from month to month not only in terms of domestic transport but also across Europe. The projected economic growth is a grand opportunity for us. PKP CARGO is one of our national champions, a company of no small consequence for the Polish economy. We are strong because of its strength. For that reason, we may gaze into the future with optimism. The more vibrant the economy, the more large-scale infrastructural projects; the stronger industry is, the more freight there will be for us to transport. As PKP CARGO we are well-poised and ready to take advantage of that opportunity. I am glad that our shareholders appreciate that fact, with the best proof being our share price, which is constantly on the rise. Their trust and the trust given by investors in this challenging year served as an additional incentive to continue working hard. I am convinced that in a year from now our satisfaction will be even more pronounced. Henry Ford used to say: „*Businesses that grow by development and improvement do not die. But when a business ceases to be creative, when it believes it has reached perfection and needs to do nothing but produce – it is done*."
Today, I can assure you that PKP CARGO is a company that does not intend to be static; it wants to grow and it has an appetite to do more.

Respectfully,

Maciej Libiszewski

Telefon: +48 22 543 16 00
Telefax: +48 22 543 16 01
E-mail: office@bdo.pl
Internet: www.bdo.pl

BDO Sp. z o.o.
ul. Postępu 12,
02-676 Warszawa
Polska

PKP CARGO SA

ul. Grójecka 17, 02-021 Warszawa

Independent Auditor's Opinion and Report on the consolidated financial statements of the PKP CARGO Group for the period from 1 January to 31 December 2016

BDO

Telefon: +48 22 543 16 00
Telefax: +48 22 543 16 01
E-mail: office@bdo.pl
Internet: www.bdo.pl

BDO Sp. z o.o.
ul. Postępu 12,
02-676 Warszawa
Polska

INDEPENDENT AUDITOR'S OPINION
for the General Meeting and Supervisory Board of
PKP CARGO SA

We have audited the accompanying consolidated financial statements of the PKP CARGO Group ("the Group"), where the holding company is PKP CARGO SA ("the Holding Company") with its registered office in Warsaw, consisting of: the consolidated statement of financial position prepared as at 31 December 2016, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the period from 1 January to 31 December 2016, as well as notes to the financial statements.

Responsibilities of Holding Company Management and Members of its Supervisory Board for the Consolidated Financial Statements

The Holding Company's Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Accounting Standards, International Financial Reporting Standards and the related interpretations announced in the form of European Commission regulations, as well as other binding legal regulations, and for the preparation of the Directors' Report on the Group's activities.

The Holding Company's Management is also responsible for such internal controls as it considers necessary to ensure that the consolidated financial statements are free of material misstatements resulting from fraud or error.

In accordance with the Accounting Act of 29 September 1994 (2016 Journal of Laws, item 1047), hereinafter referred to as "the Accounting Act", the Holding Company's Management and members of its Supervisory Board are required to ensure that the financial statements meet the requirements of the Accounting Act.

Responsibilities of the Auditor

Our responsibility was to express an opinion on whether the consolidated financial statements give a true and fair view of the Group's financial position and financial result in accordance with the applicable International Accounting Standards, International Financial Reporting Standards and the related interpretations announced in the form of European Commission regulations, as well as with the Group's accounting policies.

We performed the audit in accordance with the provisions of Chapter 7 of the Accounting Act, and in accordance with the International Standards on Auditing adopted as National Standards on Auditing in Resolution No. 2783/52/2015 passed by the National Council of Certified Auditors on 10 February 2015, with subsequent amendments.

These standards require us to comply with ethical requirements and to plan and perform the audit in a manner that allows us to obtain reasonable assurance that the consolidated financial statements are free of material misstatements.

An audit consists of performing procedures aimed at obtaining audit evidence on the amounts and information disclosed in the consolidated financial statements. We choose the procedures based on our judgement, including an assessment of the risk of material misstatements in the consolidated financial statements due to fraud or error. In assessing this risk we consider the internal controls related to the preparation and fair presentation of the consolidated financial statements in order to plan our audit procedures, and not to express an opinion on the effectiveness of the internal controls. An audit also includes assessing of the accounting policies used and the reasonableness of the estimates made by the holding company's management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the audited financial statements:

a) give a true and fair view of the financial position of the PKP CARGO group as at 31 December 2016, as well as of its financial result and cash flows for the period from 1 January to 31 December 2016 in accordance with International Accounting Standards, International Financial Reporting Standards and the related interpretations announced in the form of European Commission regulations, as well as the accounting methods (policies) adopted by the Holding Company,

b) are consistent, in content and in form, with the requirements of the Minister's of Finance Decree of 19 February 2009 on the current and periodic information submitted by the issuers of securities and on the conditions for recognizing as equally valid the information required by the regulations of a state that is not a member state (2014 Journal of Laws, item 133 with subsequent amendments), hereinafter referred to as "the MF Decree", as well as with other applicable laws and regulations and with the Holding Company's Statute.

Report on Other Legal and Regulatory Requirements

Opinion on Directors' Report on the Group's Activities

Our opinion on the consolidated financial statements does not cover the Directors' Report on the Group's activities.

In accordance with the Accounting Act and other binding regulations, the preparation of the Directors' Report on the Group's activities is the responsibility of the Holding Company's Management. The Holding Company's Management and members of its Supervisory Board are also responsible for ensuring that the Directors' Report on the Group's activities meets the requirements of the Accounting Act.

In connection with our audit of the consolidated financial statements our responsibility was to read the Directors' Report on the Group's activities and to indicate whether the information presented therein complies with the provisions of Article 49 of the Accounting Act and is consistent with the information presented in the accompanying consolidated financial statements. It was our responsibility to report whether, based on our knowledge obtained during the audit about the Group and its environment, we have identified any material misstatements in the Directors' Report on the Group's activities.

In our opinion, the information contained in the Directors' Report on the Group's activities complies with the provisions of Article 49 of the Accounting Act and with the requirements of the MF Decree, and is consistent with the information presented in the accompanying consolidated financial statements.

Furthermore, based on our knowledge obtained during the audit about the Group and its environment we have identified no material misstatements in the Directors' Report on the Group's activities.

In connection with our audit of the consolidated financial statements it was also our responsibility to read the Holding Company's declaration on the application of corporate governance, constituting a separate section of the Directors' Report on the Group's activities. In our opinion, the declaration contains the information required by the implementing provisions issued based on Article 60 par. 2 of the Act on Trading in Financial Instruments of 29 July 2005 (2016 Journal of Laws, item 1639, with subsequent amendments). The information presented therein is consistent with the applicable regulations and with the information presented in the accompanying consolidated financial statements.

Katowice, 16 March 2017

BDO Sp. z o.o.
ul. Postępu 12
02-676 Warszawa
Authorized Audit Company No. 3355

Auditor in charge:

Leszek Kramarczuk
Certified Auditor
No. 1920

On behalf of BDO Sp. z o.o.:

Dr. André Helin
Managing Partner
Certified Auditor No. 90004

Telefon: +48 22 543 16 00
Telefax: +48 22 543 16 01
E-mail: office@bdo.pl
Internet: www.bdo.pl

BDO Sp. z o.o.
ul. Postępu 12,
02-676 Warszawa
Polska

Audit Report
on the consolidated financial statements of
the PKP CARGO Group
for the period from 1 January to 31 December 2016

I. GENERAL INFORMATION

1. Information about the Holding Company

The holding company of the PKP CARGO Group is PKP CARGO SA.

The Holding Company's registered office is Warszawa, ul. Grójecka 17.

In accordance with the entry in the National Court Register and the Holding Company's Statute, the Holding Company's activities consist of rail transport of freight. In addition to rail transport of freight the Holding Company provides intermodal, shipping, terminal, siding and track line services, as well as rolling stock maintenance and repair services.

The Holding Company operates on the basis of:

- the Statute prepared in the form of a notarial deed on 29 June 2001 (Repertory A No. 1287/2001), with subsequent amendments,
- the Code of Commercial Partnerships and Companies.

On 17 July 2001 the Holding Company was entered in the National Court Register at the District Court in Katowice, in number KRS 0000027702. Due to a subsequent change in the Holding Company's registered office, its records are kept by the Registration Court for the Capital City of Warsaw, XII Business Division of the National Court Register.

The Holding Company has been assigned statistical identification number REGON 277586360, as well as tax identification number NIP 954-238-19-60.

As at 31 December 2016 the Holding Company's share capital amounted to 2.239.346 thousand zł and consisted of 44.786.917 shares with a nominal value of 50 zł per share.

The Holding Company's shareholders as at 31 December 2016, according to the information provided by the Management Board:

Shareholder	Number of shares	% of votes at General Meeting
PKP S.A.	14 784 194	33,01%
Nationale-Nederlanden OFE	6 854 195	15,30%
MetLife OFE	2 494 938	5,57%
Aviva OFE	2 338 371	5,22%
Other shareholders	18 315 219	40,90%
Total	**44 786 917**	**100,0%**

As at 31 December 2016 the Holding Company's equity totaled 3.018.440 thousand zł.

As at 31 December 2016 the Holding Company's Management Board comprised:

- Maciej Libiszewski - President of the Management Board
- Arkadiusz Olewnik - Member of the Management Board in charge of Finances
- Jarosław Klasa - Member of the Management Board in charge of Operations
- Grzegorz Fingas - Member of the Management Board in charge of Sales
- Zenon Kozendra - Member of the Management Board - Employee Representative

The following changes were made in the composition of the Management Board in the year 2016:

- on 19 January 2016 the Holding Company's Supervisory Board appointed Maciej Libiszewski to the position of President of the Management Board,
- on 24 February 2016 the following resigned from the Management Board effective immediately: Jacek Neska, Łukasz Hadyś, Wojciech Derda,

- on 31 March 2016 the Supervisory Board appointed the following as Members of the Management Board effective 1 April 2016: Grzegorz Fingas, Arkadiusz Olewnik and Jarosław Klasa,
- the mandate of Dariusz Browarek, Member of the Management Board - Employee Representative, expired on 11 May 2016,
- on 14 July 2016 the Supervisory Board appointed Zenon Kozendra as employee representative on the Management Board effective 14 July 2016.

2. Composition of the Group

The separate financial statements of the Holding Company for the financial year ended 31 December 2016 have been audited by BDO Sp. z o.o. and given an unqualified opinion.

As at 31 December 2016 the PKP CARGO Group comprised the following subsidiaries consolidated by acquisition accounting:

Company name	Auditor
PKP CARGO SERVICE Sp. z o.o.	BDO Sp. z o.o.
PKP CARGOTABOR Sp. z o.o.	BDO Sp. z o.o.
PKP CARGOTABOR USŁUGI Sp. z o.o.	not audited
PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.	Firma Biegłych Rewidentów „Mazur i Partnerzy" Sp. z o.o.
PKP CARGO Centrum Logistyczne Medyka - Żurawica Sp. z o.o.	PKF Consult Sp. z o.o. Sp. k.
PKP CARGO CONNECT Sp. z o.o.	BDO Sp. z o.o.
Cargosped Terminal Braniewo sp. z o.o.	PKF Consult Sp. z o.o. Sp. k.
CARGOTOR Sp. z o.o.	HLB M2 Sp. z o.o. Tax & Audit Sp. k.
AWT B.V. Group	BDO Audit & Assurance B.V.

The financial year of the Holding Company and of the companies comprising the PKP CARGO Group is the calendar year.

3. Information about the authorized audit company and the auditor in charge

The consolidated financial statements of the PKP CARGO Group for the year 2016 have been audited by BDO Sp. z o.o. with its registered office in Warsaw, ul. Postępu 12, an entity authorized to audit financial statements, registered with the National Chamber of Certified Auditors in number 3355.

The auditor was selected in a resolution passed by the Holding Company's Supervisory Board on 30 June 2016.

The audit was conducted based on an audit agreement signed on 27 July 2016, and performed under the direction of Leszek Kramarczuk, Certified Auditor No. 1920. The audit was performed from 27 February 2017 to the issue of the audit opinion. It was preceded with a review of the consolidated financial statements for the 1st half of 2016.

We hereby declare that BDO Sp. z o.o., its management, the certified auditor and team performing the audit of the financial statements meet the conditions required to issue an objective and independent opinion on the audited financial statements - as provided for in Article 56 par. 3 and 4 of the Act on certified auditors and their self-government, entities authorized to audit financial statements and on public supervision (2016 Journal of Laws, item 1000 with subsequent amendments).

The Holding Company's Management submitted all of the declarations, explanations and information requested by the auditor and necessary to perform the audit.

No limitations had been placed on the scope of the audit or on the methods selected by the auditor to perform the audit.

4. Information about the consolidated financial statements for the previous financial year

The consolidated financial statements of the PKP CARGO Group prepared for the period from 1 January to 31 December 2015 had been audited by KPMG Audyt Spółka z ograniczoną odpowiedzialnością sp.k. and given an unqualified opinion.

The consolidated financial statements for the year 2015 were approved by the General Meeting of 11 May 2016.

The consolidated financial statements for the year 2015 were filed with the National Court Register on 18 May 2016.

II. FINANCIAL ANALYSIS

Presented below are selected items from the consolidated statement of financial position and consolidated statement of comprehensive income, as well as key financial ratios, compared to analogical amounts for the previous year.

1. Main items from consolidated statement of financial position and consolidated statement of comprehensive income

(in '000 zł)

	31.12.2016	% of balance sheet total	31.12.2015	% of balance sheet total
Non-current assets	4 942 861	76,2	4 979 501	81,6
Current assets	1 547 936	23,8	1 122 956	18,4
Total assets	**6 490 797**	**100,0**	**6 102 457**	**100,0**
Total equity	3 242 869	50,0	3 333 945	54,6
Total liabilities	3 247 928	50,0	2 768 512	45,4
Total liabilities and equity	**6 490 797**	**100,0**	**6 102 457**	**100,0**

	2016	% of revenue	2015	% of revenue
Operating revenue	4 411 269	100,0	4 554 133	100,0
Operating costs	(4 543 340)	(103,0)	(4 498 222)	(98,8)
Profit/loss on operating activities	**(132 071)**	**(3,0)**	**55 911**	**1,2**
Profit/loss on financial activities	(18 853)	(0,4)	(45 393)	(1,0)
Gross profit/loss	**(150 924)**	**(3,4)**	**10 518**	**0,2**
Income tax	17 152	0,4	19 563	0,5
Net profit/loss	**(133 772)**	**(3,0)**	**30 081**	**0,7**

2. Key financial ratios

		2016	2015
Profitability ratios			
Gross sales profitability			
	profit/loss on operating activities / operating revenue	(3,0%)	(1,2%)
Net sales profitability			
	net profit/loss / operating revenue	(3,0%)	0,7%
Return on assets			
	net profit/loss / total assets	(2,1%)	0,5%
Liquidity ratios			
Current ratio			
	total current assets / short-term liabilities	1,3	0,9
Quick ratio			
	total current assets - inventory / short-term liabilities	1,2	0,8
Operating ratios			
Receivable days			
	average trade receivables * x 365 days / sales revenue	53	48
Inventory days			
	average inventory * x 365 days / operating costs	10	10
Debt ratios			
Payable days			
	average trade payables and accrued expenses * x 365 days / operating costs	31	26
Debt rate			
	liabilities and cost provisions / total assets	50,0%	45,4%

**) Average receivables, inventory and payables calculated as the mathematical averages of their opening and closing balances.*

3. Remarks

The following were recorded as at 31 December 2016, compared to 31 December 2015:

- a decrease in non-current asses by 0,7%,
- an increase in current assets by 37,8%,
- a decrease in equity by 2,7%,
- an increase in liabilities and cost provisions by 17,3%.

The following occurred in the audited period compared to the same period of last year:

- a decrease in operating revenue by 3,1%,
- an increase in operating costs by 1%,
- a decrease in result on operating activities by 188 million zł,
- a decrease in net financial result by 164 million zł.

In the audited period the profitability ratios deteriorated compared to the previous year, reaching negative values.

The liquidity ratios have improved, with the current reaching a value considered to be satisfactory and the quick remaining below the satisfactory range.

In the audited period the receivable days ratio and the payable days ratio increased by 5 days. The inventory days ratio has not changed from the year before.

The debt rate worsened in the audited period compared to the previous year.

In the course of the audit of the consolidated financial statements we found no indications that as a result of discontinuing or significantly limiting its operations the Group will not be able to continue as a going concern in at least the next reporting period.

III. DETAILED INFORMATION

1. Basis for the preparation of the consolidated financial statements

The consolidated financial statements of the PKP CARGO Group have been prepared in accordance with the International Accounting Standards/International Financial Reporting Standards endorsed by the European Union, and in matters unregulated by these standards - in accordance with the requirements of the Accounting Act and the related implementing provisions.

2. Completeness and correctness of consolidation documentation

The Group's consolidation documentation has been prepared in accordance with the requirements of the Minister's of Finance Decree of 25 September 2009 on the detailed methods used by entities other than banks, insurers and re-insurers to prepare the consolidated financial statements of groups (2009 Journal of Laws No. 169, item 1327).

In the course of the audit we found no un-remedied misstatements in the consolidation documentation with a significant effect on the audited consolidated financial statements.

3. Methods used to value assets, liabilities and equity

The entities covered by the Group's consolidated financial statements apply consistent accounting principles and methods in the valuation of their assets and liabilities.

4. Information about consolidated financial statements items

The structure of the Group's assets, liabilities and equity has been correctly presented in the consolidated financial statements for the financial year ended 31 December 2016.

The data disclosed in the Group's consolidated financial statements are consistent with the consolidation documentation.

5. Additional information

The information presented in the introduction and notes to the consolidated financial statements, containing a description of significant accounting methods and other information, has been presented completely and correctly in all material respects.

6. Management's Declaration

The Management Board of PKP CARGO SA submitted a written declaration about the completeness of the consolidated financial statements, disclosure of all contingent liabilities and absence of significant post-balance sheet events.

Katowice, 16 March 2017

BDO Sp. z o.o.
ul. Postępu 12
02-676 Warszawa
Authorized Audit Company No. 3355

Auditor in charge:

Leszek Kramarczuk
Certified Auditor
No. 1920

On behalf of BDO Sp. z o.o.:

Dr. André Helin
Managing Partner
Certified Auditor No. 90004

CONSOLIDATED FINANCIAL STATEMENTS OF **PKP CARGO** CAPITAL GROUP FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016 PREPARED IN ACCORDANCE WITH IFRS AS ENDORSED BY THE EUROPEAN UNION

pkpcargo.com

TABLE OF CONTENTS

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME 2
CONSOLIDATED STATEMENT OF FINANCIAL POSITION 3
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY 5
CONSOLIDATED STATEMENT OF CASH FLOWS 6
1. General information 8
2. Basis for the preparation of the financial statements 11
3. Basis for the application of International Financial Reporting Standards 11
4. Material values based on professional judgement and estimates 14
5. Accounting policies 15
6. Adjustment of prior period error 25
7. Revenue from sale of services and finished goods 28
8. Expenses by kind 29
9. Other operating revenue and expenses 31
10. Financial revenue and expenses 32
11. Income tax 33
12. Property, plant and equipment 38
13. Intangible assets 42
14. Subsidiaries 43
15. Investments in entities accounted for under the equity method 45
16. Other financial assets 46
17. Other non-financial assets 46
18. Inventories 47
19. Trade and other receivables 47
20. Cash and cash equivalents 48
21. Explanation of changes in the statement of financial position and other adjustments to the statement of cash flows 49
22. Non-monetary transactions 50
23. Non-current assets classified as held for sale 51
24. Equity 52
25. Earnings per share 53
26. Bank loans and credit facilities 54
27. Other financial liabilities 57
28. Finance lease liabilities and leases with purchase option 57
29. Trade and other payables 58
30. Employee benefits 58
31. Other provisions 62
32. Financial instruments and financial risk management 64
33. Transactions with related parties 78
34. Operating lease agreements 80
35. Commitments to incur expenses for non-financial fixed assets 81
36. Contingent liabilities 81
37. Collateral for liabilities 82
38. Subsequent events 82
39. Approval of financial statements 82

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016

	Note	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Revenue from sales of services and finished goods	7	4 341 874	4 330 336
Revenue from sales of goods and materials		30 085	33 132
Other operating revenue	9.1	39 310	190 665
Total operating revenue		**4 411 269**	**4 554 133**
Depreciation / amortization and impairment losses	8.1	621 592	648 982
Consumption of raw materials and energy	8.2	675 000	696 994
External services	8.3	1 573 059	1 501 160
Taxes and charges		36 256	38 597
Employee benefits	8.4	1 442 301	1 484 764
Other expenses by kind	8.5	55 494	53 854
Cost of merchandise and raw materials sold		22 066	25 654
Other operating expenses	9.2	117 572	48 217
Total operating expenses		**4 543 340**	**4 498 222**
Profit / (loss) on operating activities		**(132 071)**	**55 911**
Financial revenue	10.1	38 925	14 723
Financial expenses	10.2	61 239	66 397
Share in the profit/(loss) of equity accounted entities	15	3 461	4 416
Profit / (loss) on sales of shares of equity accounted entities		-	1 865
Profit / (loss) before tax		**(150 924)**	**10 518**
Income tax expense	11.1	(17 152)	(19 563)
NET PROFIT / (LOSS)		**(133 772)**	**30 081**
Other comprehensive income			
Other comprehensive income that will be reclassified to profit or loss:		**25 295**	**34 232**
The effective portion of gains / (losses) on a cash flow hedging instrument		(3 920)	3 373
Income tax on other comprehensive income	11.4	745	(641)
Foreign exchange differences on translation of financial statements of foreign entities		28 470	31 500
Other comprehensive income that will not be reclassified to profit or loss:		**17 401**	**43 106**
Actuarial gains / (losses) on post-employment benefits	30	21 482	53 217
Income tax on other comprehensive income	11.4	(4 081)	(10 111)
Total other comprehensive income		**42 696**	**77 338**
TOTAL COMPREHENSIVE INCOME		**(91 076)**	**107 419**
Net profit/(loss) attributable to:			
Shareholders of the parent company		(133 772)	30 281
Non-controlling interests		-	(200)
Total comprehensive income attributable to:			
Shareholders of the parent company		(91 076)	107 619
Non-controlling interests		-	(200)
Earnings per share (PLN per share)			
Basic earnings per share:	25.1	**(2,99)**	**0,67**
Diluted earnings per share:	25.2	**(2,99)**	**0,67**

(*)restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION PREPARED AS AT 31 DECEMBER 2016

	Note	As at 31/12/2016 (audited)	As at 31/12/2015 (restated*)	As at 01/01/2015 (restated*)
ASSETS				
Non-current assets				
Property, plant and equipment	12	4 700 550	4 719 748	4 044 606
Intangible assets	13	55 831	66 437	58 268
Goodwill		-	-	2 712
Investment properties		1 257	1 309	1 362
Investments accounted for under the equity method	15	40 810	39 831	35 246
Trade and other receivables	19	2 223	5 074	-
Other long-term financial assets	16	8 649	9 849	6 051
Other long-term non-financial assets	17	25 987	32 666	14 645
Deferred income tax assets	11.5	107 554	104 587	91 575
Total non-current assets		**4 942 861**	**4 979 501**	**4 254 465**
Current assets				
Inventories	18	121 189	128 513	115 298
Trade and other receivables	19	639 866	654 116	519 030
Income tax receivables		2 793	2 748	3 053
Other short-term financial assets	16	892	4 046	306 383
Other short-term non-financial assets	17	27 277	13 281	28 246
Cash and cash equivalents	20	755 919	276 191	429 178
		1 547 936	**1 078 895**	**1 401 188**
Non-current assets classified as held for sale	23	-	44 061	17 560
Total non-current assets		**1 547 936**	**1 122 956**	**1 418 748**
Total assets		**6 490 797**	**6 102 457**	**5 673 213**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION PREPARED AS AT 31 DECEMBER 2016 (continued)

	Note	As at 31/12/2016 (audited)	As at 31/12/2015 (restated*)	As at 01/01/2015 (restated*)
EQUITY AND LIABILITIES				
Equity				
Share capital	24.1	2 239 346	2 239 346	2 239 346
Share premium	24.2	618 666	619 407	615 343
Other items of equity		11 447	(2 779)	(48 617)
Foreign exchange differences on translation of financial statements of foreign entities		59 970	31 500	-
Retained earnings		313 440	446 471	515 392
Equity attributable to shareholders of the parent company		**3 242 869**	**3 333 945**	**3 321 464**
Equity attributable to non-controlling interests	24.4	-	-	55 238
Total equity		**3 242 869**	**3 333 945**	**3 376 702**
Non-current liabilities				
Long-term bank loans and credit facilities	26	1 273 605	460 577	208 077
Long-term finance lease liabilities and leases with purchase option	28	140 923	193 500	190 836
Long-term trade and other payables	29	1 845	25 953	67 982
Long-term provisions for employee benefits	30	525 571	603 621	687 775
Other long-term provisions	31	26 420	28 886	8 416
Other long-term financial liabilities	27	1 042	155 198	-
Deferred tax provision	11.5	106 675	118 353	2 328
Total non-current liabilities		**2 076 081**	**1 586 088**	**1 165 414**
Current liabilities				
Short-term bank loans and credit facilities	26	197 803	253 592	92 123
Short-term finance lease liabilities and leases with purchase option	28	59 567	65 416	127 742
Short-term trade and other payables	29	670 021	739 509	541 912
Short-term provisions for employee benefits	30	99 256	100 383	338 618
Other short-term provisions	31	24 950	17 856	24 214
Other short-term financial liabilities	27	118 889	2 174	3 934
Current income tax liabilities		1 361	3 494	2 554
Total current liabilities		**1 171 847**	**1 182 424**	**1 131 097**
Total liabilities		**3 247 928**	**2 768 512**	**2 296 511**
Total equity and liabilities		**6 490 797**	**6 102 457**	**5 673 213**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Note	Share capital	Share premium	Other items of equity: Actuarial gains / (losses) on post employment benefits	Other items of equity: Gains/losses on a cash flow hedging instrument	Foreign exchange differences on translation of financial statements of foreign entities	Retained earnings	Attributable to shareholders of the Parent Company	Attributable to non-controlling interests	Total
As at 1/01/2016 (restated*)		**2 239 346**	**619 407**	**(3 880)**	**1 101**	**31 500**	**446 471**	**3 333 945**	**-**	**3 333 945**
Net profit / (loss) for the year		-	-	-	-	-	(133 772)	**(133 772)**	-	**(133 772)**
Other net comprehensive income for the year		-	-	17 401	(3 175)	28 470	**-**	**42 696**	-	**42 696**
Total comprehensive income		**-**	**-**	**17 401**	**(3 175)**	**28 470**	**(133 772)**	**(91 076)**	**-**	**(91 076)**
Other changes in equity	24.2	-	(741)	-	-	-	741	**-**	-	**-**
As at 31/12/2016 (audited)		**2 239 346**	**618 666**	**13 521**	**(2 074)**	**59 970**	**313 440**	**3 242 869**	**-**	**3 242 869**
As at 1/01/2015 (restated*)		**2 239 346**	**615 343**	**(46 986)**	**(1 631)**	**-**	**515 392**	**3 321 464**	**55 238**	**3 376 702**
Net profit / (loss) for the year		-	-	-	-	-	30 281	**30 281**	(200)	**30 081**
Other net comprehensive income for the year		-	-	43 106	2 732	31 500	-	**77 338**	-	**77 338**
Total comprehensive income		**-**	**-**	**43 106**	**2 732**	**31 500**	**30 281**	**107 619**	(200)	**107 419**
Dividend income	24.3	-	-	-	-	-	(110 176)	**(110 176)**	-	**(110 176)**
Transactions with non-controlling interests	24.4	-	-	-	-	-	15 038	**15 038**	(55 038)	**(40 000)**
Other changes in equity		-	4 064	-	-	-	(4 064)	**-**	-	**-**
As at 31/12/2015 (restated*)		**2 239 346**	**619 407**	**(3 880)**	**1 101**	**31 500**	**446 471**	**3 333 945**	**-**	**3 333 945**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016 [INDIRECT METHOD]

	Note	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Cash flows from operating activities			
Profit/(loss) before tax		**(150 924)**	**10 518**
Adjustments:			
Depreciation of property, plant and equipment and amortization of intangible assets	8.1	596 178	467 611
Impairment loss on non-current assets	8.1	25 414	181 371
(Gain) / loss on disposal / liquidation of property, plant and equipment, intangible assets and non-current assets classified as held for sale		(1 558)	638
(Gain) / loss on investing activities		(724)	2 798
Foreign exchange (gain)/loss		1 473	(2 794)
(Gain) / loss on interest, dividends		31 945	24 389
Share in (profit) / loss of equity accounted entities	15	(3 461)	(4 416)
Profit / (loss) on sale of equity accounted entities		-	(1 865)
Interest received / (paid)		(523)	(210)
Income tax received / (paid)		(6 633)	(10 369)
Bargain purchase gain		-	(137 779)
Other adjustments	21	24 069	59 453
Changes in working capital:			
(Increase) / decrease in trade and other receivables	21	14 214	27 908
(Increase) / decrease in inventories	21	10 119	21 391
(Increase) / decrease in other assets	21	(10 337)	18 200
Increase / (decrease) in trade and other payables	21	(37 213)	65 470
Increase / (decrease) in other financial liabilities	21	(37 441)	6 885
Increase / (decrease) in provisions	21	(74 549)	(341 697)
Net cash provided by operating activities		**380 049**	**387 502**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE PERIOD FROM 1 JANUARY 2016 TO 31 DECEMBER 2016 [INDIRECT METHOD] (continued)

	Note	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Cash flows from investing activities			
Acquisition of property, plant and equipment and intangible assets		(588 094)	(508 662)
Proceeds from sale of property, plant and equipment, intangible assets and non-current assets classified as held for sale		13 927	7 506
Acquisition of entities accounted for under the equity method		-	(1 619)
Proceeds from sale of entities accounted for under the equity method		-	2 000
Acquisition of other financial assets		(111)	(10)
Acquisition of subsidiary, net of cash acquired		-	(325 956)
Proceeds from sale of other financial assets		932	-
Interest received		566	6 663
Dividends received		3 087	2 213
Proceeds from loans granted		(133)	-
Repayment of loans granted		-	149
Inflows from bank deposits over 3 months		1 259	299 048
Other inflows from investing activities		-	3 469
Net cash provided by investing activities		**(568 567)**	**(515 199)**
Cash flows from financing activities			
Payments of liabilities under finance lease		(67 393)	(143 111)
Payments of interest under lease agreement	10.2	(8 556)	(8 607)
Proceeds from credit facilities / loans received	26.2	1 004 598	424 957
Repayment of credit facilities / loans received	26.2	(257 855)	(137 336)
Interest on credit facilities / loans received		(16 753)	(15 403)
Grants received		13 803	6 598
Dividends paid to shareholders of the Parent Company	24.3	-	(110 176)
Transactions with non-controlling interests	24.4	-	(40 000)
Other outflows from financing activities		(3 984)	(6 369)
Net cash provided by financing activities		**663 860**	**(29 447)**
Net increase / decrease) in cash and cash equivalents		475 342	(157 144)
Opening balance of cash and cash equivalents	20	276 191	429 178
Effect of changes foreign exchange rates on cash balances in foreign currencies		4 386	4 157
Closing balance of cash and cash equivalents, of which:	20	**755 919**	**276 191**
restricted cash	*20*	*8 607*	*20 644*

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

EXPLANATORY NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS PREPARED AS AT 31 DECEMBER 2016

1. General information

1.1 Information about the Parent Company

PKP CARGO S.A. ("the Company", "the Parent Company") was formed based on a notarial deed dated 29 June 2001 (Repertory A No. 1287/2001). The Parent Company's registered office is located in Warsaw at ul. Grójecka 17. The Parent Company is registered with the National Court Register at the District Court in Katowice, Business Division of the National Court Register, in number KRS 0000027702. At present, due to a subsequent change in the Parent Company's registered office, the Parent Company's records are kept by the Registration Court for the Capital City of Warsaw, XII Business Division of the National Court Register.The Parent Company has been assigned statistical identification number REGON 277586360, as well as tax identification number NIP 954-23-81-960.

The financial year of the Parent Company and of the companies comprising the PKP CARGO Group is the calendar year.

At the preparation of these Consolidated Financial Statements, the Parent Company's management and supervisory organs comprised:

Management Board:		
Maciej Libiszewski	-	President of the Management Board
Arkadiusz Olewnik	-	Member of the Management Board in charge of Finances
Jarosław Klasa	-	Member of the Management Board in charge of Operations
Grzegorz Fingas	-	Member of the Management Board in charge of Sales
Zenon Kozendra	-	Member of the Management Board - Employee Representative
Supervisory Board:		
Andrzej Wach	-	Vice-Chairman of the Supervisory Board
Raimondo Eggink	-	Member of the Supervisory Board
Czesław Warsewicz	-	Member of the Supervisory Board
Małgorzata Kryszkiewicz	-	Member of the Supervisory Board
Zofia Dzik	-	Member of the Supervisory Board
Marek Podskalny	-	Member of the Supervisory Board
Krzysztof Czarnota	-	Member of the Supervisory Board
Tadeusz Stachaczyński	-	Member of the Supervisory Board
Krzysztof Mamiński	-	Member of the Supervisory Board
Władysław Szczepkowski	-	Member of the Supervisory Board

On 19 January 2016 the Parent Company's Supervisory Board appointed Maciej Libiszewski to the position of President of the Management Board. Maciej Libiszewski was nominated to the position of President of the Management Board by the Parent Company's shareholder - PKP S.A., based on a personal entitlement resulting from § 14 par. 4 of the Statute. The appointment was later confirmed by way of a recruitment proceeding for the position of President of the Management Board conducted by the Supervisory Board with the participation of a professional recruitment adviser.

On 24 February 2016 the following Members submitted their resignations from the Parent Company's Management Board effective immediately:
- Jacek Neska,
- Łukasz Hadyś,
- Wojciech Derda.

As a result of recruitment proceeding which was prepared and organized by professional recruitment adviser, on 31 March 2016 the Supervisory Board passed a resolutions to appoint the following persons to the Parent Company's Management Board effective from 1 April 2016:
- Grzegorz Fingas,
- Arkadiusz Olewnik,
- Jarosław Klasa.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

1.1 Information about the Parent Company (continued)

The mandates of the following Members of the Supervisory Board of the 5th term expired on 11 May 2016:
- Mirosław Pawłowski,
- Kazimierz Jamrozik,
- Andrzej Wach,
- Stanisław Knaflewski,
- Małgorzata Kryszkiewicz,
- Czesław Warsewicz,
- Raimondo Eggink,
- Jerzy Kleniewski.

On 9 May 2016 the Parent Company's shareholder - PKP S.A. informed of the appointment of the following persons to the Supervisory Board effective 11 May 2016:
- Mirosław Pawłowski,
- Andrzej Wach,
- Małgorzata Kryszkiewicz,
- Czesław Warsewicz,
- Jerzy Kleniewski.

The Ordinary General Meeting of 11 May 2016 passed a resolution to appoint the following persons to the Supervisory Board:
- Raimondo Eggink,
- Zofia Dzik.

The mandate of Dariusz Browarek, Member of the Management Board, Employee Representative, expired on 11 May 2016.

On 20 May 2016 the Parent Company's Supervisory Board appointed the following persons as employee representatives on the Supervisory Board:
- Krzysztof Czarnota,
- Marek Podskalny,
- Tadeusz Stachaczyński.

On 14 July 2016 the Supervisory Board passed a resolution to appoint Zenon Kozendra as employee representative on the Parent Company's Management Board effective from 14 July 2016.

On 6 March 2017 Mirosław Pawłowski resigned from the position of Chairman of the Supervisory Board effective immediately.
In the same date the Company's shareholder - PKP S.A. appointed Krzysztof Mamiński to the position of Member of Supervisory Board.

On 14 March 2017 Jerzy Kleniewski resigned from the position of Member of the Supervisory Board effective immediately.

On 14 March 2017 the Company's shareholder – PKP S.A. appointed Władysław Szczepkowski to the position of Member of the Supervisory Board.

The Parent Company's shareholders as at 31 December 2016 is as follows:

Entity	Registered office	Number of shares	% of share capital	% of voting rights
PKP S.A.[(1)]	Warsaw	14 784 194	33,01%	33,01%
Nationale-Nederlanden OFE [(2)]	Warsaw	6 854 195	15,30%	15,30%
MetLife OFE [(3)]	Warsaw	2 494 938	5,57%	5,57%
Aviva OFE [(4)]	Warsaw	2 338 371	5,22%	5,22%
Other shareholders		18 315 219	40,90%	40,90%
Total		**44 786 917**	**100,00%**	**100,00%**

[(1)] As per notice sent by shareholder on 24 June 2014.
[(2)] As per notice sent by shareholder on 18 October 2016.
[(3)] As per notice sent by shareholder on 18 August 2016.
[(4)] As per notice sent by shareholder on 13 August 2014.

1.1 Information about the Parent Company (continued)

On 16 March 2016 the Parent Company's Management Board was notified by Morgan Stanley of a reduction by Morgan Stanley of its holding to below 5% of total votes at the Parent Company's general meeting. The reduction occurred as a result of a sale of the Parent Company's shares, performed on the Warsaw Stock Exchange on 10 March 2016.

On 18 August 2016 the Parent Company's Management Board was notified by MetLife PTE S.A. that the MetLife Open Pension Fund (managed by MetLife PTE S.A.) has increased to more than 5% the total number of its votes at the Parent Company's general meeting. MetLife Open Pension Fund increased its holding of the Parent Company's shares to 5,57% as a result of a purchase transaction performed on the Warsaw Stock Exchange on 10 August 2016.

On 14 and 18 October 2016 the Parent Company's Management Board was notified by Nationale-Nederlanden PTE S.A. that Nationale-Nederlanden OFE has acquired the Parent Company's shares in transactions performed on the Warsaw Stock Exchange on 10 and 12 October 2016. As a result of the transactions, Nationale-Nederlanden OFE increased its interest in the Parent Company to 6.854.195 shares, or 15,30% of the share capital and of the total number of votes at the Parent Company's general meeting.

The company PKP S.A. is the parent company of PKP CARGO S.A. In accordance with the Parent Company's statute, PKP S.A. holds special personal entitlements, consisting of a right to appoint and dismiss Members of the Supervisory Board at a number equal to half of the Supervisory Board plus one. PKP S.A. holds a personal entitlement to appoint the chair of the Supervisory Board, as well as to set the number of Members of the Supervisory Board. In addition, if the percent of the Parent Company's share capital held by PKP S.A. equals to 50% or less, PKP S.A. holds a personal entitlement to solely designate candidates for the position of President of the Parent Company's Management Board. PKP S.A. holds these personal entitlements whenever it owns at least 25% of the Parent Company's share capital.

1.2 Information about the Group

As at the balance sheet date the PKP CARGO Group (hereinafter referred to as the Group) comprises PKP CARGO S.A. as the parent company and 28 subsidiary companies. In addition, the Group has 6 associated companies and shares in 4 joint ventures

On 28 May 2015 the Parent Company acquired from Mr. Zdenek Bakala and The Bakala Trust 80% of the shares of Advanced World Transport B.V. with its registered office in Amsterdam (hereinafter referred to as AWT), which is the parent company of the AWT Group.

Due to the moment at which control was acquired, the comparative data for the financial year ended 31 December 2015 presented in the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows include the financial data of the AWT Group companies for the period of 7 months ended 31 December 2015.

Detailed information on the acquisition of AWT is presented in Note 6 to the Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015, prepared in accordance with International Financial Reporting Standards endorsed by the European Union ("IFRS EU"). The fair value of the acquired net assets of AWT determined provisionally as at the acquisition date has not changed.

Additional information about the subsidiaries is presented in Note 14 to these Consolidated Financial Statements.

The Group's main area of activity is the rail transport of freight. In addition to the rail transport of freight, the Group provides the following services:

a) intermodal services,
b) shipping services (domestic and international),
c) terminal services,
d) siding and traction services,
e) rolling stock maintenance and repair services
f) reclamation services.

The duration of the companies comprising the Group is not limited, with the exception of companies in liquidation.

2. Basis for the preparation of the financial statements

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards and the related interpretations endorsed by the European Union ("IFRS EU"), published and binding during the preparation of these Consolidated Financial Statements, and in accordance with the Minister's of Finance Decree of 19 February 2009 on the current and periodic information submitted by the issuers of securities and the conditions for recognizing as equally valid the information required by the regulations of a state that is not a member state (2014 Journal of Laws, item 133 with subsequent amendments) ("the Decree").

These Consolidated Financial Statements for the year ended 31 December 2016 have been prepared on a going concern basis. At the preparation of the present Consolidated Financial Statements no circumstances existed indicating a threat to the Group's ability to continue as a going concern for at least 12 months of the date of the financial statements.

These Consolidated Financial Statements have been prepared on a historical cost basis, with the exception of derivative financial instruments measured at fair value and liabilities relating to put options for non-controlling shares.

These Consolidated Financial Statements have been prepared in Polish zlotys (PLN). The Polish zloty is the Group's functional and presentation currency. The data in the financial statements are presented in thousands of Polish zlotys, unless presented with more accuracy in specific cases.

These Consolidated Financial Statements were approved for publication by the Management Board of Parent Company on 16 March 2017.

3. Basis for the application of International Financial Reporting Standards

3.1 Status of EU endorsement of standards

The following changes to existing standards published by the International Accounting Standards Board and endorsed by the EU became effective in 2016:

- **Amendments to IFRS 11 "Joint Arrangements"** entitled Accounting for Acquisitions of Interests - apply to annual periods beginning on or after 1 January 2016. The amendments require the investor to apply accounting methods relating to business combinations when the investor acquires shares in a joint operation that is a "venture" (as defined in IFRS 3 "Business Combinations"). All other business combination accounting methods apply as long as they do not contradict IFRS 11. The amendments apply to the acquisition of an initial share in a joint operation, as well as to subsequent acquisitions of shares in the same joint operation. Whereas a previously held share is not subject to re-measurement to fair value when the acquisition of an additional share in the joint operation results in maintaining joint control. The amendments will apply to the acquisition of a share in an existing joint operation that is a venture, or when the joint operation is formed and an existing venture is contributed to it. The amendments require the disclosure of information specified in IFRS 3 and in other IFRS relating to business combinations.
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 41 "Agriculture"** entitled Agriculture – Bearer Plants – apply to annual periods beginning on or after 1 January 2016. The amendments distinguish between bearer plants and other biological assets. Bearer plants are seen as similar to production machinery used in the process of production, and as such should be classified as property, plant and equipment and recognized in accordance with IAS 16.
- **Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets"** entitled Clarification of Accepted Methods of Depreciation and Amortization - apply to annual periods beginning on or after 1 January 2016. IASB has made changes to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets" in order to clarify when the use of a depreciation method based on revenue is appropriate. The amendments to IAS 16 and IAS 38 indicate that the depreciation or amortization of property, plant and equipment and intangible assets based on revenue generated using those assets is not appropriate. With regard to the amortization of intangible assets, the standard introduces the need to consider what is the key factor that limits the benefits arising out of the asset and gives examples that show that revenue or volume may be such factors in only limited situations.
- **Amendments to IAS 1 "Presentation of Financial Statements"** entitled Disclosure Initiative – apply to periods beginning on or after 1 January 2016. IASB has taken on an initiative aimed at improving the quality of disclosures in financial statements. The amendments pertain to such matters as materiality, disaggregation of information and subtotals, presentation order of notes to financial statements, disclosure of accounting methods.

3.1 Status of EU endorsement of standards (continued)

- **Amendments to International Financial Reporting Standards 2010-2012** (annual improvements to IFRS 2010-2012 contain 8 amendments to 7 standards, with corresponding changes to the remaining standards and interpretations) - apply to periods beginning on or after 1 February 2015.
- **Amendments to International Financial Reporting Standards 2012-2014** (annual improvements to IFRS 2012-2014 contain 4 amendments to standards, with corresponding changes to the remaining standards and interpretations) - apply to periods beginning on or after 1 January 2016.
- **Amendments to IAS 19 "Employee Benefits"** entitled Defined Benefit Plans: Employee Contributions - apply to periods beginning on or after 1 February 2015. The amendments introduced to IAS 19 in 2011 distinguish between employee premiums related and unrelated to employment. The change introduces an additional differentiation between premiums associated with the provision of work only in the period, in which they were paid, and associated with the provision of work in more than one period. The amendment makes it possible for premiums related to the provision of work, which do not change depending on the length of employment, to be deducted from the cost of benefits acquired during the period of employment. Premiums related to the provision of work, which change depending on the length of employment should be spread out over the period of employment using the same method as the one applied to the benefits, i.e. either in accordance with the formula specified in the retirement plan, or – if the plan provides a higher amount of benefits associated with employment in later years – using the straight line method. The benefits arising out of employee premiums related to the length of employment are recognized in the profit or loss throughout the employee's working life. Premiums unrelated to the provision of work are reflected in the valuation of the requirement to provide the benefit. The amendments have no effect on the recognition of voluntary premiums.
- **Amendments to IFRS 10 "Consolidated Financial Statements", IFRS 12 "Disclosure of Interests in Other Entities" and IAS 28 "Investments in Associates and Joint Ventures"** entitled Investment Entities: Applying the Consolidation Exception – applicable to annual periods beginning on or after 1 January 2016. Amendments to IFRS 10 explain that the exemption from the preparation of consolidated financial statements applies to indirect parent companies that are subsidiaries of investment entities, which measure their subsidiaries at fair value. An indirect parent company must also meet the other exemption criteria listed in IFRS 10. Changes to IFRS 10 explain an investment company should consolidate subsidiaries that are not investment companies, whose main objective and area of activity is the provision of services in support of the activities performed by the investment company. Whereas the changes confirm that when a subsidiary is an investment company, the parent investment company should measure its investment in such a subsidiary at fair value through profit or loss. This approach is required irrespective of whether the subsidiary provides services associated with the investment activities of its parent company, or to third parties.

The application of the above standards, interpretations and amendments to standards had no material effect on the Group's existing accounting policies.

3.2 Standards and interpretations adopted by IASB and endorsed by the EU, but not yet effective

When approving these Consolidated Financial Statements the Group did not apply the following standards, amendments to standards and interpretations, which have been issued by the International Accounting Standards Board (IASB) and endorsed by the European Union, but have not yet become effective:

- **IFRS 15 "Revenue from Contracts with Customers"** – applies to annual periods beginning on and after 1 January 2018. This standard specifies how and when to recognize revenue, and calls for more detailed disclosures. The standard replaces IAS 18 Revenue, IAS 11 Construction Contracts and several interpretations relating to recognition of revenue. On 11 September 2015 IASB moved the effective date of the standard by a year. The new standard requires the disclosure in the financial statements of much more information on the nature, amount, distribution in time and uncertainty with regard to revenue and cash flows from contracts with customers.
- **Clarifications to IFRS 15 "Revenue from Contracts with Customers"** – apply to annual periods beginning or and after 1 January 2018.
- **IFRS 9 "Financial Instruments"** – applies to periods beginning on and after 1 January 2018. IFRS 9 introduces an approach to the classification and valuation of financial assets that reflects the business model in which they are managed and the nature of the cash flows. IFRS 9 introduces a new model of impairment testing, which will require a more timely recognition of anticipated credit losses. The new model will also result in the introduction of a standardized approach to impairment tests used on all financial instruments. In addition, IFRS 9 introduces a new model of hedge accounting, requiring extensive risk management disclosures. The changes are meant to adapt the methods used to recognize risk management matters in the financial statements, to allow entities to better reflect their actions in the financial statements.

3.2 Standards and interpretations adopted by IASB and endorsed by the EU, but not yet effective (continued)

Our initial analysis of the effect of IFRS 9 on the existing accounting methods indicates that the new standard will mainly affect the extent of disclosures and the presentation of financial instruments in the Company's financial statements. In addition, the above analysis has shown that the new approach to the impairment of financial instruments model (in the case of the Company it will pertain primarily to trade receivables) will have no material effect on the amount of impairment and most likely implementation of IFRS 9 in this area will not require adjustments of prior periods.
In the case of IFRS 15, the Company is performing analyses of the effect of variable consideration on sales revenue generated in different reporting periods. The Group is working on identifying contracts with elements of variable consideration and on developing a method to estimate the consideration due to the entity in the given reporting period. At this stage it is not possible to quantify the effect of the new standard on the Group's financial statements.

3.3 Standards and interpretations adopted by IASB, but not yet endorsed by the EU and not effective

At present the IFRS endorsed by the EU do not differ significantly from the regulations adopted by the International Accounting Standards Board (IASB), with the exception of the following standards, amendments to standards and interpretations, which as at 31 December 2016 had not yet been endorsed by the EU and were not effective:

- **IFRS 16 "Leases"** - applicable to annual periods beginning or and after 1 January 2019. In accordance with IFRS 16, a lessee recognizes the right to use an asset and the liability arising out of the lease agreement. The right to use an asset is treated similarly to other non-financial assets and amortized accordingly. The liability is initially recognized at the present value of the lease fees payable during the term of the lease, discounted by the rate contained in the lease, if its determination is not difficult. If it is not easy to determine the rate, then the lessee applies the marginal interest rate.
- **Amendments to IAS 7 "Statement of Cash Flows"** entitled Disclosure Initiative - applicable to periods beginning on 1 January 2017. The amendments introduce the requirement to include in the financial statements a disclosure that will allow the users of the financial statements to evaluate changes in liabilities arising out of financial activities, including changes arising out of cash flows and cashless changes. One of the methods of fulfilling this requirement is to present a reconciliation of debt balances broken down by type of change.
- **Amendments to IAS 12 "Income Taxes"** entitled Recognition of Deferred Tax Assets for Unrealized Losses – applicable to periods beginning on 1 January 2017. The amendments clarify the need to form deferred tax assets on losses on the valuation of financial instruments classified as available for sale. In particular, the change pertains to debt instruments, for which the entity should consider the existence of evidence that it is likely that it will realize the financial instrument for an amount higher than its balance sheet value.
- **Amendments to IFRS 2 "Share-based Payment"** entitled Classification and Measurement of Share-based Payment Transactions - applicable to periods beginning on 1 January 2018. The change to IFRS 2 clarifies that the "fair value" of share based payments settled in cash should be determined in the same manner as in the case of payments settled in equity instruments. The change has introduced a requirement to adjust the liability by considering each change in its value in the financial result before reclassifying from liabilities to equity. The cost recognized after the modification is based on the fair value at the date of modification. The change introduced an exception where the payment of funds to a tax office is treated as a settlement in equity instruments. The entity should disclose the estimated amount it expects to pay as tax to the tax office. At initial application, reclassification of liabilities to equity will have no effect on the financial result.
- **Amendments to IFRS 4 "Insurance Contracts"** entitled Applying IFRS 9 "Financial Instruments" with IFRS 4 "Insurance Contracts" - applicable to periods beginning on 1 January 2018. The changes address the matter of applying the new IFRS 9 "Financial Instruments" prior to the implementation of the new standard relating to insurance activities, on which IASB is currently working.

The Group is analyzing the effect on its accounting policies of the published IFRS 16 "Leases". Our initial analysis of the effect of IFRS 16 on the existing accounting methods indicates that the Group will have to recognize retrospectively its significant lease liabilities and asset items (mainly land, buildings and constructions), which are currently covered by long-term operating lease or rental agreements. The Group is currently in the process of identifying the agreements that are subject to the new requirements and of developing preliminary models for the valuation and recognition of the above agreements in the financial statements. At this stage it is not possible to quantify the effect of IFRS 16 on the Group's financial statements. The Group has analyzed the potential effect of the other above-listed standards, interpretations and amendments to standards on its accounting policies. In the opinion of the Parent Company's Management Board, they will have no material effect on the existing accounting policies.

4. Material values based on professional judgement and estimates

Preparation of financial statements in accordance with IFRS EU requires the adoption of certain assumptions and the performance of estimates and judgements with an effect on the values presented in the Group's financial statements.

The estimates and assumptions are made to the best of the management's knowledge and experience, as well as on the basis of other factors considered most reasonable in the given circumstances. The estimates and the related assumptions are verified on a regular basis. Changes in estimates are recognized prospectively from the moment in which the change took place.

Presented below are the material estimates that may have an effect on the balance sheet values of assets and liabilities and on the Group's financial results in future periods.

a) Economic useful lives of fixed assets and intangible assets

The Group estimates the economic useful lives of the individual fixed assets and intangible assets, and thus determines the depreciation rates for the items. The estimates are based on the expected economic useful lives of the assets. Depreciation rates may change in case of circumstances causing a change in the expected useful life, which in turn affects the value of the depreciation charge and the net carrying amount of the fixed assets and intangible assets. An analysis of the useful lives of fixed assets and intangible assets conducted in 2016 did not reveal the need to correct the previously applied depreciation rates.

b) Residual value of railroad fleet

The Group uses its own and leased train engines and wagons, for which it recognizes residual values separately. The residual value is based on the current prices of classes of scrap, subject to the cost of disposal. The residual value of railroad fleet is not depreciated, but is subject to periodic verifications at the end of each financial year. The Group analyses the residual value when a change thereto significantly affects the Group's financial statements.

As at 31 December 2015 the Group decided to reduce the residual value of its railroad fleet. The reduction in residual value and the increase in the basis for the calculation of depreciation charges raised the costs of depreciation in the year 2016 by approximately PLN 58 million. As at 31 December 2016 the Group did not find it necessary to recalculate the residual value of its railroad fleet.

c) Impairment of property, plant and equipment and intangible assets

At the end of each reporting period, in accordance with the provisions of IAS 36 "Impairment of Assets", the Group performs an analysis to determine if there are any indications of impairment of cash generating units and individual assets. If such indications of impairment are identified, the Group estimates the recoverable amount of the cash generating units or individual assets, based on a series of significant assumptions partially beyond the Group's control. The recoverable amount is determined based on an estimate of the assets' value in use using the discounted cash flows method.

Detailed information on impairment tests performed on the Group's assets is presented in Note 12.1 to these Consolidated Financial Statements.

d) Impairment allowance for receivables

At the reporting date, the Group assesses whether there is objective evidence of impairment of a receivable or group of receivables. If the recoverable amount of the asset is lower than its carrying amount, a write-down is recognized to the present value of the expected cash flows. Detailed information on write-downs of trade receivables and other receivables is presented in Note 19 to these Consolidated Financial Statements.

e) Deferred income tax

The Group recognizes a deferred income tax asset based on the assumption that in the future it will generate sufficient taxable income to use the asset. Future deterioration of taxable profits could cause this assumption to be unfounded. The Group's Management Board verifies the estimates of the probability of recovery of deferred tax assets based on changes in the factors taken into account in their calculation, new information and past experience.

Information on deferred tax assets is presented in Note 11 to these Consolidated Financial Statements.

4. Material values based on professional judgement and estimates (continued)

f) Provisions for employee benefits

Provisions for employee benefits are significantly affected by the assumptions adopted with regard to the discount rate, pay increases, the expected average length of employment. The 31 December 2016 valuation of provisions for employee benefits takes into account the effect of enter into force of the bill lowering retirement age, which is presented as a change in the plan as past service costs. Detailed information on the methods used to form the provisions is presented in Note 5.22, whereas the results of the calculation of provisions for employee benefits are presented in Note 30 to these Consolidated Financial Statements.

g) Liability relating to put options for non-controlling shares

The Group presents liabilities relating to put options for non-controlling shares of Advanced World Transport B.V. (hereinafter referred to as AWT). The fair value of the options is determined using fair valuation techniques based on the discounted cash flows (DCF) model. The main assumptions used in the model are data relating to AWT's EBITDA and net debt, the discount rate and the EUR/PLN forward rate. In accordance with the relevant Agreement described in Note 32.1.3, starting from 2017 the minority shareholder may exercise the put option, which is why the resulting liability is presented as short-term.

Detailed information on the put options for non-controlling shares of AWT are presented in Note 32.1.3 to these Consolidated Financial Statements.

5. Accounting policies

5.1 Revenue from sales of services

Sales revenue is recognized at the fair value of the consideration received or receivable for sale of services as part of the Group's ordinary operations. Revenue is presented less value added tax, returns, rebates and discounts. The Group recognizes revenue when its amount can be measured reliably and when it is likely that economic benefits will flow to the Group in the future. The Group bases its estimates on historical results, taking into account the type of client, the type of transaction and the terms of specific agreements.

Revenue from sale of services is recognized in the period in which the services were performed, using the stage of completion method. The stage of completion is measured based on the percentage of services completed in proportion to the total value of the services to be performed.

A domestic sale is recognized at the date of service performance in accordance with the purchase-sale agreement (date of shipment or making available for the recipient or service acceptance). In particular, the sale of a cargo shipment service is in each case the date on which the service was accepted (completed). For export sales, it is the date when the goods are transported across the border, which is confirmed by the Border Customs Office.

5.2 Expenses by kind

Expenses are recognized as any probable decrease of economic benefits in the reporting period, of a reliably determined value, in the form of a reduction in the value of assets or an increase in the value of liabilities and provisions that will lead to a decrease in equity or an increase in its deficit in other form than withdrawal of funds by the owners.

The Group presents the following expenses by nature in the statement of comprehensive income:
- depreciation / amortization and impairment losses,
- consumption of raw materials and energy,
- external services,
- taxes and charges,
- employee benefits,
- other expenses by kind,
- costs of merchandise and raw materials sold.

5.3 Other operating revenue and expenses

Other operating revenue and expenses include in particular:
- the sale and liquidation of tangible fixed assets, intangible assets and assets held for sale,
- recognized and released provisions, with the exception of provisions related to financial operations or recognized in expenses by kind,
- recognized and released write-downs of receivables,
- transferring or acquiring assets free of charge, including donated assets and cash,
- the received, due or paid damages, complaints, penalties and fines,
- costs of removing the consequences of damage,
- provisions for certain or probable losses from operations in progress,
- foreign exchange differences arising from the valuation and settlement of trade payables and receivables.

5.4 Financial revenue and expenses

Financial revenue and expenses include in particular:
- sale of financial assets and shares,
- revaluation of financial instruments not covered by hedge accounting,
- dividend income,
- interest,
- foreign exchange differences on financial operations,
- interest costs (discount) of the provisions for employee benefits,
- other items related to financial activities.

Interest income and expenses are recognized successively using the effective interest rate method in relation to the net carrying amount of the given financial instrument, subject to the materiality principle. Dividend income is recognized as at the moment of establishing shareholders' rights to their receipt.

5.5 Current and deferred income tax

The corporate income tax for the reporting period comprises current and deferred tax. Tax is recognized in the statement of comprehensive income excluding the portion that related directly to items recognized under other comprehensive income or equity.

The Group's current tax liability is calculated based on binding tax regulations or regulations actually introduced as at the balance sheet date in the country where the Group generates taxable income.

Deferred income tax on temporary differences between the tax and accounting values of assets and liabilities is recognized in the financial statements. If, however, a deferred income tax liability arose on the initial recognition of goodwill or initial recognition of an asset or liability as part of a transaction other than a business combination that at the moment of its performance had no effect on the financial result or taxable income (taxable loss), then it is not recognized. Deferred income tax is calculated using tax rates (and regulations) legally or actually binding on the balance sheet date, which are expected to apply at the time of realization of the respective deferred income tax assets or payment of the respective liabilities.

Deferred income tax assets and liabilities are subject to being offset if there is an enforceable legal title to offset deferred income tax assets against deferred income tax liabilities, and if the deferred income tax assets and liabilities pertain to income taxes levied by the same tax authorities and they are to be settled at net amounts.

5.6 Valuation of items expressed in foreign currencies

Transactions in foreign currencies are translated into the functional currency at the exchange rate binding on the transaction date, or when the items are re-measured. As at the reporting date, assets and liabilities expressed in foreign currencies are translated into PLN using the average exchange rate of the National Bank of Poland applicable on that day. Foreign exchange gains and losses on the settlement of those transactions and the balance sheet date valuation of assets and liabilities expressed in foreign currencies are recognized in the profit or loss, unless deferred under other comprehensive income, when they can be classified as cash flow hedges. Non-monetary assets and liabilities measured at historical cost expressed in a foreign currency are translated using the average exchange rate binding on the transaction date.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

5.6. Valuation of items expressed in foreign currencies (continued)

For consolidation purposes, the financial data of foreign companies have been translated into the Polish currency in the following manner:
a) assets and liabilities at the exchange rate as at the end of the reporting period,
b) items of statement of comprehensive income and statement of cash flows at the average exchange rate in the given reporting period, calculated as the mathematical average of the foreign exchange rates as at the last day of each month in the given period.

Foreign exchange differences resulting from the above translation are recognized in equity as foreign exchange differences on translation of subsidiaries' financial statements.

As at 31 December 2016 and 31 December 2015 the Group applied the following exchange rates for the valuation of items in the statement of financial position expressed in foreign currencies:

Currency	31 December 2016	31 December 2015
EUR	4,4240	4,2615
CHF	4,1173	3,9394
CZK	0,1637	0,1577
HUF	0,0142	0,0136

As at 31 December 2016 and 31 December 2015 the Group applied the following exchange rates to translate the items of the consolidated statement of comprehensive income arising out of the financial statements of the foreign entities covered by the consolidated financial statements:

Currency	31 December 2016	31 December 2015*
EUR	4,3757	4,2184
CZK	0,1618	0,1555
HUF	0,0140	0,0135

(*) exchange rates translated for the period from 28 May 2015 to 31 December 2015.

5.7 Property, plant and equipment

The initial value of property, plant and equipment consists of their acquisition cost or cost of production, along with any import duties, non-refundable purchase taxes, less any rebates and discounts, plus any costs directly attributable to preparing the asset for its intended use and, if applicable, the costs of external financing, less any subsidies.

Payments deferred for a period exceeding the typical payment term for a trade credit are discounted, and the initial value of a fixed asset is equal to the present value of all payments. The difference between the initial value and total payments is charged to discount expenses over the period of funding.

Maintenance and repair costs (running costs) are charged to profit or loss when incurred except for repairs and periodic reviews of wagons and train engines (P3, P4 and P5) which constitute material components and are depreciated between individual repairs.

Freehold land and rights to perpetual usufruct of land are not subject to depreciation.

Depreciation is recognized in such manner that allocates systematically initial value of assets into expenses over their useful life. The depreciable value of asset is determined after deducting its residual value. The estimated useful lives, residual values and depreciation methods are verified at the end of each reporting period (including prospective application of any changes to estimates). Depreciation of fixed assets begins when they are available for use.

Assets used under finance leases are depreciated over their expected useful lives on the same basis as the Group's owned assets. If it is not certain that the ownership will be transferred after the lease term, fixed assets used under a finance lease are depreciated over the estimated useful life of the fixed asset or the lease term, whichever is shorter.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

5.7 Property, plant and equipment (continued)

Property, plant and equipment are derecognized from statement of financial position upon disposal or if no economic benefits are expected from further use of the asset. At the time of the decision to liquidate an item of property, plant and equipment, its book value is recognized in profit or loss as an expense of the reporting period in which the decision was made, except for items of rolling stock, which at the time of the decision about liquidation are recognized as inventories at the amount of their residual value.

Economic useful life of fixed assets for the purpose of depreciation:

Buildings, premises, civil and water engineering structures	from 5 to 75 years
Plant and equipment	from 2 to 40 years
Means of transport, including	
Freight cars	from 36 to 48 years
Electric engines	from 32 to 45 years
Diesel engines	from 24 to 32 years
Other vehicles	from 2 to 10 years
Other fixed assets	from 2 to 25 years

Government grants are recognized if it is reasonably certain that they will be obtained and that all the necessary conditions will be met. The Group can obtain non-reimbursable government grants, mainly in the form of direct and indirect subsidies for investments. Grants decrease the value of assets and are recognized in profit or loss under decrease in depreciation / amortization, depending on how the expected economic benefits are obtained from a given asset. Government grants as an offset of costs incurred or losses, or as a form of direct financial support granted to the Group without any future costs involved, are recognized in the profit/loss of the period in which they mature.

5.8 Leases

A lease is classified as a finance lease when as part of the concluded agreement substantially all of the potential rewards and risks arising out of owning the asset are transferred onto the lessee; otherwise the lease agreement is classified as an operating lease.

Assets used on the basis of finance lease agreements (in which case substantially all risks and benefits are transferred onto the Group) are treated as the Group's assets and measured at fair value at the moment of acquisition, with the fair value being no higher than the value of the present minimum lease payments. The resulting liability to the lessor is presented in the statement of financial position under finance lease liabilities and leases with purchase option.

Lease payments are broken down into interest and principal to obtain a fixed periodic interest rate for the remaining liability in each period. The financial costs are charged directly to the profit and loss account, unless they can be directly attributed to the applicable assets – in which case they are capitalized.

Operating lease payments are charged to the profit or loss using the straight line method throughout the term of the lease, with the exception of cases when another, systematic method of settlement is more representative for the time model governing the consumption of the economic benefits flowing out of leasing the given asset.

5.9 Intangible assets

Intangible assets purchased with a defined economic useful life are recognized at cost less accumulated amortization and impairment. Amortization is recognized on a straight line basis over the estimated useful economic life. The estimated useful economic life and amortization method are verified at the end of each reporting period and the effects of changes in estimates are recognized prospectively. Intangible assets purchased with an unspecified economic useful life are recognized at cost less accumulated impairment.

For the purpose of amortization of intangible assets with defined economic useful life, the Group uses periods from 2 to 10 years.

5.10 Impairment of tangible fixed assets and intangible assets

At each reporting date, the Group reviews the carrying amounts of its tangible fixed assets and intangible assets in order to determine whether there is any indication of impairment. If there are such indications, the recoverable amount of the asset is estimated in order to determine a possible impairment loss.

The recoverable amount is measured at the higher of following two values: fair value less cost to sell or value in use. Value in use is defined as the present value of estimated future cash flows discounted using a discount rate before tax.

If the recoverable amount of an asset is lower than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately as a cost of the period.

A previously determined impairment loss of a non-financial asset is evaluated as at each balance sheet date for indications of the possibility of reversing the impairment loss.

Where an impairment loss is reversed, the net value of the asset (or the cash generating unit) is increased to the revised estimate of the recoverable amount, which, however, does not exceed the carrying amount of the asset that would have been determined had an impairment loss of the asset/cash flow generating unit not been recognized in previous years. Reversal of impairment is charged immediately to profit or loss.

5.11 Investments in entities accounted for under the equity method

Investments in selected subsidiaries, associates and joint ventures are valued by equity accounting. In accordance with the equity accounting method, investments are initially recognized in the consolidated statement of financial position at cost, and then included in the portion of the profit / loss corresponding to the Group, or in the valued entity's other comprehensive income. If the Group's share in the losses of an investment measured by equity accounting exceeds the value of its shares of the entity (including long-term interests which essentially constitute a portion of the net value of the investment in the entity), the Group ceases to recognize its shares in the subsequent losses of the valued entity. Subsequent losses are recognized only up to the value of the Group's legal or customary liabilities or payments made on behalf of the entity measured by equity accounting.

The excess of the costs of acquisition over the Group's share in the net value of the identifiable assets, liabilities and contingent liabilities of the entity measured by equity accounting as at the acquisition date is recognized as goodwill, constituting a component of the investment's carrying amount. The excess of the Group's share in the net value of the identifiable assets, liabilities and contingent liabilities over the costs of the acquisition after verification is recognized directly in the profit or loss.

If necessary, the carrying amount of the investment (subject to goodwill) is tested for impairment in accordance with IAS 36 "Impairment of Assets" as if it were a single asset item, by comparing its recoverable amount (higher of the two: value in use or fair value less costs to sell) with its carrying amount. Impairment losses are included in the carrying amount of the investment. Losses are reversed in accordance with IAS 36 at an amount that corresponds to the increase in the investment's recoverable amount.

If an entity belonging to the Group performs transactions with a given entity stated by equity accounting, then the profits and losses arising out of those transactions are recognized in the Group's consolidated financial statements only with regard to the shares of this entity that are unrelated to the Group.

5.12 Inventories

Inventories are measured at cost or net realizable value, whichever is lower. Release of inventories is measured using the FIFO method. The realizable value is the estimated sale price of inventories less any costs necessary to carry out the sale.

The Group recognizes impairment losses on obsolete or damaged inventories and if the net realizable value is less than the carrying amount of the inventories. Impairment losses on inventories are presented as consumption of raw materials and energy.

5.13 Trade and other receivables

Trade receivables consist of amounts due from clients for materials sold or services rendered as part of the Company's ordinary operations. If payment of the amount due may be expected within one year (or within the entity's business cycle, if longer than a year), the receivable is classified as a current assets. Otherwise it is classified as a non-current asset.

Trade receivables are initially recognized at fair value, where the fair value at initial recognition of the receivable is the nominal value arising out of the sales invoice. After initial recognition, trade and other financial receivables are stated at amortized cost using the effective interest rate, subject to impairment. Other non-financial receivables are stated as at the end of the reporting period at amounts due.

Impairment allowances of receivables are recognized when there is objective evidence that the company will not be able to collect amounts due. Receivables allowance is recognized as the difference between the carrying amount and the recoverable value. Impairment loss is recognized as other operating expenses.

5.14 Financial assets

Financial assets are classified to the following categories: financial assets measured at fair value through profit or loss, available for sale, and loans and receivables. The classification depends on the nature and designation of the financial assets and is determined at the time of initial recognition.

5.14.1 Classification, recognition and measurement

a) Financial assets measured at fair value through profit or loss

This category consists of financial assets held for sale. An asset is included in this category if it was acquired primarily to be resold within a short time. Derivative instruments are also classified as held for sale unless they are the subject of hedge accounting. Financial assets measured at fair value through profit or loss are initially recognized at fair value, whilst the transaction costs are charged to the profit and loss account. Gains or losses on changes in the fair value of financial assets measured at fair value through profit or loss are presented in the profit and loss account under financial revenue or financial costs.

b) Financial assets available for sale

Available-for-sale financial assets are non-derivative financial assets not classified as loans and receivables, financial assets held to maturity and financial assets at fair value through profit or loss. Financial assets available for sale are recognized at fair value at each reporting date.

Equity investments held for sale not listed on an active market or whose fair value cannot be reliably measured and derivatives linked to them, settled in the form of transfer of such unlisted equity investments are measured at cost less impairment at the end of each reporting period.

They are included in non-current assets, unless the Group intends to sell them within 12 months of the balance sheet date, or they mature within this period.

A dividend on equity instruments available for sale is recognized in profit or loss when the Group obtains the right to dividend.

c) Loans and receivables

Loans and receivables are non-derivative financial assets, with fixed or determinable payments, that are not listed on an active market. Loans and receivables (including trade receivables, bank balances and cash at bank) are measured at amortized cost using the effective interest rate method, taking into account the impairment.

Interest income is recognized by applying the effective interest rate, except for short-term receivables, when the recognition of interest would be immaterial.

5.14.2 Derecognition of financial assets

Financial assets are derecognized when the rights to the resulting cash flows have expired or have been transferred, and the Group has transferred substantially all of the risks and awards resulting from their ownership.

5.15 Impairment of financial assets

At each balance sheet date the Group assesses if there are indications of impairment of a financial asset or group of financial assets.

a) Financial assets recognized at amortized cost

If there are objective indications of an impairment loss of loans granted and receivables carried at amortized cost, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future

cash flows, discounted using the original (i.e. at initial recognition) effective interest rate. The carrying amount of the asset is reduced by the impairment loss. The amount of the loss is recognized in profit or loss. If in the subsequent period the amount of impairment decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Subsequent reversal of an impairment loss is recognized in profit or loss to the extent that at the reversal date, the carrying amount of the asset does not exceed its amortized cost.

b) Financial assets recognized at cost

If there are objective indications of an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or a derivative that it is linked to and must be settled by the delivery of such an unquoted equity instrument, the amount impairment write-off is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for similar financial assets.

c) Financial assets available for sale

If there are objective indications of an impairment loss on a financial asset available for sale, then the amount of the difference between the purchase price of the asset (net of any repayment of capital and interest) and its current fair value, less any impairment loss of this asset previously recognized in profit or loss, is removed from equity and transferred to profit or loss. The reversal of impairment losses on equity instruments classified as available for sale cannot be recognized in profit or loss. If, in a subsequent period, the fair value of a debt instrument available for sale increases and the increase can be objectively related to an event occurring after the impairment loss is recognized in profit or loss, then the amount of the reversed impairment loss is recognized in profit or loss.

5.16 Offsetting financial assets and liabilities

Financial assets and liabilities may be offset, and the net amount listed in the balance sheet, if there is a legally enforceable legal title to offset the amounts and if there is intent to settle at net amount or to simultaneously realize the asset and pay the liability. A legally enforceable legal title cannot be conditioned on a future event and must be enforceable as part of ordinary operations and in the event of nonpayment, insolvency or bankruptcy of the entity and all the vendors.

5.17 Other non-financial assets

The Group recognizes prepaid expenses and advance payments for purchase of tangible and intangible fixed assets and inventories as other non-financial assets.

Prepayments are established at the amount of reliably incurred expenses that relate to future periods and will generate future economic benefits. Write-offs of deferred expenses may occur pursuant to the lapse of time or the amount of benefits. The time and manner of settlement is justified by the nature of the expense, subject to the prudence principle.

5.18 Cash and cash equivalents

The cash and cash equivalents presented in the consolidated statement of cash flows consist of cash in hand, bank deposits payable on demand, other short-term highly liquid investments initially due within three months.

5.19 Non-current assets held for sale

Non-current assets and groups of assets are classified as held for sale, if their carrying amount will be recovered as a result of sale rather than as a result of their further use. This condition is considered as fulfilled only when a sale is highly probable and an asset (or group of assets held for sale) is currently available for immediate sale in its current condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of change in the classification.

5.19 Non-current assets held for sale (continued)

Non-current assets (and groups for sale) classified as held for sale are measured at the lower of the following two amounts: the carrying amount or fair value less cost to sell.

5.20 Share capital

Share capital is presented in the Consolidated Financial Statements at the amount specified in the statute and entered in the court register of the Parent Company.

5.21 Credits and loans

Credits and loans are initially recognized at fair value less the transaction costs incurred. After initial recognition, credit and loans are recognized at amortized cost using the effective interest rate method.

5.22 Employee benefits

The Group provides its employees with long-term employment benefits (jubilee bonuses), as well as post-employment benefits (retirement and disability benefits, transportation benefits and benefits from the Social Fund for pensioners, death benefits). Jubilee bonuses are paid to employees after a specified number of years. Retirement benefits are paid once at the time of retirement/pension. The amount of retirement, pension benefits depends on the length of service and average salary. Death benefits are paid after the employee's death. The Group creates a provision for future liabilities relating to the above benefits in order to allocate costs to relevant periods to which they relate. Employees are also entitled to a post-employment benefit in the form of social benefits from the Social Benefits Fund and reduced railroad fares. In the statement of financial position, the Group recognizes the above benefits at the present value of liabilities on the end of the reporting period.

The amount of long-term employment and post-employment benefits is calculated by an independent actuarial company using the projected individual benefits method. The present value of the liability is determined by discounting the estimated future expenses using interest rates based on market rates for government bonds. The current cost of the defined benefits plan recognized in the financial result as a cost of employee benefits, except when it is considered a cost of producing an asset, reflects the increase in the liability arising out of work performed by the employees in the current period, limitation and settlement of changes in benefits. Past service costs are recognized directly in the financial result. The net cost of interest is calculated using a discount rate to the net value of the liabilities and presented in financial costs.

Actuarial gains and losses on ex post adjustments to actuarial assumptions and changes in actuarial assumptions are charged to equity through other comprehensive income in the period in which they arose. In the case of jubilee bonuses, they are charged to the costs of the period.

5.23 Provisions

Provisions are recognized, if the Group has a present obligation (legal or constructive) as a result of a past event and when it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the amount required to fulfil the present obligation as at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the estimated cash flows required to fulfil the present obligation, the carrying amount corresponds to the present value of such cash flows (if the impact of cash over time is material).

If it is probable that the economic benefits required for the settlement of the provision, in part or in whole, can be recovered from a third party, the receivables are recognized as an asset, provided that the probability of recovery is sufficiently high and a reliable measurement is possible.

5.24 Trade and other payables

Liabilities constitute a present obligation of the Group resulting from past events, the fulfilment of which is expected to result in an outflow of economic benefits from the Group.

Short-term liabilities include trade and other payables that become due within 12 months from the end of the reporting period. Liabilities are recognized initially at fair value, the valuation corresponds to the amount due or the amount of liability, and subsequently financial liabilities are recognized at amortized cost using the effective interest rate method (in the case of trade payables it corresponds to the amount due) and other non-financial liabilities - at the amount due.

Long-term liabilities are recognized initially at fair value less the transaction costs incurred and subsequently measured at amortized cost using the effective interest rate method. Increase (decrease) in liabilities due to the lapse of time is recognized as financial expense (revenue).

5.25 Derivative instruments and hedge accounting

Derivative financial instruments are initially recognized at fair value as at the contract date, and then re-measured to current fair value. The method used to recognize the resulting gains or losses depends on whether the derivative instrument has been classified as a hedging instrument or not. If so, the gain or loss recognition method also depends on the nature of the hedged item. The Group designates certain derivative instruments as hedges of specified risk associated with its liabilities or highly probable planned transactions (cash flow hedge).

When concluding transactions the Group documents the relationship between the hedging instruments and the hedged items, as well as the risk management objectives and strategies of concluding various hedging transactions. In addition, the Group assesses – as at the initial hedge date and on an ongoing basis – whether the derivative instruments used in the hedge transactions are highly effective in offsetting the changes in the fair values or cash flows of the hedged items.

The total fair value of the hedging derivative instruments is included in non-current assets or long-term liabilities, if the time remaining to maturity for the hedged item exceeds 12 months, or to current assets or short-term liabilities if the time remaining to maturity for the hedged item does not exceed 12 months. Derivative instruments held for sale are included in current assets or short-term liabilities.

The effective portion of changes in the fair value of derivative instruments designated and qualifying as cash flow hedges is recognized in other comprehensive income. Gains or losses on the ineffective portion are immediately charged to the profit or loss. Amounts cumulated in equity are reclassified to the financial result in the periods, in which the hedged item affected the result.

5.26 The sale option (put) and the purchase option (call) on non-controlling interests in AWT

The sale option (put) on non-controlling interests

In the Consolidated Financial Statements, the obligation to purchase the shares of subsidiary arising from sale option (put), which are currently held by non-controlling interest, constitute the obligation to purchase own equity instruments and constitutes part of the Group's equity.

The Group recognizes sale option (put) in accordance with the expected purchase method, assuming a hypothetical assumption if the future transaction has already taken place. As a result, the accounting treatment of sale option (put) is as if the option has already been implemented. Assuming that the sale of the shares has already taken place, using this method non-controlling interests are derecognized at the moment of the recognition of a financial liability - non-controlling interests which are the subject of the sale option (put) contract are treated in such a way as if they have already been purchased, despite that formally are still non-controlling interests. In the consolidated statement of financial position and consolidated statement of comprehensive income these shares are presented as shares already held by the parent company. In accordance with IFRS 3, at the moment of acquisition the liability relating to the put option recognized using the expected purchase method constituted a contingent payment and affected the gain realized on the bargain acquisition. The liability relating to the put option is classified as a financial liability measured at fair value through profit or loss.

The purchase option (call) on non-controlling interests

The purchase option (call) on non-controlling interests is the right to purchase the shares of subsidiary arising from exercising purchase option (put) by the Parent Company.

In accordance with the Group's accounting policies, the call option does not meet the definition of a derivative under IAS 32, and as a result the purchase option (call) is not recognized in the Group's statement of financial position.

5.27 Business combinations

Acquisitions of other entities are settled using the acquisition method in accordance with IFRS 3 "Business Combinations". The consideration transferred in a business combination is measured at fair value, calculated as the aggregate of the fair values as at the acquisition date of the assets transferred by the Group, the liabilities of the Group to the past owners of the acquiree and the equity instruments issued by the Group in exchange for acquiring control over the acquiree. The costs of the acquisition are charged to profit or loss when incurred.

Identifiable assets and liabilities are measured at fair value as at the acquisition date, except:
- assets and liabilities in respect of deferred tax or employee benefit agreements, which are recognized and measured in accordance with IAS 12 "Income Taxes" and IAS 19 "Employee Benefits";
- liabilities or equity instruments in respect of payment plans based on shares in the acquiree or Capital Group that are to replace the same agreements that are in force in the acquiree, which are measured in accordance with IFRS 2 "Share-based payment" as at the acquisition date; and
- assets (or groups of assets held for sale) classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations", which are measured in accordance with that standard.

Goodwill is measured as the excess of the sum of the consideration transferred, value of non-controlling interest in acquiree and the fair value of previously held shares in the acquired entity over the fair value of the identifiable net assets acquired at the date of acquisition. If after another verification the net fair value of the identifiable assets and liabilities exceeds the sum of payment received, non-controlling interests in the acquire and the fair value of shares in that entity, previously held by the acquirer, the surplus is charged directly to profit or loss as gain on a bargain purchase.

Non-controlling shares being a part of the ownership interests and entitling their holders to a proportionate share in net assets of the acquiree in the event of liquidation, may be initially measured at fair value or according to the proportion of non-controlling interest in the recognized value of the identifiable net assets of the acquiree. The valuation method is chosen individually for each acquisition.

If payment transferred in transaction of business combination includes assets or liabilities resulting from the contract for the payment of the contingent payment that are measured at fair value at the acquisition date and are recognized as part of the consideration transferred in the business combination. Changes in the fair value of the contingent consideration classified as retrospective adjustments for the measurement period with corresponding adjustments to the goodwill. Adjustments to measurement period are the result of additional information on the "measurement period" (the measurement period shall not exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

Changes in the fair value of the contingent consideration not classified as adjustments to the measurement period are recognized depending on classification of the contingent consideration. Contingent consideration classified as equity shall not be re-measured and its subsequent settlement shall be accounted for within equity. A contingent contribution is classified as an asset of liability is re-measured as at subsequent reporting dates in accordance with IAS 39 or 37 "Provisions, contingent assets and contingent liabilities" and the resulting result is recognized under profit or loss.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the Group shall adjust the provisional amounts recognized at the acquisition date (see above) or recognized additional assets or liabilities to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognized as at that date.

Business combinations of entities under common control is described in Note 5.28.2.

5.28 Consolidation principles

The Consolidated Financial Statements comprise separate financial statements of the Parent Company and entities controlled by it (its subsidiaries) for financial year ended at 31 December 2016 and 31 December 2015. The financial statements of subsidiaries after adjustments made to ensure their compliance with IFRS EU are prepared for the same reporting period as the financial statements of the Parent Company and based the same accounting policies applied to transactions and economic events of a similar nature.

Control is exercised when the Group is able to manage financial and operating policy of the subsidiary to gain economic benefits from its operation.

5.28 Consolidation principles (continued)

Income and expenses of subsidiaries acquired or sold during the year are included in the Consolidated Statement of Comprehensive Income from the date of actual acquisition of the entity until its effective disposal. The comprehensive income of subsidiaries is attributed to the owners of the Parent Company and to non-controlling interests even if such attribution results in a negative value of the balance of non-controlling interests.

All transactions inside the Group, the balances of settlements, revenue and expenses from operations made between the entities in the Group were excluded from the consolidation.

5.28.1 Change in interest in the Group subsidiaries

Changes in interest in the Group subsidiaries which does not result in losing control are recognized as equity transactions. In order to reflect changes in the interest in subsidiaries, the Group adjusts the carrying amount of the controlling and non-controlling interests. All differences between the amount of adjustment of non-controlling interests and the fair value of the amount paid or received are directly charged to equity and attributed to the owners of the Parent Company.

When the Group loses control over a subsidiary, gains or losses constitute the difference between (i) the sum of the fair value of payment received and fair value of the interest retained, and (ii) the carrying amount of assets (including goodwill) and subsidiary's liabilities - and charged to profit or loss. The fair value of an investment retained in a former subsidiary as at the date of loss of control is the fair value upon initial recognition, recognized and measured in accordance with IAS 39 "Financial Instruments: recognition and measurement" or the expense upon initial recognition of the investment in the subsidiary or jointly controlled entity.

