

## REPORT

### on the activity of the Supervisory Board of Orange Polska S.A. and its committees and concise assessment of the Orange Polska Group's standing in 2013

#### I. COMPOSITION:

Supervisory Board composition as of January 1, 2013:

1. Prof. Andrzej K. Koźmiński - Chairman
2. Benoit Scheen - Deputy Chairman and Chairman of the Strategy Committee
3. Marc Ricau - Secretary
4. Timothy Boatman - Board Member and Chairman of the Audit Committee
5. Dr. Henryka Bochniarz - Board Member
6. Thierry Bonhomme - Board Member
7. Jacques Champeaux - Board Member
8. Dr. Mirosław Gronicki - Board Member
9. Sławomir Lachowski - Board Member
10. Marie-Christine Lambert - Board Member
11. Pierre Louette - Board Member
12. Gérard Ries - Board Member
13. Dr. Wiesław Rozłucki - Board Member and Chairman of the Remuneration Committee

In 2013 the following changes occurred in the composition of the Supervisory Board:

On April 11, 2013, the mandates of Mr. Thierry Bonhomme, Mr. Jacques Champeaux, Mr. Mirosław Gronicki and Mr. Marc Ricau expired.

On the same day, Mr. Eric Debroeck, Mr. Mirosław Gronicki, Mr. Gervais Pellissier and Mr. Marc Ricau were appointed by the Annual General Assembly as Members of the Supervisory Board.

On September 19, 2013, Mr. Jean-Marie-Culpin and Mr. Maciej Witucki were appointed by the Extraordinary General Assembly as Members of the Supervisory Board.

Supervisory Board composition as of December 31, 2013:

1. Maciej Witucki - Chairman
2. Prof. Andrzej K. Koźmiński - Deputy Chairman
3. Benoit Scheen - Deputy Chairman and Chairman of the Strategy Committee
4. Marc Ricau - Secretary
5. Timothy Boatman - Board Member and Chairman of the Audit Committee
6. Dr. Henryka Bochniarz - Board Member
7. Jean-Marie Culpin - Board Member
8. Eric Debroeck - Board Member
9. Dr. Mirosław Gronicki - Board Member
10. Sławomir Lachowski - Board Member
11. Marie-Christine Lambert - Board Member
12. Pierre Louette - Board Member
13. Gervais Pellissier - Board Member
14. Gérard Ries - Board Member

15. Dr. Wiesław Rozłucki - Board Member and Chairman of the Remuneration Committee

At present, the Supervisory Board has six independent members, namely Messrs. Prof. Andrzej K. Koźmiński, Timothy Boatman, Dr. Henryka Bochniarz, Dr. Mirosław Gronicki, Sławomir Lachowski and Dr. Wiesław Rozłucki.

Three permanent committees operate within the Supervisory Board. Their composition was the following (as of December 31, 2013):

- **Audit Committee:** Timothy Boatman – Chairman, Marc Ricau, Sławomir Lachowski and Marie-Christine Lambert – members;
- **Remuneration Committee:** Dr. Wiesław Rozłucki – Chairman, Prof. Andrzej K. Koźmiński, Benoit Scheen and Marc Ricau – members;
- **Strategy Committee:** Benoit Scheen – Chairman, Dr Henryka Bochniarz, Eric Debroeck, Dr. Mirosław Gronicki, Sławomir Lachowski and Gérard Ries – members.

## II. OPERATION

The Supervisory Board, acting in compliance with the provisions of the Commercial Companies Code and the Company's Articles of Association, exercised permanent supervision over the Company's operations in all fields of its activities.

In 2013 the Supervisory Board fulfilled its duties resulting from the provisions of the Commercial Companies Code:

1. Evaluation of the Management Board's report on Orange Polska SA operations and the financial statements for the financial year 2012 and the Management Board's motion for distribution of the Company's profit;
2. Evaluation of the Management Board's report on Orange Polska Group's operations and the consolidated financial statements for the financial year 2012;
3. Filing with the General Assembly of the Shareholders reports presenting the results of the above mentioned evaluation.

