REPORT

of the Supervisory Board on results of the assessment of the financial statements of BGŻ S.A. and the activity report of the Management Board of the Bank or the year ended 31 December 2014, and the recommendation of the Bank's Management Board on the profit distribution for the year ended 31 December 2014 together with the assessment of adequacy and effectiveness of the internal control system at the Bank

Pursuant to Article 382 §3 of the Code of Commercial Companies, the Supervisory Board of Bank Gospodarki Żywnościowej S.A. conducted an assessment of the financial statements of the Bank for the year ended 31 December 2014, the Management Board Report on the activities of BGŻ S.A., and the recommendation of the Management Board on the allocation of the profit for the year ended 31 December 2014.

The aforementioned assessment has been made based on:

1. The financial statements covering:
- profit and loss account for the period from 1 January 2014 to 31 December 2014, showing a net profit of PLN 137 730 thousand,
- statement of total income for the period from 1 January 2014 to 31 December 2014, showing a total income of PLN 301 630 thousand,
- statement of financial position prepared as at 31 December 2014 showing total assets of PLN 40 484 204 thousand,
- statement of changes in total equity for the period from 1 January 2014 to 31 December 2014, disclosing an increase in equity by PLN 646 813 thousand,
- cash flow statement for the period from 1 January 2014 to 31 December 2014, disclosing a positive net cash in the amount of PLN 299 341 thousand; and
- accounting principles (policies) and additional explanatory notes.

2. Management Board Report on the activities of BGŻ S.A. in 2014.

3. Motion of the Management Board on the profit distribution for the year ended 31 December 2014.

4. Opinion and report of the independent statutory auditor – KPMG Audyt Spółka z ograniczoną odpowiedzialnością Sp.k. – appointed to audit the financial statements based on the resolution of the Supervisory Board No. 1/2013 of 28 January 2013.

The Supervisory Board states as follows:

Ad.1. Financial statements

Based on the assessment of the financial statements of BGŻ S.A. for the year ended 31 December 2014, the Supervisory Board has concluded that these financial statements, in all material aspects, have been prepared:

- in accordance with the International Financial Reporting Standards approved by the European Union;
- based on properly maintained accounting records;
- in accordance with the provisions of the law governing preparation of the financial statements and provisions of the Bank's Statute influencing the form and content of the financial statements;

and give a fair and clear view of all information material for the evaluation of the financial result of business activities for the period from 1 January 2014 to 31 December 2014, as well as the economic and financial position of BGŻ S.A. as at 31 December 2014.

Selected financial data and ratios

tPLN	31.12.2014	31.12.2013	Change	
Profit (loss) before tax	179 376	204 437	(25 061)	(12,3%)
Net profit (loss)	137 730	162 403	(24 673)	(15,2%)
Total equity	4 151 875	3 505 062	646 813	18,5%
Balance sheet total	40 484 204	35 763 492	4 720 712	13,2%

Financial ratios	31.12.2014	31.12.2013	Change
Return on equity (ROE)(1)	3,5%	4,7%	(1,2 p.p.)
Return on assets (ROA)(2)	0,4%	0,4%	0,0 p.p.
Net interest margin (NIM)(3)	2,9%	2,7%	0,2 p.p.
Costs / Income (C/I)(4)	67,4%	68,2%	(0,8 p.p.)
Loans / Deposits(5)	101,9%	104,0%	(2,1 p.p.)
Solvency ratio	13,8%	13,2%	0,6 p.p.

(1) Net profit to average equity calculated based on balances as at the end of the quarters (annualised).
(2) Net profit to average assets calculated based on balances as at the end of the quarters (annualised).
(3) Result on interest to average assets calculated based on balances as at the end of the quarters (annualised).
(4) Total administrative costs and depreciation/amortisation to total result on banking activities and other operating income and costs.
(5) Carrying amount of loans and advances granted to clients (gross) to liabilities to clients. Balances as at the end of the period.