5.28.2 Business combinations of entities under common control

In the event of a business combination that does not result in a loss of control over the entities by their existing shareholders, the Group applies the uniting of interests method, which consists of adding up the individual corresponding assets and liabilities and revenue and expense items of the entities, as at the combination date, after first bringing their values to standardized valuation methods and performing the appropriate eliminations. Eliminated is the value of the share capital of the company, whose assets were transferred onto another company, or of the companies, which as a result of the combination were deleted from the register. After this elimination, the appropriate equity items of the company onto which the assets of the combined companies will be transferred, or of the newly formed company, are adjusted by the difference between the total of assets and liabilities.

The following are also eliminated:

- mutual receivables and payables and other similar settlements between the combining companies;
- revenue and expenses arising out of economic transactions performed between the combining companies in a given financial year prior to the combination;
- profits or losses from economic transactions performed between the combining companies prior to the combination, contained in the values that are subject to the combination of assets and liabilities.

The costs of the combination, including the costs of incorporating a new company or of raising the share capital of the company onto which the assets of the combined companies are transferred, are charged to financial costs. The financial statements of the company onto which the assets of the combined companies are transferred, or of the newly formed company, prepared as at the end of the reporting period in which the business combination took place, contain the comparatives for the previous financial year, presented as if the combination had taken place at the beginning of the previous financial year, with the individual equity items disclosed as at the end of the previous year as the sum of the individual equity items.

6. Adjustment of prior period error

In the years 2014 - 2016 the Tax Inspection Office conducted an audit proceeding at the company PKP CARGO CONNECT Sp. z o.o. (formerly: Przedsiębiorstwo Spedycyjne Trade Trans sp. z o.o., „PKP CC") with regard to the accuracy of the declared tax bases and the correctness of the calculation and payment of value added tax for the period from April 2013 to July 2013. As a result of the audit, the Tax Inspection Office found that some of the invoices did not reflect the actual economic event process, and thus that the amount of refund of the excess of input over output VAT for the months in question was calculated incorrectly. On 29 December 2016 PKPCC received a decision issued by the Director of the Tax Inspection Office in Warsaw, in which the tax organ specified the new amounts of VAT to be refunded for the period from April 2013 to July 2013; as a result, a tax arrear arose in the amount of PLN 16.627 thousand along with interest charges in the amount of 4.623 thousand

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

6. Adjustment of prior period error (continued)

as at 31 December 2016. Although PKPCC appealed the decision, on 13 January 2017 it paid the entire arrear along with interest charges.

Because the tax arrear pertains to the year 2013, the Group has adjusted its results for prior years in the following manner:
- tax arrear in the amount of PLN 16.627 thousand was charged to equity as at 1 January 2015;
- statutory interest in the amount of PLN 1.964 thousand was charged to equity as at 1 January 2015;
- statutory interest in the amount of PLN 1.330 thousand was charged to the net profit / (loss) for the financial year ended 31 December 2015.

Due to the above changes, the Group restated its comparatives. The restatement is presented in the below tables. The information presented in the explanatory notes to these Consolidated Financial Statements has also been restated accordingly.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD FROM 1 JANUARY 2015 TO 31 DECEMBER 2015

	Year ended 31/12/2015 (audited)	Adjustment of value added tax settlements	Year ended 31/12/2015 (restated)
Financial expenses	65 067	1 330	66 397
Profit / (loss) before tax	**11 848**	**(1 330)**	**10 518**
NET PROFIT / (LOSS)	**31 411**	**(1 330)**	**30 081**
TOTAL COMPREHENSIVE INCOME	**108 749**	**(1 330)**	**107 419**
Net profit / (loss) attributable to:			
Shareholders of the parent company	31 554	(1 273)	30 281
Non-controlling interests	(143)	(57)	(200)
Total comprehensive income attributable to:			
Shareholders of the parent company	108 892	(1 273)	107 619
Non-controlling interests	(143)	(57)	(200)
Earnings per share (PLN per share)			
Basic earnings per share:	**0,70**	**(0,03)**	**0,67**
Diluted earnings per share:	**0,70**	**(0,03)**	**0,67**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2015

	As at 31/12/2015 (audited)	Adjustment of value added tax settlements	As at 31/12/2015 (restated)
ASSETS			
Non-current assets			
Trade and other receivables	664 321	(10 205)	654 116
Total non-current assets	**1 133 161**	**(10 205)**	**1 122 956**
Total assets	**6 112 662**	**(10 205)**	**6 102 457**
EQUITY AND LIABILITIES			
Equity			
Retained earnings	466 392	(19 921)	446 471
Total equity	**3 353 866**	**(19 921)**	**3 333 945**
Non-current liabilities			
Short-term trade and other payables	729 793	9 716	739 509
Total non-current liabilities	**1 172 708**	**9 716**	**1 182 424**
Total liabilities	**2 758 796**	**9 716**	**2 768 512**
Total equity and liabilities	**6 112 662**	**(10 205)**	**6 102 457**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 1 JANUARY 2015

	As at 01/01/2015 (audited)	Adjustment of value added tax settlements	As at 01/01/2015 (restated)
ASSETS			
Non-current assets			
Trade and other receivables	526 149	(7 119)	519 030
Total non-current assets	**1 425 867**	**(7 119)**	**1 418 748**
Total assets	**5 680 332**	**(7 119)**	**5 673 213**
EQUITY AND LIABILITIES			
Equity			
Retained earnings	525 721	(10 329)	515 392
Equity attributable to shareholders of the parent company	**3 331 793**	**(10 329)**	**3 321 464**
Equity attributable to non-controlling interests	63 500	(8 262)	55 238
Total equity	**3 395 293**	**(18 591)**	**3 376 702**
Non-current liabilities			
Short-term trade and other payables	530 440	11 472	541 912
Total non-current liabilities	**1 119 625**	**11 472**	**1 131 097**
Total liabilities	**2 285 039**	**11 472**	**2 296 511**
Total equity and liabilities	**5 680 332**	**(7 119)**	**5 673 213**

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE PERIOD FROM 1 JANUARY 2015 TO 31 DECEMBER 2015 [INDIRECT METHOD]

	As at 01/01/2015 (audited)	Adjustment of value added tax settlements	As at 01/01/2015 (restated)
Cash flows from operating activities			
Profit / (loss) before tax	**11 848**	**(1 330)**	**10 518**
Changes in working capital:			
(Increase) / decrease in trade and other receivables	24 822	3 086	27 908
Increase / (decrease) in trade and other payables	67 226	(1 756)	65 470
Net cash provided by operating activities	**387 502**	**-**	**387 502**
Increase / (decrease) in net cash and cash equivalents	(157 144)	-	(157 144)
Opening balance of cash and cash equivalents	429 178	-	429 178
Effect of changes in foreign exchange rates on cash in foreign currencies	4 157	-	4 157
Closing balance of cash and cash equivalents	**276 191**	**-**	**276 191**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

7. Revenue from sale of services and finished goods

7.1 Operating segment products and services

The Group does not distinguish operating segments, as it has only one main product that all of its services are assigned to. The Group conducts operations as part of one main segment – domestic and international transport of freight and the provision of comprehensive logistics services relating to rail transport of freight. The Parent Company's Management analyzes the Group's financial data in the format, in which they are presented in these Consolidated Financial Statements. In addition, the Group also provides rolling stock repair and land reclamation services, which are not, however, significant from the perspective of the Group's operations and as such are not treated as separate operating segments.

The Group's revenue from its customers broken down by geographical area is presented in Note 7.2 to these Consolidated Financial Statements.

7.2 Geographical information

The Group defines a geographical area of operations as the location of the registered office of its customer rather than the country in which the service is performed. This analysis has led to the following conclusions:

The Group operates in one main geographical area - Poland, the country of the Parent Company's registered office.

The acquisition of shares of AWT significantly increased the Group's share in the Czech market. In the period ended 31 December 2016, total revenue earned from Czech customers amounted to nearly 16% of total revenue from the sale of services, compared to around 12% in the same period of last year. The increase was caused by the inclusion in the Consolidated Financial Statements for the financial year ended 31 December 2016 of the financial data of the AWT Group for 12 months, whereas the comparative data covered the financial data of the AWT Group for 7 months.

Presented below is the Group's revenue from the sale of services and finished products to customers, broken down by location of their headquarter :

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Poland	3 011 970	3 313 688
Czech Republic	685 244	494 444
Germany	180 928	185 693
France	60 569	11 191
Slovakia	75 076	76 302
Italy	69 955	30 835
Cyprus	45 026	49 086
Other countries	213 106	169 097
Total	**4 341 874**	**4 330 336**

Non-current assets other than financial instruments and deferred income tax assets, broken down by location:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Poland	3 971 390	3 979 817
Czech Republic	840 775	867 600
Other countries	12 270	12 574
Total	**4 824 435**	**4 859 991**

7.3 Information about major customers

In the financial year ended 31 December 2016, none of the Group's customers generate revenue in excess of 10% of the Group's total revenue from the sale of services and finished products.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

7.4 Structure of revenue from sale of services and finished goods

As part of its operations, the Group distinguishes groups of services, as shown in this Note. The Parent Company's Management does not, however, take this division into account when assessing the Group's performance or making decisions on the allocation of resources to the groups of services. Accordingly, the groups of services shown below are not to be treated as the Group's operating segments.

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Transport revenue and railway shipping	3 612 728	3 727 552
Revenue from other transport activities	169 180	137 363
Siding and traction revenue	267 263	235 143
Cargo revenue	81 512	44 611
Reclamation services	73 864	78 049
Other revenue [1]	137 327	107 618
Total	**4 341 874**	**4 330 336**

[1] The item other revenue for the financial year ended 31 December 2016 consists primarily of revenue from rental assets in the amount of PLN 44.222 thousand, from customs and border services in the amount of PLN 15.148 thousand, from the sale of finished products in the amount of PLN 28.200 thousand, as well as from rolling stock repairs in the amount of PLN 21.030 thousand. In the financial year ended 31 December 2015 the other revenue item consisted primarily of revenue from rental assets in the amount of PLN 33.109 thousand, from customs and border services in the amount of PLN 14.068 thousand, from sale of finished products in the amount of PLN 14.872 thousand and from rolling stock repairs in the amount of PLN 15.427 thousand.

8. Expenses by kind

8.1 Depreciation / amortization and impairment

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Depreciation of property, plant and equipment	577 609	447 833
Amortization of intangible assets	18 569	19 778
Recognized / (released) impairment allowances:		
Property, plant and equipment [1]	25 414	154 630
Goodwill	-	2 712
Non-current assets classified as held for sale	-	24 029
Total	**621 592**	**648 982**

[1] In the financial year ended 31 December 2016 the item consisted primarily of a write down resulting from an impairment test performed on the assets of AWT Group. Detailed information is presented in Note 12.1 to these Consolidated Financial Statements.

8.2 Consumption of raw materials and energy

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Consumption of fuel	161 693	188 639
Consumption of materials	101 600	85 980
Consumption of electricity, gas and water	411 386	415 541
Recognized / (derecognized) impairment losses	(1 318)	6 147
Other	1 639	687
Total	**675 000**	**696 994**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

8.3 External services

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Access to infrastructure connections	664 704	675 194
Repair services	27 645	29 315
Rent and lease fees (real estate and railroad fleet)	184 343	188 211
Transport services	427 146	328 754
Telecommunications services	8 295	9 323
Legal, advisory and similar services	23 356	35 223
IT services	48 947	53 027
Services related to property maintenance and operation of fixed assets	31 616	27 395
Reloading services	24 640	20 671
Cargo services	41 403	39 580
Reclamation services	45 132	57 993
Other services	45 832	36 474
Total	**1 573 059**	**1 501 160**

8.4 Employee benefits

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Salaries and wages	1 131 052	1 089 640
Costs of social insurance	246 534	229 533
Contributions to Company Social Benefits Fund	21 378	25 334
Other employment benefits during employment	38 160	37 504
Post-employment benefits	7 787	1 642
Voluntary Redundancy Program	-	70 179
Changes in provisions for employee benefits	(5 993)	24 681
Other costs of employee benefits	3 383	6 251
Total	**1 442 301**	**1 484 764**

8.5 Other expenses by kind

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Business travel	31 904	31 154
Advertising and representation	7 936	10 560
Property insurance	11 961	10 123
Other	3 693	2 017
Total	**55 494**	**53 854**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

9. Other operating revenue and expenses

9.1 Other operating revenue

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Gains on disposal		
Gain on the sale of non-financial fixed assets	6 859	2 142
Derecognized impairment losses		
Trade receivables	3 196	6 566
Other receivables	29	-
	3 225	6 566
Other		
AWT bargain purchase gain	-	137 779
Penalties and damage compensation	14 555	23 098
Release of provision for fine from antimonopoly UOKiK	357	4 399
Release of other provisions	2 161	9 525
Interest on trade and other receivables	1 888	1 435
Net foreign exchange gain on trade receivables and trade payables	3 788	-
Grants	1 206	1 208
Written off trade payables	3 125	-
Other	2 146	4 513
Total	**39 310**	**190 665**

9.2 Other operating expenses

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Recognized impairment losses		
Trade receivables	80 443	5 356
Other		
Penalties and damage compensation	9 935	16 835
Costs of liquidating non-current and current assets	7 352	3 998
Provision for fines from antimonopoly UOKiK	2 032	12 192
Other provisions	10 035	2 920
Court and collection costs	1 291	1 523
Costs of transport benefits for non-employees	2 204	1 932
Interest on trade and other payables	1 431	289
Net foreign exchange loss on trade receivables and trade payables	-	1 611
Other	2 849	1 561
Total	**117 572**	**48 217**

(1) In the financial year ended 31 December 2016 the item consists primarily of an impairment allowance for receivables from OKD in the amount of CZK 448.805 thousand, which is the equivalent of PLN 72.661 thousand. This has been described in detail in Note 19 to these Consolidated Financial Statements.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

10. Financial revenue and expenses

10.1 Financial revenue

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Interest and dividend income		
Bank deposits and accounts	566	4 452
Loans granted	448	465
Other (including interest on state settlements)	185	4 608
	1 199	9 525
Dividend income	434	27
Total interest and dividend income	**1 633**	**9 552**
Other		
Gains on shares, of which:		
Gains on sale of shares	85	199
Reversal of impairment losses on shares	-	47
	85	246
Gain on valuation of assets and liabilities measured at fair value through profit or loss, of which:		
Valuation of liability relating to put options for non-controlling shares	36 494	-
Valuation of forward contracts	94	-
	36 588	-
Net result on foreign exchange differences	-	4 922
Other	619	3
Total	**38 925**	**14 723**

10.2 Financial expenses

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Interest expense		
Interest on loans and borrowings	17 670	14 090
Interest on liabilities under finance lease agreements	8 556	9 634
Interest on long-term liabilities	2 587	5 193
Other (including interest on state settlements)	1 979	3 140
Total interest expense	**30 792**	**32 057**
Other		
Losses on shares, of which:		
Recognized impairment losses on shares	-	13
Loss on the valuation of financial assets and liabilities measured at fair value through profit or loss, of which:		
Valuation of liability relating to put options for non-controlling shares	-	10 738
Valuation of forward contracts	-	(623)
	-	10 115
Unwinding discount on employee benefits provision	20 527	18 923
Net result on foreign exchange differences	5 268	-
Other	4 652	5 289
Total	**61 239**	**66 397**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

11. Income tax

11.1 Income tax recognized in profit or loss

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Current income tax		
Current tax expense	4 489	5 204
Adjustments recognized in current year related to tax from prior period	626	15
	5 115	5 219
Deferred income tax		
Deferred tax occurred in the reporting period	(22 267)	(24 782)
Income tax recognized in profit or loss	**(17 152)**	**(19 563)**

The Group's current tax liability is calculated based on binding tax regulations. The application of these regulations distinguishes tax result from gross profit, due to the exclusion of non-taxable income and non-tax deductible costs, as well as costs and revenue that will never be subject to taxation. Tax liabilities are calculated based on rates binding in a given financial year. Currently binding regulations do not provide for applying different rates to future periods. The tax authorities may perform an audit of the books of account and of tax settlements within 5 years of the end of the year, in which a return was filed, and may impose on the Group additional tax and penalties with interest charges.

11.2 Reconciliation of tax profit to accounting profit

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Profit / (loss) before tax	**(150 924)**	**10 518**
Income tax expense at the rate of 19%	(28 675)	1 998
Tax effect of non-taxable revenue pursuant to tax regulations, of which:		
Release of non-taxable provisions and impairment losses	(198)	(4 059)
AWT bargain purchase gain	-	(26 178)
Recovered VAT	(1 195)	(528)
Valuation of liability of put option for non-controlling shares	(6 934)	-
Other	(2 172)	(1 428)
	(10 499)	(32 193)
Tax effect of non-tax deductible expenses pursuant to tax regulations, of which:		
Disability fund	4 354	4 375
Non-tax deductible provisions and impairment losses	1 363	3 859
Permanent differences in costs related to property, plant and equipment	679	840
Representation costs	1 213	465
Penalties and damage compensation	846	1 606
Valuation of liability of put option for non-controlling shares	-	2 040
Non-deductible VAT	1 332	723
Other	1 627	1 814
	11 414	15 722
Effect of tax losses unused / (deducted) in the period	8 089	(1 963)
Effect of recognition / (release) of impairment loss on deferred tax assets from tax losses	1 671	(3 183)
Effect of the application of different tax rates	222	41
Adjustments related to prior periods recognized in the current period	626	15
Income tax expense recognized in profit or loss	**(17 152)**	**(19 563)**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

The corporate income tax rate binding in Poland in the years 2015 - 2016 amounted to 19%. In the case of the companies belonging to the AWT Group, the tax rates amounted to: 19% in the Czech Republic, 10% in Hungary and 25% in the Netherlands. The different tax rates have immaterial effect on the effective tax rate.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

11.3 Tax Group

Starting from 1 January 2015 the Group had been a part of a Tax Group. In the financial year ended 31 December 2015 the Tax Group did not achieve the anticipated profitability of 3%, and therefore the Tax Group's second tax year ended on 31 March 2016, and the Tax Group ceased to exist.

On 29 September 2016 an agreement was signed between the companies from the PKP CARGO Group to form a new tax group for the period of three tax years starting from 1 January 2017. The Group comprises: PKP CARGO S.A., PKP CARGO SERVICE Sp. z o.o., PKP CARGOTABOR Sp. z o.o., PKP CARGOTABOR USŁUGI Sp. z o.o., PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o., PKP CARGO CENTRUM LOGISTYCZNE MEDYKA-ŻURAWICA Sp. z o.o. and PKP CARGO CONNECT Sp. z o.o. PKP CARGO S.A. is the parent company of the Tax Group and represents it with respect to the responsibilities arising out of the Corporate Income Tax Act and the Tax Ordinance. On 21 November 2016 the Head of the First Mazowiecki Tax Office issued a decision registering the agreement to form the PKP CARGO Tax Group.

The Corporate Income Tax Act treats a tax group as a separate payer of CIT. This means that the companies comprising the Tax Group cease to be separate entities for the purposes of CIT, whilst the Tax Group becomes such an entity as a whole. Subject to taxation at the Tax Group will be the total income of the group, calculated as the excess of the sum of the incomes of all of the companies comprising the group over the sum of their losses. The Tax Group will be a separate entity for the purposes of corporate income tax only. It is not to be treated as a separate legal entity. In addition, the Tax Group will not be a separate entity with respect to other taxes, in particular each of the entities comprising the Tax Group is a separate payer of VAT, the tax on civil law transactions, as well as personal income tax.

In accordance with the concluded agreements, when a given entity belonging to the Tax Group shows a tax profit, it will forward the relevant amount of income tax to PKP CARGO S.A., which will settle with the tax office as the representative company. Whereas when a company belonging to the Tax Group incurs a tax loss, then the resulting tax benefit will in the course of the year be received by the representative company, i.e. PKP CARGO S.A. The final settlement between the companies belonging to the Tax Group will be performed after the representative company files the annual tax return. This is when the final tax amounts corresponding to each company will be determined subject to their proportionate share in the tax result and using the tax losses generated by other entities in the Tax Group. The companies comprising the Tax Group must meet a series of requirements, such as: appropriate level of capital, the parent company's interest in the companies comprising the Tax Group of at least 95%, no capital links between the subsidiaries, no tax arrears, generation of income equal to at least 3% of revenue (calculated for the entire Tax Group) and the conclusion of transactions with entities from outside the Tax Group on market terms only. If any of the above requirements are breached, the Tax Group may be dissolved and lose its taxpayer status.

11.4 Deferred income tax recognized in other comprehensive income

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Income tax on re-measurement of fair value of financial instruments designated as cash flow hedges	(745)	641
Deferred tax on actuarial gains and losses on post-employment benefits	4 081	10 111
Foreign exchange differences on revaluation of deferred tax balances of foreign entities recognized in other comprehensive income [(1)]	4 286	4 790
Deferred income tax recognized in other comprehensive income	**7 622**	**15 542**

[(1)] Item presented under equity as foreign exchange differences on translation of financial statements of foreign entities.

11.5 Deferred income tax assets and liabilities

Deferred income tax assets and liabilities have been presented in the consolidated statement of financial position in the following manner:

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Deferred income tax assets	107 554	104 587
Deferred income tax liabilities	(106 675)	(118 353)
Total	**879**	**(13 766)**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

11.5.1 Deferred income tax movements

Year ended 31/12/2016 (audited)	As at 01/01/2016 (audited)	Recognized in profit or loss	Recognized in other comprehensive income	Foreign exchange differences on translation of deferred income tax recognized in other comprehensive income	As at 31/12/2016 (audited)
Temporary differences relating to deferred income tax assets/(liabilities):					
Property, plant and equipment, intangible assets and non-current assets held for sale (including finance leases)	(185 146)	6 765	-	(4 652)	(183 033)
Trade payables	4 608	(4 608)	-	-	-
Long-term liabilities	(543)	446	-	-	(97)
Inventories	466	460	-	10	936
Receivables – impairment allowance	6 856	265	-	17	7 138
Accrued interest on assets	(157)	(84)	-	-	(241)
Accrued interest on liabilities	(6)	188	-	-	182
Provisions for employee benefits	133 800	(11 250)	(4 081)	96	118 565
Other provisions	4 652	(852)	-	104	3 904
Accrued expenses	7 265	(1 257)	-	-	6 008
Deferred income	(4 731)	1 651	-	-	(3 080)
Unpaid employee benefits	7 188	187	-	-	7 375
Foreign exchange differences	1 582	(275)	928	-	2 235
Valuation of derivative instruments	450	(51)	(183)	2	218
Other	858	(858)	-	-	-
	(22 858)	**(9 273)**	**(3 336)**	**(4 423)**	**(39 890)**
Unused tax losses [(1)]	9 092	31 540	-	137	40 769
Total	**(13 766)**	**22 267**	**(3 336)**	**(4 286)**	**879**

[(1)] The deferred income tax asset recognized as at 31 December 2016 on tax losses to be used in future periods represents the Parent Company's loss in the amount of PLN 149.417 thousand, and the losses of the subsidiaries in the amount of PLN 65.157 thousand. The tax loss in the amount of PLN 176.759 thousand may be deducted in the next five tax years of the date of dissolution of the Tax Group described in Note 11.3 to these Consolidated Financial Statements. Other tax losses may be deducted in the next five years of the date they appeared. In the opinion of the Parent Company's Management, as at 31 December 2016 there is no risk of being unable to realize the above tax asset.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

11.5.1 Deferred income tax movements (continued)

Year ended 31/12/2015 (audited)	As at 01/01/2015 (audited)	Acquisition of AWT	Recognized in profit or loss	Recognized in other comprehensive income	Foreign exchange differences on translation of deferred income tax recognized in other comprehensive income	As at 31/12/2015 (audited)
Temporary differences relating to deferred income tax assets/(liabilities):						
Property, plant and equipment, intangible assets and non-current assets held for sale (including finance leases)	(139 061)	(120 410)	79 488	-	(5 163)	(185 146)
Investments in associates – impairment	3 364	-	(3 364)	-	-	-
Trade payables	-	-	4 608			4 608
Long-term liabilities	(1 575)	-	1 032	-	-	(543)
Inventories	(1 177)	219	1 414	-	10	466
Receivables – impairment allowance	6 249	651	(71)	-	27	6 856
Accrued interest on assets	(608)	-	451	-	-	(157)
Accrued interest on liabilities	-	-	(6)	-	-	(6)
Provisions for employee benefits	194 428	2 737	(53 375)	(10 111)	121	133 800
Other provisions	2 465	3 468	(1 426)	-	145	4 652
Accrued expenses	5 982	-	1 283	-	-	7 265
Deferred income	(5 454)	-	723	-	-	(4 731)
Unpaid employee benefits	8 244	89	(1 148)	-	3	7 188
Foreign exchange differences	6 980	-	(5 398)	-	-	1 582
Valuation of derivative instruments	2 670	383	(1 981)	(641)	19	450
Other	-	-	858	-	-	858
	82 507	**(112 863)**	**23 088**	**(10 752)**	**(4 838)**	**(22 858)**
Unused tax losses [(1)]	6 740	610	1 694	-	48	9 092
Total	**89 247**	**(112 253)**	**24 782**	**(10 752)**	**(4 790)**	**(13 766)**

[(1)] As at 31 December 2015 the deferred income tax asset on tax losses to be used in future periods represents the loss of subsidiaries not belonging to the Tax Group, amounting to PLN 47.847 thousand.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

11.6 Tax losses not included in the calculation of deferred income tax assets

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Deferred income tax assets on the following tax losses were not recognized as at the balance sheet date	115 682	75 562

Tax losses not included in the calculation of a deferred income tax asset as at 31 December 2016 represent the losses incurred by the companies of the AWT Group in the amount of PLN 104.774 thousand (AWT B.V. in the amount of PLN 59.333 thousand, AWT Coal Logistics in the amount of PLN 30.930 thousand and AWT Rail HU Zrt. in the amount of PLN 14.511 thousand), the loss of PKP CARGOTABOR USŁUGI Sp. z o.o. in the amount of PLN 7.540 thousand and of CARGOSPED Terminal Braniewo Sp. z o.o. in the amount of PLN 3.368 thousand. Whereas as at 31 December 2015 the tax losses not included in the calculation of a deferred income tax represented the losses of the companies of the AWT Group in the amount of PLN 73.122 thousand (AWT B.V. in the amount of PLN 61.252 thousand, AWT Rail HU Zrt. in the amount of PLN 11.870 thousand) and the loss of CARGOSPED Terminal Braniewo Sp. z o.o. in the amount of PLN 2.440 thousand.

The unused tax losses on which no deferred tax assets were recognized as at 31 December 2016 may be used in the following future years:

Year	2017	2018	2019	2020	2021	2022 and later	Total
Unused tax losses	5 711	6 093	18 352	20 221	40 979	24 326	115 682

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

12. Property, plant and equipment

Year ended 31 December 2016 (audited)	Land	Buildings, premises, civil and water engineering structures	Technical equipment and machinery	Means of transport	Other fixed assets	Fixed assets under construction	Total
Gross value							
As at 1 January 2016 (audited)	**153 323**	**735 423**	**362 904**	**5 441 611**	**39 283**	**30 332**	**6 762 876**
Additions / (disposals):							
Acquisition	-	-	-	-	-	521 727	**521 727**
Finance lease	-	-	-	3 302	-	(93)	**3 209**
Foreign exchange differences on translation of financial statements of foreign entities	489	4 275	1 420	30 312	65	444	**37 005**
Reclassification from assets held for sale	8 307	5 830	-	94 688	-	-	**108 825**
Transfer of fixed assets under construction into use	319	7 804	24 210	467 224	1 416	(500 973)	**-**
Grants to property, plant and equipment	-	-	-	-	-	(5 407)	**(5 407)**
Sale	(49)	(1 620)	(3 957)	(7 239)	(93)	-	**(12 958)**
Liquidation	-	(8 955)	(3 011)	(104 302)	(704)	(1 669)	**(118 641)**
Other	-	-	(3)	(84)	(78)	(87)	**(252)**
As at 31 December 2016 (audited)	**162 389**	**742 757**	**381 563**	**5 925 512**	**39 889**	**44 274**	**7 296 384**
Accumulated depreciation							
As at 1 January 2016 (audited)	**-**	**129 544**	**215 838**	**1 508 843**	**28 717**	**-**	**1 882 942**
Additions / (disposals):							
Depreciation charges	-	39 412	31 787	503 095	3 315	-	**577 609**
Reclassification from assets held for sale	-	1 647	-	41 234	-		**42 881**
Foreign exchange differences on translation of financial statements of foreign entities	-	225	250	3 187	13	-	**3 675**
Sale	-	(577)	(3 635)	(5 285)	(88)	-	**(9 585)**
Liquidation	-	(2 252)	(2 806)	(97 429)	(656)	-	**(103 143)**
Other	-	-	(3)	(39)	(78)	-	**(120)**
As at 31 December 2016 (audited)	**-**	**167 999**	**241 431**	**1 953 606**	**31 223**	**-**	**2 394 259**
Accumulated impairment							
As at 1 January 2016 (audited)	**751**	**8 809**	**317**	**147 799**	**8**	**2 502**	**160 186**
Additions / (disposals):							
Recognition of impairment loss	133	335	-	34 992	-	-	**35 460**
Reclassification from assets held for sale	1 495	-	-	22 451	-	-	**23 946**
Foreign exchange differences on translation of financial statements of foreign entities	1	-	-	357	-	-	**358**
Use of impairment loss	-	(7 220)	-	(1 067)	-	(42)	**(8 329)**
Reversal of impairment loss	-	-	-	(10 046)	-	-	**(10 046)**
As at 31 December 2016 (audited)	**2 380**	**1 924**	**317**	**194 486**	**8**	**2 460**	**201 575**
Net value							
As at 1 January 2016 (audited)	**152 572**	**597 070**	**146 749**	**3 784 969**	**10 558**	**27 830**	**4 719 748**
of which finance leases	-	-	*12 427*	*346 493*	-	-	***358 920***
As at 31 December 2016 (audited)	**160 009**	**572 834**	**139 815**	**3 777 420**	**8 658**	**41 814**	**4 700 550**
of which finance leases	-	-	*8 633*	*319 689*	-	-	***328 322***

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

12. Property, plant and equipment (continued)

Year ended 31 December 2015 (audited)	Land	Buildings, premises, civil and water engineering structures	Technical equipment and machinery	Means of transport	Other fixed assets	Fixed assets under construction	Total
Gross value							
As at 1 January 2015 (audited)	**140 567**	**610 590**	**309 442**	**4 565 408**	**32 904**	**20 024**	**5 678 935**
Additions / (disposals):							
Acquisition	-	-	-	-	-	454 114	**454 114**
Acquisition of AWT	13 866	101 062	32 105	695 862	1 473	2 768	**847 136**
Finance leases	-	-	4 471	5 301	-	-	**9 772**
Foreign exchange differences on translation of financial statements of foreign entities	640	4 064	1 431	31 138	65	178	**37 516**
Other	-	131	39	595	35	-	**800**
Transfer of fixed assets under construction into use	78	26 194	18 517	389 923	5 417	(440 129)	**-**
Grants to property, plant and equipment	-	-	-	-	-	(6 544)	**(6 544)**
Sale	(11)	(697)	(197)	(3 062)	(169)	-	**(4 136)**
Liquidation	-	(91)	(2 904)	(151 306)	(441)	(79)	**(154 821)**
Reclassification to assets held for sale	(1 817)	(5 830)	-	(91 969)	-	-	**(99 616)**
Other	-	-	-	(279)	(1)	-	**(280)**
As at 31 December 2015 (audited)	**153 323**	**735 423**	**362 904**	**5 441 611**	**39 283**	**30 332**	**6 762 876**
Accumulated depreciation							
As at 1 January 2015 (audited)	**-**	**102 894**	**188 591**	**1 312 149**	**25 139**	**-**	**1 628 773**
Additions/(disposals):							
Depreciation charges	-	28 431	29 669	385 647	4 085	-	**447 832**
Foreign exchange differences on translation of financial statements of foreign entities	-	34	40	369	3	-	**446**
Other	-	-	128	28	-	-	**156**
Sale	-	(114)	(79)	(921)	(168)	-	**(1 282)**
Liquidation	-	(54)	(2 511)	(144 900)	(341)	-	**(147 806)**
Reclassification to assets held for sale	-	(1 647)	-	(43 300)	-	-	**(44 947)**
Other	-	-	-	(229)	(1)	-	**(230)**
As at 31 December 2015 (audited)	**-**	**129 544**	**215 838**	**1 508 843**	**28 717**	**-**	**1 882 942**
Accumulated impairment							
As at 1 January 2015 (audited)	**691**	**3 031**	**26**	**-**	**8**	**1 800**	**5 556**
Additions/(disposals):							
Recognition of impairment loss	60	5 778	291	147 799	-	702	**154 630**
As at 31 December 2015 (audited)	**751**	**8 809**	**317**	**147 799**	**8**	**2 502**	**160 186**
Net value							
As at 1 January 2015 (audited)	**139 876**	**504 665**	**120 825**	**3 253 259**	**7 757**	**18 224**	**4 044 606**
of which finance leases	*-*	*-*	*6 138*	*324 810*	*-*	*-*	***330 948***
As at 31 December 2015 (audited)	**152 572**	**597 070**	**146 749**	**3 784 969**	**10 558**	**27 830**	**4 719 748**
of which finance leases	*-*	*-*	*12 427*	*346 493*	*-*	*-*	***358 920***

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

12. Property, plant and equipment (continued)

As at 31 December 2016 and as at 31 December 2015, the value of rolling stock belonging to the Parent Company without valid technical efficiency certificates amounted to PLN 267.659 thousand and PLN 255.547 thousand. The Management Board of the Parent Company considers liquidation about 450 engines and about 800 freight cars, due to their poor technical condition.

A technical certificate is a document issued individually for each railroad vehicle to confirm the validity of a technical inspection and thus the usability of the vehicle in the shipping process. A technical certificate is issued directly after performing maintenance activities at level P4 or P5, and when new and modernized vehicles are given over for use. Rolling stock without a valid technical certificate constitutes for the Parent Company:

a) a backup supply of vehicles, from which after the performance of P4 and P5 repairs additional resources may be obtained to increase shipping capacity,
b) the necessary supply of rolling stock for rotation in the maintenance process. The performance of P4 or P5 repairs lasts from approximately 30 to 90 days, depending on the type of vehicle. To prevent a reduction in the number of available wagons and engines with a valid technical certificate, it is necessary to have a greater group of vehicles, so that when a given vehicle's technical certificate expires it may be replaced no later than on the same day with another that has been repaired and newly certified.

12.1 Impairment of property, plant and equipment

In the year 2016 the Group performed impairment tests on two cash generating units defined as the assets of the Parent Company and of the AWT Group.

The main indications of potential impairment of the Group's selected assets were:
– the market value of the Group's net assets continued to be lower than their carrying amount,
– bankruptcy filing made by a significant Czech market customer, resulting in a high risk of a decrease in cash flows generated in the future.

Impairment tests have been performed on cash generating units by determining their recoverable amount at the level of their value in use.

PKP CARGO S.A.

The Parent Company's assets were tested for impairment as at 30 June 2016. The recoverable amount of the analyzed assets was determined by estimating their value in use using the discounted net cash flows method based on financial projections prepared for the years 2016-2025. It is the view of the Parent Company's Management that the adoption of financial projections for more than five years is justified due to the fact that the property, plant and equipment used by the Parent Company have significantly longer economic useful lives.

Presented below are the key assumptions affecting the estimate of the value in use of the tested cash generating units as at 30 June 2016:
a) throughout the entire period of the detailed projection the compound annual growth rate (CAGR) of freight weight will amount to 0,6%,
b) weighted average cost of capital (WACC) assumed at 5,83% in real terms,
c) after the projection period, growth of future cash flows assumed at 0,3% in real terms.

Because the recoverable amount determined as a result of the tests exceeded the carrying amount of the tested fixed assets, the Group recognized no impairment losses.

Presented below is the estimated amount of impairment loss as at 30 June 2016 when changing only the following key parameters and keeping the other assumptions on a fixed level:

	PKP CARGO	
	- 0,3 p.p.	+ 0,3 p.p.
WACC	no impairment loss	18 422
Growth after detailed projection period	no impairment loss	no impairment loss

As at 31 December 2016 the Parent Company analyzed indications from both external and internal sources of information, which could have an effect on the key parameters used in the asset impairment model. In the opinion of the Parent Company's Management Board, the amount and direction of changes in the key assumptions used in the impairment test performed as at

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

12.1 Impairment of property, plant and equipment (continued)

30 June 2016 have no effect on the impairment of assets as at 31 December 2016. For this reason the Parent Company's Management Board did not find it necessary to retest the assets for impairment.

AWT Group

AWT Group's assets were tested for impairment as at 31 December 2016 and as at 30 June 2016. As at 31 December 2016 the recoverable amount of the analyzed assets was determined by estimating their value in use using the discounted net cash flows method based on financial projections prepared for the years 2017-2026. It is the Group's view that the adoption of financial projections for more than five years is justified due to the fact that the property, plant and equipment used by the Group have significantly longer economic useful lives, and to better reflect the effect on the AWT Group's results of the anticipated changes on the Czech coal market.

Presented below are the key assumptions affecting the estimate of the value in use of the tested cash generating units as at 31 December 2016:
a) adopted as the cash generating unit were the entire assets belonging to the AWT Group, which are used primarily to service clients on the Czech rail market,
b) the volume of freight transported for the significant client was assumed at the level of the planned production of coal, no related volumes were assumed in the residual period,
c) the weighted average cost of capital (WACC) was assumed at 4,95% in real terms (with specific risk premium included),
d) rise in wages in the residual period at 0,15% in real terms, no growth was assumed for the other parameters.

The impairment test confirmed the need to leave the impairment loss recognized on the AWT Group's non-current assets as at 30 June 2016 in the amount of PLN 35 million.

Presented below is the estimated amount of impairment loss as at 31 December 2016 when changing only the following key parameters and keeping the other assumptions on a fixed level:

	AWT Group	
	- 0,3 p.p.	**+ 0,3 p.p.**
WACC	no impairment loss	46 218
Growth after detailed projection period	not calculated*	no impairment loss

(*) due to the fact that cash flows do not assume a rise in the residual period, not sensitivity was calculated for -0,3 of a percentage point.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

13. Intangible assets

Year ended 31 December 2016 (audited)	Licenses - computer software	Other intangible assets	Intangible assets under development	Total
Gross value				
As at 1 January 2016 (audited)	**153 420**	**10 796**	**17 909**	**182 125**
Additions / (disposals):				
Acquisition	-	-	7 803	**7 803**
Transfer of intangible assets under development into use	15 024	250	(15 274)	**-**
Liquidation	(1 729)	-	-	**(1 729)**
Foreign exchange differences on translation of financial statements of foreign entities	130	147	36	**313**
As at 31 December 2016 (audited)	**166 845**	**11 193**	**10 474**	**188 512**
Accumulated amortization				
As at 1 January 2016 (audited)	**107 585**	**8 103**	**-**	**115 688**
Additions / (disposals):				
Amortization charges	16 242	2 327	-	**18 569**
Liquidation	(1 729)	-	-	**(1 729)**
Foreign exchange differences on translation of financial statements of foreign entities	51	102	-	**153**
As at 31 December 2016 (audited)	**122 149**	**10 532**	**-**	**132 681**
Net value				
As at 1 January 2016 (audited)	**45 835**	**2 693**	**17 909**	**66 437**
As at 31 December 2016 (audited)	**44 696**	**661**	**10 474**	**55 831**

As at 31 December 2016 the Group Company did not find it necessary to recognize an impairment allowance for intangible assets under development.

Year ended 31 December 2015 (audited)	Licenses - computer software	Other intangible assets	Intangible assets under development	Total
Gross value				
As at 1 January 2015 (audited)	**120 916**	**6 934**	**26 309**	**154 159**
Additions / (disposals):				
Acquisition	-	-	20 674	**20 674**
Acquisition of AWT	2 596	3 704	721	**7 021**
Transfer of intangible assets under development into use	29 827	-	(29 827)	**-**
Liquidation	(19)	-	-	**(19)**
Foreign exchange differences on translation of financial statements of foreign entities	100	158	32	**290**
As at 31 December 2015 (audited)	**153 420**	**10 796**	**17 909**	**182 125**
Accumulated amortization				
As at 1 January 2015 (audited)	**91 283**	**4 608**	**-**	**95 891**
Additions / (disposals):				
Amortization charges	16 303	3 475	-	**19 778**
Liquidation	(10)	-	-	**(10)**
Foreign exchange differences on translation of financial statements of foreign entities	9	20	-	**29**
As at 31 December 2015 (audited)	**107 585**	**8 103**	**-**	**115 688**
Net value				
As at 1 January 2015 (audited)	**29 633**	**2 326**	**26 309**	**58 268**
As at 31 December 2015 (audited)	**45 835**	**2 693**	**17 909**	**66 437**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

14. Subsidiaries

Detailed information about consolidated subsidiaries as at 31 December 2016 and 31 December 2015:

No.	Name of subsidiary	Core business	Place of registration and operations	Percent of shares held by the Group	
				As at 31/12/2016	As at 31/12/2015
1	PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.	Services in support of land transport, reloading of cargo and wholesale and retail of waste and scrap	Małaszewicze	100,0%	100,0%
2	PKP CARGO Centrum Logistyczne Medyka Żurawica Sp. z o.o.	Reloading of cargo at other reloading centers	Żurawica	100,0%	100,0%
3	PKP CARGO SERVICE Sp. z o.o.	Comprehensive siding services	Warsaw	100,0%	100,0%
4	PKP CARGO CONNECT Sp. z o.o.	Shipping services	Warsaw	100,0%	100,0%
5	PKP CARGOTABOR Sp. z o.o.	Maintenance and repair of rolling stock	Warsaw	100,0%	100,0%
6	PKP CARGOTABOR USŁUGI Sp. z o.o.	Collection, processing and neutralization of waste and recovery of raw materials	Warsaw	100,0%	100,0%
7	CARGOTOR Sp. z o.o.	Management of logistics and service infrastructure in the form of railway sidings and railroad tracks. Provision of such infrastructure to rail carriers.	Warsaw	100,0%	100,0%
8	CARGOSPED Terminal Braniewo Sp. z o.o.	Reloading of cargo, customs warehouse	Braniewo	100,0%	100,0%
9	Advanced World Transport B.V.	Holding and financial activities	Amsterdam	80,0%	80,0%
10	Advanced World Transport a.s.	Provision of comprehensive services: rail transport, rail shipping, siding services, rolling stock repairs	Ostrava	80,0%	80,0%
11	AWT ROSCO a.s.	Rolling stock management and rentals	Ostrava	80,0%	80,0%
12	AWT Čechofracht a.s.	Rail shipping and customs services	Prague	80,0%	80,0%
13	AWT Rekultivace a.s.	Provision of comprehensive services: land reclamation, construction services, waste management, landscape planning	Havirov-Prostredni Sucha	80,0%	80,0%
14	AWT Rail HU Zrt.	Provision of comprehensive services: rail transport, rail shipping, siding services	Budapest	80,0%	80,0%
15	AWT Coal Logistics s.r.o.	Rail shipping	Prague	80,0%	80,0%

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

14. Subsidiaries (continued)

Detailed information about other subsidiaries belonging to the Group as at 31 December 2016 and 31 December 2015:

No.	Name of subsidiary	Core business	Place of registration and operations	Percent of shares held by the Group	
				As at 31/12/2016	As at 31/12/2015
16	ONECARGO Sp. z o.o.	Rail transport of freight	Warsaw	100,0%	100,0%
17	ONECARGO CONNECT Sp. z o.o.	Services in support of land transport	Warsaw	100,0%	100,0%
18	Trade Trans Karya Sp. z o.o.	Reloading of cargo, customs warehouse	Lublin	100,0%	100,0%
19	Transgaz S.A.	Shipping agency	Zalesie near Małaszewicze	64,0%	64,0%
20	Trade Trans Finance Sp. z o.o.	Financial and accounting services	Warsaw	100,0%	100,0%
21	PKP CARGO CONNECT GmbH (1)	Customs and shipping services	Hamburg	100,0%	-
22	PPHU "Ukpol" Sp. z o.o.	Reloading, commercial services	Werchrata	100,0%	100,0%
23	AWT Rail SK a. s.	Rail transport, rail shipping	Bratislava	80,0%	80,0%
24	AWT Rail PL Sp.z o.o. w likwidacji (2)	Rail shipping	Rybnik	80,0%	80,0%
25	AWT DLT s.r.o.	Siding services	Kladno	80,0%	80,0%
26	G.I.B. s.r.o. w likwidacji (3)	Rail shipping	Prague	-	80,0%
27	AWT Trading s.r.o.	Sale of military products	Petrvald	80,0%	80,0%
28	AWT Rekultivace PL Sp. z o.o.	Provision of comprehensive services: land reclamation, construction services, waste management, landscape planning	Cieszyn	80,0%	80,0%
29	Spedrapid Sp. z o.o. (4)	Rail shipping	Gdynia	-	52,8%
30	RND s.r.o.	Rail shipping, transport monitoring	Olomouc	40,8%	40,8%

(1) The Extraordinary Shareholders Meeting of PKP CARGO CONNECT Sp. z o.o. of 25 April 2016 passed a resolution, in which it gave its consent for PKP CARGO CONNECT Sp. z o.o. to take up 100% of shares, numbering 25.000, with a nominal value of1 EUR per share, with a total nominal value of 25.000 EUR, of the newly formed subsidiary PKP CARGO CONNECT GmbH.

(2) The Extraordinary Shareholders Meeting of AWT Rail PL Sp. z o.o. of 7 August 2015 passed a resolution to dissolve the company and open a liquidation proceeding. This change was entered in the relevant court register on 15 March 2016.

(3) On 21 December 2016 the company G.I.B. s.r.o. in liquidation was deleted from the Czech business register due to the completion of the liquidation proceeding.

(4) On 6 December 2016 AWT Čechofracht a.s. sold 66% of its shares of Spedrapid Sp. z o.o., and thus Spedrapid Sp. z o.o. ceased to be a related party of the Group.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

15. Investments in entities accounted for under the equity method

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Opening balance	**39 831**	**35 246**
Acquisition of shares	-	1 619
Sale of shares	-	(135)
Share in profits/(losses) of investments accounted for under the equity method [(1)]	3 461	4 416
Change in equity arising out of dividend payment	(2 663)	(2 185)
Effect of liquidation assets of companies accounted for under the equity method	-	(3 509)
Recognition of companies accounted for under the equity method as part of acquisition of AWT	-	4 292
Foreign exchange differences on translation of financial statements of foreign entities	181	87
Closing balance	**40 810**	**39 831**

[(1)] In the financial year ended 31 December 2015 the item contained PLN 1.890 thousand in a reversed impairment loss on investments accounted for under the equity method.

Summary of the financial data of the investments in entities accounted for under the equity method:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Non-current assets	38 961	40 220
Current assets	106 032	123 716
Total assets	**144 993**	**163 936**
Non-current liabilities	1 711	1 783
Current liabilities	35 897	52 531
Total liabilities	**37 608**	**54 314**
Net assets [(1)]	**107 385**	**109 622**
Group's interests in net assets of entities accounted for under the equity method	53 316	53 767
Total revenue	162 921	234 993
Net profit / (loss) for the financial year	5 898	4 419
Group's share in the profits of entities accounted for under the equity method	3 461	2 526
Group's share in total comprehensive income of entities accounted for under the equity method	3 461	2 526

[(1)] Data calculated as the total of the net assets of all of the entities measured by equity accounting.

15.1 Detailed information on entities accounted for under the equity method

Name of entity accounted for under the equity method	% of interests held by the Group		Carrying amount of asset	
	As at 31/12/2016	As at 31/12/2015	As at 31/12/2016	As at 31/12/2015
COSCO Shipping Lines (POLAND) Sp. z o.o.	20,0%	20,0%	763	1 108
Pol – Rail S.r.l	50,0%	50,0%	6 499	6 889
Terminale Przeładunkowe Sławków – Medyka Sp. z o.o.	50,0%	50,0%	19 593	19 537
Trade Trans Karya Sp. z o.o.	100,0%	100,0%	-	-
Transgaz S.A.	64,0%	64,0%	5 000	4 741
Trade Trans Finance Sp. z o.o.	100,0%	100,0%	341	302
PPHU "Ukpol" Sp. z o.o.	100,0%	100,0%	-	-
Rentrans Cargo Sp. z o.o.	29,3%	29,3%	3 433	2 632
Gdański Terminal Kontenerowy S.A.	41,9%	41,9%	-	106
AWT Rail SK a. s.	80,0%	80,0%	5 181	4 516
Total			**40 810**	**39 831**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

16. Other financial assets

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Derivatives		
Currency forwards	235	123
Investments in shares		
Shares of Polish entities [1]	7 141	7 351
Shares of foreign entities [1]	1 360	1 949
	8 501	9 300
Loans and receivables measured at amortized cost		
Loans granted to related parties	796	639
Loans granted to other parties	-	2 000
Deposits for over 3 months	-	1 282
	796	3 921
Other		
Units of investment funds	-	549
Other financial assets	9	2
Total	**9 541**	**13 895**
Non-current assets	8 649	9 849
Current assets	892	4 046
Total	**9 541**	**13 895**

[1] As at 31 December 2016 and 31 December 2015 the value of impairment allowance on investments in shares amounted to PLN 11.833 thousand.

17. Other non-financial assets

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Expenses settled in time		
Rental fees	14 210	17 071
IT services	1 521	1 164
Insurance	7 667	7 540
Prepaid electrical energy	14 673	-
Other prepaid expenses	4 062	5 242
	42 133	31 017
Other		
Advances for the purchase of fixed assets	10 477	13 385
Other	654	1 545
	11 131	14 930
Total non-financial assets	**53 264**	**45 947**
Non-current assets	25 987	32 666
Current assets	27 277	13 281
Total	**53 264**	**45 947**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

18. Inventories

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Raw materials	120 619	127 936
Semi-finished products	6 027	7 334
Merchandise	1 872	3 058
Impairment allowance	(7 329)	(9 815)
Total	**121 189**	**128 513**

Changes in inventories impairment allowance	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Opening balance	**9 815**	**3 641**
Recognition	717	6 295
Reversal	(2 035)	(148)
Utilization	(1 224)	(28)
Foreign exchange differences on translation of financial statements of foreign entities	56	55
Closing balance	**7 329**	**9 815**

19. Trade and other receivables

	As at 31/12/2016 (audited)	As at 31/12/2015 (restated*)
Trade receivables	768 873	723 386
Impairment allowance for receivables [(1)]	(152 873)	(87 252)
Total	**616 000**	**636 134**
Receivables from sale of non-financial fixed assets	-	2 197
State receivables	5 216	5 006
Guarantees, security deposits and bid bonds	1 415	3 385
VAT receivables	17 754	9 044
Other receivables	1 704	3 424
Total	**642 089**	**659 190**
Non-current assets	2 223	5 074
Current assets	639 866	654 116
Total	**642 089**	**659 190**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

[(1)] On 3 May 2016 the Czech coal consortium OKD petitioned the court to declare it bankrupt. On 11 August 2016, at a hearing of the District Court in Ostrava, OKD's creditors made a decision to start a restructuring proceeding. This means that OKD is in the process of developing a restructuring plan that is subject to the approval of the court. The receivables of AWT from OKD submitted during this process initially amounted to CZK 462.764 thousand, and were reduced to CZK 448.765 thousand as a result of offsets.

Due to the contractor's difficult financial position as at 30 June 2016 an impairment allowance was recognized for the receivables from OKD in the amount of CZK 384.674 thousand. As at 31 December 2016 the Group performed another recoverability analysis of the remaining receivables and decided to recognize an impairment allowance for the rest of its receivables from OKD in the amount of CZK 64.131 thousand.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

19.Trade and other receivables (continued)

The impairment allowance has been recognized in these Consolidated Financial Statements in the following manner:
- in trade and other receivables in the amount of PLN 73.469 thousand;
- in other operating expenses in the amount of PLN 72.661 thousand.

The difference in the value of the allowance is the result of different exchange rates used in the valuation of the statement of comprehensive income and statement of financial position. The difference was recognized in other comprehensive income as foreign exchange differences on translation of financial statements of foreign entities.

The trade and other receivables item consists of receivables from related parties. Detailed information on trade receivables from related parties is presented in Note 33 to these Consolidated Financial Statements.

19.1 Ageing of trade receivables

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Current receivables	547 240	569 335
Overdue receivables		
Up to 90 days	57 274	59 960
From 91-365 days	10 235	5 428
Over 365 days	1 251	1 411
Total	**616 000**	**636 134**
The average age of accounts receivable (days)	**51**	**53**

19.2 Change in impairment allowance for trade receivables

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Opening balance	**87 252**	**84 213**
Acquisition of AWT	-	13 617
Recognition	80 443	5 356
Utilization	(13 380)	(9 980)
Reversal	(3 196)	(6 566)
Foreign currency valuation	673	-
Foreign exchange differences on translation of financial statements of foreign entities	1 081	612
Closing balance	**152 873**	**87 252**

20. Cash and cash equivalents

For the purposes of preparing the statement of cash flows, cash and cash equivalents consist of cash in hand and at bank, including deposits for up to 3 months. Cash and cash equivalents listed in the consolidated statement of cash flows at the end of the financial year may be reconciled with the balance sheet as follows:

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Cash in hand and at bank	282 870	226 624
Bank deposits for up to 3 months	473 049	49 567
Total	**755 919**	**276 191**
of which:		
Restricted cash	8 607	20 644

As at 31 December 2016 and 31 December 2015 restricted cash consisted primarily of bank accounts for bonds and security deposits.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

21. Explanation of changes in the statement of financial position and other adjustments to the statement of cash flows

(Increase) / decrease in trade and other receivables	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Change in the statement of financial position	17 101	(140 160)
Change in net receivables from the sale of non-financial fixed assets	(1 786)	1 818
Change in interest receivables	(238)	(652)
Acquisition of AWT	-	166 902
Other	(863)	-
Change in trade receivables and other receivables in the statement of cash flows	**14 214**	**27 908**

(Increase) / decrease in inventories	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Change in the statement of financial position	7 324	(13 215)
Change in inventories reclassified from fixed assets	2 795	4 580
Acquisition of AWT	-	30 026
Change in inventories in the statement of cash flows	**10 119**	**21 391**

(Increase) / decrease in other assets	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Change in the statement of financial position	(2 963)	295 483
Change in advances for the purchase of fixed assets	(2 908)	12 326
Change in other assets from bank deposits for more than 3 months	(1 282)	(300 132)
Change in loan receivables	(1 867)	(2 999)
Change in other assets relating to sales of shares	(1 540)	-
Acquisition of AWT	-	13 813
Other	223	(291)
Change in other assets in the statement of cash flows	**(10 337)**	**18 200**

Increase / (decrease) in trade and other payables	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Change in the statement of financial position	(93 596)	155 568
Change in net payables for the purchase of non-financial fixed assets	64 776	21 655
Change in payables relating to the receipt of the grant	(8 393)	-
Acquisition of AWT	-	(114 565)
Other	-	2 812
Change in trade and other payables in the statement of cash flows	**(37 213)**	**65 470**

Increase / (decrease) in other financial liabilities	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Change in the statement of financial position	(37 441)	153 438
Recognition of liability relating to put options for non-controlling shares of AWT	-	(144 460)
Acquisition of AWT	-	(2 093)
Change in other financial liabilities in the statement of cash flows	**(37 441)**	**6 885**

Increase/(decrease) in provisions	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Change in the statement of financial position	(74 549)	(308 277)
Acquisition of AWT	-	(33 420)
Change in provisions in the statement of cash flows	**(74 549)**	**(341 697)**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

21.Explanation of changes in the statement of financial position and other adjustments to the statement of cash flows (continued)

Other adjustments	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Actuarial gains/(losses) recognized in other comprehensive income	21 482	53 217
Effective portion of gains/(losses) on a cash flow hedging instrument	966	3 373
Foreign exchange differences on translation of financial statements of foreign entities	1 621	2 863
Other adjustments to the statement of cash flows	**24 069**	**59 453**

22. Non-monetary transactions

In the 12 month period ended 31 December 2016 and 31 December 2015, the main non-monetary transactions relating to investment and financial activities, which have not been reflected in the consolidated statement of cash flows, were as follows:

Acquisition of assets in the form of finance leases

In the 12 month period ended 31 December 2016 the Group acquired PLN 3.209 thousand in fixed assets on the basis of finance lease agreements.

In the 12 month period ended 31 December 2015 the value of fixed assets used on the basis of finance lease agreements was PLN 9.772 thousand.

Liquidation of rolling stock

When a decision is made to liquidate a rolling stock item, its residual value is recognized in inventories. In 2016, the residual value of fixed assets reclassified to inventories amounted to PLN 2.795 thousand, while in 2015 it had amounted to PLN 4.580 thousand.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

23. Non - current assets classified as held for sale

Non - current assets classified as held for sale as at 31 December 2016 and 31 December 2015:

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Land	-	6 811
Buildings, premises, civil and water engineering structures	-	4 183
Means of transport	-	33 067
Total	**-**	**44 061**

The following changes were made in non-current assets classified as held for sale in the financial year ended 31 December 2016:

- the Group sold some of its rolling stock, earning a sales profit of PLN 588 thousand. The remaining rolling stock items did not find a buyer, which is why the Group is looking for alternative uses for the rolling stock items. Due to the fact that the criteria for classifying the said items as held for sale are no longer fulfilled, in the financial year ended 31 December 2016 the Group reclassified them to property, plant and equipment. As the items had been revalued to their current residual values, the change in the presentation of these items had no effect on the Group's results in the year 2016.
- the Group is analyzing an alternative way for the use of properties thus far classified as held for sale. Due to uncertainty as to its ability to sell them, in the financial year ended 31 December 2016 the Group reclassified them to property, plant and equipment. The change in the presentation of the said properties had no effect on the Group's results in the year 2016.

Changes in non-current assets held for sale in the financial year ended 31 December 2016 and 31 December 2015:

Year ended 31 December 2016 (audited)	Land	Buildings, premises, civil and water engineering structures	Means of transport	Total
As at 1 January 2016 (audited)	**6 811**	**4 183**	**33 067**	**44 061**
Sale	-	-	(2 063)	(2 063)
Reclassification to property, plant and equipment	(6 811)	(4 183)	(31 004)	(41 998)
As at 31 December 2016 (audited)	**-**	**-**	**-**	**-**

Year ended 31 December 2015 (audited)	Land	Buildings, premises, civil and water engineering structures	Means of transport	Total
As at 1 January 2015 (audited)	**4 994**	**-**	**12 566**	**17 560**
Acquisition of AWT	205	706	-	911
Reclassification from property, plant and equipment	1 817	4 183	48 669	54 669
Sale	(198)	(681)	(4 139)	(5 018)
Recognition of impairment allowance	-	-	(24 029)	(24 029)
Foreign exchange differences on translation of financial statements of foreign entities	(7)	(25)	-	(32)
As at 31 December 2015 (audited)	**6 811**	**4 183**	**33 067**	**44 061**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

24. Equity

24.1 Share capital

	As at 31/12/2016 (audited)	As at 31/12/2016 (audited)
Share capital consists of:		
Ordinary shares - fully paid up and registered	2 239 346	2 239 346

As at 31 December 2016 and 31 December 2015 the Parent Company's share capital consisted of ordinary shares with a nominal value of PLN 50 per share. Each fully paid up ordinary share, with a nominal value of PLN 50, is equal to a single vote at a general meeting and entitled to a dividend.

No changes were made in the Parent Company's share capital in the financial year ended 31 December 2016 or the financial year ended 31 December 2015.

24.2 Share premium

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Share premium, of which:	**618 666**	**619 407**
Agio	201 263	201 263
Distributions of profit (statutory)	47 346	48 087
Distributions of profit (in excess of statutory value)	230 075	230 075
Capital formed from redemption of shares	139 982	139 982

In accordance with the requirements of the Code of Commercial Partnerships and Companies, joint-stock companies are required to form a share premium to cover losses. At least 8% of the profit recorded in the company's financial statements for a given financial year is contributed to this capital, unless it reaches at least one third of the value of the company's share capital. The General Meeting makes decisions on the use of the share premium, however a portion equal to one third of the company's share capital may only be used to cover losses disclosed in the separate financial statements and cannot be used for other purposes. The amount designated for distribution amongst the shareholders may be increased by retained earnings from prior years and amounts transferred from the share premium formed from the company's profits.

Agio is the excess of the issue price over the nominal value of shares issued by the Parent Company, transferred to the share premium with no ability to pay a dividend.

The capital formed from the redemption of shares was created as a result of a reduction of the Parent Company's share capital in 2013 with the designation to cover losses.

The changes made in the Group's share premium in the financial year ended 31 December 2016 were the result of a resolution passed by the Ordinary Meeting of CARGOSPED Terminal Braniewo Sp. z o.o. of 27 June 2016 on covering from the share premium the net loss for the year 2015 amounting to PLN 876 thousand, and a resolution passed by the Ordinary Meeting of PKP CARGO CONNECT Sp. z o.o. of 30 June 2016 on transferring the profit for the year 2015, amounting to PLN 135 thousand, to the company's share premium.

24.3 Retained earnings

Retained earnings of the Group consist of:

a) net profit/loss for the year,
b) undistributed profits and uncovered losses from prior years,
c) differences from transition to IFRS EU.

The Parent Company's Ordinary General Meeting of 11 May 2016 passed a resolution to approve the Separate and Consolidated Financial Statements for the year 2015 and to cover the Parent Company's loss for the year 2015, amounting to PLN 114.125 thousand, from its future profits and by not paying a dividend for the year 2015.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

24.3 Retained earnings (continued)

In the financial year ended 31 December 2015 changes in retained earnings and share premium were the result of a resolution passed by the Ordinary General Meeting of PKP CARGO S.A. of 21 April 2015, to distribute the net profit for the year 2014, amounting to PLN 58.610 thousand, in the following manner:

a) the amount of PLN 4.689 thousand was designated to the share premium,
b) the amount of PLN 53.921 thousand was designated for the payment of a dividend.

In addition, designated for the payment of a dividend was the amount of PLN 56.255 thousand from retained earnings. A dividend in the amount of PLN 110.176 thousand was paid out on 26 June 2015.

24.4 Non-controlling interests

On 5 February 2015 the Parent Company acquired from Trade Trans Invest a.s. 44,44% of shares of the company PKP CARGO CONNECT Sp. z o.o. (formerly PS Trade Trans Sp. z o.o.) for the amount of PLN 40.000 thousand. As a result of the acquisition, the Parent Company holds 100% of the shares of PKP CARGO CONNECT Sp. z o.o.

Effect of the transaction on the Group's equity:

Transactions with non-controlling interests	Year ended 31/12/2015 (restated*)
Non-controlling interests prior to transaction	55 038
Share acquisition price	40 000
Change in non-controlling interests	(55 038)
Difference recognized in the Group's retained earnings	15 038

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

25. Earnings per share

Profit / (loss) used to calculate basic earnings and diluted earnings per share:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Profit / (loss) attributable to shareholders of the parent company	**(133 772)**	**30 281**

25.1 Basic earnings per share

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Weighted average number of ordinary shares	44 786 917	44 786 917
Basic earnings per share (PLN per share)	**(2,99)**	**0,67**

Net earnings per share for each period are calculated as the quotient of the net profit / (loss) for the given period divided by the weighted average number of shares in the period.

25.2 Diluted earnings per share

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (restated*)
Weighted average number of ordinary shares	44 786 917	44 786 917
Diluted earnings per share (PLN per share)	**(2,99)**	**0,67**

No dilutive transactions occurred in the financial year ended 31 December 2016 and 31 December 2015.

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

26. Bank loans and credit facilities

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Bank loans - pledged on assets	118 236	119 579
Bank loans - other	1 348 479	589 817
Borrowings from related parties	3 605	3 407
Borrowings from other parties	1 088	1 366
Total	**1 471 408**	**714 169**
Non-current liabilities	1 273 605	460 577
Current liabilities	197 803	253 592
Total	**1 471 408**	**714 169**

26.1 Bank loans and credit facilities - by currency / interest rate type

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
- variable interest rate		
WIBOR - PLN	1 144 157	577 949
EURIBOR - EUR	204 751	31 651
PRIBOR - CZK	48 663	97 667
- fixed interest rate		
PLN	1 088	1 366
EUR	72 749	5 536
	1 471 408	**714 169**

26.2 Changes in bank loans and credit facilities

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Opening balance	**714 169**	**300 200**
Acquisition of AWT	-	121 501
Taken out	1 004 598	424 957
Repayment	(257 855)	(137 336)
Interest accrued	965	-
Currency valuation	4 895	(7)
Foreign exchange differences on translation of financial statements of foreign entities	4 636	4 854
Closing balance	**1 471 408**	**714 169**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

26.3 Summary of loans agreements

The Group concludes credit agreements primarily to finance its investment plan, acquisitions and current operations. Credit agreements are taken out in PLN, EUR and CZK.

Parent Company

Type of loan	Name of bank	Currency	Pledge	Interest terms and conditions	Maturity date	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Investment loan	mBank S.A.	PLN	Bank enforcement title	WIBOR 1M + margin	21.03.2016	-	1 630
Investment loan	mBank S.A.	PLN	Bank enforcement title	WIBOR 1M + margin	31.03.2016	-	2 233
Investment loan	mBank S.A.	PLN	Bank enforcement title	WIBOR 1M + margin	30.06.2017	4 210	12 690
Investment loan	Bank Pekao S.A.	PLN	Bank enforcement title	WIBOR 1M + margin	31.12.2017	9 840	19 680
Investment loan	Bank Gospodarstwa Krajowego	PLN	Bank enforcement title	WIBOR 1M + margin	31.03.2021	377 478	464 123
Investment loan	European Investment Bank	PLN	None	WIBOR 3M + margin	29.05.2020	59 608	76 500
Investment loan	Bank Gospodarstwa Krajowego (1)	EUR	Notary certified declaration of submission to execution	EURIBOR 3M + margin	20.12.2026	66 373	12 363
Investment loan	Bank Gospodarstwa Krajowego (1)	EUR	Notary certified declaration of submission to execution	EURIBOR 3M + margin	20.12.2026	75 884	-
Investment loan	Bank Pekao S.A. (2)	PLN	Notary certified declaration of submission to execution	WIBOR 3M + margin	31.12.2026	649 759	-
Investment loan	European Bank for Reconstruction and Development (3)	PLN	None	WIBOR 6M + margin	25.09.2027	42 748	-
Investment loan	European Investment Bank (4)	EUR	None	EURIBOR 3M + margin	29.08.2031	62 494	-
					Total	**1 348 394**	**589 219**

(1) On 16 November 2015 the Parent Company concluded with Bank Gospodarstwa Krajowego two investment loan agreements up to the maximum amount of EUR 100.00 thousand. The loans are to be used to finance the purchase of multi-system engines and planned acquisitions. As at 31 December 2016 the Parent Company had used EUR 32.149 thousand, whilst as at 31 December 2015 it had used EUR 2.901 thousand.

(2) On 16 November 2015 the Parent Company concluded a loan agreement with Bank Pekao S.A., based on which it received an investment loan up to the maximum amount of PLN 700.000 thousand, to finance planned acquisitions and investments. As at 31 December 2016 the Parent Company had used PLN 649.500 thousand. The loan had not been used as at 31 December 2015.

(3) On 23 December 2015 the Parent Company concluded a loan agreement with European Bank for Reconstruction and Development, based on which it received an investment loan up to the maximum amount of EUR 100.000 thousand, to refinance the purchase of the company AWT B.V. As at 31 December 2016 the Parent Company had used PLN 42.450 thousand. The loan had not been used as at 31 December 2015.

(4) On 19 July 2016 the Parent Company concluded an agreement with the European Investment Bank, based on which it received an investment loan up to the maximum amount of EUR 40.000 thousand, to finance and/or refinance the purchase of multi-system engines. As at 31 December 2016 the Parent Company had used EUR 14.123 thousand.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

Subsidiaries

Type of loan	Name of bank	Currency	Pledge	Interest terms and conditions	Maturity date	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Overdraft facility	PKO BP S.A.	PLN	Capped mortgage, pledge on inventory	WIBOR 1M + margin	15.07.2019	429	495
Investment loan	mBank S.A.	PLN	Guarantee granted by PKP CARGO S.A. up to PLN 1.048 thousand	WIBOR 1M + margin	30.09.2016	-	136
Investment loan	mBank S.A.	PLN	Guarantee granted by PKP CARGO S.A. up to PLN 1.380 thousand	WIBOR 1M + margin	31.10.2016	-	206
Investment loan	mBank S.A.	PLN	Guarantee granted by PKP CARGO S.A. up to PLN 1.028 thousand	WIBOR 1M + margin	30.06.2017	85	256
Loan	WFOŚIGW Łódź[1]	PLN	1) Blank promissory note 2) Irrevocable authorization to bank account 3) Guarantee granted by PKP CARGO S.A.	fixed	31.03.2024	1 088	1 366
Investment loan	ING Bank N.V. UniCredit Bank Czech Republik and Slovakia a.s. Raiffeisenbank a.s. [2]	CZK	1) Pledge on property, plant and equipment 2) Lien on bank accounts 3) Assignment of insurance policy	PRIBOR 3M + margin	26.09.2021	48 663	-
Investment loan	ING Bank N.V. UniCredit Bank Czech Republik and Slovakia a.s. Raiffeisenbank a.s.[1] [2]	EUR	1) Pledge on property, plant and equipment 2) Lien on bank accounts 3) Assignment of insurance policy	fixed	30.06.2021	69 144	-
Investment loan	ING Bank N.V. UniCredit Bank Czech Republic a.s.	CZK	1) Pledge on shares of AWT a.s. 2) Pledge on property, plant and equipment	PRIBOR 3M + margin	30.09.2016	-	97 667
Investment loan	ING Bank N.V. UniCredit Bank Czech Republic a.s.	EUR	1) Pledge on shares of AWT a.s. 2) Pledge on property, plant and equipment	EURIBOR 3M + margin	30.09.2016	-	19 288
Investment loan	Raiffeisenbank a.s.[1]	EUR	1) Pledge on property, plant and equipment 2) Promissory notes 3) Assignment of insurance policy	fixed	30.06.2016	-	2 129
Loan	AWT Rail SK a.s. [1]	EUR	None	fixed	31.12.2017	3 605	3 407
					Total	**123 014**	**124 950**

[1] As at 31 December 2016 interest rates on bank credits and loans with a fixed interest rate fell within the range of 0,06% to 4%.

[2] On 26 September 2016 companies from the AWT Group concluded a credit agreement with the following institutions: ING Bank N.V., UniCredit Bank Czech Republik and Slovakia, a.s., Raiffeisenbank a.s. to refinance their liabilities arising out of previously concluded credit agreements. The said refinanced liabilities were fully paid on 30 September 2016.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

26.4 Unused credit lines

Type of loan	Name of bank	Currency	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Investment loan	Bank Gospodarstwa Krajowego	PLN	-	5 627
Investment loan	European Investment Bank[(1)]	PLN	155 000	-
Investment loan	European Investment Bank	EUR	113 918	-
Investment loan	Bank Gospodarstwa Krajowego[(2)]	EUR	300 171	51 560
Investment loan	Bank Pekao S.A.	PLN	50 500	100 000
Investment loan	European Bank for Reconstruction and Development	EUR	398 160	426 150
Overdraft facility	mBank S.A.	PLN	100 000	100 000
Overdraft facility	ING Bank N.V. UniCredit Bank Czech Republic a.s.	CZK	-	27 708
Overdraft facility	ING Bank Śląski S.A.	PLN	-	19 000
Overdraft facility	PKO BP S.A.	PLN	572	805
Total			**1 118 321**	**730 850**

[(1)] On 18 March 2016 an annex was concluded to the loan agreement with European Investment Bank, based on which the Parent Company received a loan of PLN 155.000 thousand.

[(2)] On 14 March 2017 an annex was concluded to the loan agreement with Bank Gospodarstwa Krajowego, based on which the availability of the said loan was extended from 31 December 2016 to 27 December 2017.

26.5 Breaches of credit agreements

As at 31 December 2016 there have been no breaches of loan agreements.

27. Other financial liabilities

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Derivative instruments		
Interest rate swap (IRS)	1 042	2 164
Currency forwards	185	10
Liability relating to put option for non-controlling shares[(1)]	118 704	155 198
Total	**119 931**	**157 372**
Non-current liabilities	1 042	155 198
Current liabilities	118 889	2 174
Total	**119 931**	**157 372**

[(1)] Detailed information presented in Note 32.1.3 to these Consolidated Financial Statements.

28. Finance lease liabilities and leases with purchase option

As at 31 December 2016, based on finance lease agreements the Group uses rolling stock components, technical equipment, cars and computer hardware. Agreements have been concluded for 3 to 10 years in PLN, EUR and CZK.

	As at 31/12/2016 (audited)			As at 31/12/2015 (audited)		
	Minimum payments	Future financial liabilities	Present value of minimum payments	Minimum payments	Future financial liabilities	Present value of minimum payments
Up to 1 year	65 173	(5 606)	59 567	73 086	(7 670)	65 416
Over 1 to 5 years	113 170	(10 890)	102 280	155 335	(14 494)	140 841
Over 5 years	33 348	(705)	38 643	54 967	(2 308)	52 659
Total	**217 691**	**(17 201)**	**200 490**	**283 388**	**(24 472)**	**258 916**
Long-term	152 518	(11 595)	140 923	210 302	(16 802)	193 500
Short-term	65 173	(5 606)	59 567	73 086	(7 670)	65 416
Total	**217 691**	**(17 201)**	**200 490**	**283 388**	**(24 472)**	**258 916**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

29. Trade and other payables

	As at 31/12/2016 (audited)	As at 31/12/2015 (restated*)
Trade payables	327 389	321 303
Accruals	49 826	62 486
Liabilities related to purchase of non-financial fixed assets	46 402	113 728
Liabilities related to security (bonds, security deposits, guarantees)	20 289	23 472
State liabilities	103 170	101 979
Voluntary Redundancy Program liabilities	-	48 249
Settlements with employee	78 836	78 097
Other liabilities (1)	11 777	6 616
VAT liabilities	34 177	9 532
Total	**671 866**	**765 462**
Non-current liabilities	1 845	25 953
Current liabilities	670 021	739 509
Total	**671 866**	**765 462**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

(1) As at 31 December 2016 the other liabilities item consisted of PLN 8.491 thousand in a grant received by AWT as part of the CEF program to support work relating to the construction of a multi-modal container terminal in Paskow. The capital expenditures to which the grant pertains will be incurred in the years 2017 and 2018.

30. Employee benefits

Actuarial valuations of provisions for employee benefits for the Group's entities located in Poland as at 31 December 2016 and 31 December 2015 were based on the following assumptions:

	Valuation as at 31/12/2016 %	Valuation as at 31/12/2015 %
Discount rate	3,50	3,10
Average assumed annual growth of calculation base for provision for retirement compensation, jubilee bonuses	1,35	1,70
Assumed growth in price of entitlement for transport benefits	0 - 2,50	0 - 2,50
Average assumed annual growth of calculation base for contribution to Company Social Benefits Fund	3,5 - 8,4	3,60
Weighted average employee mobility factor	2,30	2,50
Inflation (annually)	1,3 - 2,5	1,7-2,5

Actuarial valuations of provisions for employee benefits for the Group's entities located outside of Poland were based on specific assumptions for the countries in which they operate.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

30. Employee benefits (continued)

Amounts recognized in **profit or loss** in relation to employee benefit plans:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Defined post-employment benefit plans		
– retirement compensation	26 502	16 395
– contributions to Company Social Benefits Fund for retirees	11 527	6 352
– transport benefits	3 469	1 615
– death benefits	(17 602)	1 277
Other employee benefits		
– jubilee bonuses	(12 197)	33 060
– other employee benefits (unused annual leave/bonuses)	2 835	(14 459)
– provision for Voluntary Redundancy Program	-	70 179
Total	**14 534**	**114 419**

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Costs of employee benefits	(5 993)	94 860
Financial expenses	20 527	18 923
External services	-	636
Total recognized in profit / loss before tax	**14 534**	**114 419**

Amounts recognized in **other comprehensive income** in relation to employee benefit plans:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Defined post-employment benefit plans		
– retirement compensation	(12 526)	(2 440)
– contributions to Company Social Benefits Fund for retirees	610	(44 165)
– transport benefits	(2 781)	(4 485)
– death benefits	(6 785)	(2 127)
Total	**(21 482)**	**(53 217)**

Amount recognized in the **consolidated statement of financial position** in relation to liabilities relating to employee benefit plans:

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Defined post-employment benefit plans		
– retirement compensation	153 230	154 828
– contributions to Company Social Benefits Fund for retirees	128 614	124 118
– death benefits	6 836	31 660
– transport benefits	33 286	33 654
Other employee benefits		
– jubilee bonuses	268 875	318 239
– other employee benefits (unused annual holidays/bonuses)	33 986	41 505
Total	**624 827**	**704 004**
of which:		
– long-term	525 571	603 621
– short-term	99 256	100 383
Total	**624 827**	**704 004**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

30. Employee benefits (continued)

Change in the present value of defined employee benefit plan liabilities:

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Opening balance of defined employee benefit plan liabilities	**704 004**	**1 026 393**
Acquisition of AWT	-	13 511
Current service cost	20 209	22 876
Past service costs, to which rights were acquired	(13 822)	4 851
Cost of other employee benefits	2 835	(13 222)
Interest expense	20 527	18 923
Actuarial losses / (gains) – post-employment benefits	(21 482)	(53 217)
Actuarial losses / (gains) – other long-term benefits	(15 215)	10 812
Benefits paid	(72 780)	(349 419)
Voluntary Redundancy Program	-	70 179
Reclassification of Voluntary Redundancy Program to trade and other payables	-	(48 249)
Foreign exchange differences on translation of financial statements of foreign entities	551	566
Closing balance of defined employee benefit plan liabilities	**624 827**	**704 004**

Actuarial (gains) / losses incured in 2016 resulted from:

	changes in demographic assumptions	changes in financial assumptions	other changes	Total
Actuarial losses / (gains) – post employment benefits				
– retirement compensation	11 788	(4 293)	(20 021)	(12 526)
– contributions to Company Social Benefits Fund for retirees	4 600	9 207	(13 197)	610
– death benefits	(907)	(244)	(5 634)	(6 785)
– transport benefits	2 036	(1 789)	(3 028)	(2 781)
	17 517	2 881	(41 880)	(21 482)
Actuarial losses / (gains) – other long-term benefits				
– jubilee bonuses	(12 569)	(6 546)	3 900	(15 215)
Total	**4 948**	**(3 665)**	**(37 980)**	**(36 697)**

Actuarial (gains) / losses incured in 2015 resulted from:

	changes in demographic assumptions	changes in financial assumptions	other changes	Total
Actuarial losses / (gains) – post employment benefits				
– retirement compensation	(3 811)	(7 361)	8 732	(2 440)
– contributions to Company Social Benefits Fund for retirees	(8 738)	(9 124)	(26 303)	(44 165)
– death benefits	7 994	(961)	(9 160)	(2 127)
– transport benefits	(2 570)	(2 342)	427	(4 485)
	(7 125)	(19 788)	(26 304)	(53 217)
Actuarial losses / (gains) – other long-term benefits				
– jubilee bonuses	(3 624)	(10 508)	24 944	10 812
Total	**(10 749)**	**(30 296)**	**(1 360)**	**(42 405)**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

30. Employee benefits (continued)

Presented below is a sensitivity analysis of the value of provisions for employee benefits as at 31 December 2016 and 31 December 2015 for the key assumptions based on which an actuarial valuation was performed. The key assumptions are: the discount rate, the salary growth rate, the employee mobility factor

Sensitivity analysis	As at 31/12/2016 (audited)	Discount rate		Salary growth rate		Employee mobility factor	
		+0,30 pp.	-0,30 pp.	+0,25 pp.	-0,25 pp.	+0,25 pp.	-0,25 pp.
Jubilee bonuses	268 875	(4 257)	4 394	4 511	(3 249)	(3 435)	3 457
Retirement compensation	153 230	(2 990)	3 097	3 113	(2 381)	(2 532)	2 499
Death benefits	6 836	(139)	145	74	(57)	(56)	57
Company Social Benefits Fund	128 614	(2 009)	5 348	4 695	(4 462)	(735)	727
Transport benefits	33 286	(1 290)	1 377	1 236	(1 094)	(256)	263
Total	**590 841**	**(10 685)**	**14 361**	**13 629**	**(11 243)**	**(7 014)**	**7 003**

Sensitivity analysis	As at 31/12/2015 (audited)	Discount rate		Salary growth rate		Employee mobility factor	
		+0,30 pp.	-0,30 pp.	+0,25 pp.	-0,25 pp.	+0,25 pp.	-0,25 pp.
Jubilee bonuses	318 239	(5 464)	5 653	5 911	(3 512)	(1 824)	4 643
Retirement compensation	154 828	(4 287)	3 651	3 575	(3 662)	(2 771)	2 954
Death benefits	31 660	(656)	684	654	(497)	(523)	540
Company Social Benefits Fund	124 118	(4 945)	5 292	4 673	(4 434)	(526)	690
Transport benefits	33 654	(1 294)	1 382	1 234	(1 172)	(139)	278
Total	**662 499**	**(16 646)**	**16 662**	**16 047**	**(13 277)**	**(5 783)**	**9 105**

Analysis of maturity dates for paid employee benefits:

As at 31/12/2016 (audited)	Jubilee bonuses	Retirement compensation	Death benefits	Company Social Benefits Fund	Transport benefits	Total
less than 1 year	39 026	18 969	738	5 185	1 352	65 270
1 to 5 years	111 523	44 085	2 580	21 131	5 053	184 372
more than 5 years	118 326	90 176	3 518	102 298	26 881	341 199
Total	**268 875**	**153 230**	**6 836**	**128 614**	**33 286**	**590 841**

As at 31/12/2015 (audited)	Jubilee bonuses	Retirement compensation	Death benefits	Company Social Benefits Fund	Transport benefits	Total
less than 1 year	36 145	13 185	2 875	5 276	1 397	58 878
1 to 5 years	120 654	32 448	10 447	20 594	5 234	189 377
more than 5 years	161 440	109 195	18 338	98 248	27 023	414 244
Total	**318 239**	**154 828**	**31 660**	**124 118**	**33 654**	**662 499**

The average maturity period for employee benefits for the Parent Company amounted to 8,9 years as at 31 December 2016 and 10,3 years as at 31 December 2015. The Parent Company's share in the Group's provisions for employee benefits valued using actuarial methods amounts to more than 90%.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

31. Other provisions

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Provision for fines from antimonopoly office UOKiK	16 455	16 209
Reclamation provision	4 908	5 356
Provision for onerous contracts	8 159	9 737
Other	21 848	15 440
Total	**51 370**	**46 742**
Long-term provisions	26 420	28 886
Short-term provisions	24 950	17 856
Total	**51 370**	**46 742**

	Provision for fines from antimonopoly office UOKiK	Reclamation provision	Provision for onerous contracts	Other	Total
As at 1 January 2016 (audited)	**16 209**	**5 356**	**9 737**	**15 440**	**46 742**
Recognition	2 032	127	-	9 908	12 067
Reversal	(357)	-	-	(2 161)	(2 518)
Utilization	(1 429)	(772)	(1 926)	(1 455)	(5 582)
Foreign exchange differences on translation of financial statements of foreign entities	-	197	348	116	661
As at 31 December 2016 (audited)	**16 455**	**4 908**	**8 159**	**21 848**	**51 370**
As at 1 January 2015 (audited)	**8 416**	**-**	**-**	**24 214**	**32 630**
Acquisition of AWT	-	7 262	10 107	2 541	19 910
Recognition	12 192	62	-	2 858	15 112
Reversal	(4 399)	-	-	(9 525)	(13 924)
Utilization	-	(2 264)	(814)	(4 763)	(7 841)
Foreign exchange differences on translation of financial statements of foreign entities	-	296	444	115	855
As at 31 December 2015 (audited)	**16 209**	**5 356**	**9 737**	**15 440**	**46 742**

Provision for fines from antimonopoly office UOKiK

As at 31 December 2016 the provision represented the Parent Company's Management Board's estimate in connection with the likelihood of payment of two fines imposed on the Parent Company by the Office of Competition and Consumer Protection (UOKiK).

