



**Management report
on the operations of Emperia Holding S.A.
in 2017**

**PREPARED IN ACCORDANCE WITH IFRS
AS ENDORSED BY THE EU**
(data in PLN 000s)

WARSAW

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1. Financial highlights

Item	2017	2016	%
Revenue from sales	13 995	15 952	-12.3%
EBITDA	(3 142)	5 821	-154.0%
Operating profit (loss)	(4 989)	4 149	-220.2%
Profit (loss) before tax	(1 864)	18 869	-109.9%
Net profit (loss)	(2 078)	18 014	-111.5%
Total assets	528 869	491 531	7.6%
Liabilities and liability provisions	63 478	24 072	163.7%
Current liabilities	62 465	23 256	168.6%
Net assets	465 391	467 459	-0.4%
Weighted average number of shares	11 934	12 086	-1.3%
Net earnings (loss) per share (in PLN)	(0.17)	1.49	-111.7%

Operational performance and ability to meet liabilities

Item	2017	2016
Return on invested capital (net profit for the period / equity at the end of the period) in %	-0.45%	3.85%
Return on assets (net profit for the period / assets at the end of the period) in %	-0.39%	3.66%
Sales margin (profit from sales for the period / revenue from sales for the period) in %	55.75%	55.15%
EBITDA margin, in %	-22.45%	36.49%
EBIT operating margin (operating profit for the period / revenue from sales for the period) in %	-35.65%	26.01%
Gross margin (profit for the period / revenue from sales for the period) in %	-13.32%	118.29%
Net margin (profit from sales for the period / revenue from sales for the period) in %	-14.85%	112.93%

The Company reported a 111.5% decrease in net profit in 2017, compared with 2016. The main reasons for this were one-off events that include dividend income from subsidiaries (no dividend from Elpro Development and lower dividend from Infinite) and one-off costs related to the investor search process. Adjusting for the above factor, EBITDA declined by 1.7%, while net profit declined by 16%. The decline in net profit was significantly influenced by warranty costs and commission on bonds.

2. Scope of Emperia Holding S.A.'s business

Emperia Holding S.A. is a holding company for entities comprising Emperia Group, and in particular provides services such as legal, management accounting, book-keeping, HR, IT, cash flow management, investment and email management.

After the restructuring process, motivated by the sale of the distribution business and change in the shared services strategy, Emperia now focuses on provision of services to companies in the property development and IT segments. Emperia Holding S.A. operates in Poland.

Geographical scope of the Company's property development activities in 2017:

Lublin voivodship: Lublin (Projektowa), Lublin (Kunickiego), Lublin (Męczenników Majdanka), Lublin (Nałkowskich), Lublin (Dąbrowica),
Sub-Carpathian voivodship: Rzeszów (Kwiatkowskiego)

Emperia Holding S.A. operates in Poland.

3. Assessment of financial management in 2017 using liquidity ratios, along with the structure, rotation and level of debt

Liquidity ratios	2017	2016
Current ratio (current assets / current liabilities)	0.77	0.36
Quick ratio (liquid current assets / current liabilities)	0.77	0.36
Cash ratio (short-term investments / current liabilities)	0.73	0.23

Liquidity ratios are up from 2017. This mainly results from rapid growth in the value of current assets.

The increase in current assets by 479% y/y results largely from a substantial increase in cash. At the end of 2016, a share buy-back was executed, while bonds were issued in 2017, which are the main component of liabilities growth in 2017 by approx. 169%.

Turnover cycles for key components of working capital	2017	2016
Inventory turnover days (inventory / value of goods for resale and materials sold*number of days in period)	-	-
Receivables turnover days (current receivables / revenue from sales*number of days in period)	41.27	67.58
Payables turnover days (current trade payables / cost of products and services sold*number of days in period)	0.00	28.21
Asset productivity (revenue from sales / total assets)	0.03	0.03
Non-current asset productivity (revenue from sales / non-current assets)	0.03	0.03

In 2017, the Company did not report sales of goods and materials. A decline in the receivables turnover ratio resulted mainly from a decrease in current receivables by 46% (note 6.3.11).

