



**Report on the activities of**

# **Ceramika Nowa Gala SA**

for the period of 1 January–31 December 2014

Końskie, 19 March 2015

## **1. PRINCIPLES OF PREPARATION OF THE ANNUAL FINANCIAL STATEMENTS**

The financial statements of Ceramika Nowa Gala SA are prepared in accordance with International Financial Reporting Standards (IFRS). All data have been derived from the accounting records and off-balance sheet records.

Methods used to measure assets and liabilities and the financial profit (loss) are presented in the financial statements.

## **2. INFORMATION ON THE KEY PRODUCTS**

Products and goods sold by the Company can be divided into four categories:

- unglazed stoneware tiles (including polished and semi-polished ones);
- glazed stoneware tiles (including semi-polished ones);
- decorative elements;
- ceramic powder.

### **2.1. Unglazed tiles**

#### **Salt and pepper**

The name of this kind of tiles is derived from their appearance, as their granular structure resembles the mixture of salt and pepper. Products of this kind are offered by the largest number of manufacturers. In accordance with the strategy adopted by Ceramika Nowa Gala, this product line is a complementary one.

#### **Quarzite**

Quarzite tiles have a more complex design (structure) compared to the Salt and pepper line. They are an important item as regards sales of Ceramika Nowa Gala. This collection includes also tiles with polished surface. These tiles are particularly well suited for industrial and commercial buildings, with heavy traffic (aisles).

#### **Magma**

This collection is inspired by volcanic lava. It is distinguished by a clearly marked structure. A five-colour range (white, dark beige, red, light and dark grey) and two types of surface (natural and semi-polished) enable laying the tiles in a variety of combinations. The tiles are available also in a size of 60x120 cm.

#### **Dolomia**

The collection is inspired by natural basalt rocks. It is available in a modular system (a number of different sizes can be combined), in six colours: white, black, light grey, dark grey, light brown, dark brown, and with two types of surface: natural and semi-polished. The collection is complemented with borders and mosaics with metal and quartz glass inserts.

#### **Concept**

The collection is inspired by natural sandstone and loess. It is characterized by a minimalist design. The tiles are available with two types of surface: polished and natural, and in a large size: 60x120 cm.

#### **Zenith**

Zenith tiles are characterized by a soft linear drawing in monochrome colours. Besides natural and polished surface, the tiles are available also with structural surface which provides slip resistance in areas where it is particularly important to ensure safety conditions. The collection is complemented with two lines of modern decors, manufactured using the modern waterjet technology.

## **Neutro**

A minimalist collection whose design resembles concrete structure. The tiles are formed using the double charge technology, by combining two layers: the base and top (micronized) one. The drawing is diverse, yet subdued and limited to a homogeneous range of colours. The same colours used in both layers allow for obtaining a tile with a uniform cross-section. In this collection, polished tiles are also available.

## **Prestige**

A collection inspired by old stone slabs, with marks of long use: subtle cavities, highlighted by the play of light on a relief structure. Prestige tiles come in subdued shades of grey.

## **Basis**

A "salt and pepper" type collection complemented with decorative elements with inclusions. The tiles in this collection are manufactured in five colours corresponding to the current market trends.

## **2.2. Glazed tiles**

Glazed tiles offered by Ceramika Nowa Gala are manufactured in production facilities belonging to other companies in the Group.

## **Orientale**

The design of these tiles resembles natural stones. Dimensional accuracy, achieved through mechanical processing of the edges (rectification) is an additional advantage of this product. Due to their excellent performance properties, the tiles are suitable for finishing both interior surfaces (walls, floors, window sills) and external facades, stairs, terraces or balconies.

## **Travertino**

A collection designed for a very demanding customer appreciating the combination of the natural appearance of floors and wall with unique technical parameters of stoneware tiles. The dry glaze technology enabled to obtain remarkable surface: smooth and natural, yet resistant to abrasion and staining. The tile faithfully reproduces the structure of travertine, surpassing, however, its strength parameters.

## **Signum**

The tiles making up this collection have a minimalist design, with slight glitter sheen on a matte surface. Though these tiles are recommended especially for buildings such as shopping centres, they are enjoyed also by individual customers. The collection is distinguished by its high stain and abrasion resistance. It is available in a modular system. The colours used in the Signum collection include: light and dark beige, brown and light and dark grey.

## **Stonewood**

Tiles with a drawing resembling natural wood, intended to be used both as floor and wall cladding. The collection is complemented with decorative borders and mosaics. The sizes correspond to the characteristics of the collection (board): 30x60, 15x60 and 10x60 cm. A modular system enables arranging the tiles in different combinations. All tiles are rectified.

## **Muscat**

The tiles in this collection have strong colours of soil and are inspired by stone structures. The granilla layer applied on the surface of the tiles resembles water drops. The tiles are produced in sizes of 60x60 and 30x60 cm, in five colours, and have natural or semi-polished surface. The collection includes floral ornaments, made using a novel sanding method.

## **Trend Stone**

A collection of tiles whose design has been derived from natural stones with minimalist appearance. The tiles are offered in two colour ranges – grey and beige. Both the graphics and the colour range correspond to modern trends found in the design of ceramic tiles. Due to their subdued colours of soil and natural satin surface, the tiles can be used in different types of buildings. Tiles in sizes of 60x60, 30x60 and 30x30 cm can be complemented with a wide selection of mosaics used as decorative elements of wall and floor cladding.

## **Lumina**

This modern collection is available in five vibrant colours. Glossy surface in the semi-polished version enhances the impression of colour sharpness. The tiles are complemented with modern decors. The collection is designed for finishing of interior walls and floors.