The first fine was imposed further to an earlier antimonopoly proceeding in the matter of the Parent Company's abuse of its dominant position on the domestic market of rail freight transport (proceeding concluded with Decision No. DOK-3/2009 of 7 July 2009). On 22 August 2014 the Parent Company was notified by the President of UOKiK that the proceeding is being continued. After the renewed proceeding, by virtue of Decision No. DOK-5/2015 of 31 December 2015, the President of UOKiK found that the Parent Company had abused its dominant position on the domestic market of rail freight transport, by preventing the creation of conditions necessary for the formation or development of competition, by way of implementing effective 1 May 2006 changes in Sales Terms, which allowed the Parent Company to sign special agreements with businesses considered to be its competitors. The President of UOKiK found that the above practice was discontinued effective 1 July 2007, and imposed on the Parent Company a fine in the amount of PLN 14.224 thousand. As at 31 December 2015, following the Management Board's assessment of the risk, a provision was recognized in the amount of PLN 12.192 thousand. On 4 February 2016 an appeal was filed against Decision NO. DOK-5/2015 with Competition and Consumer Protection Court.

31. Other provisions (continued)

In the period of 12 months ended 31 December 2016, following a reassessment of facts and circumstances, the Management Board decided to increase the previously recognized provision by the amount of PLN 2.032 thousand, thereby providing for the entire amount of the potential fine as at 31 December 2016.

The second fine, in the amount of PLN 16.576 thousand, was imposed on the Parent Company by virtue of Decision No. RWR 44/2012 issued by the President of UOKiK on 31 December 2012, finding that the Parent Company made it difficult for its business partner to compete with shipping companies belonging to the PKP CARGO Group. In 2013, following a recalculation of the risk, the Parent Company reduced the provision by the amount of PLN 9.946 thousand, finding that a provision of PLN 6.630 thousand is the best estimate of the amount that it will likely have to pay. On 23 November 2015, the District Court in Warsaw ruled on the Parent Company's appeal against Decision No. RWR 44/2012 of 31 December 2012. The court of first instance changed the appealed decision and significantly lowered the initial fine from PLN 16.576 thousand to PLN 2.231 thousand. As at 31 December 2015, following a reassessment of facts and circumstances, the Management Board decided to release the previously formed provisions in the amount of PLN 4.399 thousand. On 19 January 2016 the Parent Company filed an appeal against part of the ruling of 23 November 2015. No circumstances occurred in the financial year ended 31 December 2016 with an effect on the Parent Company's estimate.

On 20 April 2016 the Parent Company paid a fine of PLN 1.429 thousand imposed based on Decision No. DOK-4/2012 issued by the President of UOKiK on 26 July 2012, and changed in a ruling issued by the Appellate Court on 5 April 2015. As at 31 December 2015 the said fine had been covered by a provision in the amount of 1.786 thousand. The surplus of the provision over the actually paid fine, amounting to PLN 357 thousand, has been recognized in the Group's financial result under other operating revenue.

Future events may lead to changes in the Management Board's estimates in the subsequent reporting periods.

Reclamation provision

The provision was formed to cover the future expenses associated with the obligation to reclaim land. The estimate corresponds to the present value of the anticipated future expenses.

Provision for onerous contracts

The Group has recognized a provision for losses on a concluded property lease agreement, where the anticipated revenue will not cover the lease costs incurred by the Group.

Other provisions

This item consists primarily of provisions formed for disputed claims, litigation and contractual penalties . According to the Parent Company's Management Board, the amount of other provisions as at 31 December 2016 and as at 31 December 2015, constitutes the best estimate of the amount that will likely have to be paid. In the event of other fines being imposed, their amount would depend on future events the result of which is uncertain. In consequence, the amount of the provisions may change in the subsequent periods.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32. Financial instruments and financial risk management

32.1 Financial instruments

32.1.1 Categories and classes of financial instruments

Financial assets by category and class	Note	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Hedging financial instruments		**235**	**123**
Derivative instruments	16	235	123
Financial assets available for sale		**8 501**	**9 849**
Shares of unlisted companies	16	8 501	9 300
Units of investment funds	16	-	549
Loans and receivables		**1 372 724**	**918 443**
Trade receivables	19	616 000	636 134
Receivables from the sale of non-current assets	19	-	2 197
Loans granted	16	796	2 639
Bank deposits	16	-	1 282
Other	16	9	-
Cash and cash equivalents	20	755 919	276 191
Total		**1 381 460**	**928 415**

Financial liabilities by category and class	Note	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Financial liabilities measured at fair value through profit or loss		**118 704**	**155 208**
Held for sale			
Derivative instruments	27	-	10
Liabilities measured at fair value on initial recognition			
Liabilities relating to put option for non-controlling shares	27	118 704	155 198
Hedging financial instruments		**205 938**	**2 164**
Derivative instruments	27	1 227	2 164
Credits and loans	26	204 711	-
Financial liabilities measured at amortized cost		**1 690 314**	**1 211 686**
Credits and loans	26	1 266 697	714 169
Trade payables	29	377 215	383 789
Liabilities relating to purchase of non-current assets	29	46 402	113 728
Financial liabilities excluded from the scope of IAS 39	28	**200 490**	**258 916**
Total		**2 215 446**	**1 627 974**

Impairment losses on shares of unlisted companies and trade receivables are described in Notes 16 and 19, respectively, to these Consolidated Financial Statements.

(1) In the financial year ended 31 December 2016 the Parent Company applied cash flow hedge accounting. The objective of the hedging activities is to limit the effect of currency risk arising out of the EUR / PLN exchange rates on future cash flows. The hedged item consists of the highly probable future cash flows expressed in EUR. The following hedging instruments have been established:

- investment credits expressed in EUR starting from 1 January 2016. The Parent Company expects the realization of the hedged cash flows starting from February 2017. As at 31 December 2016 the nominal value of the hedging instrument is EUR 46.273 thousand, which is the equivalent of PLN 204.711 thousand.
- currency forward contracts starting from 1 June 2016. Realization of the hedged cash flows started in July 2016. As at 31 December 2016 the value of assets arising from the valuation of the hedging instrument amounted to PLN 235 thousand.

The item also includes a subsidiary's valuation of hedging instruments in the form of:

- interest rate swaps (IRS) to hedge cash flows relating to the future payment of lease payables at variable rates. As at 30 September 2016 the value of liabilities arising from valuation of the hedging instrument amounted to PLN 1.042 thousand,
- currency forwards on the EUR/PLN currency pair, to hedge future cash flows. As at 31 December 2016 the value of liabilities arising from valuation of the hedging instrument amounted to PLN 185 thousand.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.1.1 Categories and classes of financial instruments (continued)

The effect of hedge accounting valuation for the financial year ended 31 December 2016 on the statement of comprehensive income is presented in Note 32.1.7 to these Consolidated Financial Statements.

32.1.2 Fair value hierarchy

As at 31 December 2016 and 31 December 2015, financial instruments measured at fair value consisted of derivative financial instruments and investment fund units. The maturity dates of these instruments fall after the end of the reporting period. With regard to the valuation procedures, they qualify as level 2 and 3 of the fair value hierarchy.

Financial assets and liabilities stated at fair value	As at 31/12/2016 (audited)		As at 31/12/2015 (audited)		
	Level 2	Level 3	Level 1	Level 2	Level 3
Assets	**235**	**-**	**549**	**123**	**-**
Derivative instruments – forward contracts	235	-	-	123	-
Investment fund units	-	-	549	-	-
Liabilities	**1 227**	**118 704**	**-**	**2 174**	**155 198**
Derivative instruments – forward contracts and IRS	1 227	-		2 174	-
Derivative instruments - put option for non-controlling shares	-	118 704	-	-	155 198

32.1.3 Valuation of financial instruments measured at fair value

a) Liabilities relating to put option for non-controlling shares

The Parent Company concluded with Minezit S.E. (hereinafter "MSE"), a minority shareholder holding 20% of the shares of AWT, an Agreement relating to call and put options for a packet of non-controlling shares of AWT B.V. Based on the Agreement the Parent Company is both the buyer of call options and the issuer of put options, i.e. has the right to both buy the shares from MSE (exercising call option), as well as an obligation to buy the shares from MSE if MSE performs the put option.

The accounting methods used to recognize and value the liabilities relating to the put options are described in Note 5.26 to these Consolidated Financial Statements.

The fair value of the liability relating to the put option is based on discounted cash flows at an interest rate appropriate for such liabilities. The fair value of the put option depends on the results of the AWT Group and is determined as the product of EBITDA and the multiplier specified in the Agreement, adjusted by net debt. The main assumptions used in the valuation are:
- EBITDA and net debt,
- the EUR / PLN forward rate,
- the discount rate appropriate for such liabilities.

As at 31 December 2016, the model used in the valuation of liabilities relating to put option assumes that the put option will be exercised within 1 year. The EBITDA and net debt parameters of the entity that is the subject of the option contract used in the model were adopted based on financial data as at 31 December 2016. This results from the provisions of the Agreement, under which when the options are exercised the data relating to AWT's EBITDA and net debt will come from the last statutory consolidated financial statements of AWT preceding the option exercise date.

All changes to the amount of the liability after its initial recognition affect the financial result through the financial revenue and expenses item. The amount recognized on re-measurement of the liability after its initial recognition is presented in Note 10 to these Consolidated Financial Statements.

b) Currency forward contracts

The fair value of currency forward contracts is determined based on the discounted future cash flows from concluded transactions, calculated based on the difference between the forward and the transaction price. The forward price is calculated based on an NBP fixing rate and the interest rate curve implicated by fxswap transactions.

32.1.3 Valuation of financial instruments stated at fair value (continued)

c) Interest rate swaps (IRS)

The fair value of interest rate swaps is determined based on the discounted future cash flows from concluded transactions, calculated based on the difference between the swap and the transaction price. The fair value is calculated and discounted by the Bank based on WIBOR 1 M.

d) Other financial instruments

The fair values of investment fund units were based on their current market listings.

The Group does not disclose the fair values of financial instruments not measured at fair value as at the balance sheet date. This is because the fair values of these financial instruments as at 31 December 2016 and as at 31 December 2015 did not differ significantly from their values presented in the statement of financial position.

The Group does not disclose the fair value of shares not listed in active markets classified as financial assets available for sale. The Group is unable to reliably determine the fair value of its shares of companies not listed in active markets. As at the balance sheet date they are measured at acquisition cost less impairment losses.

32.1.4 Change in the valuation of financial instruments for Level 3 of the fair value hierarchy

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Opening balance	**(155 198)**	**(144 461)**
Gains/(losses) recognized in profit or loss	36 494	(10 737)
Closing balance	**(118 704)**	**(155 198)**

32.1.5 Quantity information on valuation at fair value using significant unobservable input data (Level 3)

Financial instrument	Fair value as at 31/12/2016	Valuation technique	Unobservable input data	Value
Liabilities relating to put option for non-controlling shares	118 704	DCF	Discount rate (1)	2,89 %
			Forward rate EUR / PLN (2)	4,5232
			EBITDA (3)	2.684 PLN thousand
			Net debt (3)	56.418 PLN thousand

(1) Determined based on the volatility of the SWAP curve and the credit risk margin.
(2) Determined based on SWAP point quotations for the EUR/PLN currency pair.
(3) Financial values calculated based on the financial statements of the entity covered by the option contract.

32.1.6 Sensitivity to changes in significant unobservable input data (Level 3)

Presented below is a sensitivity analysis of the liability relating to put option as at 31 December 2016 for significant unobservable input data used to perform the valuation.

	Discount rate		Forward rate EUR / PLN	
	+ 0,25 p.p.	- 0,25 p.p.	+ 9 p.p.	- 9 p.p.
Liabilities relating to put option for non-controlling shares	(574)	580	10 450	(10 450)

The Group did not perform a sensitivity analysis of the EBITDA and net debt parameters, because in the opinion of the Parent Company's Management, due to the adopted anticipated period of option performance of up to 1 year, the said parameters are not exposed to a significant risk of future changes. This arises out of the provisions of the Agreement, which state that when the options for non-controlling shares of AWT are performed, the parameters relating to AWT's EBITDA and net debt will come from the last statutory financial statements of AWT prior to the performance of the options.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.1.7 Revenue, costs, profits and losses contained in the statement of comprehensive income by category of financial instruments

As at 31/12/2016 (audited)	Hedging financial instruments	Financial assets available for sale	Loans and receivables	Financial liabilities measured at fair value through profit or loss	Financial liabilities measured at amortized cost	Financial liabilities excluded from the scope of IAS 39	Total
Dividends and shares in profits	-	434	-	-	-	-	434
Interest income / (expense)	(765)	-	2 902	-	(21 688)	(8 556)	(28 107)
Foreign exchange differences	(10)	-	(150)	-	2 158	(3 478)	(1 480)
Impairment/revaluation	94	-	(77 247)	36 494	-	-	(40 659)
Commissions on loans	-	-	-	-	(1 398)	-	(1 398)
Profit/(loss) on the sale of investments	-	85	-	-	-	-	85
Effect of cash flow hedge accounting[1]	(131)	-	-	-	-	-	(131)
Gross profit/(loss)	**(812)**	**519**	**(74 495)**	**36 494**	**(20 928)**	**(12 034)**	**(71 256)**
Change in valuation	(3 920)	-	-	-	-	-	(3 920)
Other comprehensive income	**(3 920)**	**-**	**-**	**-**	**-**	**-**	**(3 920)**

[1] In the 12-month period ended 31 December 2016 the effect of settling cash flow hedges was disclosed in the following statement of comprehensive income items:
– revenue from sale of services and finished goods in the amount of PLN 896 thousand ,
– financial expenses – interest on finance lease payables in the amount of PLN 1.027 PLN.

As at 31/12/2015 (audited)	Hedging financial instruments	Financial assets available for sale	Loans and receivables	Financial liabilities measured at fair value through profit or loss	Financial liabilities measured at amortized cost	Financial liabilities excluded from the scope of IAS 39	Total
Dividends and shares in profits	-	27	-	-	-	-	27
Interest income / (expense)	-	-	6 352	-	(19 571)	(9 634)	(22 853)
Foreign exchange differences	-	-	7 863	-	1 792	(6 344)	3 311
Impairment / revaluation	-	33	(1 788)	(10 114)	-	-	(11 869)
Commissions on loans	-	-	-	-	(1 052)	-	(1 052)
Profit/(loss) on the sale of investments	-	199	-	-	-	-	199
Gross profit / (loss)	**-**	**259**	**12 427**	**(10 114)**	**(18 831)**	**(15 978)**	**(32 237)**
Change in valuation	2 732	-	-	-	-	-	2 732
Other comprehensive income	**2 732**	**-**	**-**	**-**	**-**	**-**	**2 732**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.1.8 Offset of financial assets and liabilities

Financial assets as at 31/12/2016 (audited)	Gross value of recognized financial assets	Gross value of recognized financial liabilities offset in the balance sheet	Net value of financial assets presented in the balance sheet	Related amounts not offset in the balance sheet – cash hedges received	Net value
Currency forwards	930	(695)	235	-	235
Trade receivables	616 000	-	616 000	(20 289)	595 711
Total	**616 930**	**(695)**	**616 235**	**(20 289)**	**595 946**

Financial assets as at 31/12/2015 (audited)	Gross value of recognized financial assets	Gross value of recognized financial liabilities offset in the balance sheet	Net value of financial assets presented in the balance sheet	Related amounts not offset in the balance sheet – cash hedges received	Net value
Currency forwards	221	(98)	123	-	123
Trade receivables	636 134	-	636 134	(23 472)	612 662
Total	**636 355**	**(98)**	**636 257**	**(23 472)**	**612 785**

Financial liabilities as at 31/12/2016 (audited)	Gross value of recognized financial liabilities	Gross value of recognized financial assets offset in the balance sheet	Net value of financial liabilities presented in the balance sheet	Related amounts not offset in the balance sheet – transferred cash collateral	Net value
Currency forwards	357	(172)	185	-	185
Trade liabilities	377 215	-	377 215	(1 415)	375 800
Total	**377 572**	**(172)**	**377 400**	**(1 415)**	**375 985**

Financial liabilities as at 31/12/2015 (audited)	Gross value of recognized financial liabilities	Gross value of recognized financial assets offset in the balance sheet	Net value of financial liabilities presented in the balance sheet	Related amounts not offset in the balance sheet – transferred cash collateral	Net value
Currency forwards	281	(271)	10	-	10
Trade liabilities	383 789	-	383 789	(3 385)	380 404
Total	**384 070**	**(271)**	**383 799**	**(3 385)**	**380 414**

32.2 Objectives and methods of financial risk management

In the years covered by these Consolidated Financial Statements the Company was exposed to the following types of financial risk:
a) market risk, of which:
   - currency risk;
   - interest rate risk;
b) credit risk;
c) liquidity risk.

Detailed information on the management of market risk, credit risk and liquidity risk are presented in Notes 33.2.1, 33.2.2 and 33.2.3, to these Consolidated Financial Statements, respectively.

32.2.1 Market risk

The Group is exposed to market risks associated with foreign exchange rates and interest rates. The objective of the market risk management process is to limit the undesirable effects of changes in market risk factors on cash flows and results in the short and mid-term. The Group manages the market risk arising out of the above factors based on internal procedures, which define the methods used to measure the various exposures, parameters and time horizon. Market risk management is performed by especially appointed organizational units supervised by the Parent Company's Management Board. Market risk is managed using determined strategies, partially based on derivative instruments. Derivative instruments are used only to limit the risk of changes in carrying amounts and cash flows. Transactions are concluded only with reliable partners admitted to taking part in the transactions based on internal procedures and after they have signed relevant documents.

32.2.1.1 Currency risk management

As at 31 December 2016 the Group was exposed to currency risk relating primarily to trade receivables, bank loan liabilities, lease liabilities and liabilities relating to put option for non-controlling shares of AWT, expressed in foreign currencies.

Foreign exchange differences arise as a result of balance sheet date valuations of receivables and payables expressed in foreign currencies, and as a result of ongoing settlements in foreign currencies. Their value fluctuates in the course of the year due to changes in foreign exchange rates.

In the long-term, the currency risk is compensated by the risk of cash flow changes, which is why the Group's cash flows are subject to hedging activities.

A partial natural hedge occurs for the EUR/PLN rate since revenue denominated in EUR is partly offset by expenses denominated in the same currency. The objective of the currency risk management transactions used by the Group is to hedge the free net exposure to changes in the value of PLN. For this purpose in the years 2015 -2016 the Group used forward transactions on the EUR/PLN currency pair.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.1.1 Items in foreign currencies

As at 31/12/2016 (audited)

Financial statements item	Total value of item in PLN	EUR / PLN		CHF / PLN		CZK / PLN	
		in currency	in PLN	in currency	in PLN	in currency	in PLN
ASSETS							
Trade receivables	213 632	31 631	139 935	294	1 210	442 805	72 487
Other short-term financial assets	796	180	796	-	-	-	-
Cash and cash equivalents	107 807	18 949	83 831	15	60	146 096	23 916
Total	**322 235**	**50 760**	**224 562**	**309**	**1 270**	**588 901**	**96 403**
LIABILITIES							
Long-term liabilities							
Long-term credits and loans	297 238	56 190	248 583	-	-	297 220	48 655
Long-term finance lease liabilities and leases with purchase option	77 134	16 150	71 448	-	-	34 733	5 686
Short-term liabilities							
Short-term credits and loans	28 831	6 515	28 823	-	-	50	8
Short-term finance lease liabilities and leases with purchase option	39 038	8 405	37 184	-	-	11 325	1 854
Trade and other payables	153 541	12 092	53 493	813	3 348	590 713	96 700
Other short-term financial liabilities	118 704	27 000	118 704	-	-	-	-
Total	**714 486**	**126 352**	**558 235**	**813**	**3 348**	**934 041**	**152 903**
Net currency item	**(392 251)**	**(75 592)**	**(333 673)**	**(504)**	**(2 078)**	**(345 140)**	**(56 500)**

As at 31/12/2015 (audited)

Financial statements item	Total value of item in PLN	EUR / PLN		CHF / PLN		CZK / PLN	
		in currency	in PLN	in currency	in PLN	in currency	in PLN
ASSETS							
Trade receivables	241 342	28 732	122 443	223	878	748 387	118 021
Other short-term financial assets	1 892	150	640	-	-	7 941	1 252
Cash and cash equivalents	136 696	8 636	36 801	34	135	632 383	99 727
Total	**379 930**	**37 518**	**159 884**	**257**	**1 013**	**1 388 711**	**219 000**
LIABILITIES							
Long-term liabilities							
Long-term credits and loans	12 363	2 901	12 363	-	-	-	-
Long-term finance lease liabilities and leases with purchase option	113 950	24 542	104 587	-	-	59 374	9 363
Other long-term financial liabilities	155 198	36 419	155 198	-	-	-	-
Short-term liabilities							
Short-term credits and loans	122 491	5 675	24 185	-	-	623 375	98 306
Short-term finance lease liabilities and leases with purchase option	50 283	10 872	46 330	201	791	20 048	3 162
Trade and other payables	161 930	13 147	56 025	1 757	6 921	627 675	98 984
Total	**616 215**	**93 556**	**398 688**	**1 958**	**7 712**	**1 330 472**	**209 815**
Net currency item	**(236 285)**	**(56 038)**	**(238 804)**	**(1 701)**	**(6 699)**	**58 239**	**9 185**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.1.2 Sensitivity to currency risk

As part of its operating and financial activities the Group is exposed primarily to the risk of fluctuations in the exchange rates of EUR/PLN, CHF/PLN and CZK/PLN. The below tables show the Group's exposure to currency risk in the years 2016 and 2015. Exchange rate fluctuations have been calculated based on the average volatility of the various currencies. The same range of fluctuations as in the year 2015 was used for the purpose of performing the sensitivity to currency risk analysis due to a close similarity between the exchange rates in the years 2016 and 2015. The sensitivity of financial instruments to currency risk was calculated as the difference between the carrying amount of the financial instruments (excluding forward type derivatives and liabilities relating to put option for non-controlling shares for which the sensitivity analysis is presented in Note 32.1.6) and their potential value after the assumed changes in exchange rates. The below tables show the Group's exposure to currency risk as at 31 December 2016 and 31 December 2015.

As at 31/12/2016 (audited)

Financial statements item	Value of item in PLN	Currency risk EUR / PLN				Currency risk CHF / PLN		Currency risk CZK / PLN			
		effect on profit / loss		effect on other comprehensive income		effect on profit / loss		effect on profit / loss		effect on other comprehensive income	
		+9%	-9%	+9%	-9%	+18%	-18%	+10%	-10%	+10%	-10%
ASSETS											
Trade receivables	213 632	12 594	(12 594)	-	-	218	(218)	-	-	7 249	(7 249)
Other short-term financial assets	796	72	(72)	-	-	-	-	-	-	-	-
Cash and cash equivalents	107 807	7 545	(7 545)	-	-	11	(11)	-	-	2 392	(2 392)
LIABILITIES											
Long-term liabilities											
Long-term credits and loans	297 238	(22 373)	22 373	(17 531)	17 531	-	-	-	-	(4 865)	4 865
Long-term finance lease liabilities and leases with purchase option	77 134	(6 430)	6 430	-	-	-	-	-	-	(569)	569
Short-term liabilities											
Short-term bank credits and loans	28 831	(2 594)	2 594	(897)	897	-	-	-	-	(1)	1
Short-term finance lease liabilities and leases with purchase option	39 038	(3 347)	3 347	-	-	-	-	-	-	(185)	185
Trade and other payables	153 541	(4 814)	4 814	-	-	(603)	603	(158)	158	(9 512)	9 512
Total gross effect		**(19 347)**	**19 347**	**(18 428)**	**18 428**	**(374)**	**374**	**(158)**	**158**	**(5 491)**	**5 491**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.1.2 Sensitivity to currency risk (continued)

As at 31/12/2015 (audited)

Financial statements item	Value of item in PLN	Currency risk EUR / PLN effect on profit / loss		Currency risk EUR / PLN effect on other comprehensive income		Currency risk CHF / PLN effect on profit / loss		Currency risk CZK / PLN effect on profit / loss		Currency risk CZK / PLN effect on other comprehensive income	
		+9%	-9%	+9%	-9%	+18%	-18%	+10%	-10%	+10%	-10%
ASSETS											
Trade receivables	241 342	11 020	(11 020)	-	-	158	(158)	-	-	11 802	(11 802)
Other short-term financial assets	1 892	58	(58)	-	-	-	-	-	-	125	(125)
Cash and cash equivalents	136 696	3 312	(3 312)	-	-	24	(24)	-	-	9 973	(9 973)
LIABILITIES											
Long-term liabilities											
Long-term credits and loans	12 363	(1 113)	1 113	-	-	-	-	-	-	-	-
Long-term finance lease liabilities and leases with purchase option	113 950	(9 413)	9 413	-	-	-	-	-	-	(936)	936
Short-term liabilities											
Short-term bank credits and loans	122 491	(2 177)	2 177	-	-	(142)	142	-	-	(9 831)	9 831
Short-term finance lease liabilities and leases with purchase option	50 283	(4 170)	4 170	-	-	(1 244)	1 244	(109)	109	(316)	316
Trade and other payables	161 930	(5 042)	5 042	-	-	-	-	-	-	(9 790)	9 790
Total gross effect		**(7 525)**	**7 525**	**-**	**-**	**(1 204)**	**1 204**	**(109)**	**109**	**1 027**	**(1 027)**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.1.3 Currency forward transactions

In the years 2016 and 2015 currency risk was managed using forward transactions on the EUR / PLN pair. Detailed information on the Group's currency risk management is presented in Note 33.2.1.1 to these Consolidated Financial Statements.

The below tables present a list of currency forward contracts unrealized as at 31 December 2016 and 31 December 2015, respectively:

As at 31 December 2016 (audited):

Entity	Transaction type	Transaction date	Transaction settlement date	Currency pair	Amount in base currency	Amount in variable currency	Fair value
BZ WBK	forward	06.2016 – 12.2016	05.2017 – 10.2018	EUR / PLN	4 000	18 199	160
mBank	forward	02.2016 – 12.2016	01.2017 – 12.2018	EUR / PLN	17 900	80 026	(27)
Pekao	forward	04.2016 – 12.2016	01.2017 – 12.2018	EUR / PLN	12 100	54 569	(26)
PKO BP	forward	01.2016 – 11.2016	01.2017 – 11.2018	EUR / PLN	21 100	94 989	24
RCB	forward	10.2016 – 12.2016	09.2017 – 11.2018	EUR / PLN	1 500	6 723	(67)
Credit Agricole	forward	07.2016 – 09.2016	07.2017 – 08.2017	EUR / PLN	300	1 330	(14)
		Total			**56 900**	**255 836**	**50**

As at 31 December 2015 (audited):

Entity	Transaction type	Transaction date	Transaction settlement date	Currency pair	Amount in base currency	Amount in variable currency	Fair value
BZ WBK	forward	08.2015 - 10.2015	01.2016 - 06.2016	EUR / PLN	1 000	4 259	(18)
mBank	forward	08.2015 - 12.2015	02.2016 - 11.2016	EUR / PLN	8 060	34 322	35
Pekao	forward	06.2015 - 12.2015	01.2016 - 12.2016	EUR / PLN	9 610	40 981	72
PKO BP	forward	07.2015 - 12.2015	01.2016 - 12.2016	EUR / PLN	12 400	53 330	24
		Total			**31 070**	**132 892**	**113**

32.2.1.2 Interest rate risk management

As at 31 December 2016 the Group is exposed to the risk of changes in cash flows relating to interest rates on bank loans, lease agreements with variable interest rates. Interest on lease agreements was accrued using reference rates plus the lessor's margin. The reference rate for agreements expressed in EUR is EURIBOR 3M and 6M, whilst for agreements in PLN - WIBOR 1M and 3M. Interest on loan agreements is accrued based on the WIBOR 1M, 3M and 6M and EURIBOR 3M reference rates plus the banks' margin. Interest rate risk in loan and lease agreements is realized by revaluating lease installments on a monthly, quarterly or half-yearly basis, depending on the agreement.

In the years 2016 and 2015 the Group used interest rate risk management transactions, IRS, to hedge against interest rate fluctuations on some of its financial lease liabilities.

As at 31 December 2016 the Group's cash funds consisted primarily of bank deposits with fixed interest rates, concluded most often for a period from a few days to 1 month, depending on the Group's liquidity needs. In future periods, due to changes in interest on bank deposits, the cash item may be exposed to interest rate risk.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.2.1 Opened interest rate

The Group (at the subsidiary PKP CARGO CONNECT Sp. z o.o.) used hedge accounting to present the effects of hedging transactions in accordance with their economic substance. In the process of managing interest rate risk, the Group uses interest rate swaps (IRS).

These transactions hedge variable interest rates on lease liabilities. Following a hedge effectiveness test, the valuation of the below instruments (IRS) was charged to the Group's equity.

As at 31 December 2016 (audited)

Entity	Transaction type	Transaction date	Transaction expiration date	Nominal amount	The Group pays	The Group receives	Fair value
CITI Handlowy	IRS	2013-04-09	2018-05-01	74 776	3,33%	WIBOR 1M + margin	(1 042)

As at 31 December 2015 (audited)

Entity	Transaction type	Transaction date	Transaction expiration date	Nominal amount	The Group pays	The Group receives	Fair value
CITI Handlowy	IRS	2013-04-09	2018-05-01	74 776	3,33%	WIBOR 1M + margin	(2 164)

32.2.1.2.2 Financial instruments by type of interest rate

Financial assets	As at 31/12/2016 (audited)			As at 31/12/2015 (audited)	
	Interest rate			Interest rate	
	fixed rate	variable rate	Total	fixed rate	Total
Loans granted	663	133	796	2 639	2 639
Bank deposits	-	-	-	1 282	1 282
Cash and cash equivalents	755 919	-	755 919	276 191	276 191
Total financial liabilities	**756 582**	**133**	**756 715**	**280 112**	**280 112**

Financial liabilities	As at 31/12/2016 (audited)			As at 31/12/2015 (audited)		
	Interest rate			Interest rate		
	fixed rate	variable rate	Total	fixed rate	variable rate	Total
Derivative instruments - IRS	1 042	-	1 042	2 164	-	2 164
Credits and loans	73 837	1 397 571	1 471 408	6 902	707 267	714 169
Liabilities for the purchase of fixed assets	22 896	-	22 896	67 939	-	67 939
Finance lease liabilities and leases with purchase option	67 931	132 559	200 490	83 456	175 460	258 916
Total financial assets	**165 706**	**1 530 130**	**1 695 836**	**160 461**	**882 727**	**1 043 188**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.1.2.3 Sensitivity to interest rate fluctuations

The sensitivity analyses presented below are based on the degree of exposure of financial instruments to interest rate risk as at the balance sheet date. In the case of liabilities with variable interest rates, for the purpose of the analysis the amount outstanding as at the reporting date was assumed as outstanding for the entire year. The Group identifies exposure to interest rate fluctuations primarily for WIBOR, EURIBOR and PRIBOR. Deviations in interest rates have been calculated based on the observed average fluctuations of interest rates. The results of the analysis are presented on a gross basis (before tax).

As at 31/12/2016 (audited)

Financial statements item	Value of item in PLN	Interest rate risk					
		WIBOR		EURIBOR		PRIBOR	
		effect on profit/loss		effect on profit/loss		effect on profit/loss	
		+ 100 pb	- 100 pb	+ 70 pb	- 70 pb	+ 70 pb	- 70 pb
ASSETS							
Other short-term financial assets	133	1	(1)	-	-	-	-
LIABILITIES							
Long-term liabilities							
Long-term credits and loans	1 219 825	(9 764)	9 764	(1 364)	1 364	(341)	341
Long-term finance lease liabilities and leases with purchase option	91 326	(604)	604	(216)	216	-	-
Short-term liabilities							
Short-term credits and loans)	177 877	(1 679)	1 679	(69)	69	-	-
Short-term finance lease liabilities and leases with purchase option	41 422	(186)	186	(160)	160	-	-
Total gross effect		**(12 232)**	**12 232**	**(1 809)**	**1 809**	**(341)**	**341**

As at 31/12/2015 (audited)

Financial statements item	Value of item in PLN	Interest rate risk					
		WIBOR		EURIBOR		PRIBOR	
		effect on profit/loss		effect on profit/loss		effect on profit/loss	
		+ 100 pb	- 100 pb	+ 70 pb	- 70 pb	+ 70 pb	- 70 pb
ASSETS							
Other short-term financial assets	2 032	20	(20)	-	-	-	-
LIABILITIES							
Long-term liabilities							
Long-term credits and loans	459 390	(4 470)	4 470	(87)	87	-	-
Long-term finance lease liabilities and leases with purchase option	138 428	(768)	768	(432)	432	-	-
Short-term liabilities							
Short-term credits and loans	247 877	(1 309)	1 309	(135)	135	(684)	684
Short-term finance lease liabilities and leases with purchase option	55 109	(150)	150	(279)	279	-	-
Total gross effect		**(6 677)**	**6 677**	**(933)**	**933**	**(684)**	**684**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.2 Credit risk management

The below table shows items from the consolidated statement of financial position that are exposed to credit risk, broken down by class of financial instruments:

Classes of financial instruments	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Trade receivables	616 000	636 133
Cash and cash equivalents	755 919	276 191
Bank deposits	-	1 282
Other financial assets	796	2 639
Total	**1 372 715**	**916 245**

The Group makes sales to its business partners on deferred payment terms, which may lead to the risk of non-payment by the clients of the amounts due for the services. To minimize credit risk, the Group manages it by assessing the creditworthiness of its clients. Such assessments are performed with regard to all the clients with deferred payment terms. As part of its internal policies, the Group conditions the use of deferred payment terms on the client's acceptable financial standing and positive history of cooperation.

Concentration of risk relating to trade receivables is limited due to a large number of clients with trade credits spread throughout different sectors. Presented below are the Group's trade receivables by entity:

Trade receivables by entity	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Group of entities related to largest external vendor	7,7%	7,7%
Related parties from PKP Group	0,9%	2,1%
Other related entities of the State Treasury	25,5%	21,5%
Other entities	65,9%	68,7%
Total	**100,0%**	**100,0%**

In addition, in order to minimize the risk of trade receivables turning into bad debts, the Group insures its receivables and accepts collateral from its clients in the form of: bank/insurance guarantees, contract assignments, bank accounts locks and promissory notes. As at 31 December 2016, 12,6% of trade receivables were secured with such collaterals.

Credit risk related to cash and bank deposits is considered low. All of the entities with which the Group places its free funds operate in the financial sector. They include domestic and foreign banks, as well as branches of foreign banks.

32.2.3 Liquidity risk management

The Group may be exposed to liquidity risk arising from the ratio of current assets to short-term liabilities. To secure additional sources of funds necessary to secure its short-term financial liquidity, the Group had overdraft facilities. In addition, to secure long-term liquidity, the Group used investment loans and leases (to finance property, plant and equipment).

As at 31 December 2016 the Group had a total of PLN 1.118.321 thousand in unused credit lines.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

32.2.3 Liquidity risk management (continued)

The Company's financial liabilities as at the balance sheet date by maturity date based on undiscounted contractual payments (including future interest charges):

As at 31/12/2016 (audited)	Less than 3 months	3 to 12 months	1 to 5 years	More than 5 years	Total
Interest bearing credits and loans	57 504	165 757	848 494	519 745	1 591 500
Trade payables	375 596	359	1 260	-	377 215
Liabilities relating to purchase of property, plant and equipment	33 290	13 018	586	-	46 894
Finance lease liabilities	14 319	50 855	113 170	39 348	217 692
Derivative instruments	-	185	1 042	-	1 227
Liabilities relating to put option for non-controlling shares	-	118 704	-	-	118 704
Total	**480 709**	**348 878**	**964 552**	**559 093**	**2 353 232**

As at 31/12/2015 (audited)	Less than 3 months	3 to 12 months	1 to 5 years	More than 5 years	Total
Interest bearing credits and loans	32 959	233 658	459 499	19 893	746 009
Trade payables	395 948	4 124	3 343	217	403 632
Liabilities relating to purchase of property, plant and equipment	58 347	35 579	22 896	-	116 822
Finance lease liabilities	21 710	51 376	155 335	54 967	283 388
Derivative instruments	-	10	2 164	-	2 174
Liabilities relating to put option for non-controlling shares	-	-	155 198	-	155 198
Total	**508 964**	**324 747**	**798 435**	**75 077**	**1 707 223**

32.3 Equity management

In accordance with its policies and the terms of the loan agreements concluded by the companies from the Group, the Group allows its maximum level of debt to reach 60% of its balance sheet total (thus its equity cannot be lower than 40% of the balance sheet total). The Group checks the level of debt at the end of each quarter.

Ratio of net debt to the balance sheet total at the year-end:

	As at 31/12/2016 (audited)	As at 31/12/2015 (restated*)
Equity (1)	3 242 869	3 333 945
Borrowed capital (2)	3 247 928	2 768 512
Cash and cash equivalents	(755 919)	(276 191)
Net debt	2 492 009	2 492 321
Balance sheet total	6 490 797	6 102 457
Ratio of net debt to balance sheet total	**38 %**	**41%**

(*) restatement of comparatives described in Note 6 to these Consolidated Financial Statements

(1) The Group defines equity as total equity.
(2) Borrowed capital is defined as long- and short-term debt.

Equity management is performed at the level of the Group and is meant to ensure the Group's ability to continue as a going concern.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

33. Transactions with related parties

33.1 Transaction with the State Treasury

In the years 2016 and 2015, the State Treasury was the ultimate parent company of the PKP CARGO Group. In view of this, all of the companies belonging (directly or indirectly) to the State Treasury are the Group's related parties and are presented broken down into related entities from the PKP Group and other entities related to the State Treasury. In these Consolidated Financial Statements the Management Board of the Parent Company has disclosed transactions with significant related parties, identified as related parties to the best of the Management's knowledge.

No individual transactions concluded between the PKP CARGO Group and the State Treasury were identified in the financial year ended 31 December 2016 or the financial year ended 31 December 2015, which would be significant due to their unusual scope or amount.

33.1.1 Transactions with related parties from PKP Group

In the period covered by these Consolidated Financial Statements the Group concluded the following transactions with related parties from the PKP Group:

	2016 (audited)			
	Sales to related parties	Purchases from related parties	Receivables from related parties	Liabilities to related parties
Parent Company	398	71 921	1 247	7 811
Subsidiaries / co-subsidiaries - unconsolidated	13 579	17 707	1 389	1 559
Associates	2 442	506	161	4
Other related parties from PKP Group (1)	38 157	655 479	3 062	75 331

	2015 (audited)			
	Sales to related parties	Purchases from related parties	Receivables from related parties	Liabilities to related parties
Parent Company	817	79 188	1 233	4 980
Subsidiaries / co-subsidiaries - unconsolidated	9 654	17 091	3 619	2 959
Associates	8 130	1 483	2 566	54
Other related parties from PKP Group	43 990	1 060 490	6 445	98 794

(1) The value of purchases made from other parties from the PKP Group was lower in the financial year ended 31 December 2016 than in the same period of the previous year due primarily to the fact that on 25 September 2015 the parent company PKP S.A. sold 100% of its shares of PKP Energetyka S.A., and thus in the financial year ended 31 December 2016 transactions with PKP Energetyka S.A. were no longer treated as transactions with related parties from the PKP Group.

Purchase transactions with the parent company (PKP S.A.) consist primarily of leases and rentals of real estate, the supply of utilities and occupational medicine services.

Sales transactions concluded with other related parties from the PKP Group consisted of such services as track line services, rental of manned engines, financial settlements with foreign rail companies, rolling stock maintenance, sub-lease of real estate. Purchase transactions consisted mainly of access to rail infrastructure, track line electrical energy (until 25 September 2015), lease of real estate, supply of utilities, maintenance of rail traffic control equipment, network maintenance services, IT services, purchase of transport benefits for employees and retirees.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

33.1.2 Transactions with other related parties of the State Treasury

No individual transactions concluded between the Group and the State Treasury's related parties were identified in the financial year ended 31 December 2016 or the financial year ended 31 December 2015, which would be significant due to their unusual scope or amount. In the periods covered by these Consolidated Financial Statements the Group's most significant customers that are companies controlled by the State Treasury were Jastrzębska Spółka Węglowa S.A., Węglokoks S.A., PGE Górnictwo i Energetyka Konwencjonalna S.A. as well as ENEA Wytwarzanie Sp. z o.o. Whereas in the periods covered by these Consolidated Financial Statements no significant purchases were recorded from other related parties of the State Treasury.

All transactions with related parties were performed on arm's length basis.

33.2 Loans granted to/received from related parties

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Loans granted to related parties	796	639
Loans received from related parties	3 605	3 407

33.3 Remuneration of key management personnel

Remuneration of members of the Parent Company's Management Board:	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	3 192	3 964
Post-employment benefits	1 515	69
Severance benefits	459	315
Total	**5 166**	**4 348**

Remuneration of members of the Parent Company's Supervisory Board:	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	1 385	1 219
Total	**1 385**	**1 219**

Remuneration of the Parent Company's other key personnel (Representatives-Managing Directors):	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	779	1 999
Post-employment benefits	1 032	181
Severance benefits	109	204
Total	**1 920**	**2 384**

Remuneration of members of the Management Boards of subsidiary companies:	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	8 409	6 553
Post-employment benefits	1 994	611
Severance benefits	471	264
Total	**10 874**	**7 428**

Remuneration of members of the Supervisory Boards of subsidiary companies:	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	1 428	1 125
Total	**1 428**	**1 125**

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

33.3 Remuneration of key management personnel (continued)

Remuneration of other key personnel (Representatives-Managing Directors) of subsidiary companies:	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Short-term benefits	5 449	3 687
Post-employment benefits	-	337
Severance benefits	148	96
Total	**5 597**	**4 120**

No loan or guarantee transactions were concluded with the Group by members of the key management personnel of the Parent Company or of the subsidiaries of the PKP CARGO Group in the financial year ended 31 December 2016 or the financial year ended 31 December 2015.

34. Operating lease agreements

34.1 The Group as a lessee

34.1.1 Lease terms

As at 31 December 2016 the Group's operating lease agreements consist primarily of leases of land and the rental of buildings and office space. Key property lease agreements are long-term agreements with possibility of early termination at specified times. For lease agreements that provide for early termination at no additional cost, the Group presents as future lease payments the fees it is required to pay within the notice periods of those agreements.

34.1.2 Lease payments recognized as an expense in the period

	Year ended 31/12/2016 (audited)	Year ended 31/12/2015 (audited)
Minimum lease payments	148 807	130 129
Sublease fees received	(2 237)	(1 163)
Total	**146 570**	**128 966**

34.1.2.1 Future minimum lease payments on non-cancellable operating lease agreements

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Less than 1 year	58 249	61 827
1 to 5 years	56 805	47 886
More than 5 years	7 404	11 347
Total	**122 458**	**121 060**

35. Commitments to incur expenses for non-financial fixed assets

As at 31 December 2016 the Group has future contractual investment obligations associated primarily with an agreement for the supply and maintenance of multi-system engines. The primary order consists of the supply of 15 multi-system engines along with equipment and computer software, spare parts and full maintenance for 8 years. The agreement also calls for the performance of first periodic service repairs after 8 years of use, with the Parent Company being able to waive using the supplier's service in this area. Until 31 December 2016 the Group took delivery of 12 engines, with the other to be delivered by 30 June 2017.

As at 31 December 2016 the total value of the future liability relating to the primary order is EUR 27.715 thousand, which is the equivalent of PLN 122.613 thousand, of which EUR 12.451 thousand (PLN 55.084 thousand) pertains to the delivery of 3 engines and computer equipment, whilst the other unrealized portion of the agreement pertains to maintenance and periodic repairs of the engines after 8 years.

The agreement provides for widening the order by another 5 multi-system engines along with additional services. The value of the additional option of the agreement is 26.038 EUR thousand (PLN 115.194 thousand). The Parent Company has time to make a decision on utilizing this option until 31 December 2017.

As at 31 December 2016 the Group's other contractual investment obligations amounted to approximately PLN 11.194 thousand and consist primarily of rolling stock, technical equipment and the expansion of the cargo terminal in Paskow.

36. Contingent liabilities

	As at 31/12/2016 (audited)	As at 31/12/2015 (audited)
Guarantees issued by banks at the request of the Group (1)	142 251	106 781
Other contingent liabilities (2)	73 525	68 797
Total	**215 776**	**175 578**

(1) Guarantees issued at the request of the Group

As at 31 December 2016 and 31 December 2015 the Group recognizes as contingent liabilities the guarantees issued by banks and insurance companies at the request of the entities comprising the PKP CARGO Group. The item consists primarily of performance bonds, bid bonds and customs bonds.

(2) Other contingent liabilities

The item includes court claims filed against the Group, where the probability of the outflow of funds is low, or with regard to which it is not possible to reliably estimate the amount to be paid by the Group in the future. The amounts presented in this Note correspond to the full values of the claims filed by third parties. The estimates may change in the subsequent periods as a result of future events.

On 30 January 2015 the Parent Company was notified of an administrative proceeding started by the President of the Office of Rail Transport (UTK) in the matter of imposing a fine on the Parent Company for conducting operations without proper authorization, i.e. managing rail infrastructure without security authorization. As part of the proceeding the Parent Company exercised its right to express its views on the evidence and materials collected and on the demands submitted prior to the issue of a decision. The proceeding completion date has been extended until 31 March 2017. As at 31 December 2016 the amount of the potential contingent liability arising out of the proceeding and the likelihood of its payment are not known.

PKP CARGO GROUP CONSOLIDATED FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2016, PREPARED IN ACCORDANCE WITH IFRS EU (IN PLN '000)

37. Collateral for liabilities

37.1 Assets pledged as collateral for liabilities

As at 31 December 2016 and 31 December 2015 the Group had assets that had been pledged as collateral for its liabilities. The assets secure the proper performance of loan agreements. The amounts of the collateral are limited to the value of the loan liability as at the balance sheet date. Detailed information on liabilities secured on assets is presented in Note 26.3 to these Consolidated Financial Statements.

The balance sheet value of assets pledge as collateral for liabilities as at 31 December 2016 and 31 December 2015:

	As at 31/12/2016 (audited)	**As at 31/12/2015 (audited)**
Property, plant and equipment	301 460	295 044
Inventories	600	600
Trade receivables	56 773	44 773
Cash	197	4 322
Total	**359 030**	**344 739**

In addition, as at 31 December 2015 the Parent Company had in its fixed assets registered a property secured with a mortgage, but the credit liability that the said property had been used to secure was fully repaid as at 31 December 2015. Therefore, on 13 January 2016 the mortgage was deleted from the land and mortgage register.

37.2 Other collateral

As at 31 December 2016 the Group has the following blank promissory notes issued to secure the repayment of liabilities:

- Blank promissory notes up to the amount of PLN 39.512 thousand to secure the proper performance of financing agreements for the Parent Company's investment projects,
- Blank promissory note up to the maximum amount of PLN 60.000 thousand, to secure an agreement with a bank for a guarantee line, as part of which the Group may request the issue of bank guarantees for up to PLN 60.000 thousand. As at 31 December 2016, the amount of the guarantee line used by the Group amounted to PLN 18.130 thousand. The used amount of the line is recognized in Note 36 to these Consolidated Financial Statements under guarantees issued by banks at the Group request.

38. Subsequent events

No significant events took place after the balance sheet date with an effect on the Group operations, with the exception of the events described in Note 1.1 and Note 26.4 to these Consolidated Financial Statements date.

39. Approval of financial statements

These Consolidated Financial Statements were approved for publication by the Parent Company's Management Board on 16 March 2017.

The Parent Company's Management Board

Maciej Libiszewski	President of the Management Board
Grzegorz Fingas	Member of the Management Board
Jarosław Klasa	Member of the Management Board
Arkadiusz Olewnik	Member of the Management Board
Zenon Kozendra	Member of the Management Board

Warsaw, 16 March 2017

MENAGEMENT BOARD'S REPORT OF THE ACTIVITIES OF **PKP CARGO** CAPITAL GROUP IN 2016

PKP CARGO S.A.

with its registered office in Warsaw, ul. Grójecka 17, 02-021 Warsaw, registered in the District Court for the capital city of Warsaw, 12th Commercial Division under file number KRS 0000027702, with the share capital of PLN 2,239,345,850.00, paid up in full.

This document comprises the Report of the Management Board of PKP CARGO S.A. ("Company", "Parent Company") on the Activity of the PKP CARGO Group ("Group") in 2016. The document comprises also a report on the activity of the Parent Company.

MANAGEMENT BOARD REPORT ON THE ACTIVITY OF THE PKP CARGO GROUP FOR THE FINANCIAL YEAR 2016

TABLE OF CONTENTS

1. Financial highlights of PKP CARGO S.A. and the PKP CARGO Group ... 7
2. Investor Relations ... 10
3. Organization of the PKP CARGO Group ... 13
3.1. Highlights on the Company and the PKP CARGO Group ... 13
3.2. Entities subject to consolidation ... 13
3.3. Organizational structure of the Company and PKP CARGO Group ... 16
3.4. Description of changes in the Group's organization ... 19
3.5. Information on organizational or capital ties of PKP CARGO S.A. with other entities, taking into account the following groups of entities ... 20
4. Key areas of operation of the Company and PKP CARGO Group ... 21
4.1. Macroeconomic environment ... 21
4.2. Freight transportation activity ... 29
4.2.1. Rail transport market in Poland ... 29
4.2.2. Position of the PKP CARGO Group and the Parent Company in the rail transport market in Poland ... 30
4.2.3. Rail freight transport market in the Czech Republic ... 32
4.2.4. Position of the AWT Group in the rail transport market in the Czech Republic ... 33
4.2.5. The Company's and PKP CARGO Group's rail transport ... 35
4.3. Other services ... 42
4.4. Information on selling markets and sources of supply. ... 43
4.5. Headcount ... 44
4.6. The Company's and the PKP CARGO Group's investments ... 46
4.6.1. Capital expenditures ... 46
4.6.2. Assessment of the capacity to execute investment plans ... 47
5. Analysis of the PKP CARGO Group's financial standing and assets ... 48
5.1. PKP CARGO S.A.'s economic and financial highlights ... 48
5.1.1. PKP CARGO S.A.'s statement of comprehensive income ... 48
5.1.2. Description of the structure of assets and liabilities of PKP CARGO S.A. ... 54
5.1.3. Cash flow statement of PKP CARGO S.A. ... 60
5.1.4. Selected financial and operating ratios of PKP CARGO S.A. ... 61
5.2. Key economic and financial figures of PKP CARGO Group ... 63
5.2.1. Statement of comprehensive income of PKP CARGO Group ... 63
5.2.2. Description of the structure of assets and liabilities of the PKP CARGO Group ... 71
5.2.3. Statement of cash flows of the PKP CARGO Group ... 76
5.2.4. Selected financial and operating ratios of the PKP CARGO Group ... 77
5.3. Information about production assets ... 79
5.3.1. Rolling stock ... 79
5.3.2. Real estate ... 81
5.4. Key information about the financial standing of the Company and the PKP CARGO Group ... 81
5.4.1. Information on loans and borrowings agreements executed and terminated ... 81
5.4.2. Information about granted loans ... 81
5.4.3. Information about granted and received sureties and guarantees ... 82
5.4.4. Issues, redemptions and repayments of debt securities and equity securities ... 82
5.4.5. Assessment of management of financial resources ... 82
5.4.6. Description of the structure of key equity investments or key investments made within the Company and the PKP CARGO Group ... 83
5.4.7. Current and forecast financial standing of the Company and the PKP CARGO Group ... 83
5.5. Key risk factors and threats ... 83
5.5.1. Description of the key threats and risks ... 83
5.5.2. Information on financial instruments with respect to the risk and financial risk management objectives and methods adopted by the Company and the PKP CARGO Group ... 90
6. Key events and information about the activity of the Company and the PKP CARGO Group ... 91
6.1. Key information and events ... 91
6.2. Evaluation of factors and unusual events affecting the result recorded by the Company and the PKP CARGO Group ... 95

6.3. Information on contracts of significance for the Company and the PKP CARGO Group. 97
6.4. The Management Board's stance with respect to the possibility of realizing previously published result forecasts for the year 98
7. Company's and PKP CARGO Group's development policy 99
7.1. Description of external and internal factors of relevance for the development of the Company and the PKP CARGO Group 99
7.2. Description of the growth prospects and development policy of the Company and the PKP CARGO Group at least in the next financial year 101
8. Other key information and events 103
8.1. Information on PKP CARGO S.A. shares 103
8.1.1. Issue of securities and use of proceeds from the issue 103
8.1.2. Information about agreements which may in the future cause changes to the proportions of shares held by the current shareholders 103
8.1.3. Acquisition of treasury stock 103
8.1.4. Information on the employee share plan control system 103
8.1.5. Shares held by management board and supervisory board members 104
8.1.6. Dividends paid or declared 105
8.2. Information on transactions with related parties 105
8.3. Proceedings pending before courts, arbitration bodies or public administration authorities 105
8.4. Major achievements in research and development 105
8.5. Information on natural environment issues 106
8.6. Description of the Company's and the PKP CARGO Group's sponsoring, charitable or other similar activities 109
8.7. Information about existing Compensation Policy 110
8.7.1. General information about the compensation system accepted in the Parent Company 110
8.7.2. Terms and value of compensation and fringe benefits of Management Board and Supervisory Board members 110
8.7.3. Terms of non-financial components of compensation for other key managers 112
8.7.4. Indication of material changes introduced in the compensation policy in the last financial year or information on absence of such changes 112
8.7.5. Evaluation of the practical application of the compensation policy in the context of its goals, in particular the long-term increase of the company's value for shareholders and stability of its operations 113
8.7.6. Agreements entered into between PKP CARGO S.A. and managers which provide for compensation in specific cases114
8.8. Information about the financial statements 115
8.8.1. Information about the agreement entered into with an entity authorized to audit financial statements 115
8.8.2. Rules for preparing the annual financial statements 116
8.8.3. Description of unusual items in the standalone financial statements of PKP CARGO S.A. and the consolidated financial statements of the PKP CARGO Group. 116
8.8.4. Description of important off-balance sheet line items 117
9. Representation on the application of corporate governance 118
9.1. Indication of a set of corporate governance rules applicable to PKP CARGO S.A. and of the place where the wording of such rules is publicly available 118
9.2. Extent to which PKP CARGO S.A. failed to observe the provisions of the set of corporate governance rules, indication of such provisions and explanation of the reasons for the failure 118
9.3. Description of the primary attributes of the internal control and risk management systems used in PKP CARGO S.A. in respect of the process of preparing standalone and consolidated financial statements 121
9.4. Shareholders holding directly or indirectly significant blocks of shares 122
9.5. Holders of securities giving special controlling rights and a description of such rights 123
9.6. Restrictions concerning voting rights 123
9.7. Restrictions on the transfer of ownership title to PKP CARGO S.A. securities 124
9.8. Rules for appointment and dismissal of managers and their rights 126
9.9. Rules for amending the Articles of Association of PKP CARGO S.A. 126
9.10. Manner of operation and key powers of the Shareholder Meeting, description of shareholders' rights and the manner of their exercise 127
9.11. Personnel composition and changes to it during the most recent financial year, description of the activity of PKP CARGO S.A.'s managing, supervising or administering authorities and their committees 127
10. Other information of relevance for evaluation of the employment situation, financial standing, financial performance, assets and their movements as well as information of relevance for assessment of the ability of the issuer and other Group companies to pay their debts. 138

LIST OF TABLES

Table 1 Financial highlights of PKP CARGO S.A. 7
Table 2 Reconciliation of the differences between the reported and adjusted result on operating activities of PKP CARGO S.A. ..7
Table 3 Financial highlights of the PKP CARGO Group 8
Table 4 Reconciliation of the differences between the reported and adjusted result on operating activities 9
Table 5 Major events and activities in the area of investor relations in 2016 12
Table 6 Companies in which PKP CARGO S.A. owned shares directly as at 31 December 2016 20
Table 7 PKP CARGO Group's freight turnover in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 37
Table 8 PKP CARGO S.A. freight turnover in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 37
Table 9 PKP CARGO Group's freight volume in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 39
Table 10 PKP CARGO S.A.'s freight volume in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 39
Table 11 PKP CARGO Group's average distance in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 40
Table 12 PKP CARGO S.A.'s average distance in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016 41
Table 13 Headcount in 12M and Q4 2016 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees) 44
Table 14 Headcount in 12M and Q4 2015 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees) 44
Table 15 Headcount in 12M and Q4 2014 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees) 44
Table 16 Average headcount in 12M of 2014-2016 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees) 44
Table 17 Movement in the headcount structure in 12M and Q4 2016 in the PKP CARGO Group and PKP CARGO S.A. (active employees only) 45
Table 18 Movement in the headcount structure in 12M and Q4 2015 in the PKP CARGO Group and PKP CARGO S.A. (active employees only) 45
Table 19 Movement in the headcount structure in 12M and Q4 2014 in the PKP CARGO Group and PKP CARGO S.A. (active employees only) 45
Table 20 Capital expenditures in PKP CARGO S.A. in 2014 – 2016 (000s PLN) 46
Table 21 Capital expenditures in the PKP CARGO Group in 2014 – 2016 (thousands PLN) 47
Table 22 PKP CARGO S.A.'s result in 2014-2016 (thousands of PLN) 48
Table 23 PKP CARGO S.A.'s adjusted results in 2014 – 2016 (thousands of PLN) 49
Table 24 PKP CARGO S.A.'s operating revenue in 2014-2016 (thousands of PLN) 50
Table 25 PKP CARGO S.A.'s operating expenses in 2014 – 2016 (thousands of PLN) 51
Table 26 Adjusted operating expenses of PKP CARGO S.A. in 2014 – 2016 (thousands of PLN) 51
Table 27 Financial activities of PKP CARGO S.A. in 2014-2016 (thousands of PLN) 53
Table 28 Horizontal and vertical analysis of assets of PKP CARGO S.A. (thousands of PLN) 54
Table 29 Days inventory as at the end of 2014-2016 57
Table 30 Horizontal and vertical analysis of liabilities and equity of PKP CARGO S.A. (thousands of PLN) 58
Table 31 Main line items of the cash flow statement of PKP CARGO S.A. in 2014-2016 60
Table 32 Selected financial and operating ratios of PKP CARGO S.A. in the period of 2014-2016 61
Table 33 Adjusted selected financial and operating ratios of PKP CARGO S.A. in the period of 2014-2016 62
Table 34 Results of the PKP CARGO Group in 2014-2016 (thousands of PLN) 64
Table 35 Adjusted results of the PKP CARGO Group in 2014-2016 (thousands of PLN) 65
Table 36 Operating revenues of the PKP CARGO Group in 2014-2016 (thousands of PLN) 66
Table 37 Adjusted operating revenues of the PKP CARGO Group in 2014-2016 (thousands of PLN) 67
Table 38 Operating expenses of the PKP CARGO Group in 2014-2016 (thousands of PLN) 68
Table 39 Adjusted operating expenses of the PKP CARGO Group in 2014-2016 (thousands of PLN) 68
Table 40 Financial activities of the PKP CARGO Group in 2014-2016 (thousands of PLN) 70
Table 41 Horizontal and vertical analysis of PKP CARGO Group's assets (thousands of PLN) 71
Table 42 Horizontal and vertical analysis of PKP CARGO Group's equity and liabilities (thousands of PLN) 74
Table 43 Main line items in the PKP CARGO Group's statement of cash flows in the years 2014-2016 76
Table 44 Selected financial and operating ratios of the PKP CARGO Group in the period of 2014-2016 77
Table 45 Adjusted selected financial and operating ratios of the PKP CARGO Group in the period of 2014-2016 78
Table 46 Structure of the locomotives used by the PKP CARGO Group and PKP CARGO S.A., by traction type and ownership 80
Table 47 Structure of the wagons used by the PKP CARGO Group and PKP CARGO S.A., by ownership 80
Table 48 Real estate owned and used by the PKP CARGO Group and PKP CARGO S.A. as at 31 December 2016 compared to 31 December 2015 and 31 December 2014. 81
Table 49 Key information and events which occurred in 2016 and after the balance sheet date 91
Table 50 PKP CARGO S.A. shares held by Management Board members 104

Table 51 PKP CARGO S.A. shares held by Supervisory Board members 104
Table 52 Expenditures on salaries and fringe benefits for PKP CARGO S.A. Management Board members in 2016 (PLN) 111
Table 53 Expenses on compensation and fringe benefits of members of the PKP CARGO S.A. Supervisory Board in 2016 (PLN) 112
Table 54 Total fees of entities authorized to audit financial statements (PLN, net of VAT) 116
Table 55 Shareholder structure of PKP CARGO S.A. as at 1 January 2016 122
Table 56 Shareholder structure of PKP CARGO S.A. as at 31 December 2016 and as at the delivery date of this report.........123
Table 57 Structure of PKP CARGO S.A.'s share capital 123
Table 58 Composition of the PKP CARGO S.A. Management Board from 1 January 2016 to the delivery date of this report...128
Table 59 Composition of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report.....133
Table 60 Composition of the Audit Committee of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report....................136
Table 61 Composition of the Nomination Committee of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report 137
Table 62 Composition of the Strategic Committee of the PKP CARGO S.A. Supervisory Board from establishment (on 23 June 2016) to the delivery date of this report 137

LIST OF FIGURES

Figure 1 Stock exchange quotes for PKP CARGO S.A. in 2016 10
Figure 2 Structure of equity links of PKP CARGO S.A. as at 31 December 2016 18
Figure 3 Structure of the AWT Group as at 31 December 2016 19
Figure 4 GDP growth in Poland in 2011-2018 21
Figure 5 Real GDP growth in the Czech Republic in 2012-2018 22
Figure 6 Coal prices on ARA vs. RB markets* 25
Figure 7 Extraction of hard coal in Poland in 2014-2016 (thousand tons) 26
Figure 8 Extraction of hard coal in the Czech Republic in 2014-2016 (thousand tons) 28
Figure 9 Rail freight volumes in Poland in individual quarters of 2013-2016 (in million tons) 30
Figure 10 Rail freight turnover in Poland in individual quarters of 2013-2016 (in billions tkm) 30
Figure 11 Share of the PKP CARGO Group in freight volume in 2014-2016 in Poland 31
Figure 12 Share of the PKP CARGO Group in freight turnover in 2014-2016 in Poland 31
Figure 13 Market shares of the biggest rail operators in Poland in 2016, by freight volume and freight turnover 31
Figure 14 Rail freight volumes in Czech Republic in individual quarters of 2013-2016 (in million tons) 32
Figure 15 Rail freight turnover in Czech Republic in individual quarters of 2013-2016 (in billions tkm) 33
Figure 16 Share of AWT a.s. in freight volume in the Czech Republic in 2014-2016 33
Figure 17 Share of AWT a.s. in freight turnover in the Czech Republic in 2014-2016 34
Figure 18 Market shares of the biggest rail operators by operational freight turnover in the Czech Republic in 2016 (btkm) 34
Figure 19 Structure of the PKP CARGO Group's freight turnover by cargo category in 2015 and 2016 38
Figure 20 Structure of PKP CARGO S.A.'s freight turnover by cargo category in 2015 and 2016 38
Figure 21 Structure of the PKP CARGO Group's freight volume by cargo category in 2015 and 2016 39
Figure 22 Structure of PKP CARGO S.A.'s freight volume by cargo category in 2015 and 2016 40
Figure 23 Adjusted EBITDA margin compared to the Company's adjusted operating revenues and expenses in 2014-2016 *,** 49
Figure 24 Structure of non-current assets of PKP CARGO S.A. in 2015 and 2016 55
Figure 25 Structure of current assets of PKP CARGO S.A. in 2015 and 2016. 56
Figure 26 Structure of equity and liabilities of PKP CARGO S.A. in 2015 and 2016 59
Figure 27 Adjusted EBITDA margin compared to the Group's adjusted operating revenues and expenses in 2014-2016* 66
Figure 28 Structure of non-current assets of PKP CARGO Group in 2015 and 2016 72
Figure 29 Structure of current assets of PKP CARGO Group in 2015 and 2016 73
Figure 30 Structure of equity and liabilities of PKP CARGO Group in 2015 and 2016 75
Figure 31 Duties and responsibilities of the Parent Company's Management Board Members 130

1. Financial highlights of PKP CARGO S.A. and the PKP CARGO Group

Table 1 Financial highlights of PKP CARGO S.A.

PKP CARGO S.A.	PLN 000s[1]			EUR 000s		
	2016	2015	2014[2]	2016	2015	2014
Operating revenues	3,250,457	3,514,154	3,880,181	742,843	839,742	926,212
Profit (loss) on operating activities	-31,111	-115,180	92,813	-7,110	-27,523	22,155
Profit (loss) before tax	-70,690	-139,107	87,532	-16,155	-33,241	20,894
Net profit (loss) from continuing operations	-68,565	-114,125	75,607	-15,669	-27,271	18,048
Comprehensive income	-53,876	-73,827	48,936	-12,313	-17,642	11,681
*Adjusted profit (loss) on operating activities **	*-31,111*	*126,544*	*349,929*	*-7,110*	*30,239*	*83,529*
*Adjusted profit (loss) before tax **	*-70,690*	*102,617*	*344,648*	*-16,155*	*24,521*	*82,269*
*Adjusted net profit (loss) **	*-68,565*	*81,671*	*283,871*	*-15,669*	*19,516*	*67,761*
*Adjusted total comprehensive income attributable to the owners of the parent company **	*-53,876*	*121,969*	*257,200*	*-12,313*	*29,146*	*61,394*
Weighted average number of shares	44,786,917	44,786,917	44,524,924	44,786,917	44,786,917	44,524,924
Weighted average number of shares used to calculate diluted profit	44,786,917	44,786,917	44,790,878	44,786,917	44,786,917	44,790,878
Earnings / (losses) per share (PLN/EUR)	-1.53	-2.55	1.70	-0.35	-0.61	0.41
*Adjusted earnings / (losses) per share (PLN/EUR) **	*-1.53*	*1.82*	6.38	*-0.35*	*0.44*	*1.52*
Diluted earnings / (losses) per share (PLN/EUR)	-1.53	-2.55	1.69	-0.35	-0.61	0.40
Net cash flow from operating activities **	237,526	325,876	462,459	54,238	77,871	110,391
Net cash flow from investing activities	-440,642	-584,858	-208,082	-100,702	-139,758	-49,670
Net cash flow from financing activities	731,009	-38,341	-102,189	167,061	-9,162	-24,393
Movement in cash and cash equivalents	527,893	-297,323	152,188	120,642	-71,048	36,328
	31/12/2016	31/12/2015	31/12/2014	31/12/2016	31/12/2015	31/12/2014
Non-current assets	4,441,320	4,458,145	4,129,487	1,003,915	1,046,145	968,840
Current assets	1,106,405	559,110	1,207,089	250,091	131,200	283,201
Non-current assets classified as held for sale	6,000	44,061	17,560	1,356	10,339	4,120
Share capital	2,239,346	2,239,346	2,239,346	506,181	525,483	525,384
Equity	3,018,440	3,072,316	3,256,319	682,287	720,947	763,982
Non-current liabilities	1,697,385	1,150,212	1,034,276	383,676	269,908	242,657
Current liabilities	837,900	838,788	1,063,541	189,399	196,829	249,523

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

* the 2014 data were adjusted for presentation purposes for the costs following from the implemented 1st Voluntary Redundancy Program ("VRP") in the amount of PLN 257.1 million; additionally, the adjusted net result and adjusted comprehensive income take into consideration the deferred tax on the 1st VRP in the amount of PLN 48.9 million
the 2015 data were adjusted for presentation purposes for the costs following from the implemented 2nd VRP in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale, in the amount of PLN 177.9 million; additionally, the adjusted net result and adjusted comprehensive income take into consideration the deferred tax on the 2nd VRP in the amount of PLN 12.1 million and deferred tax on impairment losses on non-current assets and assets classified as held for sale in the amount of PLN 33.8 million
** including the payment of liabilities stemming from the implemented 1st and 2nd Voluntary Redundancy Programs in the amount of PLN 273.7 million in 2015, including the payment of liabilities stemming from the implemented 1st and 2nd Voluntary Redundancy Programs in the amount of PLN 47.4 million in 2016

Table 2 Reconciliation of the differences between the reported and adjusted result on operating activities of PKP CARGO S.A.

PKP CARGO S.A.	PLN 000s			EUR 000s		
	2016	2015	2014	2016	2015	2014
Profit (loss) on operating activities	**-31,111**	**-115,180**	**92,813**	**-7,110**	**-27,523**	**22,155**
Adjustments:						
Operating expenses						
VRP 1			257,116			61,374
VRP 2		63,862			15,260	
Impairment losses on assets		177,862			42,502	
Adjusted profit (loss) on operating activities	**-31,111**	**126,544**	**349,929**	**-7,110**	**30,239**	**83,529**

Source: Proprietary material

[1] In this Management Board Report on the Activity of the PKP CARGO Group for the financial year 2016, to facilitate the reading, some figures were rounded off which may cause slight deviations in the presented data. If there was a risk of distortion, data were presented with more accuracy.
[2] The 3-year period is presented due to availability of comparable financial data, their transparency as well as a relatively short history of the Company's listing on the regulated market of the Warsaw Stock Exchange.

Table 3 Financial highlights of the PKP CARGO Group

PKP CARGO Group	PLN 000s			EUR 000s		
	2016	2015 (restated*)	2014	2016	2015 (restated*)	2014
Operating revenues	4,411,269	4,554,133	4,274,335	1,008,129	1,088,256	1,020,298
Profit (loss) on operating activities	-132,071	55,911	120,927	-30,183	13,361	28,866
Profit (loss) before tax	-150,924	10,518	93,521	-34,491	2,513	22,324
Net profit (loss)	-133,772	30,081	78,282	-30,572	7,188	18,686
Total comprehensive income attributable to the owners of the parent company	-91,076	107,619	43,759	-20,814	25,717	10,445
*Adjusted profit (loss) on operating activities ** *	*-25,293*	*166,970*	*386,258*	*-5,780*	*39,899*	*92,201*
*Adjusted profit (loss) before tax ** *	*-44,146*	*121,577*	*358,852*	*-10,089*	*29,052*	*85,659*
*Adjusted net profit (loss) ** *	*-41,470*	*93,861*	*293,200*	*-9,477*	*22,429*	*69,988*
*Adjusted total comprehensive income attributable to the owners of the parent company ** *	*1,227*	*171,399*	*258,677*	*280*	*40,957*	*61,747*
Weighted average number of shares	44,786,917	44,786,917	44,524,924	44,786,917	44,786,917	44,524,924
Weighted average number of shares used to calculate diluted profit (loss) (units)	44,786,917	44,786,917	44,790,878	44,786,917	44,786,917	44,790,878
Earnings / (losses) per share (PLN/EUR)	-2.99	0.67	1.70	-0.68	0.16	0.41
Adjusted earnings / (losses) per share (PLN/EUR)	*-0.93*	*2.10*	*6.59*	*-0.21*	*0.50*	*1.57*
Diluted earnings / (losses) per share (PLN/EUR)	-2.99	0.67	1.70	-0.68	0.16	0.41
Net cash flow from operating activities ***	380,049	387,502	559,932	86,854	92,598	133,658
Net cash flow from investing activities	-568,567	-515,199	-238,743	-129,937	-123,112	-56,989
Net cash flow from financing activities	663,860	-29,447	-155,711	151,715	-7,037	-37,169
Movement in cash and cash equivalents	475,342	-157,144	165,478	108,632	-37,551	39,500
	31/12/2016	31/12/2015	31/12/2014	31/12/2016	31/12/2015	31/12/2014
Non-current assets	4,942,861	4,979,501	4,254,465	1,117,283	1,168,485	998,162
Current assets	1,547,936	1,078,895	1,401,188	349,895	253,173	328,740
Non-current assets classified as held for sale	-	44,061	17,560	-	10,339	4,120
Share capital	2,239,346	2,239,346	2,239,346	506,181	525,483	525,384
Equity attributable to the owners of the parent company	3,242,869	3,333,945	3,321,464	733,017	782,341	779,266
Equity attributable to non-controlling interests	-	-	55,238	-	-	12,960
Non-current liabilities	2,076,081	1,586,088	1,165,414	469,277	372,190	273,424
Current liabilities	1,171,847	1,182,424	1,131,097	264,884	277,467	265,372

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6[3] CFS for the financial year ended 31 December 2016
** the data for 2014 were adjusted for presentation purposes for the costs following from the implemented 1st Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 265.3 million; additionally, the adjusted net profit and adjusted comprehensive income attributable to the owners of the Parent Company include deferred tax on account of VRP 1 in the amount of PLN 50.4 million
the data for 2015 were adjusted for presentation purposes for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, and impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million; additionally, the adjusted net profit and adjusted comprehensive income attributable to the owners of the Parent Company includes deferred tax on account of VRP 2 in the amount of PLN 13.3 million, deferred tax on impairment of non-current assets and assets classified as held for sale in the amount of PLN 33.9 million, while profit on bargain acquisition of AWT does not include deferred tax
the data for 2016 are adjusted for presentation purposes for an impairment loss on assets in the amount of PLN 34.1 million (the adjustment takes into account a loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly, in H2 2016 in the amount of PLN 0.9 million), as described in Note 12.1 CFS, and impairment loss on receivables in the amount of PLN 72.7 million (described in Note 19); moreover, adjusted net profit and adjusted comprehensive income attributable to the owners of the Parent Company includes deferred tax resulting from an impairment loss resulting from an impairment test on AWT in the amount of PLN 6.5 million and the deferred tax on account of an impairment loss on receivables from OKD a.s. ("OKD") in the amount of PLN 8.0 million; the change in the impairment loss on assets and the impairment loss on receivables presented in CFS results from changes in the exchange rates applied for the conversion of the impairment losses into Polish zloty
*** including the payment of liabilities stemming from the implemented 1st and 2nd Voluntary Redundancy Programs in the amount of PLN 287.4 million in 2015, including the payment of liabilities stemming from the implemented 1st and 2nd Voluntary Redundancy Programs in the amount of PLN 48.2 million in 2016

[3] Any reference to a Note in these Statements should be construed as a Note to the Standalone Financial Statements of PKP CARGO S.A. ("SFS") for the financial year ended 31 December 2016 prepared according to EU IFRS, if the reference is made to standalone data. In the case of consolidated data, it should be construed as a Note to the Consolidated Financial Statements of the PKP CARGO Group ("CFS") for the financial year ended 31 December 2016 prepared according to EU IFRS

Table 4 Reconciliation of the differences between the reported and adjusted result on operating activities

PKP CARGO Group	PLN 000s			EUR 000s		
	2016	2015 (restated*)	2014	2016	2015 (restated*)	2014
Profit (loss) on operating activities	**-132,071**	**55,911**	**120,927**	**-30,183**	**13,361**	**28,866**
Adjustments:						
Operating revenues						
Bargain acquisition of AWT		-137,779			-32,924	
Operating expenses						
VRP 1			265,331			63,335
VRP 2		70,179			16,770	
Impairment loss on receivables from OKD	72,661			16,605		
Impairment losses on assets		178,659			42,692	
Impairment loss on AWT's assets	34,117			7,797		
Adjusted profit (loss) on operating activities	**-25,293**	**166,970**	**386,258**	**-5,780**	**39,899**	**92,201**

Source: Proprietary material

* restatement of comparative data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

The following average PLN to EUR exchange rates set by the National Bank of Poland ("NBP") have been used to translate selected financial data in the periods covered by CFS and SFS:

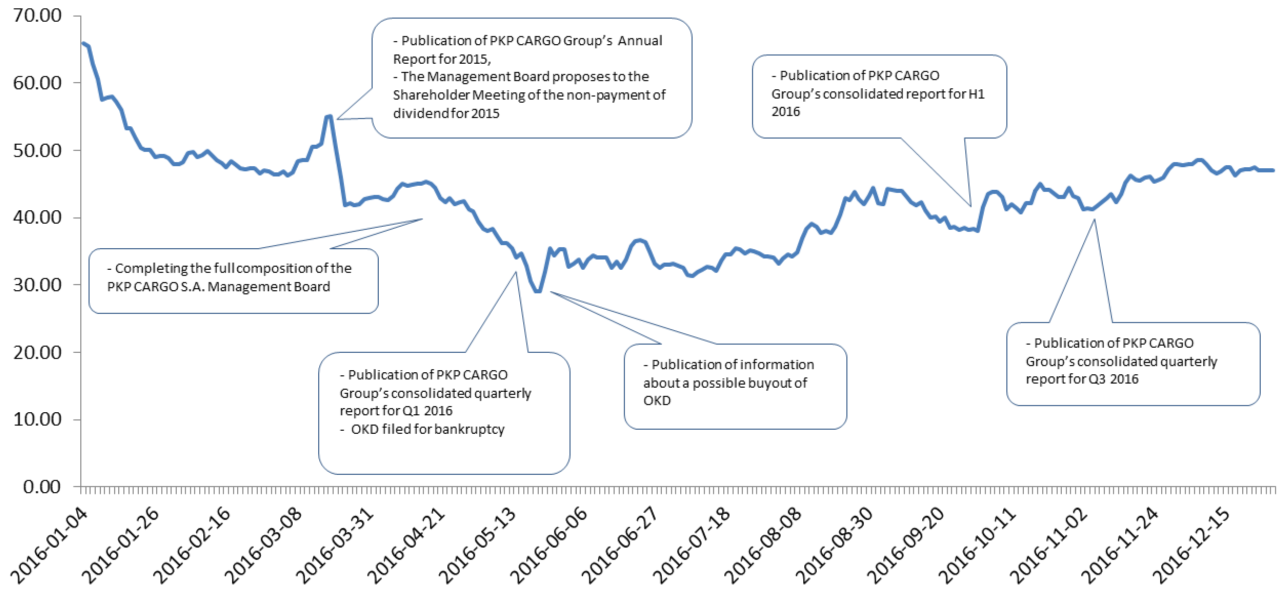
- exchange rate prevailing on the last day of the reporting period: 31 December 2016 – 4.4240 PLN/EUR, 31 December 2015 – 4.2615, PLN/EUR, 31 December 2014 – 4.2623 PLN/EUR.
- the average exchange rate in the period calculated as the arithmetic mean of the FX rates prevailing on the last day of each month in a given period: 1 January – 31 December 2016 – 4.3757 PLN/EUR, 1 January – 31 December 2015 – 4.1848 PLN/EUR, 1 January – 31 December 2014 – 4.1893 PLN/EUR.

2. Investor Relations

To the Company's best knowledge, 13 recommendations were issued in 2016 for PKP CARGO S.A. stock. The target price of the Company's shares, according to valuations in 2016, oscillated between PLN 39.0 and PLN 78.1.

The following chart presents the stock exchange quotes for PKP CARGO S.A. in 2016.

Figure 1 Stock exchange quotes for PKP CARGO S.A. in 2016



Source: Proprietary material

A key element of the effective operation of PKP CARGO S.A. as a stock exchange-listed company is the maintenance of professional communication with capital market stakeholders. A matter of priority in the Company's communication conducted within framework of its investor relations endeavors is to present to investors a reliable picture of the Company's operations, including its financial standing, to ensure equal access to information for all market participants.

In 2016, PKP CARGO S.A., seeking to ensure the highest standards in the area of investor relations, conducted numerous events targeted at the investor community.

The primary objective of PKP CARGO S.A. is the correct and timely fulfillment of a listed company's disclosure duties. In this context, the Company identified a number of events in 2016 that require an immediate public announcement. As part of its stock exchange reporting activities, PKP CARGO S.A. published 57 current reports in 2016.

In 2016, PKP CARGO S.A. held four conferences for analysts and investors to discuss the Company's published interim results. During the conference, representatives of the PKP CARGO S.A. Management Board presented the Company's results and answered the participants' questions. In order to ensure the broadest possible outreach to the conference, PKP CARGO S.A. provided webcasts of the events through the Company's website. During the conference, PKP CARGO S.A. provided simultaneous translation into English of each event, both for the attending participants and for Internet viewers or persons participating via teleconference.

Within the framework of activities targeted at the Company's current and potential investors, in 2016 representatives of PKP CARGO S.A. participated in domestic and foreign conferences and roadshows organized by professional capital market institutions.

Due to the change of regulations, as of 3 July 2016, concerning the reporting duties of listed companies (the Market Abuse Regulation), the Company has adjusted its internal procedures applicable to reporting duties.

PKP CARGO S.A. runs a corporate website containing a comprehensive section for investors. The "Investor Relations" section, in order to ensure equal access to information for Polish and international investors and analysts is provided and continuously updated in two languages (Polish and English). In order to provide transparent and easy access, the section has been broken down into the following topics:

1. Financial data – a block containing the Company's fundamental data on its operating and financial performance as well as financial reports (quarterly, semi-annual and annual),
2. Presentations – containing presentations prepared for conferences devoted to end-of-period results and industry-specific events,
3. Current reports – a block containing all current reports published by the Company.
4. Shares – a block containing stock exchange data such as: an up-to-date share price chart, data on the current share price, shareholders and dividend payments as well as a calculator of the current value of shares. Moreover, this block features analysts' recommendations and information about employee shares.
5. General Meetings – containing information on General (Shareholder) Meetings convened by PKP CARGO S.A., including announcements on convening the General Meetings, draft resolutions and forms enabling the exercise of voting rights by proxy.
6. Corporate governance – a block containing bios of persons in charge of PKP CARGO S.A. (Management Board and Supervisory Board) and information on the Audit Committee, the Nomination Committee and the Strategy Committee. This block also contains the Company's constitutional documents such as the Articles of Association, the Management Board Bylaws, the Supervisory Board Bylaws and the issue prospectus. Also published under this heading are the principles of good practice which PKP CARGO S.A. applies to achieve maximum operational transparency and an appropriate, high quality of communication with investors.
7. Calendar – containing events of the highest significance from the investor's point of view.
8. Contact – a block containing contact data of PKP CARGO S.A.'s Investor Relations Department.

On a monthly basis, the Company distributes a PKP CARGO S.A. investor relations newsletter to a group of interested analysts and investors as well as its own Management Board Members, Supervisory Board Members and employees, containing useful data, including macroeconomic, transport and market-related data, information on the Company's performance and achievements as well as a summary of last month's most important events in the life of PKP CARGO S.A.

On 7-8 June 2016, PKP CARGO S.A. held the second edition of the "Investor Day" targeted at stock exchange analysts and institutional investors. The event was attended by several dozen participants representing various financial institutions. During the "Investor Day", the participants visited the PKP CARGO Group's key assets located in Małaszewicze, including the bulk cargo terminal and the container terminal in Małaszewicze and the terminal in Kowalewo.

The high level of PKP CARGO S.A.'s investor relations was confirmed by the received awards and recognitions, including in the Golden Issuer Website contest organized by the Association of Stock Exchange Issuers for the highest quality of on-line corporate communication on the Polish capital market.

As part of the Company's continuous efforts aimed at improving the quality of its investor services, in 2017 PKP CARGO S.A. intends to continue its activities and develop communication tools in the area of investor relations.

The table below presents a timeline demonstrating key investor relations events and activities which occurred in 2016.

Table 5 Major events and activities in the area of investor relations in 2016

No.	Date	Event
1	8 February 2016	Extraordinary Shareholder Meeting of PKP CARGO S.A.
2	18 March 2016	Publication of the consolidated annual financial statements of the PKP CARGO Group for 2015 Meeting of the Management Board with analysts and investors concerning the publication of financial results for 2015
3	10-12 May 2016	Participation in the 9th European Economic Congress, Katowice
4	11 May 2016	Ordinary Shareholder Meeting of PKP CARGO S.A.
5	16 May 2016	Publication of the consolidated quarterly financial statements of the PKP CARGO Group for Q1 2016 Meeting of the Management Board with analysts and investors concerning the publication of financial results for Q1 2016
6	17-18 May 2016	5th Congress of CFOs of Listed Companies held by the Polish Association of Listed Companies (SEG), Ossa
7	7-8 June 2016	PKP CARGO Investor Day, Małaszewicze
8	25-26 August 2016	Participation in the ABC Countries Forum, Dubrovnik
9	28 September 2016	Publication of the consolidated semi-annual financial statements of the PKP CARGO Group for H1 2016 Meeting of the Management Board with analysts and investors concerning the publication of financial results for H1 2016
10	19 October 2016	Participation in the conference held by the Ministry of Infrastructure and Construction on the corridors of the Trans-European Transport Networks, Warsaw
11	28 October 2016	Customer Forum 2016, Warsaw
12	11-13 October 2016	Erste Investor Conference, Stegersbach
13	16 November 2016	Publication of the consolidated quarterly financial statements of the PKP CARGO Group for Q3 2016 Meeting of the Management Board with analysts and investors concerning the publication of financial results for Q3 2016
14	17-18 November 2016	Participation in the 590 Congress, Rzeszów
15	23 November 2016	Participation in the 6th Railway Congress, Gdańsk
16	30 November – 1 December 2016	WOOD's Winter in Prague, Prague

Source: Proprietary material

3. Organization of the PKP CARGO Group

3.1. Highlights on the Company and the PKP CARGO Group

Both PKP CARGO S.A. and the PKP CARGO Group are the biggest in Poland and one of the biggest rail freight operators in the European Union ("EU"). The Group's development is focused on enhancing and extending its operations in terms of its product range and geographic area. At present, the Group is the leader on the Polish market (according to the Office of Rail Transport - UTK[4]) and it is the second largest operator on the Czech market (according to SZDC[5]). Notwithstanding the areas mentioned above, the Company and the Group conduct and constantly develop operations in the Czech Republic, Slovakia, Germany, Austria, Belgium, the Netherlands, Lithuania and Hungary.