Assets

As at the end of 2014 the total value of the Bank's assets amounted to PLN 40 484 204 thousand and was by PLN 4 720 712 thousand, i.e. by 13.2% higher than at the end of 2013.

Asset structure was dominated by loans and advances to customers which share decreased by 0.4 p.p. compared to 31 December 2013. In terms of volume it increased by PLN 3 327 163 thousand, i.e. 12.6% and was the main factor of assets increase. Increased loan activity was a result of, among others, acquisition of Rabobank loans portfolio amounting to PLN 1.9 billion as at 18 June 2014 (PLN 1.2 billion as at 31 December 2014).

Additionally financial assets available for sale increased by PLN 2 257 944 thousand, i.e. 46.8% due to increase of PLN 1 849 916 thousand of NBP bills and treasury bonds (of PLN 418 176 thousand).

Cash remained at similar level, but balances with Central Bank fluctuated and was followed by the current needs of the Bank to settle the obligatory reserve requirements. Declared obligatory reserve in December 2014 amounted to PLN 1 086 490 thousand (compared to PLN 896 724 thousand in December 2013).

As at 31 December 2014 investment in associates includes only shares in Bankowy Fundusz Nieruchomościowy Actus Sp. z o.o. On 10 September 2014 BGŻ and De Lage Landen International B.V. signed a sale agreement of shares of BGŻ Leasing Sp. z o.o. with the Head Office in Warsaw. By the agreement BGŻ disposed 42 373 shares of total net nominal value of PLN 42 373 000 (nominal value of one share amounts to PLN 1 000) which accounted for 49% of share capital of BGŻ Leasing. The sale price amounted to PLN 35 005 thousand. The transfer of shares' ownership occurred on 11 September 2014 as a result of termination of cooperation agreement between BGŻ S.A., BGŻ Leasing and De Lage Landen International.

Liabilities and equity

As at the end of 2014 total value of Bank's liabilities amounted to PLN 36 332 329 thousand and was by PLN 4 073 899 thousand (i.e. 12.6%) higher than at the end of 2013.

Main increase factor were amounts due to customers. Increase was mainly a result of:

- increase of liabilities due to other financial entities by PLN 3 175 167 thousand, primarily due to acquisition of Rabobank's liabilities under the agreement signed by Societe Anonyme De Gestion D'Investissements Et De Participations ("Sagip"), BNP Paribas SA and Rabobank on 19 September 2014. As at 31 December 2014 state of the loan capital amounted to PLN 2 286 332 thousand;
- increase of amounts due to corporate clients and budget entities by total PLN 974 565 thousand (i.e. 10.7%). In analyzed period amounts due to farmers decreased in the volume of current accounts by PLN 158 578 thousand, what was partially off-set by increase of volume of term deposits (increase of 101.2%);
- increase of amounts due to retail customers by PLN 2 162 246 thousand (i.e. 13.2%), resulting mainly from increase of volume of term deposits by PLN 2 603 559 thousand, what increased their share by 10 p.p. in liabilities of this segment. Volume of deposits collected by BGŻOptima increased by 22% in this period.

Liabilities from debt securities issuance have been reduced by PLN 429 015 thousand (i.e. 36.0%) as a result of non-renewal of expiring portion of securities in a situation of Bank's reduced demand for funding. As at 31 December 2014 state of issuance of deposit certificates amounted to PLN 755 000 thousand (nominal value) compared to 1 184 000 (nominal value) as at 31 December 2013.

By the end of 2014 Bank's equity amounted to PLN 4 151 875 thousand and was by PLN 646 813 thousand higher than at the end of 2013. The change in equity during the period was the result of merger with Rabobank Polska. There was an increase of other supplementary capital by PLN 345 726 thousand (i.e. 11.2%) and other reserve capital by PLN 320 758 thousand (i.e. 155.4%), which covered lower financial result generated in 2014, compared to 2013 (decrease by PLN 24 673 thousand).