The Supervisory Board took due care to ensure that the Management Board's reports and the financial statements were in compliance with the law.

The Supervisory Board also executed its rights and obligations arising from the Company's Articles of Association and the Best Practices for Companies listed on the Warsaw Stock Exchange, of which the following should be mentioned:

- 1) expressing opinions on motions addressed to the General Assembly including the motion on amendments to the Articles of Association,
- 2) selecting an independent auditor to audit the Company's financial statements,
- 3) preparing opinions on Orange Polska S.A. and Orange Polska Group budgets,
- 4) concise assessing of the Orange Polska Group's standing in 2012, including an assessment of the internal control system and the significant risks management system,

The Supervisory Board met 7 times in 2013. The SVB adopted 29 resolutions, of which 9 in writing (by correspondence).

The Supervisory Board used in its operations opinions of its Committees (the Audit Committee, the Remuneration Committee and the Strategy Committee), wherever applicable.

The reports of the three permanent committees of the Supervisory Board on their activities in 2013 are attached hereto.

The Supervisory Board formulated a number of recommendations, remarks and motions to the Management Board, referring to different aspects of the company's operations.

The Supervisory Board was regularly monitoring the execution of its resolutions and recommendations, analysing the information presented by the Management Board.

### **III. CONCISE ASSESSMENT OF ORANGE POLSKA GROUP'S STANDING IN 2013**

This section contains the Supervisory Board assessment of the Orange Polska Group's performance in 2013 in accordance with the recommendation no. III. 1.1 of the Code of Best Practices for WSE Listed Companies, introduced by the Warsaw Stock Exchange. The assessment is based on the 2013 financial results of the Group (the Company and its subsidiaries) as well as on the information obtained by the Supervisory Board during conducting its statutory tasks.

Throughout 2013, the Supervisory Board focused on the following issues:

- a) Group's financial results and performance in comparison to the budget;
- b) Development and beginning of implementation of the medium term action plan for 2013-2016;
- c) Concluding financing agreements with Orange Group;
- d) Monitoring of the key programs for the Group's future, particularly the program of mobile access network sharing with T-Mobile;
- e) Disposal of a subsidiary, Wirtualna Polska;
- f) Merger of the main Group entities, Telekomunikacja Polska S.A. and PTK Centertel, into Orange Polska S.A.;
- g) Customer satisfaction – the customer excellence programme.

The Supervisory Board, through the work of its committees and all its members (including six independent members), was actively engaged in the process of evaluation of the most important initiatives, having in mind the interest of all the Group's stakeholders, including shareholders. In addition, it maintained oversight of the Group's operational and financial goals through management reporting at its quarterly meetings and was able, through the Audit Committee, to review and challenge the control, risk management and budgeting functions performed by the Management.

#### **Group's Operational Review**

Despite intensive competitive environment, Orange Polska achieved a visible improvement in its commercial momentum in 2013. In particular, the commercial focus placed on convergence, resulted in a dynamic growth of the Orange Open product, which reached 286,000 customers, up from 33,000 at the end of 2012. Roughly 58% of these customers bought additional services when entering into Orange Open, underscoring the upsell potential of Open. Group's mobile customer base expanded by 430,000, including 310,000 customers added in post-paid. This was well supported by the Group's second mobile brand, nju.mobile, which was launched in April 2013. Its customer base reached 353,000, mostly gained from the competition. In fixed line, the Group limited the loss of its fixed voice customers to 345,000 in 2013, versus 590,000 customers lost in 2012. The customer base of fixed broadband decreased by 44,000, mainly due to services based on ADSL and CDMA, while the Group increased the number of clients using its VDSL services by 38,000. The Group continued to bundle fixed broadband with television and VoIP, and these efforts resulted in a 103,000 increase in its 3P bundles in 2013. The number of clients of Group's mobile broadband clients increased by 180,000, also due to commercial actions including subsidised equipment (netbooks, tablets).

Another major event was the merger of the Group's fixed and mobile entities, TP S.A. and PTK Centertel, into Orange Polska S.A. The process was completed on December 31,

2013. It is an important step for the Group, as it will further facilitate the implementation of the Group's convergent product strategy.