The Group (Parent Company, AWT, CARGO SERVICE) offers domestic and international transport of cargo as well as comprehensive logistics services for rail freight. In addition, the following services are provided to support clients and supplement the offering:

- intermodal logistics;
- freight forwarding (domestic and international);
- terminal services;
- siding and traction services;
- maintenance and repair of rolling stock;
- reclamation activity.

3.2. Entities subject to consolidation

The Consolidated Financial Statements for the financial year ended on 31 December 2016 encompass PKP CARGO S.A. and 15 subsidiaries consolidated by the full method:

1. PKP CARGO SERVICE Sp. z o.o.
2. PKP CARGOTABOR Sp. z o.o.
3. PKP CARGOTABOR USŁUGI Sp. z o.o.
4. PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.
5. PKP CARGO Centrum Logistyczne Medyka-Żurawica Sp. z o.o.
6. CARGOSPED Terminal Braniewo Sp. z o.o.
7. CARGOTOR Sp. z o.o.
8. PKP CARGO CONNECT Sp. z o.o.
9. Advanced World Transport B.V. ("AWT B.V.", "AWT")
10. Advanced World Transport a.s. ("AWT a.s.")
11. AWT ROSCO a.s.
12. AWT Čechofracht a.s.
13. AWT Rekultivace a.s.
14. AWT Coal Logistics s.r.o.
15. AWT Rail HU Zrt.

[4] Office of Rail Transport
[5] Správa železniční dopravní cesty (entity responsible for management of the state railway network in the Czech Republic)

In addition, the following companies are measured using the equity method as at 31 December 2016 in the PKP CARGO Group's Consolidated Financial Statements:

- COSCO Shipping Lines (POLAND) Sp. z o.o.
- Pol – Rail S.r.l.
- Terminale Przeładunkowe Sławków – Medyka Sp. z o.o.
- Trade Trans Karya Sp. z o.o.
- Transgaz S.A.
- Trade Trans Finance Sp. z o.o.
- PPHU "Ukpol" Sp. z o.o.
- Rentrans Cargo Sp. z o.o.
- Gdański Terminal Kontenerowy S.A.
- AWT Rail SK a.s.

A short description of the companies whose financial statements are subject to consolidation by the full method has been presented below.

PKP CARGO S.A.

The Parent Company was established by the power of article 14 of the Act of 8 September 2000 on Commercialization, Restructuring and Privatization of the state-owned enterprise "Polskie Koleje Państwowe". The Company was founded by a notary deed of 29 June 2001, and subsequently registered under the name of PKP CARGO Spółka Akcyjna in the District Court in Katowice, 8th Commercial Division of the National Court Register under file number KRS 0000027702. As a consequence of moving the Company's registered office, which as of 7 October 2002 has been specified as Warsaw, ul. Grójecka 17, the registration files are kept by the District Court for the capital city of Warsaw, 12th Commercial Division of the National Court Register. From its inception, the Company has functioned within the PKP Group. The Company's core business is domestic and international rail freight transportation.

PKP CARGO SERVICE Sp. z o.o.

PKP CARGO SERVICE Sp. z o.o. was established as Agencje Celne PKP CARGO Sp. z o.o. on 11 July 2002 by PKP CARGO S.A. It launched operations on 1 December 2002. The company's core business is to provide services concerning the comprehensive handling of sidings as well as transporting cargo by rail transport. In areas where the company concentrates its rail siding services activity, "execution areas" are created to handle rail sidings.

PKP CARGOTABOR Sp. z o.o.

On 1 July 2014, the operations of companies belonging to the PKP CARGO Group dedicated to the repair and maintenance of rolling stock were consolidated. At present, the competences in this area are concentrated in PKP CARGOTABOR Sp. z o.o. This company's core business entails services in the area of repair and maintenance of rolling stock and the physical decommissioning of wagons and locomotives. Moreover, the company renders comprehensive services concerning repairs of electrical machines and wheel sets as well as weighing and regulating rolling stock. The company focuses on repairing and maintaining rolling stock in the PKP CARGO Group.

PKP CARGOTABOR USŁUGI Sp. z o.o.

Until 22 October 2014, PKP CARGOTABOR USŁUGI Sp. z o.o. did business under the name of PKP CARGOLOK Sp. z o.o. The Company's line of business includes activity related to collecting, processing and neutralizing waste and recovery of raw materials. As at the delivery date of the report, the company does not conduct any operating activity.

PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.

PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o. was established on 22 February 2010. This company's line of business is to provide comprehensive cargo handling through transshipment, storage, segregation, packaging, crushing and a number of other border services. PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o. holds terminals that facilitate the transshipment of bulk and unit cargo, including containers.

PKP CARGO Centrum Logistyczne Medyka – Żurawica Sp. z o.o.

PKP CARGO Centrum Logistyczne Medyka - Żurawica Sp. z o.o. was established on 5 January 2011. It has been conducting business since 1 February 2011. The company's line of business is to provide comprehensive cargo handling through transshipment, storage, segregation, packaging, crushing and a number of other border services. The company has the ability to offer rail gauge switching services (change of carriages at an intersection point between normal, i.e. 1,435 mm, and wide, i.e. 1,520 mm gauge rail tracks), chiefly in the transport of hazardous materials and the transshipment of oversized consignments necessitating the usage of specialized transshipment equipment.

PKP CARGO CONNECT Sp. z o.o.

PKP CARGO CONNECT Sp. z o.o. was established on 8 March 1990 under the business name Przedsiębiorstwo Spedycyjne TRADE TRANS Sp. z o.o. (PS TRADE TRANS Sp. z o.o.). On 17 August 2015, the Extraordinary Shareholder Meeting of the company was held and adopted a resolution to change the company's business name, from PS TRADE TRANS Sp. z o.o. to PKP CARGO CONNECT Sp. z o.o. The change was registered on 30 October 2015.

On 29 September 2015, the Management Boards of PS TRADE TRANS Sp. z o.o. (as the Acquiring Company) and CARGOSPED Sp. z o.o. (as the Acquired Company) signed the "Merger Plan for Przedsiębiorstwo Spedycyjne TRADE TRANS Sp. z o.o. and CARGOSPED Sp. z o.o.". The merger of the companies was registered on 31 December 2015 following the procedure set forth in Article 492 § 1 item 1) of the Commercial Company Code, by transferring all the assets of CARGOSPED Sp. z o.o. to PS TRADE TRANS Sp. z o.o. in exchange for the shares that PKP CARGO CONNECT Sp. z o.o. issued to PKP CARGO S.A. as the sole shareholder of CARGOSPED Sp. z o.o.

The company's core business involves freight forwarding and logistics services in Poland and abroad. The company provides comprehensive logistics services using rail and vehicle, marine and inland water transportation by organizing transport, transshipment, storage, warehousing, packaging and distribution. The company also provides overall customs service to clients of the PKP CARGO Group.

Cargosped Terminal Braniewo Sp. z o. o.

Cargosped Terminal Braniewo Sp. z o.o. has been part of the PKP CARGO Group since January 2010, when it was acquired by CARGOSPED Sp. z o.o. The company's major areas of activity constitute transshipment of goods and buying and selling coal. The company is a direct importer of coal from Russia and it is active in wholesale and retail sales in this area.

CARGOTOR Sp. z o.o.

CARGOTOR Sp. z o.o. was registered on 13 November 2013 and PKP CARGO S.A. subscribed for a 100% equity stake. This company does business across Poland in the area of managing track and service infrastructure in the form of rail sidings and track systems along with the requisite plant and buildings. It also makes infrastructure available to rail operators on commercial terms.

Advanced World Transport B.V.

Parent Company in the AWT Group. The company's line of business is to discharge the function of the holding company. The company was established under Dutch law on 11 June 2007. PKP CARGO S.A. acquired an 80% stake in the company on 28 May 2015.

Advanced World Transport a.s.

ADVANCED WORLD TRANSPORT a.s. was established on 1 January 1994 doing business as OKD DOPRAVA, a.s. The company is the largest entity in the structure of the AWT Group. The company's line of business is to render comprehensive rail freight transport and siding handling services. At present, the company is the second largest rail operator in the Czech Republic. Rail freight transport services are also rendered by the company in Slovakia and Poland.

On top of providing transportation service on its own leveraging its own authorizations, the company continues to be active as a rail freight forwarder throughout Central and Eastern Europe.

In addition, the company manages an intermodal terminal located in the community of Paskov in the north of the Czech Republic and it offers comprehensive services to make deliveries and pick-ups by road transport ("last mile").

AWT Čechofracht a.s.

AWT ČECHOFRACHT a.s. was established on 1 January 1991. The company's primary line of business is to offer international freight forwarding services.

AWT Rekultivace a.s.

The company was established on 1 January 1994 with its registered offices in Hawierzów and is specialized in civil engineering construction activity. The company's core offering consists of managing and revitalizing post-industrial areas (including mining areas), demolition works, managing waste utilization facilities, eliminating underground mining pits, decontaminating soil, providing specialist technical resources, storage of coal, etc.

On account of the nature of this activity, the services rendered by the company frequently require transportation handling, which in the event of AWT a.s. handling the rail transport, makes it possible to generate added value and ensure comprehensive service for its clients.

AWT ROSCO a.s.

Since 1 May 2010, the company has been operating within the group under the business name of AWT VADS a.s. In July 2011, the company's name was changed to AWT ROSCO a.s. The company is dedicated to the AWT Group's wagon fleet management. Within the scope of its operations, the company's fundamental mission is to provide the rolling stock needed for the AWT Group's transportation companies to perform transportation services. The company's operations involve the rental of rail wagons and the cleaning of rail and automobile cisterns.

AWT Coal Logistics s.r.o.

The company was registered on 4 April 2013. The Company's main line of business is railway freight forwarding focused on catering to the transportation of hard coal from mines belonging to OKD a.s.

AWT Rail HU Zrt.

The company was registered on 31 December 2008. It offers rail transport services and rail siding handling in Hungary on the basis of its own rail operator's license. The company's development is an element of the Group's international expansion. At present, the company is participating in handling a large amount of international transportation taken care of in cooperation with other Group entities.

3.3. Organizational structure of the Company and PKP CARGO Group

PKP CARGO S.A.

PKP CARGO S.A.'s Management Board performs its tasks with the aid of reporting organizational units and their constituent organizational cells.

The following organizational units have been distinguished within the Company's organizational structure:

- The Company's Head Office, which is made up of departments, each of them managed by its director,
- Units performing the Company's tasks in specific areas of Poland.

Company's Head Office

The key tasks of the Company's Head Office include supporting the operation of the Company's Management Board in the area of strategic, operational and financial management and handling the Company's affairs vis-a-vis its main clients and business partners, administration and coordination of the freight procedure. Departments of the Company's Head Office are organizational cells reporting to the President of the Management Board or individual Management Board members.

Units

The key tasks of the Units is to manage the resources in the area of their operations, organize and perform cargo deliveries in accordance with executed agreements using the rail freight procedure, transshipment, storage, transport with the use of other carriers, traction service of freights performed by the Company, lease of traction vehicles, repair of own rolling stock and provision of repair services, maintenance of technical equipment and workshop facilities and performance of the Company's objectives in the area of marketing and sales services.

The Units of the Company are as follows:

1) PKP CARGO S.A. Central Unit of the Company,
2) PKP CARGO S.A. Lower Silesian Unit of the Company
3) PKP CARGO S.A. Southern Unit of the Company
4) PKP CARGO S.A. Northern Unit of the Company
5) PKP CARGO S.A. Silesian Unit of the Company
6) PKP CARGO S.A. Eastern Unit of the Company
7) PKP CARGO S.A. Western Unit of the Company

PKP CARGO Group

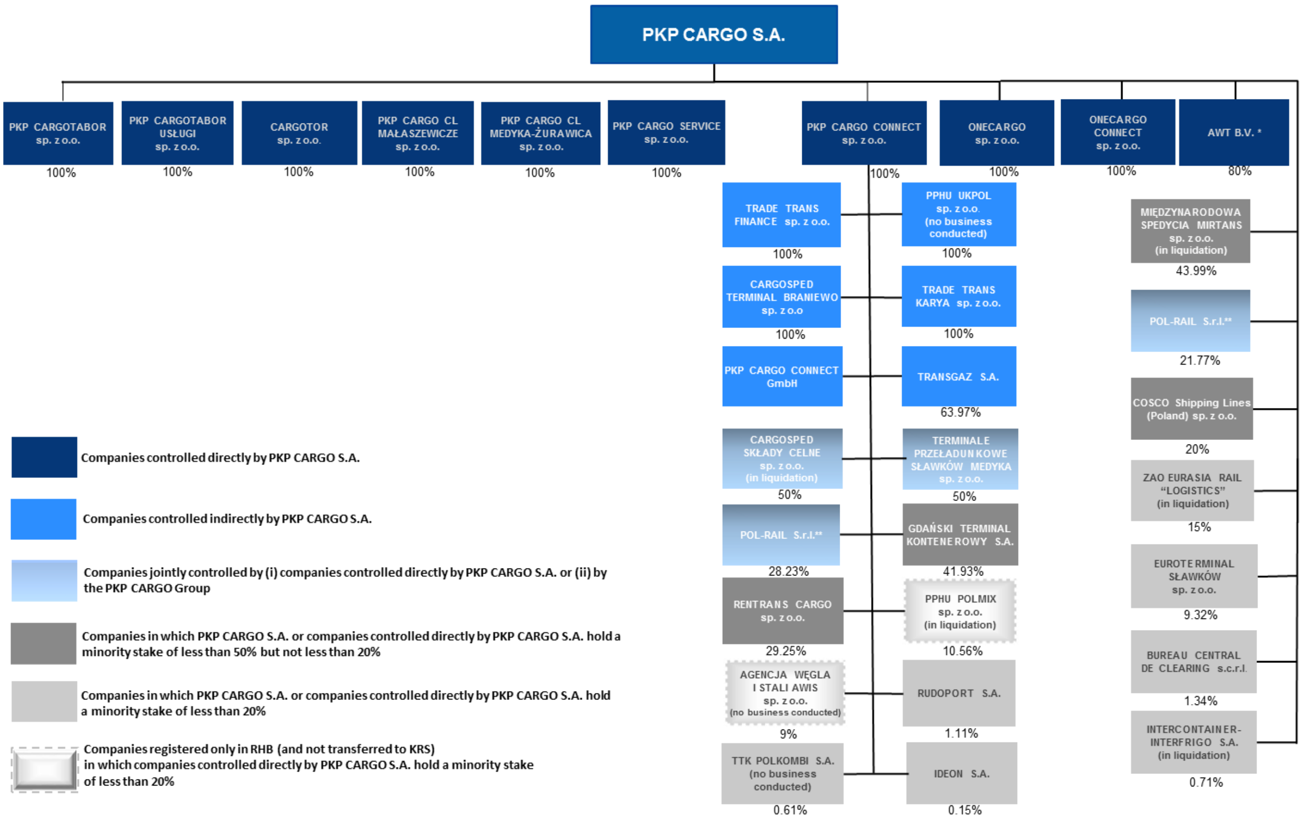
As at 31 December 2016, the PKP CARGO Group included, besides PKP CARGO S.A., 28 subsidiaries controlled directly or indirectly (by entities controlled by PKP CARGO S.A.), including:

- 10 subsidiaries controlled directly by PKP CARGO S.A.,
- 13 subsidiaries controlled directly by companies directly controlled by PKP CARGO S.A. (and indirectly controlled by PKP CARGO S.A.), including 6 companies directly controlled by PKP CARGO CONNECT Sp. z o.o. and 7 companies directly controlled by AWT B.V.,
- 5 AWT Group companies controlled directly by companies indirectly controlled by PKP CARGO S.A. (indirectly controlled by PKP CARGO S.A.);

In addition the Group had 6 associated entities and shares in 4 joint ventures.

The figure below presents the organizational links between PKP CARGO S.A. and other entities as at 31 December 2016:

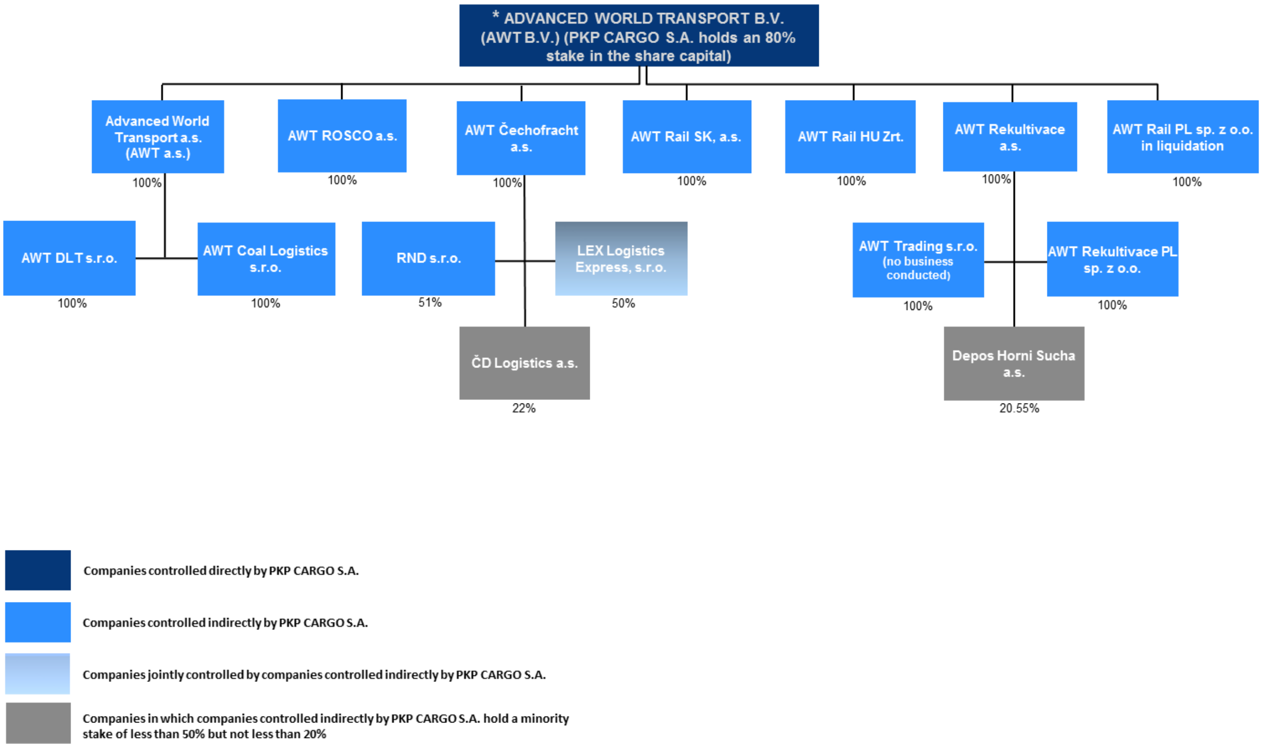
Figure 2 Structure of equity links of PKP CARGO S.A. as at 31 December 2016



Source: Proprietary material

** Figure 3 depicts the AWT Group's full structure and capital ties with companies in which the AWT Group's companies hold shares or interests (minority stakes);*
*** both PKP CARGO S.A. and one of the companies controlled directly by PKP CARGO S.A. - PKP CARGO CONNECT sp. z o.o. hold shares in POL-RAIL s.r.l. with its registered office in Rome in such a manner that in total these two entities belonging to the PKP CARGO Group hold a 50% equity stake in the share capital of POL-RAIL s.r.l.*

Figure 3 Structure of the AWT Group as at 31 December 2016



Source: Proprietary material

3.4. Description of changes in the Group's organization

The Parent Company had in place a management system based on hierarchic subordination of the individual levels of management in functional divisions ("division-based management") including structures of the Head Office and Company's units. On 8 June 2016, the Management Board of PKP CARGO S.A. approved new Organizational Bylaws and introduced them for application as of 1 August 2016. Under the new bylaws, the management model in the Company was changed by restoring the previous model with a more important role of Directors managing the Company's units exercising substantive oversight over the unit's cells. As a result of this change, the units (which become more autonomous) may implement the Company's policy on their own in the specified area.

On 7 August 2015, the Extraordinary Shareholder Meeting of AWT RAIL PL sp. z o.o. was held and adopted a resolution to dissolve and launch liquidation proceedings of AWT RAIL PL sp. z o.o. The change was registered in the court register on 15 March 2016. The launch of the liquidation was caused by lack of a business case for further existence of the company. However putting the company in liquidation has no material effect on the Group's operating activity. As at the delivery date of this report the liquidation proceeding is under way.

In June 2016, PKP CARGO CONNECT GmbH, a German freight forwarding company based in Hamburg, launched its operating activity. Its main goal is to provide freight forwarding services focused on intermodal, marine and road transport in Germany and Western Europe. Establishment of the company will help to make use of the potential offered by western European markets.

On 24 June 2016, PKP CARGO S.A. and its subsidiary PKP CARGOTABOR USŁUGI Sp. z o.o. decided to exercise their right to withdraw from the conditional binding purchase agreement for 40,796 shares representing approx. 99.85% of the share capital of Orlen KolTrans sp. z o.o. entered into with PKN Orlen S.A. and PKP CARGO S.A. exercised its right to withdraw from the conditional binding agreement to purchase an organized part of the enterprise of Euronaft Trzebinia sp. z o.o. Withdrawal from the purchase agreements does not provide for any financial consequences for PKP CARGO S.A. or PKP CARGOTABOR USŁUGI Sp. z o.o. arising from their termination.

On 23 November 2016, AWT a.s. acquired from AWT B.V. 100% shares in AWT Coal Logistics s.r.o.

On 6 December 2016, AWT Čechofracht a.s. sold its 66% shares in the share capital of Spedrapid Sp. z o.o. As a result of the transaction AWT Čechofracht a.s. ceased to be a shareholder in Spedrapid Sp. z o.o.

On 21 December 2016 G.I.B., s.r.o. v likvidaci (subsidiary of AWT Čechofracht a.s.) was deleted from the Czech business register due to completion of the liquidation process. As a result, AWT Čechofracht a.s. ceased to be a shareholder in G.I.B., s.r.o. v likvidaci.

3.5. Information on organizational or capital ties of PKP CARGO S.A. with other entities, taking into account the following groups of entities

The table below shows a list of all the shares owned directly by PKP CARGO S.A. as at 31 December 2016.

Table 6 Companies in which PKP CARGO S.A. owned shares directly as at 31 December 2016

Item	Company name	Place in the PKP CARGO Group	Registered office	Share capital amount	Value per share	Number of shares held	% of the share capital
SUBSIDIARIES in which PKP CARGO S.A. has over 50% shares and COMPANIES WITH PARTICIPATION OF PKP CARGO S.A.'S SUBSIDIARIES							
1.	PKP CARGO SERVICE Sp. z o.o.	daughter	Warsaw	PLN 30,827,000	PLN 500	61,654	100%
2.	PKP CARGOTABOR Sp. z o.o.	daughter	Warsaw	PLN 88,087,000	PLN 1,000	88,087	100%
3.	PKP CARGOTABOR USŁUGI Sp. z o.o.	daughter	Warsaw	PLN 18,138,000	PLN 1,000	18,138	100%
4.	PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.	daughter	Małaszewicze	PLN 54,016,000	PLN 1,000	54,016	100%
5.	PKP CARGO CENTRUM LOGISTYCZNE MEDYKA-ŻURAWICA Sp. z o.o.	daughter	Żurawica	PLN 13,086,000	PLN 1,000	13,086	100%
6.	CARGOTOR Sp. z o.o.	daughter	Warsaw	PLN 20,181,000	PLN 1,000	20,181	100%
7.	PKP CARGO CONNECT Sp. z o.o.	daughter	Warsaw	PLN 24,750,000	PLN 10,000	2,315	100%
8.	ONECARGO Sp. z o.o.	daughter	Warsaw	PLN 5,000	PLN 50	100	100%
9.	ONECARGO CONNECT Sp. z o.o.	daughter	Warsaw	PLN 5,000	PLN 50	100	100%
10.	ADVANCED WORLD TRANSPORT B.V.	daughter	Amsterdam (The Netherlands)	EUR 75,000	EUR 1	60,000	80%
ASSOCIATES in which PKP CARGO S.A. has no less than 20% and no more than 50% shares							
11.	Międzynarodowa Spedycja MIRTRANS Sp. z o.o. in liquidation	company with participation of PKP CARGO S.A.	Gdynia	PLN 1,114,000	PLN 2,000	245	43.99%
12.	POL-RAIL S.r.l.	company with participation of PKP CARGO S.A.	Rome (Italy)	EUR 2,000,000	shares of varied value	1 share worth EUR 435,443	21.77%
13.	COSCO SHIPPING LINES (POLAND) Sp. z o.o.	company with participation of PKP CARGO S.A.	Gdynia	PLN 250,000	PLN 2,500	20	20%
OTHER COMPANIES WITH PARTICIPATION of PKP CARGO S.A. in which PKP CARGO S.A. has less than 20% shares							
14.	ZAO "Eurasia Rail Logistics" in liquidation	company with participation of PKP CARGO S.A.	Moscow (Russia)	RUB 1,670,000	RUB 1,670	150	15%
15.	EUROTERMINAL SŁAWKÓW Sp. z o.o.	company with participation of PKP CARGO S.A.	Sławków	PLN 182,479,000	PLN 50	340,000	9.32%
16.	Bureau Central de Clearing s.c.r.l.	company with participation of PKP CARGO S.A.	Brussels (Belgium)	EUR 110,250	EUR 750	2	1.34%
17.	Intercontainer-Interfrigo S.A. in liquidation	company with participation of PKP CARGO S.A.	Brussels (Belgium)	-	-	-	0.71%

Source: Proprietary material

A list of all the subsidiaries and associates can be found in Notes 14 and 15.1 CFS.

4. Key areas of operation of the Company and PKP CARGO Group

4.1. Macroeconomic environment

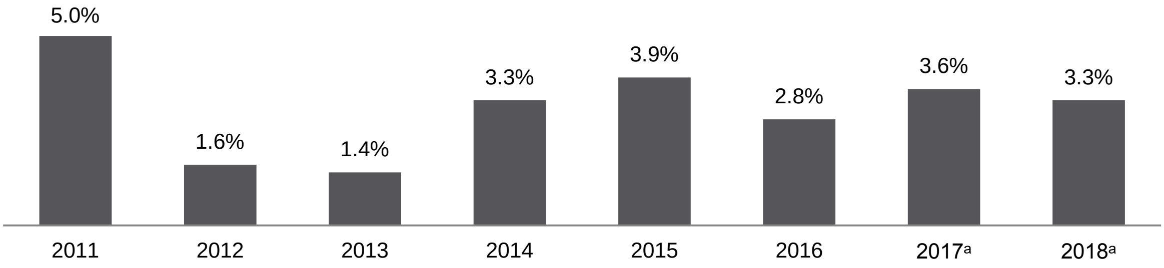
Polish economy

According to GUS estimates[6], the GDP growth in Poland in 2016 was 2.8% yoy, i.e. was 1.1 p.p. lower than the year before (3.9% in 2015). According to NBP projections, the GDP growth rate in 2016 was 3.0% and will be 3.6% yoy in 2017 and 3.3% yoy in 2018. The estimate projections for 2016 were affected by the lower capital expenditures associated with transitional decrease in the utilization of EU funds after the end of the previous EU financial framework and slow-down of the individual consumption growth rate in Q2 2016. In addition, the GDP growth was held back by the continuing uncertainty regarding the regulatory environment of private companies. However, the growth rate was stimulated by improving situation in the labor market and better, than in previous years, financial standing of enterprises as well as high availability of loans and lower interest rates than in previous years.[7]

It is expected that the impact of the factors that held back the GDP growth in 2016 will decrease in the years to come. In 2017 an increase in the inflow of European Union funds is expected.[8] This may have significant impact on future adjustment of the investment growth rate and increase of the economic growth. GDP growth in H1 2017 is to be based mainly on consumption and intensification of capital expenditures should be expected only in H2 2017. Market analysts predict that the first effects of the increase in the level of investments will be visible by the end of the year and the investment boom may reach its peak in 2018-2019.[9]

It is also expected that launch of disbursements under the Family 500 Plus program will have positive impact on the growth rate of private consumption and thus economic growth. Despite a noticeable increase in demand for consumer goods, it is not as strong as expected in earlier forecasts. This may result from the use of the funds disbursed under the program for repayment of earlier liabilities (credits and loans). In Q2 last year the increase of private consumption was 3.3% yoy and in Q3 grew by 0.6 p.p. to 3.9% yoy. However one may expect that after repayment of the debt, the money will go to a larger extent to private consumption, as intended.

Figure 4 GDP growth in Poland in 2011-2018



Source: Central Statistical Office (revised estimate of gross domestic product for 2010-2015 dated 19 October 2016); NBP forecast (September 2016)

a. - NBP forecast on the basis of the Inflation Report, November 2016

According to NBP's current forecasts, one should expect that[10]:

- the GDP growth rate in 2017 will increase to 3.6% yoy (compared to 2.8% yoy in 2016[11]) and 3.3% yoy in 2018. The increase is to be supported primarily by increasing private demand. Individual consumption is expected to be at 4.1% yoy in 2017 and 3.5% yoy in 2018.
- the inflation rate will increase from -0.6% yoy in 2016 to 1.3% yoy in 2017 and 1.5% yoy in 2018
- the unemployment rate will drop from the projected level of 6.0% in 2016 to 5.4% in 2017 and 5.0% in 2018
- the employment will increase by 0.3% yoy in 2017 and by the same rate in 2018

[6] Central Statistical Office of Poland
[7] Inflation report. November 2016, NBP
[8] Inflation report. November 2016, NBP
[9] Inwestycje.pl
[10] NBP's Inflation Report, November 2016
[11] Central Statistical Office of Poland

- the balance of the current account and capital account is expected to decline from the estimate level of 1.1% of GDP in 2016 to 0.1% of GDP in 2017 and 2018

The uncertainty of the forecasts is associated primarily with slower growth of the global economy, caused among others by the lower GDP growth rate in China, attributable to the instability of this country's financial system. If the GDP growth in China slows down, as a consequence one should expect also lower domestic product growth rates in the United States, one of China's most important business partners. In the case of deterioration of the situation in both of these markets one should expect perturbations in the global financial market and the risk of decreased global growth rates.

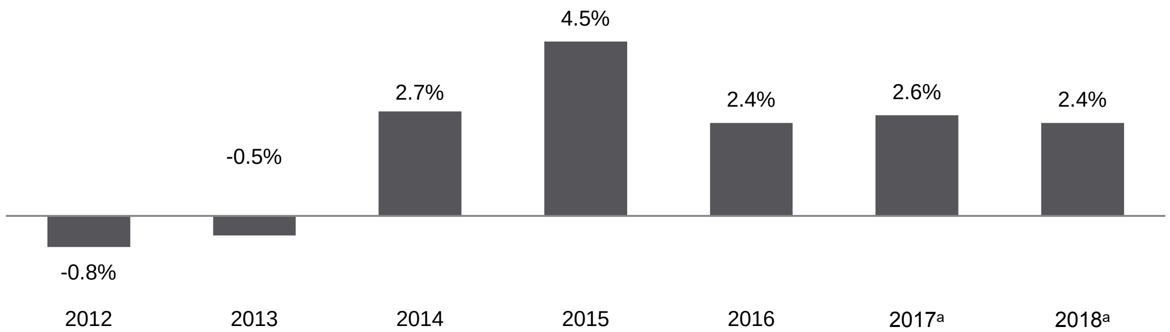
The risk of adverse impact on the Polish economy is also caused by the political situation in European countries, among others, the "hard Brexit" announced by Theresa May and the nearest parliamentary elections in France, Germany and Spain.

Czech economy

In accordance with the Finance Ministry's expectations, the economic growth of the Czech Republic slowed down and in Q4 2016 was only 0.4% qoq (1.9% yoy). The slow-down of the gross domestic product growth rate results from, among other things, the lower growth rate of real export of goods and services, which slowed down from 8.4% yoy in Q2 2016 to 1.5% yoy in Q3, and to 1.8% yoy in Q4 2016. In addition, growth of domestic product decreased from 1.6% in Q2 2016 to 1.1% in Q3 2016 (with 2010 as the base year). Additionally, central and local government investments declined by over 25% yoy, which is the result of the high base in 2015. On the other hand, the increase in investment activity in the non-financial enterprise sector is perceived as a very positive phenomenon.[12]

The supply side is impacted by the dynamics of the gross added value in Q3 2016, which slowed down to 1.3% yoy. The slow-down, with varying intensity, is visible in all sectors of economy, except for the finance and insurance sector and the real estate and agriculture industries. Decreases in 2016 were recorded primarily in construction (-7.6% yoy), mining and extraction of raw materials (-9.0% yoy), metal production and metallurgical products (-0.5% yoy), and production of chemicals and chemical products (-7.0% yoy).

Figure 5 Real GDP growth in the Czech Republic in 2012-2018



Source: European Commission

a Forecast of the Czech Republic's Finance Ministry – January 2017

According to current forecasts of the Czech Republic's Finance Ministry till the end of 2018 one should expect that:

- the GDP growth rate in 2017 is to reach 2.6% yoy and 2.4% yoy in 2018. This forecast is based on the following assumptions: good situation in the labor market with relatively dynamic growth of salaries and beneficial changes in household consumption. Both of these factors are expected to boost the economy. Increase in the prices of oil and minerals is also expected to have positive impact, but to a lesser extent.
- the increase in the inflation rate in 2017 will reach 2.0% yoy (previous forecast provided for 1.2% yoy). In 2018, inflation is expected to be 1.6% yoy.
- the unemployment rate is expected to drop from the 4.0% estimated for 2016 to 3.9% in 2017 and in 2018. The expected growth in employment will slow down from the estimate level of 1.8% in 2016 to 0.3% yoy in 2017 and 2018.
- a current account balance will be at a level of 1.8% of GDP in 2017 and 1.3% of GDP in 2018.

[12] Macroeconomic Forecast of the Czech Republic, January 2017

The Czech Republic's Finance Ministry sees the main threats to development of the Czech economy in the uncertainty related to the process and consequences of United Kingdom leaving the European Union. Brexit may impact the Czech economy in particular in the area of foreign trade (slow-down of the growth of foreign demand). If the future setup of the trade relations between the United Kingdom and the European Union significantly deviates from the existing one, one should expect that some investment projects may be postponed due to slower increase in the foreign demand or increase in investment uncertainty.

Also the increasing uncertainty regarding the upcoming elections in France, Germany and the Netherlands may have negative impact. Change of the internal and international policy of these countries (and of the United States), in particular with regard to openness of foreign trade, may have significant impact on the global, also Czech, economic growth.

European economy

According to preliminary estimates of the World Bank from January 2017, economic growth in the Eurozone in 2016 was 1.6% yoy and the forecasts for 2017 and 2018 are 1.5% yoy and 1.4% yoy, respectively.[13] The main factors holding back the growth rate in the assumptions of the forecast were: lower level of investments and decreasing number of people in production age. Internal demand will have positive impact on economy.

European Central Bank ("ECB") forecasts point to progressing economic recovery in the Eurozone. Real GDP is estimated at 1.7% yoy in 2016 and in 2017 (and upward adjustment compared to the projection from September 2016, when 1.6% yoy in 2017 was projected). Compared to the previous forecast, 2018 remains unchanged, which means that the economic growth will be 1.6% yoy.[14] Just like in the September projection, European Central Bank attributed the positive forecast to: domestic demand supported by the ECB's more lenient monetary policy, favorable fiscal policy, improved conditions in the labor market and progress in reducing financial leverage in various sectors. Also export-related factors point to growth. External growth is expected to be driven both by developed economies and developing ones (including Brazil and Russia), with simultaneous slow-down by the United Kingdom, for which weak growth of imports is expected.

According to ECB forecasts, the inflation in 2016 was 0.2% yoy and in 2017 it is expected to be 1.3% yoy (in the September 2016 forecast the inflation was projected at 1.2% yoy) and in 2018 will reach 1.5% yoy (according to the forecasts from September 2016, 1.6% yoy).[15]

Industry in Poland

Transport in Poland is inseparably linked to the economic situation in the main branches of Polish industry, i.e. mining, metallurgy and construction. To a slightly lesser extent the growth rate of cargo transport will be impacted also by such industries as: fuel industry, metal processing, chemical, timber or automotive industry.

In 2016, total industrial production sold increased 3.2% yoy, compared to a 6.0% yoy growth in 2015. Increases were recorded in such industries as: industrial processing (+4.2% yoy); water supply, sewage and waste management and reclamation (+3.0% yoy); production of foodstuffs (+6.4% yoy); production of wooden, cork and wicker products (+3.2% yoy); production of chemicals and chemical products (+2.2% yoy); production of rubber and plastic products (+6.8% yoy); production of furniture (+12.1% yoy); production of motor vehicles, trailers and semi-trailers (+7.2% yoy); production of products from other mineral non-metallic raw materials (+6.3% yoy); production of metals (+0.5% yoy) and products from metals (+8.8% yoy). Decreases in industrial production sold were recorded in: mining and extraction industry (-5.2% yoy); generation and supply of electricity, gas, steam and hot water (-3.5% yoy); production of coke and petroleum refinery products (-4.7% yoy); production of other transport equipment (except for motor vehicles, trailers and semi-trailers; -5.3% yoy). The same increase, i.e. 3.2% yoy in 2016 was recorded in industrial sold production in enterprises employing more than 9 employees (compared to 4.9% yoy in 2015).[16]

Labor productivity in industry (defined as industrial production sold per employee) in 2016 was 1.0% higher yoy. At the same time, in the same period, the average headcount increased by 2.2% yoy, and average monthly gross salary by 3.2% yoy.[17]

In the period of 11 months of 2016, compared to a corresponding period of 2015, Poland recorded an increase in foreign trade with developed countries (exports grew 2.3% yoy and so did imports - 2.3% yoy), including with European Union countries (exports increased 2.0% yoy and imports 2.2% yoy). There was also an increase in exports to the countries of Central and Eastern Europe (by 5.2% yoy) and imports from developing countries (by 2.3% yoy). However there was a decrease in exports to developing countries (by 6.5% yoy) and imports from the countries of Central and Eastern Europe (by 16.3% yoy).[18]

[13] World Bank (methodology: percentage change compared to 2010, GDP translated into USD)
[14] Macroeconomic projections of ECB experts, December 2016
[15] Macroeconomic projections of ECB experts, December 2016
[16] Central Statistical Office of Poland
[17] Central Statistical Office of Poland
[18] Central Statistical Office of Poland

During the first 10 months of 2016, the terms of trade index recorded an increase by 1.1% yoy, which was a better result than in the first 10 months of 2015, when the increase was 0.4% yoy. Exports, amounting in total to PLN 730.0 billion increased 5.7% compared to the corresponding period of last year, and imports (PLN 711.1 billion) increased 4.4% yoy. Thus, Poland's net foreign trade recorded a positive balance of PLN 18.9 billion, which is better than last year, when the balance was PLN 9.6 billion.[19]

In December 2016, PMI (*Purchasing Managers Index*) was 54.3, which points to increasing optimism among entrepreneurs (in December 2015 this was 52.1).[20] Polish industry is affected not only by the overall condition of the country's economy but also by the economic situation in the countries which are the business partners of Polish manufacturers. In January this year, the World Bank lowered its forecast for global economic growth for 2017 to 2.7% (from 2.8% in the previous projection). One should note, however, that the forecasts entail risk caused by the uncertainty associated with the political decisions of the most powerful countries. Continuing uncertainty is closely related to extension of the period of weaker investments. The World Bank pays special attention to a slow-down in investments in developing countries, which account for over 30% of global GDP and approx. 75% of the global population and poverty. The main obstacles to growth of investments may include low oil prices (which is important for exporter countries), slowing down foreign investments (factor important for importers of raw materials), high level of private debt or political risk.[21]

Mining industry

In 2016, 70.4 million tons of hard coal were mined in Poland, which was 1.8 million tons, i.e. 2.5%, less than in 2015[22]. According to information from the Industrial Development Agency, 81.3% of total production (57.2 million tons) was steam coal. In this regard, a 3.4% yoy decrease was recorded, caused by restructuring of the mining industry and hand-over of some of the mines for the management of Spółka Restrukturyzacji Kopalń. The remaining part of total production in 2016, i.e. 13.2 million tons (18.7%) was coking coal, where a 1.7% yoy was recorded, which, in the context of the problems faced by Jastrzębska Spółka Węglowa (key player in this product market), one may recognize as a positive result.

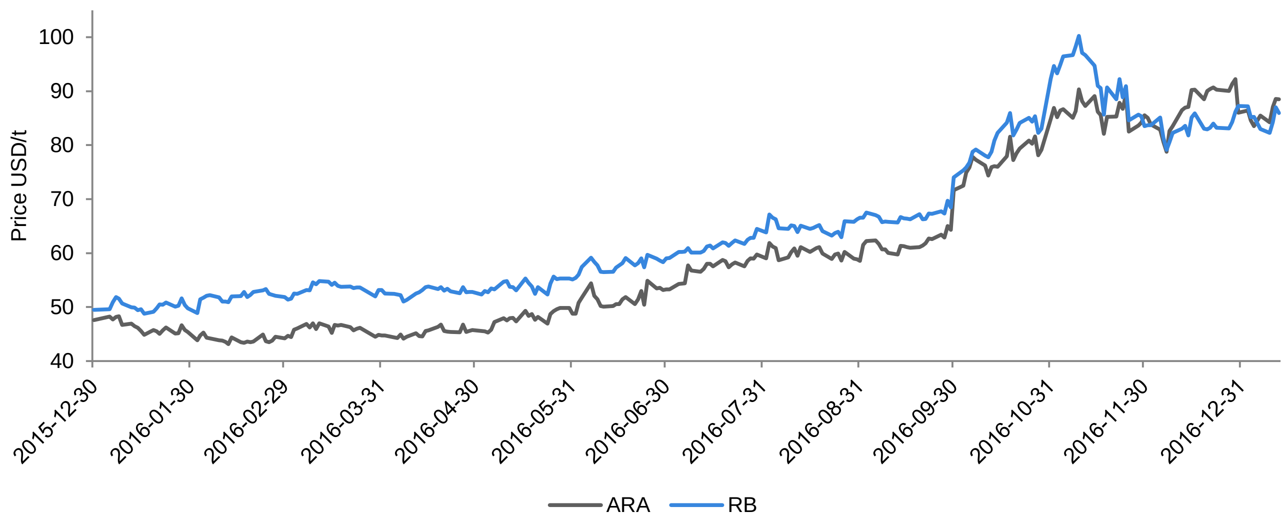
In 2016 the total volume of sold coal in Poland and abroad decreased to 73.1 million tons, i.e. 0.5% yoy (73.5 million tons in 2015). The sales of steam coal was 59.6 million tons, 1.5% yoy down (60.5 million tons in 2015) and coking coal to 13.5 million tons, 3.9% up compared in 2015, when 13.0 million tons were sold.[23]

According to analyses carried out by Polskie Sieci Elektroenergetyczne ("PSE") in 2016 total production of electricity was 162,626 GWh (in 2015 the production was 161,772 GWh), up by 0.5% yoy. Professional heat generation plants relying on hard coal produced in 2016 81,348 GWh, which in yoy terms (81,883 GWh in 2015) means a 0.7% decrease. According to the Industrial Development Agency, production of electricity from coal in December 2016 accounted for 77.3% of total electricity, and in the whole 2016 this share was 81.5%.[24]

Starting from May 2016 one can observe a constant increase of hard coal prices in global markets. In August 2016, the average monthly price per ton of steam coal in ARA ports was over 60 USD/t, whereas in December 92.7 USD/t (at the end of 2016 there were occasional transactions with the price exceeding 100 USD/t). The price increase was primarily associated with the start of the heating season in China (main exporter and at the same time the biggest consumer of coal) leading to increase of the demand for this raw material.

[19] Central Statistical Office of Poland
[20] http://stooq.pl/q/d/?s=pmmnpl.m&c=0&d1=19980731&d2=20161030&i=m
[21] Global Economic Prospects, January 2017, A World Bank Group
[22] Polish Press Agency (PAP)
[23] Industrial Development Agency (ARP)
[24] Industrial Development Agency (ARP)

Figure 6 Coal prices on ARA vs. RB markets*



Source: Wirtualny Nowy Przemysł
*ARA – Amsterdam, Rotterdam and Antwerp; RB – Richards Bay (RSA)

In the 2017 forecasts according to Arctic Securities in Oslo, further increase in prices is expected until the end of the winter season. Together with the end of the winter (end of the heating season) the price in ARA ports is expected to periodically return to the downward trend. A subsequent increase in prices may be an impulse for coal producers from Australia and Indonesia to increase production. Such an increase of supply may contribute to decrease in coal prices. Long-term forecasts assume continuation of the high supply and the demand in the European market and in the US is expected to decrease. This will be caused by the announced transition of these economies towards increased share of renewable energy sources in the energy mix.

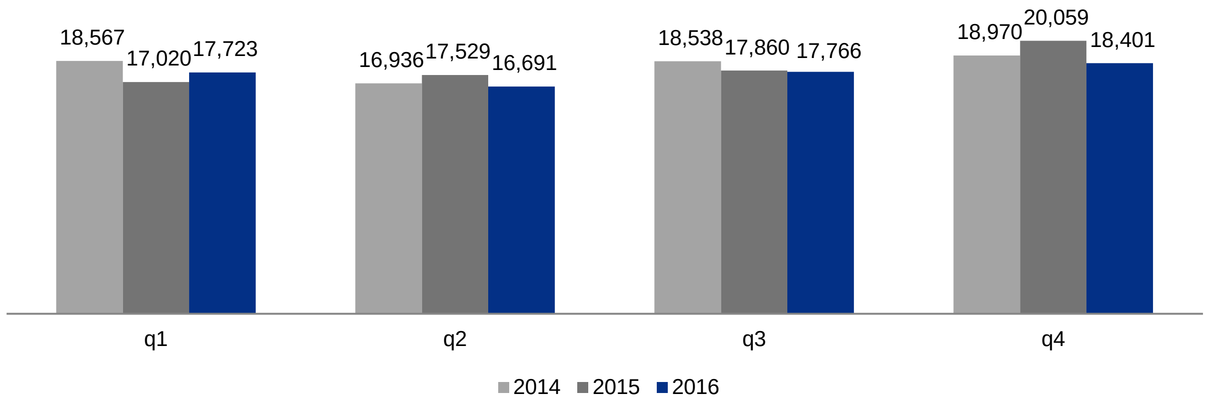
Based on the forecasts of Marex Spectron Ltd. in London, which do not anticipate any short-term power cuts in 2017 (as for example in the nuclear power plants in France, which happened in Q4 2016), one may expect that the demand for conventional fuel, that is hard coal and brown coal, will successively decrease. Another risk factor for the industry may come from the outcome of the last presidential elections in the US. One of the major election promises of the existing president (Donald Trump) was to reactivate American coal mining industry and additionally reduce the legal restrictions pertaining to industrial use of this raw material. If Donald Trump keeps his promise this will mean an increased probability of increases in coal prices in global markets.

Also Chinese economy will continue to be important to further development of the mining industry. In 2017 China will want to continue its production and mining policy (in 2016 China was responsible for half of the global consumption of coal) and is likely to continue to significantly impact the development of the situation in the global market. Nonetheless one should note that also the problems of the Chinese economy will have an impact: increasing debt, speculative bubbles in the real estate industry, state-owned enterprises holding back the development of certain industries and banks facing problems. In 2016, in the raw material industry, there was in addition a stimulation plan supported by the Chinese government, focusing on infrastructural projects funded through increase in debt. Preliminary estimates indicate that China's economic growth in 2016 will be 6.7% yoy.

The forecasts of the International Energy Agency published in the Mid-Term Coal Market Report assume that the global demand for coal will not be subject to any major changes in the next 5 years. The decrease in the consumption of this raw material in Europe and North America is to be offset by increased consumption in India and South-East Asia. Further projections assume progressing decrease in the share of coal in the global energy mix to 36% in 2021 (from over 41% in 2013). In 2015 global consumption of coal dropped for the first time since 2000 by 2.7% yoy. In this period the production of this raw material has shown a decline for the second year in a row. Limited demand for coal in Europe and the US resulting from application of cleaner electricity generation technologies and more restrictive climate policy will shift the main coal consumption region towards the east of the globe, mainly to India, Vietnam and Indonesia.

The factors that are very important for the coal market are not only the recent elections in the US but also the upcoming elections: presidential elections in France (at the end of April/beginning of May 2017) and parliamentary elections in Germany (autumn 2017). The parliamentary elections in the Netherlands and Czech Republic, or presidential elections in Hungary, Serbia and Slovenia will have lesser impact. The series of elections in European countries may cause significant economic instability not only in these countries but also in the countries which are their business partners.

Figure 7 Extraction of hard coal in Poland in 2014-2016 (thousand tons)



Source: Central Statistical Office of Poland

Steel industry

According to the data presented by the World Steel Association ("WSA"), steel production in the 66 member countries, 2016 saw an increase of 0.7% yoy. Only in December 2016 it was 5.5% higher than the year before. In Poland steel production in December 2016 grew 24.3% yoy to 0.8 million tons (from 0.7 million tons in December 2015) and in the whole 2016 dropped by 2.8% yoy to 8.9 millon tons from 9.2 million tons in 2015.[25]

The European Union produced 162.3 million tons of steel (down 2.3% yoy). Germany, being one of the biggest producers, reduced production by 1.4% yoy from 42.7 million tons to 42.1 million tons. The yoy decline in steel production in 2016 was also recorded in such countries as: Spain (by 8.8%, 13.6 million tons were produced), France (by 2.3%, production of 14.6 million tons), United Kingdom (by 30.5%, production of 7.6 million tons), and non-EU countries – Russia (by 0.1%, production of 70.8 million tons) and Belarus (by 11.2% with production of 2.2 million tons). Italy achieved a 6.0% yoy growth, producing 23.3 million tons and Ukraine a 5.5% yoy growth with the production of 24.2 million tons.

Among non-EU countries one should note the production of the leader in the steel industry, i.e. China, where in 2016 steel production increased 1.2% yoy to 808.4 million tons. This is half of the total steel production in the 66 member countries of the World Steel Association (in 2016 it reached 1.604 billion tons). The surplus of China's production potential is estimated at 350 million tons.

In 2016 Beijing reduced its production capacity by 45 million tons. However one should note that most of the production capacity was inactive. Despite the reductions, the increased activity of the steelworks was attributable to an increase in steel prices (approx. 60% per annum), as a result of which steel production in this country still shows an upward trend.

In 2016-2020 China is planning to reduce steel production by 100-150 million tons.

In addition to China, the biggest steel producers are: Japan, which reduced its production in 2016 by 0.3% yoy (104.8 million tons in 2016) and India, where production increased by 7.4% yoy (95.6 million tons in 2016).[26]

Construction industry

Based on the GUS data, construction and assembly production in December 2016 at fixed prices (including investment and renovation works executed in Poland, on the basis of data from construction enterprises employing more than 9 employees) is 8.0% lower yoy and 34.8% higher mom. However this indicator adjusted for seasonality was 9.8% lower yoy and 2.5% higher mom.

[25] World Steel Association
[26] World Steel Association

Over the entire year 2016, total construction and assembly production was 7.0% lower than the year before (compared to 3.7% yoy increase in 2015).

Construction and assembly production at fixed prices (works conducted in Poland by companies employing more than 9 employees) in 2016 dropped by 14.1% yoy. A decline was also recorded by the building construction industry (decrease by 12.9% yoy), construction of civil and marine engineering facilities (decrease by 14.5% yoy) and specialized construction works (decrease by 15.2% yoy).

These decreases were caused primarily by a relatively low level of expenditures on public investments. Over the entire year 2016 investment expenditures recorded a decrease by 5.5% yoy. The last such significant decrease was seen in 2002 when it reached -6.1% yoy. The declines in investments are attributable to delays in preparations for the use of subsidies under the new EU financial framework. The preparations included, among other things, amendment of the public procurement law, which was delayed by several months. As a result, the use of the funds started only by the end of 2016, which had an impact on the performance for the full year 2016.

Apart from delays associated with the use of EU funds, one should additionally note the risk for some of the construction companies in connection with the new VAT law. As of 1 January 2017, construction companies are subject to the so-called VAT reverse charge. The new regulations may cause a risk of deterioration of the financial liquidity of construction companies and increase of the prices of their services.[27]

Industry in the Czech Republic

In 2016 industrial production increased 2.9% yoy. The biggest contributors to the growth of industrial production in 2016 were: the production of motor vehicles, trailers and semi-trailers (increase of the share in total production by 2.0 p.p., total increase by 11.0% yoy), production of finished metal products (increase of the share in total production by 0.4 p.p.,total increase of 4.5% yoy) and production of rubber and plastic products (increase of the share in total production by 0.3 p.p., total increase of 4.9% yoy). Industrial production dropped in such industries as: (mining and extraction (decrease of the share in total production by 0.3 p.p., total decrease by 9.0% yoy), chemicals and chemical products (decrease of the share in total production by 0.2 p.p., total increase of 7.0% yoy) and production of foodstuffs (decrease of the share in total production by 0.1 p.p., by 2.5% yoy).[28]

Revenues from industrial activity at current prices rose by 1.0% yoy in 2016 and direct export sales revenues of industrial enterprises at current prices increased 2.7% yoy. Domestic sales, which comprises indirect exports (through non-industrial companies) at current prices decreased 1.3% yoy.

The value of new orders in selected sectors of industry rose 4.5% yoy throughout 2016. The number of new orders from abroad increased by 6.4% yoy, while new domestic orders rose by only 0.9% yoy.

In 2016 in companies with 50 employees or more the headcount increased by 2.8% yoy. Their average monthly nominal gross salary in 2016 increased by 3.8% yoy.

Mining industry

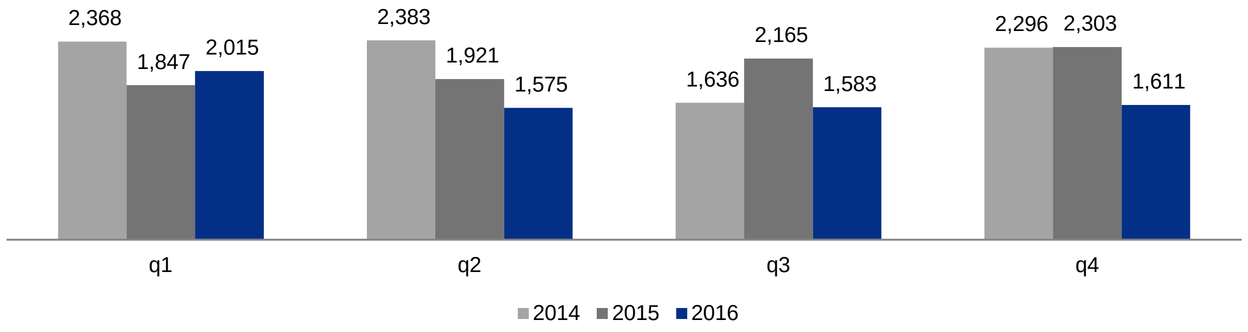
The hard coal production in 2016 amounted to 6.8 million tons, down by 17.6% yoy i.e. 1.5 million tons. The situation of the Czech mining industry is still unstable. The continued plan of gradual phase-out of OKD's operations means that this raw material will not be mined in the Czech Republic after 2023 as OKD is the only mining company in the country. These are the assumptions of the restructuring plan, which was one of the suspending conditions that had to be fulfilled in order to obtain a loan of CZK 700 million (approx. PLN 113.2 million). An important event for OKD, and thus for the whole mining industry of the Czech Republic is, among other things the legal action taken by the company's existing owners against the former owner (Zdenek Bakala), most probably in connection with payment of excessive dividends from New World Resources ("NWR", OKD's parent company). In addition, a factor that has significant importance not only for OKD but also for Polish mining is the complaint filed with the European Commission by the end of October/beginning of November 2016 by one of OKD's lenders, Arca Capital, challenging the amount of state aid given to Polish mines, which allegedly had negative impact on the activity of Czech mines (declaration of bankruptcy at the beginning of May 2016). Closing down of OKD's mines has impact primarily on the social situation and to a lesser extent on the energy situation. This results from the number of OKD's employees reaching 12 thousand (9.4 thousand own employees, 2.7 thousand from cooperating companies and 200 from employment agencies). The Czech Republic's demand for energy is satisfied largely with nuclear energy and renewable energy sources, while steam coal is

[27] Next.gazeta.pl
[28] CZSO, Industry in December 2016

much less important. In 2015, the share of renewable energy sources in production of electricity in the Czech Republic exceeded 13%. In 2020, RES are expected to produce 15.3% of electricity.

The figure below presents quarterly hard coal production (coking and steam coal, without coke and coal deposit) in 2014-2016.

Figure 8 Extraction of hard coal in the Czech Republic in 2014-2016 (thousand tons)



Source: Czech Ministry of Industry and Trade

Steel industry

The metallurgical industry in the Czech Republic consists mainly of two sectors: metal processing (ferrous and non-ferrous metals) and metal foundry industry. This industry is primarily driven by the demand of the automotive industry, construction and mechanical engineering. The biggest limitations for the development of this industry are: higher costs of international transport due to the Czech Republic's location away from the sea and small amount of inland waters.[29]

According to the data of Steel Federation a.s., the production growth rate went up in 2016 in the case of each of the 3 key products: metallurgical pig iron (increase by 3.3% yoy to 4.2 million tons), raw steel (increase by 0.9% yoy to 5.3 million tons) and rolled products, which recorded an increase of 5.8% yoy, i.e. from 4.9 million tons in 2015 to 5.2 million tons in 2016.

Construction industry

In 2016, a 7.6% yoy decrease in real terms in construction and installation production was recorded. Building production, in turn, was down 3.3% yoy (2.2 p.p. decrease of the share in total construction production) and engineering construction production dropped by 16.0% yoy (5.4 p.p. decline in the share in total construction production).[30]

The average number of registered employees[31] in construction companies employing 50 or more staff in 2016 fell 2.7% yoy. The average monthly nominal gross salary of such employees increased by 4.2% yoy and amounted to CZK 33,012 (approx. PLN 5,272).

In 2016 the number of construction orders undertaken by companies employing 50 or more employees increased by 27.0% yoy, which translated into 61,508 orders executed in the Czech Republic. The total value of orders, in turn, dropped 1.9% yoy to CZK 183.8 billion (i.e. approx. PLN 29.3 billion).

Last year, the number of granted building permits amounted to 83,340, up by 3.6% yoy. The approximate value of construction orders for which building permits have been obtained is estimated at CZK 284.3 billion (i.e. approx. PLN 45.4 billion), up 11.5% yoy.

[29] http://www.budoucnostprofesi.cz/sectoral-studies/industries-development/14_manufacture-of-basic-metals-and-fabricated-metal-products.html
[30] Czech Statistical Office
[31] the breakdown does not comprise persons working on the basis of different employment contracts, business owners and cooperating household members who do not have employment contracts

Automotive Industry

The Czech Republic is an important European producer of cars and the automotive industry is an important branch of the country's economy. This is the effect of the long tradition of car production. Thanks to increasing number of jobs in this industry and continuous increase in yoy production, the automotive industry is perceived as one of the best stimuli of the Czech economy.[32]

The biggest manufacturers of passenger cars in the Czech Republic are: Škoda Auto (56.9% share in the Czech production in 2016), Hyundai Motor Manufacturing Czech s.r.o. (26.7% share in production in 2016) and Toyota Peugeot Citroën Automotive (16.4% share in 2016). Delivery vans and buses are manufactured by: Iveco Bus (88.5% share in production of buses in the Czech Republic in 2016) and SOR Libchavy (10.4% share in 2016).

According to the Automotive Industry Association, during 2016, the Czech Republic manufactured 1,351.1 thousand road vehicles, which constituted a 8.2% yoy increase. In 2016 the Czech industry manufactured 1,344.2 thousand passenger cars, up by 8.3% yoy. Production also included 4,388 buses (down by 2.9% yoy) and 1,228 motorcycles (down by 28.9% yoy). The biggest increase was observed in production of trucks: 1,326 trucks were manufactured in 2016, marking an increase of 56.0% yoy.

4.2. Freight transportation activity

The rail transport market was presented taking into account the transport in the domestic and Czech markets where the transport activity in 2016 was the most important for the PKP CARGO Group, especially for PKP CARGO S.A., PKP CARGO SERVICE Sp. z o.o. and AWT a.s.

4.2.1. Rail transport market in Poland

In 2016, rail freight services in Poland were provided by 69 licensed operators, including PKP CARGO S.A. and PKP CARGO SERVICE Sp. z o.o. During that period, railways carried 222.6 million tons of cargo, which is 0.8% less than in 2015, when the total weight of 224.3 million tons was transported. The freight turnover in rail cargo transport in 2016 was at a level similar to the one in 2015, i.e. 50.6 billion tkm. The average haul increased by 1.8 km yoy (+0.8% yoy) to 227.4 km.[33]

Lower freight volume in 2016 resulted from, among others, delays in preparation and execution of infrastructural investments, mainly construction of roads, rail infrastructure and power generation units. The delays have direct impact on decrease in transport of aggregates. For the same reasons the transport of cement, line and gypsum was lower than in 2015. One should note that in December 2016, thanks to the favorable weather conditions there was a recovery in transport of stone – mainly for contruction of ring roads and modernization of rail lines.

In the first 11 months of 2016 in yoy terms the transport of metal ores decreased as a result of the situation in the metallurgical industry in the global markets (economic slow-down in China also affects the demand for steel, hence also the raw material required for its production). During the year, the transport was also impacted by temporary breaks in delivery of the raw materials due to failures in the industrial plants and overhauls of the COS (continuous steel casting) line. In connection with the overhauls, steel production fell in Poland in 2016 by 2.8% yoy to 8.9 million tons.

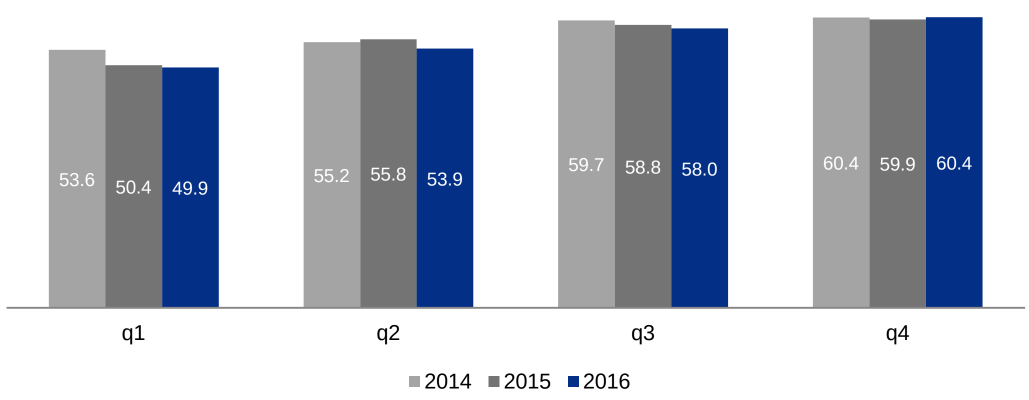
In the the first 11 months of 2016 also rail transport of hard coal dropped to 81.4 million tons, down by 0.2% from the corresponding period of 2015 (81.6 million tons). In addition, in the whole 2016, one could observe a decrease in the level of coal inventories in the mine storage yards. In December 2015 hard coal inventories were at 5.82 million tons and in December 2016 this level dropped by 2.31 million tons to less than 2.51 million tons. Higher sales of the raw material should be attributable to higher coal prices in the global markets (ARA and RB).

Increase in transportation of goods by rail in the period of the first 11 months of 2016 was observed in the following cargo categories: coke, briquettes, petroleum refinery products; wood and wooden products; machinery, devices and electric and electronic equipment, and in intermodal transport. The increase in coke transport was attributable to, among others, increase of the average benchmark price of coking coal by 12% yoy to 114 USD/t in 2016. According to the forecasts of Jastrzębska Spółka Węglowa in 2017 the average price will reach 130 USD/t.[34] Globally, the price increase is attributable to the limited production in

[32] AutoSAP
[33] Central Statistical Office of Poland
[34] Nettg.pl

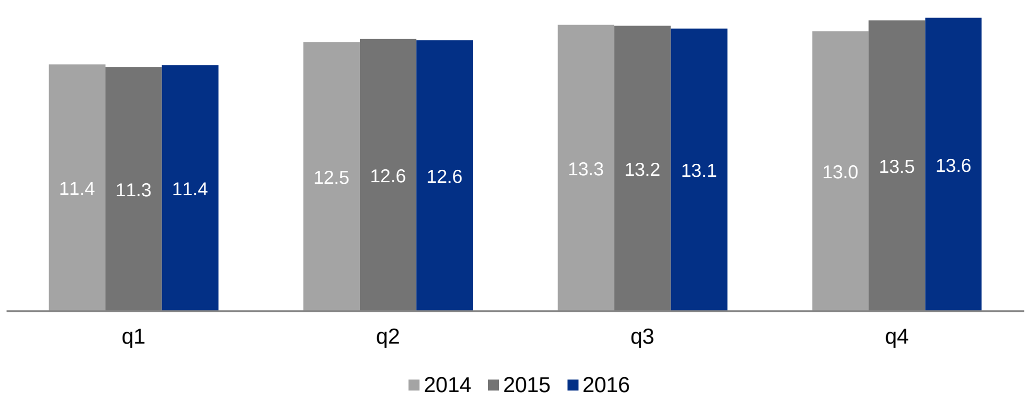
China and downtimes in Australian mines.[35] The increase in intermodal transport is driven significantly by the development of transit routes and the handling in Poland and abroad of cargo connections on the China-Europe-China route as part of the "New Silk Road".Significant impact also had transport of cargo between seaports and inland terminals (transshipment of containers in Polish seaports increased 9.3% yoy). Moreover, higher percentage of bulk cargo being transported in containers (such as e.g. coke, wood chips) was observed.

Figure 9 Rail freight volumes in Poland in individual quarters of 2013-2016 (in million tons)



Source: Office of Rail Transport

Figure 10 Rail freight turnover in Poland in individual quarters of 2013-2016 (in billions tkm)



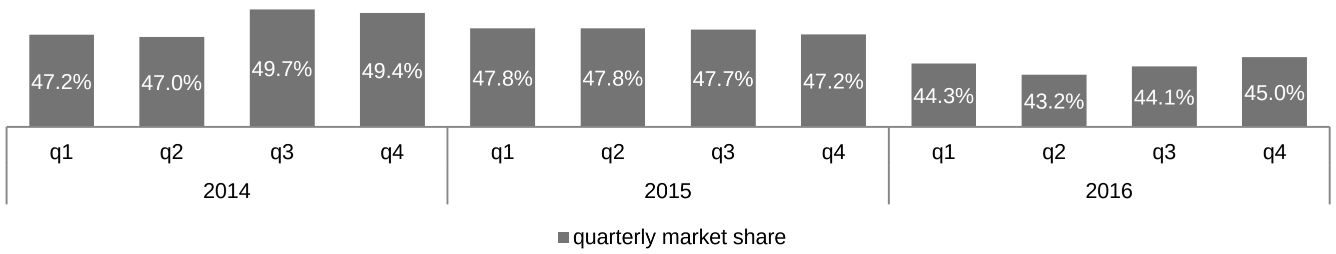
Source: Office of Rail Transport

4.2.2. Position of the PKP CARGO Group and the Parent Company in the rail transport market in Poland

In 2016, the PKP CARGO Group remained the leader in the Polish rail freight market; transport operations in the group are performed mainly by PKP CARGO S.A. In Q4 2016, the Group had a 45.0% market share (-2.2 p.p. yoy) in terms of freight volume and a 52.0% market share in terms of freight turnover (-3.6 p.p. yoy). In the Group the Parent Company had a 44.6% market share (-2.4 p.p. yoy) in terms of freight volume and a 51.7% market share in terms of freight turnover (-3.6 p.p. yoy).

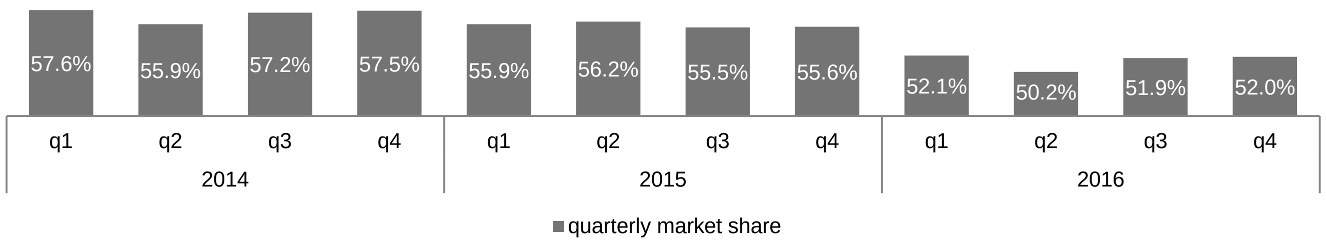
[35] Information Center on the Energy Market

Figure 11 Share of the PKP CARGO Group in freight volume in 2014-2016 in Poland



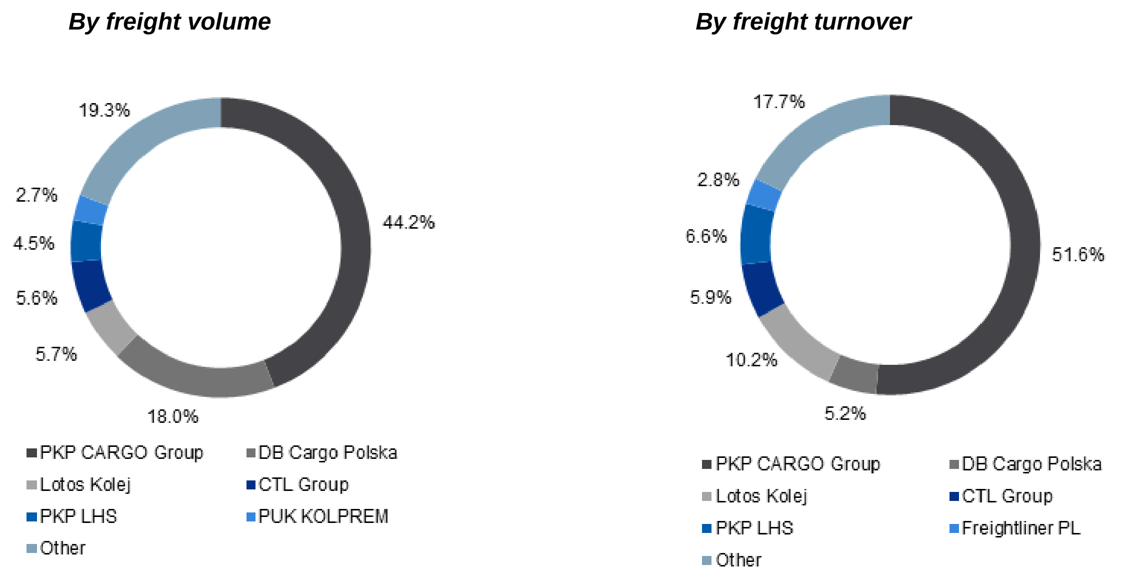
Source: proprietary material based on Office of Rail Transport's data

Figure 12 Share of the PKP CARGO Group in freight turnover in 2014-2016 in Poland



Source: proprietary material based on Office of Rail Transport's data

Figure 13 Market shares of the biggest rail operators in Poland in 2016, by freight volume and freight turnover



Source: proprietary material based on Office of Rail Transport's data

*The share of the PKP CARGO Group by freight volume is the sum of the share of the Parent Company of 43.9% and other Group companies of 0.3

*The share of the PKP CARGO Group by freight turnover is the sum of the share of the Parent Company of 51.4% and other Group companies of 0.2%

The most important operators conducting activity competitive to the activity of the PKP CARGO Group in the Polish freight rail transport market include the following companies: DB Cargo Polska, Lotos Kolej, Grupa CTL, PKP LHS, PUK KOLPREM, Freightliner PL, Pol-Miedź Trans and Orlen Kol-Trans.

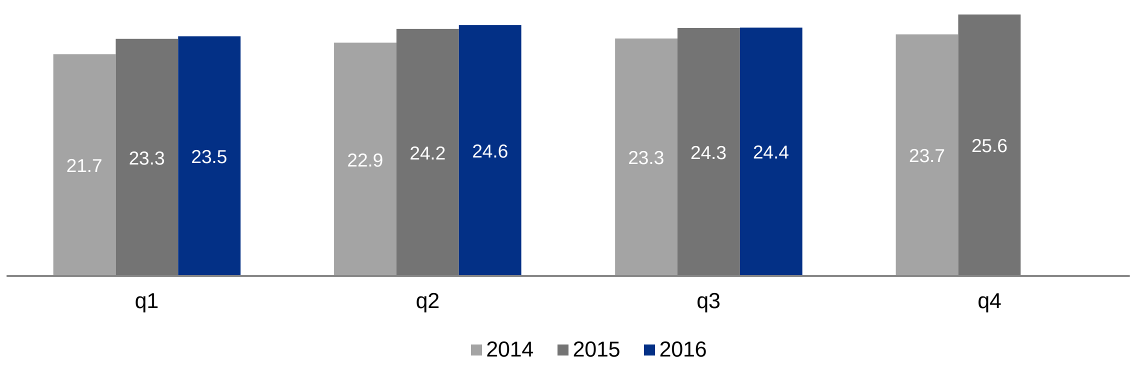
In 2016 the strongest competitors for the PKP CARGO Group in terms of freight volume were the following companies: DB Cargo Polska, Lotos Kolej and CTL Group, recording market shares of: 18.0%, 5.7% and 5.6%, respectively. In terms of freight turnover, the most active competitors of the Company were: Lotos Kolej (10.2% market share), PKP LHS (6.6%) and CTL Group (5.9%).

In the whole year 2016, compared with 2015, the largest increase in freight turnover were posted by the following competitive rail operators: PUK Kolprem (+179.3 million tkm, increase in the share of 0.4 p.p.) and PKP LHS (+172.5 million tkm, increase in the share of 0.3 p.p.). The largest drops were recorded by CTL Group (-380.1 million tkm, decrease in the share by 0.8 p.p.). Increases in freight volume in the analyzed period relative to 2015 were recorded by the following operators: PUK Kolprem (+1,058.6 thousand tons, increase in the market share of 0.5 p.p.), Rail Polska (+451.1 thousand tons, up 0.2 p.p.) and Ciech Cargo (+434.6 thousand tons, up 0.2 p.p.) and Orlen Kol-Trans (+318.5 thousand tons, up 0.2 p.p.).

4.2.3. Rail freight transport market in the Czech Republic

The total cargo transport market in the Czech Republic in the period of 3 quarters of 2016 in terms of freight volume amounted to 404.0 million tons, and 45.6 billion tkm in terms of freight turnover. Out of that, 72.5 million tons of cargo (increase by 710 thousand tons, i.e. 1.0% yoy), or 18.0% of the total freight volume, were transported by rail. Rail freight turnover accounted for 25.0% of the total freight turnover and was 11.5 billion tkm (up by 187.3 millions tkm, i.e. 1.7% yoy).[36] The sub-group of transport with the highest share, both in terms of freight volume and turnover, was road transport. The volume carried by this means of transport in the first 9 months of 2016 was 330.1 million tons (down by 4.4 million tons , i.e. 1.3% yoy), and the freight turnover reached 38.4 billion tkm (down by 6.9 billion tkm, i.e. 15.2% yoy). These accounted for 81.7% and 84.2% of the market, respectively. Air transport and inland navigation had marginal shares, reaching the total share of nearly 0.4% in freight volume and less than 1.1% in freight turnover.

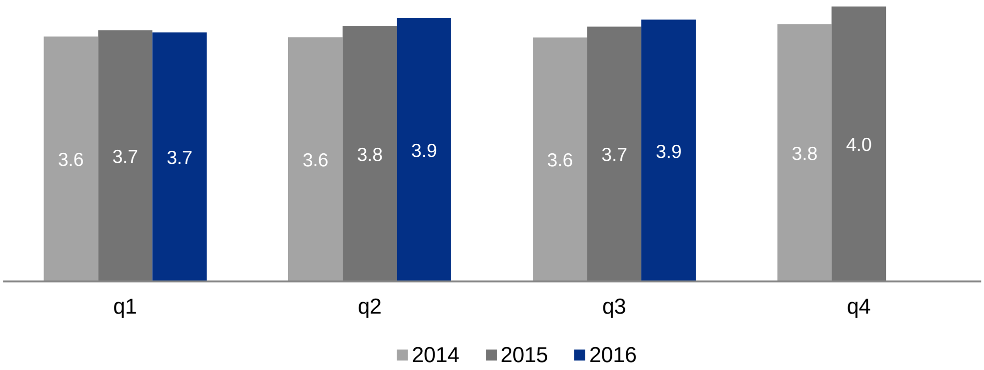
Figure 14 Rail freight volumes in Czech Republic in individual quarters of 2013-2016 (in million tons)



Source: Czech Statistical Office

[36] Ministry of Transport of the Czech Republic

Figure 15 Rail freight turnover in Czech Republic in individual quarters of 2013-2016 (in billions tkm)



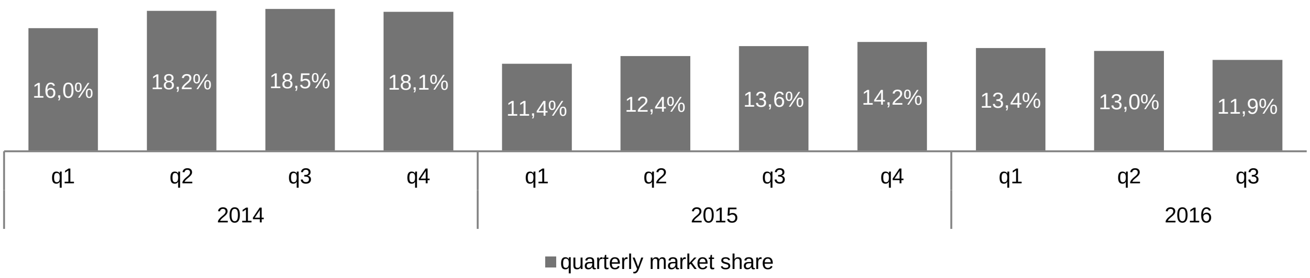
Source: Czech Statistical Office

4.2.4. Position of the AWT Group in the rail transport market in the Czech Republic

According to the data published by the Czech infrastructure manager (SŽDC), in 2016 there were 96 carriers in the Czech Republic holding licenses to provide rail freight services, including PKP CARGO S.A. and Advanced World Transport a.s.[37]

In H1 2016 AWT had a bigger share in terms of freight volume than in the corresponding period of the year before (increase by 1.3 p.p. yoy from a 11.9% to 13.2%).In connection with the poor financial standing of OKD - the only hard coal mining company in the Czech Republic, the AWT's market share in terms of freight volume dropped by 1.7 p.p. yoy in Q3 2016 (from 13.6% to 11.9%). The significant decrease of hard coal production, and hence the volume of cargo transported by AWT is attributable to the uncertain situation of OKD and mine closures. In the first place, the Paskov mine is to be closed down (H1 2017), followed by the Darkov plant (end of 2017) and the Lazy plant (2018), CSA plant (2021) and CSM plant (2023).[38] For the same reason the quarterly market shares in net freight turnover in Q1-Q3 2016 showed a downward trend. The market share mentioned above in Q3 2016 was 7.5% and was 1.3 p.p. yoy lower (in Q3 2015 the share was 8.8%).

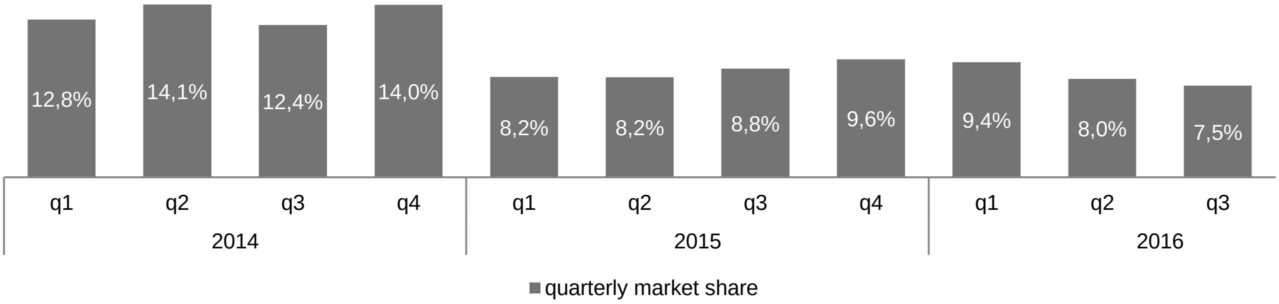
Figure 16 Share of AWT a.s. in freight volume in the Czech Republic in 2014-2016



Source: Proprietary material

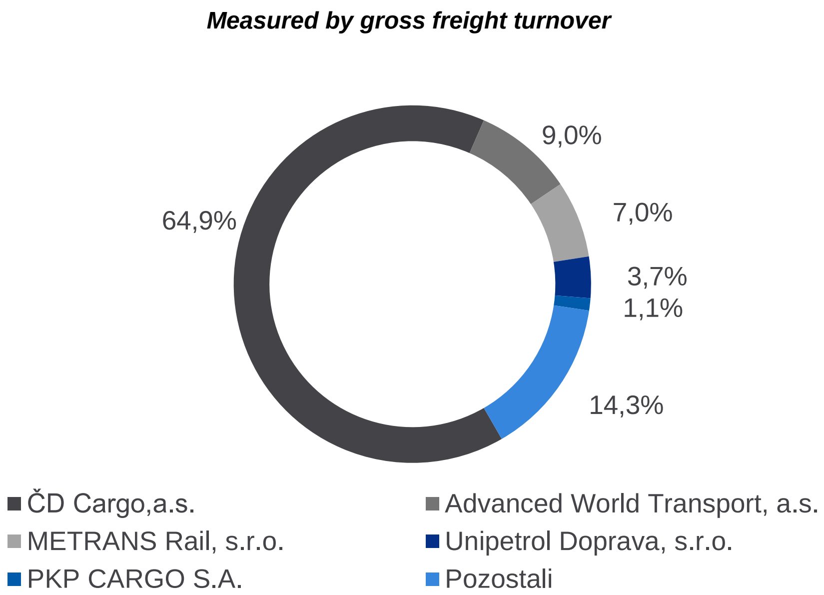
[37] Správa železniční dopravní cesty (SŽDC) – status as at 20 January 2017
[38] Nettg.pl

Figure 17 Share of AWT a.s. in freight turnover in the Czech Republic in 2014-2016



Source: Proprietary material

Figure 18 Market shares of the biggest rail operators by operational freight turnover in the Czech Republic in 2016 (btkm)



Source: SŽDC

In 2016, the number one operator in the Czech rail freight market was unchangeably ČD Cargo a.s. with a share of 64.9% in terms of gross freight turnover. The company recorded a market share drop by 1.7 p.p. yoy (in 2015 it held 66.6% of the market). These shares have been taken over largely by METRANS Rail s.r.o. (+0.8 p.p. yoy to 7.0% in the whole 2016). Also IDS Cargo has increased its share by 0.8 p.p. yoy (from 2.6% in 2015 to 3.4% in 2016). AWT a.s. recorded a market share decrease by 0.2 p.p. yoy from 9.2% in 2015 to 9.0% in 2016. The list prepared by the Rail Infrastructure Authority (SŽDC) comprised also PKP CARGO S.A. with a share of 1.1% in 2016 as a result of intensification of the Company's foreign transport activity in the Czech Republic associated with:

- increase of cabotage transport of coal from the Czech Republic to Slovakia,
- commencement of transport of coal in export to the Czech Republic in December 2016,
- increase of container transport to Piacenza, Italy.[39]

The main rail transport operators in the Czech Republic with market shares above 5% in terms of gross freight turnover in 2016 were: state-owned ČD Cargo a.s., Advanced World Transport a.s. and METRANS Rail s.r.o. Other carriers in the rail transport market with less than 5% but more than 1% share included: Unipetrol Doprava, s.r.o., IDS Cargo a.s., Rail Cargo Carrier - Czech Republic s.r.o, SD - Kolejova doprava a.s. and PKP CARGO S.A.