Debt ratios	2017	2016
Debt ratio (liabilities and liability provisions / total assets)	0.12	0.05
Debt to equity (liabilities and liability provisions / equity)	0.14	0.05
Equity-to-assets ratio (equity / total assets)	0.88	0.95
Long-term debt ratio (non-current liabilities / total assets)	-	-

4. Sales markets

Despite a limited scope for holding services provided, the Company's main customers continue to be subsidiaries within Emperia Group.

5. Significant agreements

As regards banking services, the Group works with the following banks: Bank PEKAO S.A., Bank PKO BP S.A., mBank S.A. and Bank BGŻ BNP Paribas S.A.

From 1 April 2017, Compensa TU S.A. is property insurer. Emperia also holds civil liability insurance. Insurance agreements are executed for a 12-month period. As regards motor insurance, an agreement was entered into with AXA Ubezpieczenia TUiR S.A.

6. Key events at Emperia Holding S.A. in 2017

Significant events are described in Note 6.3.51 in Emperia Holding S.A.'s financial statements.

7. Significant events after the balance sheet date

Significant events taking place after the balance sheet date are described in Note 6.3.52 in Emperia Holding S.A.'s financial statements.

8. Extraordinary events having an impact on annual financial performance

No such events took place during the period.

9. Revenue and profit by operating segment

Revenue and profit by operating segment at Emperia Holding S.A. in 2017: are described in point 6.2.3 in Emperia Holding S.A.'s financial statements.

10. Capital expenditures

Capital expenditures of PLN 189 000 were made in 2017. They were related to replacements or the purchase of vehicles.

11. Company's dividend policy

As of the date on which this report was prepared, the Management Board had not adopted a resolution on a recommendation on the allocation of the 2017 profit.

In 2017, Emperia Holding S.A. did not pay out a dividend as part of allocating its 2016 profit. On 28 June 2017, the General Meeting of Emperia Holding S.A. adopted a resolution on use of Emperia Holding S.A.'s 2016 profit to cover prior-period losses and as reserve capital.

Dividends received:

The management board of subsidiary Infinite Sp. z o.o. passed a resolution on the payment of a dividend of PLN 6 384 000 to Emperia Holding S.A.

12. External factors that might have an impact on Emperia Holding S.A.'s results in the coming year:

External:

- a) Financial and economic situation in the retail industry, primarily concerning the Group's suppliers and customers, as regards financing and meeting liabilities
- b) Market prices for goods and services used by the Group
- c) Activities by competing businesses and consolidation processes in Polish retail
- d) Poland's economic situation and household wealth, having an impact on demand for the Group's products and services
- e) Government policy regarding interest rates and taxes
- f) Employment situation - ability to hire creative employees for new ventures
- g) Financial and economic conditions in the property development sector
- h) Higher competition for commercial facilities

Internal:

- a) Further investment in property, plant and equipment and software; on-time and on-budget investment delivery
- b) Reduction in operating costs through deployment of new organisational and IT solutions and growth in operating scale
- c) Introduction of structural and organisational changes intended to create an organisation having a substantial market share
- d) Procurement of attractive locations for retail operations
- e) Expansion and supplementation of assortment
- f) Qualified and experienced management
- g) Stable supplier base

13. Growth perspectives

Emperia Holding S.A. is a holding company the core business of which is management of the Group's subsidiaries and certain central functions such as: financial management, IT services, management of selected asset and liability groups.

In 2017, the Company was involved in property development. This business diversification is in line with the Company's strategy.

14. Significant related-party transactions

In 2017, Emperia Holding S.A. did not execute any significant transactions with related parties other than transactions in the ordinary course of business on market terms. Short-term bonds were issued as part of the Group's cash flow management, as described in Note 6.3.19. Other intra-Group transactions are presented in detail in Note 6.3.41.

15. Information regarding on-going proceedings

Tax probe by Treasury Control Office

1. On 31 January 2017, Emperia Holding S.A. received from a law firm representing it in the case a decision by the Head of the Tax Control Office in Lublin issued in an inspection proceeding concerning the accuracy of declared tax basis and the correctness of CIT calculations and payments for 2011. In the Decision, the Head of the Tax Control Office in Warsaw established the Company's tax liability regarding corporate income tax for 2011 at PLN 142 463 805. Under art. 53 and 55 of the Tax Ordinance, the Company is also obligated to calculate and pay late interest on the liability.