## **Everstone**

The collection is inspired by the appearance of natural basalt, made up of various fine grains, and the tiles have monochrome colours. The surface is distinguished by a fine texture and sparkling inclusions. The tiles are complemented with monochrome mosaics.

In 2015, further work is planned as regards the development and modernization of the product portfolio.

### **2.3. Decorative elements**

Decorative elements are complementary elements of the offer. Not only do they increase its attractiveness, but they are also a source of additional revenues. Most of them are manufactured in the Company's production facility provided with modern equipment for processing stoneware tiles.

### **2.4. Tiles polished for the purposes of Ceramika Gres SA subsidiary**

As part of cooperation between the companies in the Group, Ceramika Nowa Gala SA renders to Ceramika Gres SA subsidiary services involving polishing of certain product lines. The process is organized as follows: Ceramika Nowa Gala SA purchases from Ceramika Gres SA semi-finished stoneware tiles, processes them in its own facility in which the tiles are polished, and sells the finished product back to Ceramika Gres SA. Those sales are recognized in the separate financial statements as sales of glazed tiles.

### **2.5. Ceramic powder**

Ceramic powder is a semi-finished product from which ceramic tiles are made in the pressing and firing processes. The powder is produced by mixing, milling and drying mineral raw materials. Ceramika Nowa Gala SA produces high quality ceramic powder in a wide range of colours both for its own purposes and for sale, mainly to Ceramika Nowa Gala II subsidiary, where by its processing ceramic tiles are obtained.

### 3. DATA ON SALES AND SELLING MARKETS

#### 3.1. Percentage sales structure

Amounts in PLN thousand (PLN '000).

|                       | 2014           |             | 2013           |             |
|-----------------------|----------------|-------------|----------------|-------------|
| Unglazed tiles        | 71,409         | 48%         | 77,453         | 49%         |
| Glazed tiles          | 46,398         | 32%         | 51,836         | 34%         |
| Decors and step tiles | 6,879          | 5%          | 7,928          | 5%          |
| Ceramic powder        | 11,106         | 8%          | 15,638         | 10%         |
| Other sales           | 9,486          | 7%          | 6,162          | 4%          |
|                       | <b>145 278</b> | <b>100%</b> | <b>159 017</b> | <b>100%</b> |

#### 3.2. Quantitative sales structure

|                | 2014   |                 | 2013   |                 |
|----------------|--------|-----------------|--------|-----------------|
| Unglazed tiles | 2,202  | thousand sq. m. | 2,405  | thousand sq. m. |
| Glazed tiles   | 1,253  | thousand sq. m. | 1,336  | thousand sq. m. |
| Ceramic powder | 20,719 | tonnes          | 27,468 | tonnes          |

A decrease in sales was recorded in respect to all items except for "other sales". An increase in "other sales" is mainly due to a change in the range of services provided to the companies in the Group.

#### 3.3. Sales by selling markets

Amounts in PLN thousand (PLN '000).

|                 | 2014           |             | 2013           |             |
|-----------------|----------------|-------------|----------------|-------------|
| Domestic market | 123,702        | 85%         | 131 330        | 83%         |
| Export          | 21,576         | 15%         | 27 687         | 17%         |
|                 | <b>145,278</b> | <b>100%</b> | <b>159 017</b> | <b>100%</b> |

The decrease in sales was recorded both in the domestic markets and exports, yet compared to 2013, the decrease rate was significantly greater in export markets. Domestic sales declined by almost 5.8%, while export sales fell by 22%. Export performance was adversely affected by the conflict in Ukraine and the depreciation of the national currencies in the eastern markets, which significantly worsened the competitive edge of our products.

Customers of the Company's products are diversified. Except for the subsidiaries to which ceramic powder, tiles and raw materials are sold and services are rendered, the share of any customer did not exceed 10% of revenues, therefore the Company is not dependent on one or several external customers.

### 4. SUPPLY SOURCES

In 2014, the most significant suppliers included subsidiaries:

- Ceramika Nowa Gala II which supplied tiles manufactured in its plant (the total production of this company is distributed by Ceramika Nowa Gala SA which has a sales department and warehouses);
- Ceramika Gres SA which supplied semi-products (tiles to be polished) and advertising materials, including displays.

Besides the subsidiaries, the most important suppliers of the Company included local providers of gas and electricity as well as producers and distributors of materials used in production (feldspars, clays, mineral pigments, enamels, etc.). The Company procures commercially available natural resources used in the production of tiles, mainly imported ones due to a higher quality of raw materials. The suppliers are diversified and, except for two subsidiaries: Ceramika Nowa Gala II Sp. z o.o. and Ceramika Gres SA, the share of any

of them does not exceed 10% of supplies.

## **5. INFORMATION ON ORGANIZATIONAL RELATIONSHIPS AND TRANSACTIONS WITH RELATED PARTIES**

Information on the structure of the Group and transactions with related parties is provided in the financial statements.