[39] SZDC; the list presents operators holding more than 1% share of the Czech market

4.2.5. The Company's and PKP CARGO Group's rail transport

The data on the transport activity conducted by the PKP CARGO Group in 12 months of 2016 and 12 months of 2015 comprise consolidated data for PKP CARGO S.A., PKP CARGO SERVICE Sp. z o.o. and the AWT Group, however the data on the AWT Group pertain only to the period from its acquisition by PKP CARGO S.A. (it has been consolidated by the full method since 28 May 2015). In 2016, the acquired AWT Group companies recorded freight turnover of 1,592 million tkm and carried freight volume of 13,263 thousand tons.[40]

The transport activity in 2016 was conducted by 5 entities from the Group. After acquisition of an 80% stake in AWT B.V., as of 28 May 2015 three additional carriers (AWT a.s., AWT Rail HU Zrt, AWT Rail SK a.s.) joined two other carriers operating in the PKP CARGO Group, i.e. PKP CARGO S.A. and PKP CARGO SERVICE sp. z o.o. (a wholly-owned subsidiary of PKP CARGO S.A.).

The PKP CARGO Group collaborates with the largest Polish and global groups, including ArcelorMittal, PKN Orlen, PGNiG, Lafarge Group, Azoty Group, Jastrzębska Spółka Węglowa, Węglokoks, Enea Group, PGE Group, Tauron Group, Polska Grupa Górnicza and International Paper. The contracts with these business partners are regularly renewed, which confirms the high quality of the transportation services provided by the PKP CARGO Group. The coal transport tender proceedings won (Enea Wytwarzanie, PGNiG Termika, Engie Energia Polska) and the extension of collaboration with key clients in a given cargo category, including aggregates, chemicals and timber serve as an example.

The PKP CARGO Group provides rail freight services in the territory of Poland and seven other European Union states, i.e.: Germany, the Czech Republic, Slovakia, Austria, the Netherlands, Hungary and Lithuania. The presence in these markets is a growth opportunity for the Group, since it allows the Group to handle independently the volumes transported to and from key European seaports, including those located on the North Sea (Amsterdam, Rotterdam, Zeebrugge, Antwerp, Hamburg) and those located on the Adriatic Sea (Koper, Triest, Rijeka).

Regardless of foreign ports, the PKP CARGO Group remains actively involved in the operation and further development of transport as part of a route leading from China through Poland to Western Europe, which has led to cooperation with Chinese partners aimed at developing a whole-train rail link between China and Europe and developing strategic cooperation in the field of transshipment activity in Małaszewicze. The primary objective of the project is to increase the volumes of overland intermodal transport between China and Western Europe through Małaszewicze and back to Asia. Development of trade cooperation between Poland and People's Republic of China is expected to be facilitated thanks to execution of many trade agreements and bilateral treaties on the government and enterprise level during the visit of China's president Xi Jinping in Poland.

In 2016, the PKP CARGO Group carried 111.5 million tons of cargo (-4% yoy) and achieved freight turnover of 28.5 billion tkm (-4% yoy), with the Parent Company carrying 98.6 million tons (-8% yoy) and 26.8 billion tkm (-7% yoy). PKP CARGO S.A. accounted for 88.4% of the Group's transport in terms of freight volume and 94.1% of freight turnover.

In the individual quarters of 2016, the Group recorded movements in freight volume: in Q1 (+5 yoy), Q2 (-4% yoy), Q3 (-10% yoy) and Q4 (-5% yoy), respectively, and in freight turnover: in Q1 (+2 yoy), Q2 (-6% yoy), Q3 (-7% yoy) and Q4 (-5% yoy), respectively. The movements in the Parent Company's freight volume were as follows: in Q1 (-7% yoy), Q2 (-12% yoy), Q3 (-9% yoy) and Q4 (-4% yoy), respectively, with the following declines in freight turnover: in Q1 (-5% yoy), Q2 (-10% yoy), Q3 (-7% yoy) and Q4 (-5% yoy), respectively.

The Group's performance also enjoyed a contribution from the development of freight transport outside Poland, totaling 17.6 million tons (+43% yoy) with freight turnover of 2.4 billion tkm (+50% yoy), including: PKP CARGO S.A. freight volume - 4.3 million tons (+18% yoy) and freight turnover - 0.8 billion tkm (+50% yoy).

2016 featured more extensive price competition characterized among other things by the PKP CARGO Group's competitors entering tenders in consortiums and by buyers diversifying their freight service providers.

Solid fuels were the main type of goods carried by the Group, with hard coal being the dominating cargo. Transportation of solid fuels represented 54% of the PKP CARGO Group's freight volume and 44% of freight turnover in 2016 (of which PKP CARGO S.A.'s transport services accounted for 46% and 42%, respectively). The Group's transportation of solid fuels was down by 6% yoy in terms of freight turnover and by 8% yoy in terms of freight volume, while the Parent Company's results were 11% and 9%, respectively. In 2016, the Group's freight volume in hard coal transport decreased by 7% yoy and freight turnover fell by

[40] This applies to the AWT Group companies consolidated by the full method.

11% yoy, driven primarily by less extensive transport of this commodity in Poland. In hard coal transport in Poland, a 12% decrease of freight volume was recorded and a 13% decrease of freight turnover, which results from the reorganization efforts underway in the Polish mining sector (including the establishment of Polska Grupa Górnicza, the transfer of unviable mines to the SRK Mine Restructuring Company) and diminished hard coal demand. Oversupply of this commodity and stockpiled inventories of unsold coal in coalyards result in smaller volumes to be transported in the market. In addition, offtakers from the power sector employ carrier diversification (following tender procedures, as at the beginning of 2016 the PKP CARGO Group lost some of its freight transport done for PGE GiEK S.A. Opole Power Plant Branch and Tauron Wytwarzanie S.A.). Rising, albeit still low coal prices on international markets have changed the directions of supply for international buyers. Polish hard coal has partially been squeezed out by better quality coal from Australia and Africa, contributing to PKP CARGO S.A.'s exported freight volume diminishing by 17% yoy in 2016. The rebound in hard coal prices observed in recent months may reverse the trend in exported transport of this commodity. The Group's freight volume of hard coal outside the country is up by 33% yoy while freight turnover is up by 19% yoy. In another cargo category forming part of solid fuels, namely coke, PKP CARGO Group's transport has trended up by 12% yoy, while freight turnover has climbed 22% yoy, chiefly driven by the quantum of transport handled by AWT Group companies (launch of consolidation at the end of H1 2015), higher transport volumes handled by PKP CARGO S.A. outside Poland and higher imported and transit volumes in Poland (to and from the Czech Republic).

Aggregates and construction materials were the second largest group of products carried by the PKP CARGO Group in 2016, with a 16% share in total freight turnover and freight volume. The Parent Company's transport of aggregates and construction materials accounted for 16% of freight turnover and 15% of freight volume in the Group. In transport of aggregates and construction materials in 2016, a 9% yoy decrease was recorded in the Group in terms of freight volume and a 12% yoy decrease in terms of freight turnover, while PKP CARGO S.A. experienced 13% and 12%, respectively. The decrease of transport in this cargo category results from postponing road investment projects in Poland ("design and build" tenders), downturn of local investments financed by local governments, decrease of expenditures on rail investments in connection with low progress of the projects, decrease of hydrotechnical investments and decrease of demand for limestone due to lower production of metallurgical products. The emergence of many rail operators entering the market and pursuing aggressive pricing policies and competition from road carriers were additional contributors to the decrease in transport in this cargo category. Revival is gradually being observed in this cargo category on account of the rising number of projects under execution, as evidenced by the 9% yoy growth in freight volume and freight turnover recorded in Q4 2016 (for the first time in 2016). Conducive weather conditions also contributed to the quantum of transport of aggregates and construction materials in Q4 2016: above zero temperatures permitted continuation of road and rail work and higher deliveries of limestone exported to Belarus and Ukraine.

Products associated with the metallurgical industry, i.e. metals and ores, are another important market area serviced by the PKP CARGO Group. Their percentage of the Group's freight turnover in 2016 was 12%, i.e. it stayed at the same level as in 2015, while the Parent Company's transportation services accounted for 98% of the Group's freight turnover in this area. Transported freight volume was down by 8% yoy in this area in connection with lower demand for metal ores resulting from the situation in the metallurgical industry on global markets and periodic suspension of deliveries of this raw material to one of the Group's key customers as a result of the overhaul of a furnace. Overhauls of the COS (continuous steel casting) line at two of the Group's most important customers carried out at the turn of Q2 and Q3 2016 exerted a significant impact on the level of transport of metals and ores (raw materials, semi-finished products and finished goods) in 2016. In conjunction with these overhauls, steel production diminished in Poland (in 2016 steel production was 8.9 million tons, i.e. it was down by 2.8% yoy).

The percentage of transport of chemicals in the Group's freight turnover in 2016 was 7%, i.e. it stayed close to the level seen in 2015, while the Parent Company's transport services represented 93% of freight turnover in this area. In 2016, the Group's freight volume rose by 8% yoy and freight turnover by 3% yoy in the transport of chemicals. The lower growth in freight turnover stemmed from the decline in the average haul by 4% yoy. In turn, in Q4 2016, the freight volume climbed by 12% yoy and freight turnover by 8% yoy. The growth in the transport of this product group is driven by higher imports of gas and methanol from the east.

The percentage of transport of liquid fuels in the Group's freight turnover in 2016 was 4%, i.e. it was down by 1 p.p. compared to 2015. The Parent Company's transport services represented 81% of freight turnover in this area. In transport of liquid fuels in 2016, the Group's freight volume rose by 1% yoy and freight turnover by 30% yoy (increase of the average haul by 28% yoy). The growth in transport of this product group ensues from commencing cooperation with clients for whom liquid fuels were transported over a long distance, among others, in imports and transit from Belarus.

In 2016, a 6% yoy decrease in freight turnover and a 7% yoy decrease in freight volume was recorded in timber and agricultural produce transport, which was driven by the lower volume of domestic and imported transport of timber and exported transport of agricultural produce. The Parent Company's transport services accounted for 86% of the freight turnover in this area. The shifting of some timber chip transport into the category of cargo container transport also contributed to lower timber transport.

The PKP CARGO Group continues to be the market leader in intermodal transport in Poland, an important element of its growth strategy. In 2016, the transport of intermodal units increased in terms of container freight volume by 25% yoy, while freight turnover increased by 22% yoy. The Parent Company's intermodal transport accounted for 94% of freight turnover and 87% of freight volume in this area. The increase in intermodal transport is driven mainly by the development of transit routes and the handling of cargo connections on the China-Europe-China route as part of the "New Silk Road" and a higher percentage of bulk cargo now being transported in containers (e.g. coke, wood chips). Transit between marine ports and inland terminals accounts for a significant share (which is closely associated with the development of this segment of the rail market – the transshipment of containers in Polish marine ports has climbed by 9.3% yoy).

Table 7 PKP CARGO Group's freight turnover in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	(m tkm)				%	*(m tkm)*				%
Solid fuels[1]	12,542	13,593	12,181	-1,052	-8%	3,339	3,926	3,307	-587	-15%
of which hard coal	11,070	12,387	10,757	-1,317	-11%	2,971	3,629	2,938	-658	-18%
Aggregates and construction materials[2]	4,636	5,261	6,142	-625	-12%	1,368	1,256	1,609	112	9%
Metals and ores[3]	3,401	3,709	3,650	-309	-8%	819	991	868	-172	-17%
Chemicals[4]	2,072	2,013	1,903	59	3%	524	483	497	40	8%
Liquid fuels[5]	1,091	839	781	252	30%	272	255	210	17	7%
Timber and agricultural produce[6]	1,533	1,629	1,694	-96	-6%	469	436	394	33	8%
Intermodal transport	2,474	2,031	1,832	442	22%	721	593	451	128	22%
Other[7]	774	764	764	10	1%	196	207	189	-11	-5%
Total	**28,521**	**29,839**	**28,947**	**-1,318**	**-4%**	**7,707**	**8,148**	**7,525**	**-440**	**-5%**

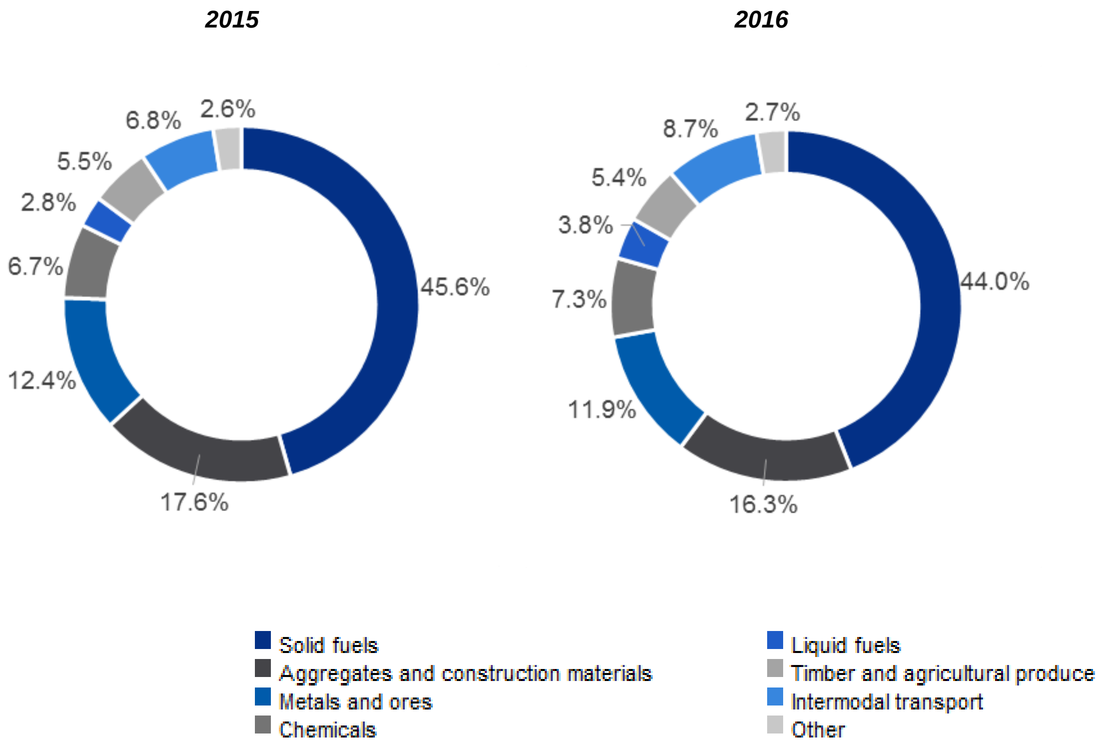
Source: Proprietary material

Table 8 PKP CARGO S.A. freight turnover in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	(m tkm)				%	*(m tkm)*				%
Solid fuels[1]	11,911	13,059	12,025	-1,148	-9%	3,185	3,664	3,283	-479	-13%
of which hard coal	10,605	11,967	10,601	-1,361	-11%	2,864	3,423	2,914	-559	-16%
Aggregates and construction materials[2]	4,555	5,216	6,123	-661	-13%	1,343	1,240	1,607	104	8%
Metals and ores[3]	3,333	3,654	3,650	-322	-9%	799	965	868	-166	-17%
Chemicals[4]	1,936	1,963	1,903	-28	-1%	493	460	497	34	7%
Liquid fuels[5]	885	743	781	142	19%	205	210	210	-5	-3%
Timber and agricultural produce[6]	1,312	1,483	1,694	-171	-12%	374	364	394	10	3%
Intermodal transport	2,316	1,928	1,832	388	20%	703	537	451	165	31%
Other[7]	589	673	764	-84	-12%	150	164	189	-14	-9%
Total	**26,836**	**28,720**	**28,772**	**-1,884**	**-7%**	**7,252**	**7,603**	**7,499**	**-351**	**-5%**

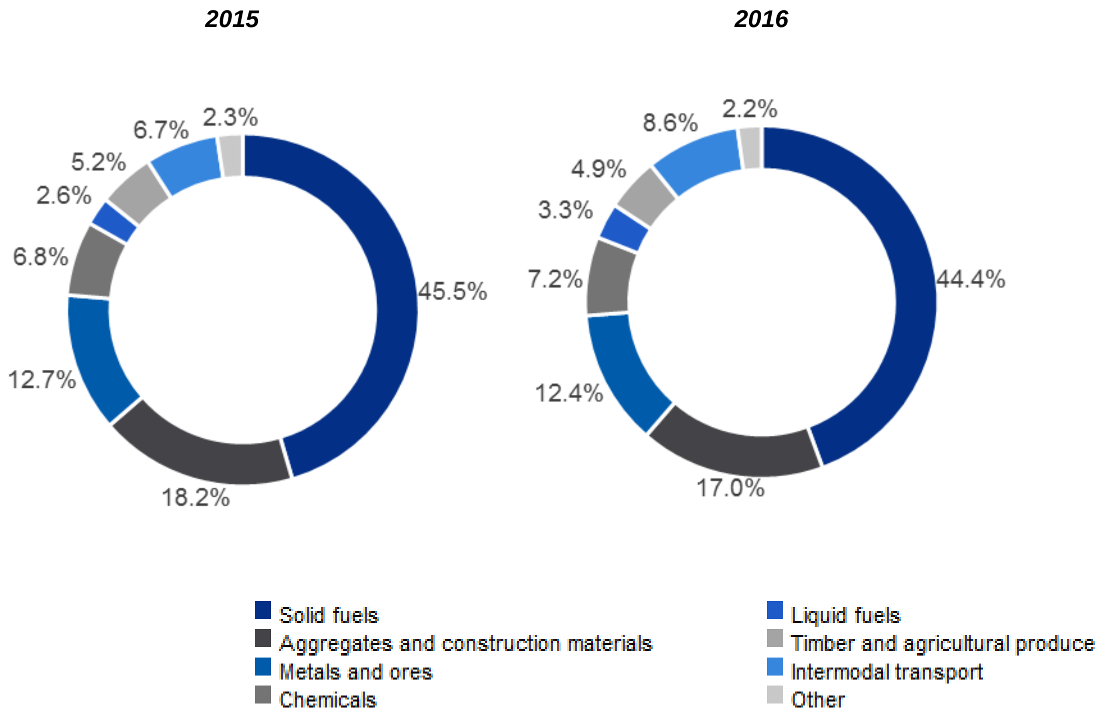
Source: Proprietary material

Figure 19 Structure of the PKP CARGO Group's freight turnover by cargo category in 2015 and 2016



Source: Proprietary material

Figure 20 Structure of PKP CARGO S.A.'s freight turnover by cargo category in 2015 and 2016



Source: Proprietary material

Table 9 PKP CARGO Group's freight volume in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	(000s tons)				%	(000s tons)				%
Solid fuels[1]	59,768	63,285	56,919	-3,517	-6%	16,078	18,726	16,150	-2,648	-14%
of which hard coal	53,690	57,847	51,976	-4,156	-7%	14,520	17,182	14,854	-2,662	-15%
Aggregates and construction materials[2]	18,173	19,898	21,526	-1,725	-9%	5,464	5,008	5,647	456	9%
Metals and ores[3]	11,266	12,311	12,293	-1,045	-8%	2,988	2,993	2,932	-5	0%
Chemicals[4]	6,295	5,846	5,961	449	8%	1,603	1,428	1,491	175	12%
Liquid fuels[5]	3,042	3,001	2,692	41	1%	843	870	759	-27	-3%
Timber and agricultural produce[6]	4,331	4,673	4,709	-342	-7%	1,207	1,247	1,187	-40	-3%
Intermodal transport	6,473	5,173	4,536	1,300	25%	1,853	1,549	1,113	304	20%
Other[7]	2,147	2,070	2,072	77	4%	571	554	513	17	3%
Total	**111,495**	**116,257**	**110,706**	**-4,762**	**-4%**	**30,607**	**32,375**	**29,792**	**-1,769**	**-5%**

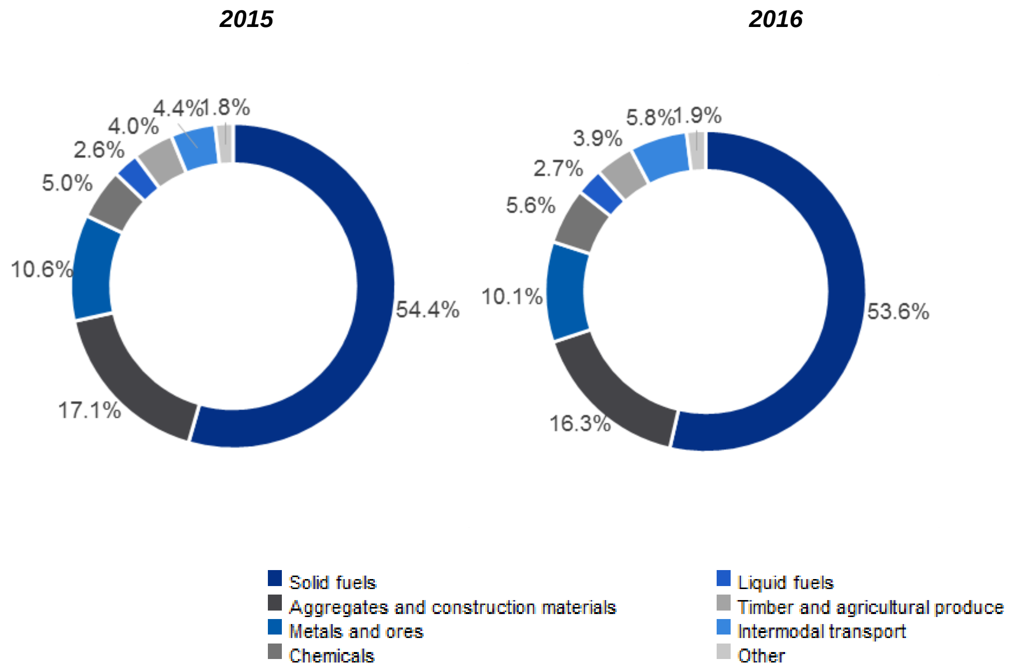
Source: Proprietary material

Table 10 PKP CARGO S.A.'s freight volume in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	(000s tons)				%	(000s tons)				%
Solid fuels[1]	51,375	57,491	56,237	-6,116	-11%	13,989	16,127	15,967	-2,138	-13%
of which hard coal	47,130	53,232	51,294	-6,101	-11%	12,929	15,130	14,670	-2,201	-15%
Aggregates and construction materials[2]	16,433	18,706	21,221	-2,273	-12%	4,933	4,464	5,610	469	11%
Metals and ores[3]	11,104	12,148	12,293	-1,044	-9%	2,944	2,916	2,932	28	1%
Chemicals[4]	5,749	5,581	5,961	168	3%	1,477	1,306	1,491	170	13%
Liquid fuels[5]	2,743	2,725	2,692	18	1%	731	741	759	-9	-1%
Timber and agricultural produce[6]	3,862	4,321	4,709	-459	-11%	1,028	1,071	1,187	-43	-4%
Intermodal transport	5,622	4,671	4,536	951	20%	1,651	1,312	1,113	338	26%
Other[7]	1,714	1,857	2,072	-143	-8%	463	460	513	3	1%
Total	**98,602**	**107,499**	**109,720**	**-8,898**	**-8%**	**27,216**	**28,397**	**29,571**	**-1,181**	**-4%**

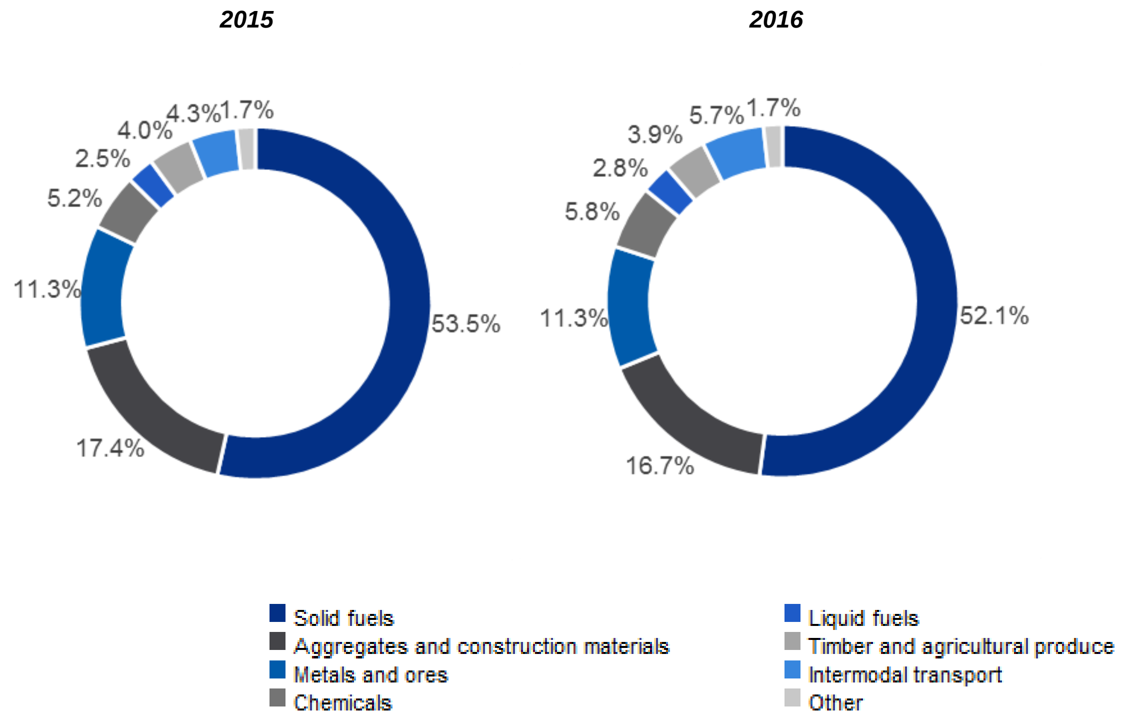
Source: Proprietary material

Figure 21 Structure of the PKP CARGO Group's freight volume by cargo category in 2015 and 2016



Source: Proprietary material

Figure 22 Structure of PKP CARGO S.A.'s freight volume by cargo category in 2015 and 2016



Source: Proprietary material

Table 11 PKP CARGO Group's average distance in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	km				%	km				%
Solid fuels[1]	210	215	214	-5	-2%	208	210	205	-2	-1%
of which hard coal	206	214	207	-8	-4%	205	211	198	-7	-3%
Aggregates and construction materials[2]	255	264	285	-9	-4%	250	251	285	-1	0%
Metals and ores[3]	302	301	297	1	0%	274	331	296	-57	-17%
Chemicals[4]	329	344	319	-15	-4%	327	338	333	-12	-3%
Liquid fuels[5]	359	280	290	79	28%	322	293	276	30	10%
Timber and agricultural produce[6]	354	348	360	5	2%	389	350	332	39	11%
Intermodal transport	382	393	404	-11	-3%	389	383	406	6	2%
Other[7]	360	369	369	-9	-2%	343	373	368	-30	-8%
Total	**256**	**257**	**261**	**-1**	**0%**	**252**	**252**	**253**	**0**	**0%**

Source: Proprietary material

[1] Includes hard coal, coke and lignite.
[2] Includes all kinds of stone, sand, bricks and cement.
[3] Includes ores and pyrites, as well as metals and metal products.
[4] Includes fertilizers and other chemicals.
[5] Includes crude oil and petrochemical products.
[6] Includes grain, potatoes, sugar beets, other produce, wood and wooden products.
[7] Includes ferry transportation and other freight.

Table 12 PKP CARGO S.A.'s average distance in 2014, 2015 and 2016 and in Q4 2014, 2015 and 2016

Item	2016	2015	2014	Change 2016/2015		Q4 2016	Q4 2015	Q4 2014	Change Q4 2016/Q4 2015	
	km				*%*	*km*				*%*
Solid fuels[1]	232	227	214	5	2%	228	227	206	1	0%
of which hard coal	225	225	207	0	0%	222	226	199	-5	-2%
Aggregates and construction materials[2]	277	279	289	-2	-1%	272	278	286	-5	-2%
Metals and ores[3]	300	301	297	-1	0%	271	331	296	-60	-18%
Chemicals[4]	337	352	319	-15	-4%	334	352	333	-18	-5%
Liquid fuels[5]	323	273	290	50	18%	280	284	276	-4	-1%
Timber and agricultural produce[6]	340	343	360	-4	-1%	364	340	332	24	7%
Intermodal transport	412	413	404	-1	0%	426	409	406	16	4%
Other[7]	344	362	369	-19	-5%	324	357	368	-33	-9%
Total	**272**	**267**	**262**	**5**	**2%**	**266**	**268**	**254**	**-1**	**0%**

Source: Proprietary material

[1] Includes hard coal, coke and lignite.
[2] Includes all kinds of stone, sand, bricks and cement.
[3] Includes ores and pyrites, as well as metals and metal products.
[4] Includes fertilizers and other chemicals.
[5] Includes crude oil and petrochemical products.
[6] Includes grain, potatoes, sugar beets, other produce, wood and wooden products.
[7] Includes ferry transportation and other freight.

From the point of view of the directions in which the PKP CARGO Group's transportation services were provided, transportation within Poland was dominant, constituting 91% of the realized freight turnover in 2016. In comparison with 2015, the percentage of freight turnover performed outside Poland rose by 3 p.p., which highlights the rapid growth of freight outside Poland.

PKP CARGO S.A.'s transportation services performed in Poland accounted for 97% of the Company's freight turnover realized in 2016 (98% in 2015). Compared to 2015, the Company delivered material growth in freight volume and freight turnover outside Poland, by 18% and 50% yoy, respectively, which highlights the growth of freight outside Poland.

4.3. Other services

The Company and Group's core business is rail transport of cargo. In addition to cargo rail transport services, the Group also provides additional services:

- forwarding services – the Group's freight forwarding offering consists of comprehensive logistics services using vehicle, marine and inland water transportation incorporating transshipment, storage, warehousing and packaging. The Group also offers customs handling. The comprehensive transport solutions designed and implemented (3PL solutions) are an additional strength for the Group's services. Freight forwarding services are provided chiefly by PKP CARGO CONNECT Sp. z o.o. and AWT Čechofracht a.s.;

- traction services and locomotive lease services which involve the provision of a traction unit with an operating team to perform a railway transport operation or to ensure its readiness, e.g. to propel repair or rescue trains. Such services are provided on the Polish market and abroad;

- comprehensive siding services, entailing among others formation of trains, maneuvering services, rail traffic management on sidings, loading and unloading, warehouse management, conservation and ongoing maintenance of point infrastructure. PKP CARGO SERVICE Sp. z o.o. and AWT a.s. are the main entities providing these services. Siding services are offered in Poland, the Czech Republic and Hungary;

- transshipment services – the PKP CARGO Group has been developing its transshipment activity on the basis of conventional and intermodal transshipment terminals owned by PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o., PKP CARGO Centrum Logistyczne Medyka-Żurawica Sp. z o.o., PS TRADE TRANS Sp. z o.o., CARGOSPED Sp. z o.o. and AWT a.s.;

- intermodal logistics services – the Group takes care of all the elements of the logistics chain, including: rail transport, road transport, transshipment and storing intermodal units. This activity is based on a network of intermodal terminals. Within the Group, PKP CARGO CONNECT Sp. z o. o. is the company specializing in, and dedicated to, comprehensive intermodal transport service. The service of constantly monitoring the traffic of intermodal trains called "Track and Trace" implemented by AWT brings added value to the Group's offer;

- rolling stock repairs – maintenance of the Group's rolling stock is provided mainly by a dedicated company PKP CARGOTABOR Sp. z o.o. Additionally, selected repair and maintenance work is also done in the facilities situated in the structures of the Units of PKP CARGO S.A. and by AWT a.s.;

- land reclamation services – the Group's service offering in this area consists of managing and revitalizing post-industrial premises (including mining areas), work to raze objects, managing facilities allocated to utilize waste, eliminating underground mining pits and de-contaminating soil. Additionally, the Group offers services in the area of civil engineering. The land reclamation activity is carried out by AWT Rekultivace a.s. and AWT Rekultivace PL sp. z o.o., chiefly in the Czech Republic in the vicinity of Ostrava where mining waste deposits are located.

Neither PKP CARGO S.A. nor the PKP CARGO Group distinguishes operating segments in their business since they have one main product to which all the material services rendered are allocated. They conduct business within one main segment – domestic and international cargo freight and provision of comprehensive logistics services related to rail freight. The Management Board of the Parent Company analyzes financial data in the layout in which they have been presented in the Standalone and Consolidated Financial Statements. The Group additionally provides services related to rolling stock repairs and land reclamation services, but they are not material for the Group's business and therefore are not treated as separate operating segments.

4.4. Information on selling markets and sources of supply.

Key customers

PKP CARGO S.A. operates in one principal geographic area, i.e. Poland, where the Company is domiciled. Total revenues for all geographic areas outside Poland in 2016 and 2015 did not exceed 12% of the Company's total revenues. There is no single geographic area (outside of Poland) which generates more than 5% of revenues from sales of services.

In the period ended 31 December 2016, sales to the ArcelorMittal Group represented 12.8% of total revenues from the sales of the Company's services, while in the period ended 31 December 2015 they represented 11.4%.

In the period ended 31 December 2016, sales to PKP CARGO CONNECT sp. z o.o. represented 12.9% of total revenues from the sales of the Company's services, while in the period ended 31 December 2015 they represented 11.7%.

The PKP CARGO Group, just like the Parent Company, operates in one principal geographic area, i.e. Poland. Following the acquisition of shares in AWT, the Group's market share in the Czech Republic increased significantly. In the period ended 31 December 2016, total revenues from Czech partners reached almost 16% of total revenues on the sale of the Group's services, compared to nearly 12% in the corresponding period of the previous year.

The Group does not publish information on its leading customers, since revenues from any single Group client do not exceed 10% of the total revenues on the sales of services and finished goods.

Note 7.2 of the Consolidated Financial Statements and Note 6.2 of the Standalone Financial Statements present the Group's revenues generated by external clients by geographic area.

Key suppliers

As they operate on the freight transport market, both the Parent Company and the PKP CARGO Group are dependent on the largest supplier of access services to rail infrastructure in Poland, namely PKP Polskie Linie Kolejowe S.A. (PKP PLK). This company is a domestic supplier that provides access to the prevalent portion of rail infrastructure in Poland in accordance with the price list approved annually by the President of the Office of Rail Transport. This infrastructure is made available for a fee on the same terms to all carriers offering passenger and cargo rail transport. PKP PLK renders services to the PKP CARGO Group that include the provision of access to rail infrastructure, the provision of access to traction network equipment, the directing and carrying of traffic and access to train handling equipment. PKP PLK's percentage of procurement costs in 2016 (meaning the sum of the costs of external services and of the consumption of raw materials and supplies) was 34.0% in PKP CARGO S.A., while it was 24.5% in the Group.

Moreover, the Group's main supplier for traction fuel and traction energy is PKP Energetyka S.A. This supplier specializes in selling and supplying electricity, selling liquid fuels and providing electrical energy-related services. PKP Energetyka S.A.'s percentage of procurement costs in 2016 (meaning the sum of the costs of external services and of the consumption of raw materials and supplies) was 24.9% in the PKP CARGO S.A., while it was 17.9% in the Group.

4.5. Headcount

Information concerning movements in headcount in the PKP CARGO Group and PKP CARGO S.A. in 2014, 2015 and 2016 is provided below.

Table 13 Headcount in 12M and Q4 2016 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees)

Item	Headcount as at:			Change YTD	Movement in Q4 2016
	31/12/2016*	30/09/2016**	31/12/2015***		
PKP CARGO Group	**23,144**	**23,292**	**23,805**	**-661**	**-148**
including: PKP CARGO S.A.	*17,429*	*17,569*	*17,979*	*-550*	*-140*

Source: Proprietary material

** including AWT Group's employees (2031 persons)*
*** including AWT Group's employees (2074 persons)*
**** including AWT Group's employees (2149 persons)*

Table 14 Headcount in 12M and Q4 2015 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees)

Item	Headcount as at:			Change YTD	Change in Q4 2015
	31/12/2015*	30/09/2015**	31/12/2014		
PKP CARGO Group	**23,805**	**23,634**	**24,960**	**-1,155**	**171**
including: PKP CARGO S.A.	*17,979*	*17,819*	*20,830*	*-2,851*	*160*

Source: Proprietary material

** including AWT Group's employees (2149 persons)*
***including AWT Group's employees (2132 persons)*

Table 15 Headcount in 12M and Q4 2014 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees)

Item	Headcount as at:			Change YTD	Change in Q4 2014
	31/12/2014	30/09/2014	31/12/2013		
PKP CARGO Group	**24,960**	**26,090**	**26,553**	**-1,593**	**-1,130**
including: PKP CARGO S.A.	*20,830*	*21,870*	*22,480*	*-1,650*	*-1,040*

Source: Proprietary material

Table 16 Average headcount in 12M of 2014-2016 in the PKP CARGO Group and PKP CARGO S.A. (pertains to active employees)

Item	Average headcount in FTEs			Change 2016-2015	Average headcount in persons			Change 2016-2015
	12 months* 2016	12 months** 2015	12 months 2014		12 months* 2016	12 months** 2015	12 months 2014	
PKP CARGO Group	**23,441**	**24,375**	**26,185**	**-934**	**23,465**	**24,407**	**26,215**	**-942**
including: PKP CARGO S.A.	*17,698*	*18,484*	*22,010*	*-786*	*17,702*	*18,486*	*22,012*	*-784*

Source: Proprietary material

** including AWT Group's employees (2089 FTEs / 2095 persons)*
*** including AWT Group's employees (2115 FTEs / 2124 persons)*

Table 17 Movement in the headcount structure in 12M and Q4 2016 in the PKP CARGO Group and PKP CARGO S.A. (active employees only)

Item	Headcount as at:			Change YTD	Movement in Q4 2016
	31/12/2016*	30/09/2016**	31/12/2015***		
White-collar positions - Group	**5,272**	**5,263**	**5,324**	**-52**	**9**
including: PKP CARGO S.A.	*3,825*	*3,833*	*3,863*	*-38*	*-8*
Blue-collar positions - Group	**17,872**	**18,029**	**18,481**	**-609**	**-157**
including: PKP CARGO S.A.	*13,604*	*13,736*	*14,116*	*-512*	*-132*
Total	**23,144**	**23,292**	**23,805**	**-661**	**-148**
including: PKP CARGO S.A.	*17,429*	*17,569*	*17,979*	*-550*	*-140*

Source: Proprietary material

** including AWT Group's employees (2031 persons)*
*** including AWT Group's employees (2074 persons)*
**** including AWT Group's employees (2149 persons)*

Table 18 Movement in the headcount structure in 12M and Q4 2015 in the PKP CARGO Group and PKP CARGO S.A. (active employees only)

Item	Headcount as at:			Change YTD	Change in Q4 2015
	31/12/2015*	30/09/2015**	31/12/2014		
White-collar positions - Group	**5,324**	**5,284**	**5,349**	**-25**	**40**
including: PKP CARGO S.A.	*3,863*	*3,819*	*4,462*	*-599*	*44*
Blue-collar positions - Group	**18,481**	**18,350**	**19,611**	**-1,130**	**131**
including: PKP CARGO S.A.	*14,116*	*14,000*	*16,368*	*-2,252*	*116*
Total	**23,805**	**23,634**	**24,960**	**-1,155**	**171**
including: PKP CARGO S.A.	*17,979*	*17,819*	*20,830*	*-2,851*	*160*

Source: Proprietary material

** including AWT Group's employees (2149 persons)*
*** including AWT Group's employees (2132 persons)*

Table 19 Movement in the headcount structure in 12M and Q4 2014 in the PKP CARGO Group and PKP CARGO S.A. (active employees only)

Item	Headcount as at:			Change YTD	Change in Q4 2014
	31/12/2014	30/09/2014	31/12/2013		
White-collar positions - Group	**5,349**	**5,464**	**5,566**	**-217**	**-115**
including: PKP CARGO S.A.	*4,462*	*4,577*	*4,706*	*-244*	*-115*
Blue-collar positions - Group	**19,611**	**20,626**	**20,987**	**-1,376**	**-1,015**
including: PKP CARGO S.A.	*16,368*	*17,293*	*17,774*	*-1,406*	*-925*
Total	**24,960**	**26,090**	**26,553**	**-1,593**	**-1,130**
including: PKP CARGO S.A.	*20,830*	*21,870*	*22,480*	*-1,650*	*-1,040*

Source: Proprietary material

When comparing 2016 to 2015, one may observe a decline in the average headcount in the PKP CARGO Group by 934 FTEs (786 FTEs in just PKP CARGO S.A.). This results directly from the Voluntary Redundancy Programs carried out in 2015. The execution of the first Voluntary Redundancy Program led to a diminishment in headcount as of 1 February 2015, while the execution of the second Voluntary Redundancy Program prompted the same from 1 July and 1 August 2015. The execution of the VRP schedule meant that the average headcount in 2015 was higher than the headcount at yearend 2015.

In addition, headcount movements in the PKP CARGO Group also ensued from the termination of employment contracts for natural causes, chiefly in connection with obtaining retirement or disability rights.

4.6. The Company's and the PKP CARGO Group's investments

4.6.1. Capital expenditures

PKP CARGO S.A.

In 2016, the Company incurred capital expenditures for the acquisition of property, plant and equipment and intangible assets in the form of procurement, modernization and the overhaul component (periodic repairs of P4 and P5 rolling stock and P3 periodic inspections) of PLN 445.8 million, which accounted for 102.0% of the actuals for 2015.

In 2016, the Company incurred capital expenditures in property, plant and equipment outside of Poland, primarily to purchase multi-system locomotives.

The biggest part of capital expenditures in the Company in 2016 was allocated for the execution of investment tasks associated with the rolling stock, mainly for periodic repairs of the rolling stock, including periodic inspections (the number of periodic repairs and periodic inspections of the rolling stock performed in individual periods is derived from the cycles specified in the Maintenance System Documentation "MSD" of the rolling stock approved by the Office of Rail Transport and the quantum of rolling stock maintained as fit for operation as required for the provision of transportation services), purchase of multi-system locomotives (12 units) and modernization of locomotives (7 locomotives) – for a total amount of PLN 419.8 million (i.e. 94.2% of the capital expenditures). In addition, expenditures were incurred for computerization, i.e. purchases of computer hardware, servers and intangible assets (software) in the amount of PLN 16.5 million (chiefly to implement IT systems and buy computers and GSM handsets), for investment construction activity in the amount of PLN 4.5 million (chiefly to modernize buildings, including workshop buildings and to build and modernize gas, water supply, sewer and heat grids) and purchases of machinery and equipment, workshop and office equipment and vehicles for PLN 5.0 million.

Table 20 Capital expenditures in PKP CARGO S.A. in 2014 – 2016 (000s PLN)

Item	2016	2015	2014	Change 2016 - 2015	Change %
Investment construction activity	4,528	19,870	11,135	-15,342	-77.2%
Purchase of traction vehicles	199,417	0	0	199,417	-
Modernization of locomotives	35,375	69,642	48,242	-34,267	-49.2%
Purchase of wagons	0	20,063	57,224	-20,063	-100.0%
Machinery and equipment	2,827	6,051	5,900	-3,224	-53.3%
ICT development	16,477	32,294	20,615	-15,817	-49.0%
Other	2,207	5,473	2,673	-3,266	-59.7%
Components in overhaul:	184,981	283,609	433,203	-98,628	-34.8%
Repairs and periodic inspections of locomotives	45,001	137,824	125,198	-92,823	-67.3%
Repairs and periodic inspections of wagons	139,980	145,785	308,005	-5,805	-4.0%
Total	**445,812**	**437,002**	**578,992**	**8,810**	**2.0%**

Source: Proprietary material

The funding mix of capital expenditures for property, plant and equipment and intangible assets was as follows: PLN 106.2 million from own funds, PLN 332.3 million from loans, PLN 1.9 million as a lease and PLN 5.4 million from the Cohesion Fund, which the Company received under the "Infrastructure and Environment" Operational Programme. In addition, in 2016 the Company also used loans to refinance capital expenditures from the previous year in the amount of PLN 134.2 million.

Overall, credit lines earmarked for investments were originated for a total amount of PLN 466.5 million, of which:

- PLN 332.3 million to finance 2016 expenditures,
- PLN 134.2 million to refinance expenditures from the previous year.

PKP CARGO Group

In 2016, the Company incurred capital expenditures for the acquisition of property, plant and equipment and intangible assets in the form of procurement, modernization and the overhaul component (periodic repairs of P4 and P5 rolling stock and P3 periodic inspections) of PLN 532.7 million, which accounted for 109.9% of the actuals for 2015.

In 2016, the Group incurred capital expenditures outside Poland for property, plant and equipment, chiefly to purchase multi-system locomotives.

The majority of the capital expenditures in the Group in 2016 was allocated for the execution of investment tasks associated with rolling stock, mainly to purchase multi-system locomotives (12 units), for periodic repairs and periodic inspections of the rolling stock (the number of periodic repairs and periodic inspections performed in individual periods is derived from the cycles specified in the MSD of the rolling stock approved by the Office of Rail Transport and the quantum of rolling stock maintained as fit for operation as required for the provision of transportation services) and modernization of locomotives and wagons – for a total amount of PLN 474.9 million (i.e. 89.1% of the capital expenditures). In addition, expenditures were incurred for computerization, i.e. purchases of computer hardware, servers and intangible assets (software) in the amount of PLN 20.1 million, for investment construction activity in the amount of PLN 19.1 million (chiefly to modernize buildings, including workshop buildings and to build and modernize gas, water supply, sewer and heat grids) and purchases of machinery and equipment, workshop and office equipment and vehicles for PLN 18.6 million.

Table 21 Capital expenditures in the PKP CARGO Group in 2014 – 2016 (thousands PLN)

Item	2016	2015	2014	Change 2016 - 2015	Change %
Investment construction activity	19,079	28,084	18,130	-9,005	-32.1%
Purchase of traction vehicles	200,188	0	0	200,188	-
Modernization of locomotives	40,470	70,400	48,544	-29,930	-42.5%
Purchase of wagons	0	20,063	57,301	-20,063	-100.0%
Wagon upgrades	3,606	1,624	0	1,982	122.0%
Machinery and equipment	14,416	12,170	9,469	2,246	18.5%
ICT development	20,114	34,862	21,972	-14,748	-42.3%
Other	4,206	9,744	4,163	-5,538	-56.8%
Components in overhaul:	230,660	307,613	437,154	-76,953	-25.0%
Repairs and periodic inspections of locomotives	72,134	150,681	126,072	-78,547	-52.1%
Repairs and periodic inspections of wagons	158,526	156,932	311,082	1,594	1.0%
Total	**532,739**	**484,560**	**596,733**	**48,179**	**9.9%**

Source: Proprietary material

The funding mix of capital expenditures for property, plant and equipment and intangible assets was as follows: PLN 191.8 million from own funds, PLN 332.3 million from loans, PLN 3.2 million as a lease and PLN 5.4 million from the Cohesion Fund, which the Company received under the “Infrastructure and Environment” Operational Programme.

4.6.2. Assessment of the capacity to execute investment plans

PKP CARGO S.A. and the Group are able to finance their investment plans using current and planned financial surpluses of own funds, available credit facilities and by contracting new financial lease contracts and other forms of external financing.

Additionally, a cash pooling system is in place in the PKP CARGO Group which comprises, as at 31 December 2016, 7 Group companies.

PKP CARGO S.A. has been efficiently managing the cash management cycle by matching the maturity of receivables and liabilities. To hedge the possible risk of a short-term cash shortage, PKP CARGO S.A. has in place an overdraft facility with a limit of PLN 100 million.

5. Analysis of the PKP CARGO Group's financial standing and assets

5.1. PKP CARGO S.A.'s economic and financial highlights

5.1.1. PKP CARGO S.A.'s statement of comprehensive income

In 2016, PKP CARGO S.A. transported 98.6 million tons of cargo (i.e. 8% less than in 2015) and recorded freight turnover of 26.8 billion tkm (i.e. 7% less than in 2015), which is described in detail in the chapter entitled "The Company's and the PKP CARGO Group's rail transport business".

PKP CARGO S.A.'s operating revenues in 2016 dropped 7.5% yoy while operating expenses fell by 9.6% yoy. The Company's result on operating activities and net result in 2016 were PLN -31.1 million and PLN -68.6 million. The Company's adjusted operating revenue fell by 7.5% yoy while its adjusted operating expenses diminished by 3.1% yoy. The changes to the adjusted result pertained to 2015, in which adjustments were made for the second VRP (VRP 2) in the amount of PLN 63.9 million and the impairment loss on non-current assets and non-current assets classified as held for sale in the amount of PLN 177.9 million. Additionally, the adjusted net result takes into consideration the deferred tax on the second VRP in the amount of PLN 12.1 million and deferred tax on impairment losses on non-current assets and assets classified as held for sale in the amount of PLN 33.8 million. Accordingly, the adjusted result on operating activities for 2015 was PLN 126.5 million, while the net result was PLN 81.7 million. No material non-recurring events transpired in the Company in 2016; for that reason no adjustments were made to the result. The main cause of the decline in the adjusted result in 2016 compared to the adjusted result for the previous year was the challenging situation on the transport market, which directly contributed to a lower freight volume and to lower prices for transportation services.

The details of individual line items of the Statement of comprehensive income are presented in the further part of this section. The tables below present PKP CARGO S.A.'s results and adjusted results from 2014 to 2016.

Table 22 PKP CARGO S.A.'s result in 2014-2016 (thousands of PLN)

No.	Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
1	Total operating revenue	3,250,457	3,514,154	3,880,181	-263,697	-7.5%
2	Total operating expenses	3,281,568	3,629,334	3,787,368	-347,766	-9.6%
3	**Result on operating activities**	**-31,111**	**-115,180**	**92,813**	**84,069**	**-**
4	*EBIT margin*	*-1.0%*	*-3.3%*	*2.4%*	*2.3 p.p.*	-
5	*EBITDA margin*	*13.7%*	*12.9%*	*11.4%*	*0.7 p.p.*	*5.6%*
6	Financial revenue	20,532	45,024	49,497	-24,492	-54.4%
7	Financial expenses	60,111	68,951	54,778	-8,840	-12.8%
8	**Result before tax**	**-70,690**	**-139,107**	**87,532**	**68,417**	**-**
9	*Net profit margin*	*-2.2%*	*-4.0%*	*2.3%*	*1.8 p.p.*	-
10	Income tax	-2,125	-24,982	11,925	22,857	-
11	**NET RESULT**	**-68,565**	**-114,125**	**75,607**	**45,560**	**-**
12	*Net profit margin*	*-2.1%*	*-3.2%*	*1.9%*	*1.1 p.p.*	-

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

Table 23 PKP CARGO S.A.'s adjusted results in 2014 – 2016 (thousands of PLN)

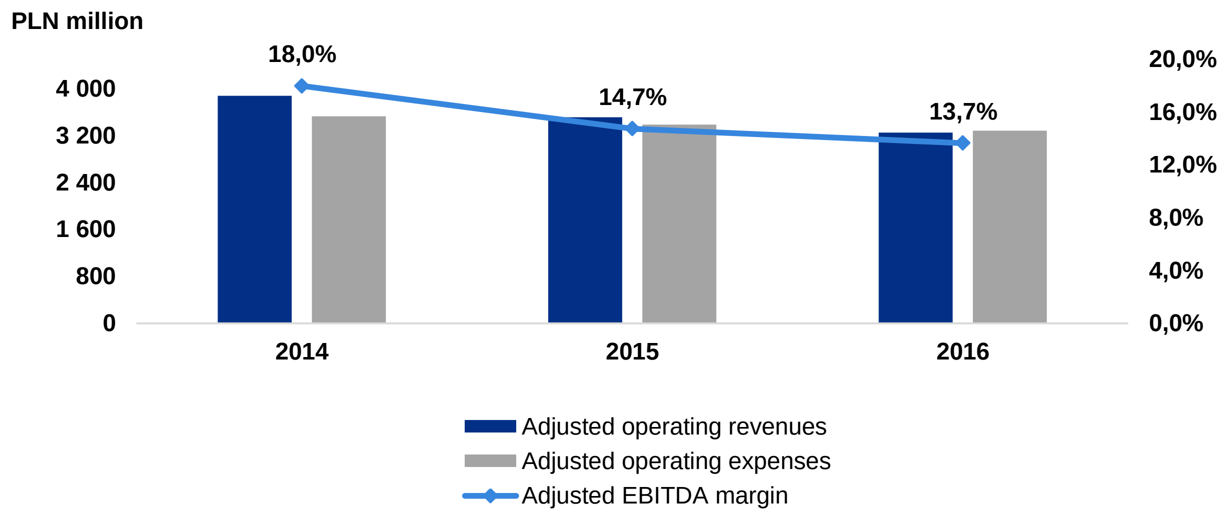
No.	Item	2016	2015 adjusted **	2014 adjusted *	Change 2016 - 2015	% change 2016/2015
1	Total operating revenue	3,250,457	3,514,154	3,880,181	-263,697	-7.5%
2	Total operating expenses	3,281,568	3,387,610	3,530,252	-106,042	-3.1%
3	**Result on operating activities**	**-31,111**	**126,544**	**349,929**	**-157,655**	**-**
4	*EBIT margin*	*-1.0%*	*3.6%*	*9.0%*	*-4.6 p.p.*	-
5	*EBITDA margin*	*13.7%*	*14.7%*	*18.0%*	*-1.1 p.p.*	*-7.4%*
6	Financial revenue	20,532	45,024	49,497	-24,492	-54.4%
7	Financial expenses	60,111	68,951	54,778	-8,840	-12.8%
8	**Result before tax**	**-70,690**	**102,617**	**344,648**	**-173,307**	**-**
9	*Net profit margin*	*-2.2%*	*2.9%*	*8.9%*	*-5.1 p.p.*	-
10	Income tax	-2,125	20,945	60,777	-23,070	-
11	**NET RESULT**	**-68,565**	**81,671**	**283,871**	**-150,236**	**-**
12	*Net profit margin*	*-2.1%*	*2.3%*	*7.3%*	*-4.4 p.p.*	-

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

* the 2014 data were adjusted for presentation purposes for the costs following from the first Voluntary Redundancy Program implemented in the amount of PLN 257.1 million; additionally, the adjusted net result takes into consideration the deferred tax on the first VRP in the amount of PLN 48.9 million.
** the 2015 data were adjusted for presentation purposes for the costs following from the second VRP implemented in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale, in the amount of PLN 177.9 million; additionally, the adjusted net result takes into consideration the deferred tax on the second VRP in the amount of PLN 12.1 million and deferred tax on impairment losses on non-current assets and assets classified as held for sale in the amount of PLN 33.8 million.

The figure below presents the adjusted EBITDA margin compared to selected items in the Company's statement of comprehensive income for 2014-2016.

Figure 23 Adjusted EBITDA margin compared to the Company's adjusted operating revenues and expenses in 2014-2016 *,**



Source: Proprietary material

* the 2014 data were adjusted for presentation purposes for the costs following from the first Voluntary Redundancy Program implemented in the amount of PLN 257.1 million
** the 2015 data were adjusted for presentation purposes for the costs following from the second VRP implemented in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale in the amount of PLN 177.9 million

Operating revenues

Table 24 PKP CARGO S.A.'s operating revenue in 2014-2016 (thousands of PLN)

No.	Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
1	Revenues from the sale of services	3,208,165	3,472,945	3,775,863	-264,780	-7.6%
1.1	*Revenue from rail transportation and freight forwarding services*	*3,095,973*	*3,360,873*	3,646,968	*-264,900*	-7.9%
2	Revenues from sales of materials	10,840	9,435	28,809	1,405	14.9%
3	Other operating revenue	31,452	31,774	75,509	-322	-1.0%
4	**Total operating revenue**	**3,250,457**	**3,514,154**	**3,880,181**	**-263,697**	**-7.5%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

In the Company's total operating revenue the biggest item was revenue from sales of services (98.7% in 2016 compared to 98.8% in 2015). Revenue on the sale of services comprises mainly: revenue from rail transportation and freight forwarding services, revenue from siding and traction services and other revenue, which chiefly includes revenue on the lease of assets, revenue on administrative support services and rolling stock repair services. The remaining part of the operating revenue of PKP CARGO S.A. consists of revenue from the sales of materials, which includes, among others, sales of steel and cast iron scrap as well as other operating revenue comprising, among others, gains from the sale of non-financial non-current assets, movement in impairment losses on receivables and interest on receivables, received fines and compensation, net foreign exchange gains on trade receivables and liabilities and reversal of provisions.

The decline in revenue from rail transportation and freight forwarding services by 7.9% yoy to PLN 3,096 million resulted from the the Company's lower freight transport volume. The details pertaining to PKP CARGO S.A.'s transport business are described in chapter 4.2.5, "The Company's and the PKP CARGO Group's rail transport business".

The growth in revenues from sales of materials by PLN 1.4 million (i.e. 14.9% yoy) was caused primarily by rebounding scrap prices in H2 2016. This contributed to the higher viability of decommissioning the extraneous, unused and obsolete rolling stock remaining in the Company.

Other operating revenue edged down by PLN 0.3 million, i.e. by 1.0% yoy. The greatest movements were recorded in the following line items: revenue on the reversal of provisions totaling PLN 9.0 million, including for the Office of Competition and Consumer Protection for PLN 4.0 million, higher revenue on the net FX gains on trade receivables and liabilities of PLN 3.4 million, higher revenue on written off trade liabilities of PLN 3.1 million, higher profit on the sale of non-financial non-current assets by PLN 1.2 million and higher revenue on received penalties and compensation by PLN 1.0 million.

Operating expenses

Table 25 PKP CARGO S.A.'s operating expenses in 2014 – 2016 (thousands of PLN)

No.	Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
1	Depreciation and amortization and impairment losses	474,844	569,630	347,782	-94,786	-16.6%
2	Consumption of materials and energy	532,655	595,633	587,736	-62,978	-10.6%
3	External services	1,078,527	1,114,951	1,169,207	-36,424	-3.3%
4	Taxes and charges	28,587	31,875	35,941	-3,288	-10.3%
5	Employee benefits	1,089,101	1,229,890	1,553,670	-140,789	-11.4%
6	Other expenses by kind	41,820	44,611	43,117	-2,791	-6.3%
7	Cost of materials sold	7,670	5,840	15,353	1,830	31.3%
8	Other operating expenses	28,364	36,904	34,562	-8,540	-23.1%
9	**Total operating expenses**	**3,281,568**	**3,629,334**	**3,787,368**	**-347,766**	**-9.6%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

Table 26 Adjusted operating expenses of PKP CARGO S.A. in 2014 – 2016 (thousands of PLN)

No.	Item	2016	2015 adjusted **	2014 adjusted *	Change 2016 - 2015	% change 2016/2015
1	Depreciation and amortization and impairment losses	474,844	391,768	347,782	83,076	21.2%
2	Consumption of materials and energy	532,655	595,633	587,736	-62,978	-10.6%
3	External services	1,078,527	1,114,951	1,169,207	-36,424	-3.3%
4	Taxes and charges	28,587	31,875	35,941	-3,288	-10.3%
5	Employee benefits	1,089,101	1,166,028	1,296,554	-76,927	-6.6%
6	Other expenses by kind	41,820	44,611	43,117	-2,791	-6.3%
7	Cost of materials sold	7,670	5,840	15,353	1,830	31.3%
8	Other operating expenses	28,364	36,904	34,562	-8,540	-23.1%
9	**Total operating expenses**	**3,281,568**	**3,387,610**	**3,530,252**	**-106,042**	**-3.1%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

* the 2014 data were adjusted for presentation purposes for the costs following from the first Voluntary Redundancy Program implemented in the amount of PLN 257.1 million;
** the 2015 data were adjusted for presentation purposes for the costs following from the implemented 2nd VRP in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale, in the amount of PLN 177.9 million

In 2016, operating expenses decreased by PLN 347.8 million, or 9.6%, to PLN 3,281.6 million, while adjusted operating expenses decreased by PLN 106.0 million compared to 2015, or 3.1% yoy. Higher operating expenses were caused by certain non-recurring events, i.e. the costs of implementation of VRP 2 (in the amount of PLN 63.9 million) and an impairment loss of non-current assets and assets classified as held for sale in the amount of PLN 177.9 million.

In 2016, depreciation and amortization expenses and impairment losses fell by PLN 94.8 million (or 16.6% yoy) to PLN 474.8 million, mainly because of the mentioned above non-recurring events which occurred in 2015.Additionally, in 2015 the residual value of rolling stock was reduced, which translated into a higher base for the calculation of depreciation charges in subsequent years. Depreciation in 2016 compared to 2015 increased by PLN 83.1 million, i.e. 21.2%, which was related predominantly to depreciation of means of transport. One of the main reasons for the increase in depreciation and amortization expenses in 2016 was a change in the residual value of rolling stock and a higher depreciation from capital expenditures, especially on multi-system locomotives in 2016. Moreover, the increase in depreciation was affected by the stretching of the wagon repair cycle from 4 years to 6 years, which came into effect in 2011 and the amendments to accounting policy starting from the financial statements for 2015, according to which periodic inspections P3 are not recognized in the profit and loss account on the date of the expense but are treated as a repair component which is subject to depreciation over a period of 36 months.

In 2016, the consumption cost of materials and energy declined by PLN 63.0 million, i.e. by 10.6% yoy, mainly due to a decline in rail freight volumes. The costs of fuel consumption dropped by PLN 40.5 million, or 27.7% yoy, which was affected, among other factors, by a lower unit cost of fuel and a decline in the share of freight volumes transported over the diesel traction. The costs of electricity, gas and water declined by PLN 15.5 million, or 3.9% yoy, as well as the costs of materials which fell by PLN 0.6 million, or 1.2% yoy.

The costs of external services decreased by PLN 36.4 million, or 3.3% yoy, reaching the amount of PLN 1,078.5 million. The main reason for this decrease was a decrease in the costs of access to the lines of infrastructure managers by PLN 23.7 million, or 3.5% yoy, caused by a decline in freight volumes. Moreover, a decrease in rents and fees for the use of real properties and rolling stock by PLN 20.7 million, or 15.2% yoy, was caused predominantly by the purchase of multi-system locomotives.Decrease in costs of external services, compared to the previous year was also recorded in legal and advisory services in the amount of PLN 17.0 million, or 57.1% yoy, driven mainly by the costs incurred in 2015 in connection with the acquisition of the Czech operator AWT. Simultaneously, within the scope of external services - transportation services increased by PLN 19.3 million, or 24.3% yoy, which was caused by an increase in intermodal transport volumes.

In 2016, adjusted employee benefits declined to PLN 1,089.1 million, compared to PLN 1,166.0 million in 2015, down 6.6% yoy. This change was driven by the costs of implementing the headcount optimization process in the form of Voluntary Redundancy Programs as well as terminations of employment contracts due to the acquisition of pension rights by eligible employees. Accordingly, the average headcount in 2016 decreased by 786 FTEs, or 4.3% yoy. Moreover, at the end of 2016 employee provisions were updated due to changes in legislation increasing the minimum wage, reducing the retirement age for men and women and changing in the discount rate. The changes in headcount are presented in chapter 4.5 “Headcount”.

Other expenses by kind in 2016 decreased by PLN 2.8 million, or 6.3% yoy, predominantly due to a decrease in advertising and representation costs by PLN 3.0 million, or 37.0% yoy.

In 2016, the cost of goods and materials sold increased by PLN 1.8 million, or 31.3%, to PLN 7.7 million, following an increase in revenues from sales of scrap.

Other operating expenses in 2016 decreased by PLN 8.5 million, or 23.1% yoy, to PLN 28.4 million. This change was driven by movements in provisions, in particular related to the UOKiK penalty and other provisions. Moreover, fines and compensations paid by the Company fell by PLN 7.1 million, or 49.1% yoy.

Result on operating activities

As a result of the aforementioned changes in operating revenue and operating expenses, the result on operating activities in 2016 reached PLN -31.1 million. Whereas, the adjusted result on operating activities decreased by PLN 157.7 million.

EBITDA

The result on operating activities increased by the line item “Depreciation and amortization and impairment losses” referred to as EBITDA, amounted to PLN 443.7 million in 2016. Whereas, the adjusted EBITDA fell by PLN 74.6 million.

Financial activities

Table 27 Financial activities of PKP CARGO S.A. in 2014-2016 (thousands of PLN)

No.	Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
1	Financial revenue	20,532	45,024	49,497	-24,492	-54.4%
2	Financial expenses	60,111	68,951	54,778	-8,840	-12.8%
3	**Result on financial activities**	**-39,579**	**-23,927**	**-5,281**	**-15,652**	**-**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

In 2016, PKP CARGO S.A. recorded a loss on financial activities in the amount of PLN -39.6 million. In the corresponding period of the previous year, the Company also generated a loss on financial activities in the amount of PLN -23.9 million. The main reason behind the PLN 15.7 million drop in the result on financial activities was a PLN 13.5 million, or -40.8% yoy, decrease in revenues from dividends, a decrease in interest income by PLN 3.1 million, or 76.0% yoy, and a drop in foreign exchange gains by PLN 8.8 million yoy. The most significant driver behind the change in the yoy result on financial activities was a decline in the costs of valuation of the put and call options for non-controlling interest in AWT by PLN 15.6 million, or -56.4% yoy.

For more detailed information, see Note 9 to the SFS.

Result before tax

In 2016, the result before tax increased by PLN 68.4 million yoy to PLN -70.7 million. In turn, the adjusted result before tax decreased by PLN 173.3 million yoy.

Income tax

In 2016, PKP CARGO S.A. posted income tax in the amount of PLN -2.1 million, of which current tax was PLN 1.0 million and deferred income tax was PLN -3.1 million.

Net result

In 2016, the Company generated a net result of PLN -68.6 million, up from the year before by PLN 45.6 million, while adjusted net result was lower by PLN 150.2 million yoy.

5.1.2. Description of the structure of assets and liabilities of PKP CARGO S.A.

ASSETS

Table 28 Horizontal and vertical analysis of assets of PKP CARGO S.A. (thousands of PLN)

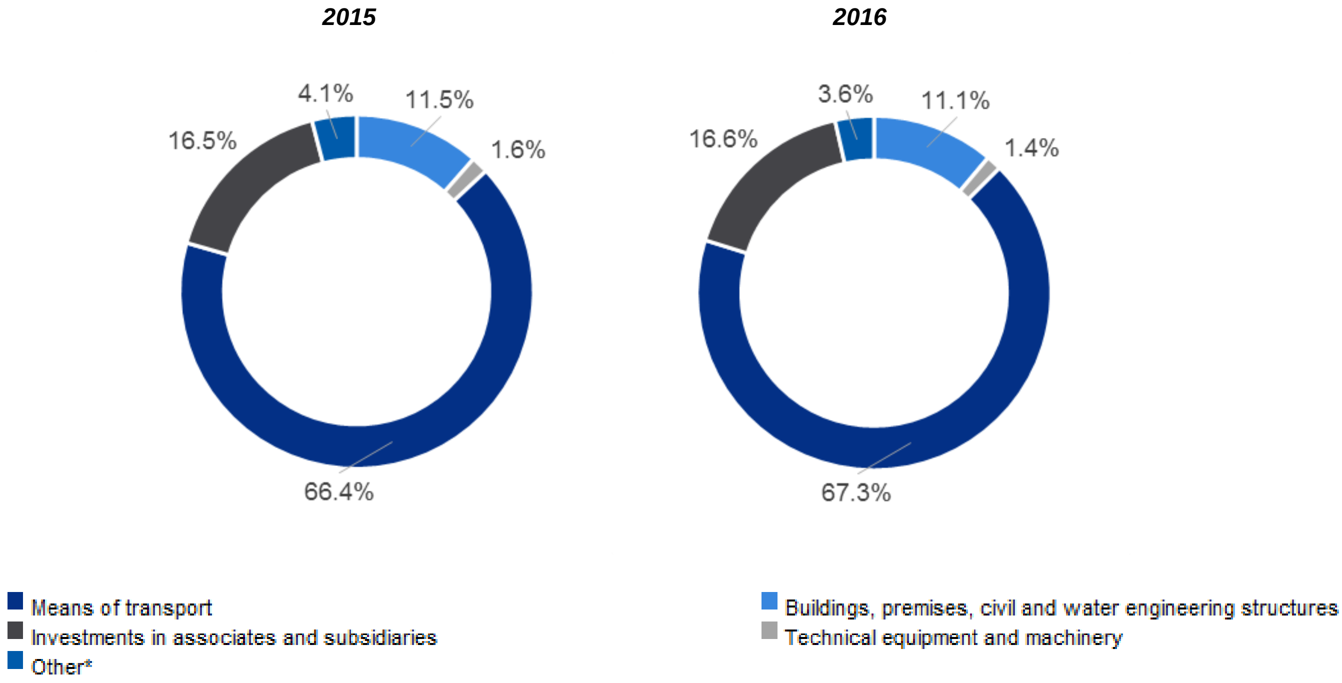
	As at 31 December 2016	As at 31 December 2015	As at 31 December 2014	Asset structure		Change	% change
				31/12/2016	31/12/2015	2016 - 2015	2016/2015
ASSETS							
Non-current assets							
Property, plant and equipment	3,561,993	3,562,716	3,742,185	64.1%	70.4%	-723	0.0%
Intangible assets	50,778	59,236	55,990	0.9%	1.2%	-8,458	-14.3%
Investments in subsidiaries, associates and joint ventures	737,974	734,643	262,846	13.3%	14.5%	3,331	0.5%
Other long-term financial assets	6,169	6,021	6,021	0.1%	0.1%	148	2.5%
Other long-term non-financial assets	8,162	18,927	1,464	0.1%	0.4%	-10,765	-56.9%
Deferred tax assets	76,244	76,602	60,981	1.4%	1.5%	-358	-0.5%
Total non-current assets	**4,441,320**	**4,458,145**	**4,129,487**	**80.0%**	**88.1%**	**-16,825**	**-0.4%**
Current assets							
Inventories	59,701	60,743	75,759	1.1%	1.2%	-1,042	-1.7%
Trade and other receivables	413,607	384,228	423,171	7.4%	7.6%	29,379	7.6%
Income tax receivables	1,304	-	-	0.0%	-	1,304	-
Other short-term financial assets	87	25,057	301,818	0.0%	0.5%	-24,970	-99.7%
Other short-term non-financial assets	19,716	4,985	24,921	0.4%	0.1%	14,731	295.5%
Cash and cash equivalents	611,990	84,097	381,420	11.0%	1.7%	527,893	627.7%
Non-current assets classified as held for sale	6,000	44,061	17,560	0.1%	0.9%	-38,061	-86.4%
Total current assets	**1,112,405**	**603,171**	**1,224,649**	**20.0%**	**11.9%**	**509,234**	**84.4%**
Total assets	**5,553,725**	**5,061,316**	**5,354,136**	**100.0%**	**100.0%**	**492,409**	**9.7%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

Non-current assets

The graph below presents the structure of non-current assets in 2015 and 2016.

Figure 24 Structure of non-current assets of PKP CARGO S.A. in 2015 and 2016



Source: Proprietary material

* The “other” item includes: intangible assets, other long-term financial assets, other long-term non-financial assets, deferred tax assets, other fixed assets and fixed assets under construction

Means of transport constitute the largest percentage of non-current assets: 67.3% of non-current assets in 2016. Compared to the previous year, the percentage of means of transport rose by 0.9 p.p. Other significant items included investments in subsidiaries, associates and joint ventures with a 16.6% share in 2016 compared to a 16.5% share in 2015, land and buildings, facilities and land and water engineering objects with a 11.1% share in 2016 compared to 11.5% in 2015. The remaining items, i.e. technical machinery and equipment and others accounted for 5.0% in 2016.

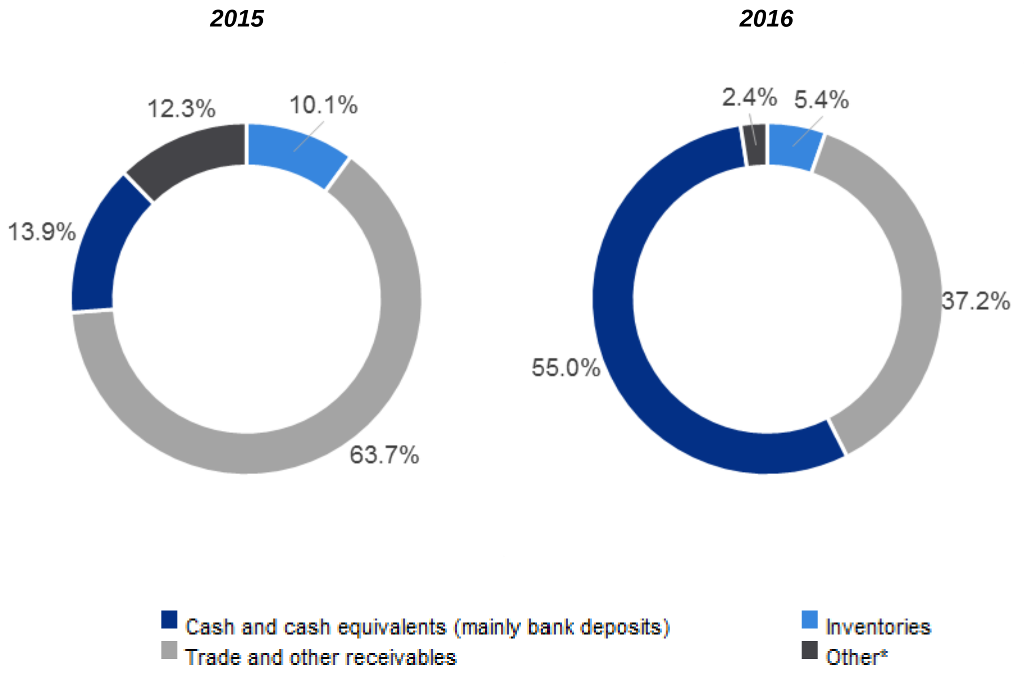
Property, plant and equipment dominated the structure of assets; at the end of 2016, this line item represented 64.1% of total assets, compared to 70.4% at the end of 2015. Means of transport (which include mainly locomotives and wagons) are the main component of non-current assets; their value at the end of 2016 was PLN 2,989.0 million (up by PLN 28.6 million or 1.0% yoy), which at the end of 2016 accounted for 83.9% of all property, plant and equipment, compared to 83.1% at the end of 2015. The increase in the value of means of transport was driven by the purchase of 12 multi-system locomotives, periodic repairs and periodic inspections of rolling stock, modernization of rolling stock and reclassification from assets treated as held for sale due to the absence of demand from the market. For more detailed information, see Notes 11 and 24 to the SFS.

Out of other changes within the structure of property, plant and equipment, the largest movement was recorded in buildings, facilities and land and water engineering objects and in machinery and equipment, which fell by PLN 22.4 million yoy and PLN 7.7 million yoy, respectively. The primary reasons for the decrease in the value of these assets were depreciation costs and the absence of major capital expenditures. Details are presented in Note 11 to the SFS. Other long-term non-financial assets fell in 2016 compared to the previous year by PLN 10.8 million, or 56.9% yoy, mainly as a result of the reclassification of advance payments towards the purchase of non-financial non-current assets, mainly the multi-system locomotives, to capital expenditures. The decrease in intangible assets by PLN 8.5 million, or 14.3% yoy, was caused by a relatively low level of capital expenditures.

Current assets

The figure below presents the structure of current assets in 2015 and 2016.

Figure 25 Structure of current assets of PKP CARGO S.A. in 2015 and 2016.



Source: Proprietary material

* The other item includes: income tax receivables, other short-term financial assets, other short-term non-financial assets and non-current assets classified as held for sale

In 2016, the largest portion of current assets consisted of cash and cash equivalents (mainly bank deposits) at 55.0%, which increased by 41.1 p.p. from 2015. The second largest item of current assets in 2016 were trade and other receivables which stood at 37.2% (in 2015: 63.7%). The remaining items, i.e. inventories and other, in aggregate amounted to 7.8% in 2016, compared to 22.4% in the previous year..

As at the end of 2016, current assets increased by PLN 509.2 million, or 84.4% yoy, in relation to the end of 2015, primarily as a result of an increase in cash and cash equivalents (mainly bank deposits) by PLN 527.9 million, or 627.7% yoy, as a result of bank loans necessary to finance the Company's planned investments in rolling stock. These include mostly repairs and periodic inspections resulting from the cycles defined in the Maintenance System Documentation and planned freight volumes. Accordingly, it is expected that in 2017 a large portion of Technical Railworthiness Certificates will be renewed for the Company's rolling stock. The level of cash as at the end of 2016 fully protects the Company's general corporate needs.

Among current assets, an increase was also recorded in trade and other receivables by PLN 29.4 million, or 7.6% yoy. This was due to a decline in the business of some of the Company's business partners, which translated into an extension of payment terms and a higher level of revenues as at the end of 2016 compared to 2015. Moreover, there was observed an increase in other short-term non-financial assets by PLN 14.7 million, or 295.5% yoy, which was mainly due to a prepayment for the purchase of electricity in the amount of PLN 14.7 million.

Among all the current asset items, non-current assets classified as held for sale posted the sharpest decline, by PLN 38.1 million, or 86.4% yoy. In connection with the low scrap metal prices persisting in H1 2016, PLN 33.1 million worth of means of transport (mainly locomotives and wagons) was reclassified from the mentioned above asset items to the property, plant and equipment, which is described in detail in Note 24 to the SFS. Furthermore, other short-term financial assets declined by PLN 25.0 million, or 99.7% yoy, mainly due to a drop in the cash pool level by PLN 25.1 million, and a drop in the level of inventories by PLN 1.0 million, or 1.7% yoy.

The table below presents the days inventory in 2014 - 2016

Table 29 Days inventory as at the end of 2014-2016

Item	2016	2015	2014	Change 2016-2015	Change rate 2016/2015
Days inventory*	110.6	87.1	77.5	23.5	27.0%

Source: Proprietary material

* Indicator calculated for the number of days and depletion on a year-to-date basis since the beginning of the reporting year

The actual net days inventory as at 31 December 2016 was 110.6 days and increased by 23.5 days compared to 31 December 2015, with:

- material inventories at the level of PLN 59.7 million;
- net value of materials sold in the amount of PLN 7.7 million;
- consumption of materials, together with employee benefits in the amount of PLN 186.7 million.[41]

The indicator increased due to a 23.8% drop in the consumption of materials with a concurrent 1.7% decrease in net inventories of materials. Consumption of materials in 2015 was PLN 245.1 million compared to PLN 186.7 million in 2016.

The level of inventories is adapted mainly to the level of the rolling stock maintenance and repair activity. The details regarding the level of inventories are presented in Note 19 to the SFS.

[41] Consumption of materials – comprising consumption of materials for OPEX, CAPEX, consumption of fuel and employee benefits

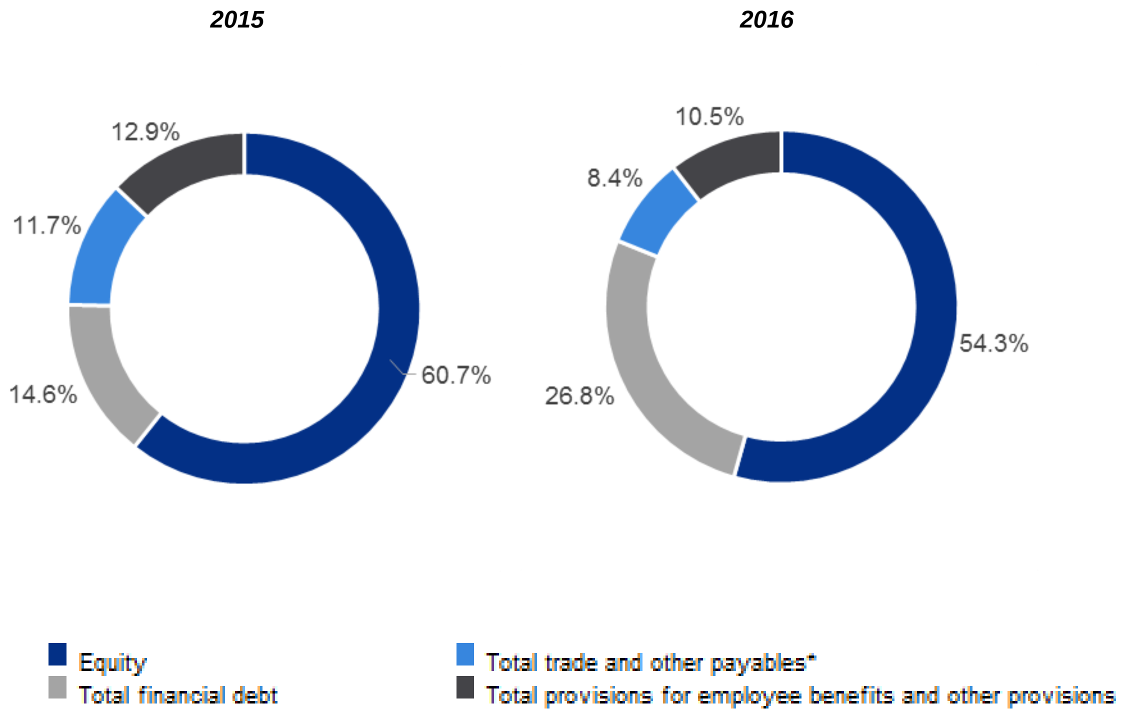
EQUITY AND LIABILITIES

Table 30 Horizontal and vertical analysis of liabilities and equity of PKP CARGO S.A. (thousands of PLN)

	As at 31 December 2016	As at 31 December 2015	As at 31 December 2014	Structure of equity and liabilities		Change	% change
				31/12/2016	31/12/2015	2016 - 2015	2016/2015
EQUITY AND LIABILITIES							
Equity							
Share capital	2,239,346	2,239,346	2,239,346	40.3%	44.2%	0	0.0%
Supplementary capital	589,202	589,202	584,513	10.6%	11.6%	0	0.0%
Other items of equity	18,415	3,726	-36,572	0.3%	0.1%	14,689	394.2%
Retained earnings	171,477	240,042	469,032	3.1%	4.7%	-68,565	-28.6%
Total equity	**3,018,440**	**3,072,316**	**3,256,319**	**54.3%**	**60.7%**	**-53,876**	**-1.8%**
Non-current liabilities							-
Long-term bank loans and borrowings	1,170,224	459,305	206,112	21.1%	9.1%	710,919	154.8%
Long-term finance lease liabilities and leases with purchase option	36,159	75,333	114,027	0.7%	1.5%	-39,174	-52.0%
Long-term trade and other payables	582	22,389	67,938	0.0%	0.4%	-21,807	-97.4%
Long-term provisions for employee benefits	473,965	549,280	637,783	8.5%	10.9%	-75,315	-13.7%
Other long-term provisions	16,455	16,209	8,416	0.3%	0.3%	246	1.5%
Other long-term financial liabilities	-	27,696	-	-	0.5%	-27,696	-
Non-current liabilities, total	**1,697,385**	**1,150,212**	**1,034,276**	**30.6%**	**22.7%**	**547,173**	**47.6%**
Current liabilities							-
Short-term bank loans and borrowings	178,170	129,914	87,971	3.2%	2.6%	48,256	37.1%
Short-term finance lease liabilities and leases with purchase option	43,176	48,914	120,505	0.8%	1.0%	-5,738	-11.7%
Short-term trade and other payables	465,411	568,085	457,602	8.4%	11.2%	-102,674	-18.1%
Short-term provisions for employee benefits	80,524	81,581	318,600	1.4%	1.6%	-1,057	-1.3%
Other short-term provisions	11,640	8,256	17,414	0.2%	0.2%	3,384	41.0%
Other short-term financial liabilities	58,979	10	59,393	1.1%	0.0%	58,969	589690.0%
Current tax liabilities	-	2,028	2,056	-	0.0%	-2,028	-
Current liabilities, total	**837,900**	**838,788**	**1,063,541**	**15.1%**	**16.6%**	**-888**	**-0.1%**
Total liabilities	**2,535,285**	**1,989,000**	**2,097,817**	**45.7%**	**39.3%**	**546,285**	**27.5%**
Total liabilities and equity	**5,553,725**	**5,061,316**	**5,354,136**	**100.0%**	**100.0%**	**492,409**	**9.7%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

Figure 26 Structure of equity and liabilities of PKP CARGO S.A. in 2015 and 2016



Source: Proprietary material

* Total trade and other payables also include current tax liabilities

In 2016, equity constituted the largest part (54.3%) of total liabilities and equity, although its share declined by 6.4 p.p. compared to 2015. The second largest line item in the 2016 structure of liabilities and equity was financial debt at 26.8%, which rose by 12.2 p.p. from the previous year, chiefly because of a new bank loan which also contributed to the increased balance of cash and cash equivalents (mainly bank deposits). The remaining items, i.e. total trade and other payables, total provisions for employee benefits constituted 8.4% and 10.5%, respectively, compared to 11.7% and 12.9%, respectively, one year earlier.