Profit and loss account

In 2014, the Bank generated **net profit** of PLN 137 730 thousand i.e. PLN 24 673 thousand lower than in 2013 (15.2%). Main factors impacting the net result were single one-offs. In IV quarter of 2014 the Bank created higher allowances for impairment of assets, mostly due to review of loan portfolio by BNP Paribas Group, review of assets quality of (AQR) by the PFSA and creating of additional provisions for potential impact of Russian embargo. Additionally, integration costs related to the upcoming merger resulted in higher administrative costs. Above mentioned negative factors were partially off-set by higher net interest income as well as net fee and commission income.

If impact of mentioned above one-off events and integration costs were eliminated, net profit would amount to PLN 237 400 thousand and would be by 46% higher than in 2013.

In 2014, **net interest income**, being the main source of income, increased by PLN 114 284 thousand, i.e. 11.4%, what was an effect of reducing interest expenses by PLN 218 924 thousand, i.e. 24.4% y/y, off-setting decrease of interest income of PLN 104 640 thousand, i.e. 5.5% y/y. Both external factors and growth rate of commercial volumes had impact on the level of interest income and expense.

Among the external factors should be mentioned policy of the Polish National Bank regarding shaping of basic interest rates. In 2013, occurred six interest rates cuts of total value of 1.75 p.p. Another cut in October 2014 pushed the interest rates to the record low level (reference rate was set at 2%).

Interest income from loans and advances to customers is the biggest position in the structure of interest income (67%). However, their value decreased by PLN 28 190 thousand (2.3%) in comparison to 2013, mostly due to interest rate cuts combined with the fact that significant part of loan volume is based on the variable rate.

The decrease in interest expense was caused mainly by the reduction of interest expense on amounts due to customers by PLN 147 243 thousand (i.e. 21.8% y/y), mainly due to cuts in interest rates on deposits following NBP reference rate cuts. Price adjustments of deposits to the low interest rate level, which started in the second half of 2013, had positive impact on net interest result in 2014.

Net fee and commission income in 2014 was higher by PLN 22 569 thousand, i.e. 7.8% y/y in comparison to 2013. This was mainly due to the increase in fee and commission income by PLN 23 532 thousand (i.e. 7.1% y/y) and simultaneous increase in fee and commission expense by PLN 963 thousand (i.e. 2.1% y/y).

Increase in the net fee and commission income was a result of higher income on:

- account maintenance – thanks to the increase in the number of accounts and the effect of changes to the Fees and Commissions Table,
- loans and advances - primarily in mikrocompanies segment,
- brokerage operations – due to focusing on retail services and selected institutional clients, constant increase of distributed investment funds, higher activity on primary market and service of tender offer for BGŻ shares, the Bank recorded good results of the Brokerage Office, which resulted in 57.9% increase of fees and commissions from brokerage operations.

Interchange fee cut since 1 July 2014 and lower income from card organizations due to transactional bonuses resulted in decrease of PLN 2 114 thousand (i.e. 2.6%) of net fee and commission income from payment cards in comparison to 2013.

The increase of fee and commission expense was mainly caused higher costs of loans and advances, partially off-set by lower costs of insurance products sale.

Dividend income in 2014 increased by PLN 455 thousand, i.e. 16.0%.

Net trading income in 2014, was lower by PLN 16 701 (i.e. 20.8% y/y) thousand than in 2013. The level and volatility of this result is shaped mainly by the valuation of the Bank's position in the instruments of interest rate swaps (IRS) as a hedge against interest rate risk, and trading activity on debt securities whose profitability is dependent on the accuracy of predicted changes on the market.

The most significant impact on the net trading income had the negative valuation of derivatives in the 1st, 2nd and 4rt quarter of 2014, which was partially off-set by positive result generated in the period from August to September.