## **6. INFORMATION ON SIGNIFICANT AGREEMENTS**

### **6.1. Agreements on purchase of fuel gas entered into by the companies in the Group (events after the balance sheet date)**

On January 23, 2015, Ceramika Nowa Gala SA and its subsidiaries: Ceramika Gres SA and Ceramika Nowa Gala II Sp. z o.o. entered into agreements on purchase of fuel gas with PGNiG Obrót Detaliczny Sp. z o.o. All the agreements have been concluded for an indefinite period. The estimated total value of purchases under these agreements for the period of 5 years will be approx. PLN 130,482 thousand. The most important details concerning the agreement of the highest value are as follows:

- the agreement was concluded by Ceramika Gres SA subsidiary;
- the price to be paid by the subsidiary for received fuel gas will depend on the current tariff;
- the debtor's consent for voluntary submission to enforcement of up PLN 2,500 thousand will be used as a performance bond;
- where the actual annual purchase of fuel gas is lower than the minimum quantity specified in the agreement, the subsidiary will be required to pay the seller liquidated damages in the amount of 75% of the price for uncollected fuel gas;
- the agreement has been concluded for an indefinite period;
- the Polish zloty is the currency of the agreement;
- the value of purchases made under the agreement within 5 years is estimated at approx. PLN 58,137 thousand.

## **7. INFORMATION ON ENTERING BY THE COMPANY OR A SUBSIDIARY THEREOF INTO ONE OR MORE TRANSACTIONS WITH RELATED PARTIES, WHERE SUCH TRANSACTIONS ARE SIGNIFICANT, EITHER INDIVIDUALLY OR COLLECTIVELY, AND WERE CONCLUDED ON TERMS OTHER THAN ON AN ARM'S LENGTH BASIS**

In the period covered by this report, neither Ceramika Nowa Gala SA nor its subsidiaries entered into transactions with related parties, which would be significant, either individually or collectively, and concluded on terms other than on an arm's length basis.

## **8. LOANS CONTRACTED IN 2014 AND SURETIES AND GUARANTIES GRANTED WITHIN THAT YEAR**

### **8.1. Loans**

#### **8.1.1. Loan agreement with mBank SA concluded on 28 January 2014**

In order to purchase manufacturing equipment, in January 2014, the Company contracted a 5-year investment loan at mBank SA (former BRE Bank SA) in the amount of EUR 680 thousand. The deadline for payment of the last instalment falls on January 25, 2019.

#### **8.1.2. Loan agreement with Bank Handlowy SA of 25 April 2014**

The deadline for payment of the overdraft line of credit granted to the Company by Bank Handlowy w Warszawie SA was set at April 25, 2014. On April 25, 2014, Ceramika Nowa Gala SA signed a revolving credit facility agreement with Bank Handlowy w Warszawie SA,

with the repayment deadline set at April 22, 2016, while maintaining the existing collateral and limit.

### **8.1.3. Annex to the loan agreement with Bank Pekao SA**

The deadline for repayment of the overdraft line of credit in the amount of PLN 15,000 thousand granted to the Company by Bank Pekao SA fell on 30 September 2014. On September 29, 2014, Ceramika Nowa Gala SA signed an annex to the loan agreement which extended the deadline for payment to September 30, 2016, while maintaining the existing collateral. At the same time, the Company decreased its existing overdraft limit from PLN 15,000 thousand to PLN 9,000 thousand, in line with the strategy which assumes debt reduction.

## **8.2. Loans received**

No loans were contracted by the Company in 2014.

## **9. INFORMATION ON GRANTED LOANS AND GUARANTEES**

### **9.1. Loans granted**

In January 2014, Ceramika Nowa Gala SA increased the loan for CNG Luxembourg S.à.r.l. by EUR 60,000 and extended the deadline for its repayment until March 31, 2015. In December 2014, the subsidiary repaid the total interest accrued by that time and the capital in the amount of EUR 120 thousand. The amount of the loan granted to the subsidiary (without accrued interest) is currently EUR 25 thousand. At the same time, the deadline for repayment of the remaining amount has been postponed till December 31, 2015.

### **9.2. Guarantees granted**

No financial guarantees were granted in 2014.

### **9.3. Sureties granted**

Due to the refinancing of the working capital credit performed by Ceramika Gres SA subsidiary (see also section 7.2.1 in the consolidated report on the operations of the Group), Ceramika Nowa Gala SA and Ceramika Nowa Gala II Sp. z o.o. provided ING Bank Śląski SA with surety on behalf of Ceramika Gres SA up to the amounts of: PLN 21,000 and PLN 10,000, respectively. At the same time, the analogous guarantees granted to Alior Bank SA expired.

No other sureties were granted except those granted on behalf of the companies in the Group.

## **10. ULIZATION OF PROCEEDS FROM ISSUED SECURITIES**

No security placements were carried out in 2014.

## **11. IMPLEMENTATION OF FINANCIAL FORECASTS**

The Company did not publish any forecasts in 2014.

## **12. ASSESMENT OF FINANCIAL RESOURCES MANAGEMENT**

Ceramika Nowa Gala SA implements a policy of maintaining a secure asset financing structure so that the cash flow generated by the current operations less capital expenditure commitments allows for settling liabilities of the Group, with due account of a margin of safety.

At the end of 2014, the Group's equity represented 78% of total assets. The current liquidity ratio was 3.04, and the Company settled its commitments on an ongoing basis (minor delays occurred as regards certain trade liabilities). All indicators related to working

capital management improved compared to the previous year. With a dividend paid from the subsidiary at a level lower than in 2013, in 2014 the Company incurred a loss. The Company is the parent company in the Group, hence it should be remembered that the analysis of the separate statement of financial position does not fully reflect its financial position.