Equity

As at the end of 2016, equity amounted to PLN 3,018.4 million and was declined by 53.9 million, or 1.8% yoy, compared to 2015. The level of equity was adversely affected by the decline in retained earnings by PLN 68.6 million, or 28.6% yoy, driven mainly by the negative financial result in 2016. Other items of equity increased by PLN 14.7 million, or 394.2% yoy, compared to 2015.

Non-current liabilities

As at the end of 2016, non-current liabilities rose by PLN 547.2 million, or 47.6%, from 31 December 2015. Long-term loans and borrowings increased by PLN 710.9 million (154.8% yoy) which is related to the CAPEX loans taken out by the Company.Long-term provisions for employee benefits decreased by PLN 75.3 million, or 13.7% yoy, mainly due to the reversal of employee provisions caused by a change in the discount rate, changes in legislation increasing the minimum wage and reducing the retirement age for men and women(mainly changes in the provisions for jubilee awards and death benefits). Long-term lease liabilities and long-term liabilities on account of leases with purchase option decreased by PLN 39.2 million, or 52.0% yoy, due to the gradual repayment of this form of financing. The decline in other long-term financial liabilities by PLN 27.7 million was caused by the reclassification of the net liability on account of put and call options for non-controlling interest in AWT to current liabilities in the full amount. The decline in long-term trade and other payables by PLN 21.8 million, or 97.4% yoy, was caused mainly by the reclassification of liabilities resulting from the modernization of rolling stock to current liabilities resulting from timely repayment of liabilities.

Current liabilities

Current liabilities dropped at the end of 2016 compared to the end of 2015 by PLN 0.9 million (or 0.1%). The largest movements were recorded in the following line items:

- short-term bank loans and credit facilities – an increase by PLN 48.3 million, or 37.1% yoy, associated with the loans granted to the Company
- other short-term financial liabilities – an increase by PLN 59.0 million, driven primarily by the net liability on account of put and call options for non-controlling interest in AWT in the amount of PLN 39.8 million; moreover, part of this amount results from a reclassification from long-term liabilities to short-term liabilities and cash pool liabilities in the amount of PLN 19.2 million.
- short-term trade and other payables – a decrease by PLN 102.7 million, or 18.1% yoy, mainly due to the PLN 45.7 million, or 18.1% yoy, decline in trade and other payables, which was driven in part by a decline in freight volumes; the second significant item contributing to the decline in trade and other payables was the reduction in liabilities on account of the Voluntary Redundancy Program by PLN 47.4 million following the disbursement of the second tranche for the employees taking part in VRP 1 and VRP 2.

5.1.3. Cash flow statement of PKP CARGO S.A.

The table below depicts the main line items of the cash flow statement of PKP CARGO S.A. in 2014-2016

Table 31 Main line items of the cash flow statement of PKP CARGO S.A. in 2014-2016

Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
Net cash on operating activities	237,526	325,876	462,459	-88,350	-27.1%
Net cash on investing activities	-440,642	-584,858	-208,082	144,216	-
Net cash on financial activities	731,009	-38,341	-102,189	769,350	-
Net increase / (decrease) in cash and cash equivalents	**527,893**	**-297,323**	**152,188**	**825,216**	**-**
Cash and cash equivalents at the beginning of the reporting period	**84,097**	**381,420**	**229,232**	**-297,323**	**-78.0%**
Cash and cash equivalents at the end of the reporting period	**611,990**	**84,097**	**381,420**	**527,893**	**627.7%**

Source: Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 prepared according to EU IFRS, Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2015 prepared according to EU IFRS

Cash flow from operating activities

In 2016, net cash flow from operating activities was PLN 237.5 million compared to PLN 325.9 million in 2015. The cash flow was generated on the result before tax of PLN -70.7 million and depreciation of property, plant and equipment and amortization of intangible assets and impairment losses of PLN 474.8 million. As regards changes in working capital, the largest movement was recorded in trade and other payables which decreased by PLN 89.5 million. The decrease resulted predominantly from a decrease in the carrying value of trade and other payables, both long-term and short-term by PLN 124.5 million, offset by a PLN 35.0 million increase in liabilities on the purchase of non-financial non-current assets. The balance of cash from operating activities was adversely affected by an increase in receivables by PLN 30.2 million, mainly trade and other receivables, both long-term and short-term, in the amount of PLN 29.4 million.

Cash flow from investing activities

In 2016, net cash flow used in connection with investing activities was PLN -440.6 million versus PLN -584.9 million in the previous year. Net cash flow from investing activities was affected primarily by capital expenditures on rolling stock, in particular on the purchase of 12 multi-system locomotives, for which the company spent PLN 187.1 million in 2016. The Company is still awaiting 3 locomotives, which are due to be delivered in 2017. The Company's major capital expenditures will also include spending on the existing rolling stock: periodic repairs (NO) and periodic inspections (P3) in the amount of PLN 185.0 million. Periodic repairs (NO) and periodic inspections (P3) enable the Company to obtain or extend its Technical Railworthiness Certificates without which the Company's rolling stock would not be approved for traffic. Another major expenditure incurred by the Company in 2016 was the modernization of locomotives in the amount of PLN 35.4 million. The modernizations offer the possibility of extending life of a locomotive by replacing its engine with a new one and contribute to the reduction in the quantity of fuel used by up to 40%. In 2016 the Company received proceeds from the disposal of property, plant and equipment, intangible assets and non-current assets held for sale in the amount of PLN 6.4 million and dividends from subsidiaries in the amount of PLN 19.5 million.

Cash flow from financing activities

In 2016, net cash flow from financing activities was PLN 731.0 million compared to PLN -38.3 million in 2015. Proceeds of PLN 884.5 million were received from loan drawn down in 2016, versus PLN 424.8 million in 2015. In 2016, total cash expenditures for leases and repayments bank loans and borrowings with interest were PLN 199.4 million versus PLN 269.4 million in 2015. Proceeds from the cash pool in the amount of PLN 44.3 million were an additional significant item that contributed to the increase in net cash from financing activities in 2016.

5.1.4. Selected financial and operating ratios of PKP CARGO S.A.

The table below presents PKP CARGO S.A.'s key financial and operating ratios in the period of 2014-2016

Table 32 Selected financial and operating ratios of PKP CARGO S.A. in the period of 2014-2016

No.	Item	2016	2015	2014	Change 2016 - 2015	% change 2016/2015
1	EBITDA margin[1]	13.7%	12.9%	11.4%	0.7 p.p.	5.6%
2	Net profit margin[2]	-2.1%	-3.2%	1.9%	1.1 p.p.	-35.0%
3	Net financial debt to EBITDA ratio[3]	2.0	1.4	-0.2	0.6	41.7%
4	ROA[4]	-1.2%	-2.3%	1.4%	1 p.p.	-45.2%
5	ROE[5]	-2.3%	-3.7%	2.3%	1.4 p.p.	-38.8%
6	Average distance covered by one locomotive (km/day)[6]	249.5	240.6	243.9	8.9	3.7%
7	Average gross train tonnage per operating locomotive (tons)[7]	1502.0	1523.0	1481.0	-21.0	-1.4%
8	Average running time of train locomotives (hours per day)[8]	15.1	15.2	15.4	-0.1	-0.7%
9	Freight turnover per employee (thousands tkm/employee)[9]	1516.3	1553.8	1307.2	-37.5	-2.4%

Source: Proprietary material

Table 33 Adjusted selected financial and operating ratios of PKP CARGO S.A. in the period of 2014-2016

No.	Item	2016	2015 adjusted **	2014 adjusted *	Change 2016 - 2015	% change 2016/2015
1	EBITDA margin[1]	13.7%	14.7%	18.0%	-1.1 p.p.	-7.4%
2	Net profit margin[2]	-2.1%	2.3%	7.3%	-4.4 p.p.	-190.8%
3	Net financial debt to EBITDA ratio[3]	2.0	1.2	-0.1	0.8	61.6%
4	ROA[4]	-1.2%	1.6%	5.3%	-2.8 p.p.	-176.5%
5	ROE[5]	-2.3%	2.7%	8.7%	-4.9 p.p.	-185.5%

Source: Proprietary material

* the 2014 data were adjusted for presentation purposes for the costs following from the first Voluntary Redundancy Program implemented in the amount of PLN 257.1 million;
** the 2015 data were adjusted for presentation purposes for the costs following from the implemented 2nd VRP in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale, in the amount of PLN 177.9 million

The adjustment concerns only data from the Statement of comprehensive income.

1. *Calculated as the ratio of the operating result plus amortization/depreciation and impairment losses to total operating revenue*
2. *Calculated as the ratio of net profit to total operating revenue*
3. *Calculated as the ratio of net financial debt (constituting the sum of (i) long-term bank loans and borrowings; (ii) short-term bank loans and borrowings, (iii) long-term finance lease liabilities and leases with purchase option; (iv) short-term finance lease liabilities and leases with purchase option; and (v) other short-term financial liabilities and (vi) other long-term financial liabilities, minus (i) cash and cash equivalents; and (ii) other short-term financial assets) to EBITDA for the last 12 months (result on operating activities plus amortization/depreciation and impairment losses).*
4. *Calculated as the ratio of net result for the past 12 months to total assets.*
5. *Calculated as the ratio of net profit for the past 12 months to equity.*
6. *Calculated as the quotient of vehicle-kilometers (i.e. distance covered by Company's vehicles in the given period) / vehicle-days (i.e. product of the number of active vehicles and number of calendar days in the given period)*
7. *Calculated as the quotient of gross ton-kilometers and train-kilometers in train work in relation to the locomotives driving the train (in dual traction or pushing the train in the given period).*
8. *Calculated as the quotient of vehicle-hours (i.e. number of hours of work of Company'svehicles in the given period) and vehicle-days (i.e. the product of the number of active vehicles and number of calendar days in the given period).*
9. *Calculated as the ratio of the Company's freight turnover to the average headcount (in FTEs) in the PKP CARGO S.A. in the given period.*

In 2016, the key profitability ratios, i.e. EBITDA margin, net result margin, ROA, ROE were higher than in the same period of the previous year, for the reasons described above. The net financial debt to EBITDA ratio deteriorated. It increased from 1.4 at the end of 2015 to 2.0 at the end of 2016. The deterioration of the ratio is attributable to increased spending of cash associated with capital expenditures in particular with the purchase of multi-system locomotives.

The adjustment to results (referring to 2015) has an adverse effect on the ratios (EBITDA margin, net result margin, ROA, ROE) as compared top the adjusted values from 2015. This was caused mainly by the occurrence of non-recurring events in 2015: 2nd VRP in the amount of PLN 63.9 million and impairment losses on non-current assets and assets classified as held for sale in the amount of PLN 177.9 million.

In 2015 the average daily mileage of locomotives was 240.6 km/day. In 2016, this figure grew by 8.9 km/day, reaching 249.5 km/day. Hence the average daily mileage increased 3.7%. The improvement of this indicator resulted from the optimization of the transportation process.

The gross average train freight turnover per locomotive moved down from 1523.0 tons (2015) to 1502.0 tons (2016). Hence a decrease of 21.0 tons was recorded (the average freight turnover of driven trains fell by 1.4%). This figure fell due to a decline in the transport business.

In 2015, the average running time of locomotives was 15.2 hours/day. In 2016, this figure fell by 0.1 hours/day, reaching 15.1 hours/day. Hence the average daily running time of locomotives decreased 0.7%. The decrease of the figure results from execution of the transport process with a very high level of closures and operating difficulties in the PKP PLK grid, and a decline in the transport business.

The freight turnover per employee ratio in 2016 fell compared to 2015 by -2.4%, which was mainly attributable to the decline of the freight turnover by 7% yoy, while the headcount level fell by 4.3% yoy.

5.2. Key economic and financial figures of PKP CARGO Group

5.2.1. Statement of comprehensive income of PKP CARGO Group

On 28 May 2015, the Parent Company acquired an 80% stake in AWT B.V. Because AWT's data have been consolidated since the date of acquisition, the consolidated data for 2016 take into account the AWT Group's financial performance for the whole period, while the 2015 financial data are presented with the AWT Group's figures starting from 28 May 2015.

Analysis of key economic and financial figures of the PKP CARGO Group presented in this chapter takes into account a presentation adjustment of data in 2016 and 2015. The 2016 financial data are adjusted for presentation purposes for an impairment loss on receivables from OKD in the amount of PLN 72.7 million (described in Note 19 of CFS) and impairment losses arising from a test for impairment of AWT Group's non-current assets in the amount of PLN 34.1 million (the adjustments takes into account a loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly in H2 2016 in the amount of PLN 0.9 million), as described in Note 12.1. CFS; moreover, adjusted net result includes deferred tax resulting from an impairment loss resulting from an impairment test on AWT in the amount of PLN 6.5 million and the deferred tax on account of an impairment loss on receivables from OKD in the amount of PLN 8.0 million; the change in the impairment loss on assets and the impairment loss on receivables presented in CFS results from changes in the exchange rates applied for the conversion of the impairment losses into Polish zloty. The 2015 financial data were adjusted for presentation purposes for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, and impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million; additionally, the adjusted net profit includes deferred tax on account of VRP 2 in the amount of PLN 13.3 million, deferred tax on impairment of non-current assets and assets classified as held for sale in the amount of PLN 33.9 million, while profit on bargain acquisition of AWT does not include deferred tax

In 2016, the PKP CARGO Group transported 111.5 million tons of cargo (i.e. 4% less than in 2015) and recorded freight turnover of 28.5 billion tkm (i.e. 4% less than in 2015), which is described in detail in the chapter entitled “Company's and PKP CARGO Group's rail transport business”.

In 2016, PKP CARGO Group's operating revenues decreased by 3.1% yoy and operating expenses increased by 1.0% yoy. In 2016, the Group's result on operating activities and net result were PLN -132.1 million and PLN -133.8 million, respectively. The level of operating revenues and expenses in 2016 resulted to a large extent from the consolidation of AWT and the occurrence of non-recurring events, which is described in detail in the comments under the tables. The Group's adjusted operating revenue fell by 0.1% yoy (adjustment by gains on the bargain acquisition of AWT in the amount of PLN 137.8 million in 2015). The adjusted operating expenses increased 4.4% yoy (adjusted for VRP 2 in the amount of PLN 70.2 million and adjustment for impairment loss on non-current assets and assets classified as held for sale in the amount of PLN 178.7 million in 2015, impairment loss on receivables from OKD in the amount of PLN 72.7 million and impairment loss resulting from a test for impairment of AWT Group's non-current assets in the amount of PLN 34.1 million (the loss includes the loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly, in H2 2016 in the amount of PLN 0.9 million) – both these adjustments were effected in 2016. The increase in expenses in the Group was driven mainly by the consolidation of AWT. The relatively stable revenue and the consolidation of AWT resulted in a decline in the adjusted result.

The details of individual line items of the Statement of comprehensive income are presented in the further part of this section. Tables below present the results of the PKP CARGO GROUP and adjusted results of the PKP CARGO Group from 2014 to 2016.

Table 34 Results of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	Total operating revenue	4,411,269	4,554,133	4,274,335	-142,864	-3.1%
2	Total operating expenses	4,543,340	4,498,222	4,153,408	45,118	1.0%
3	**Result on operating activities**	**-132,071**	**55,911**	**120,927**	**-187,982**	**-**
4	*EBIT margin*	*-3.0%*	*1.2%*	*2.8%*	*-4.2 p.p.*	-
5	*EBITDA margin*	*11.1%*	*15.5%*	*11.8%*	*-4.4 p.p.*	*-28.3%*
6	Financial revenue	38,925	14,723	33,812	24,202	164.4%
7	Financial expenses	61,239	66,397	62,099	-5,158	-7.8%
8	Share in the profit / (loss) of entities accounted for under the equity method	3,461	4,416	881	-955	-21.6%
9	Result on the sale of shares in entities accounted for under the equity method	-	1,865	-	-1,865	-100.0%
10	**Result before tax**	**-150,924**	**10,518**	**93,521**	**-161,442**	**-**
11	*Net profit margin*	*-3.4%*	*0.2%*	*2.2%*	*-3.7 p.p.*	-
12	Income tax	-17,152	-19,563	15,239	2,412	-
13	**NET RESULT**	**-133,772**	**30,081**	**78,282**	**-163,853**	**-**
14	*Net profit margin*	*-3.0%*	*0.7%*	*1.8%*	*-3.7 p.p.*	-

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Table 35 Adjusted results of the PKP CARGO Group in 2014-2016 (thousands of PLN)

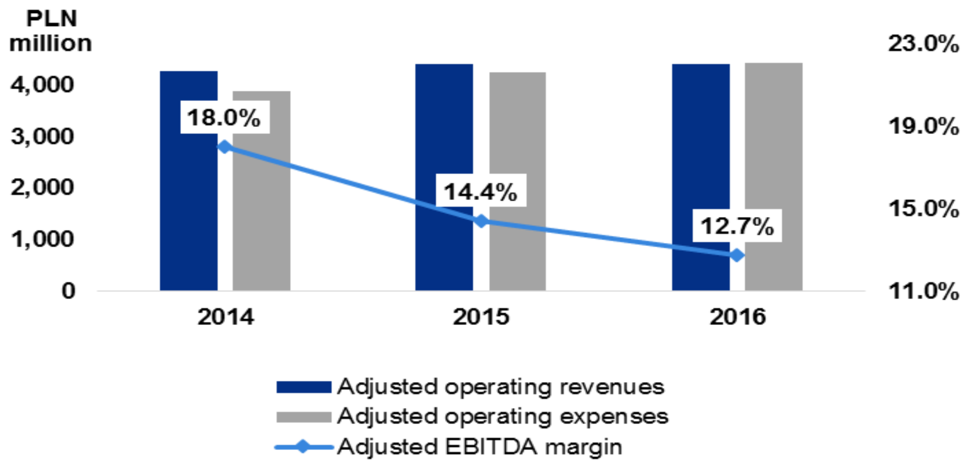
No.	Item	2016 adjusted ****	2015 adjusted *** (restated*)	2014 adjusted **	Change 2016 - 2015	% change 2016/2015
1	Total operating revenue	4,411,269	4,416,355	4,274,335	-5,085	-0.1%
2	Total operating expenses	4,436,562	4,249,384	3,888,077	187,178	4.4%
3	**Result on operating activities**	**-25,293**	**166,970**	**386,258**	**-192,263**	**-**
4	*EBIT margin*	*-0.6%*	*3.8%*	*9.0%*	*-4.4 p.p.*	-
5	*EBITDA margin*	*12.7%*	*14.4%*	*18.0%*	*-1.7 p.p.*	*-11.7%*
6	Financial revenue	38,925	14,723	33,812	24,202	164.4%
7	Financial expenses	61,239	66,397	62,099	-5,158	-7.8%
8	Share in the profit / (loss) of entities accounted for under the equity method	3,461	4,416	881	-955	-21.6%
9	Result on the sale of shares in entities accounted for under the equity method	-	1,865	-	-1,865	-100.0%
10	**Result before tax**	**-44,146**	**121,578**	**358,852**	**-165,724**	**-**
11	*Net profit margin*	*-1.0%*	*2.8%*	*8.4%*	*-3.8 p.p.*	-
12	Income tax	-2,676	27,716	65,652	-30,392	-
13	**NET RESULT**	**-41,470**	**93,861**	**293,200**	**-135,330**	**-**
14	*Net profit margin*	*-0.9%*	*2.1%*	*6.9%*	*-3.1 p.p.*	-

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016
** the data for 2014 were adjusted for presentation purposes for the costs following from the implemented 1st Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 265.3 million; additionally, the adjusted net profit includes deferred tax on account of VRP 1 in the amount of PLN 50.4 million
*** the 2015 data were adjusted for presentation purposes for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, and impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million; additionally, the adjusted net profit includes deferred tax on account of VRP 2 in the amount of PLN 13.3 million, deferred tax on impairment of non-current assets and assets classified as held for sale in the amount of PLN 33.9 million, while profit on bargain acquisition of AWT does not include deferred tax
**** the data in 2016 were adjusted for presentation purposes for an impairment loss on assets in the amount of PLN 34.1 million (the adjustment includes an impairment loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly, in H2 2016 in the amount of PLN 0.9 million) described in Note 12.1 CFS and an impairment loss on receivables amounting to PLN 72.7 million (described in Note 19 CFS); the adjusted net result additionally includes deferred tax resulting from an impairment loss resulting from a test for impairment of AWT's value in the amount of PLN 6.5 million and deferred tax resulting from an impairment loss on receivables from OKD in the amount of PLN 8.0 million; the change in the impairment loss on assets and the impairment loss on receivables presented in the CFS results from changes in the exchange rates applied for the conversion of the impairment losses into Polish zloty.

The figure below presents the adjusted EBITDA margin compared to the selected items of the Group's statement of comprehensive income for 2014-2016

Figure 27 Adjusted EBITDA margin compared to the Group's adjusted operating revenues and expenses in 2014-2016*



Source: Proprietary material

* presentation data for 2014 adjusted for the costs following from the implemented 1st Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 265.3 million
presentation data for 2015 adjusted for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, as well as the impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million
presentation data for 2016 adjusted for an impairment loss on assets in the amount of PLN 34.1 million (the adjustments takes into account an impairment loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly in H2 2016 in the amount of PLN 0.9 million), as described in Note 12.1. CFS and the impairment loss on receivables in the amount of PLN 72.7 million (described in Note 19 CFS)

Operating revenues

Table 36 Operating revenues of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	Revenue from the sale of services and finished products	4,341,874	4,330,336	4,162,171	11,538	0.3%
1.1	*Revenue from rail transportation and freight forwarding services*	*3,612,728*	*3,727,552*	3,791,533	*-114,825*	-3.1%
2	Revenue from sales of goods and materials	30,085	33,132	54,902	-3,047	-9.2%
3	Other operating revenue	39,310	190,665	57,262	-151,356	-79.4%
4	**Total operating revenue**	**4,411,269**	**4,554,133**	**4,274,335**	**-142,864**	**-3.1%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Table 37 Adjusted operating revenues of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016	2015 adjusted ** (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	Revenue from the sale of services and finished products	4,341,874	4,330,336	4,162,171	11,538	0.3%
1.1	*Revenue from rail transportation and freight forwarding services*	*3,612,728*	*3,727,552*	*3,791,533*	*-114,825*	-3.1%
2	Revenue from sales of goods and materials	30,085	33,132	54,902	-3,047	-9.2%
3	Other operating revenue	39,310	52,886	57,262	-13,577	-25.7%
4	**Total operating revenue**	**4,411,269**	**4,416,354**	**4,274,335**	**-5,084**	**-0.1%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016
** the 2015 data were adjusted for presentation purposes for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million

In the Group'stotal operating revenue the biggest item was revenue from sales of services (98.4% in 2016 compared to 95.1% in 2015). Revenue on the sale of services comprises mainly: revenue from rail transportation and freight forwarding services, revenue from other transportation activity, revenue from siding and traction services, revenue from transshipment, rolling stock repairs, land reclamation, sale of finished products, as well as other revenue, which includes revenue on the lease of assets, revenue on the customs agency and border freight forwarding services, revenue on the sale of finished products and revenue on rolling stock repair services. The remaining part of the operating revenue of Group consists on revenue from sales of goods and materials, which includes, among others, sales of steel and cast iron scrap as well as other operating revenue comprising, among others, gains from the sale of non-financial non-current assets, movement in impairment losses on receivables and interest on receivables, received fines and compensations and net foreign exchange gains on trade receivables and liabilities, reversal of other provisions, as well as the non-recurring 2015 item, i.e. profit on the bargain acquisition of AWT.

The decline in revenue from rail transportation and freight forwarding services by 3.1% yoy to PLN 3,612.7 million resulted from the lower freight transport volume. The details pertaining to the Group's transport business are described in chapter 4.2.5, "Company's and PKP CARGO Group's rail transport business". Revenue on the sale of non-transportation services rose by 21.0% yoy to PLN 729.1 million, whereas the highest improvement was recorded in revenue from transshipment services, from siding and traction services and revenue from other transportation activity, mainly due to the consolidation of AWT.

The decline in the revenue on the sale of goods and materials by PLN 3.0 million (or 9.2% yoy) was driven by the declining prices of scrap metal in H1 2016, which led to a decision by some subsidiaries (mainly AWT) to delay the scrapping of a larger quantity of worn out rolling stock, and discontinuation of the transportation and sales of filling sand to Polska Grupa Górnicza by PKP CARGOSERVICE Sp. z o.o.

Other operating revenue dropped by PLN 151.4 million, or 79.4% yoy. Such a significant decline in 2016 resulted from the non-recurring event in 2015, which was entailed as a profit on the bargain acquisition of AWT. Other significant changes involved the following items: revenues from fines and compensations fell by PLN 8.5 million, or 37.0%, revenues from the reversal of the provision for the UOKiK penalty fell by PLN 4.0 million, or 91.9% yoy, revenues from the reversal of other provisions dropped by PLN 7.4 million, or 77.3% yoy, while profit on the sale of non-financial non-current assets rose by PLN 4.7 million, or 220.2% yoy.

Operating expenses

Table 38 Operating expenses of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	Depreciation and amortization and impairment losses	621,592	648,982	382,791	-27,390	-4.2%
2	Consumption of materials and energy	675,000	696,994	594,010	-21,994	-3.2%
3	External services	1,573,059	1,501,160	1,315,778	71,898	4.8%
4	Taxes and charges	36,256	38,597	40,759	-2,341	-6.1%
5	Employee benefits	1,442,301	1,484,764	1,698,873	-42,463	-2.9%
6	Other expenses by kind	55,494	53,854	43,955	1,640	3.0%
7	Cost of goods and materials sold	22,066	25,654	38,203	-3,588	-14.0%
8	Other operating expenses	117,572	48,217	39,039	69,356	143.8%
9	**Total operating expenses**	**4,543,340**	**4,498,222**	**4,153,408**	**45,118**	**1.0%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Table 39 Adjusted operating expenses of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016 adjusted ****	2015 adjusted *** (restated*)	2014 adjusted **	Change 2016 - 2015	% change 2016/2015
1	Depreciation and amortization and impairment losses	587,475	470,323	382,791	117,152	24.9%
2	Consumption of materials and energy	675,000	696,994	594,010	-21,994	-3.2%
3	External services	1,573,059	1,501,160	1,315,778	71,898	4.8%
4	Taxes and charges	36,256	38,597	40,759	-2,341	-6.1%
5	Employee benefits	1,442,301	1,414,585	1,433,543	27,716	2.0%
6	Other expenses by kind	55,494	53,854	43,955	1,640	3.0%
7	Cost of goods and materials sold	22,066	25,654	38,203	-3,588	-14.0%
8	Other operating expenses	44,912	48,217	39,039	-3,305	-6.9%
9	**Total operating expenses**	**4,436,562**	**4,249,384**	**3,888,077**	**187,178**	**4.4%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016
** presentation data for 2014 adjusted for the costs following from the implemented 1st Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 265.3 million
*** presentation data for 2015 adjusted for the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, as well as the impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million
**** presentation data for 2016 adjusted for an impairment loss on assets in the amount of PLN 34.1 million (the adjustment takes into account a loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly, in H2 2016 in the amount of PLN 0.9 million), which was described in note 12.1. CFS and impairment loss on receivables in the amount of PLN 72.7 million (described in Note 19 CFS)

In 2016, Group's operating expenses increased by PLN 45.1 million, or 1.0% yoy, to PLN 4,543.3 million. Adjusted operating expenses increased by PLN 187.2 million, or 4.4% yoy, driven mainly by the consolidation of AWT.

In 2016, amortization and depreciation expenses and impairment losses fell by PLN 27.4 million (or 4.2% yoy) to PLN 621.6 million, mainly because of the non-recurring events in 2016 and 2015. In 2016, adjusted amortization and depreciation expenses and impairment losses were PLN 587.5 million compared to PLN 470.3 million in 2015, increasing by PLN 117.2 million, or 24.9% yoy, which resulted from the growth experienced by the Parent Company, as described in chapter 5.1.1. of the "Statement of comprehensive income of PKP CARGO S.A.", and from the consolidation of AWT.

In 2016, the consumption cost of materials and energy declined by PLN 22.0 million or 3.2% yoy; within this item, fuel consumption costs decreased by PLN 26.9 million, or 14.3% yoy, mainly due to the decline in unit prices of fuel and generally in the transport business. The lower consumption of electricity, gas and water resulted mainly from the decline in the transport business. These lower variable costs, mainly of traction fuel and traction energy, related to the decline in PKP CARGO Group's transport business, occurred despite the consolidation of AWT.The increase of material costs by PLN 15.6 million, or 18.2% yoy, was caused directly by the consolidation of AWT.

In the analyzed period of 2016, the cost of external services grew by PLN 71.9 million, or 4.8% yoy, up to PLN 1,573.1 million. This increase was driven mainly by the consolidation of AWT, which caused a rise in the costs of transportation services by PLN 98.4 million, or 29.9% yoy, costs of services related to the maintenance of facilities and use of fixed assets by PLN 4.2 million, or 15.4% yoy, and transshipment services by PLN 4.0 million, or 19.2% yoy. The largest reductions were observed in the following items: legal, consulting and similar services by PLN 11.9 million, or 33.7% yoy, driven mainly by the acquisition costs of the Czech operator AWT incurred in 2015 and costs of lines access services from infrastructure managers by PLN 10.5 million, or 1.6% yoy, which resulted from the decline in PKP CARGO Group's transport business.

In 2016 employee benefits fell by PLN 42.5 million, or 2.9% yoy, to PLN 1,442.3 million from PLN 1,484.8 million in 2015. Higher level of this costs was driven by the costs of implementing the headcount optimization process in the form of the Voluntary Redundancy Program, which increased employee benefits by PLN 70.2 million. In turn adjusted employee benefits rose in 2016 by PLN 27.7 million or 2.0% yoy, mainly due to the consolidation of AWT and employment cuts achieved through the Voluntary Redundancy Program in PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o., as well as termination of employment agreements with the employees who were vested with retirement rights. Consequently, the average headcount in 2016 decreased by 934 FTEs yoy. Changes in headcount are presented in the section "Information on headcount". The decline in costs was also affected by the change in the balance of provisions for employee benefits, which decreased by PLN 30.7 million.

Other expenses by kind in 2016 increased compared to the corresponding period of 2015 by PLN 1.6 million, or 3.0% yoy, mainly due to an increase in the costs of property insurance by PLN 1.8 million or 18.2% yoy and costs of business travel by PLN 0.7 million or 2.4% yoy and the other costs item by PLN 1.7 million or 83.1% yoy (with decreasing advertising and representation costs by PLN 2.6 million or 24.8% yoy). These increases were caused by the consolidation of the AWT Group.

In 2016, the cost of goods and materials sold fell by PLN 3.6 million, or 14.0%, to PLN 22.1 million, following a decrease in revenue from sales of goods and materials.

Other operating expenses in 2016 increased by PLN 69.4 million, or 143.8% yoy, to PLN 117.6 million, chiefly on account of the impairment loss on receivables from OKD in the amount of PLN 72.7 million. Adjusted other operating expenses dropped by PLN 3.3 million, or 6.9%, yoy.

Result on operating activities

As a result of these changes in operating revenue and operating expenses, the result on operating activities in 2016 reached PLN -132.1 million, while the adjusted result on operating activities in 2016 was PLN -25.3 million.

EBITDA

The adjusted result on operating activities increased by the line item "Depreciation/amortisation and impairment losses" referred to as EBITDA, amounted to PLN 489.5 million in 2016, while the adjusted EBITDA was PLN 562.2 million in 2016.

Financial activities

Table 40 Financial activities of the PKP CARGO Group in 2014-2016 (thousands of PLN)

No.	Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	Financial revenue	38,925	14,723	33,812	24,202	164.4%
2	Financial expenses	61,239	66,397	62,099	-5,158	-7.8%
3	Share in the profit / (loss) of entities accounted for under the equity method	3,461	4,416	881	-955	-21.6%
4	Result on the sale of shares in entities accounted for under the equity method	-	1,865	-	-1,865	-100.0%
5	**Result on financial activities**	**-18,853**	**-45,392**	**-27,406**	**26,539**	**-**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

In 2016, the PKP CARGO Group recorded a loss on financial activities in the amount of PLN 18.9 million, compared to the loss in the amount of PLN 45.4 million in 2015. The main cause of the improvement in the result on financial activities was the PLN 47.2 million yoy increase in the valuation of the liability on account of the "put" option for non-controlling interest in AWT. Following the revaluation of the "put" option, revenues on financial activities rose by PLN 36.5 million in 2016, while in 2015 the revaluation of the "put" option contributed PLN 10.7 million to financial expenses. Details regarding the valuation of the option are presented in Note 32 CFS. In 2016, interest income and dividends fell by PLN 7.9 million, or 82.9% yoy the main contributor was the decline in interest income from deposits and bank accounts by PLN 3.9 million, or 87.3% yoy (lower average cash balance in the period) and a decrease of other revenue (mainly interest on public-law settlements) by PLN 4.4 million, or 96.0% yoy. Financial expenses fell by PLN 5.2 million, or 7.8% yoy, following the PLN 10.7 million decline in the costs on the valuation of the "put" option liability for non-controlling interest, partially offset by the increase in financial expenses on exchange differences by PLN 5.3 million yoy.

Details are presented in Note 10 CFS.

Result before tax

In 2016, result before tax fell by PLN 161.4 million to PLN -150.9 million, while adjusted result before tax shrank by PLN 165.7 million down to PLN -44.1 million. This decrease resulted from the lower result on operating activities and the improved result on financial activities.

Income tax

In 2016, the PKP CARGO Group posted income tax in the amount of PLN -17.2 million, of which current tax was PLN 5.1 million and deferred tax was PLN -22.3 million.

Net result

In 2016, net result amounted to PLN -133.8 million while adjusted net result was PLN -41.5 million, compared to PLN 93.9 million in 2015.

5.2.2. Description of the structure of assets and liabilities of the PKP CARGO Group

ASSETS

Table 41 Horizontal and vertical analysis of PKP CARGO Group's assets (thousands of PLN)

	As at 31 December 2016	As at 31 December 2015 (restated*)	As at 31 December 2014 (restated*)	Asset structure		Change	% change
				31/12/2016	31/12/2015	2016 - 2015	2016/2015
ASSETS							
Non-current assets							
Property, plant and equipment	4,700,550	4,719,748	4,044,606	72.4%	77.3%	-19,197	-0.4%
Intangible assets	55,831	66,437	58,268	0.9%	1.1%	-10,606	-16.0%
Goodwill	-	-	2,712	-	-	-	-
Investment property	1,257	1,309	1,362	0.0%	0.0%	-52	-4.0%
Investments accounted for under the equity method	40,810	39,831	35,246	0.6%	0.7%	979	2.5%
Trade and other receivables	2,223	5,074	-	0.0%	0.1%	-2,851	-56.2%
Other long-term financial assets	8,649	9,849	6,051	0.1%	0.2%	-1,200	-12.2%
Other long-term non-financial assets	25,987	32,666	14,645	0.4%	0.5%	-6,679	-20.4%
Deferred tax assets	107,554	104,587	91,575	1.7%	1.7%	2,968	2.8%
Total non-current assets	**4,942,861**	**4,979,501**	**4,254,465**	**76.2%**	**81.6%**	**-36,640**	**-0.7%**
Current assets							-
Inventories	121,189	128,513	115,298	1.9%	2.1%	-7,324	-5.7%
Trade and other receivables	639,866	654,116	519,030	9.9%	10.7%	-14,249	-2.2%
Income tax receivables	2,793	2,748	3,053	0.0%	0.0%	45	1.7%
Other short-term financial assets	892	4,046	306,383	0.0%	0.1%	-3,155	-78.0%
Other short-term non-financial assets	27,277	13,281	28,246	0.4%	0.2%	13,996	105.4%
Cash and cash equivalents	755,919	276,191	429,178	11.6%	4.5%	479,728	173.7%
							-
Non-current assets classified as held for sale	-	44,061	17,560	-	0.7%	-44,061	-
Total current assets	**1,547,936**	**1,122,956**	**1,418,748**	**23.8%**	**18.4%**	**424,980**	**37.8%**
Total assets	**6,490,797**	**6,102,457**	**5,673,213**	**100.0%**	**100.0%**	**388,340**	**6.4%**

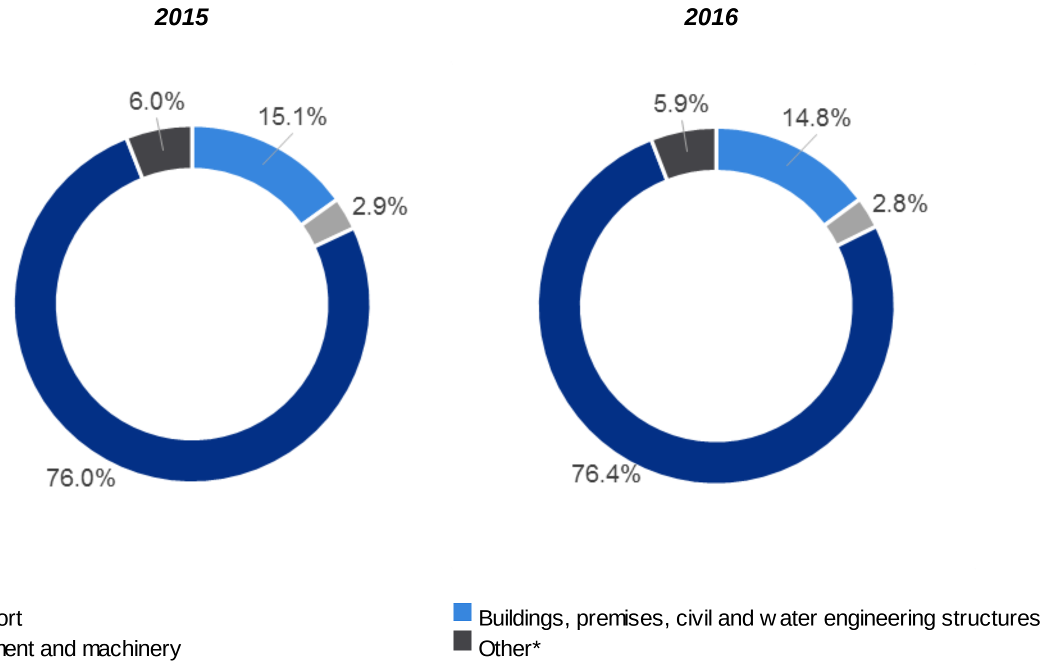
Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Non-current assets

The graph below presents the structure of non-current assets in 2015 and 2016.

Figure 28 Structure of non-current assets of PKP CARGO Group in 2015 and 2016



Source: Proprietary material

* The “other” item includes: intangible assets, goodwill, investment property, trade and other receivables, other long-term financial assets, other long-term non-financial assets, investments accounted for under the equity method, deferred tax assets, other fixed assets and fixed assets under construction

Means of transportation constitute the largest percentage of non-current assets: 76.4% of non-current assets in 2016. Compared to the previous year, the percentage of the means of transportation rose by 0.4 p.p. Other items include land and buildings, facilities and land and water engineering objects with 14.8% share in 2016, compared to 15.1% in 2015. The remaining items, i.e. technical machinery and equipment and others constituted 8.7% of non-current assets in 2016.

Property, plant and equipment dominated the structure of assets; at the end of 2016, it represented 72.4% of total assets, compared to 77.3% at the end of 2015. Means of transportation (which include mainly locomotives and wagons) are the main component of property, plant and equipment; their value at the end of 2016 was PLN 3,777.4 million, declining by PLN 7.5 million (or 0.2%), compared to 2015. At the end of 2016, means of transportation constituted 80.4% of all property, plant and equipment, compared to 80.2% at the end of 2015.

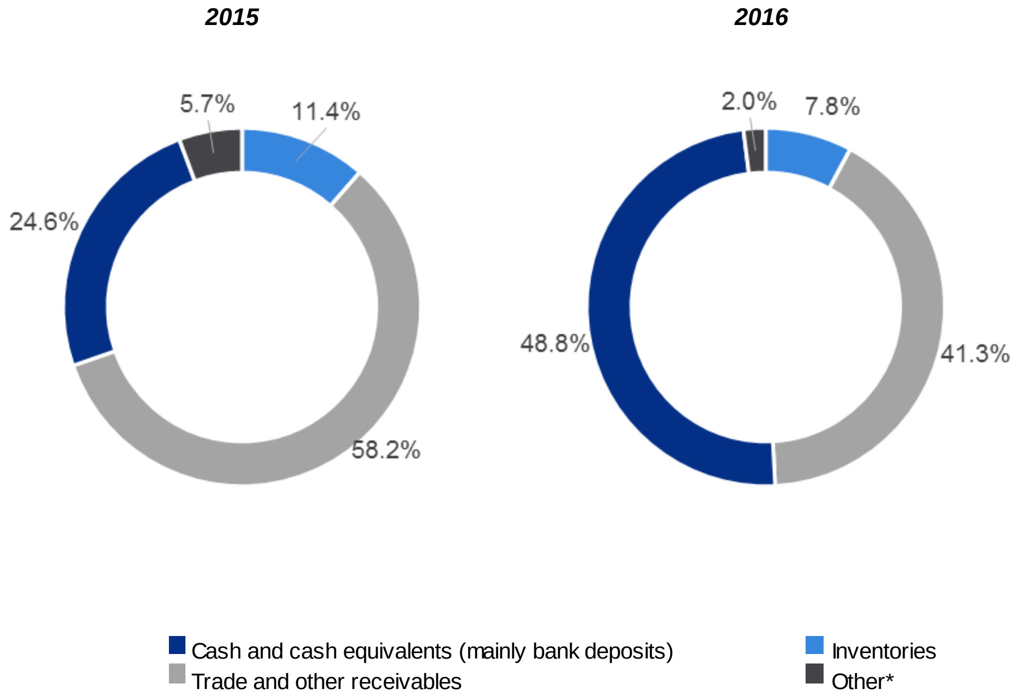
Out of other changes within the structure of property, plant and equipment, the largest movement was recorded in buildings, facilities and land and water engineering objects, which fell by PLN 24.2 million or 4.1% yoy and in fixed assets under construction, which increased by PLN 14.0 million, or 50.3% yoy. A detailed description of changes in other property, plant and equipment items is presented in Note 12 CFS.

Intangible assets fell by PLN 10.6 million, or 16.0% yoy, which was related mainly to the decline in intangible assets in the course of adjustment by PLN 7.5 million, or 41.6% yoy and the level of depreciation/amortization costs. Other long-term non-financial assets fell in 2016 by PLN 6.7 million, or 20.4% yoy, from the previous year, mainly as a result of the reclassification of advance payments towards the purchase of non-financial non-current assets, mainly the multi-system locomotives, to other short-term non-financial assets.

Current assets

The figure below presents the structure of total current assets in 2015 and 2016.

Figure 29 Structure of current assets of PKP CARGO Group in 2015 and 2016



Source: Proprietary material

* The other item includes: income tax receivables, other short-term financial assets, other short-term non-financial assets and non-current assets classified as held for sale

In 2016, the largest portion of current assets consisted of cash and cash equivalents (mainly bank deposits) at 48.8%, which increased by 24.2 p.p. from 2015. The second largest item in the 2016 current assets were trade and other receivables at 41.3%, which constituted 58.2% of current assets in 2015. The remaining items, i.e. inventories and other, in aggregate amount to 9.8% in 2016, compared to 17.1% in 2015.

Current assets rose at the end of 2016 by PLN 425.0 million, or 37.8%, in relation to the end of 2015, mainly as a result of an increase in cash and cash equivalents (mainly bank deposits) by PLN 479.7 million, or 173.7% yoy,as a resultof the bank loans taken out by the Parent Company. Other short-term non-financial assets rose by PLN 14.0 million, or 105.4%, yoy. The key reasons for the increase in cash and other short-term non-financial assets in the Parent Company are described in section “5.2.2 Description of the asset and liability structure in PKP CARGO S.A.”. Among all the current asset items, non-current assets classified as held for sale posted the sharpest decline, by PLN 44.1 million yoy. In connection with the low scrap metal prices persisting in H1 2016, PLN 33.1 million worth of means of transportation (mainly locomotives and wagons) was reclassified from asset items described above to the property, plant and equipment; the value of land fell PLN 11.0 million (described in detail in Note 23 CFS). The trade and other receivables fell by PLN 14.2 million, or 2.2% yoy, and inventories by PLN 7.3 million, or 5.7% yoy, reflecting an improvement in the utilization of the working capital.

EQUITY AND LIABILITIES

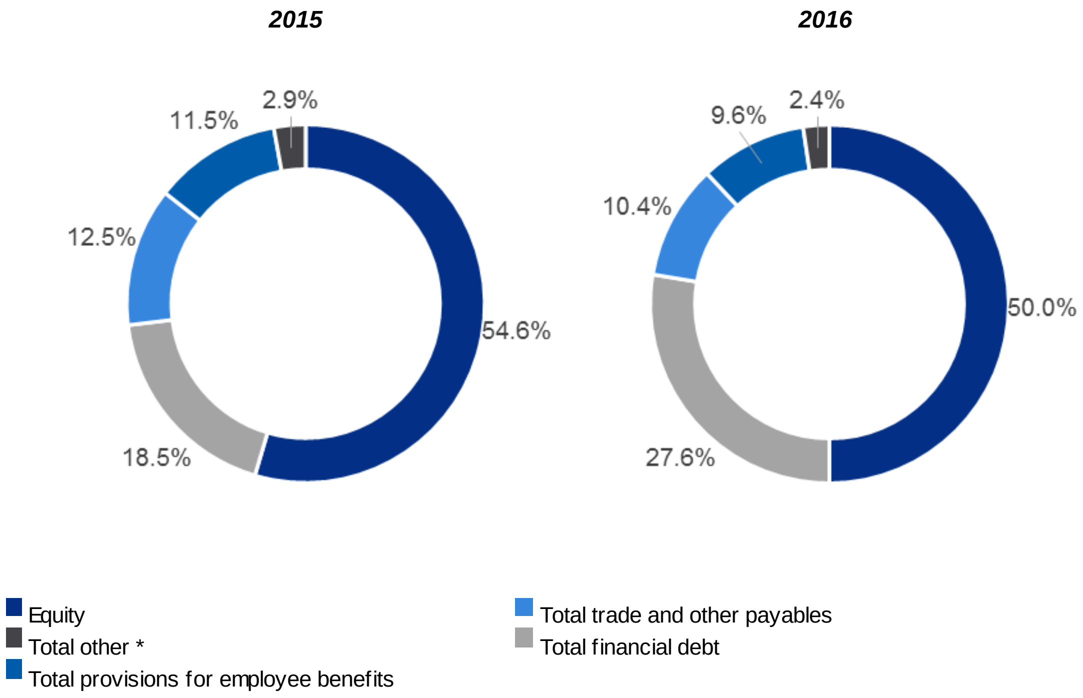
Table 42 Horizontal and vertical analysis of PKP CARGO Group's equity and liabilities (thousands of PLN)

	As at 31 December 2016	As at 31 December 2015 (restated*)	As at 31 December 2014 (restated*)	Structure of equity and liabilities		Change	% change
				31/12/2016	31/12/2015	2016 - 2015	2016/2015
EQUITY AND LIABILITIES							
Equity							
Share capital	2,239,346	2,239,346	2,239,346	34.5%	36.7%	0	0.0%
Supplementary capital	618,666	619,407	615,343	9.5%	10.2%	-741	-0.1%
Other items of equity	11,447	-2,779	-48,617	0.2%	0.0%	14,226	-
Exchange differences resulting from conversion of financial statements of foreign operations	59,970	31,500	-	0.9%	0.5%	28,470	90.4%
Retained earnings	313,440	446,471	515,392	4.8%	7.3%	-133,031	-29.8%
Equity attributable to the owners of the parent company	3,242,869	3,333,945	3,321,464	**50.0%**	**54.6%**	**-91,076**	**-2.7%**
Non-controlling interest	-	-	55,238	-	-	-	-
Total equity	**3,242,869**	**3,333,945**	**3,376,702**	**50.0%**	**54.6%**	**-91,076**	**-2.7%**
Non-current liabilities							-
Long-term bank loans and borrowings	1,273,605	460,577	208,077	19.6%	7.5%	813,027	176.5%
Long-term finance lease liabilities and leases with purchase option	140,923	193,500	190,836	2.2%	3.2%	-52,577	-27.2%
Long-term trade and other payables	1,845	25,953	67,982	0.0%	0.4%	-24,108	-92.9%
Long-term provisions for employee benefits	525,571	603,621	687,775	8.1%	9.9%	-78,050	-12.9%
Other long-term provisions	26,420	28,886	8,416	0.4%	0.5%	-2,466	-8.5%
Other long-term financial liabilities	1,042	155,198	-	0.0%	2.5%	-154,156	-99.3%
Deferred tax liabilities	106,675	118,353	2,328	1.6%	1.9%	-11,677	-9.9%
Non-current liabilities, total	**2,076,081**	**1,586,088**	**1,165,414**	**32.0%**	**26.0%**	**489,993**	**30.9%**
Current liabilities							-
Short-term bank loans and borrowings	197,803	253,592	92,123	3.0%	4.2%	-55,790	-22.0%
Short-term finance lease liabilities and leases with purchase option	59,567	65,416	127,742	0.9%	1.1%	-5,849	-8.9%
Short-term trade and other payables	670,021	739,509	541,912	10.3%	12.1%	-69,489	-9.4%
Short-term provisions for employee benefits	99,256	100,383	338,618	1.5%	1.6%	-1,127	-1.1%
Other short-term provisions	24,950	17,856	24,214	0.4%	0.3%	7,095	39.7%
Other short-term financial liabilities	118,889	2,174	3,934	1.8%	0.0%	116,715	5369.2%
Current tax liabilities	1,361	3,494	2,554	0.0%	0.1%	-2,133	-61.0%
Current liabilities, total	**1,171,847**	**1,182,424**	**1,131,097**	**18.1%**	**19.4%**	**-10,577**	**-0.9%**
Total liabilities	**3,247,928**	**2,768,512**	**2,296,511**	**50.0%**	**45.4%**	**479,416**	**17.3%**
Total liabilities and equity	**6,490,797**	**6,102,457**	**5,673,213**	**100.0%**	**100.0%**	**388,340**	**6.4%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Figure 30 Structure of equity and liabilities of PKP CARGO Group in 2015 and 2016



Source: Proprietary material

* The total other line item includes: other long-term and short-term provisions, provision on deferred tax liabilities and current tax liabilities

In 2016, equity constituted the largest part (50.0%) of liabilities and equity, decreasing by 4.6 p.p. from 2015. The second largest line item in the 2016 liabilities and equity was financial debt at 27.6%, which rose by 9.1 p.p. from 2015, chiefly because of the bank loans taken out by the Parent Company. The remaining items, i.e. total trade and other payables, total provisions for employee benefits constituted 10.4% and 9.6%, respectively, compared to 12.5% and 11.5%, respectively, one year earlier. The share of the remaining items was 2.4% in 2016, down by 0.5 p.p from the previous year.

Equity

At the end of 2016, equity amounted to PLN 3,242.9 million, decresing by PLN 91.1 million, compared to 2015.. The level of equity was adversely affected by the decline in retained earnings by PLN 133.0 million, or 29.8% yoy, driven mainly by the negative financial result in 2016, while other items of equity increased by PLN 14.2 million and the exchange differences resulting from conversion of financial statements of foreign operations by PLN 28.5 million, or 90.4% yoy.

Non-current liabilities

At the end of 2016, non-current liabilities rose by PLN 490.0 million, or 30.9%, from 31 December 2015. Long-term loans and borrowings increased by PLN 813.0 million (176.5% yoy) which is related to the loans taken out by the Parent Company. Long-term provisions for employee benefits fell by PLN 78.1 million, or 12.9% yoy; long-term lease liabilities and leases with purchase option fell by PLN 52.6 million, or 27.2% yoy and long-term trade and other payables dropped by PLN 24.1 million, or 92.9% yoy. The changes in these items were driven by the changes in the Parent Company. They are explained in section “5.2.2 Description of the asset and liability structure in PKP CARGO S.A.”. Other long-term financial liabilities dropped by PLN 154.2 million, or 99.3% yoy, driven primarily by the reclassification of the net liability on account of the “put” option for non-controlling interest, to short-term financial liabilities.

Current liabilities

Current liabilities dropped at the end of 2016 compared to the end of 2015 by PLN 10.6 million (or 0.9%). The largest movements were recorded in the following line items:

- short-term bank loans and borrowings: a decrease of PLN 55.8 million, i.e. by PLN 22.0% yoy, associated with the regular repayment of loans in the subsidiaries (mainly AWT)
- other short-term financial liabilities increased by PLN 116.7 million, driven primarily by the reclassification of the net liability on account of put and call options for non-controlling interest in AWT in the amount of PLN 118.7 million from the long-term part to the short-term part
- short-term trade and other payables fell by PLN 69.5 million, or 9.4% yoy, mainly because of the PLN 45.5 million, or 49.8% yoy, decline in liabilities on the purchase of non-financial non-current assets; the second significant item contributing to the decline in trade and other payables was the reduction in liabilities on account of the Voluntary Redundancy Program by PLN 48.2 million resulting from the disbursement of the second tranche for the employees taking part in VRP 1 and VRP 2, partly offset by an increase in VAT settlement by PLN 26.4 million, or 258.5%; the main cause of this increase is described in Note 6.

5.2.3. Statement of cash flows of the PKP CARGO Group

The table below depicts the main line items in the PKP CARGO Group's statement of cash flows in the years 2014-2016

Table 43 Main line items in the PKP CARGO Group's statement of cash flows in the years 2014-2016

Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
Net cash on operating activities	380,049	387,502	559,932	-7,453	-1.9%
Net cash on investing activities	-568,567	-515,199	-238,743	-53,368	-
Net cash on financial activities	663,860	-29,447	-155,711	693,307	-
Net increase / (decrease) in cash and cash equivalents	**475,342**	**-157,144**	**165,478**	**632,486**	**-**
Cash and cash equivalents at the beginning of the reporting period	**276,191**	**429,178**	**263,700**	**-152,987**	**-35.6%**
Impact exerted by FX rate movements on the cash balance in foreign currencies	4,386	4,157	-	229	5.5%
Cash and cash equivalents at the end of the reporting period	**755,919**	**276,191**	**429,178**	**479,728**	**173.7%**

Source: Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 prepared according to EU IFRS, Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2015 prepared according to EU IFRS

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Cash flow from operating activities

In 2016 net cash flow from operating activities was PLN 380.0 million compared to PLN 387.5 million in 2015. The cash flow was generated on the result before tax of PLN -150.9 million and depreciation of property, plant and equipment and amortization of intangible assets and impairment losses of PLN 621.6 million. Cash in 2016 is PLN 37.2 million less because of the PLN 93.6 million decrease in the carrying amount of trade and other payables, both long-term and short-term, offset by the PLN 64.8 million increase in liabilities on the purchase of non-financial non-current assets. The level of cash from operating activities was adversely affected by the PLN 74.5 million decline in provisions and reduction of other liabilities by PLN 37.4 million. The items with positive contribution to the level of cash included: the PLN 14.2 million drop in trade and other receivables and the PLN 10.1 million reduction in inventories.

Cash flow from investing activities

In 2016 net cash flow used in connection with investing activities was PLN -568.6 million compared to PLN -515.2 million in the previous year. Significant investments of the PKP CARGO Group include capital expenditures for the purchase of property, plant and equipment and intangible assets, on which the Group expended PLN 588.1 million in 2016 vs. PLN 508.7 million in the previous year. Additionally in 2016 the Group received proceeds on the disposal of property, plant and equipment, intangible assets and non-current assets held for sale in the amount of PLN 13.9 million. The Parent Company contributed heavily to the Group's investing cash flows; a more detailed description of PKP CARGO S.A.'s cash flows is provided in section "5.1.3 Statement of cash flows of PKP CARGO S.A."

Cash flow from financing activities

In 2016, net cash flow from financing activities was PLN 663.9 million compared to PLN -29.4 million in 2015. Proceeds of PLN 1,004.6 million were received from loans drawn down in 2016, versus PLN 425.0 million in 2015. In 2016, total cash expenditures for leases and repayments of bank loans and borrowings with interest were PLN 350.6 million versus PLN 304.5 million in 2015.

5.2.4. Selected financial and operating ratios of the PKP CARGO Group

The table below presents the key financial and operating ratios of the PKP CARGO Group in the period of 2014-2016

Table 44 Selected financial and operating ratios of the PKP CARGO Group in the period of 2014-2016

No.	Item	2016	2015 (restated*)	2014	Change 2016 - 2015	% change 2016/2015
1	EBITDA margin[1]	11.1%	15.5%	11.8%	-4.4 p.p.	-28.3%
2	Net profit margin[2]	-3.0%	0.7%	1.8%	-3.7 p.p.	-559.1%
3	Net financial debt to EBITDA ratio[3]	2.1	1.2	-0.2	0.9	75.3%
4	ROA[4]	-2.1%	0.5%	1.4%	-2.6 p.p.	-518.1%
5	ROE[5]	-4.1%	0.9%	2.3%	-5 p.p.	-557.2%
6	Average distance covered by one locomotive (km/day)[6]	238.4	233.3	243.9	5.1	2.2%
7	Average gross train tonnage per operating locomotive (tons)[7]	1436.0	1500.0	1481.0	-64.0	-4.3%
8	Average running time of train locomotives (hours per day)[8]	14.8	14.9	15.4	-0.1	-0.7%
9	Freight turnover per employee (thousands tkm/employee)[9]	1216.7	1224.2	1105.5	-7.5	-0.6%

Source: Proprietary material

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016

Table 45 Adjusted selected financial and operating ratios of the PKP CARGO Group in the period of 2014-2016

No.	Item	2016 adjusted ****	2015 adjusted *** (restated*)	2014 adjusted **	Change 2016 -2015	% change 2016/2015
1	EBITDA margin[1]	12.7%	14.4%	18.0%	-1.7 p.p.	-11.7%
2	Net profit margin[2]	-0.9%	2.1%	6.9%	-3.1 p.p.	-144.2%
3	Net financial debt to EBITDA ratio[3]	1.8	1.3	-0.1	0.5	38.0%
4	ROA[4]	-0.6%	1.5%	5.2%	-2.2 p.p.	-141.5%
5	ROE[5]	-1.3%	2.8%	8.7%	-4.1 p.p.	-145.4%

Source: Proprietary material

* restatement of data is described in detail in Note 6 CFS for the financial year ended 31 December 2016
** the 2014 data were adjusted for presentation purposes for the costs following from the implemented 1st Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 265.3 million; additionally, the adjusted net profit includes deferred tax on account of VRP 1 in the amount of PLN 50.4 million
*** the 2015 data were adjusted for presentation purposes for the profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, and impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million; additionally, the adjusted net profit includes deferred tax on account of VRP 2 in the amount of PLN 13.3 million, deferred tax on impairment of non-current assets and assets classified as held for sale in the amount of PLN 33.9 million, while profit on bargain acquisition of AWT does not include deferred tax
****the 2016 data were adjusted for presentation purposes for an impairment loss on assets in the amount of PLN 34.1 million (the adjustment takes into account a loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly, in H2 2016 in the amount of PLN 0.9 million), which was described in note 12.1. CFS and an impairment loss on receivables amounting to PLN 72.7 million (described in Note 19 CFS); the adjusted net result additionally includes deferred tax resulting from an impairment loss resulting from a test for impairment of AWT's value in the amount of PLN 6.5 million and deferred tax resulting from an impairment loss on receivables from OKD in the amount of PLN 8.0 million; the change in the impairment loss on assets and the impairment loss on receivables presented in the CFS results from changes in the exchange rates applied for the conversion of the impairment losses into Polish zloty.

The adjustment concerns only data from the Statement of comprehensive income.

1. Calculated as the ratio of the operating result plus amortization/depreciation and impairment losses to total operating revenue
2. Calculated as the ratio of net profit to total operating revenue
3. Calculated as the ratio of net financial debt (constituting the sum of (i) long-term bank loans and borrowings; (ii) short-term bank loans and borrowings, (iii) long-term finance lease liabilities and leases with purchase option; (iv) short-term finance lease liabilities and leases with purchase option; and (v) other short-term financial liabilities and (vi) other long-term financial liabilities, minus (i) cash and cash equivalents; and (ii) other short-term financial assets) to EBITDA for the last 12 months (result on operating activities plus amortization/depreciation and impairment losses).
4. Calculated as the ratio of net result for the past 12 months to total assets.
5. Calculated as the ratio of net profit for the past 12 months to equity.
6. Calculated as the quotient of vehicle-kilometers (i.e. distance covered by PKP CARGO Group's vehicles in the given period) / vehicle-days (i.e. product of the number of active vehicles and number of calendar days in the given period)
7. Calculated as the quotient of gross ton-kilometers and train-kilometers in train work in relation to the locomotives driving the train (in dual traction or pushing the train in the given period).
8. Calculated as the quotient of vehicle-hours (i.e. number of hours of work of PKP CARGO Group's vehicles in the given period) and vehicle-days (i.e. the product of the number of active vehicles and number of calendar days in the given period).
9. Calculated as the ratio of the Group's freight turnover to the average headcount (in FTEs) in the Group in the given period. The calculation took into account the AWT data as of the purchase date

In 2016, the key profitability ratios, i.e. EBITDA margin, net result margin, ROA, ROE were lower than in 2015, for the reasons described above. The net financial debt to EBITDA ratio also deteriorated as it rose from 1.2 in 2015 to 2.1 in 2016. The deterioration of the ratio is attributable to increased spending of cash associated with capital expenditures in particular with the purchase of multi-system locomotives and the decline in EBITDA generated by the Group in 2016.

The above adjustment to the results improves the ratios of EBITDA margin, net result margin, ROA, ROE and the ratio of net financial debt to EBITDA in relation to the reported figures. This was caused by the non-recurring events in 2016: impairment loss recognized on assets in the amount of PLN 34.1 million (the adjustments takes into account an impairment loss on fixed assets in the amount of PLN 35.0 million and depreciation, reduced accordingly in H2 2016 in the amount of PLN 0.9 million), as described in Note 12.1. CFS and the impairment loss on receivables in the amount of PLN 72.7 million (described in Note 19 CFS). The following events were included in 2015: profit on the bargain acquisition of AWT in the amount of PLN 137.8 million and the costs following from the implemented 2nd Voluntary Redundancy Program pursuant to Resolutions adopted by the Management Boards and Supervisory Boards of PKP CARGO S.A. and PKP CARGOTABOR Sp. z o.o. in the amount of PLN 70.2 million, as well as the impairment of non-current assets and assets classified as held for sale in the amount of PLN 178.7 million.

In 2015 the average daily mileage of locomotives was 233.3 km/day. In 2016, this figure grew by 5.1 km/day, reaching 238.4 km/day. Hence the average daily mileage increased 2.2%. The improvement of this indicator resulted from the optimization of the transportation process.

The gross average train freight turnover per locomotive moved down from 1500.0 tons (2015) to 1436.0 tons (2016). Hence a decrease of 64.0 tons was recorded (the average freight turnover of driven trains fell by 4.3%). This figure fell due to a decline in the transport business.

In 2015, the average running time of locomotives was 14.9 hours/day. In 2016, this figure fell by 0.1 hours/day down to 14.8 hours/day. Hence the average daily running time of locomotives decreased 0.7%. The decrease of the figure results from execution of the transport process with a very high level of closures and operating difficulties in the PKP PLK grid, and a decline in the transport business.

The freight turnover per employee ratio in 2016 fell by 0.6% compared to 2015, which was mainly attributableto a decrease of the average headcount level in the Group by 3.8% yoy with a simultaneous decline of freight turnover by 4.4% yoy.

5.3. Information about production assets

5.3.1. Rolling stock

PKP CARGO Group’s rolling stock is maintained through repair points functioning within the structures of PKP CARGO S.A. Units and in subsidiaries. The PKP CARGO Group’s rolling stock repair and maintenance organization has the competences to repair and maintain wagons, electric locomotives at all the maintenance levels from P1 to P5 and to repair diesel locomotives at maintenance levels from P1 to P4. In addition to the rolling stock owned by the PKP CARGO Group, this organization belonging to the Group also repairs rolling stock and subassemblies for other owners.

Wagons and traction rolling stock are the main elements of the PKP CARGO Group’s production assets. Changes in the rolling stock levels result directly from such actions as liquidation and sale of rolling stock or purchase of rolling stock. Additionally, locomotive modernizations are carried out, which do not affect the overall size of the rolling stock but they do change its age structure and in some cases change the quantities in individual series when a locomotive after a modernization changes its series and purpose.

In 2016, the number of locomotives in the Group fell after some of them were sold, even though 12 multi-system locomotives were delivered to PKP CARGO S.A. The reduction in the numbers of owned wagons was caused by the liquidation of redundant rolling stock because of its technical condition (they were removed from the records).

The tables below present the structure of the locomotives and wagons used, by type and ownership in 2014-2016.

Table 46 Structure of the locomotives used by the PKP CARGO Group and PKP CARGO S.A., by traction type and ownership

Item	31/12/2016***	30/09/2016**	31/12/2015*	31/12/2014	Change 2016-2015	Change Q4 2016
diesel locomotives	1,398	1,399	1,429	1,300	-31	-1
of which in PKP CARGO S.A.	*1,200*	*1,200*	*1,231*	*1,256*	*-31*	*0*
electric locomotives	1,173	1,177	1,173	1,162	0	-4
of which in PKP CARGO S.A.	*1,161*	*1,164*	*1,158*	*1,162*	*3*	*-3*
Total	**2,571**	**2,576**	**2,602**	**2,462**	**-31**	**-5**
of which in PKP CARGO S.A.	***2,361***	***2,364***	***2,389***	***2,418***	***-28***	***-3***
locomotives owned (also under a finance lease)	2,556	2,557	2,579	2,451	-23	-1
of which in PKP CARGO S.A.	*2,360*	*2,360*	*2,380*	*2,409*	*-20*	*0*
locomotives in operational lease or rented	15	19	23	11	-8	-4
of which in PKP CARGO S.A.	*1*	*4*	*9*	*9*	*-8*	*-3*
Total	**2,571**	**2,576**	**2,602**	**2,462**	**-31**	**-5**
of which in PKP CARGO S.A.	***2,361***	***2,364***	***2,389***	***2,418***	***-28***	***-3***

Source: Proprietary material

** including AWT Group locomotives (169 units)*
*** including AWT Group locomotives (166 units)*
**** including AWT Group locomotives (164 units)*

Table 47 Structure of the wagons used by the PKP CARGO Group and PKP CARGO S.A., by ownership

Item	31/12/2016***	30/09/2016**	31/12/2015*	31/12/2014	Change 2016-2015	Change Q4 2016
wagons owned (also under a finance lease)	64,519	64,708	64,907	62,086	-388	-189
of which in PKP CARGO S.A.	*60,954*	*61,116*	*61,324*	*61,593*	*-370*	*-162*
wagons in operational lease or rented	1,167	1,316	1,868	0	-701	-149
of which in PKP CARGO S.A.	*0*	*0*	*0*	*0*	*0*	*0*
Total	**65,686**	**66,024**	**66,775**	**62,086**	**-1,089**	**-338**
of which in PKP CARGO S.A.	***60,954***	***61,116***	***61,324***	***61,593***	***-370***	***-162***

Source: Proprietary material

** including AWT Group's wagons (4,980 units)*
*** including AWT Group's wagons (4,437 units)*
**** including AWT Group's wagons (4,261 units)*

On 23 September 2015, an agreement was signed with the Consortium composed of Siemens Sp. z o.o. and Siemens A.G. for the delivery of 15 multi-system locomotives on delivery dates from 31 January 2016 to 30 June 2017 (basic order) with an option to purchase 5 additional locomotives at basic order prices, where PKP CARGO S.A. must take the decision to exercise this option no later than on 31 December 2017 (optional order).

Between 1 January 2016 and 31 December 2016, 12 multi-system locomotives were delivered by the manufacturer.

The Management Board is considering liquidation of ca. 800 wagons and 450 locomotives for unsatisfying technical condition purposes.

5.3.2. Real estate

In the transport process, due to the necessity to guarantee appropriate maintenance and repair support, real estate plays an important role. Most real estate used by the Group is used on the basis of lease and rental agreements. The table below presents the change in the balance of real properties owned and used by the PKP CARGO Group and PKP CARGO S.A. in 2014 - 2016.

Table 48 Real estate owned and used by the PKP CARGO Group and PKP CARGO S.A. as at 31 December 2016 compared to 31 December 2015 and 31 December 2014.

Item	31/12/2016*	31/12/2015*	31/12/2014	Change 2016-2015
Land - owned, in perpetual usufruct and leased from other entities [ha]	1,584	1,560	1,006	24
of which in PKP CARGO S.A.	*578*	*585*	*583*	*-7*
Buildings - owned, leased and rented from other entities [sqm]	781,998	794,303	684,945	-12,305
of which in PKP CARGO S.A.	*585,690*	*592,893*	*601,269*	*-7,203*

Source: Proprietary material

**including AWT Group's real property*

The increase in land in perpetual usufruct and leased from other entities is driven by the adjustment of the Group's assets to its business activity.

The decrease in the size of buildings owned, leased and rented results from the on-going verification of the size of the assets used by the Parent Company and its Subsidiaries.

5.4. Key information about the financial standing of the Company and the PKP CARGO Group

5.4.1. Information on loans and borrowings agreements executed and terminated

On 19 July 2016, the Parent Company entered into an investment loan agreement with the European Investment Bank for the maximum amount of EUR 40,000,000.00 (EURIBOR or WIBOR + margin). The loan was granted for financing and/or refinancing of the purchase of multi-system locomotives. The loan is available till 19 July 2020. The loan may be disbursed in EUR or PLN. The full loan repayment should take place by 19 July 2035.

On 26 September 2016, AWT Group Companies entered into an agreement to refinance credit liabilities with the following institutions: ING Bank N.V., UniCredit Bank Czech Republik and Slovakia, a.s., Raiffeisenbank a.s. up to the maximum amount of EUR 27,500,000.00 (including up to EUR 16.5 million (at a fixed interest rate) and CZK equivalent of EUR 11 million (PRIBOR + margin)). The loan should be repaid in full by 26 September 2021.

In 2016, no loan agreement with the Company or any of its related entities was terminated.

Details of the bank loans and borrowings are presented in Note 27 SFS and in Note 26 CFS.

5.4.2. Information about granted loans

In 2016 the Parent Company did not grant any loans to any affiliates of PKP CARGO.

On 1 July 2016, AWT Rekultivace granted a loan of PLN 550,000.00 to its subsidiary, to be repaid by 31 December 2016. The loan bore interest at a fixed interest rate and has already been repaid.

On 30 August 2016, AWT BV signed a loan agreement with AWT Rosco up to the maximum amount of EUR 1 million. The loan should be repaid in full by 31 December 2017. The loan bears interest at a fixed interest rate.

On 13 September 2016, PKP CARGO CONNECT sp. z o.o. granted a loan of EUR 90,000.00 to its subsidiary (from which EUR 30,000.00 was disbursed). The loan will be repaid within 364 days of the disbursement of the last tranche of the loan, but no later than by 31 December 2017. The loan bears interest at the reference rate of EURIBOR 1M, plus margin. The loan is secured with a blank promissory note with a relevant declaration.

5.4.3. Information about granted and received sureties and guarantees

In 2016 banks, on PKP CARGO S.A.'s request, issued bank guarantees for its business partners in the total amount of PLN 20.7 million.

As at 31 December 2016, PKP CARGO S.A. has outstanding bank guarantees issued for its business partners for the total amount of PLN 18.3 million.

In connection with the signed freight transport contracts, the Parent Company has ordered bank guarantees to be issued for the total amount of PLN 15.5 million.

Additional information about contingent liabilities is presented in note 37 SFS and in Note 36 CFS 2016.

5.4.4. Issues, redemptions and repayments of debt securities and equity securities

In the analyzed period, in the PKP CARGO Group there were no issues, redemptions and repayments of debt securities and equity securities.

5.4.5. Assessment of management of financial resources

PKP CARGO S.A. and the Group have been efficiently managing the cash management cycle by matching the maturity of its receivables and payables. To secure the possible risk associated with a shortage of cash in the short run, in 2016 PKP CARGO S.A. had current account overdraft agreements with limits amounting to PLN 100 million.

Internal financial risk management policy, allowing for optimization of the maturities and types of investment instruments and the liquidity reserve level, is an element supporting efficient management of the Company's and the Group's finances. Excess cash generated by the Companies and the Group was invested in fixed rate bank deposits with maturities of mainly up to approx. 3 months. Decisions made with regard to bank deposits are based on maximizing the rate of return and current assessment of the financial standing of the banks. The structure of assets, including cash and short-term investments, secured the Company's and the Group's ability to settle their liabilities in a timely manner.

The finance management system in PKP CARGO Group companies is efficiently supplemented by the cash pooling mechanism, which makes it possible to reduce the costs incurred in connection with the use of short-term external financing sources and maximize the financial revenues in connection with available cash surpluses.

In H2 2016, the Parent Company entered into a bank guarantee limit agreement on the basis of which it is possible to issue guarantees on the order of any company from the PKP CARGO Group, which made it possible to reduce the costs incurred in connection with obtained guarantees and made the guarantees independent of the financial standing of the given company.

In 2016, the Group companies had the capacity to settle their liabilities at maturity.

5.4.6. Description of the structure of key equity investments or key investments made within the Company and the PKP CARGO Group.

Most financial investments made by the Company and the Group in 2016 were bank deposits, which are concluded for the period from a few days up to 1 month, depending on the Company's liquidity needs.

5.4.7. Current and forecast financial standing of the Company and the PKP CARGO Group

The financial standing of the Company and the Group is stable. There were no negative events that could endanger its status as an ongoing concern or cause a significant deterioration of their financial standing.

5.5. Key risk factors and threats

5.5.1. Description of the key threats and risks

Risks related to the economic and market environment

Risk arising from macroeconomic conditions – Transport is one of the most important sectors of every economy (Poland and Czech Republic included). In the countries mentioned above, road and rail transport are of particular importance. As transport influences the economy, the condition of the economy also has a significant effect on the level of development of transport services. The key macroeconomic factors affecting rail transport include primarily the overall growth rate of industrial production and the level of development of those sectors of the industry, which require raw materials that must be delivered, among others, by rail. Both these factors have a direct impact on the level of international trade, which in turn is reflected in the data on rail cargo transport. Road transport must also be taken into account, which is a direct substitute and as such affects the development of rail transport. The better the condition of the road transport is, the greater the potential risk of its negative influence on the condition of rail transport.

The economic conditions in the individual countries and in the entire macroeconomic environment in which the PKP CARGO Group provides transportation services is reflected directly in the Group's business activity. There is a strong correlation of the freight turnover achieved by rail transport with the GDP growth rate, but also with the periods of economic declines and hikes or long-term fluctuations in individual branches of the industry.

The Group's financial performance is also affected by the condition of foreign economies where its business partners are domiciled. This is because the Group earns its revenues on the transportation services rendered not only on the territory of Poland and Czech Republic, but also in other countries (that is on account of transportation services provided internationally).

At present, the entire cargo transport industry (including cargo transport by rail) is also affected by the approach of the business partners to open trade. So far, trade in the European Union has been conducted without major issues, but after the United Kingdom's decision to leave the Union, we should expect changes in the operation of the common EU market and also the UK market. After the statement made in January by the UK Prime Minister Theresa May, we do know that the Union will have to deal with a "hard Brexit". During the Brexit negotiations, the United Kingdom will not pursue membership in the common EU market and will also leave the customs union. The UK Prime Minister also stated that, during the negotiations of the new trade agreement with the European Union, she would pursue the broadest possible exchange of goods and services. This will not be an easy feat and both sides will be difficult to satisfy. Therefore it is highly probable that there will be some turmoil in international trade related, among others, to the negotiation of customs rates. The "hard Brexit" will also affect the corporate strategies of the service or trading companies operating in the United Kingdom.

The growth rate of the exchange of goods and the structure of the transport business in the Central and Eastern Europe will also be affected by the condition of the Chinese economy, where GDP growth fell to 6.7% yoy in 2016. Even though this figure was consistent with the assumptions made by the Chinese authorities (6.5%-7.0% yoy) it was nevertheless the lowest level in 26 years. The lower growth of the Chinese economy was significantly affected by the level of credit debt and the real property market. In the coming quarter,[42] the real property market will contribute to the fall of the Chinese GDP growth rate to 6.6% yoy in Q1 2017 (from 6.8% yoy in Q4 2016). This will probably result from the introduction of more stringent regulation of this industry in order to restrict the increase in prices on the residential market. The Chinese government expects GDP growth of 6.7% yoy in 2017. Stabilization of the economic growth at this level may have a favorable effect on the Group's transport

[42] Business Inquirer

business due to the signed trade contracts and bilateral agreements between Poland and China as part of the land transport of goods via the New Silk Road[43].

Risk associated with the situation on the rail transport market in the main cargo categories – Certain industry sectors are highly correlated with rail transport. They include, among others: mining, metals, refining and chemical industry, construction and timber industry. The condition of those sectors has a significant effect on the growth of freight volume transported by the PKP CARGO Group.

The hard coal mining and processing sector continues to be of key importance for the transport business conducted by the Group. Despite the considerable improvement following from an increase in the average monthly price of the commodity on ARA markets (up to 87.0 USD/t in December 2016), it should still be considered to be uncertain, because of the following factors:

- growing significance of renewable energy sources ("RES") – according to the Energy Market Agency, in 2015 in Poland renewable energy represented 13.7% of gross final energy consumption (12.4% in 2014 according to the European Commission).[44] According to the plans developed by the Ministry of Energy, this percentage should increase to 15% by 2020. As the Czech Republic exceeded its 2020 target in 2015, that is a 13% share of RES in electricity production, the National Action Plan set out a new target of 15.3%.[45]

- closure of mines of the OKD coal mining company currently in bankruptcy. Successive mines are designated for closure: Paskov (1st half of 2017), Darkow (by the end of 2017), Lazy (in 2018), CSA (in 2021) and CSM (in 2023). The situation may improve if a new owner or a strategic investor is found, however if this does not occur by 12 April 2017, OKD will have to be liquidated. The main reason for the financial problems is the excessive indebtedness of NWR (the owner of OKD) and the excessive cost of servicing own liabilities. The liquidation of OKD will have a material negative impact on the public because of the loss of jobs by miners and loss of an important business partner of numerous cooperating companies. There may be as many as over 500 such companies in the Czech Republic alone.[46]

In 2016, the mines in Poland produced 70.4 million tons of hard coal, 1.8 million tons (or 2.5% yoy) less than in 2015 when 72.2 million tons were produced. This is caused by the lack of stability of Polish coal mines, which are undergoing a restructuring process, despite the many changes introduced in the previous year.[47]

Another threat is posed by the trend in electricity production in Poland. According to data from the National Electrical Energy System and the Balancing Market[48], 162,626 GWh of electricity was generated in 2016, compared to 161,772 GWh one year earlier. This means an increase by 954 GWh, or 0.53% yoy. Professional heat generation plants relying on hard coal produced 81,348 GWh in 2016, down 535 GWh or 0.65% yoy from 81,883 GWh in 2015. Energy production increased yoy in wind power plants (up by 15.76% yoy from 10,041 GWh in 2015 to 11,623 GWh in 2016). Energy production from other renewable sources continues to increase very quickly (a 100.03% yoy increase from 73 GWh in 2015 to 146 GWh in 2016).[49]

Risk associated with the rail freight sector – The liberalization of standards and regulations governing the railway business in Poland and in the Czech Republic has made it much easier for new operators to enter the cargo transport market. As a result, the number of potential competitors continues to change: there were 67 operators on the market in 2015 and 69 in 2016. In addition to the new operators, the operators that were present on the market before 2016 may also return if they decide to renew their licence and recommence their business in competition to the PKP CARGO Group.

The Group is still a leader on the rail cargo transport market in Poland. In 2015, the competitors had a 52.22% market share in terms of freight volume, which rose to 55.90, or by 3.76 p.p yoy in 2016. In terms of freight turnover, the competitors had a 48.45% market share in 2016, raising the overall market share by 4.23 p.p. yoy from 44.22% in 2015. In 2016, AWT had a 9.00% share in the Czech market in terms of freight turnover, down by 0.22 p.p. yoy from 9.22% in 2015.[50]

The Group's key competitors in rail transport in Poland are: DB Cargo Polska, Lotos Kolej, PKP LHS and CTL Logistics. Their services are focused on the transportation of coal, aggregates, other bulk commodities, liquid fuels, chemical products and intermodal transport.

[43] Business Insider Polska
[44] Wysokienapiecie.pl
[45] TZBinfo - Technická Zařízení Budov
[46] Wirtualny Nowy Przemysł [Virtual New Industry]
[47] PAP
[48] Polskie Sieci Elektroenergetyczne
[49] Polskie Sieci Elektroenergetyczne
[50] SZDC

AWT's key competitors on the Czech market include: CD CARGO a.s., METRANS Rail s.r.o., Unipetrol Doprava s.r.o., IDS Cargo a.s., SD – Kolejova doprava a.s., Rail Cargo Carrier - Czech Republic and LTE Logistik a Transport Czechia s.r.o. The other operators focus on transporting coal, bulk commodities, liquid fuels, chemical products and intermodal transport.

The greatest risk in the rail transport business in Poland involves the transport of aggregate and other products of key importance for infrastructural investments, which is affected by delays in the execution of tenders and in launching the construction phase of the proceedings that have already been decided. The greatest risks on the Czech market are related to the coal transportation business, since OKD, the only coal mining company, is closing its mines.

Risks in the operations conducted

Risks associated with rail infrastructure – The activities of the PKP CARGO Group depend on the condition of the rail infrastructure and the railway network being used is characterized by low quality. An intensive railway network modernization program, although ultimately it will entail improvement of operating conditions, during the course of the construction and renovation work will cause hindrances and a necessity to route the railway traffic using detours. Since many tracks are closed and there is no throughput available, there are instances where schedules are received for distant dates, which adversely affect wagon turnover and therefore the possibility of using wagons for additional routes.

Risk of changes to legal regulations

Technical specifications for interoperability Noise (NOI TSI)

The European Commission continues its work on the revision of TSI Noise, which will most probably result in an obligation imposed on rail cargo operators to install composite brake blocks or possibly also to change wheelsets, especially in the case of wagons equipped with tyred wheel sets. According to the most recent proposals, the deadlines for installing the composite brake blocks is the year 2022 for international traffic and 2026 for domestic traffic. Alternatively, the EC is also considering the concept of "silent rail line sections" but its final outcome and the possible deadlines for the operators are not yet known. It must be noted that the work and analysis is in progress and their ultimate outcome remains unknown. Both PKP Cargo and MIB are involved in the discussion with the EC aimed at delaying those deadlines and a separate approach to the Polish rolling stock, which uses mainly tyred wheelset.

