

## REPORT

### ON THE ACTIVITIES OF THE SUPERVISORY BOARD OF IZOSTAL S.A. FOR THE YEAR 2019

#### 1. COMPOSITION OF THE SUPERVISORY BOARD IN 2019

As at 31 December 2019, the Supervisory Board of Izostal S.A. was composed of the following persons:

Jerzy Bernhard	- Chairman of the Supervisory Board
Andrzej Baranek	- Vice-Chairman of the Supervisory Board
Grażyna Kowalewska	- Secretary of the Supervisory Board
Jan Kruczak	- Member of the Supervisory Board
Lech Majchrzak	- Member of the Supervisory Board
Adam Matkowski	- Member of the Supervisory Board

During the reporting period there were no changes in the composition of the Supervisory Board of Izostal S.A. The Supervisory Board acted in accordance with the Company's Articles of Association and its Regulations, which are publicly available on the Company's website.

The Supervisory Board of Izostal S.A. assessed the fulfilment of independence criteria by its individual members and, in accordance with the statements submitted by members of the Supervisory Board, four out of six members of the Supervisory Board, i.e. Mr Jan Kruczak, Adam Matkowski, Lech Majchrzak and Mrs Grażyna Kowalewska, fulfill the independence criteria referred to in principle II.Z.4 of the document "Best Practices for WSE Listed Companies 2016" and in Article 129 of the Act of 11 May 2017 on Expert Auditors, Audit Firms and Public Supervision.

There is one Audit Committee within the Supervisory Board of Izostal S.A., which consists of three members appointed by the Supervisory Board from among its members. The 8th term of the Audit Committee of the Supervisory Board worked in 2019 in the unchanged composition, which as at 31 December 2019 was as follows:

Jan Kruczak	- Chairman of the Audit Committee
Adam Matkowski	- Vice-Chairman of the Audit Committee
Andrzej Baranek	- Secretary of the Audit Committee

In accordance with the assessment of the Board, based on the statements by the members of the Audit Committee of the Supervisory Board of Izostal S.A., two members of the Audit Committee, i.e. the Chairman of the Audit Committee and Vice-Chairman of the Audit Committee meet the independence criteria referred to in Article 129 of the Act of 11 May 2017 on statutory auditors, audit firms and public oversight, and also meet the independence criteria within the meaning of the Code of Best Practice for WSE Listed Companies 2016, i.e. set out in Annex II to Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. In accordance with Article 129 of the Act of 11 May 2017 on statutory auditors, audit firms and public oversight, the Chairman of the Audit Committee has knowledge and skills in accounting or auditing financial statements, and two members of the Audit Committee have knowledge and skills in the industry in which the Company operates.

#### 2. ACTIVITY AND SELF-ASSESSMENT OF THE WORK OF THE SUPERVISORY BOARD

Members of the Supervisory Board of Izostal S.A. performed their duties on the basis of the provisions of the Commercial Companies Code, the Company's Articles of Association, the Regulations of the Supervisory Board and the "Code of Best Practice for WSE Listed Companies 2016". The Supervisory Board exercised permanent control and supervision over the current operating and financial activities of the Company, monitored the results achieved by the Company and the Izostal S.A. Capital Group, participated in providing opinions and

supervision over the implementation of the Company's strategic plans, and assessed the effectiveness of risk management systems significant for the Company, compliance, internal audit functions and the internal control system. Within the scope of its powers and duties, the Supervisory Board assessed the manner in which the Company fulfilled its disclosure obligations concerning the application of corporate governance rules and the provision of current and periodic information by issuers of securities. The Supervisory Board also assessed the rationality of the Company's sponsorship and charity policy.

The Supervisory Board fulfilled its tasks in 2019 at three meetings and in accordance with the Commercial Companies Code and the Regulations of the Supervisory Board adopted a resolution in a special mode. The Audit Committee held three meetings in 2019. Members of the Supervisory Board participated in Audit Committee meetings. In 2019, the Supervisory Board exercised permanent supervision and control over the current operating and financial activities of the Company, gave opinions and supervised the implementation of the Company's strategic plans and the performance of financial reporting obligations by the Company, making decisions in the form of resolutions, recommendations and arrangements, and issuing such opinions. All important issues discussed by the Supervisory Board and not requiring the adoption of resolutions were included in the minutes of the Board meeting in the form of motions and recommendations.

In the opinion of the Supervisory Board, the Board fulfilled its duties with due diligence, exercising its statutory and statutory competences. The Supervisory Board exercised constant supervision over the Company's activity, reviewing the matters reported by the Management Board of the Company as important and necessary for the efficient functioning of the Company and the effecting of its development.