In 2013, the Group continued to implement its co-operation with T-Mobile, concerning a common use of their mobile access networks. At the end of the year, ca 8,200 sites (out of the total target of 10,000) have been modernised and put in common use. The co-operation was enlarged to the 4G LTE technology, and subsequently the Group gained access to the 1 800MHz LTE spectrum, which is owned by T-Mobile. As a result of the co-operation, the Group launched services based on 4G LTE, and enlarged its service coverage to ca. 90% of population in 3G and achieved ca. 16% coverage (in population) in 4G.

In line with its strategy of disposing of non-core assets, on October 23, 2013 the Group signed a sale agreement to dispose its wholly owned subsidiary, Wirtualna Polska, to O2 sp. z o.o., subject to an approval by the Competition Office (UOKiK). Following the approval by UOKiK, the transaction was finalised in 2014, for a total price of PLN 383 million.

On December 9, 2013 the Group reached an agreement with its trade unions, regarding a new social plan for years 2014-2015. Pursuant to this agreement, the Group will help those employees, who cannot adjust their professional profile to the changing environment, by enabling them to take advantage of a voluntary leaves program, which includes severance packages. Up to 2,950 employees will be able to leave the Group on a voluntary leaves basis in 2014-2015, including 1,530 in 2014.

## **Group's Financial Overview**

The Group's key goals in 2013 were to:

- Effect the merger of TP S.A. and PTK Centertel Sp. z o.o.;
- Monitor business performance closely so as to be able to react quickly to unfavourable trading conditions caused by the continued volatility of the financial markets;
- Effectively promote Orange Open-like convergent services and, consequently, strengthen the leadership in value in fixed voice, mobile and broadband markets;
- Take actions to enable the Group's growth outside the telecommunication business in line with the strategic plan;
- Review outsourcing options for various activities and dispose of non-core assets to improve efficiency;
- Increase customer satisfaction and loyalty, also by implementing the customer excellence program;
- Monitor the Group's EBITDA margin;
- Optimise capital expenditure to below PLN 2 billion;
- Mitigate foreign exchange effect on commercial expenses, financial costs and capital expenditure;
- Intensify the cost base optimisation;
- Maintain financial stability, including taking advantage of Orange S.A. funding opportunities, and monitor the level and prognosis of debt ratios closely;
- Generate organic cash flow of at least PLN 0.8 billion<sup>1</sup>; later revised to at least PLN 1 billion;
- Develop a shareholder remuneration approach based on changing market dynamics;

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<sup>1</sup> Excluding spectrum acquisition, change in consolidation and impact of risk and litigation.

Organic cash flow = Net cash provided by operating activities - (CAPEX + CAPEX payables) + proceeds from sale of property, plant and equipment and intangible assets.

- Complete the execution of the Memorandum of Understanding with the Regulator;
- Further enhance internal control and risk management measures;
- Continue with the network infrastructure and frequency sharing cooperation with T-Mobile Polska through the NetWorks! joint venture.

The Group achieved notable commercial successes, resulting from the implementation of its new medium term action plan for 2013-2016. Nevertheless, it continued to be significantly affected by adverse impact stemming from the cuts of the Mobile Termination Rate, which was reduced by 65% since December 31, 2012, as well as by a negative impact of price pressure in the mobile segment, which was accelerated in 2012 in anticipation of the MTR decreases, and which contributed to a decline in mobile ARPU. As a result of a combination of these factors, the Group's revenue totalled PLN 12,923 million and decreased by 8.6% over 2012. Excluding the PLN -693 million regulatory impact, which was mainly due to the MTR cuts, the revenue declined by 3.7% year-on-year. The restated EBITDA margin<sup>2</sup> stood at 31.6%, while the organic cash flow totalled PLN 1,105 million, compared with PLN 1,593<sup>3</sup> million generated in 2012.