#### **Selected economic indicators\***

|                                | <b>2014</b> | <b>2013</b> |
|--------------------------------|-------------|-------------|
| Current liquidity ratio        | 3.04        | 2.49        |
| Current liquidity ratio II     | 1.29        | 0.99        |
| Return on assets               | -0.78%      | 12.99%      |
| Return on equity               | -1.01%      | 16.45%      |
| Net return on sales            | -1.28%      | 22.16%      |
| Receivables turnover (in days) | 91          | 99          |
| Liabilities turnover (in days) | 61          | 77          |
| Inventory turnover (in days)   | 160         | 179         |

\*In the case of indicators in which the balance sheet data were used, the analysis was based on data derived from the closing balance

### **13. ASSESSMENT OF FEASIBILITY OF INVESTMENT PLANS**

The Group's development strategy for 2014-2016 announced by Ceramika Nowa Gala (see section 15.2) assumes an increase in capital expenditure in the total amount of PLN 45 million, whereby expenditure in the amount of PLN 20 million for the development of logistics and warehouses depends on an improvement in financial performance of the Group.

The Group develops appropriate measures for the implementation of other planned replacement and modernization investments, which means that there are no plans to increase the existing loan debt.

### **14. UNUSUAL EVENTS AFFECTING THE FINANCIAL STATEMENTS OF THE COMPANY**

The following unusual events occurred in 2014:

- decrease in profit due to production downtime: PLN 7.845 thousand;
- offsetting the remaining part of the dividend paid by Ceramika Nowa Gala II Sp. Z o.o. subsidiary to the parent company (see section 34);
- dividend payment (see section 35);
- acquisition of treasury shares from a subsidiary without compensation – a impairment on shares in that subsidiary (see section 31);
- redemption of treasury shares (see section 30).

### **15. EXTERNAL AND INTERNAL FACTORS IMPORTANT FOR THE DEVELOPMENT OF THE COMPANY AND ITS BUSINESS DEVELOPMENT PROSPECTS**

#### **15.1. Economic situation**

Due to the dependence of the demand for tiles on the economic situation, GDP growth and the development of the construction industry in Poland – which is the main selling market for the Company – are of great importance for its operations. In the case of Ceramika Nowa Gala SA, the sales performance is adversely affected by the exacerbating conflict in Ukraine (see section 25.2.1).

#### **15.2. Strategy and development of the Group for which the Company is its parent company**



On March 12, 2014, the Management Board announced a new development strategy of the Ceramika Nowa Gala Group for 2014-2016. Its key assumptions are as follows:

- sales growth at the annual rate of 5% within the period covered;
- EBITDA margin increase by the end of 2016 by 7 percentage points until it reaches approx. 17% as a result of carrying out strategic initiatives in three main areas:
  - a. increasing utilization of production capacity (margin increase of 4-5 percentage points);
  - b. new technologies (investments in production of unglazed tiles and digital printing should result in a margin increase of 1-2 percentage points);
  - c. process optimization (a number of activities, including product offer simplification, purchase consolidation, redundancies, process simplification, should result in a margin increase of 3 percentage points);
- shortened supply chain with regard to ceramic tiles distribution;
- allocation of a total of PLN 45 million for capital expenditure in the period of 2014-2016, including PLN 10 million for replacements maintenance, PLN 15 million for modernization and new technologies and PLN 20 million for the development of logistics and warehouses;
- maintaining the average level of working capital and the average interest debt at the levels from the end of 2013;
- redemption of treasury shares held by the Group (9,220,757 shares representing 16.43% of share capital) in 2014;
- proposal to introduce a dividend policy assuming an annual allocation of at least 30% of the Group's net consolidated profit for dividend payment, no more, however, than PLN 0.1 per share.

## **16. AMENDMENTS TO THE PRINCIPLES OF MANAGEMENT OF THE COMPANY AND THE GROUP FOR WHICH IT IS THE PARENT COMPANY**

No amendments to the principles of the management of the Company and the Group for which it is its parent company were introduced in 2014.

## **17. CHANGES IN THE COMPOSITION OF THE MANAGING AND SUPERVISORY BODIES**

The composition of the managing and supervisory bodies of the Company remained the same as in 2013. The Supervisory Board of Ceramika Nowa Gala SA is composed of:

- Mr. Paweł Marcinkiewicz: Chairman of the Supervisory Board;
- Mr. Grzegorz Ogonowski: Vice Chairman of the Supervisory Board;
- Mr. Łukasz Żuk: Member of the Supervisory Board;
- Mr. Wojciech Włodarczyk: Member of the Supervisory Board;
- Mr. Jacek Tomasiak: Member of the Supervisory Board.

The Management Board of the Company is composed of:

- Mr. Waldemar Piotrowski, acting as President of the Management Board;
- Mr. Paweł Górnicki, acting as Vice President of the Management Board.

Mr. Zbigniew Polakowski acts as a proxy in Ceramika Nowa Gala SA and Ceramika Nowa Gala Sp. z o.o. subsidiary.

## **18. AGREEMENTS WITH MANAGING PERSONS PROVIDING FOR COMPENSATION IN THE CASE OF THEIR RESIGNATION OR DISMISSAL**

Under the contracts of employment, each member of the Management Board is entitled to severance pay in the amount of three months' basic salary. All members of the Management Board have signed non-competition agreements. Members of the Management Board are entitled to compensation during the non-competition period.