Implementing act in the matter of establishing a single European railway area

The draft act (implementing act for Article 13 of Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area) is the subject matter of intensive work in the European Commission (the work is scheduled for completion in H2 2017). The draft sets out the detailed rules of using service infrastructure facilities. The proposed provisions may entail risks involving:

- increased bureaucracy and increased administrative expenses of service infrastructure facilities in the PKP CARGO Group,
- the necessity of conducting organizational changes,
- lower profitability of some PKP CARGO Group companies.

Sunday trading restrictions

The bill initiated by citizens to restrict Sunday trading may introduce restrictions for conducting business on Sundays in entities such as logistic centers, warehouse centers, container terminals, distribution centers. Entry of this act into force may have an adverse effect for the entire TSL sector.

Provision of access to rail infrastructure

The draft regulation of the Minister of Infrastructure and Construction in the matter of providing access to rail infrastructure introduces new procedures and deadlines for submitting applications to provide access to rail infrastructure, which affect PKP CARGO S.A. in the following areas:

- ordering train routes in the annual timetable,
- extending deadlines for the filing of requests for an individual timetable,
- increasing booking fees.

EU Emissions Trading Scheme (EU ETS)

Uncertainty related to the changes in the EU Emissions Trading Scheme (EU ETS) made the Company's client, ArcelorMittal Poland (AMP) suspend its decision to renovate the blast furnace no. 2 in Dąbrowa Górnicza. The possible resignation from the furnace could affect not only AMP but also e.g. on mining and rail transport. Closure of the blast furnace would require a fundamental change of the entire production model of the steel mill and many other plants. First of all, the level of raw steel production would decline and the level of material supplies would follow. The risk of extinguishing one of two currently operational blast furnaces in Dąbrowa Górnicza would create risk that some of the transport business provided by PKP CARGO S.A. could be lost.

Road transport constitutes an ever increasing competition for the Group – Road freight transport in Poland poses the most serious competition to rail transport. The road network is developing at an increasing pace within the framework of the extensive domestic road construction program, while the slower pace of modernization of rail routes, temporary closures and the resulting detours result in the road transport increasingly becoming the method of choice for freight transport. The increasing density of motorways and express roads acts to the detriment of the entire rail transport market and not just the PKP CARGO Group. According to the Council of Ministers' regulation of 2016, the total length of fast highways was to be about 7,650 km, including 2,000 km motorways and 5,650 expressways. Only in 2016, 123 km of motorways and express roads were commissioned for use and contracts were signed for the construction of roughly 234 km. 322 km of fast highways are to be commissioned for use in 2017 and about 369 km in 2018.[51]

The increasing density of the road network, coupled with the better quality of surface course has a positive effect on the cost of road transport and shorter delivery times. Additionally, goods may be delivered to a specified recipient without any need to use other means of transport from the terminal, as is the case for rail transport. The progressing work on the development of additional fast road sections contributes to putting rail transport in a more challenging competitive position.

In the Czech Republic, the total length of the network of motorways and express roads is 1,225 km (as at 1 January 2017). The network is to be expanded by additional 43 km, which is currently in construction. Ultimately, upon completion of all the motorway construction plans, the final length of the network is to be 2,134 km. This is of critical importance for the road transport in the Czech Republic.

The Group's customer base is highly dependent on a limited number of industries and their suppliers – Many of PKP CARGO Group's key customers choose a long-term business cooperation by signing transportation services contracts. This is required to ensure transportation capacity for large quantities of goods, such as e.g. coal, aggregate, construction materials, metal ore, metals and merchandise. There exists a risk for the Group that its customers would request a lower freight volume than declared in the contract or that they do not extend the contract because of the changing business conditions (e.g. lack of goods to be transported) or because of the activity of competitive operators on the rail transport market (who may offer better terms and conditions of the contract). The larger number of operators providing similar services makes it ever more difficult to find a customer, for whom transportation services can be rendered at a similar level.

New contracts are particularly important for AWT, whose main customer, the coal mining company OKD, is likely to close five mines in the period from 2017 to 2023. New contracts acquired by AWT following its acquisition by PKP CARGO S.A. partially offset the lower volume of services provided to OKD, but the loss can still be felt. The industries in which new contracts were acquired include: the chemical, agricultural, steel sectors and intermodal transport.

Structural changes in the business of key customers – Change in the business profile of major customers is another risk that the PKP CARGO Group is facing. The main threat arises from the fact that some companies establish subsidiaries, which become operators and handle the transportation of all or some of their products. Another risk is that a transport subsidiary, which was responsible for a portion of transport, may take over all the transportation activity. As a result, the Group's share in the transportation of such a client's cargo may decline and be gradually taken over by the transport subsidiary. The initial preference for a subsidiary providing rail transport services to a production company may become a step towards a subsequent expansion of the subsidiary's business to transport services provided to external clients. Therefore, there is a real risk that a new competing rail transport operator may be formed.

Other risks involving the Group's current clients are the potential chances in the location of their business activity or changes in the production cycle. This may directly affect the volumes of transports commissioned to the Group.

[51] Regulation issued by the Council of Ministers on 19 May 2016 amending the regulation in the matter of the network of motorways and express roads (Journal of Laws of 2016, Item 784)

Risk associated with the declaration of OKD's insolvency – On 11 August 2016, at a session of the Regional Court in Ostrava, the creditors of OKD A.S, a company which had been declared insolvent, made a decision to initiate a restructuring procedure in OKD in accordance with the provisions of Czech law. In accordance with the register, the receivables from OKD reported in the process, including the receivables due to AWT in the amount of CZK 462.9 million (PLN 73.0 million), were accepted. The decision means that OKD will continue its operations under a restructuring plan involving, among others, the phasing out of unprofitable mines.This was one of the necessary pre-conditions for obtaining a loan of CZK 700 million (about PLN 113.2 million).

Risk associated with shortage of trained personnel – In connection with increase of the average age of many train crews and shortage of graduates, the Group has undertaken a number of actions aimed at reducing the risk of shortage of personnel. However there is still a risk of shortage of key professionals, such as members of train crews, mainly train engineers. However the Group takes measures to mitigate the risk such as recruitment campaigns, dialogue with technical education institutions, personnel skills improvement and broadening the knowledge of routes.

Risk of collective disputes and strike – Since 2 July 2015, a collective dispute was pending in PKP CARGO S.A. associated with the failure of the Company's Management Board to comply with the demand to raise salaries on 1 July 2015 to the level requested by the trade unions. Nevertheless, the dialogue between the partners conducted over the year 2016 and the memorandums of agreements signed with the trade unions in March and June 2016 stabilized the social situation in the Company and allowed it to conduct its statutory business in a peaceful atmosphere. Under the memorandum of agreement dated 15 March 2016, the trade unions dissolved the Protest and Strike Committee and company-level committees, and cancelled all protest and strike activities as regards the structural and organizational changes in the Company. On 16 November 2016, a Memorandum of Agreement was executed between the parties to the Company Collective Bargaining Agreement for Employees Hired by PKP CARGO S.A. Units, which ended the collective dispute commenced on 2 July 2015. By the power of this Memorandum of Agreement, PKP CARGO S.A. employees were awarded a one-off special award, which was paid out in December 2016.

Given consideration to the above, we should remember that any future protest or strike activity would have a negative effect on the Company's financial performance. On the delivery date of this report, there was no risk of protest and strike activities.

Risk of wage increases – In 2017, the risk of wage increases will be enhanced especially by the following two facts:

- the undertaking of the parties to the Employee Guarantee Package of 2 September 2013 as regards annual negotiation of wage increases and its implementation no later than by 1 July, depending on the of the Company's performance and financial standing (permanent, predictable risk),
- the work of the Team appointed by the decision of the PKP CARGO S.A. Management Board President pursuing the goal of developing the rules for setting basic salary for the employees covered by the Company Collective Bargaining Agreement; the new rules should ensure consistency of the internal regulations governing the terms of remuneration in the Company and would also constitute the implementation of the post-inspection request from the Regional Labour Inspector in Warsaw of 15 October 2015.

At present the impact of the expectations regarding the possible increase in wages on the Parent Company's performance in 2017 is difficult to quantify.

Financial risks

Liquidity risk – PKP CARGO S.A. and other Group companies are exposed to liquidity risk following from the ratio of current assets to net current liabilities (current liabilities without short-term provisions).

In 2015 and 2016, the Group's liquidity remained at the level that ensured timely payment of all due and payable liabilities. To ensure an additional source of funds required to secure its financial liquidity, the Group used external financing sources, such as a current account overdraft facility, investment loans and leasing.

As at 31 December 2016, the Company had in aggregate unused credit facilities in the amount of PLN 1,117.7 million, while for the entire Group the unused credit facilities were PLN 1,118.3 million.

Additionally, in order to optimize financial expenses in the PKP CARGO Group, a cash pooling system is in place which comprises, as at 31 December 2016, 7 Group companies. Under the cash pooling agreement, PKP CARGO S.A. may use a current account overdraft of up to PLN 100 million.

Market risk – The Group is exposed to market risks associated with changes of the exchange rates and interest rates. The objective of the market risk management process is to limit undesirable impact of changes of market risk factors on the cash flows and results in the short- and medium-term. The Group manages market risks following from the aforementioned factors on the basis of internal procedures which define the rules of measurement of individual exposures, parameters and time horizon.

The principles of market risk management are implemented through assigned organizational units under the supervision of the Parent Company's Management Board. Market risk management is executed based on developed strategies, with partial utilization of derivative instruments. Derivative instruments are used only to limit the risk of change of the balance sheet value and the risk of cash flow changes. Transactions are concluded only with reliable partners, admitted to participation as a result of application of internal procedures and execution of appropriate documentation.

FX risk – In 2016, the Group was exposed to FX risk resulting from the receivables, payables and cash denominated in foreign currencies. The Group's receivables expressed in foreign currencies are short-term receivables with the maturity up to 1 month and payables expressed in foreign currencies are mostly short- and long-term liabilities on account of investment loan agreements with maturities of up to 15 years.

The balance sheet valuation of receivables and some current and non-current liabilities long-term liabilities expressed in foreign currencies, settlements in foreign currencies both on the side of receivables and liabilities, lead to financial revenues (positive FX differences) and financial expenses (negative FX differences). The level of financial revenues and financial expenses fluctuates during the year, which is caused by changes in the exchange rates.

Cash in foreign currencies deposited on bank accounts follow from timing mismatch of receipts and expenditures and the surplus of receipts over expenditures. In the long run, the valuation risk matches the risk of change of cash flows, therefore it is the cash flows, not balance sheet items, that are subject to hedging transactions.

For the EUR/PLN exchange rate, there is partial natural hedging due to the fact that proceeds in EUR are partly balanced out by expenditures in the same currency. The FX risk management transactions used by the Group are aimed at hedging the net free position (understood as the difference between FX proceeds and expenditures) exposed to change of the value in PLN.

According to the Financial Risk Management Policy prevailing in the Company, in 2016, FX risk management transactions were used for the EUR/PLN currency pair.

Forward transactions were used to hedge FX risk in 2016.

In 2016, the Company hedged the surplus in EUR through forward transactions on the EUR/PLN pair at the levels and with transaction maturities determined in accordance with the procedures of the Financial Risk Management Policy.

These transactions were effected by the Parent Company and PKP CARGO CONNECT sp. z o.o. Details are presented in Note 34.1 SFS and in Note 33 CFS.

Interest rate risk – Most financial investments made by PKP CARGO S.A. and other Group companies as at the end of 2016 were bank deposits, which are concluded for the period from a few days up to 1 month, depending on the Company's liquidity needs.

In addition, the Group is exposed to the risk of volatility of interest rate cash flows following from bank loans, leasing based on variable interest rates. Interest on leasing agreements was accrued according to the reference rates increased by the financing party's margin. The reference rate for agreements denominated in EUR is EURIBOR 3M and 6M and for agreements signed in PLN – WIBOR 1M and 3M. The interest rate risk in leasing agreements is executed through revaluation of leasing installments in the periods of 1 month, 3 months, 6 months, depending on the agreement.

Interest on loan agreements were accrued according to the WIBOR 1M, WIBOR 3M, WIBOR 6M, EURIBOR 3M and PRIBOR 3M reference rates plus the banks' margins. The interest rate risk in loan agreements is executed through revaluation of loan installments in monthly, quarterly and semi-annual periods.

At the same time, in accordance with the Financial Risk Management Policy, one of the Group companies entered into interest rate hedging transactions, the so-called IRS.

In 2013, due to its external financing based on variable interest rates, PKP CARGO CONNECT Sp. z o.o. entered into IRS transactions to hedge the volatility of interest rates for PLN loans, adapted properly to fit the assume principal repayment schedule. In the case of lease agreements for the lease agreement for 210 TALNS series wagons, IRS transactions were executed in the financial year 2013. As at the balance sheet date, a subsidiary, PKP CARGO CONNECT Sp. z o.o., had outstanding interest rate transactions.

Credit risk – PKP CARGO Group companies, while conducting their trading activity, sell services to business entities for a deferred payment, which may lead to the risk of business partners defaulting on the payments for the services. To minimize the credit risk, the Group manages the risk through a prevailing client creditworthiness assessment procedure. This assessment is carried out for all clients who use a deferred payment date. As part of its internal policy, the Company makes application of the deferred term of payment conditional on acceptability of the business partner's condition and positive history of cooperation.

Receivables from business partners are monitored on a regular basis. In the case of overdue receivables, in accordance with prevailing procedures, the delivery of services is suspended and recovery procedures are triggered.

Concentration of risk associated with trade receivables is limited due to the large number of business partners with commercial credit dispersed among different sectors of economy. In addition, to reduce the risk of problems with recovery of trade receivables, the companies from the Group accept security interests from their customers in the form of, among others: bank/insurance guarantees, assignment of contracts, security deposits and promissory notes.

The credit risk associated with cash and bank deposits is perceived as low. All the entities in which Group companies invest their free cash operate in the financial sector. These include domestic banks, foreign banks and branches of foreign banks.

The maximum exposure to credit risk is presented by balance sheet balances of trade and other receivables, cash and other financial assets. This exposure is limited through securities established in favor of the Group (in the form of, inter alia, bank/insurance guarantees, guarantee deposits).

5.5.2. Information on financial instruments with respect to the risk and financial risk management objectives and methods adopted by the Company and the PKP CARGO Group.

In 2016 both PKP CARGO S.A. and the Group did not record any significant cash flow disruptions and loss of financial liquidity.

The financial standing is stable and there were no negative events that could endanger its status as an ongoing concern or cause a significant deterioration of their financial standing.

The principles of market risk management are implemented through assigned organizational units under the supervision of the Parent Company's Management Board. Financial risk in the PKP CARGO Group is managed using strategies, with partial use of derivative instruments (SPOT FX transactions, FORWARD FX transactions and IRS transactions), which are used only to limit the risk of change of the balance sheet values and the risk of cash flow changes.

In 2016, the Parent Company applied cash flow hedge accounting using financial instruments such as forward currency sales transactions and an investment loan. The purpose of the hedging activity is to mitigate the impact of the FX risk within the EUR/PLN currency pair on the future cash flows. The hedged item is a highly probable cash flow denominated in EUR.

Hedge accounting was used by a PKP CARGO Group company: PKP CARGO CONNECT Sp. z o.o. To manage FX risk, this company used financial instruments, primarily forward sales transactions and variable interest rate hedges to hedge interest rate fluctuations for its investment loans in PLN. To this end it concluded IRS transactions.

6. Key events and information about the activity of the Company and the PKP CARGO Group

6.1. Key information and events

Table 49 Key information and events which occurred in 2016 and after the balance sheet date

Period	Event
January	• The Company's Management Board received a decision of the President of the Competition and Consumer Protection Office ("President of UOKiK") No. DOK-5/2015 of 31 December 2015 pursuant to which the President of UOKiK: i. concluded that the Company abused the dominant position in the domestic rail freight market by preventing the development of conditions required for the emergence or development of competition through the introduction, as of 1 May 2006, of changes to the "Rules of sale of freight services by PKP CARGO S.A.", in particular § 5 sec. 6-10 contained in chapter I of these rules which authorized the Company to refuse to sign special agreements with commercial undertakings considered to be the Company's competitors; ii. concluded that the aforementioned practice was abandoned as of 1 July 2007; and iii. imposed on the Company a fine in the amount of PLN 14,224,272.18. In the opinion of the Company's Management Board, the decision of the President of the UOKiK of 31 December 2015 is groundless. PKP CARGO S.A. filed an appeal to UOKiK against the Decision. • PKP CARGOTABOR USŁUGI Sp. z o.o. ("PKP CU") was notified by PKN ORLEN S.A. of the fulfillment of the first condition precedent specified in the conditional binding purchase agreement for a 99.85% stake in the share capital of Orlen KolTrans Sp. z o.o. ("KolTrans") entered into by and between PKP CU as the buyer, PKP CARGO S.A. as the guarantor and PKN Orlen as the seller, as none of KolTrans' minority shareholders exercised its priority right to purchase KolTrans' shares they had pursuant to the KolTrans articles of association within the deadline prescribed therein. • The PKP CARGO S.A. Supervisory Board, following a recruitment procedure, on 19 January 2016 appointed Maciej Libiszewski to the position of President of the PKP CARGO Management Board. On the same day, Maciej Libiszewski resigned from the position of member of the Company's Supervisory Board. • Commencement of performance of the agreement with a consortium of Siemens Group companies for delivery of multi-system locomotives - the first 3 out of a total of 15 locomotives to be operated by PKP CARGO S.A. on international routes were delivered.
February	• Resignations from the PKP CARGO S.A. Management Board submitted by Łukasz Hadyś, Management Board Member in charge of Finance, Jacek Neska, Management Board Member in charge of Commerce, and Wojciech Derda, Management Board Member in charge of Operations. These resignations entered into force with immediate effect. • Satisfied was the other condition precedent provided for in the conditional binding agreement for the purchase of shares in Orlen KolTrans sp. z o.o., consisting of registration, by the competent court of registration, of amendments to KolTrans's articles of association agreed upon in the Purchase Agreement concerning, among others, the termination of PKN ORLEN's rights to appoint and dismiss members of KolTrans's corporate authorities upon sale by PKN ORLEN of all shares held in KolTrans's share capital. • On 16 November 2015, PKP CARGO S.A. made the first withdrawal under the loan from Bank Polska Kasa Opieki S.A.
March	• Following a material decline in the market prices of scrap metal in Q4 2015, the Company's Management Board, having analyzed the impact of this change on the 2015 standalone and consolidated financial statements, decided to recognize impairment losses based on the prices of appropriate scrap metal classes as at the end of 2015, on the following assets: 1) property, plant and equipment – rolling stock, in the amount of PLN 147,799 thousand, 2) inventories, in the amount of PLN 5,288 thousand; 3) non-current assets classified as held for sale, in the amount of PLN 24,029 thousand. The total amount of the impairment losses in the 2015 standalone and consolidated financial statements is PLN 143,464 thousand, which includes the effect of tax. The impairment losses are non-cash items and have no effect on PKP CARGO S.A.'s liquidity and do not affect its compliance with financial covenants under the existing loan agreements. • On 15 March 2016, a memorandum of agreement was executed between the parties to the Company Collective Bargaining Agreement for Employees Hired by the Establishments of PKP CARGO S.A. ("CCBA Memorandum of Agreement"), in particular with respect to the collective dispute commenced on 2 July 2015. Under the memorandum of agreement dated 15 March 2016, the trade unions dissolved the Protest and Strike Committee and company-level committees, and cancelled all protest and strike activities as regards the structural and organizational changes in the Company. At the same time, the Company withdrew the claims of 2 November 2015 to rule non-existence of collective disputes in the Company's individual plants and on the level of the entire Company. Moreover, the parties to the CCBA Memorandum of Agreement undertook to enter into a memorandum of agreement pertaining to the collective dispute commenced on 2 July 2015 by 30 June 2016 to implement, in particular, the post-inspection report of the Regional Labour Inspector in Warsaw of 15 October 2015 on making changes to the terms and conditions of salary in the form of additional protocols to the Company Collective Bargaining Agreement.

- On 16 March 2016 the Company's Management Board received a notification from Morgan Stanley (Institutional Securities Group and Global Wealth Management) concerning a reduction of the stake held by Morgan Stanley (Institutional Securities Group and Global Wealth Management) below 5% of the overall number of votes at the Company's Extraordinary Shareholder Meeting ("SM"). This threshold was crossed by selling the Company's shares on the Warsaw Stock Exchange on 10 March 2016 ("Transaction"). Before the Transaction, Morgan Stanley (Institutional Securities Group and Global Wealth Management) held 2,380,008 shares of the Company representing 5.31% of the Company's share capital and 2,380,008 votes at the SM, which is 5.31% of all the votes. After the Transaction, Morgan Stanley (Institutional Securities Group and Global Wealth Management) holds 2,225,827 shares of the Company representing 4.97% of the Company's share capital and 2,225,827 votes at the SM, which is 4.97% of all the votes.
- On 18 March 2016, the Management Board adopted a resolution on submitting a motion to the Company's Shareholder Meeting to adopt a resolution to cover the net loss incurred in the amount of PLN 114,125,438.44 stemming from the Standalone Statement of Comprehensive Income for the period from 1 January 2015 to 31 December 2015 from future earnings and to recommend to the Company's Shareholder Meeting that no dividend be paid for the financial year starting on 1 January 2015.
- Execution of an annex to the Investment Loan Agreement with European Investment Bank, extending the loan availability period until 3 December 2016.
- Satisfaction of the first of the conditions precedent defined in the conditional preliminary purchase agreement (*warunkowa zobowiązująca umowa sprzedaży*) signed by PKP CARGO S.A. and Euronaft Trzebinia sp. z o.o. ("Euronaft") by the fact that both Orlen KolTrans sp. z o.o. ("KolTrans") and Euronaft obtained consistent individual tax interpretations from the relevant tax authorities, i.e. in both cases confirming classification of ZCP Kolej as an organized part of an enterprise, as defined by the relevant provisions of law.
- Withdrawal of statements of claim for the ascertainment of non-existence of collective disputes in the Company's individual plants and on the level of the entire Company.
- Adoption of the consolidated text of the Company's Articles of Association by the Company's Supervisory Board
- Adoption of resolutions by the Supervisory Board to appoint the following persons to the PKP CARGO S.A. Management Board as of 1 April 2016:
  1) Grzegorz Fingas for the position of Management Board Member in charge of Commerce,
  2) Arkadiusz Olewnik for the position of Management Board Member in charge of Finance,
  3) Jarosław Klasa, for the position of Management Board Member in charge of Operations.
- Supervisory Board adopting a resolutions on initiating the recruitment procedure for the position of Management Board Member – Representative of the Employees of PKP CARGO S.A.
- Positive opinion of the Supervisory Board on the PKP CARGO S.A. Management Board's motion to the Company's Shareholder Meeting on covering the Company's net loss for 2015 and not paying a dividend for the financial year from 1 January 2015 to 31 December 2015.
- In the year ended 31 December 2015, the Tax Group failed to reach the assumed profitability at the level of 3% – accordingly, PGK's second financial year ended on 31 March 2016 and thus the Tax Group ceased to exist.

April

- PKP CARGO S.A. started to transport 15 new rail vehicles Flirt 3 from the Stadler factory in Siedlce to Hungary. The biggest Polish rail operator will deliver them to the Slovak-Hungarian border. From there, a Hungarian carrier will take them over.
- A memorandum of agreement was signed to launch the operations of a Polish Mining Group (PGG). It will be established in place of Kompania Węglowa.
- DB Schenker Rail Polska changed its name to DB Cargo Polska. The change of the name and brand is dictated by structural transformations and new naming approach introduced on the Deutsche Bahn group level. Last year the rail, passenger and freight activity was merged into one organizational area, in which freight services are performed under the DB Cargo name. The DB Schenker brand will be still used by the DB Schenker Logistics business unit.

May

- The Czech coal consortium OKD filed for bankruptcy. The AWT Group will continue to provide services to OKD; nevertheless, in order to preclude the risk of improper and untimely payment for freight, the principle has been implemented for prepayments to be made for the amounts due for the services provided.
- PKP CARGO S.A.'s Shareholder Meeting adopted a resolution to cover the Company's net loss for 2015 and refrain from paying a dividend for the financial year from 1 January 2015 to 31 December 2015.
- On 11 May 2016, the mandate of Dariusz Browarek, the Management Board Member in charge of Employees, expired.
  With effect from 11 May 2016, the Ordinary Shareholder Meeting adopted a resolution on the appointment of Raimondo Eggink and Zofia Dzik to the Supervisory Board, both of the new Supervisory Board members satisfying the independence criteria defined in § 20 and 21 of the Company's Articles of Association.
  With effect from 11 May 2016, PKP S.A. appointed the following persons to the PKP CARGO S.A. Supervisory Board of the sixth term of office: Mirosław Pawłowski, Andrzej Wach, Małgorzata Kryszkiewicz, Czesław Warsewicz and Jerzy Kleniewski.

	• PKP CARGO S.A. won a tender for the transportation of coal to the Enea Group from the Bogdanka mine in Lublin to the Kozienice power plant. Under the new contract, the Company will transport more than 5 million tons of coal over a period of 15 months. • The Company's Supervisory Board adopted a resolution on appointing, with effect from 20 May 2016, the following elected candidates for employee representatives to the Supervisory Board of PKP CARGO S.A. of the 6th term of office: – Krzysztof Czarnota, – Marek Podskalny, – Tadeusz Stachaczyński.
June	• PKP CARGO S.A. won a tender for the transportation of coal to the Enea Group from Silesian mines to the Kozienice power plant. Under the new contract, PKP CARGO S.A. will transport more than 1.25 million tons of coal over a period of 12 months. • Commencement of operations by a freight forwarding company in Germany – PKP CARGO CONNECT GmbH with its registered office in Hamburg. Its main goal is to provide freight forwarding services focused on intermodal, marine and road transport in Germany and Western Europe. • Execution of a memorandum of agreement between the parties to the Company Collective Bargaining Agreement for Employees Hired by the Establishments of PKP CARGO S.A. ("CCBA Memorandum of Agreement"). Under the CCBA Memorandum of Agreement, the Parties resolved to postpone the time limit for the execution of a memorandum of agreement constituting the implementation of the post-inspection report of the District Labor Inspector in Warsaw of 15 October 2015 to 31 December 2016 and to execute, by this new time limit, a memorandum of agreement ending the collective dispute commenced in the Company on 2 July 2015. • Establishment of the Strategy Committee of the PKP CARGO S.A. Supervisory Board. • PKP CARGO S.A. and the Azoty Group signed a two-year contract for the transportation of more than 4 million tons of fertilizer and chemical products and raw materials for the Azoty Group companies. The estimated total value of the contract is nearly PLN 200 million. • PKP CARGO S.A. and its subsidiary PKP CARGOTABOR USŁUGI Sp. z o.o decided to exercise their right to withdraw from the conditional binding purchase agreement for 40,796 shares, representing approx. 99.85% of the share capital of Orlen KolTrans sp. z o.o. entered into with PKN Orlen S.A. and PKP CARGO S.A. exercised its right to withdraw from the conditional binding agreement to purchase an organized part of the enterprise of Euronaft Trzebinia sp. z o.o. Withdrawal from the Purchase Agreements does not provide for any financial consequences for PKP CARGO S.A. or PKP CARGOTABOR USŁUGI Sp. z o.o. arising from their termination. • The Supervisory Board of PKP CARGO S.A. selected the audit firm BDO Sp. z o.o. as the entity authorized to audit the standalone and consolidated financial statements of PKP CARGO S.A. for 2016-2018 and to review the interim condensed standalone and consolidated financial statements of PKP CARGO S.A. in 2016-2018 prepared in accordance with IFRS. • The President of the PKP CARGO S.A. Management Board and representatives of the Office of the Marshal of Wielkopolskie Voivodship, Wolsztyn County and the Town of Wolsztyn signed an agreement on the establishment of a cultural institution on the basis of the Wolsztyn Roundhouse.
July	• PKP CARGO S.A. commissioned the preparation of an expert opinion regarding methodological correctness of the valuation of AWT B.V. prepared for the needs of acquisition of an 80% stake in the company by PKP CARGO S.A. The expert opinion showed deviations from the methodology of estimation of the enterprise value and mistakes in the assumptions for the valuation and in the valuation technique, which could have led to overstatement of the recommended value of the enterprise, which could have made the transaction value exceed the level acceptable to a typical reasonable investor. • Appointment, by the PKP CARGO S.A. Supervisory Board, with effect from 14 July 2016, of Zenon Kozendra, the candidate nominated to be the employee representative in the PKP CARGO S.A. Management Board. • Execution of a credit facility agreement with the European Investment Bank on whose basis an investment loan will be made available to the Company up to a maximum value of EUR 40 million, earmarked to finance and/or refinance the purchase of multi-system locomotives. • The President of the Office of Rail Transport approved the unit rates of the basic fee for access to rail infrastructure, the unit rates of the basic fee for access to train handling devices and the unit rates of extra fees for access to railway infrastructure with a track gauge of 1435 mm managed by PKP PLK which will apply from 11 December 2016. PKP PLK's approved price list will bring a slight decrease in the rates of the basic fee and increases in most rates of additional fees and fees for the basic services related to access to train handling devices.
August	• At a session of the Regional Court in Ostrava, the creditors of OKD A.S, a company which had been declared insolvent, made a decision to initiate a restructuring procedure in OKD in accordance with the provisions of Czech law. In

	accordance with the register, the receivables from OKD reported in the process, including the receivables due to AWT in the amount of CZK 462.9 million (PLN 73.0 million), were accepted. The decision means that OKD will continue its operations under a restructuring plan involving, among others, the phasing out of unprofitable mines. • Receipt of a notification from MetLife PTE S.A. reporting that the MetLife Open-end Pension Fund it manages ("OPF") increased its exposure to above 5% of the total number of votes in PKP CARGO S.A. Its exposure exceeded 5% as a result of the purchase of shares in PKP CARGO S.A. on 10 August 2016. Directly before the change in its shareholding OPF held 2,162,347 shares, representing 4.83% of the share capital of PKP CARGO S.A. giving it the right to 2,162,347 votes at the shareholder meeting, representing 4.83% of the total number of votes at the shareholder meeting of PKP CARGO S.A. At present, OPF holds 2,494,938 shares, representing 5.57% of the share capital of PKP CARGO S.A. giving it the right to 2,494,938 votes at the shareholder meeting, representing 5.57% of the total number of votes at the shareholder meeting of PKP CARGO S.A.
September	• Due to the petition for insolvency of OKD a.s. filed on 3 May 2016, impairment tests for AWT Group's assets were carried out as at 30 June 2016 and the executability of the receivables from OKD was assessed. As a result of the completed tasks, on 26 September 2016 the Company's Management Board decided to recognize the following in the Condensed Interim Consolidated Financial Statements of the PKP CARGO Group for the period of 6 months ended 30 June 2016: – impairment losses for AWT Group's assets in the amount of PLN 35 million – impairment losses for trade receivables in the amounted of PLN 63 million. • AWT Group companies entered into a loan agreement with the following institutions: ING Bank N.V., UniCredit Bank Czech Republik and Slovakia, a.s., Raiffeisenbank a.s. in order to refinance the liabilities following from earlier loan agreements. The liabilities subject to refinancing were repaid in full on 30 September 2016.
October	• PKP Cargo announced an unlimited tender for leasing and delivery of 180 new wagons with a buy-out option. • Receipt of a notice that as a result of the acquisition of a stake in PKP CARGO S.A. settled on 10 October 2016, Nationale-Nederlanden Otwarty Fundusz Emerytalny has increased its stake in the Company by at least 2% of votes at the Company's Shareholder Meeting. Prior to the acquisition of the shares, the Fund held 6,535,170 shares representing 14.59% of the Company's share capital and was entitled to 6,535,170 votes at the Shareholder Meeting representing 14.59% of the total number of votes. On 10 October 2016, the Fund's securities account showed 6,699,668 shares, which accounted for 14.96% of the Company's share capital. The shares entitled the holder to 6,699,668 votes at the Company's Shareholder Meeting representing 14.96% of the total number of votes. • Receipt of a notice that as a result of the acquisition of a stake in PKP CARGO S.A. in transactions executed on the Warsaw Stock Exchange and settled on 12 October 2016, Nationale-Nederlanden Otwarty Fundusz Emerytalny has increased its stake in the Company by more than 15% of votes at the Company's Shareholder Meeting. Prior to the settlement of the transaction, i.e. as at 11 October 2016, the Fund held 6,711,846 shares representing 14.99% of the Company's share capital and was entitled to 6,711,846 votes at the Shareholder Meeting representing 14.99% of the total number of votes. After settlement of the transactions on 12 October 2016, the Fund's securities account showed 6,854,195 shares, which accounted for 15.30% of the Company's share capital. The shares entitled the holder to 6,854,195 votes at the Company's Shareholder Meeting representing 15.30% of the total number of votes. • Execution of an electricity sales and distribution service agreement between PKP CARGO S.A. and PKP Energetyka S.A. The agreement pertained to sale of (traction) electricity and provision of traction energy distribution services for the needs of conduct of transport services using electrical traction. The agreement is for a specified term, from the execution date to 31 December 2018. The expected value of the agreement during its term will total PLN 700 million net (PLN 861 million gross). • Rail infrastructure access agreement signed between PKP CARGO S.A. and PKP Polskie Linie Kolejowe S.A. for cargo transport covering the 2016/2017 timetable. The agreement is in effect from 11 December 2016 to 9 December 2017. The expected aggregated net value of the Agreement during its term is PLN 615.1 million (gross value of PLN 756.6 million).
November	• CARGOTOR became a beneficiary of support from the Connecting Europe Facility (CEF). CARGOTOR will receive support of EUR 3.2 million for the "Modernization of railway infrastructure at the Małaszewicze Transloading Zone of the corridor of 8 cargo lines at the border of EU and Belarus" (study work). • PKP CARGO S.A. signed a memorandum of cooperation with the representatives of the Xinjiang province. In the document, both parties expressed interest in cooperating and declared their strategic and active partnership int he execution of the project entitled Urumqui International Dry Port and the Poland-China Railway Trail, which serves the purpose of improving logistics services in handling trade exchange between China and Poland. • Memorandum of Agreement signed on 16 November 2016 between the parties to the Company Collective Bargaining Agreement for Employees Hired by the PKP CARGO S.A. Units. The execution of the Memorandum of Agreement ended the collective dispute initiated on 2 July 2015. By the power of the Memorandum of Agreement, the Parties decided to pay out a one-off special award on the occasion of the 15th anniversary of the Company's establishment, in the gross amount of PLN 800 to PKP CARGO S.A. employees, who remain employed and have at least 1 year of

	tenure. The Parties additionally decided to appoint a team to implement the post-inspection report of the Regional Labour Inspector in Warsaw dated 15 October 2015.
December	• AWT a.s. signed a grant agreement with the Innovation Networks Executive Agency (INEA). The subsidy in the amount of EUR 5.88 million was obtained from the CEF (Connecting Europe) to support the preparatory work and the 3rd stage of construction of the multimodal container terminal in Pasków. • The President of the Office of Rail Transport approved the unit rates of the basic fee and additional fees for the use of CARGOTOR Sp. z o.o.'s rail infrastructure by railway operators, for the 2016/2017 timetable.
January 2017	• PKP CARGO S.A. signed an annex to the investment loan agreement with Bank Polska Kasa Opieki S.A., extending the term of availability for PKP CARGO Group companies.
March 2017	• Mr. Mirosław Pawłowski stepped down from his function of the PKP CARGO S.A. Supervisory Board Chairman. • Mr. Krzysztof Mamiński was appointed to the PKP CARGO S.A. Supervisory Board as of 6 March 2017. • Mr. Jerzy Kleniewski stepped down from his function of the PKP CARGO S.A. Supervisory Board Member. • On 14 March 2017 Parent Company renegotiated with BGK an Investment Credit Agreement from 16 November 2015 and signed an Annex. According tto the new conditions, credit will be available until 27 December 2017 in the amount of EUR 67,850,591.20. • Mr. Władysław Szczepkowski was appointed to the PKP CARGO S.A. Supervisory Board as of 14 March 2017.

Source: Proprietary material

6.2. Evaluation of factors and unusual events affecting the result recorded by the Company and the PKP CARGO Group

Memorandum of Agreement between the parties to the Company Collective Bargaining Agreement

Starting on 2 July 2015, a collective dispute was pending in PKP CARGO S.A. In 2016, a social dialog was conducted between the partners and in March and June 2016, memorandums of agreements were signed with the trade unions, which stabilized the social situation in the Company and allowed it to conduct its statutory business in a peaceful atmosphere. On 16 November 2016, a Memorandum of Agreement was executed between the parties to the Company Collective Bargaining Agreement for Employees Hired by PKP CARGO S.A. Units, which ended the collective dispute commenced on 2 July 2015. By the power of the Memorandum of Agreement, the Parties decided to pay out a one-off special award on the occasion of the 15th anniversary of the Company's establishment, in the gross amount of PLN 800 to PKP CARGO S.A. employees, who remain employed and have at least 1 year of tenure.

Situation on the rail transport market in the main cargo categories

The rail freight market is closely dependent on the business conditions on the market for coal, aggregates, coke, iron ore, metals, petroleum oil refinery products, chemical products,as well as container transport market. The growth rate of the freight volumes transported by cargo carrier companies in the PKP CARGO Group is strongly linked to changes in the transport in the aforementioned cargo categories.

The hard coal mining and processing sector continues to be of key importance for the transport business conducted by the Group. Despite the considerable improvement following from an increase in the average monthly price of the commodity on ARA markets (up to 87.0 USD/t in December 2016), it should still be considered to be uncertain, because of the following factors:

— growing significance of renewable energy sources ("RES") – according to the Energy Market Agency, in 2015 in Poland renewable energy represented 13.7% of gross final energy consumption (12.4% in 2014 according to the European Commission).[52] According to the plans developed by the Ministry of Energy, this percentage should increase

[52] Wysokienapiecie.pl

to 15% by 2020. As the Czech Republic exceeded its 2020 target in 2015, that is a 13% share of RES in electricity production, the National Action Plan set out a new target of 15.3%.[53]

— closure of mines of the OKD coal mining company currently in bankruptcy. Successive mines are designated for closure: Paskov (1st half of 2017), Darkow (by the end of 2017), Lazy (in 2018), CSA (in 2021) and CSM (in 2023). The situation may improve if a new owner or a strategic investor is found, however if this does not occur by 12 April 2017, OKD will have to be liquidated. The main reason for the financial problems is the excessive indebtedness of NWR (the owner of OKD) and the excessive cost of servicing own liabilities. The liquidation of OKD will have a material negative impact on the public because of the loss of jobs by miners and loss of an important business partner of numerous cooperating companies. There may be as many as over 500 such companies in the Czech Republic alone.[54]

In 2016, mines in Poland produced 70.4 million tons of coal, 1.8 million tons yoy (2.5% yoy) less than in 2015 when 72.2 million tons were produced. This is caused by the lack of stability of Polish coal mines, which are undergoing a restructuring process, despite the many changes introduced in the previous year.[55]

Another threat is posed by the trend in electricity production in Poland. According to data from the National Electrical Energy System and the Balancing Market[56], 162,626 GWh of electricity was generated in 2016, compared to 161,772 GWh one year earlier. This constituted an increase by 954 GWh, or 0.5% yoy. Professional heat generation plants relying on hard coal produced 81,348 GWh in 2016, down 535 GWh or 0.7% yoy from 81,883 GWh in 2015. Energy production increased yoy in wind power plants (up by 15.8% yoy from 10,041 GWh in 2015 to 11,623 GWh in 2016). Energy production from other renewable sources continues to increase very quickly (a 100.0% yoy increase from 73 GWh in 2015 to 146 GWh in 2016).[57]

The situation on the transportation market in 2016 adversely affected the revenues earned on rail transportation and freight forwarding services by PKP CARGO S.A. (PLN 3.1 billion, or 7.9% down from 2015) and by the Group (PLN 3.6 billion, or 3.1% down from 2015).

Situation in the Czech coal sector – insolvency of OKD a.s.

On 11 August 2016, at a session of the Regional Court in Ostrava, the creditors of OKD A.S, a company which had been declared insolvent, made a decision to initiate a restructuring procedure in OKD in accordance with the provisions of Czech law. In accordance with the register, the receivables from OKD reported in the process, including the receivables due to AWT in the amount of CZK 462.9 million (PLN 73.0 million), were accepted. This decision means that OKD will continue its operations under a restructuring plan involving, among others, the phasing out of unprofitable mines – this was one of the necessary pre-conditions for obtaining a loan of CZK 700 million (about PLN 113.2 million).

Costs of access to infrastructure

The performance of both PKP CARGO S.A. and the PKP CARGO Group largely depend on the amount of rail infrastructure access charges. The cost of access to infrastructure in 2016 accounted for approx. 20.1% of PKP CARGO S.A.'s operating expenses. and about 14.6% of PKP CARGO Group's operating expenses.

In 2016, access to infrastructure owned by PKP PLK and private domestic managers and foreign managers was subject to price lists for the timetables from 13 December 2015 to 10 December 2016 and the price lists from 11 December 2016 to 9 December 2017.

In respect to the domestic infrastructure, for those services that require access to infrastructure, the successive price lists usually increased the fees and therefore also the costs of using access to infrastructure, affecting the performance of the Company and the PKP CARGO Group. Introduction of a separate type of fee for the use of broad gauge (1520 mm) infrastructure as of 13 December 2015 on the infrastructure managed by PKP PLK S.A. is an example of such a change.

In the 2016/2017 timetable, PKP PLK reduced the basic fee rates slightly for the 1435 mm gauge rail infrastructure and raised most of the additional fees and fees for the basic services of access to devices related to the handling of trains. Other domestic managers in the 2016/2017 timetable raised the rates for minimum access, additional services, basic services related to the access to devices.

[53] TZBinfo - Technická Zařízení Budov
[54] Wirtualny Nowy Przemysł [Virtual New Industry]
[55] Wirtualny Nowy Przemysł [Virtual New Industry]
[56] Polskie Sieci Elektroenergetyczne
[57] Polskie Sieci Elektroenergetyczne

International managers in countries such as Germany, Netherlands, Hungary, Austria, except for Slovakia and Czech Republic, also increased the fees for access to infrastructure in the 2016/2017 timetable.

Additionally, the activities of the PKP CARGO Group depend on the condition of the rail infrastructure, and the railway network is of low quality. An intense railway network modernization program, although expected to ultimately result in improved operating conditions, during the course of the construction and renovation work will cause hindrances and the need to route railway traffic through detours.

Technical regulations related to rolling stock

The rolling stock used in rail transport must satisfy appropriate technical standards and requirements, determining the scale of the Group's modernization and repair activity. The investments in this area depend directly on the current technical condition of the rolling stock owned and the resulting mandatory periodic repairs. They may also depend on the requirements imposed by EU regulations.

6.3. Information on contracts of significance for the Company and the PKP CARGO Group.

Contracts with vendors

Execution of a significant agreement with PKP PLK S.A.

On 29 November 2016, PKP CARGO S.A. signed with PKP Polskie Linie Kolejowe S.A. a rail infrastructure access agreement for cargo transport covering the 2016/2017 timetable. The agreement will be in effect from 11 December 2016 to 9 December 2017.

Under the Agreement, PKP PLK provides the Company with access to rail infrastructure to perform cargo transport operations in accordance with the 2016/2017 timetable. Under the Agreement, PKP PLK provides basic services of minimum access to rail infrastructure that comprises, among others, the preparation of an annual timetable in consultation with PKP CARGO S.A., the provision of access to the rail infrastructure in accordance with the allotted train routes, the provision of access to traction network devices, the directing and carrying of traffic, including the use of the rail radio communication by the Company and delivery of information regarding train passage, if so requested by the Company. Under the Agreement, PKP PLK also renders basic services involving access to facilities related to the servicing of trains and additional services comprising the provision of assistance in connection with unusual loads and the preparation and commissioning of trains.

The fees for the use of rail infrastructure were calculated based on the Price list for the use of rail infrastructure managed by PKP PLK, effective from 11 December 2016 approved by the President of the Office of Rail Transport by Decision No. DRRKWKL.730.5.2016.RK of 27 July 2016 and provisions of the Regulations on awarding rail routes and using the awarded rail routes by licensed rail operators in the 2016/2017 train timetable. The expected total value of the Agreement during its term is PLN 615.1 million net (PLN 756.6 million gross).

Execution of a significant agreement with PKP Energetyka S.A.

On 27 October 2016, PKP CARGO S.A. signed the Electricity and Distribution Services Sale Agreement with PKP Energetyka S.A.

The agreement pertained to the sale of electricity ("Traction Energy") and provision of Traction Energy distribution services for the needs of the transport services rendered using electrical traction with trains owned by PKP CARGO S.A. and with trains using the Company's electric locomotives but run by other operators, who are not charged for the electricity under separate agreements. The agreement defines the level of power contracted in the settlement period and the forecast consumption of Traction Energy.

The agreement is for a specified term, from the execution date to 31 December 2018. The expected value of the agreement during its term will total PLN 700.0 million net (PLN 861.0 million gross).

Contracts with buyers

Execution of a contract with the Azoty Group

On 23 June 2016, PKP CARGO S.A. and the Azoty Group signed a two-year contract for the transportation of more than 4 million tons of fertilizer and chemical products and raw materials for the Azoty Group companies. The estimated total value of the contract is nearly PLN 200 million. The cooperation between PKP CARGO and the Azoty Group is governed by a framework agreement and separate volume-based agreements with 5 companies of that chemical and fertilizer powerhouse. This is how the past cooperation between these entities is continued.

Execution of a contract with PGNiG Termika

In early September 2016, PKP CARGO S.A. signed a contract with PGNiG Termika for the transportation of coal from Silesia to Termika's two heat and power plants and one heat plant in Warsaw. The contract will be performed from January to December 2017. Its estimated value during its term is greater than PLN 28 million. Under the new contract, PKP CARGO S.A. will transport hard coal from several producers in Silesia, including: Katowicki Holding Węglowy, Jastrzębska Spółka Węglowa, Polska Grupa Górnicza (formerly Kompania Węglowa), Spółka Restrukturyzacji Kopalń, PG Silesia and Węglokoks Kraj to three PGNiG Termika's plants in Warsaw: Siekierki CHP Plant, Żerań CHP Plant and the Kawęczyn Heat Plant.

Execution of contracts with the Enea Group

PKP CARGO S.A. signed coal transport contracts with the Enea Group – transport of coal to Enea's power plant in Kozienice from the mines in Silesia (12 months, about PLN 37 million) and from the LW Bogdanka mine (15 months, about PLN 54 million).

Execution of a contract with ENGIE Energia Polska

The PKP CARGO Group has signed a contract with ENGIE Energia Polska (formerly GDF Suez Polska) for the transportation of coal in 2016. Under the contract, the PKP CARGO Group will transport 2.1 million tons of coal from Silesian mines and LW Bogdanka to the power plant in Połaniec in Świętokrzyskie Voivodship.

Loan agreements

Execution of a significant loan agreement with the European Investment Bank

On 19 July 2016, PKP CARGO S.A. entered into an investment loan agreement with the European Investment Bank for the maximum amount of EUR 40,000,000.00 (EURIBOR or WIBOR + margin). The loan was granted for financing and/or refinancing of the purchase of multi-system locomotives. The loan is available till 19 July 2020. The loan may be disbursed in EUR or PLN. The full loan repayment should take place by 19 July 2035.

Execution of a loan agreement with ING Bank N.V. and UniCredit Bank Czech Republic and Slovakia, a.s. and Raiffeisenbank a.s.

On 26 September 2016, AWT Group Companies entered into an agreement to refinance credit liabilities with the following institutions: ING Bank N.V., UniCredit Bank Czech Republik and Slovakia, a.s., Raiffeisenbank a.s. up to the maximum amount of EUR 27.5 million (including up to EUR 16.5 million (at a fixed interest rate) and CZK equivalent of EUR 11.0 million (PRIBOR + margin). The loan should be repaid in full by 26 September 2021.

6.4. The Management Board's stance with respect to the possibility of realizing previously published result forecasts for the year

The Parent Company has not published financial forecasts pursuant to § 5 Section 1 Item 25 of the Regulation issued by the Finance Minister on 19 February 2009 on the Current and Periodic Information Transmitted by Securities Issuers and the Conditions for Recognizing the Information Required by the Regulations of a Non-Member State as Equivalent, consolidated version of 27 June 2013 (Journal of Laws of 2014 Item 133, as amended) pertaining to the results of the Company and the PKP CARGO Group in 2016.

7. Company's and PKP CARGO Group's development policy

7.1. Description of external and internal factors of relevance for the development of the Company and the PKP CARGO Group

Economic situation in Europe

The economic conditions in the individual countries and in the entire macroeconomic environment in which the PKP CARGO provides transportation services is reflected directly in PKP CARGO's business activity. There is a strong correlation of the freight turnover achieved by rail transport with the GDP growth rate, but also with the periods of economic declines and hikes or long-term fluctuations in individual branches of the industry.

At present, the entire cargo transport industry (including cargo transport by rail) is also affected by the approach of the business partners to open trade. So far, trade in the European Union has been conducted without major issues, but after the United Kingdom's decision to leave the Union, we should expect changes in the operation of the common EU market and also the UK market.

Situation on the transportation market

The reduced freight volume carried by rail in Poland in 2016 resulted among other from delays in the commencement of the construction phase in infrastructural work or delays in the resolution of tenders. First of all, the construction of roads, rail infrastructure and power units should be considered. Slow recovery is visible in the transport of aggregate due to the increasing number of projects in progress. The Group is in the position to tackle the possible increase in transport of construction materials: it has the necessary rolling stock and human resources.

Demand for metal ores also affect the situation on the transport market. The demand for this commodity has fallen in connection with the current situation in the metals industry on the global markets (economic slowdown in China suppresses demand for steel) and has affected the volumes of metals and ores transported by the PKP CARGO Group.

An especially rapid growth is expected in the coming years in the intermodal transport market. The Group remains actively involved in the handling of transports over the New Silk Road line. The primary objective of the project is to increase the volumes of overland intermodal transport between China and Western Europe through Małaszewicze and back to Asia. Development of trade cooperation between Poland and People's Republic of China is expected to be facilitated thanks to execution of trade agreements and bilateral treaties, which will be an important stimulus increasing the level of intermodal transport carried out by the Group.

Situation in the energy fuel market

Due to the primary rail cargo categories, the fuel and energy industry is expected to remain the most important sector of the economy. The overall economic situation in the sector will continue to affect the 's freight volumes and the freight transport market.

The transportation of coal forms the primary cargo category for the PKP CARGO Group, hence the situation in this market has a strong impact on the Company's performance and market share, among others because of the restructuring activity in the Polish mining sector, lower demand on for hard coal or diversification of operators by energy sector buyers.

Track construction and maintenance market

Through AWT Group companies the Group specializes in the construction and maintenance of rail tracks. On top of maintenance alone, the function of OKD sidings operator necessitates the application of unique technological solutions to maintain the efficiency of OKD's external logistics. One of the examples of activity in this area is the construction of new tracks for new locations to store coal and gangue. Accordingly, the Group has at its disposal a qualified and professional workforce and the required equipment.

In the context of the closure of mines of the OKD coal mining company, which is currently in bankruptcy, the Group's resources and experience allow it to diversify its revenues by selling such services on the Czech and Polish markets and possibly expand to other countries.

Condition of the railway infrastructure

The operation of the PKP CARGO Group relies on the condition of the rail infrastructure, and the polish railway network used is of low quality. An intense railway network modernization program, although expected to ultimately result in improved operating conditions, during the course of the construction and renovation work will cause hindrances and the need to route railway traffic through detours. Railway track closures caused by modernization works have in 2016 and will continue to have a direct negative impact on the throughput of the lines and stations used, and rejection of applications for Individual Timetables (IRJ), extension of the travel time, longer train travel courses and longer train stays at the stations, which requires increased human, rolling stock and traction resources to be involved in the transport process.

Looking at the year 2017, strategic investments in rail infrastructure include modernization of the Lublin-Otwock and Swarzędz-Kutno lines with 24 hour interruptions in traffic and detours of the closed line sections, which is problematic for the correct execution of the transportation process. The investments are slated for commencement in June 2017 and they are to be continued in 2018. Other projects important for the transport process include modernizations of access lines to the border crossings in the south.

Rail infrastructure access charges

The performance of both PKP CARGO S.A. and the PKP CARGO Group largely depend on the amount of rail infrastructure access charges. The cost of access to infrastructure in 2016 accounted for approx. 20.1% of PKP CARGO S.A.'s operating expenses. and about 14.6% of PKP CARGO Group's operating expenses.

On 29 November 2016, PKP CARGO S.A. signed with PKP Polskie Linie Kolejowe S.A. a rail infrastructure access agreement for cargo transport covering the 2016/2017 timetable. The agreement is in effect from 11 December 2016 to 9 December 2017. The expected aggregated net value of the Agreement during its term is PLN 615.1 million (gross value of PLN 756.6 million).

On 2 December 2016, the President of the Office of Rail Transport approved the unit rates of the basic fee and additional fees for the use of CARGOTOR Sp. z o.o.'s rail infrastructure by railway operators, for the 2016/2017 timetable.

Technical regulations related to rolling stock

The rolling stock used in rail transport must satisfy appropriate technical standards and requirements, determining the scale of the Group's modernization and repair activity. The investments in this area depend directly on the current technical condition of the rolling stock owned and the resulting mandatory periodic repairs. The number of periodic repairs and check-ups performed in various periods results from the cycles specified in the Maintenance System Documentation (DSU) of the rolling stock approved by the Office of Rail Transport.

Risk of changes to legal regulations

On 16 November 2016, the act amending the rail transport act came into effect; this is the most extensive amendment of the rail transport act. The main changes refer to: the financing of rail transport, position of the President of the Office of Rail Transport, issues related to service infrastructure facilities and provision of access to rail infrastructure. Since a new group of facilities is introduced, that is the so-called service infrastructure facilities, administrative costs are expected to increase along with the increased proceeds from fees for using the facilities. The act harmonizes the Polish law with the European regulations of rail transport by implementing Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area and the executive regulations issued on its basis.

Directive (EU) 2016/2370 of the European Parliament and of the Council of 14 December 2016 amending Directive 2012/34/EU has come into effect; this change pertains to the opening of the market for domestic passenger transport services and the governance of the rail infrastructure. This directive introduces changes among others in the following areas: payment of dividends by rail infrastructure managers, restrictions in the selection of people appointed to the Management Board and the Supervisory Board of an infrastructure manager within the meaning of the definitions used in this Directive and the outsourcing and sharing of the infrastructure manager's functions.

The European Commission continues its work on the revision of TSI Noise, which will most probably result in an obligation imposed on rail cargo operators to install composite brake blocks or possibly also to change wheelsets, especially in the case of wagons equipped with tyred wheel sets.

One should also consider the planned changes in the EU Emissions Trading Scheme (EU ETS) – the related uncertainty has become the reason why the Company's client, ArcelorMittal Poland (AMP), suspended its decision to renovate the blast furnace no. 2 in Dąbrowa Górnicza. The possible resignation from the furnace could affect not only AMP but also e.g. on mining and rail transport; it would put PKP CARGO S.A. at the risk of losing some of the transport volumes effected for the client.

Financing of capital expenditures

The Group will finance capital expenditures with investment loans, its own funds and from other sources. The increase of borrowing liabilities will result in an increase of (short- and long-term) liabilities and financial expenses.

Social dialog

On 13 December 2016, the Team appointed by the President of the PKP CARGO S.A. Management Board in its decision of 4 November 2016 launched its operations. It consists of the representatives of the employer and the trade unions. According to the Memorandum of Agreement of 16 November 2016, the key task of the Team is to develop the rules for setting basic salary for the employees covered by the Company Collective Bargaining Agreement; the new rules should ensure consistency of the internal regulations governing the terms of remuneration in the Company and would also constitute the implementation of the post-inspection request from the Regional Labour Inspector in Warsaw of 15 October 2015.

7.2. Description of the growth prospects and development policy of the Company and the PKP CARGO Group at least in the next financial year

CARGO'20 Strategy

Development of PKP CARGO Group's business in the coming reporting periods will remain aligned with the Group's existing strategy for 2016-2020, with the main goal of developing and improving the business of a leading logistics operator in the Central and Eastern Europe based on four pillars:

Pillar I. Leader on the domestic transport market: the Group's operations on the Polish rail freight market are aimed at consolidating its leading position in all cargo categories carried in rail transport. The projected and observed market characteristics (including, among others, the multiple planned infrastructural investments, trends in the mining, metals and chemical industry) is a priority for the Group in terms of developing and securing assets and the proper offering. The activity is expected to result in improved satisfaction of service buyers and increased freight turnover and margins earned on the services. Irrespective of the activities undertaken to improve competitiveness and the high quality of services offered by the PKP CARGO Group in the current market environment, the Group has been conducting activities focused on promoting rail transport, which are expected to increase the railway's share in the transport industry, thus developing the foundations and additional space for further growth.

Pillar II. Significant position on the international market – it is the Group's ambition to ensure further dynamic growth and a significant position in the Central and Eastern Europe. Activity in the area of handling international freight is based on cz. B safety certificates authorizing PKP CARGO S.A. to carry out independent transports in the territory of 8 countries and the AWT Logistics Group, which conducts its transport activity in the Czech Republic, Slovakia and Hungary, incorporated in the PKP CARGO Group in 2015. The Group's transport business is supported by subsidiaries specializing in international freight forwarding. Handling of transports from/to North Sea ports and the Adriatic Sea is an important element of PKP CARGO Group's strategic growth on international markets. Transport to/from China is a critical and forward-looking project developed dynamically by the Group. One should note that one of the Group's advantages are long-standing strategic alliances with international partners.

Pillar III. Leader of the intermodal market in CEE: Because of the observed dynamic growth of intermodal transport and the perceived outlook for further increase in containerization of goods transported internationally, the key pillar of growth of the PKP CARGO Group is to remain active and build a strong international position in handling this cargo category. The Group's growth on the intermodal market is based on the improved product logistics, implementation of modern management technologies for managing the transportation process, development of new service distribution channels and building of competence for the operations of an intermodal operator, offering its customers locations on the continuously and permanently launched services. The activity of PKP CARGO S.A. in the handling of transports over the New Silk Road line is an important element for developing intermodal products.

Pillar IV. Development in adjacent elements of the value chain – Within this pillar, the Group continues to expand its offering by services supplementing rail transport, including freight forwarding and road transport, and optimizes its terminal business. The measures taken in this area will allow PKP CARGO Group to offer solutions that ensure efficient handling of complex and demanding logistic chains.

The adopted CARGO'20 strategy also assumes acquisition activities which will, however, depend on the market situation and attractiveness of potential acquisition targets. Implementation of the planned measures will allow the Group to develop dynamically and consolidate its market position in the coming years.

New Silk Road

The continuing cooperation with the Chinese Xinjiang province is another factor contributing to the growth of the PKP CARGO Group. In November 2016, PKP CARGO S.A. signed with the province's representatives a memorandum of cooperation in the project entitled Urumqui International Dry Port and the Poland-China Railway Trail. In the document, both parties expressed interest in cooperating and declared their strategic and active partnership int he execution of this project, which serves the purpose of improving logistics services in handling trade exchange between China and Poland. The Chinese side is to ensure, among others, infrastructural support expressed in awarding the strategic status to the dry port in Urumqui located in the Xinjiang province on the New Silk Road. PKP CARGO S.A. will ensure, among others, execution of rail transport services in Europe. The memorandum opened new cooperation opportunities with Chinese partners on the New Silk Road.

PKP CARGO S.A. is additionally increasing its cooperation with PKP LHS, which joined the Trans-Caspian corridor TMTM connecting China to Europe and offering the opportunity to increase container freight transport using the LHS line and Euroterminal in Sławków. The PKP LHS broad gauge rail line has six stations that share tracks with the regular gauge line and a gauge switching station from broad to regular gauge. PKP CARGO S.A. and PKP LHS will develop mechanisms that will make it easier for clients to transport cargo using the potential of the shared track stations and the different gauge lines. An increase in rail transport volumes from Asia to the Western Europe opens new cooperation opportunities for both companies. The main goals of PKP LHS and PKP CARGO S.A. include a joint international consignment note and elevated transshipment at the Euroterminal in Sławków; they will allow them to make a better use of the potential presented by the New Silk Road.

Specialized transport

PKP CARGO S.A. plans to continue its active operation on the specialized transport market, which will include, among others, transport of food, intermodal, automotive, oversized, military, hazardous and other goods. It is one of the directions that the Group intends to pursue to maintain its market share.

8. Other key information and events

8.1. Information on PKP CARGO S.A. shares

8.1.1. Issue of securities and use of proceeds from the issue

In the reporting period, in PKP CARGO S.A. there were no issues, redemptions or repayments of debt securities or equity securities.

8.1.2. Information about agreements which may in the future cause changes to the proportions of shares held by the current shareholders

PKP CARGO S.A. is unaware of any agreements entered into by its existing shareholders which may result in future changes to the proportions of their shareholdings.

8.1.3. Acquisition of treasury stock

In 2016, PKP CARGO S.A. did not effect any purchase or sale of its treasury stock.

8.1.4. Information on the employee share plan control system

According to the Employee Guarantee Package signed on 2 September 2013 by the Company's Management Board and the trade unions operating in the Company (agreement on labor and social guarantees) covering staff employed by the PKP CARGO S.A. Units and staff employed by the PKP CARGO Group Companies, employees of PKP CARGO S.A. and its five subsidiaries obtained guarantees of employment and acquired the right to a one-off cash benefit (privatization bonus) on the terms set forth in the Package. The bonus took the form of an employee share plan, because the parties to the Package agreed that it will be paid out in series C shares with a prohibition of sale within two years from the first day of stock exchange listing. According to the Information Memorandum issued for the public offering of the series C shares, subscriptions for the PKP CARGO S.A. employee shares were registered in the period from 2 December 2013 to 28 February 2014. A total of 22,146 (i.e. 99.8%) eligible employees of PKP CARGO S.A. and 2,395 (i.e. 99.9%) of eligible employees of the subsidiaries subscribed for the shares.

On 7 March 2014, the PKP CARGO S.A. Management Board adopted a resolution on the allocation of 1,448,902 series C ordinary registered shares. The plan was administered by the brokerage house Dom Maklerski PKO Banku Polskiego. On 3 November 2015, in connection with the expiration of the prohibition on the sale of series C shares, pursuant to Resolution No. 1104/2015 adopted by the Management Board of Giełda Papierów Wartościowych w Warszawie S.A. (Warsaw Stock Exchange), a total of 1,448,902 series C shares were admitted to trading on the main market of the Warsaw Stock Exchange, which shares, pursuant to § 6 Section 5 of the Company's Articles of Association were subsequently converted into bearer shares.

Moreover, 15% of the funds generated by PKP S.A. as a result of the sale of PKP CARGO S.A. shares by way of a public offering effected on the basis of the Company's issue prospectus approved by the Polish Financial Supervision Authority (KNF) on 4 October 2013 was transferred to the PKP Employee Ownership Fund in accordance with the Act of 8 September 2000 on the Commercialization, Restructuring and Privatization of the State-Owned Enterprise "Polskie Koleje Państwowe".

8.1.5. Shares held by management board and supervisory board members

The holdings of shares in the Company or rights to such shares by members of the Company's Management Board from 18 March 2016, i.e. from the delivery date of the 2015 annual report to the date of submission of this report, were as follows:

Table 50 PKP CARGO S.A. shares held by Management Board members

Name	Number of PKP CARGO S.A. shares held by Management Board members	Par value of shares [PLN]
as at the delivery date of this report		
Maciej Libiszewski	0	0
Arkadiusz Olewnik	0	0
Grzegorz Fingas	0	0
Jarosław Klasa	46	2,300
Zenon Kozendra	46	2,300
as at 18 March 2016		
Maciej Libiszewski	0	0
Dariusz Browarek	370	18,500

Source: Proprietary material

The holdings of shares in the Company or rights to such shares by members of the Company's Supervisory Board from 18 March 2016, i.e. the delivery date of the 2015 annual report to the date of submission of this report, were as follows:

Table 51 PKP CARGO S.A. shares held by Supervisory Board members

Name	Number of PKP CARGO S.A. shares held by Supervisory Board members	Par value of shares [PLN]
as at the delivery date of this report		
Raimondo Eggink	0	0
Małgorzata Kryszkiewicz	0	0
Andrzej Wach	0	0
Czesław Warsewicz	0	0
Zofia Dzik	0	0
Krzysztof Czarnota	70	3,500
Marek Podskalny	70	3,500
Tadeusz Stachaczyński	0	0
Krzysztof Mamiński	0	0
Władysław Szczepkowski	0	0
as at 18 March 2016		
Kazimierz Jamrozik	70	3,500
Stanisław Knaflewski	0	0
Raimondo Eggink	0	0
Mirosław Pawłowski	0	0
Jerzy Kleniewski	0	0
Małgorzata Kryszkiewicz	0	0
Andrzej Wach	0	0
Czesław Warsewicz	0	0

Source: Proprietary material

The holdings of shares in the Company or rights to such shares by members of the Company's Management Board and Supervisory Board as at 31 December 2016 are the same as those as at the delivery date of this report.

No members of the issuer's Management Board or Supervisory Board, as at 31 December 2016 or as at the delivery date of this report, hold any shares or ownership interests in PKP CARGO S.A.'s related parties.

8.1.6. Dividends paid or declared

On 11 May 2016, PKP CARGO S.A.'s Shareholder Meeting adopted a resolution to approve the loss incurred in 2015 included in the Standalone Financial Statements of PKP CARGO S.A. for the period from 1 January 2015 to 31 December 2015 and decided to cover it from the future profits and refrain from paying a dividend for the financial year from 1 January 2015 to 31 December 2015.

8.2. Information on transactions with related parties

No entity from the PKP CARGO Group entered in any transactions with related parties on non-market terms in 2016. Also after the balance sheet date no such transactions have been entered into.

Detailed information on related party transactions are presented in Note 35 to the Standalone Financial Statements and in Note 34 to the Standalone Financial Statements.

8.3. Proceedings pending before courts, arbitration bodies or public administration authorities

PKP CARGO S.A. and its subsidiaries are not parties to proceedings pending before courts, arbitration bodies or public administration authorities pertaining to liabilities or claims the value of which constitutes at least 10% of the Parent Company's equity.

PKP CARGO S.A. and its subsidiaries are not parties to proceedings pertaining to liabilities or claims of the issuer or the issuer's subsidiary where the total value of such liabilities or claims constitutes at least 10% of the Parent Company's equity.

8.4. Major achievements in research and development

Drones

PKP CARGO S.A. has been using drones to protect its trains against theft. The actions taken by the Company are generating positive results – according to figures after the first 3 quarters of 2016, the number of incidents decreased by 39% and the value of theft declined by 48% compared with the same period in 2015. To date, the fleet of PKP CARGO S.A.'s drones consisted of two types of machines: "DJI Phantom 3" and "Eagle". Currently, the Company also operates a modern, ultra-lightweight drone "Bielik" which is fitted with cameras that are even better than those of its predecessors. The drones transmit the recorded images live to the Threat Prevention Team's center. This allows the Team members to act swiftly when they see a theft in progress.

The promising results and a successful track record of efforts aimed at ensuring the security of transported cargo suggest that the fleet of unmanned aerial vehicles should be enlarged, which could contribute to the synchronization of the Company's drones with modern law enforcement IT systems and to the use of other modern technological solutions in monitoring the most vulnerable railway routes.

Rail traffic safety

In order to ensure the safety of railway traffic, PKP CARGO S.A. is gradually implementing new solutions in this area. They include, above all, the following two areas: professional preparation and training of staff and development of IT systems supporting transportation process management. The Company is also developing its Electronic Logistics Book (EKL) system by improving it with new functionalities based on modern IT solutions and the GPS technology.

Industrial Development Agency

The Technology Transfer Platform administered by the Industrial Development Agency links the owners of innovative solutions with their potential purchasers and experts willing to share their knowledge. PKP CARGO S.A. has made use of the Platform by announcing its need for technologies that would enable the Company to reduce the consumption of electricity and traction fuel. The Company expects interested bidders to propose a solution that will enable a reduction in the consumption of traction fuel in its locomotives.

Golden Issuer Website

PKP CARGO S.A. received an award in the 9th edition of the Golden Issuer Website contest for the highest quality of on-line corporate communication on the Polish capital market. The purpose of the contest held by the Association of Stock Exchange Issuers was to select the best website of a listed company. The contest jury assessed websites of Polish and foreign companies listed on the Warsaw Stock Exchange and on the New Connect market.

Sound Employer of the Year

In 2016, PKP CARGO S.A. received an award for its broad offer of support programs for employees and its efforts aimed at creating a modern and forward-looking work environment. The contest jury selected PKP CARGO S.A. for this prestigious title in appreciation of its training program for train drivers who have been recruited since the program came into effect in 2014, among other achievements noted by the jury.

8.5. Information on natural environment issues

Implementation of the Company's strategy is based on adapting its resources and organization to the requirements of the contemporary transportation market, taking into account the principles of sustainable development, in accordance with the adopted policy of the Integrated Management System (IMS): quality, occupational health and safety, environmental protection.

The Company's environmental policy forms an integral part of its overall corporate management system. The strategic objective for responsible actions taken by PKP CARGO S.A. in the field of environmental protection is to ensure a safe carriage of merchandise using rolling stock that meets the applicable environmental requirements. The Company invests both in the purchases of new rolling stock and in the modernization of its existing rolling stock as well as in maintenance and repair facilities and devices for diagnostics of the Company's rolling stock. These efforts are aimed at achieving high standards of rolling stock maintenance and protecting the natural environment against the possible consequences of breakdowns and accidents involving the Company's rolling stock.

In the process of environmental review (conducted on an annual basis), the effects of the Company's environmental initiatives are evaluated and specific environmental targets and tasks are formulated for subsequent years according to criteria selected based on:

- assessment of compliance with the legal requirements,
- results of system reviews and internal audits,
- results of internal inspections and inspections conducted by competent authorities in charge of environmental protection,
- data on the current and past performance of PKP CARGO S.A.

The Company diligently monitors all environmental aspects considered to be significant. The following is the list of such significant aspects:

1. Potential risk of a release of hazardous substances into the environment during the carriage of hazardous cargo
2. Failures of installations and equipment resulting in a potential risk of a release of hazardous substances into the environment
3. Fugitive emissions from fuel combustion by locomotives
4. Fugitive emissions of volatile organic compounds (technological processes)
5. Emissions from the consumption of traction electricity
6. Discharges of sewage into the sewer system
7. Discharges of rainwater and snowmelt into waters
8. Discharges of sewage into waters

9. Management of hazardous waste
10. Potential spills of diesel fuel and heating oil during transshipment of fuels from tank wagons to storage sites
11. Potential spills of diesel fuel during refueling of traction vehicles, cars and machinery
12. Potential spills during the storage and transshipment of hazardous waste
13. Historical contaminations
14. Emissions of noise from traction rolling stock
15. Emissions of noise from wagon rolling stock
16. Consumption of traction electricity
17. Consumption of diesel fuel for traction purposes
18. Management of construction asbestos
19. Handling of asbestos in locomotives

The objective of the monitoring of significant aspects is not only to gain knowledge of the magnitude of impacts on the natural environment by tracking certain assumed indicators but also to implement the environmental protection program in order to improve the emission indicators (energy intensity).

Year by year, through the introduction of objectives and tasks in significant areas in relation to the adopted classification criteria, the Company keeps reducing its environmental impact.

The significant aspects are related to the Company's core business of the carriage of cargo and the maintenance and repairs of rolling stock. Accordingly, the risk of sanctions in the following areas was evaluated:

1) Carriage of hazardous cargo

First of all, the Company is a rail freight carrier, hence the carriage of hazardous materials is subject to monitoring. In 2016, PKP CARGO S.A. did not record any events resulting in environmental damage, and because Company is aware of the costs involved in restoring the environment to the required standards following an accident or an event resulting in environmental damage, it continuously monitor the quality of the environmental safety of our transport. This process is supported by improvements in diagnostics and inspections of its rolling stock, on whichconsiderable funds are spent: purchases of diagnostic equipment, repair equipment, garage equipment for diagnostics and repairs of locomotives and wagons and on purchases of new rolling stock and modernizations of wagons.

2) Emissions into the air

The Company consumes large amounts of traction electricity and traction fuel, hence this consumption is subject to monitoring. In recent years, as a result of a gradual replacement of engines, the traction fuel consumption ratio has been significantly reduced; despite an insufficient throughput of the lines and an insufficient commercial speed, the electricity consumption ratio has also been reduced. This translates directly into emission volumes and environmental fees. As at the end of 2016, the Company had 12 Siemens multi-system locomotives and 223 modernized diesel locomotives with engines satisfying the requirements of stage IIIA in terms of gas and dust emissions. Capital expenditures aimed at reducing emissions from traction vehicles will be continued in the form of engine replacements, modernization of rolling stock, purchases of new locomotives and metering of electricity consumption.

3) Emissions into waters

PKP CARGO S.A. is taking actions aimed at renovation and reconstruction of the existing sewage and rainwater discharge system in its Rolling Stock Maintenance Centers in Rybnik and Żurawica, which will have a direct impact on a reduction in fees charged for the discharge of wastewater without treatment.

4) Protection of the earth's surface

The Company's operations exert an impact on the ground water environment. This fact prompted the implementation of the Company's program of the construction of container fuel stations which has led to the decommissioning of all fuel stations with single-shell tanks leased from PKP S.A.

In 2016, 4 new container fuel stations were accepted for operation (Toruń, Iława, Ełk, Ostrów Wielkopolski). At the same time, the Company is implementing a plan to decommission old tanks for used oil and build in the Rolling Stock Maintenance Centers of all the Company's Units forced-drain installations for used oil (to tighten the process). In 2016, technical documentation was developed for new tanks in 17 locations along with administrative decisions permitting development. By the end of 2017, the construction of facilities for 10 tanks is planned.

The provision of rail transport services requires subjecting the rolling stock to regular inspections, repairs, modernizations and withdrawals from service, with an associated generation of waste (including hazardous waste). Due to its volume (thousands of tons per year) and diversity (potentially, over 100 various types of waste may be generated), the conduct of waste management without appropriate legal regulations and monitoring the situation on the ground would significantly increase the Company's exposure to the risk of sanctions.

Accordingly, on an ongoing basis, in accordance with existing needs, updated or obtained are decisions concerning generation, collection and recycling of waste and internal regulations. The creation of an internal waste management system resulted in assigning responsibility to each of the main employee groups at successive stages of the waste management process, thus effectively minimizing the risk of waste disposal in a place not intended for this purpose.

In 2016, no sanctions were imposed on the Company for breaches of any waste management regulations.

As a significant environmental aspect, asbestos storage places are subject to strict documentation and inspection. In accordance with the applicable legal requirements, the Company assesses the situation and the possibility of a safe use of products containing both construction asbestos and asbestos used in its assets (electric locomotives), and submits the required reports to the competent environmental protection authorities. Asbestos is being gradually withdrawn to comply with the statutory deadline for its disposal (by 2032).

No sanctions are envisaged due to any irregularities in the management of asbestos.

5) Organizational actions

In response to changes in legislation in the area of environmental protection management, the Company runs annual inspections and updates of the following:

- Instructions for handling installations and equipment causing emissions and for handling waste at PKP CARGO S.A. - Cs
- Company's internal regulations related to generation of municipal and industrial waste
- transmission of data, drafting of information on the extent of use of the environment and its protection.

Internal control over the proper use of the environment in all aspects is exercised by the environmental protection division.

The PKP CARGO Group runs its business throughout the country and beyond its borders. The consumption of materials, fuels and electricity during the conduct of business operations causes an extensive impact on the environment. In order to avoid any breaches of environmental protection laws and minimize the risk of sanctions against the Group's member companies, continuous monitoring and inspection of the conduct of their operations are required. Aware of their impact on the environment, the companies take actions aimed at preventing environmental pollutions. Moreover, they make efforts aimed at ensuring the constant raising of environmental awareness among their personnel by training all staff responsible for performing tasks associated with the transport of cargo, supervision and maintenance of installations causing emissions into the environment and waste management.

The Group is involved in achieving compliance of its actions with the applicable laws and regulations, has in place a program of environmental measures and achieves measurable results of these activities, has qualified personnel conducting environmental matters with the use of instruments in the form of software for calculating environmental fees and databases of the extent of the use of the environment, with access to current laws, regulations and instructions, and keeps raising the environmental awareness among its employees. All this means that serious sanctions for the use of the environment are rather unlikely to be imposed against members of the PKP CARGO Group. As users of the environment, they fulfill their financial obligations resulting from environmental fees in a timely manner.

8.6. Description of the Company's and the PKP CARGO Group's sponsoring, charitable or other similar activities

Among the areas of the Company's sponsorship activities, in accordance with the Brand Strategy, are innovative initiatives in the TSL industry, cooperation with institutions of higher education and scientific centers, culture, safety, sports and recreation. Charitable support activities are focused on environmental protection and ecology, science and education, culture and art, safety and equalization of social differences.

European Economic Congress (EEC)

The European Economic Congress is one of the most important business events in Central Europe. In 2016, PKP CARGO S.A. was one of its main sponsors. During the 3-day series of debates on new trends in thinking about the economic future of Europe, the European Economic Congress brought together 8,000 participants from various European countries and from Asia and Africa. Representatives of PKP CARGO S.A. participated in panel discussions on such issues as the condition of the Polish transport sector, the global expansion of Polish companies and the potential of the New Silk Road – China's railway link with Europe, of which the PKP CARGO Group is a partner.

Sports

A significant role in PKP CARGO S.A.'s long-term sponsoring strategy is played by sports initiatives targeted at children and youths. PKP CARGO S.A.'s involvement in the development of youths through sports is a reflection of the Company's social responsibility. Sport is a carrier of values that are of great significance in shaping individual attitudes and social relationships. Team spirit, passion, fair play and focus on the development and acquisition of targets are necessary skills to be had both in sports and in business. These values are also appreciated by PKP CARGO S.A. Since October 2015, PKP CARGO is an official partner of Legia Warsaw's Football Academy for young talents.

Railway Resort

PKP CARGO S.A. and several other PKP Group members supported the renovation of the Railway Resort in Łąck. This enabled the organization of summer rehabilitation courses for disabled children from low-income families of railway employees. Within the framework of the renovation work, the roof of the canteen and common room was repaired, the kitchen was dried, the walls were painted and the floors were replaced. This enabled the organization to organise, at the end of June, first rehabilitation course for several dozen disabled children. Before the end of the summer vacation season, 3 more such courses were held.

Wolsztyn Railway Roundhouse

On 29 June 2016, the President of the PKP CARGO S.A. Management Board and representatives of the Office of the Marshal of Wielkopolskie Voivodship, Wolsztyn County and the Town of Wolsztyn signed an agreement on the establishment of a cultural institution on the basis of the Wolsztyn Railway Roundhouse. Thanks to this initiative, the nearly 110-year-old historical facility may continue to develop its operations and bear witness about the heritage of railways in Poland. PKP CARGO S.A. acquired the Wolsztyn roundhouse in 2003. The Company performs inspection repairs and overhauls of steam locomotives, has rebuilt the historical wagon depots and has renovated a large number of machines, devices, tools and other items used on the railways. Following the signing of the agreement on the establishment of this cultural institution, the activities of the roundhouse are funded by all its co-founders.

The "Wolsztyn Railway Roundhouse" cultural institution has received a certificate and license of a rail carrier. This means that since the beginning of January 2017 it has been permitted to organize train rides pulled by historical locomotives.

The Wolsztyn roundhouse is the last place in Europe where until recently regular passenger traffic was run with the use of steam locomotives. This is also the place where every year at the turn of April and May parades of steam locomotives are held, attracting thousands of enthusiasts of historical locomotives.

"Parowozjada"

PKP CARGO S.A.'s social activities are also focused on caring for the national heritage in the area of railway history. Every year, PKP CARGO's Open-Air Museum of Rolling Stock in Chabówka in Małopolskie voivodeship holds "Parowozjada", a great festival of railways and steam. The main attraction of the event is a parade of historical steam locomotives and vintage train rides pulled by steam locomotives. The organizer of the "Parowozjada" festival is PKP CARGO S.A.

PKP CARGO S.A.'s care for the historical and cultural heritage and tradition of the railway is an important element of the Company's social responsibility. The Company is multigenerational: it employs representatives of, in some cases, three generations of the same family. Initiatives such as the Company's patronage over the Open-Air Museum of Rolling Stock in Chabówka, combined with modern communications, strengthen PKP CARGO S.A.'s image of a patron of and contributor to railway history.

8.7. Information about existing Compensation Policy

8.7.1. General information about the compensation system accepted in the Parent Company

On 30 December 2016, by Resolution No. 432/2016 adopted by the PKP CARGO S.A. Management Board, the "Compensation policy for key management personnel of PKP CARGO S.A." was introduced.

The policy summarizes the general assumptions regarding the rules for compensating key management personnel of PKP CARGO S.A., Management Board Members, Supervisory Board Members and key managers of the Company, and is part of the internal set of corporate governance rules in force in the Company.

The detailed rules for compensating the Company's key management personnel are established in accordance with the generally applicable laws and internal regulations in force in the Company, including in particular the provisions of the Articles of Association, the Bylaws of the Shareholder Meeting, the Bylaws of the Supervisory Board and the Bylaws of the Management Board.

The Company's key managers are deemed to be its Supervisory Board Members, Management Board Members, directors of the Head Office departments and directors of the Company's Units.

The policy constitutes an important element of the development and safety of PKP CARGO S.A., and its main objective is to support the strategies aimed at achieving the Company's assumed business goals.

8.7.2. Terms and value of compensation and fringe benefits of Management Board and Supervisory Board members

Management Board

In accordance with the provisions of the "Compensation policy for key management personnel of PKP CARGO S.A.", the Company applies the following rules to the hiring and compensating its Management Board Members:

1. Possible forms of employment for Management Board Members are: employment contract or other type of contract, e.g. contract for the provision of management services, management contract.
2. Management Board Members hired under an employment contract are subject to all regulations arising from the provisions of labor law, i.e. the Labor Code, other statutes and executive regulations specifying the rights and obligations of employees and employers, as well as from internal company regulations.
3. The type of contract with a Management Board Member and the amount of compensation consisting of fixed and variable components are determined by the Supervisory Board.
4. A Management Board member is be entitled to a monthly base salary calculated on the basis of an objective and measurable indicator, corresponding to the size of the enterprise and remaining in a reasonable relation to the Company's economic performance.
5. Management Board Members are entitled to a variable compensation (bonus) for the achievement of objectives of special importance to the Company, as specified by the Supervisory Board. Objectives of special importance to the Company should be specified no later than by the end of February of each year and should include short- and long-term targets corresponding with the Company's long-term strategy. Such targets are defined on an individual and company-wide basis and contain information about the indicators, weights and expected level of achievement.
6. Management Board Members may be granted the right to use, in accordance with the rules in force in the Company, any tools and technical equipment necessary to discharge the duties of a Management Board Member, a company car, a company payment card, a medical care package and an apartment.
7. The Company's Management Board Member are bound by a non-compete clause during their employment and after the termination or expiration of their contract ("extended non-compete clause"). On account of the extended non-

compete clause, they are entitled to compensation as determined by the Supervisory Board. During the term of validity of the non-compete clause, Management Board Members may not conduct any business competitive to that of the Company or of any member of the PKP CARGO Group.

8. The discharge of a function in a governing body is the main area of professional activity of a Management Board Member. It may be permitted for a Management Board Member to be additionally involved in the activities of the management or supervisory bodies of other members of the PKP CARGO Group.
9. The amount of compensation for such additional activities and the conditions under which a function may be discharged in a corporate body of a subsidiary are defined by the competent corporate body of that subsidiary.

The table below presents total compensation and fringe benefits for PKP CARGO S.A. Management Board members in 2016.