Result on investing activities in 2014 fell by PLN 7 437 thousand (i.e. 23.3%) compared to 2013. The main component of the result of investment activity remained realized gains on the portfolio of securities available for sale, even though it was lower by PLN 14 671 thousand than in 2013. The decrease was partially off-set by low allowances for impairment on investments in subsidiary (PLN 47 thousand compared to PLN 7 321 thousand as at the end of 2013 created due to financial net loss of BGŻ Leasing Sp. z o.o.).

Other operating income decreased by PLN 13 211 thousand (i.e. 26.6%) as at the end of 2014 compared to the analogical period of the previous year, mostly due to decreased income from recovery of overdue, amortized and uncollectable debts, and repayment of debts excluded from statement of financial position, in which in 3Q 2013 the Bank recognized a substantial income from payment of receivable from a corporate client from agricultural sector, which was earlier written off from the Bank's balance sheet.

Moreover, in 4Q 2013, the Bank partially (PLN 7 788 thousand) released provision for penalty imposed on the Bank by the President of the Office of Competition and Consumer Protection in 2006 regarding fees from credit cards – due to decision of court about decrease of penalty.

General administrative expenses in 2014 increased by PLN 51 340 thousand (i.e. 5.2%) compared to 2013, primarily due to increase in personnel expenses, external services, the Bank Guarantee Fund fee (new prudential fee), combined with lower marketing costs.

In 2014, **other operating expenses** increased by PLN 8 344 thousand (i.e. 39.5%) in comparison to 2013, primarily due to higher debt collection costs by PLN 3 193 thousand (i.e. 42.3%) being a result of increased engagement of external law firms in servicing debt collection process and higher by PLN 1 626 thousand costs of impairment charges on other receivables.

Loan portfolio quality

As at 31 December 2014 the share of loans with identified impairment, in the portfolio of loans and advances granted to customers amounted to 8.0% in comparison to 8.1% as at 31 December 2013.

Change of this indicator was mainly a result of lower share of impaired exposures in the cash loans portfolio (9.8% as at 31 December 2014 compared to 13.2% in 2013), what was a result of dynamic growth of this portfolio (increase of volume by 34% y/y) and of decrease of share of impaired exposures in the portfolio of mortgage loans decreased from 5.2% to 4.2%.

Equity and solvency ratio

The capital adequacy ratio increased from 13.22% at the end of 2013 to 13.78% at the end of the 2014.

Own funds increased by PLN 371 103 thousand, which was the result of the merger with Rabobank Polska and in particular of following factors:

- increase of equity by PLN 5 002 thousand – due to issuance of H series shares;
- increase of supplementary capital, of which: (i) retained Bank's net profit from 2013 in amount higher by PLN 28 060 thousand than in 2012, (ii) capital created as a result of merger – PLN 183 323 thousand;
- increase of supplementary capital and general risk fund by total PLN 156 859 thousand due to merger.

Assessment made by the Supervisory Board

After reviewing the financial statements of BGŻ S.A. for the year ended 31 December 2014 prepared by the Management Board and the independent registered auditor's opinion and report, the Supervisory Board decides to issue a positive opinion on the financial statements of BGŻ S.A. for the year ended 31 December 2014 and to recommend the Ordinary General Meeting to approve these financial statements.

Ad.2. Management Board Report on the activities of BGŻ S.A. in 2014

The Supervisory Board concludes that the Management Board Report on activities of Bank Gospodarki Żywnościowej S.A. for 2014 contains information consistent with the information included in the financial statements for the year ended 31 December 2014. The Supervisory Board recommends the Ordinary General Meeting of BGŻ S.A. to approve the Management Board Report on activities of BGŻ S.A. in 2014 and to grant a vote of acceptance to the Members of the Management Board in respect of their duties.