## 19. REMUNERATION AND BONUSES PAID OR PAYABLE TO THE MANAGING AND SUPERVISORY PERSONS

### 19.1. Remuneration and other benefits paid to the managing persons (gross)

Amounts in PLN thousand (PLN '000).

| Name and surname    | CNG SA     | CNG II     | CGR SA     | CNG Lux   | Total        |
|---------------------|------------|------------|------------|-----------|--------------|
| Waldemar Piotrowski | 386        | 87         | 216        | 26        | 715          |
| Paweł Górnicki      | 272        | 57         | 179        | 26        | 534          |
| Zbigniew Polakowski | 141        | 81         | 60         | -         | 282          |
| <b>Total</b>        | <b>799</b> | <b>225</b> | <b>455</b> | <b>52</b> | <b>1 531</b> |

### 19.2. Remuneration paid to members of the Supervisory Board (gross)

Amounts in PLN thousand (PLN '000).

| Name and surname    | Company | Amount     |
|---------------------|---------|------------|
| Paweł Marcinkiewicz | CNG SA  | 60         |
| Grzegorz Ogonowski  | CNG SA  | 54         |
| Wojciech Włodarczyk | CNG SA  | 48         |
| Łukasz Żuk          | CNG SA  | 48         |
| Jacek Tomasiak      | CNG SA  | 48         |
| <b>Total</b>        |         | <b>258</b> |

## 20. OUTSTANDING LOANS, GUARANTEES, SURETIES, ETC. GRANTED BY THE COMPANY OF SUBSIDIARIES THEREOF TO THE MANAGING AND SUPERVISORY PERSONS, OR TO PERSONS AFFILIATED WITH THEM

So such transactions occurred as of the last day of the reporting year.

### 21. SHARES OF THE COMPANY HELD BY THE MANAGING AND SUPERVISORY PERSONS

According to the information available to the Company in 2014, there was no change in the ownership of the Company's shares by the Issuer's managing and supervisory persons. As of the date of this report, it follows from the information available to the Issuer that:

- Mr. Waldemar Piotrowski, acting as President of the Management Board, holds: 10,806,249 shares of the Company, representing 23.04% of the share capital and authorizing their holder to the same number of votes at the General Shareholders Meeting;
- Mr. Paweł Górnicki, acting as Vice President of the Management Board, holds: 352,077 shares of the Company, representing 0.75% of the share capital and authorizing their holder to the same number of votes at the General Shareholders Meeting;
- Mr. Zbigniew Polakowski, acting as a proxy, holds: 12,070 shares of the Company, representing 0.02% of the share capital and authorizing their holder to the same number of votes at the General Shareholders Meeting.

### 22. INFORMATION ON SIGNIFICANT SHAREHOLDERS

According to the information obtained by the company, the following shareholders hold shares authorizing them to at least 5% of votes at the General Shareholders' Meeting. This information was determined based on communications received by the Company from shareholders or based on the number of shares from which a given shareholder was entitled to dividend payment.

| Shareholder  | Number of shares taken up | Percentage share in the share capital | Number of votes at the General Meeting | Percentage share in votes at the General Meeting |
|--|---------------------------|---------------------------------------|--|--|
| Waldemar Piotrowski  | 10,806,249                | 23.04%                                | 10,806,249                             | 23.04%   |
| MetLife Otwarty Fundusz Emerytalny                                   | 9,356,722                 | 19.95%                                | 9,356,722                              | 19.95%   |
| PTE Allianz Polska SA  | 6,049,157                 | 12.90%                                | 6,049,157                              | 12.90%   |
| Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK                        | 5,834,364                 | 12.44%                                | 5,834,364                              | 12.44%   |
| ING Otwarty Fundusz Emerytalny and ING Dobrowolny Fundusz Emerytalny | 3,293,725                 | 7.02%                                 | 3,293,725                              | 7.02%  |

There are no securities conferring special control right with respect to the Company. Shares of the Company bear no restrictions as to the transfer of property rights or limitations on the exercise of voting rights.

### **23. INFORMATION ON AGREEMENTS KNOWN TO THE COMPANY, AS A RESULT OF WHICH CHANGES IN THE PROPORTIONS OF SHARES HELD BY THE EXISTING SHAREHOLDERS MAY OCCUR IN THE FUTURE**

The Company is not aware of any such agreements.

### **24. INFORMATION ON AGREEMENTS WITH CERTIFIED AUDITOR**

The financial statements of the Company were audited by TPA Horwath Horodko Audit Sp. Z o.o. The audit of the financial statements for 2014 was carried out under an agreement concluded on July 10, 2014. The agreement concerns audit of the separate financial statements of the Company for 2014, the consolidated financial statements of the Company for 2014, review of the interim separate financial statements as of June 30, 2014 and review of the interim consolidated financial statements as of June 30, 2014. The total net remuneration of the audit firm under the aforementioned agreement is PLN 44.9 thousand. TPA Horwath Horodko Audit Sp. z o.o. is also entitled to net remuneration of PLN 29.1 thousand under agreements concerning audit of annual separate financial statements and review of semi-annual financial statements of the subsidiaries. The audit firm is also entitled to reimbursement of actual audit costs.

In 2013, the financial statements of the Group were audited by TPA Horwath Horodko Audit Sp. z o.o. as well. The audit firm rendered services to the companies in the Group under agreements of July 1, 2013. The services included:

- review of the interim separate financial statements of the Company, the separate financial statements of the subsidiaries and the consolidated financial statements of the Company as of June 30, 2013;
- audit of the annual separate financial statements of the Company, the separate financial statements of the subsidiaries and the consolidated financial statements of the Company as of December 31, 2013.

TPA Horwath Horodko Audit Sp. z o.o. received under the agreements concluded in 2013 remuneration in the amount of PLN 69 thousand plus VAT and reimbursement of the actual costs of the audit.