Group's net debt decreased to PLN 4,512 million at the end of 2013. The Group has a solid balance-sheet with net gearing at 26% and the net debt to EBITDA ratio at 1.1. This, coupled with an effective hedging policy, enabled the Group to maintain its solid credit rating (Baa1/BBB with a negative outlook at December 31, 2013).

In 2013, the Group paid a dividend of PLN 656 million, an equivalent of PLN 0.5 per share, payable in cash.

### **Conclusions and 2013 Recommendations**

The Polish telecom market underwent important changes, driven by MTR cuts and price wars in the mobile post-paid market. As a result, this has forced a major adaptation at the Group, reflected in the new medium term action plan for 2013-2016. Despite these pressures, the Group delivered results within the revised guidance in 2013. The Supervisory Board believes that the Management Board will make the appropriate efforts to reach Group's 2014 objectives.

The Supervisory Board's opinion is that in 2014 the Group should focus its activities on further implementing the new medium term action plan. In order to do so, the Group needs to build a much leaner and more flexible organisation, and also to:

- Draw benefits from the merger of TP S.A. and PTK Centertel Sp. z o.o. and to put further focus on convergent product strategy and the Orange Open;
- Monitor business performance closely so as to be able to react quickly to unfavourable trading conditions caused by the continued volatility of the financial markets;
- Strengthen the leadership in value in fixed voice, mobile and broadband markets;
- Take actions to enable the Group's growth outside the telecommunication business in line with the strategic plan;
- Increase customer satisfaction and loyalty, also by further implementing the customer excellence program;
- Monitor the Group's EBITDA margin;
- Optimise capital expenditure to below PLN 1.8 billion, excluding one-off spectrum;

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<sup>2</sup> excluding PLN 147mn restructuring costs and PLN -33mn adjustment linked to the TPSA/PTK merger (VAT and inventories).

<sup>3</sup>OCF for 2012 excluding EUR 550 million payment to DPTG.

- Mitigate foreign exchange effect on commercial expenses, financial costs and capital expenditure;
- Intensify the cost base optimisation;
- Maintain financial stability, including taking advantage of Orange S.A. funding opportunities, and monitor the level and prognosis of debt ratios closely;
- Generate organic cash flow of at least PLN 1.1 billion<sup>4</sup>;
- Remunerate shareholders on a reasonable level, taking into consideration the Group's financial structure and future capital requirements;
- Further enhance internal control and risk management measures;
- Continue with the network infrastructure and frequency sharing cooperation with T-Mobile Polska through the NetWorkS! joint venture;
- Pursue the rollout of 4G LTE services and make reasonable efforts to ensure access to the 4G LTE spectrum.

#### **IV. ASSESSMENT OF THE GROUP'S INTERNAL CONTROLS INCLUDING RISK MANAGEMENT**

The Supervisory Board is responsible for reviewing the effectiveness of the Group's system of internal control and risk management designed and established by the Management Board.

This system facilitates the management of the risk of failure to achieve business objectives and provides reasonable assurance against material misstatement or loss (risk management does not mean the full elimination of risk, but provides for better risk identification and the implementation of adequate measures as needed). The relevant processes are designed to give reasonable, but cannot give absolute, assurance that the risks significant to the Group are identified and addressed.

The key elements of the system of internal control, including risk management, were presented in the Management Board's Report on the Activity of the Group for 2013, published on February 12, 2014.

In 2013, the Group again completed a comprehensive assessment of its processes of internal control over financial reporting within the framework of the Sarbanes-Oxley Program of Orange S.A. Main deficiencies both in design and in effectiveness of internal control have been identified and corrected, or appropriate action points have been launched. As a result of the assessment, the Management concluded that there were no weaknesses that would materially impact the internal controls and financial reporting at December 31, 2013. Continued efforts by the Management in this regard are also needed in 2014.

Both the internal and external auditors report to the Management Board and also to the Audit Committee on control deficiencies which they identified during their audit. Their recommendations are being implemented.

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<sup>4</sup> Excluding spectrum acquisition, and impact of risk and litigation.

Organic cash flow = Net cash provided by operating activities – (CAPEX + CAPEX payables) + proceeds from sale of property, plant and equipment and intangible assets.