Factual status:

- As a result of an arrangement of 21 December 2011, P1 sp. z o.o. (subsidiary of Emperia Holding S.A.) sold its distribution segment to Eurocash S.A. for approx. PLN 1.1 billion. After the above transaction, P1 on the one hand ceased to perform its holding-company functions (in relation to the distribution companies segment) while on the other hand it held substantial cash, which had to be immediately and rationally used by Emperia Group.
- On 29 December 2011, an Extraordinary General Meeting of P1 (i.e. the sole shareholder - Emperia Holding S.A.), in line with the company's founding agreement, carried out a mandatory cancellation of 13

200 000 shares of P1 in exchange for a consideration of PLN 1.090 billion. The reduction in P1's share capital was registered through a decision of the District Court in Lublin Wschód, 6th Commercial Division of the National Court Register, on 27 April 2012.

- According to the Act on Corporate Income Tax, the consideration received by Emperia Holding S.A. from the mandatory share cancellation is exempt from tax.

Charges made by the Tax Control Office:

- According to the Head of the Tax Control Office in Lublin, the mandatory cancellation of shares in subsidiary P1 was illusive and the legal activity performed on 29 December 2011 was actually a voluntary share cancellation. This is supposed to be proven by, among other things, the fact that P1 was controlled, in capital and personal terms, by Emperia Holding, and by the fact that reasons for the mandatory cancellation were introduced in P1's founding agreement only when the distribution segment was transferred to it. The Tax Control Office considered that Emperia Holding de facto had agreed to the share cancellation, making it easier to qualify this activity as a voluntary cancellation;
- The Tax Control Office considered that "the parties' intent was to form relations between Emperia Holding S.A. and P1 in a way that, while maintaining legal compliance, they would aim to reach an objective that would be against tax law." The Tax Control Office made a reference to the tax equality and universality rules and to the autonomy of tax law;
- In consequence, according to the Tax Control Office, the consideration for the alleged transaction consisting of a voluntary cancellation of P1 shares, constituted tax income for Emperia Holding in 2011 (tax arrears of approx. PLN 142.5 million).

Company's position:

- The decision by the Tax Control Office is in clear violation of tax law but also civil and corporate law. The Tax Control Office incorrectly equates the illusiveness of legal activities with formulating the transaction in a manner that does not bring the expected tax proceedings;
- The Extraordinary General Meeting resolution on the mandatory share cancellation may not be considered to be illusive because illusiveness does not apply to one-sided legal activities that are not addressed to anyone in particular;
- There is no legal basis whatsoever for concluding that this matter involves a voluntary cancellation of P1's shares. This form of cancellation requires a share purchase agreement to be executed between the shareholder and the company in order for the company to cancel the shares. No such agreement was executed - which precludes concluding that this was a voluntary cancellation of P1's shares;
- The mandatory cancellation was carried out in compliance with the law and the company's founding agreement, which is confirmed by the register court's decision. Therefore, the Tax Control Office's decision is in contravention to a binding court ruling;
- Despite the fact that the dispute de facto revolves around there being a legal relation (the acquisition by P1 of its own shares for cancellation), the Tax Control Office refused to file a suit in a general court to determine that such an activity had been performed - citing a "lack of objective doubt." The above proves that the Tax Control Office does not have evidence allowing this to be determined by an independent court and, in violation of tax proceeding rules, is making standalone rulings in the area of private law.
- In reference to the principle of equity, the Tax Control Office seems to be assuming that in the circumstances of the matter the sole economically justified transaction was a voluntary share cancellation. The business objective of the share cancellation was the transfer of financial resources from P1 to the Group. According to the law, the above objective could have alternatively been achieved through other legal activities that are exempt from tax based on European Union law. The economic sense of the share cancellation should be compared to generating income from equity (as in the case of company liquidation or dividend payment) rather than income from a transaction (from the sale of property rights).