## **25. DESCRIPTION OF SIGNIFICANT RISK FACTORS WITH INFORMATION ON THE EXTENT TO WHICH THE COMPANY IS EXPOSED TO THEM**

### **25.1. Risk factor related to the activities of the Company**

#### **25.1.1. Risk associated with increased production costs**

The production plant belonging to the Company consumes during the production process significant quantities of natural gas, electricity and raw materials. An increase in the prices of gas, electricity or raw materials may adversely affect the performance of the Company, in particular with respect to gas and electricity, in the case of which the Company is dependent on single suppliers with monopolistic positions. The Company attaches great importance to cost control and reduction at various stages of production. In 2014, the positive tendency of electricity prices to fall was stopped and reversed. It follows from talks and negotiations that in 2015, electricity prices will be higher than in previous years. The Company has taken active steps to diversify gas suppliers, hoping that such action will lead to a reduction in the costs of purchase of raw material.

#### **25.1.2. Risk associated with incomplete use of the Company's production capacity**

After a decline in sales in 2014, no upturn in the domestic market is expected in 2015. The situation in the eastern markets is deteriorating while that in the European Union is becoming increasingly more uncertain (see below). Given the above and in the absence of sales growth, it will be necessary to reduce production in order to adapt it to the level of sales. This approach is considered advantageous, as liquidity can be maintained at a safe level. However, this means that some of the fixed costs of production will continue to have a direct effect on the financial profit (loss) of the Company.

#### **25.1.3. Risks associated with the availability of high-quality raw materials used in the production process**

The Company uses high-quality raw materials to produce ceramic tiles. . In order to obtain high quality homogeneous ceramics it is necessary to use ingredients with a low level of impurities. For colours to be vivid, a mass which does not darken after firing needs to be applied. There is a risk of limited availability of raw materials with the required quality (part of the raw materials is imported from eastern Ukraine, in an area which is not, however, covered by the war), and the Company may be forced to modify formulations used by them. The Company hedges against this risk by developing alternative formulations, using substitute ingredients.

#### **25.1.4. Risk associated with changes in consumer preferences**

The ceramic tiles market is sensitive to trends, which forces manufacturers to keep up with the varying preferences of consumers. Any mismatch between the offered product range and customers' expectations gives rise to a risk of excessive inventory or being forced to sell products at lower prices. The risk associated with a failure to match the product range with the tastes of buyers increases as the offer is extended with new designs. To reduce this risk the Company monitors prevailing market trends and adjust their product portfolio to the tastes and requirements of customers.

### **25.2. Risk factors related to the environment in which the Company operates**

#### **25.2.1. Risk associated with the macroeconomic and political situation**

Despite optimistic forecasts, the economic and political environment in which the Company operates continues to be characterized by a very high degree of instability. Economic

forecasts for Poland and the European Union account for a high degree of uncertainty. The situation in Greece after the parliamentary elections and the risk of another recession observed in numerous EU countries make this uncertainty even greater. Currently, it is the situation in Ukraine that is the most severe threat to the Company. The adverse effects of this situation experienced by the Company are as follows:

- decline in sales to Eastern Europe countries;
- the risk of insolvency of customers from this region;
- significant reduction in the price competitiveness of products offered in eastern markets as a result of the depreciation of the currencies used in those countries;
- increased competition in the domestic market as a result of the decline in exports of other manufacturers' products to eastern markets;

There are also potential risks (which have not materialized yet), arising from the situation described above:

- increase in prices of natural gas or reduction in its supplies;
- increase in prices of raw materials essential for the production of tiles (clay) or reduction in their supplies.
- increase in prices of raw materials essential for the production of tiles (clay) or reduction in their supplies.

#### **25.2.2. Risk associated with the activities of competitors**

The Company positions its products in the higher end of the market, dominated traditionally by Italian and Spanish companies. As regards cost-effective products, the domestic competition is of the greatest significance. As a result of the economic downturn recorded in recent years and a sharp decline in exports to eastern markets (the conflict in Ukraine), increased competition has been observed in relation to all segments. The Company makes every effort to maintain its position as the leading manufacturer of ceramic stoneware floor tiles by seeking actively new opportunities for expansion of its capacities to strengthen the Company. Furthermore, to maintain its competitive edge the Company continuously improves and expands its product portfolio.

#### **25.2.3. Risk of increased competition from manufacturers of finishes other than ceramic tiles**

Ceramic tiles for wall and floor cladding are one of the most popular finishes. The Company competes to some extent with manufacturers of other materials such as natural stone and wood. There is a risk that in the future new or existing finishes will become an attractive substitute for ceramic tiles. Such a situation could adversely affect the level of sales and the performance of the Company.

#### **25.2.4. Risk associated with the instability in Eastern European and Asian markets**

The Company sells part of its products in Eastern Europe and Eurasian markets. Regardless of the risks described in section 2.1, claim enforcement in these regions can be difficult due to the still vague rules governing the operation of these markets and the conflict between Russia and Ukraine. This risk is mitigated by the lending policy with respect to customers.

#### **25.2.5. Risk associated with the tax system**

The Polish tax system is characterized by frequent changes in laws, many of which are not defined clearly enough, leaving room for ambiguous interpretation. Interpretations of the tax laws change frequently, and both the activities of tax authorities and case law in the field of taxation remain patchy. The harmonization of tax law in the EU Member States is another factor contributing to reduced stability of the Polish tax law. Due to divergent interpretations

of tax regulations, the risk that the solutions used by the reporting entity in this area will be considered incompliant with tax regulations is greater in the case of a Polish company than in the case of a company operating under more stable tax systems. One of the aspects of insufficient precision in tax laws is the lack of provisions providing for formal procedures for final verification of the accuracy of tax liabilities for the period. Tax returns and the amount of actual payments on this account can be controlled by the tax authorities for five years from the end of the year in which tax was to be paid. Adoption by the tax authorities of a different interpretation of tax laws than that assumed by the Company may have a material adverse effect on the Company's operations, its financial condition, performance and prospects for development. The Company does not anticipate any threat of this type, though it cannot be completely ruled out. The same risk exists for mandatory burden due to social and health insurance.