Ad.3. Recommendation of the Management Board on 2014 profit allocation

The Supervisory Board would like to express a positive opinion on the recommendation of the Management Board to allocate net profit for the period from 1 January 2014 to 31 December 2014 in the amount of PLN 137 730 149.06 to the supplementary capital of BGŻ S.A. After the General Meeting of BGŻ S.A.'s approval of the proposed allocation of net profit for 2014, the Bank's supplementary capital would equal PLN 3 568 515 397.57.

Assessment of adequacy and effectiveness of the internal control system at the Bank

The organisation of the internal control system is in line with the banking law requirements and resolution of the Polish Financial Supervision Authority No. 258/2011 and it encompasses the risk control mechanisms (including: functional control), checking the compliance of the Bank's activities with the provisions of law and internal regulations, as well as the internal audit. The internal control system is adjusted to the specifics of the conducted activity and takes into consideration the Bank's resources. The Bank performs periodic verification of the risk control mechanisms functioning in the Bank. Besides, the effectiveness of key control mechanisms is tested in selected areas.

The Management Board of the Bank is responsible for the effectiveness of the risk management system, internal control system, internal capital assessment and reviews, the internal capital assessment and maintenance process, and for the supervision over the efficiency of these processes, making necessary adjustments and improvements in case of a change of the risk level in the Bank's activity, economic environment factors, and irregularities in systems and processes functioning. Moreover, the Management Board determines the principles of functioning of the organizational units which participate in the Bank management, and is responsible for the preparation, introduction, and update of the written policies, strategies, and procedures in this respect.

The Supervisory Board performs supervision over the internal control system and evaluates its adequacy and effectiveness via the Bank's Internal Audit Committee. The Committee performs assessment, among others, on the basis of the results of audits conducted by the internal audit unit, about which it is informed in quarterly reports on audits and recommendations issued after them. Besides the Committee becomes familiar with the progress in the realization of the recommendations issued by the internal audit unit, external auditor and the Polish Financial Supervision Authority.

The Committee was informed about the changes in the Audit Plan and the level of its realization. The Internal Audit Department monitors the situation in the Bank on the current basis, including the realization of the key undertakings and changes in its environment and – if needed – makes necessary adjustments in the Audit Plan.

The Internal Audit Department supports the Bank in achieving its targets by the checking and assessing, in an independent and objective manner, the compliance as well as adequacy and effectiveness of the internal control system, the correctness and effectiveness of the systems and internal procedures in the Bank, and by providing opinions on the Bank's management system, including the effectiveness of management of the risk related to the Bank's activity.

Compliance is, in addition to the Internal Audit, a significant element of the internal control system.

The term “compliance” embraces employee behaviours, systems and processes taking place in the Bank, and means compliance with the requirements arising out of commonly applicable regulations, as well as regulations within Bank and standards of conduct, with a special emphasis on market behaviours.

In the Bank there is a dedicated unit responsible for the monitoring and assessment of non-compliance risk.

This assessment is based on: assessment of the key risks in the area of compliance, monitoring of Bank’s units, opinions issued by the Compliance Department to the internal regulations and risk assessment carried out within the process of implementing new Bank’s products and services.

Results of such assessment are presented to the Management Board and, further, to the members of the Supervisory Board by delivering reports of the activities of the Compliance Department to the Internal Audit Committee.

The Compliance unit supports the decision making process in the Bank ensuring that proper aid is given to the Bank’s Management and Supervisory Boards with regard to identification and assessment of compliance risk, and acting as an advisory function, points to potential dangers, and also presents proposed solutions concerning effective management of compliance risk.

The Operational Risk Management Department supervises and coordinates the process of implementation of functional control in the Bank, carried out semi-annually, as well as the process of verification of the mechanisms and procedures of internal control in the Bank, realised annually. Functional control is realised semi-annually by managers of all units of the Bank (network and Head Office units), or by persons appointed by them. Periodical functional control covers verification of correctness of operation of individual areas, and risk self-assessment. With respect to the functional control process, the monitoring of post-control recommendations implementation rated as high and medium risk, is undertaken.