- The circumstances of the matter and the accusations made by the Tax Control Office were analysed by renowned representatives of academia, tax law and corporate law, who have considered that the position of the Tax Control Office is completely unjustified and in violation of the law.
 - The Company does not agree with these findings and the legal assessment carried out by the Head of the Tax Control Office in the Decision, further it does not see grounds for recognising a provision for the amounts of tax arrears indicated in the Decision.
2. On 10 February 2017, Emperia appealed the decision to the Head of the Tax Chamber in Warsaw.
 3. 8 August 2017 – the Head of the Tax Authority Chamber in Warsaw issued a decision upholding the decision issued by the Head of the Tax Control Office
 4. 21 August 2017 – the Company lodged a complaint with the Voivodeship Administrative Court, with the intermediation of the Head of the Tax Authority Chamber, regarding the decision issued by the Head of the Tax Control Office, moreover:
 - it lodged a motion with the Head of the 2nd Mazowieckie Tax Office in Warsaw for suspension of decision issued by the Head of the Tax Control Office together with a motion to accept collateral for the tax liability concerning corporate income tax for 2011 together with late interest, in the form of a bank guarantee;
 - provided four bank guarantee documents to the Head of the 2nd Mazowieckie Tax Office in Warsaw, issued by the following banks: PKO BP S.A., BGŻ BNP Paribas S.A., mBank S.A. and Bank Pekao S.A., for a total amount of PLN 198 million.
 5. 5 September 2017 – the Company received a ruling from the Head of the 2nd Mazowieckie Tax Office in Warsaw on acceptance until 20 August 2018 of a security for the payment of corporate income tax for 2011 in the form of four bank guarantees (PKO BP S.A., BGŻ BNP Paribas S.A., mBank S.A., Bank Pekao S.A.) up to a maximum amount of PLN 198.1 million
 6. 5 September 2017 – the Company received a ruling from the Head of the 2nd Mazowieckie Tax Office on suspension of a decision issued by the head of a tax administration chamber until 20 August 2018
 7. Expected deadline for the case to be examined by the Voivodship Administrative Court: end of Q2 2018

Aside from the above case, in 2017 the Company did not participate in any other proceedings before a court or other authority concerning liabilities or receivables with an aggregate value exceeding 10% of its equity.

16. Credit facilities, guarantees, loans and sureties

In 2017, Emperia Holding executed a credit and guarantee agreement. Details of the agreement are presented in Current Report 31/2017 of 27 April 2017 "Execution of credit and guarantee agreement."

17. Financial instruments and assessment of the associated risks

Information on financial instruments held, along with the associated risks, is presented in note 6.3.46 to Emperia Holding S.A.'s financial statements.

18. Changes in key management principles

Emperia Holding S.A. did not introduce any changes to its key management principles in 2017.

19. Description of Group structure

The Group's organisational structure, showing the companies subject to consolidation, is presented in point 6.1 of Emperia Holding S.A.'s financial statements for 2017.

20. Changes in Management Board and Supervisory Board composition

Changes in Emperia Holding S.A.'s Management Board

The composition of the Management Board of Emperia Holding S.A. did not change in 2017.

At report publication date, the Management Board of Emperia Holding S.A. comprised:

1. Dariusz Kalinowski – President of the Management Board
2. Cezary Baran – Vice-President of the Management Board, Finance Director

Changes in Emperia Holding S.A.'s Supervisory Board

Composition of Emperia Holding S.A.'s Supervisory Board was not subject to changes in 2017.

Composition of Emperia Holding S.A.'s Supervisory Board as at 31 December 2017:

1. Artur Kawa – Chairperson of the Supervisory Board
2. Michał Kowalczewski – Deputy Chairman, Independent Member of the Supervisory Board
3. Artur Laskowski – Member of the Supervisory Board
4. Jarosław Wawerski – Member of the Supervisory Board
5. Aleksander Widera – Independent Member of the Supervisory Board

21. Effects of changes in the Company's structure

In line with the merger plan dated 29 November 2016, a merger of Elpro Development S.A. (the acquiring company) with the following companies took place on 3 April 2017: ELPRO EKON, P3 EKON, P5 EKON and EKON. In connection with this, departments related to the property segment were transferred from Emperia to Elpro Development, including accounting, leases, operations and settlements.