### **25.3. Financial risk as well as the purposes and principles of its management**

The main financial instruments used by the Company include bank loans, cash and short-term deposits. The main purpose of these financial instruments is to raise funds for the Company's business activities. The Company has also other financial instruments, such as trade receivables and payables that arise directly in the course of its business. The Company has also interests in other business entities, but the value of these interests is immaterial. The Company did not enter into any transactions involving derivatives. The principle applied by the Company at present and throughout the period covered by the financial statements is no trade in financial instruments.

The main risks arising from financial instruments held by the Company include the interest rate risk, currency risk and credit risk. The Management Board reviews and adopts policies for managing each of these risks. These policies are briefly described below. The magnitude of this risk in the period concerned is shown below as well. The accounting principles applied by the Company in relation to financial instruments have been discussed in the introduction to the financial statements.

#### **25.3.1. Interest rate risk**

At present, the assets and liabilities recognized in the statement of financial position are not subject to fluctuations due to changes in interest rates. However, due to the fact that the Company uses financing sources with variable interest rates, an increase (decrease) in base rates or an increase (decrease) in margins used by financial institutions may result in an increase (decrease) in financial expenses. The Company does not use cash flow hedges against changes in interest rates.

#### **25.3.2. Risk associated with foreign exchange rates**

The Company carries out import and export transactions in foreign currencies (the US Dollar and the Euro) on a significant scale. Change in exchange rates against the Polish zloty may result in profits lower than expected. Foreign exchange volatility affects the profit (loss) by:

- changes in the value of export sales denominated in PLN and production costs denominated in PLN, in the part relating to imported raw materials;
- changes in the competitiveness of the Company's offer in export markets;
- changing costs of raw and other materials as well as energy and services purchased in Poland, whose prices depend, either directly or indirectly, on currency exchange rates;
- realized foreign exchange differences arising between the date of sale or purchase and the date of payment of receivables or payables;
- unrealized foreign exchange differences on measurement of accounts and other monetary items as of the balance sheet date;

- varying intensity of competition associated with prices of imported tiles.

The risk of foreign exchange volatility is largely offset, as the Company carries out foreign transactions involving both export and import. Trade transactions in foreign currencies (import and export) are part of the normal course of business pursued by the Company. Therefore, future cash flows from such transactions are subject to the risk of change in their value resulting from foreign exchange volatility, and at the same time the available instruments hedging against foreign exchange risk are limited due to uncertainty prevailing in export markets. In particular, the level of offsetting expenses and income denominated in foreign currencies has become less predictable.

### 25.3.3. Credit risk

Receivables from customers are associated with credit risk. Each year, part of receivables is lost (write-downs are made). Credit risk related to receivables from customers is limited by:

- limiting exposure to a single entity (credit limits);
- diversification through cooperation with multiple entities, so that none of them has a dominant position;
- insuring the majority of receivables;
- daily control of exposure facilitated by an integrated IT system;
- other security measures (e.g. promissory notes, bank guarantees or letters of credit).

Debt of individual customers is monitored and – in case of problems – action is taken to recover amounts due. In determining credit risk mitigation policies, lost profits arising from decreased sales to a given customer as a result of adopted restrictions are also taken into account.

### 25.3.4. Liquidity risk

The Company uses external financing which determines its liquidity. In order to ensure the availability of funding the Company maintains the proportion of debt in financing at a safe level. The table below shows maturity of the different classes of liabilities, beginning from the balance sheet date.

Amounts in PLN thousand (PLN '000).

| Class of liabilities             | Total         | up to 6 months | from 6 to 12 months | in 2015       | Subsequent years |
|----------------------------------|---------------|----------------|---------------------|---------------|------------------|
| Trade and other liabilities      | 22,829        | 22,829         | -                   | -             | -                |
| Payments under operating leases* | 5,533         | 1,266          | 1,308               | 1,840         | 1,119            |
| Loans eligible for refinancing** | 24,360        | 4,360          | 4,500               | 15,500        | -                |
| Loans to be repaid               | 3,628         | 189            | 378                 | 1,486         | 1,575            |
| <b>Total</b>                     | <b>56,350</b> | <b>28,644</b>  | <b>6,186</b>        | <b>18,826</b> | <b>2,694</b>     |

\*concerns the most significant lease agreements concerning office space and warehouse space as well as car and forklift rental agreements

\*\*amounts resulting from the maximum debt limits granted, regardless of the debt amount as of the end of 2014

In the case of significant agreements classified as operating leases that cannot be terminated or have a defined minimum contractual period of notice, the total amounts that the Company would have to pay for the period till the dates of expiry of the agreements is PLN 4,136 thousand.