Table 52 Expenditures on salaries and fringe benefits for PKP CARGO S.A. Management Board members in 2016 (PLN)

Name	Compensation, unused holiday leave compensation, (VAT included)	Bonuses, occasional and anniversary rewards	Terminal wage, damages, non-compete clause (VAT included)	Other revenues after tax and obligatory contributions	Subsidiaries**	Total
Current Management Board Members						
Libiszewski Maciej	576,000	0	0	5,616	632,156	**1,213,772**
Fingas Grzegorz	387,000	0	0	11,700	80,180	**478,880**
Olewnik Arkadiusz	387,000	0	0	4,145	479,401	**870,546**
Klasa Jarosław	387,000	18,707	0	14,471	105,253	**525,431**
Kozendra Zenon	239,571	0	0	2,400	26,816	**268,787**
Former Management Board Members *						
Purwin Adam	158,918	0	614,198	933	106,539	**880,588**
Neska Jacek	277,708	0	590,129	733	186,438	**1 055,008**
Hadyś Łukasz	283,218	0	590,129	733	19,366	**893,446**
Derda Wojciech	230,258	0	479,780	733	38,882	**749,654**
Browarek Dariusz	459,265	0	0	2,640	0	**461,905**

Source: Proprietary material

* in compensation, the additional compensation for sevices concerning handing over duties (for 3 months period) paid after resignation from the position, Mr. Adam Purwin (14 December 2015), Mr. Jacek Neska, Mr. Łukasz Hadyś i Mr. Wojciech Derda (24 February 2016), Mr. Dariusz Browarek (11 May 2016).
** compensation for holding position in the Management Powers of the Company's subsidiaries during term of the member of the PKP CARGO S.A. Management Board

Supervisory Board

In accordance with the provisions of the "Compensation policy for key management personnel of PKP CARGO S.A.", the Company applies the following rules to the hiring and compensating its Supervisory Board Members:

1. Supervisory Board Members are not employed by the Company (it relates to the form of appointment for the Supervisory Board; Supervisory Board Members – Employee Representatives can be employed by the Company, but for the term in Supervisory board, their employment contract is suspended.) .
2. The amounts of compensation of the Supervisory Board Members are set by the Company's Shareholder Meeting.
3. Compensations of the Supervisory Board Members are not related to the Company's financial performance, options or other financial instruments or with any variable component.
4. Compensations of the Supervisory Board Members do not constitute a significant item in the costs of the Company's operations and do not significantly affect its financial performance.
5. Compensations of the Supervisory Board Members should be commensurate with the entrusted scope of activities and discharged functions, e.g. work in Supervisory Board's committees.

6. Supervisory Board Members may be granted the right to use, in accordance with the rules in force in the Company, any tools and technical equipment necessary to discharge the duties of a Supervisory Board Member.

The table below presents total compensation and fringe benefits of the Company's Supervisory Board members in 2016.

Table 53 Expenses on compensation and fringe benefits of members of the PKP CARGO S.A. Supervisory Board in 2016 (PLN)

Name	Position	Compensation from holding position in Supervisory Board of PKP CARGO S.A.	Other Compensation (PKP CARGO S.A.)	Subsidiaries
Jamrozik Kazimierz	Supervisory Board Member	44 298	0	
Knaflewski Stanisław	Supervisory Board Member	44 298	0	
Eggink Raimondo	Supervisory Board Member	121 734	0	
Kleniewski Jerzy	Supervisory Board Member	121 734	0	
Kryszkiewicz Małgorzata	Supervisory Board Member	121 734	0	
Pawłowski Mirosław	Supervisory Board Member	147 417	0	243 448*
Wach Andrzej	Supervisory Board Member	121 734	0	
Warsewicz Czesław	Supervisory Board Member	121 734	0	
Dzik Zofia	Supervisory Board Member	77 884	0	
Czarnota Krzysztof	Supervisory Board Member	74 939	84 895	
Podskalny Marek	Supervisory Board Member	74 939	103 326	
Stachaczyński Tadeusz	Supervisory Board Member	74 939	49 002	

Source: Proprietary material

** compensation for holding position in the team of experts*

8.7.3. Terms of non-financial components of compensation for other key managers

Department Directors and Unit Directors

In accordance with the provisions of the "Compensation policy for key management personnel of PKP CARGO S.A.", the Company applies the following rules to non-financial components of compensation:

1. In addition to the fixed and variable components of their compensation, the Company's key managers may be granted, in accordance with the rules in force in the Company, the right to obtain co-financing of the rent for an apartment, a company car, a company payment card, tools and technical equipment necessary to discharge the duties of a given position, and the right to medical care.

2. The Company's key managers may subject to a ban on conducting any business competitive to that of PKP CARGO S.A. after the termination of their employment relationship, in accordance with the terms defined by a Management Board Resolution, and on this account are entitled to receive compensation for observing the ban on conducting any business competitive to that of PKP CARGO S.A. and other members of the PKP CARGO Group.

8.7.4. Indication of material changes introduced in the compensation policy in the last financial year or information on absence of such changes

No material changes in the Company's compensation policies were introduced in 2016.

8.7.5. Evaluation of the practical application of the compensation policy in the context of its goals, in particular the long-term increase of the company's value for shareholders and stability of its operations

The introduction in 2016 of the binding formal document entitled "Compensation policy for key management personnel of PKP CARGO S.A." enables the Company to generate value for its shareholders in the following aspects:

- The implementation of an official document describing the rules for compensating the Company's key management personnel ensures compliance with the standards generally applicable to companies listed on the Warsaw Stock Exchange.

- The adoption of the Compensation Policy means that the compensation rules defined therein are not set on an ad hoc basis under the influence of any current events or in response to the current financial performance but are a set of permanent, transparent and independent compensation rules contributing to the stability of the enterprise.

- The Policy enables the selection of groups of employees who, through the functions they discharge, exert a significant impact on the efficient management of the organization and on the implementation of the Company's strategic objectives.

- In particular, the Compensation Policy adopted by the Company defines a transparent form, structure and manner for determining the compensations of key managers in terms of their fixed and variable components and fringe benefits, which helps reduce the risks that would arise from unstable compensation rules applicable to the Company's key personnel.

8.7.6. Agreements entered into between PKP CARGO S.A. and managers which provide for compensation in specific cases

On 19 January 2016, by Resolution No. 1511/V/2016 Maciej Libiszewski was appointed to the position of President of the PKP CARGO S.A. Management Board for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1512/V/2016, Maciej Libiszewski was appointed to the position of President of the PKP CARGO S.A. Management Board for the term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the PKP CARGO S.A.'s Articles of Association. The employment contract with the President of the PKP CARGO S.A. Management Board was entered into pursuant to Resolution No. 1516/V/2016 adopted by the Supervisory Board on 9 February 2016.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1570/V/2016 appointing as of 1 April 2016 Arkadiusz Olewnik to the position of the PKP CARGO S.A. Management Board Member in charge of Finance for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1571/V/2016, Arkadiusz Olewnik was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Finance for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A. The employment contract with the PKP CARGO S.A. Management Board Member in charge of Finance was entered into pursuant to Resolution No. 1576/V/2016 adopted by the Supervisory Board on 31 March 2016.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1572/V/2016 appointing as of 1 April 2016 Jarosław Klasa to the position of the PKP CARGO S.A. Management Board Member in charge of Operations for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1573/V/2016, Jarosław Klasa was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Operations for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A. The employment contract with the PKP CARGO S.A. Management Board Member in charge of Operations was entered into pursuant to Resolution No. 1577/V/2016 adopted by the Supervisory Board on 31 March 2016.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1574/V/2016 appointing as of 1 April 2016 Grzegorz Fingas to the position of the PKP CARGO S.A. Management Board Member in charge of Commerce for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1575/V/2016, Grzegorz Fingas was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Commerce for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A. The employment contract with the PKP CARGO S.A. Management Board Member in charge of Commerce was entered into pursuant to Resolution No. 1578/V/2016 adopted by the Supervisory Board on 31 March 2016.

On 14 July 2016, the PKP CARGO S.A. Supervisory Board adopted Resolution No. 1599/VI/2016 to appoint as of 14 July 2016 Mr. Zenon Kozendra to the position of Management Board Member – Employee Representative. The employment contract with the PKP CARGO S.A. Management Board Member – Employee Representative was entered into pursuant to Resolution No. 1600/V/2016 adopted by the Supervisory Board on 14 July 2016.

The basic provisions of the said employment contracts are as follows:

- Management Board members perform the tasks specified in the employment contract on a full-time basis;
- the contract is entered into for the period of discharge of the position of President/Member of the Management Board of the current term of office of the Company's Management Board within the meaning of § 27 section 5 of the Articles of Association and the term of office following the current term of office within the meaning of § 27 section 5 of the Articles of Association. The contract will be terminated upon expiration of the said term. The contract may be terminated at any time by mutual agreement of the Parties;
- Management Board members are entitled to a monthly base compensation and a variable compensation (bonus) for the achievement of objectives of special importance to the Company, as specified by the Supervisory Board;
- Management Board members undertake that during the term of validity of their contract they will not conduct any business competitive to that of the Company or of any member of the PKP CARGO Group;

- the non-compete clause will continue to be binding for a period of 12 months after the termination or expiration of the contract and the expiration of the term of office of the Management Board member. Due to the obligation to adhere to the extended non-compete clause by Management Board members, the Company will pay them a base compensation for each month of validity of the extended non-compete clause applicable to the pertinent Management Board member;

at the written request of a Management Board member, the Supervisory Board may, by way of a resolution, waive the non-compete clause in respect of that Management Board member. In any such case, the Supervisory Board will specify in its resolution the scope of the waiver, indicating the applicable activities, entities or functions.

8.8. Information about the financial statements

8.8.1. Information about the agreement entered into with an entity authorized to audit financial statements

By Resolution No. 1597/VI/2016 of the PKP CARGO S.A. Supervisory Board adopted on 30 June 2016, BDO Spółka z ograniczoną odpowiedzialnością ("BDO") with its registered office in Warsaw at ul. Postępu 12, entered in the register of entities authorized to audit financial statements under the file number 3355, was selected as the auditor.

The agreement with BDO was entered into on 27 July 2016 to perform the following activities:

- audit of the standalone financial statements of PKP CARGO S.A. and consolidated financial statements of the PKP CARGO Group for 2016-2018,
- review of the semi-annual standalone financial statements of PKP CARGO S.A. and consolidated financial statements of the PKP CARGO Group for 2016-2018,
- verification of the reporting package prepared for the purposes of consolidation with PKP S.A.
- conduct of agreed procedures aimed at confirming the correct calculation of the annual ratios defined in the loan agreements,
- translation of quarterly, semi-annual and annual standalone and consolidated financial statements into English.

The financial statements of PKP CARGO S.A. for 2015 were audited by KPMG Audyt Spółka z ograniczoną odpowiedzialnością spółka komandytowa ("KPMG") with its registered office in Warsaw at ul. Inflancka 4a. KPMG was selected as the auditor by the PKP CARGO S.A. Supervisory Board by Resolution No. 1272/V/2013 adopted on 17 December 2013. KPMG is entered in the register of entities authorized to audit financial statements under the file number 3546. The agreement on the audit of financial information was entered into with KPMG on 31 January 2014 and covered the following:

- audit of the standalone financial statements of PKP CARGO S.A. and consolidated financial statements of the PKP CARGO Group for 2013-2015,
- verification of the reporting package prepared for the purposes of consolidation with PKP S.A.
- translation of annual standalone and consolidated financial statements into English.

Moreover, an agreement was entered into with KPMG on 8 May 2014 on the audit of interim standalone and consolidated financial statements for H1 2014 and H1 2015.

The financial statements of other members of the PKP CARGO Group were audited by BDO, KPMG Audit and other authorized entities.

The total fees charged by the entities authorized to audit financial statements, paid or due for the relevant financial year is as follows:

Table 54 Total fees of entities authorized to audit financial statements (PLN, net of VAT)

Item	Year ended 31 Dec 2016	Year ended 31 Dec 2015
Audit of the standalone and consolidated financial statements	120,427	205,072
Audit of the financial statements of the subsidiaries	139,308	171,422
Other attestation services, including a review of the financial statements	105,520	143,950
Other services (including training)	5,000	241,340
Total	**370,255**	**761,784**

Source: Proprietary material

8.8.2. Rules for preparing the annual financial statements

The Standalone Financial Statements of PKP CARGO S.A. for the financial year ended 31 December 2016 and the Condensed Interim Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 have been prepared in accordance with International Financial Reporting Standards and related interpretations adopted by the European Union ("EU IFRS"), published and in effect at the time of preparation of the standalone and consolidated financial statements and in accordance with the Finance Minister's Regulation of 19 February 2009 on the current and periodic information transmitted by securities issuers and the conditions for recognizing the information required by the regulations of a non-member state as equivalent (Journal of Laws of 2014 Item 133, as amended) ("Regulation").

The Standalone Financial Statements PKP CARGO S.A. for the financial year ended 31 December 2016 and the Consolidated Financial Statements of the PKP CARGO Group for the financial year ended 31 December 2016 have been prepared based on the assumption that both PKP CARGO S.A. and the Group will continue to be a going concern in the foreseeable future. As at the preparation date of these financial statements, there are no circumstances indicating any substantial threat to PKP CARGO S.A.'s and the Group's ability to continue to run their business as a going concern for a period of at least 12 months from the date of these financial statements.

The Standalone Financial Statements for 2016 have been prepared in accordance with the historic cost principle, except for derivatives measured at fair value.

The Consolidated Financial Statements for 2016 have been prepared in accordance with the historic cost principle, except for derivatives measured at fair value and liabilities on account of put options for non-controlling interest.

8.8.3. Description of unusual items in the standalone financial statements of PKP CARGO S.A. and the consolidated financial statements of the PKP CARGO Group.

Tests for impairment of the AWT Group's assets were conducted as at 31 December 2016 and as at 30 June 2016. The test for impairment as at 30 June 2016 confirmed the need to maintain the impairment loss on the AWT Group's non-current assets recognized as at that date in the amount of PLN 35 million.

Due to a difficult financial situation of a business partner, an impairment loss was established as at 30 June 2016 on receivables from OKD in the amount of CZK 384,674 thousand. As at 31 December 2016, the Group conducted another analysis of the possibilities to recover the outstanding part of the receivable and made the decision to recognize an impairment loss on the remaining part of the receivable from OKD in the amount of CZK 64,131 thousand.

The impairment loss is recognized in the CFS as follows:

- in trade and other receivables in the amount of PLN 73,469 thousand,
- in other operating expenses in the amount of PLN 72,661 thousand.

Details are presented in Notes 12.1 and 19 to the CFS.

8.8.4. Description of important off-balance sheet line items

Material off-balance sheet items are described in the following Notes to the SFS and CFS:

- contingent liabilities in Note 37 to the SFS and Note 36 to the CFS,
- operational lease in Note 29 and 35 to the SFS and Note 28 and 34 to the CFS,
- promissory notes collateralizing the repayment of liabilities in Note 38 to the SFS and Note 37 to the CFS

9. Representation on the application of corporate governance

9.1. Indication of a set of corporate governance rules applicable to PKP CARGO S.A. and of the place where the wording of such rules is publicly available

In the period from the date of admission of the Company's shares to public trading, i.e. from 28 October 2013 to 31 December 2016, the Company was subject to the corporate governance rules described in the Code of Best Practice for WSE-Listed Companies ("Code of Best Practice") forming an attachment to Resolution No. 12/1170/2007 of 4 July 2007 adopted by the Supervisory Board of the Warsaw Stock Exchange, as amended by the following resolutions adopted by the Supervisory Board of the Warsaw Stock Exchange: Resolution No. 17/1249/2010 of 19 May 2010 (effective from 1 July 2010), Resolution No. 15/1282/2011 of 31 August 2011 (effective from 1 January 2012), Resolution No. 20/1287/2011 of 19 October 2011 (effective from 1 January 2012) and Resolution No. 19/1307/2012 of 21 November 2012 (effective from 1 January 2013).

The wording of the Code of Best Practice to which the Company was subject in 2016 is available on the website of the Warsaw Stock Exchange at http://static.gpw.pl/pub/files/PDF/dobre_praktyki/dobre_praktyki_16_11_2012.pdf.

On 13 October 2015, the Supervisory Board of the Warsaw Stock Exchange adopted a resolution on the adoption of a new set of corporate governance rules entitled the "Code of Best Practice for WSE-Listed Companies 2016" (hereinafter referred to as the "Code of Best Practice 2016") which entered into force on 1 January 2016 and replaced the previous set of corporate governance rules adopted by Resolution of the Warsaw Stock Exchange of 4 July 2007, as amended. The wording of the "Code of Best Practice 2016" to which the Company has been subject since 1 January 2016 is available on the website of the Warsaw Stock Exchange at http://static.gpw.pl/pub/files/PDF/RG/DPSN2016__GPW.pdf.

In connection with the entry into force on 1 January 2016 of the "Code of Best Practice 2016", on 4 January 2016 the Management Board published a current report in Electronic Information Base format containing "Information on the progress of the Company's application of recommendations and rules laid down in the Code of Best Practice for WSE-Listed Companies 2016, the wording of which is available on the Company's website in the section Investor Relations/Corporate Governance/Good Practices.

9.2. Extent to which PKP CARGO S.A. failed to observe the provisions of the set of corporate governance rules, indication of such provisions and explanation of the reasons for the failure

In 2016, the Company complied with the recommendations and rules laid down in the Code of Best Practice for WSE-Listed Companies, except for the following ones:

<u>Chapter II Recommendation 2 of the Code of Best Practice concerning the appointment of management board members or supervisory board members</u>

The Company expresses its support for this recommendation concerning the pursuit of versatility and diversity in the process of selection of members of the management board and the supervisory board, in terms of such criteria as gender, field of education, age and professional experience. However, the Company has a policy in place under which the Company employs competent, creative individuals with appropriate professional experience and education, without considering the gender and age criterion.

<u>Chapter IV Recommendation 2 of the Code of Best Practice concerning the enabling of shareholders to participate in a Shareholder Meeting using electronic means of communication</u>

The Company decides not to apply this principle because of the legal, organizational and technical risks, which may pose a threat to the correct course of the general shareholder meeting if means of remote communication are provided to the shareholders. Additionally, none of the shareholders has notified the Company about being interested in such a manner of participating in the general shareholder meeting. We must assert that the principles governing the participation in general shareholder meetings currently allow the shareholders to exercise all the rights arising from their shares efficiently and protect interests of all the shareholders.

<u>Chapter VI Recommendation 3 of the Code of Best Practice concerning the functioning of the compensation committee</u>

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter VI Recommendation 4 of the Code of Best Practice concerning the levels of compensation for members of the management board and the supervisory board and key managers

Remuneration of the Supervisory Board members is currently differentiated only in respect to the Chairperson of the Company's Supervisory Board who, pursuant to Resolution 5/2014 adopted by the Extraordinary Shareholder Meeting on 30 July 2014, receives remuneration higher than other Supervisory Board Members. However, the remuneration does not take into account additional functions of the Company's Supervisory Board members, such as activity in Supervisory Board committees. Accordingly, this corporate governance principle is complied with only partially. The Company's Management Board will recommend amendments in this respect to the General Shareholder Meeting to ensure that it is possible to fully comply with this corporate governance principle.

Chapter I Rule 1.15 concerning the diversity policy applied by the company to its authorities and key managers

The Company has a policy in place under which the Company employs competent, creative individuals with appropriate professional experience and education, without considering the sex and age criterion.

Chapter I Rule 1.16 concerning the planned broadcasting of shareholder meetings

Non-application of this corporate governance principle is a consequence of the Company's decision not to apply principle IV.R.2., which requires the Company to enable shareholders to participate in the General Shareholder Meeting using means of electronic communication, in particular by real-time broadcast of the general shareholder meeting.

Chapter I Rule 1.20 concerning the recording of the course of shareholder meetings in audio or video form

The Company believes that non-application of this principle does not affect the reliability of the Company's information policy or the completeness of the material information provided by the Company to its shareholders.

Chapter II Rule 2 concerning the consent of the supervisory board for members of the management board to sit on the management boards or supervisory boards of companies other than members of the company's group

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 5 concerning the submission, by a member of the supervisory board to the other members of the company's supervisory board and management board, of a statement on his/her meeting of the independence criteria

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 6 concerning the assessment of fulfillment of the independence criteria by members of the supervisory board

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 7 concerning the tasks and functioning of the supervisory board committees

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 8 concerning the fulfillment of the independence criteria by the chairperson of the audit committee

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 10.1 concerning the assessment of the company's standing, taking into account the assessment of the internal control, risk management and compliance systems and the internal audit function

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 10.2 concerning the supervisory board's activity reports

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 10.3 concerning the assessment of the manner of the company's fulfillment of reporting duties concerning the application of corporate governance principles

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter II Rule 10.4 concerning the assessment of reasonability of the company's policy related to sponsorship activities, charitable activities or other activities of a similar nature

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter III Rule 2 concerning persons responsible for risk management, internal audit and compliance – their reporting directly to the president or another member of the management board, and ensuring the possibility of reporting directly to the supervisory board or the audit committee

The Company decides not to apply this corporate governance principle until it completes the process to analyze the rationale and the possible method to be used to implement this corporate governance principle in the Company and until the Company's Management Board decides whether or not to apply this principle.

Chapter III Rule 4 concerning presentation to the supervisory board by the person in charge of internal audit (in case such a separate function exists in the company) and by the management board of own assessment of the effectiveness of operation of the internal control, risk management and compliance systems and the internal audit function

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter III Rule 5 concerning the supervisory board's monitoring of the effectiveness of operation of the internal control, risk management and compliance systems and the internal audit function and annual assessments of this effectiveness

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter IV Rule 2 concerning the provision of publicly available broadcasts of shareholder meetings in real time.

The Company is of the opinion that non-application of this principle does not affect the reliability of the Company's information policy or the completeness of the material information provided by the Company to its shareholders.

Chapter V Rule 5 concerning the company's execution of a significant agreement with a shareholder holding at least 5% of the total number of votes in the company or with a related party

The Company decides not to apply this corporate governance principle on a temporary basis, until appropriate amendments are made to its corporate documents.

Chapter V Rule 6 concerning the specification, in the company's internal regulations, of the criteria and circumstances in which a conflict of interest may emerge in the company and the rules of conduct in an actual or threatened conflict of interest situation

Currently, this corporate governance principle is complied with only partially. Although the Management Board bylaws contain provisions about the conduct if a conflict of interest arises between the Company's interests and the personal interests of a Company's Management Board member, but they do not include all the requirements of this corporate governance practice, i.e. they do not identify for example the criteria and circumstances under which a conflict of interest may arise in the company. The Company's Management Board will take steps to fully comply with this corporate governance principle and will recommend such steps to the Company's Supervisory Board.

9.3. Description of the primary attributes of the internal control and risk management systems used in PKP CARGO S.A. in respect of the process of preparing standalone and consolidated financial statements

Uniform accounting policy

PKP CARGO S.A.'s parent company has developed and implemented the Accounting Policy designed in accordance with EU IFRS. The document is updated on an ongoing basis as statutory amendments are introduced. The principles contained in the document are applied to standalone financial statements of PKP CARGO S.A. and consolidated financial statements of the PKP CARGO Group. Companies subject to consolidation are required to apply the Accounting Policy of PKP CARGO S.A. in their preparation of reporting consolidation packages which form the basis for preparation of the PKP CARGO Group's consolidated financial statements.

Uniform consolidation packages of subsidiaries

For the purposes of preparation of the consolidated financial statements of the PKP CARGO Group, a uniform pattern of reporting packages based on EU IFRS to be prepared by the subsidiaries has been adopted. The subsidiaries prepare their reporting packages in accordance with EU IFRS taking into account the differences between Polish Accounting Standards and EU IFRS.

Bookkeeping

The reliability of financial statements is ensured by using data derived directly from the accounting ledgers. The Parent Company keeps a set of accounting ledgers forming the basis for preparation of financial statements in its computerized financial and accounting system SAP. The Company updates its financial and accounting system on an ongoing basis in line with the changing legislation and reporting requirements, both internal and external. Access to the IT systems is restricted by appropriate permissions granted to authorized employees. The IT and organizational solutions used by the Company secure control of access to the financial and accounting system and ensure appropriate protection and archiving of accounting ledgers.

Procedures for the closing of ledgers and authorization of financial statements

PKP CARGO S.A. and the subsidiaries have implemented internal procedures for closing the reporting periods, setting the dates and defining the responsibilities of internal departments for each reporting area; financial statements are subjected to internal procedures aimed at verifying their completeness and compliance; EU IFRS-compliant reporting packages are signed by the Management Boards of the subsidiaries and EU IFRS-compliant consolidated financial statements are properly authorized and signed by the Company's Management Board.

Supervision by the Audit Committee

Within the structure of the PKP CARGO S.A. Supervisory Board, the Audit Committee has been established which, in accordance with the applicable regulations, exercises supervision over the process of preparation of consolidated financial statements and the process of financial audit and which analyzes and monitors interim and annual financial data of both the Company and the Group.

Audit and review of financial statements

Annual standalone and consolidated financial statements are audited by a statutory auditor, semi-annual standalone and consolidated financial statements are reviewed by a statutory auditor; opinions and reports on the auditor's activities are appended to all approved and published financial statements.

9.4. Shareholders holding directly or indirectly significant blocks of shares

As at the delivery date of this report, the total number of the Company's outstanding shares is 44,786,917. According to notices received by the Company, the structure of shareholders holding directly or indirectly significant blocks of shares in the Company was as follows:

Table 55 Shareholder structure of PKP CARGO S.A. as at 1 January 2016

Shareholder	Number of shares	% in share capital	Number of votes	% in the total number of votes at the Shareholder Meeting
PKP S.A. (1)	14,784,194	33.01%	14,784,194	33.01%
Nationale-Nederlanden OFE (2)	5,771,555	12.89%	5,771,555	12.89%
Morgan Stanley (3)	2,380,008	5.31%	2,380,008	5.31%
AVIVA OFE (4)	2,338,371	5.22%	2,338,371	5.22%
Other shareholders	19,512,789	43.57%	19,512,789	43.57%
Total	**44,786,917**	**100.00%**	**44,786,917**	**100.00%**

Source: Proprietary material

(1) According to a notice sent by the shareholder on 24 June 2014.

(2) According to a notice sent by the shareholder on 12 November 2015.

(3) According to a notice sent by the shareholder on 18 June 2014.

(4) According to a notice sent by the shareholder on 13 August 2014.

On 16 March 2016 the Company's Management Board received a notification from Morgan Stanley (Institutional Securities Group and Global Wealth Management) concerning a reduction of the stake held by Morgan Stanley (Institutional Securities Group and Global Wealth Management) below 5% of the overall number of votes at the Shareholder Meeting ("SM").

This threshold was crossed by selling the Company's shares on the Warsaw Stock Exchange on 10 March 2016 ("Transaction").

Before the Transaction, Morgan Stanley (Institutional Securities Group and Global Wealth Management) held 2,380,008 shares of the Company representing 5.31% of the Company's share capital and 2,380,008 votes at the SM, which is 5.31% of all the votes. After the Transaction, Morgan Stanley (Institutional Securities Group and Global Wealth Management) held 2,225,827 shares of the Company representing 4.97% of the Company's share capital and 2,225,827 votes at the SM, which is 4.97% of all the votes.

On 18 August 2016, the Company's Management Board received a notification from MetLife PTE S.A. reporting that the MetLife Open-end Pension Fund it manages increased its exposure to above 5% of the total number of votes in PKP CARGO S.A.

Its exposure exceeded 5% as a result of the purchase of shares in PKP CARGO S.A. on 10 August 2016. Directly before the change in its shareholding, OPF held 2,162,347 shares, representing 4.83% of the share capital of PKP CARGO S.A. giving it the right to 2,162,347 votes at the Shareholder Meeting, representing 4.83% of the total number of votes at the Shareholder Meeting of PKP CARGO S.A.

At present, OPF holds 2,494,938 shares, representing 5.57% of the share capital of PKP CARGO S.A. giving it the right to 2,494,938 votes at the shareholder meeting, representing 5.57% of the total number of votes at the shareholder meeting of PKP CARGO S.A.

Table 56 Shareholder structure of PKP CARGO S.A. as at 31 December 2016 and as at the delivery date of this report

Shareholder	Number of shares	% in share capital	Number of votes	% in the total number of votes at the Shareholder Meeting
PKP S.A. (1)	14,784,194	33.01%	14,784,194	33.01%
Nationale-Nederlanden OFE (2)	6,854,195	15.30%	6,854,195	15.30%
MetLife OFE (3)	2,494,938	5.57%	2,494,938	5.57%
AVIVA OFE (4)	2,338,371	5.22%	2,338,371	5.22%
Other shareholders	18,315,219	40.89%	18,315,219	40.89%
Total	**44,786,917**	**100.00%**	**44,786,917**	**100.00%**

Source: Proprietary material

(1) According to a notice sent by the shareholder on 24 June 2014.
(2) According to a notice sent by the shareholder on 18 October 2016.
(3) According to a notice sent by the shareholder on 18 August 2016.
(4) According to a notice sent by the shareholder on 13 August 2014.

The structure of PKP CARGO S.A.'s share capital as at the delivery date of this report is presented in the table below:

Table 57 Structure of PKP CARGO S.A.'s share capital

Shares	Issue date	Issue registration date	Number of shares
Series A	8 July 2013	2 October 2013	43,338,000
Series B	8 July 2013	2 October 2013	15
Series C	2 October 2013	25 April 2014	1,448,902
Total			**44,786,917**

Source: Proprietary material

PKP CARGO S.A. is unaware of any agreements entered into by its existing shareholders which may result in future changes to the proportions of their shareholdings.

9.5. Holders of securities giving special controlling rights and a description of such rights

No PKP CARGO S.A. securities give any of the shareholders of any special control rights. Restrictions regarding the exercise of voting rights

9.6. Restrictions concerning voting rights

Right to participate in the Shareholder Meeting and voting rights

Shareholder exercise their right to vote at Shareholder Meetings in accordance with the provisions of the Commercial Company Code - the Company's shareholders may participate in the Shareholder Meeting and exercise their voting right in person or by proxy. A shareholder wishing to participate in a Shareholder Meeting by proxy must grant the proxy powers in writing or in electronic form. The Company provides a form of proxy in the notice on convening the Shareholder Meeting. Moreover, the Company should be notified about granting proxy powers in electronic form using the means of electronic communication specified in the announcement on convening the Shareholder Meeting. The Company takes proper action to identify the shareholder and his/her/its proxy to verify the validity of the proxy powers granted in electronic form. A detailed description of the manner of verification of the validity of proxy powers granted in electronic form must be included in the contents of the notice on convening the Shareholder Meeting.

A shareholder holding shares registered in more than one securities account may appoint separate proxies to exercise the rights attached to shares registered in each of his/her/its accounts.

If a member of the Management Board, a member of the Supervisory Board, the liquidator, an employee of the Company, or a member of a corporate body or an employee of the Company's subsidiary or cooperative acts as a proxy, then the proxy document may authorize such a person to represent the shareholder at a single Shareholder Meeting only. The proxy is obligated to disclose to the shareholder any circumstances indicating the existence or possibility of a conflict of interest. In such a situation, it is not permitted for the proxy to grant proxy powers to others. The proxy will vote in accordance with the instructions given by the shareholder.

Pursuant to § 11 Section 2 of the Articles of Association, each share entitles its holder to one vote at the Shareholder Meeting. Pursuant to § 13 Section 1 of the Company's Articles of Association, voting rights of the shareholders holding more than 10% of all the votes in the Company are restricted in such a manner that no such shareholder may exercise more than 10% of all the votes in the Company existing on the date of the Shareholder Meeting. This restriction does not apply for the purposes of determining the obligations of buyers of significant blocks of shares, which are prescribed by the Act on Public Offering. The above restriction of the voting rights does not apply to shareholders who, on the date of adoption of the Shareholder Meeting resolution introducing the restriction, were entitled to exercise voting rights, also as users, attached to shares representing more than 10% of the total number of votes existing in the Company or any other entity that acquires the Company's shares held by the shareholders referred to above in connection with their liquidation.

In accordance with the provisions of the Articles of Association, the limitation of voting rights of shareholders representing more than 10% of the total number of votes in the Company will not cease after a sale of all shares held by PKP S.A. to which the said limitation does not apply. As a consequence, the limitation of voting rights makes it potentially difficult for a single investor to gain control of the Company even if the stake held by PKP S.A. in the Company's share capital drops to zero.

Moreover, pursuant to § 13 Section 1 of the Company's Articles of Association, for the purposes of restricting the voting rights, the votes of the shareholders connected by a parent or subsidiary relationship are added up according to the principles described below.

The shareholders whose votes are accumulated and reduced are jointly referred to as a "Grouping". Vote accumulation involves adding up the votes held by individual shareholders from a Grouping. Reduction of votes involves reduction of the total number of votes in the Company at the Shareholder Meeting vested in the shareholders from a Grouping. Reduction of votes is effected according to the following principles:

1) for each shareholder associated with a Grouping, a percentage of votes vested in the shareholder in the cumulative number of votes vested in the entire Grouping is calculated;

2) the number of votes corresponding to 10% of all the votes in the Company is calculated on the date of holding the Shareholder Meeting;

Pursuant to § 13 Section 7 of the Company's Articles of Association, in order to determine the basis for vote accumulation and reduction, each Company shareholder, the Management Board, Supervisory Board and individual members of these bodies, as well as the Chairperson of the Shareholder Meeting may demand that a Company shareholder whose votes are reduced provide information as to whether he/she/it is a person having the status of a controlling entity or subsidiary of another shareholder.

9.7. Restrictions on the transfer of ownership title to PKP CARGO S.A. securities

Statutory restrictions on the transferability of shares

The Public Offering Act, the Act on Trading in Financial Instruments and the Commercial Companies Code provide, among others, for the following restrictions on the unconstrained transferability of shares:

- the obligation to notify the Polish Financial Supervision Authority and the Company applies to anyone who: (i) has reached or exceeded 5%, 10%, 15%, 20%, 25%, 33%, $33^1/_3$%, 50%, 75% or 90% of the total number of votes in a public company; (ii) holds at least 5%, 10%, 15%, 20%, 25%, 33%, $33^1/_3$%, 50%, 75% or 90% of the total number of votes in a company and, as a result of a reduction in this shareholding, reached 5%, 10%, 15%, 20%, 25%, 33%, $33^1/_3$%, 50%, 75% or 90%, respectively, or less of the total number of votes; (iii) has changed his/her/its previously held share greater than 10% of the total number of votes by at least 2% of the total number of votes in a public company whose shares are admitted to trading on an official stock market (as at the Prospectus Date, the market in question is the main market of the Warsaw Stock Exchange); (iv) has changed his/her/its previously held share greater than 33% of the total number of votes in a public company by at least 1% of the total number of votes;
- the obligation to announce a call to subscribe for the sale or conversion of shares in the event of: (i) the acquisition of shares entitling the holder to exercise more than 10% or 5% of the total number of votes at the Shareholder Meeting, (ii)

exceeding the threshold of 33% of the total number of votes at the Shareholder Meeting, (iii) exceeding the threshold of 66% of the total number of votes at the Shareholder Meeting;

- the prohibition of the acquisition or sale, for one's own account or for a third party, of any financial instruments, based on confidential information;
- the prohibition of the acquisition or sale of financial instruments during the lock-up period by the persons referred to in the Act on Trading in Financial Instruments;
- the parent company, within the meaning of Article 4 Section 1 Item 4 of the Commercial Companies Code, is required to inform a subsidiary of the establishment or termination of a relationship of dominance within two weeks of the date of establishment of such a relationship, otherwise its voting rights attached to the shares held by the parent company representing more than 33% of the share capital of the subsidiary will be suspended.

Apart from the foregoing, there are no other statutory restrictions on the transferability of shares in the Company.

Contractual restrictions on the transferability of shares

Contractual restrictions of the transferability of shares applied to shares subscribed for by eligible employees in connection with the right granted to them as part of the Employee Guarantee Package. Each eligible employee submitting a subscription for shares was required to sign an agreement providing for restrictions on the transferability of shares for a period of 2 years from the Company's first day of trading on the Warsaw Stock Exchange, i.e. until 30 October 2015. Any submitted subscription without signing the said agreement would have been considered invalid and the eligible employee would have lost his/her right to the privatization bonus, hence also to the shares. A sale of or encumbrance on any shares or rights to shares prior to 30 October 2015 was ineffective against the Company and may have exposed the employee to compensatory liability.

On the date of expiration of the above prohibition on the sale of shares, i.e. on 30 October 2015, series C shares were converted into bearer shares.

Pursuant to the Conditional Agreement for Underwriting the Subscriptions of Institutional Investors on the Principles of Underwriting the Initial Public Offering of PKP CARGO S.A. Shares (hereinafter referred to as the Underwriting Agreement) entered into on 8 October 2013 by and between PKP S.A. and PKP CARGO S.A. on the one side and the following entities:

1. Goldman Sachs International,
2. Morgan Stanley & Co. International plc,
3. Powszechna Kasa Oszczędności Bank Polski S.A. (also acting through its branch: Powszechna Kasa Oszczędności Bank Polski S.A. Oddział – Dom Maklerski PKO Banku Polskiego w Warszawie),
4. Dom Inwestycyjny Investors S.A.,
5. IPOPEMA Securities S.A.,
6. Mercurius Dom Maklerski Sp. z o.o.,
7. Raiffeisen Centrobank AG,
8. UniCredit Bank AG, London Branch,
9. UniCredit Bank Austria AG,
10. UniCredit CAIB Poland S.A.,

on the other side, collectively referred to as the "IPO Managers", the Company and PKP S.A. were subject to the following contractual restriction on the transferability of shares and the issue of shares:

1. PKP S.A. made a commitment to the IPO Managers that from the date of execution of the Underwriting Agreement to the end of the period of 180 days from the first listing of the Company's shares on the Warsaw Stock Exchange it will not execute, without the written consent of the Global Coordinators (which consent will not be unreasonably withheld or delayed), any other transaction that might result in the issue, offer of a sale or issue, sale or disposal of Company securities similar to securities forming the subject matter of the IPO. The restriction referred to above does not apply to the disposal of shares by PKP S.A. in response to a call to subscribe for a conversion or sale of Company shares to a strategic investor for a price not lower than that provided for in the IPO.
   The Company made a commitment to the IPO Managers that from the date of execution of the Underwriting Agreement to the end of the period of 180 days from the first listing of the Company's shares on the Warsaw Stock Exchange it will not execute, without the written consent of the Global Coordinators (which consent will not be unreasonably withheld or delayed), any other transaction that might result in the issue, offer of a sale or issue, sale or disposal of Company securities similar to securities forming the subject matter of the IPO.

9.8. Rules for appointment and dismissal of managers and their rights

The PKP CARGO S.A. Management Board consists of between one and five members, including the President of the Management Board. Management Board members are appointed for a joint 3-year term of office. The President and other Members of the Management Board are appointed by the Supervisory Board pursuant to the Articles of Association and the Bylaws for Appointment of Management Board Members. The Supervisory Board sets the number of Management Board members.

Management Board Members are appointed following the conduct of a recruitment procedure only from among candidates participating in the qualification procedure who received a favorable opinion from the recruitment consultant. The recruitment procedure for a Management Board Member is prepared and organized by a professional personnel consulting company selected by a resolution of the PKP CARGO S.A. Supervisory Board. A participant in the procedure for appointment of Management Board Members is the Nomination Committee which exercises ongoing supervision over the process of selection of a Management Board Member and the process of evaluation and appointment of Management Board Members.

The Supervisory Board also selects one Management Board Member from among candidates nominated by the Company's employees. Such a candidate should have higher education, at least 5 years of professional experience in the PKP Group and have no criminal record. A Management Board member may not discharge an elected function or sit in the bodies of a company, inter-company or national trade union organization, a federation of trade unions or a confederation of trade unions. The bylaws for electing candidates for a representative of employees in the Management Board shall be adopted by the Supervisory Board. A failure to appoint an employee representative to the Management Board does not prevent the Management Board from being appointed or from adopting effective resolutions. The power referred to in the first sentence above was granted to the Company's employees in connection with Article 4 section 4 of the Act on Commercialization, Restructuring and Privatization of PKP and the provisions of the Employee Guarantee Package.

As long as the State Treasury, PKP S.A. or other state legal persons hold less than 100% of the Company's shares, the President of the Management Board and other Management Board members are appointed and dismissed by the Supervisory Board.

In the event that PKP S.A.'s share in the Company's share capital is 50% or less, PKP S.A. will have the personal power to select candidates for the President of the Management Board on its own. The personal rights referred to in the preceding sentence are exercised by way of delivering a written statement to the Supervisory Board Chairperson.

Pursuant to § 18 and § 25 Section 3 Item 2 of the Articles of Association, the PKP CARGO S.A. Management Board is authorized, with the consent of the Supervisory Board, in accordance with the rules laid down in the provisions of the Commercial Companies Code, to pay shareholders an interim dividend towards the dividend expected at the end of the financial year.

The Company's executives are not authorized to make any decisions on the issue or redemption of shares.

9.9. Rules for amending the Articles of Association of PKP CARGO S.A.

The rules for amending the Company's Articles of Association are based on Article 430 and Article 402 § 2 of the Commercial Company Code.

Any amendment to the Articles of Association requires a resolution of the Shareholder Meeting. Moreover, the adoption of a resolution on amendments to § 14 Section 6, § 26 Section 3 or 4 or § 27 Section 7 of the Articles of Association requires a resolution of the Shareholder Meeting adopted by a majority of four-fifths of the votes in the presence of shareholders representing three-fourths of the Company's share capital.

Any amendments to the Articles of Association are subject to approval by the Shareholder Meeting and their registration by the appropriate court. Pursuant to § 25 Section 3 Item 11, the Supervisory Board is entitled, after the court's decision on the registration of amendments to the Company's Articles of Association becomes final non-appealable, to adopt the consolidated version of the Company's Articles of Association.

An amendment to the Company's Articles of Association which involves a material change in the line of business does not require a buyout of the shares held by the shareholders objecting to such an amendment if the relevant resolution of the Shareholder Meeting in this matter is adopted by a majority of two thirds of the votes in the presence of shareholders representing at least one half of the share capital.

9.10. Manner of operation and key powers of the Shareholder Meeting, description of shareholders' rights and the manner of their exercise

The Company's Shareholder Meeting operates pursuant to the provisions of the Commercial Companies Code, the Company's Articles of Association (in particular, §10-§13) and the Bylaws of the Shareholder Meeting. Shareholders are entitled to participate in and exercise their voting rights at the Shareholder Meeting in person or by proxy.

The Shareholder Meeting is valid irrespective of the number of shares represented thereat.

Resolutions of the Shareholder Meeting are adopted by an absolute majority of votes except for resolutions the adoption of which is subject to more stringent requirements provided for by the Commercial Companies Code or the Articles of Association. Moreover, the adoption of a resolution on amendments to § 14 Section 6, § 26 Section 3 or 4 or § 27 Section 7 of the Articles of Association requires a resolution of the Shareholder Meeting adopted by a majority of four-fifths of the votes in the presence of shareholders representing three-fourths of the Company's share capital.

Votes at the Shareholder Meeting are cast in an open ballot. A secret ballot is ordered for elections and motions for the dismissal of members of the Company's corporate bodies or the Company's liquidators, or for holding them accountable, or in other personal matters. Moreover, a secret ballot must be ordered at the request of at least one shareholder attending or represented at the Shareholder Meeting.

In accordance with the Bylaws of the Shareholder Meeting, open and secret ballots may be held using means of electronic communication with the consent of the Shareholder Meeting. The Shareholder Meeting may adopt a resolution on waiving the secrecy of voting in matters concerning the selection of a committee appointed by the Shareholder Meeting.

The Shareholder Meeting is presided over by its Chairman who oversees its efficient conduct in accordance with the adopted agenda. The Chairman may make decisions concerning procedural matters. Without the consent of the Shareholder Meeting, the Chairman may not remove or change the order of business entered in the adopted agenda.

The Shareholder Meeting of PKP CARGO S.A. is opened by the Chairman of the Shareholder Meeting appointed by the Management Board. If the President of the Management Board fails to appoint the Chairman of the Shareholder Meeting prior to the designated start time of the meeting, the provisions of Article 409 § 1 of the Commercial Companies Code are applied and then the Chairman of the Shareholder Meeting is elected from among the persons entitled to participate in the Shareholder Meeting. The Chairman of the Shareholder Meeting is elected by an absolute majority of votes cast in a secret ballot.

The Extraordinary Shareholder Meeting may be convened by a shareholder whose stake in the total number of votes in the Company is greater than 33%. In such a case, the shareholder convening the Extraordinary Shareholder Meeting appoints the Chairman of the Shareholder Meeting.

The Shareholder Meeting adopts the Bylaws of the Shareholder Meeting laying down a detailed procedure of conduct for its meetings. Draft Bylaws of the Shareholder Meeting are presented by the Management Board. It is permitted to participate in the Shareholder Meeting by means of electronic communication, provided that the notice of convocation of the Shareholder Meeting contains information about such a possibility.

9.11. Personnel composition and changes to it during the most recent financial year, description of the activity of PKP CARGO S.A.'s managing, supervising or administering authorities and their committees

MANAGEMENT BOARD

The Management Board of PKP CARGO S.A. with its registered office in Warsaw operates on the basis of the applicable provisions of law, in particular:

1) Act of 15 September 2000 entitled the Commercial Companies Code (Journal of Laws No. 94 Item 1037, as amended);
2) Act of 8 September 2000 on the Commercialization, Restructuring and Privatization of the State-Owned Enterprise "Polskie Koleje Państwowe" (Journal of Laws No. 84 Item 948, as amended)
3) Articles of Association of PKP CARGO S.A. (consolidated text adopted by Resolution No. 1529/V/2016 of the PKP CARGO S.A. Supervisory Board dated 30 March 2016)

4) Bylaws of the PKP CARGO S.A. Management Board adopted by Resolution No. 252/2016 of the PKP CARGO S.A. Management Board dated 29 July 2016

5) other internal regulations.

Powers of the Management Board

The Management Board manages the Company's day-to-day business, manages its assets and represents the Company in relations with third parties. The responsibilities of the Management Board include any activities that are not reserved for the Shareholder Meeting or the Supervisory Board. Management Board resolutions are adopted by an absolute majority of votes present at the meeting, provided that at least half of the Management Board members are in attendance. The President of the Management Board acting individually or two Management Board Members acting jointly or a Management Board Member acting jointly with a commercial proxy are authorized to make declarations of will.

Operation of the Management Board

The procedure of the Management Board's operation is described in detail in the Bylaws of the Management Board. The Bylaws are adopted by the Management Board and approved by the Company's Supervisory Board. In accordance with the provisions of the Bylaws of the Management Board, the Management Board makes decisions in the form of resolutions. Management Board resolutions are adopted by an absolute majority of votes, with at least half of the Management Board members attending the meeting; they may only be adopted if all the Management Board Members have been duly notified about the Management Board meeting. According to the Bylaws, if an equal number of votes is cast "for" and "against" together with abstentions, the President of the Management Board will have the casting vote. Management Board meetings are held at least once a week. In particularly justified cases, Management Board meetings may be held on a later date but no later than within 14 days of the date of the preceding meeting.

According to the Bylaws of the Management Board, if a conflict of interest arises between the Company and a Management Board member, a spouse, kin or relative (up to the second degree of affinity) or another person with whom the Management Board member has personal relations, the Management Board member should immediately inform the remaining Management Board members about the conflict and, in the case of the President of the Management Board, also the Company's Supervisory Board, and refrain from discussing and from voting on a resolution in the matter in which the conflict of interest has arisen and may demand this to be recorded in the minutes of the Management Board meeting.

Table 58 Composition of the PKP CARGO S.A. Management Board from 1 January 2016 to the delivery date of this report

Name	Position	Period in office	
		from	to
Maciej Libiszewski	acting President of the Management Board President of the Management Board	18 December 2015 19 January 2016	19 January 2016 to date
Arkadiusz Olewnik	Management Board Member in charge of Finance	1 April 2016	to date
Grzegorz Fingas	Management Board Member in charge of Commerce	1 April 2016	to date
Jarosław Klasa	Management Board Member in charge of Operations	1 April 2016	to date
Zenon Kozendra	Management Board Member – Employee Representative	14 July 2016	to date
Dariusz Browarek	Management Board Member – Employee Representative	24 April 2014	11.05.2016
Wojciech Derda	Management Board Member in charge of Operations	24 April 2014	24 February 2016 (resignation)
Jacek Neska	Management Board Member in charge of Commerce	24 April 2014	24 February 2016 (resignation)
Łukasz Hadyś	Management Board Member in charge of Finance	12 May 2014	24 February 2016 (resignation)

Source: Proprietary material

On 11 January 2016, the PKP CARGO S.A. Supervisory Board adopted Resolution No. 1509/V/2016 on initiating the recruitment procedure for the position of President of the PKP CARGO S.A. Management Board.

The recruitment procedure was carried out in accordance with § 14 Section 4 of the Articles of Association of PKP CARGO S.A. and the Bylaws for Appointing Management Board Members in PKP CARGO S.A.

On 19 January 2016, by Resolution No. 1511/V/2016 Maciej Libiszewski was appointed to the position of President of the PKP CARGO S.A. Management Board for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1512/V/2016, Maciej Libiszewski was appointed to the position of President of the PKP CARGO S.A. Management Board for the term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the PKP CARGO S.A.'s Articles of Association.

On 8 February 2016, the PKP CARGO S.A. Supervisory Board adopted Resolution No. 1514/V/2016 on initiating the recruitment procedure for Management Board Member in charge of Finance, Management Board Member in charge of Commerce and Management Board Member in charge of Operations.

The recruitment procedure was carried out in accordance with § 14 Section 6 of the Articles of Association of PKP CARGO S.A. and the Bylaws for Appointing Management Board Members in PKP CARGO S.A.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1570/V/2016 appointing as of 1 April 2016 Arkadiusz Olewnik to the position of the PKP CARGO S.A. Management Board Member in charge of Finance for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1571/V/2016, Arkadiusz Olewnik was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Finance for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1572/V/2016 appointing as of 1 April 2016 Jarosław Klasa to the position of the PKP CARGO S.A. Management Board Member in charge of Operations for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1573/V/2016, Jarosław Klasa was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Operations for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A.

On 31 March 2016, the Supervisory Board adopted Resolution No. 1574/V/2016 appointing as of 1 April 2016 Grzegorz Fingas to the position of the PKP CARGO S.A. Management Board Member in charge of Commerce for the joint term of office of the Company's Management Board within the meaning of § 27 sec. 5 of the Company's Articles of Association and by Resolution No. 1575/V/2016, Grzegorz Fingas was appointed to the position of the PKP CARGO S.A. Management Board Member in charge of Commerce for the joint term of office following the term of office of the Company's Management Board Members within the meaning of § 27 sec. 5 in conjunction with § 14 sec. 1 of the Articles of Association of PKP CARGO S.A.

On 30 March 2016, the PKP CARGO S.A. Supervisory Board adopted Resolution No. 1532/V/2016 on initiating the recruitment procedure for the position of PKP CARGO S.A. Management Board Member – Employees' Representative.

On 11 May 2016, the mandate of Dariusz Browarek, the Management Board Member in charge of Employees, expired.

On 14 July 2016, the PKP CARGO S.A. Supervisory Board adopted Resolution No. 1599/VI/2016 to appoint as of 14 July 2016 Mr. Zenon Kozendra to the position of Management Board Member – Employee Representative.

The internal allocation of tasks and functions discharged by Management Board members is as follows:

1) President of the Management Board – the scope of the President's activity include directing the activities of the Management Board and the Company's ongoing operations and overseeing the management of specific areas of the Company's activity, in particular:

   - business strategy,
   - business security and internal audit.

   Special powers of the President of the Company's Management Board include performance of the Company's defense tasks resulting from the regulations on general defense obligation.

2) Management Board Member in charge of Finance – the scope of duties of the Management Board Member in charge of Finance covers responsibility for rational management of the Company's resources and overseeing the management of specific areas of the Company's business, in particular:

   - finance management,
   - purchase and sale of assets.

   Special powers of the Management Board Member in charge of Finance include the performance, on behalf of PKP CARGO S.A., of obligations arising from accounting, tax and insurance regulations.

3) Management Board Member in charge of Commerce – the scope of duties of the Management Board Member in charge of Commerce covers responsibility for adequate sales levels and customer relations and overseeing the management of specific areas of the Company's business, in particular:

- commercial policy,
- sales of transportation services.

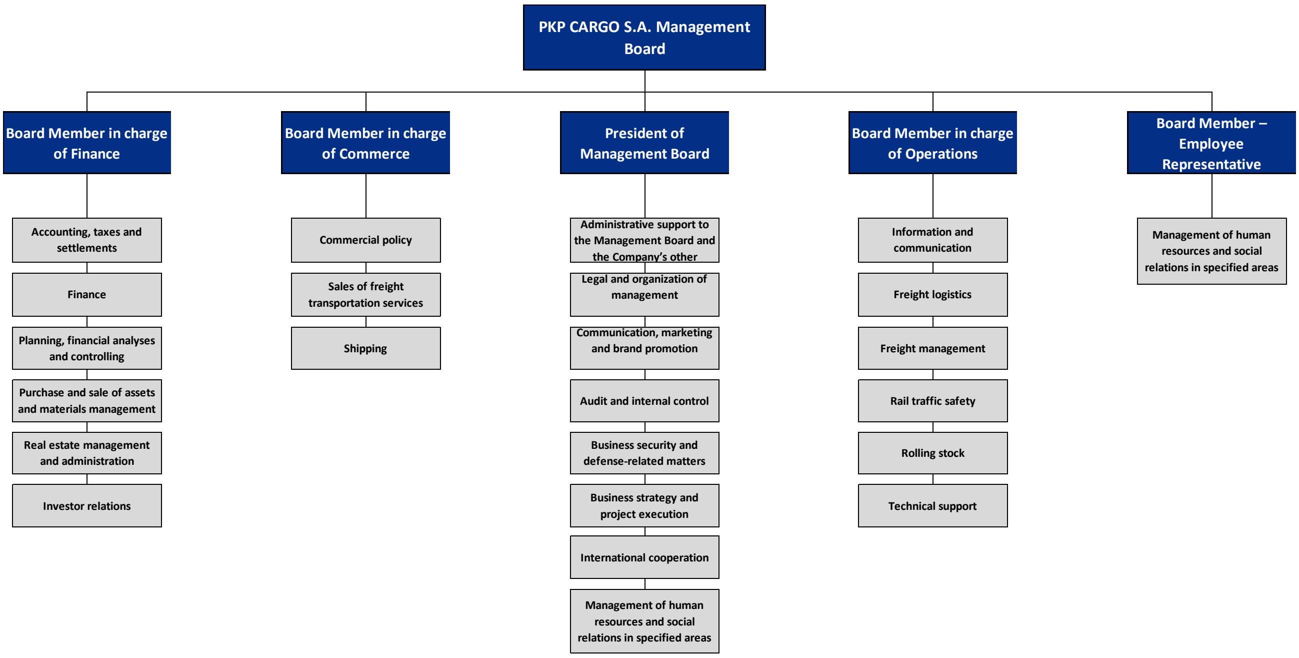
4) Management Board Member in charge of Operations – the scope of activity of the Management Board Member in charge of Operations includes caring for the effective execution of the Company's business and technological processes and overseeing the management of specific areas of the Company's activity, in particular in the following areas:

- execution of transports,
- maintenance of rolling stock.

5) Management Board Member – Employee Representative in the Management Board – the scope of activity of the Employee Representative in the Management Board includes overseeing tasks pursued in the area of human resources management, particularly in the following areas:

- relations with social partners,
- communication with social organizations.

Figure 31 Duties and responsibilities of the Parent Company's Management Board Members



Source: Proprietary material

Maciej Andrzej Libiszewski – President of the Management Board

Mr. Maciej Andrzej Libiszewski is a lawyer by education. He graduated from the Faculty of Law and Administration at the Gdańsk University and then completed Polish-German Finance, Management and Marketing Studies. He has experience in top executive positions with a good track record of managing interdisciplinary teams and running complex projects. Experienced negotiator who successfully signed agreements ending numerous disputes with trade unions. He has written restructuring and optimization programs for the financial area of commercial law companies. Ran his own business and subsequently worked for transport-related companies. He served on many supervisory boards and management boards of state, local government and privately-owned capital companies (also as a supervisory board member and a management board member of PKP CARGO S.A. from 2005 to 2008). His professional career from 2001 through 2015 was focused on the transport sector. He speaks English, French, German and Russian. He passed an examination for supervisory board member candidates in State Treasury-owned companies.

Grzegorz Fingas – Management Board Member in charge of Commerce

Mr. Grzegorz Fingas is a manager with many years of experience in building trade strategy and managing sales teams, associated with the PKP CARGO Group since 2008.

From May 2008, he discharged the function of Director of the PKP CARGO S.A. Trade Department and in the period 2010 – 2013 he was a Member of the Management Board of PKP CARGO International a.s. with its registered office in Bratislava. From the beginning of his professional career in 1988, Mr. Grzegorz Fingas discharged, among others, the following functions: Director of the Marketing Department of BOT Górnictwo i Energetyka S.A. in Łódź (2005-2008) and sub-department manager in the Statistical Office in Katowice (2002-2006). In 2003, Mr. Grzegorz Fingas graduated from MA studies at the Economics and Philology Faculty of the School of Marketing Management and Foreign Languages in Katowice, specializing in Marketing Management and, in 2012, MBA studies at the Gdańsk Foundation for Management Development. In 2010 – 2014 he discharged the function of Member of the Supervisory Board of Zakład Przewozu i Spedycji “Spedkoks” Sp. z o.o. with its registered office in Dąbrowa Górnicza.

Arkadiusz Olewnik – Management Board Member in charge of Finance

Mr. Arkadiusz Olewnik has been associated with PKP CARGO S.A. since March 2016. He discharged the function of Director of the Financial Controlling and Investor Relations Department.

In 2013 – 2016 he discharged the function of infrastructure market expert, carrying out, among others, a financial audit in Koleje Śląskie Sp. z o.o. or rail infrastructure audit in Kopalnia Węgla Brunatnego Konin in Kleczew.

Mr. Arkadiusz Olewnik has many years of experience in management positions in companies from the railway industry. In 2005-2012 he discharged, among others, the following functions: Management Board Member – CFO in Koleje Mazowieckie Sp. z o.o. (2009-2012), Management Board Proxy for Investments in POC Dipservice (currently Polski Holding Nieruchomości S.A.) (2008 – 2009) and Management Board Member – Privatization and Corporate Governance Director in PKP S.A. (2005 – 2008). In the period 2005-2008, he also was the Chairman of the Supervisory Board of PKP CARGO S.A. and Member of the Trade Trans S.A. Supervisory Board. Earlier on, in 1994-2005, Mr. Olewnik discharged medium-level managerial functions. Mr. Arkadiusz Olewnik is a graduate of the Production Economics Faculty of the Warsaw School of Economics (SGH).

Jarosław Klasa – Management Board Member in charge of Operations

Mr. Jarosław Klasa has been associated with PKP CARGO S.A. since 1985 where, having completed the railway secondary school in Bydgoszcz, he started his work on lower levels of the Company's operations division, exerting influence on optimization of the strategic areas of its activities. Then he discharged, among others, the functions of ICT Department Director (2010-2014 and 2016), Deputy ICT Department Director (2009-2010) and Manager of the Data Transmission Sub-Department (2008-2009).

In 2014-2015, Mr. Klasa was an Advisor to the Management Board of PKP Informatyka Sp. z o.o., and in 2015-2016 Director of the Systems Operations Department in PKP Informatyka Sp. z o.o. Mr. Jarosław Klasa graduated from the Mechanical Faculty of the Koszalin University of Technology. In 2013, he obtained the MBA title from the Gdańsk Foundation for Management Development.

Zenon Kozendra – Management Board Member – Employee Representative

Mr. Zenon Kozendra is a graduate of the Higher School of Public Administration in Kielce. He completed postgraduate studies in the organization of management at the Kozminski Academy. He has been associated with PKP since 1985.

From 2005 to 2008, Zenon Kozendra was the Management Board Member responsible for Employee and Administrative Affairs and from 2008 he was the Management Board's Plenipotentiary responsible for Personnel Strategy. Zenon Kozendra was a member of the PKP CARGO Supervisory Board from 2001 to 2005 and a Management Board Member of the Trade Union of Rail Employers from 2006 to 2008. Moreover, Zenon Kozendra sat on the supervisory boards of the following companies: - PKP CARGO SERVICE – as Chairman of the Supervisory Board in 2006-2007, - PKP CARGO WAGON Kraków – as Chairman of the Supervisory Board in 2007-2008, - PKP CARGO TABOR Karsznice – as Member of the Supervisory Board in 2010-2014, - PKP S.A. – as Member of the Supervisory Board in 2014-2016.

Commercial proxies established and revoked:

As of 1 March 2016, following the procedure prescribed in Article 371 § 5 of the Commercial Companies Code, the commercial proxy powers granted to Mr. Arkadiusz Pokropski were revoked.

On 18 July 2016, following the procedure prescribed by Article 371 § 5 of the Commercial Companies Code, the commercial proxy powers vested in Mr. Ireneusz Wasilewski were revoked.

SUPERVISORY BOARD

In accordance with the adopted consolidated version of PKP CARGO S.A.'s Articles of Association (Resolution No. 1529/V/2016 of the PKP CARGO S.A. Supervisory Board dated 30 March 2016) The Supervisory Board consists of 11 to 13 members (including the Supervisory Board Chairperson and Deputy Chairperson) appointed for a joint term of office. The Supervisory Board is appointed and dismissed by the Shareholder Meeting, subject to the provisions of § 19 Sections 2 and 3 of the Articles of Association of PKP CARGO S.A.

Powers of the Supervisory Board

The Supervisory Board exercises permanent supervision over the Company's operations in all areas of its activity. Moreover, its powers, in addition to matters reserved by the Commercial Companies Code or other statutes, include: selecting and changing the entity authorized to audit the Company's financial statements and to review the Company's accounting records, granting consent for the payment of an interim dividend by the Management Board towards the anticipated end-of-the-year dividend, appointing and dismissing the President and Members of the Management Board, setting the number of Management Board Members, granting consent for the establishment or liquidation of the Company's branch, granting consent for the Company's accession to business organizations, issuing opinions on proposals submitted by the Management Board to the Shareholder Meeting.

Operation of the Supervisory Board

The procedure of the Supervisory Board's operation is described in detail in the Bylaws of the Company's Supervisory Board. The Bylaws are adopted by the Company's Supervisory Board. In accordance with the provisions of the Bylaws of the Supervisory Board, the Supervisory Board makes decisions in the form of resolutions. For Supervisory Board resolutions adopted at the meeting to be valid, all Supervisory Board members are required to be invited and at least half of them need to be present, including the Supervisory Board Chairman. Resolutions of the Supervisory Board are adopted by an absolute majority of votes. If an equal number of votes is cast "for" and "against" together with abstentions, the Supervisory Board Chairman shall have the casting vote. Supervisory Board resolutions in the matter of suspension of Management Board members or Management Board shall require the consent of the Supervisory Board Chairman. Supervisory Board resolutions may be also adopted without holding a meeting, using written ballot or using means of remote direct communication, excluding resolutions pertaining to election of the Supervisory Board Chairman and Deputy Chairman, appointment of a Management Board member and dismissal and suspension of these persons in their duties. Supervisory Board meetings are convened by the Supervisory Board Chairman as needed, but at last once every month.

In accordance with the Bylaws of the Supervisory Board, in the event of conflicting interests of the Company and personal interests of a Supervisory Board member, his/her spouse, relatives or relatives and second degree next of kin, the Supervisory Board member should refrain from participating in the discussion and voting on the resolution of such matters and request that this fact be recorded in the minutes of the Supervisory Board meeting.

The table below presents the composition of the Supervisory Board as at the delivery date of this report.

Table 59 Composition of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report

Name	Position	Period in office	
		from	to
Kazimierz Jamrozik	Supervisory Board Member	24 May 2012	11 May 2016
Stanisław Knaflewski	Supervisory Board Member	17 December 2013	11 May 2016
Raimondo Eggink	Supervisory Board Member	13 April 2015*	to date
Jerzy Kleniewski	Supervisory Board Member	17 December 2015*	14 March (resignation)
Małgorzata Kryszkiewicz	Supervisory Board Member	17 December 2015*	to date
Maciej Libiszewski	Supervisory Board Member	17 December 2015 (from 18 December 2015 delegated as acting President of the Management Board)	19 January 2016 (resignation)
Mirosław Pawłowski	Supervisory Board Member Supervisory Board Chairman	17 December 2015 18 December 2015*	18 December 2015 6 March 2017 (resignation)
Andrzej Wach	Supervisory Board Member Supervisory Board Deputy Chairman	17 December 2015* 11 May 2016 27 April 2016 20 May 2016	27 April 2016 20 May 2016 11 May 2016 to date
Czesław Warsewicz	Supervisory Board Member	17 December 2015*	to date
Zofia Dzik	Supervisory Board Member	11 May 2016	to date
Krzysztof Czarnota	Supervisory Board Member	20 May 2016	to date
Marek Podskalny	Supervisory Board Member	20 May 2016	to date
Tadeusz Stachaczyński	Supervisory Board Member	20 May 2016	to date
Krzysztof Mamiński	Supervisory Board Member	6 March 2017	to date
Władysław Szczepkowski	Supervisory Board Member	14 March 2017	to date

Source: Proprietary material

* the 6th term of office of the PKP CARGO S.A. Supervisory Board began on 11 May 2016, the date of holding the Ordinary Shareholder Meeting ("OSM") of PKP CARGO S.A.

Raimondo Eggink – Supervisory Board Member – independent member

Since 2002, Mr. Raimondo Eggink has been running an independent business as a consultant and trainer for entities operating in the financial market. At the same time, he has been a member of the Supervisory Boards of the following public and private companies: Zespół Elektrociepłowni Wrocławskich KOGENERACJA S.A. (since 2009), AmRest Holding SE (since 2010), PERŁA – Browary Lubelskie S.A. (2004-2005 and since 2008), Prime Car Management (since 2015), PKP Cargo S.A. (since 2015), Górnośląskie Przedsiębiorstwo Wodociągów S.A. (since 2015) and Suwary S.A. (since 2015).

Prior to that, he was a member of the Supervisory Boards in the following companies: Stomil-Olsztyn S.A. (2002-2003), Giełda Papierów Wartościowych w Warszawie S.A. (2002-2008), Wilbo S.A. (2003-2005), Mostostal Płock S.A. (2003-2006), Swarzędz Meble S.A. (2004-2005), PKN Orlen S.A. (2004-2008), KOFOLA S.A. (2004-2012, previously HOOP S.A.), Zachodni Fundusz Inwestycyjny NFI S.A. (2006), Firma Oponiarska Dębica S.A. (2008-2012), Netia S.A. (2006-2014) and Lubelski Węgiel “Bogdanka” S.A. (2012-2015).

Earlier, he served as Management Board Member, Investment Director, President of the Management Board and, most recently, liquidator of ABN AMRO Asset Management (Polska) S.A., a firm managing the assets of Polish institutional investors and high-net-worth individuals which terminated its business in 2001. He began his professional career in 1995 in the Warsaw branch of ING Bank N.V. where he played a major role in the establishment of Poland’s first asset management firm. In 1995-1997, he served as Vice-President of the Council of Brokers and Advisers, and in 2004-2013, he was a member of the Management Board of the CFA Society of Poland. He is the author of a number of articles on the development of the Polish capital market, especially on the protection of minority shareholders.

Mr. Eggink is a graduate of the Jagiellonian University majoring in theoretical mathematics where in 2010 he obtained his Ph.D. degree. He also holds an investment advisor’s license and is a CFA (Chartered Financial Analyst) Charterholder.

Małgorzata Kryszkiewicz – Supervisory Board Member

Ms. Małgorzata Kryszkiewicz is a graduate of the Finance and Banking Faculty of the Warsaw School of Economics (SGH). She started her professional career in 1995. In subsequent years, she worked in various positions associated with accounting, tax and financial management. From 2002 to 2014, she headed the Accounting Department and the Finance and Accounting Department at PKP S.A. Currently she runs a statutory auditor’s office providing financial revision, advisory and consulting services. Statutory auditor since 2009.

Andrzej Wach – Supervisory Board Deputy Chairman

Andrzej Wach is a graduate of the Faculty of Electrical Engineering at the Warsaw University of Technology and of the Department of Law of the Post-Graduate College of Administration at the University of Warsaw. He started his professional career in Polskie Koleje Państwowe. From 1980 to 2010, he worked as an instructor, controller, branch director, PKP’s chief electrical engineer, President of the Management Board of PKP Energetyka S.A. and President of the Management Board of PKP S.A. Since 2011, he has been an advisor to the Management Board of PORR Polska Construction S.A. where he oversees the performance of investment contracts for a rail infrastructure administrator.

Since 2000, he has served on the Supervisory Boards of Elester PKP Sp. z o.o. and Kolejowe Zakłady Łączności Sp. z o.o. as the Supervisory Board Chairman, PKP Polskie Linie Kolejowe S.A. as the Supervisory Board Chairman, Telekomunikacja Kolejowa as the Supervisory Board Chairman, PKP Przewozy Regionalne as the Supervisory Board Chairman, Rail Project Sp. z o.o. as the Supervisory Board Chairman and PKP CARGO S.A. as the Supervisory Board Chairman. From 2005 to 2009, he was a member of the Steering Committee for the Community of European Railway and Infrastructure Companies (CER) in Brussels and, from 2009 to 2010, a member of the Executive Board of the International Union of Railways (UIC) in Paris.

Czesław Warsewicz – Supervisory Board Member

Mr. Czesław Warsewicz is an economist by education. He graduated from the Management and Marketing Faculty of the Warsaw School of Economics (SGH) and subsequently conducted research at the Postgraduate Doctoral Course of the SGH Strategic Management Faculty. He participated in the first Polish edition of AMP – Advanced Management Program organized by the IESE Business School in Barcelona. A specialist in transportation and management. He has capital market experience gathered in the consulting firms EVIP and CAL where he prepared issue prospectuses for ZML “Kęty”, Cersanit and Hydrobudowa 7.

From 1993 to 1999, he worked for the private sector, including the following companies: Company Assistance Sp. z o.o., Raab Karcher Energieservice Sp. z o.o, EVIP International Sp. z o.o. In 1997, he joined the stock-exchange listed Provimi-Rolimpex S.A. group where he worked for 9 years. In 2006-2009, the President of the Management Board of PKP Intercity S.A. Currently, the President of the Management Board of “Blue Ocean” Business Consulting Sp. z o.o., a strategic consultancy firm specializing in the development of transportation plans for local government units. A member of the Program Committee of the

Law and Justice party (PiS) responsible for the preparation of its transportation program, in particular in the area of railway transportation.

Zofia Dzik – Supervisory Board Member – independent member

Ms. Zofia Dzik is a graduate of the Kraków University of Economics, University of Illinois in Chicago, University of Social Sciences and Humanities in Warsaw and of the Executive Programs at INSEAD Business School. She holds an MBA title from Manchester Business School and is a certified member of the Association for Project Management (APMP) and a certified member of The John Maxwell Team, a top international organization associating eminent leadership coaches, trainers and speakers.

In the years 1995-2003 she worked for Andersen Business Consulting as a consultant responsible for the insurance sector (Insurance Division Director). From 2003 she was associated with Intouch Insurance Group (RSA Group), where in the years 2004–2007 she performed the function of the CEO of Towarzystwo Ubezpieczeń LINK4 S.A., whereas in the years 2007–2009 a function of a management board member of Intouch Insurance B.V. in the Netherlands and the CEO for East-Central Europe of Intouch Insurance Group. In that capacity, she was responsible for developing new markets; she was also the chairwoman of the supervisory boards of: TU Link4 S.A. and Direct Insurance Shared Services Center in Poland, Intouch Strachowanie in Russia (a start-up) and Direct Pojistovna in the Czech Republic (a start-up), as well as the deputy chairwoman of the supervisory board of TU na Życie Link4 Life S.A.

In 2006-2008, she served as a management board member of the Polish Insurance Association. In the years 2007–2010 a supervisory board member of the Insurance Guarantee Fund. She also sat on the supervisory boards of: KOPEX S.A. and Polish Energy Partners S.A (PEP S.A.)

Currently, she is the CEO of the Humanites - Art of Upbringing Foundation, which has the goal of supporting social transformation in Poland and qualitative growth of the young generation, mentor, author of the “Consistent Leadership” model, an 8-stage growth programme for leaders building engaging organizations, director of the Academy for Leaders in Education as well as member of supervisory boards of TU Link4 S.A., ERBUD S.A., Foundation for Strategic Competencies Development and PKO Bank Polski, where she also serves as the deputy chairwoman of the Bank’s Audit Committee.

Krzysztof Czarnota – Supervisory Board Member

Mr. Krzysztof Czarnota completed the Railway Technical School in Skarżysko-Kamienna as a Transportation Technician. Since 1977, he has worked for PKP, including in the Locomotive Depot in Skarżysko-Kamienna, in the Unclassified Station in Skarżysko, in the District Station in Skarżysko, in the Freight Division in Skarżysko and currently in the Company’s Eastern Division in Lublin as a dispatcher in charge of the shift.

Since 1992, Mr. Krzysztof Czarnota has served as Chairman of the Independent Trade Union of Railway Workers of PKP Cargo S.A. in Skarżysko-Kamienna. Since the establishment of the Freight and Transshipment Industry Board at the Federation of Trade Unions of Railway Workers, he had served as its Chairman and currently is Vice Chairman of the Cargo Industry Board at the Federation of Trade Unions of Railway Workers. He is a member of the Bureau, the Board and the National Council of the Federation of Trade Unions of Railway Workers.

From the incorporation of the Company, i.e. from 2001 until 29 September 2015, he was a member of the PKP Cargo S.A. Supervisory Board and a representative of all employees of PKP Cargo S.A. as a delegate of the Federation of Trade Unions of Railway Workers.

Marek Podskalny – Supervisory Board Member

In 1978, Mr. Marek Podskalny qualified as a metallurgist technician specializing in non-ferrous metals. In 2005, Mr. Podskalny graduated from the School of Management in Legnica with an engineering degree in transportation management.

Mr. Marek Podskalny has been employed by PKP Cargo S.A.’s Lower Silesian Division since 1983. In 1979, he began his professional career in the Copper Smelter in Legnica. Between 1983 and 1998, he worked for the Locomotive Depot in Legnica. Since 1998, he has been employed in the Traction Rolling Stock Operating Section in Legnica in the position of senior train driver.

From 25 September 2001 to 30 June 2006, Mr. Marek Podskalny was a member of the Supervisory Board of WAGREM Kluczbork, and then, from 6 July 2006 to 30 September 2015, a member of the Supervisory Board of PKP Cargo S.A.

Tadeusz Stachaczyński – Supervisory Board Member

In 1980, Mr. Tadeusz Stachaczyński completed a Railway Technical School specializing in the operation and repair of traction vehicles. In 2010, he graduated in engineering from the Subcarpathian School of Higher Education in Jasło, majoring in transportation and freight forwarding. In 2011, Mr. Stachaczyński completed postgraduate studies in marketing and market research.

Since 1974, Mr. Tadeusz Stachaczyński has been employed by PKP CARGO S.A.'s Southern Division (formerly, PKP's Locomotive Depot in Jasło). In 1995-2014, Mr. Stachaczyński was a councilor of the Town Council of Jasło where he served in the budget, development and audit committees.

Since 2009, Mr. Tadeusz Stachaczyński has served as Chairman of the Company Council of the Trade Union of Train Drivers at PKP CARGO S.A.'s Southern Division, and since 2013 has been Chairman of the Freight Sector of the Trade Union of Train Drivers.

Mr. Tadeusz Stachaczyński was a member of the Supervisory Board of PKP CARGO S.A. Centrum Logistyczne Medyka-Żurawica Sp. z o.o. in 2011-2013.

Krzysztof Mamiński – Supervisory Board Member

Mr. Krzysztof Mamiński is a graduate of the University of Szczecin. He also completed post-graduate courses in European Management Model in the Kozminski University in Warsaw. He has been involved with the Polish railway sector for 36 years now. In 1998-2002 he sat on the Management Board of Polskie Koleje Państwowe, first as the Management Board Member on Restructuring and then the Management Board Member responsible for Employee Relations. Subsequently, from 2002 to 2012 he was the President of the Management Board of "KPTW Natura Tour" Sp. z o.o. From 2001 to 2013, Mr. Krzysztof Mamiński was also the President of the Railway Employers' Union. From 2012 to 2013 he acted as the PKP S.A. Management Board Representative for Social Dialog in the PKP Group and from 2013 to 2016 he was the President of the Management Board of "CS Szkolenie i Doradztwo" Sp. z o.o. From 2016 to 2017 he was the President of the Management Board of Przewozy Regionalne Sp. z o.o. Additionally, in 2006 Mr. Krzysztof Mamiński served as a member of the Supervisory Board of PKP Linia Hutnicza Szerokotorowa Sp. z o.o., and from 2006 to 2013 he was a member of the Supervisory Board of WARS S.A.

Władysław Szczepkowski – Supervisory Board Member

Mr. Władysław Szczepkowski graduated in law from the Faculty of Law and Administration in the Department of Theory of the State and Law of the Nicolaus Copernicus University in Toruń in 1992. From 1992 to 2005, he pursued his career in banking where he was involved in financial analysis and corporate restructuring projects; he also worked for legal departments. From 2005 to 2007, he was the President of the PKP Cargo S.A. Management Board. From 2010 to 2016, he worked for companies of the PGNiG Group. From September 2016 to March 2017, he was employed by Przewozy Regionalne sp. z o.o. Since the beginning of March 2017, he has been working for PKP S.A. as the Director – PKP S.A. Management Board Representative for the Strategy and Organization of the PKP Group. Since 2000, he has been entered in the list of legal counsels.

SUPERVISORY BOARD AUDIT COMMITTEE

The PKP CARGO S.A. Audit Committee is appointed by the PKP CARGO S.A. Supervisory Board. It consists of at least three Supervisory Board Members, including two Members (including the Committee Chairman) meeting the independence criteria and appointed in the manner specified in § 20 and 21 of the Company's Articles of Association. At least one Audit Committee member should be qualified in accounting or financial audit. Committee members are appointed for a term corresponding to the Supervisory Board's term of office. Tasks of the Audit Committee include in particular: supervision over the organizational unit responsible for internal audit, monitoring the financial reporting process, monitoring the performance of financial audit activities, monitoring the independence of the statutory auditor and the entity authorized to audit financial statements, recommending an entity authorized to audit financial statements to the Supervisory Board to perform financial audit activities for the Company, etc.

Table 60 Composition of the Audit Committee of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report

Name	Position	Period in office	
		from	to
Stanisław Knaflewski	Committee Member	6 February 2014	11 May 2016*
Raimondo Eggink	Committee Member	30 April 2015 20 May 2015	18 December 2015 31 May 2016
	Committee Chairman	18 December 2015 31 May 2016	11 May 2016* to date
Małgorzata Kryszkiewicz	Committee Member	18 December 2015 20 May 2016	11 May 2016* to date
Zofia Dzik	Committee Member	20 May 2016	to date

Source: Proprietary material

* expiration date of the 5th term of office of the PKP CARGO S.A. Supervisory Board

NOMINATION COMMITTEE

The Nomination Committee is appointed by the PKP CARGO S.A. Supervisory Board. It consists of three Supervisory Board members, of whom at least one Supervisory Board Member must satisfy the independence criteria and be appointed in the manner provided for in § 20 and 21 of the Company's Articles of Association, to discharge the function of Committee Chairman. Committee members are appointed for a term corresponding to the Supervisory Board's term of office. The Nomination Committee organizes and exercises ongoing oversight over the recruitment procedure for the positions of the Company's Management Board members and over the process of assessment and appointment of the Company's Management Board members, and supports the attainment of the Company's strategic objectives by presenting opinions and findings to the Supervisory Board pertaining to the employment structure and compensation for the Company's employees, including in particular the Company's Management Board Members and upper level management.

Table 61 Composition of the Nomination Committee of the PKP CARGO S.A. Supervisory Board from 1 January 2016 to the delivery date of this report

Name	Position	Period in office	
		from	to
Stanisław Knaflewski	Committee Chairman	17 December 2013	11 May 2016
Mirosław Pawłowski	Committee Member	18 December 2015 20 May 2016	11 May 2016* 6 March 2017
Andrzej Wach	Committee Member	18 December 2015 20 May 2016	11 May 2016* to date
Zofia Dzik	Committee Chairwoman	20 May 2016	to date

Source: Proprietary material

* expiration date of the 5th term of office of the PKP CARGO S.A. Supervisory Board

STRATEGIC COMMITTEE

The Strategic Committee is appointed by the PKP CARGO S.A. Supervisory Board. It consists of at least three Supervisory Board members, of whom at least one Supervisory Board Member must satisfy the independence criteria and be appointed in the manner provided for in § 20 and 21 of the Company's Articles of Association. Committee members are appointed for a term corresponding to the Supervisory Board's term of office. The Strategic Committee supports the Supervisory in the oversight over the definition of the strategy as well as the appropriate implementation of the strategy and annual and long-term activity plans for the Company and its Group.

Table 62 Composition of the Strategic Committee of the PKP CARGO S.A. Supervisory Board from establishment (on 23 June 2016) to the delivery date of this report

Name	Position	Period in office	
		from	to
Czesław Warsewicz	Committee Chairman	23 June 2016	to date
Raimondo Eggink	Committee Member	23 June 2016	to date
Andrzej Wach	Committee Member	23 June 2016	to date

Source: Proprietary material

10. Other information of relevance for evaluation of the employment situation, financial standing, financial performance, assets and their movements as well as information of relevance for assessment of the ability of the issuer and other Group companies to pay their debts.

Other than the information presented in this Report, no other information has been identified that would be of relevance for evaluation of the employment situation, financial standing, financial performance, assets or their movements or information of relevance for assessment of the ability of the issuer to pay its debts.

This Annual Report was approved by the PKP CARGO S.A. Management Board on 16 March 2017.

……………………………………………

Maciej Libiszewski

President of the Management Board

……………………………………………

Arkadiusz Olewnik

Management Board Member

……………………………………………

Grzegorz Fingas

Management Board Member

……………………………………………

Jarosław Klasa

Management Board Member

……………………………………………

Zenon Kozendra

Management Board Member

STATEMENT

of the Management Board of PKP CARGO S.A. on the compliance of the Consolidated Financial Statement of the PKP CARGO Capital Group for the year ended 31 December 2016 and the Management Board's report on the operation of the PKP CARGO Capital Group for the year 2016

I, the undersigned, hereby represent that to the best of my knowledge, the Consolidated Financial Statement the PKP CARGO Capital Group for the year ended on 31 December 2016, and the comparable data have been drawn up in observance of the applicable accounting standards and that they truly, reliably and clearly represent the asset-related and financial standing of the PKP CARGO Capital Group, as well as its financial result.

I also represent that the Management Board's report on the operation of the PKP CARGO Capital Group in 2016 presents a true picture of the growth, achievements and standing of the PKP CARGO Capital Group, as well as a description of the key threats and risks.

Management Board Members

....
Maciej Libiszewski
President of the Board

....
Arkadiusz Olewnik
Board Member

....
Grzegorz Fingas
Board Member

....
Jarosław Klasa
Board Member

....
Zenon Kozendra
Board Member

Warszawa, 16 March 2017

STATEMENT

of the Management Board of PKP CARGO S.A. on the choice of the entity authorized to audit Consolidated Financial Statement of the PKP CARGO Capital Group for the year ended 31 December 2016

I, the undersigned, hereby represent that the entity authorized to audit annual consolidated financial statements, auditing the Consolidated Financial Statement of the PKP CARGO Capital Group for the year ended on 31 December 2016, has been appointed in observance of the rule of law, and that the said entity, as well as the certified auditors performing the audit, met the requirements that need to be fulfilled in order to issue an impartial and independent opinion on the annual consolidated financial statement audited, in line with the applicable regulations and professional standards.

Management Board Members

....
Maciej Libiszewski
President of the Board

....
Arkadiusz Olewnik
Board Member

....
Grzegorz Fingas
Board Member

....
Jarosław Klasa
Board Member

....
Zenon Kozendra
Board Member

Warszawa, 16 March 2017

For more information on PKP CARGO please contact
Investor Relations Team

PKP CARGO S.A.
Investor Relations Team
Grójecka 17
02-021 Warsaw

Tel.: +48 22 391-47-09
Fax: +48 22 474-29-53

e-mail: relacje.inwestorskie@pkp-cargo.eu