22. The management's view as regards meeting guidance published for a given year

The Company did not publish earnings guidance for 2017.

23. Shareholder information

Information on shareholders with at least 5% of the total number of votes at the general meeting is presented in Note 6.3.14 in Emperia Holding S.A.'s financial statements for 2017.

24. Shareholding by management and supervisory personnel

The holdings of Management Board and Supervisory Board members are presented in note 6.3.14 in Emperia Holding S.A.'s financial statements for 2017.

25. Related-party transactions

Information on the Company's related-party transactions is presented in Note 6.3.41 in Emperia Holding S.A.'s financial statements for 2017.

26. Information on securities issued

Transactions concerning issued short-term bond (expressed in par values)

Issue and buy-back of bonds in 2017	Elpro Development S.A.	<u>Total</u>
As at the beginning of period	20 000	20 000
<i>Issue of bonds</i>	235 000	235 000
<i>Redemption of bonds by issuer</i>	(196 000)	(196 000)
As at the end of period	59 000	59 000
As at the end of period, after discount	-	-

Issue and buy-back of bonds in 2016	P3 Ekon Sp. z o.o. S.K.A.	<u>Total</u>
As at the beginning of period	-	-
<i>Issue of bonds</i>	40 000	40 000
<i>Redemption of bonds by issuer</i>	(20 000)	(20 000)
As at the end of period	20 000	20 000
As at the end of period, after discount	-	-

The above bond issues were carried out as part of Emperia Group's cash flow management programme.

27. Fees to entity authorised to audit financial statements

Information on fees for the entity authorised to audit financial statements is presented in note 6.3.25 to Emperia Holding S.A.'s consolidated financial statements for 2017.

28. Remuneration of Management Board and Supervisory Board members

As specified in the relevant regulations established by the Supervisory Board, remuneration of Emperia Holding S.A.'s Management Board comprises a salary component and a pay bonus component.

Remuneration paid to Emperia Holding S.A.'s Management Board members in 2017 (cash basis):

First and last name	Total salary	Pay bonus	Material considerations and sick pay	TOTAL
Kalinowski Dariusz	122.9	4 094.7	-	4 217.6
Baran Cezary	116.9	1 856.5	-	1 973.4
TOTAL	239.8	5 951.2	-	6 191.0

Remuneration paid to Emperia Holding S.A.'s Management Board members in 2017 for work at subsidiaries (cash basis):

First and last name	TOTAL
Kalinowski Dariusz	523.6
Baran Cezary	305.8
TOTAL	829.4

Remuneration of Emperia Holding S.A. Supervisory Board members in 2017:

First and last name	Salary
Kawa Artur	86.40
Kowalczewski Michał	43.20
Laskowski Artur	43.20
Wawerski Jarosław	43.20
Widera Aleksander	43.20
TOTAL	259.20

29. Declaration on application of corporate governance principles

The declaration on application of corporate governance principles is presented in the 2017 report on Emperia Group's operations.

30. Management Board declarations

The Management Board of Emperia Holding S.A. declares that to the best of its knowledge the annual financial statements and comparative data are drawn up in accordance with International Financial Reporting Standards and interpretations, published in the form of Commission Regulations, and that they correctly, reliably and clearly reflect the Company's financial and asset position together with its financial performance, and that the report on Company operations contains a true depiction of the development, achievements and situation of the Company and the Group, including a description of key threats and risks.

The Management Board of Emperia Holding S.A. further declares that the entity authorised to audit financial statements, which audited the Company's annual financial statements, was selected in accordance with the provisions of law and that this entity and the statutory auditors conducting the audit fulfilled the conditions for issue of an impartial and independent report on audit of the separate annual financial statements in accordance with binding regulations and professional standards.

Warsaw, 15 March 2017

Signatures of all Management Board members:

Dariusz Kalinowski President of the Management Board

.....
Signature

Cezary Baran Vice-President of the Management Board

.....
Signature

Signatures of persons responsible for book-keeping

Elżbieta Świniarska Economic Director

.....
Signature