## 25.4. Analysis of sensitivity of equity instruments to the risks to which these instruments are exposed

Amounts in PLN thousand (PLN '000), except for balances in foreign currencies.

| Financial instrument                     | Currency | Balance in the currency given on the left | Balance in PLN | Risk type        | Adopted fluctuation range | Sensitivity level |
|--|----------|---|----------------|------------------|---------------------------|-------------------|
| Foreign currency denominated receivables | EUR      | 263                                       | 1,120          | foreign exchange | +/-20%                    | +/-224            |
| Foreign currency denominated receivables | USD      | 505                                       | 1,771          | foreign exchange | +/-20%                    | +/-354            |
| Foreign currency cash                    | EUR      | 446                                       | 1,902          | foreign exchange | +/-20%                    | +/-380            |
| Foreign currency cash                    | USD      | 599                                       | 2,102          | foreign exchange | +/-20%                    | +/-420            |
| Foreign currency denominated liabilities | EUR      | 795                                       | 3,390          | foreign exchange | +/-20%                    | +/-678            |
| Foreign currency denominated liabilities | USD      | 156                                       | 546            | foreign exchange | +/-20%                    | +/-109            |
| Loans contracted in foreign currencies   | EUR      | 596                                       | 2,541          | foreign exchange | +/-20%                    | +/-508            |
| Variable interest rate loans             | EUR      | 596                                       | 2,541          | interest rate    | +/-3.00%                  | +/-76             |
| Variable interest rate loans             | PLN      | 16,580                                    | 16,580         | interest rate    | +/-3.00%                  | +/-497            |

## 26. DESCRIPTION OF SIGNIFICANT OFF-BALANCE SHEET ITEMS

The description of significant off-balance sheet item has been provided in the separate financial statements.

## 27. DESCRIPTION OF PROCEEDINGS PENDING BEFORE COURT, AN ARBITRATION AUTHORITY OR A PUBLIC ADMINISTRATION AUTHORITY

None of the judicial or administrative proceedings involving the Company or its subsidiaries concerns a dispute with a value in excess of 10% of the equity of the Company.

## 28. STATEMENT OF CORPORATE GOVERNANCE PRACTICES

The Company has drawn up a separate document in this regard, audited by a certified auditor and attached to the annual report.

## 29. INFORMATION ON THE CONTROL SYSTEM FOR EMPLOYEE STOCK OWNERSHIP PLANS

Currently, the Company does not operate any ESOPs.

## 30. ADOPTION BY THE GENERAL SHAREHOLDERS MEETING OF A RESOLUTION ON REDEMPTION OF TREASURY SHARES WITHOUT COMPENSATION AND DECREASE IN THE COMPANY'S SHARE CAPITAL

On June 30, 2014, the General Shareholders Meeting resolved to decrease the Company's share capital from PLN 56,114,378 to PLN 46,893,621 by redemption of 9,220,757 shares. The redemption of 8,983,608 shares held by CNG Luxembourg S.à.r.l. subsidiary did not include compensation, which was agreed to by the shareholder in the agreement on the transfer of the ownership of shares, concluded outside the regulated market between the shareholder and the Company (for more information see also section 31). The objective of



the redemption of 8,983,608 shares held by the subsidiary and 237,149 shares held by the Company was to organize the Company's shareholding structure and ensure its transparency and stability with regard to the shareholding structure in the future.

### **31. ACQUISITION OF TREASURY SHARES FROM A SUBSIDIARY WITHOUT COMPENSATION**

On September 19, 2014, Ceramika Nowa Gala SA acquired 8,983,608 treasury shares from CNG Luxembourg S.à.r.l. subsidiary without compensation. The transaction was made under the resolutions adopted at the General Shareholders Meeting of Ceramika Nowa Gala SA on June 30, 2014.

Although the aforementioned shares were the only significant assets of the subsidiary, their disposal did not result in winding up the company, which still operates.

As a result of the aforementioned transaction, the separate financial statements of Ceramika Nowa Gala SA include the shares in CNG Luxembourg S.à.r.l. as deducted by reason of impairment in the amount of PLN 23,838 thousand. At the same time, the treasury shares acquired without compensation have been recognized in equities (as negative values) in the amount resulting from their measurement at the moment of their contribution in kind to CNG Luxembourg S.à.r.l. This amount was equal to the book value of shares in the subsidiary, obtained in return for the contribution in kind. This means that it is equal to the value of the aforementioned write-down.

The results of both of these transactions were mutually offset, directly at the level of the parent company's equities, and they did not affect the total profit presented in the separate financial statements.

### **32. DECREASE IN THE AUTHORIZED SHARE CAPITAL OF THE COMPANY**

On October 16, 2014, the District Court in Kielce, Commercial Division of the National Court Register, registered a decrease in the Company's authorized share capital. After the registration, the share capital amounts to PLN 46,893,621 and consists of 46,893,621 series A shares.

### **33. INCREASE IN THE CAPITAL OF LUXEMBOURG S.à.r.l. – SUBSIDIARY OF CNG**

On August 6, 2014, the share capital of CNG Luxembourg S.à.r.l. was increased by EUR 200 thousand. The increase in the capital was paid entirely in cash by the parent company, Ceramika Nowa Gala SA.

### **34. OFFSETTING THE REMAINING PART OF THE DIVIDEND FROM THE SUBSIDIARY**

On June 26, 2013, the Annual Shareholders Meeting of Ceramika Nowa Gala II Sp. z o.o. subsidiary resolved that the net profit of the company for 2012 in the amount of PLN 12,678,303.72 and the amount of PLN 32,791,458.09 which comes from the reserve capital for the payment of dividend, would be allocated for the payment of the dividend for Ceramika Nowa Gala SA. The dividend was paid in instalments in the following manner:

- the amount of PLN 32,791,458.09 by 30 June 2013;
- the amount of PLN 12,678,303.72 – was offset against other accounts was on January 31, 2014.

This financial operation was not accounted for in the consolidated financial statements.

**35. PAYMENT OF DIVIDEND**

In accordance with Resolution No. 7 adopted by the General Meeting of Shareholders of Ceramika Nowa Gala SA on June 30, 2014, on October 15, 2014 the Company paid a dividend in the amount of PLN 3,751,489.68. This amount was part of the profit for 2013. Dividend from one share was PLN 0.08.