The Operational Risk Management Department prepares semi-annual reports including the results of functional control, indicating the areas with biggest irregularities identified, and in consultation with the competent units actions are determined, aiming at elimination of irregularities in the future. The reports are presented to the Management Board for approval.

The process of verification of mechanisms and procedures of internal control is realized every year through self-assessment of risk and control environment by managers supervising individual areas of the Bank’s activity (owners of control processes and mechanisms). The purpose of the review is identification of possible gaps in the control environment, including potential ineffectiveness of some controls. The review results in a report indicating cross-sectional data and statistics with respect to currently applied in the Bank control mechanisms, as well as deficiencies in the control process. In case of analysis shows gaps and irregularities, such report indicates actions to be taken to eliminate such gaps/ irregularities. The report is presented to the Management and Supervisory Board for approval.

Assessment of adequacy and effectiveness of risk management with regard to risks essential for the Bank

The system of risk management in the Bank is a formal system governed, i.e., by the policy of managing capital adequacy of the bank (ICAAP), policy of managing retail exposures risk, strategy of managing risk, specifying the Bank's appetite for key risks associated with the Bank's activity, approved by the Supervisory Board. The Bank has a list of essential risks, approved by the Management Board, and the system of their measuring, limiting and reporting. The limits and thresholds for the major risks are specified once a year and reflected in the risk appetite statement of Bank BGŻ. The Bank regularly monitors and reports compliance with the limits, and if a limit is exceeded, the Bank takes actions to restore the situation where the risks are held within the limits specified by the Management and Supervisory Boards of the Bank. Regular monitoring and reporting cover also the size and type of deviations from the principles and policies applicable in the Bank.

The Management Board of the Bank and the relevant Committees approve detailed policies and principles of risk management and perform daily supervision over the risk management system. The Bank has a Balance Sheet and Risk Management Committee (BRMC) which is responsible for managing all kinds of risk important in the Bank's activity, including also through dedicated committees:

a) Liquidity Sub-committee,
b) Operational and Compliance Risk and Fraud Preventing Sub-committee,
c) Product Sub-committee,
d) Credit Policy, Monitoring and Control Sub-committee,
e) Ethics Sub-committee.

The Supervisory Board of the Bank receives quarterly information on essential risks in the activity of the Bank, in the form of report „Risk Dashboard". The scope of information reported covers assessment of the Bank's exposure to credit risk (including: stress tests and concentration risks) operational risk (including: compliance and HR risks), market, interest rate and liquidity risks. The Management Board receives, via BRMC and dedicated sub-committees, regular complex monthly information on the Bank's exposure to credit, operational, financial liquidity and market risks and the banking book interest rate risk. The reports and information are presented at meetings of the committees which decide on the actions to be taken if the Bank's takes excessive risk.

In 2014 the Bank continued to enhance its risk management system. The major actions in this respect were associated with the extension of the product and client scope covered by the monitoring of overdue payments, as part of the in-house soft vindication. The improvement included the process of granting loans, monitoring clients, credit ability and creditworthiness criteria, both with regard to retail and institutional clients. A number of changes were initiated and implemented regarding the limiting of the level of operational risk the Bank was taking. As a result of those actions the level of losses associated with operational risk events dropped significantly. Financial liquidity risk remained under effective, strict control. The Bank acted in compliance with the external regulatory liquidity standards, optimising at the same time the level and structure of liquidity in the context of credit business, lower than planned. Market risk was held within the strict internal limit grid and, as to the principle, remained at a low level. In 2014 the Bank more actively managed its banking book interest rate risk which allowed it to earn additional incomes in the portfolio of securities for sale while at the same time maintaining the level of risk taken under the limits set.

Conclusion

In the opinion of the Supervisory Board the system of internal controls is adequate for the level of activity and complexity of the activities of the Bank. Additionally the key risks are managed adequately accordance with adopted policies.