### **3. ASSESSMENT OF THE COMPANY'S SITUATION**

The main topic and subject of permanent control and supervisory activities considered by the Supervisory Board in the reporting period was the analysis of the current economic and financial situation of the Company and key decisions taken in the area of the Company's business activity in 2019. The Supervisory Board monitored and analysed the implementation of the assumptions of the approved Company's Plan and capital expenditure plans on a quarterly, semi-annual and annual basis. The Supervisory Board also monitored and analysed the financial results of the Izostal S.A. Capital Group and investment plans implemented by Kolb Sp. z o.o., – a member of Izostal S.A. Capital Group. The Supervisory Board examined the Company's documents and obliged the Management Board to provide explanations and prepare current analyses and reports. In carrying out its statutory obligations, the Supervisory Board gave a positive opinion on the Management Board's Activity Report and the Financial Statements for the previous financial year and the Management Board's motion concerning the distribution of profit, requesting the General Meeting to approve them. The Supervisory Board positively assessed the work of the Management Board, which was the basis for a motion to grant a discharge to the Management Board members. The Supervisory Board considered and issued opinions on the matters being the subject of resolutions of the Ordinary General Meeting of Shareholders, and the Members of the Board took part in the General Meeting of Shareholders of the Company in a composition sufficient to provide explanations and answers to shareholders' questions. The Supervisory Board controlled the financial reporting process in the Company and the auditor's independence through the Audit Committee. In terms of risk management with respect to the process of preparing financial statements, the Company monitors on an ongoing basis the changes in external regulations and rules related to the preparation of financial statements. The Company's internal regulations are also updated on an ongoing basis in order to adapt them to the changing law. The Audit Committee familiarizes itself with the audit schedule and, through ongoing cooperation with the external auditor carrying out financial audit activities, monitors the process of preparing financial statements and the quality of cooperation with the Management Board. The Audit Committee also monitors the personal independence of the auditors and the independence of the Law Firm conducting the audit in relation to the members of the management and supervisory bodies and in relation to the Company itself. Every year the Supervisory Board evaluates the reports on the Company's operations and financial statements to the extent of their compliance with the books, documents and the actual state of affairs, and informs about the results of that evaluation in its report available on the Company's website.

The Supervisory Board assessed the effectiveness of the Company's significant risk management systems, internal audit function and internal control system. The Company's internal control system is a process implemented in response to the identified risk and constitutes an element of risk management. The Management Board of the Company on an ongoing basis identifies risks and monitors the areas of activity exposed to risk in order to implement protections limiting the level of risk.

When assessing the significant risk management system for the Company, the Supervisory Board takes into consideration the following risk areas:

1. Risk related to dependence on the largest customers

Due to the structural features of the Polish gas market, there is indirect dependence on companies: PGNiG S.A. (exploration, exploitation, marketing and distribution of gas) and O.G.P. Gaz-System S.A. (transmission system operator), as well as on their planned and implemented investments. In addition to sales made directly to O.G.P. Gaz-System S.A. and PGNiG S.A. the Company provides services for companies that are contractors or subcontractors of investment projects. In order to minimize the risk, Izostal S.A. is also looking for new markets both in Poland (private gas companies) and abroad. One of the elements of minimizing the risk is the Company's entry into the casing and mining pipes market. In connection with the launch of the Research and Development Centre for Steel Technologies and Products, the Company's range has been extended by conducting research and analyses of raw materials, developing new construction and technological solutions and introducing new products and services (GRP coating - a specialist coating for drilling and jacking) for companies from the gas, construction and steel industries.

2. Risk related to the quality assurance of offered services

The recipients of services and products offered by the Company are entities operating in the gas and petrochemical industries, which are characterized by high quality requirements. The quality of services offered by the Company is ensured by the implemented and adhered to principles of the Integrated Quality Management System according to the requirements of ISO 9001:2015, ISO 14001:2015, PN-N 18001:2004/OHSAS 18001:2007 and ISO 50001:2011. Pipe coatings produced by the Company meet the requirements of the highest quality standards and are constantly adjusted to new quality requirements. The quality of products and services offered by the companies from the Capital Group is ensured by the implemented and observed principles of Quality Management Systems and obtained certificates of conformity of products approved for use in the construction industry, issued and supervised by authorised certification bodies, confirming compliance with specific requirements.

3. Risk related to the general macroeconomic situation of Poland

The financial situation of the Capital Group companies is correlated with the macroeconomic situation in Poland. Financial performance is influenced by general factors such as GDP growth rate, investment growth rate, changes in the level of inflation, exchange rates, unemployment rate and the level of personal income of the population. There is a risk that if the pace of economic development in Poland and worldwide worsens or if instruments of shaping the economic policy of the state are applied which may have a negative impact on the functioning of the companies of the Capital Group, the financial results achieved may change. A particularly negative impact on the operations of the companies of the Capital Group may be caused by a decrease in investment outlays in the economy, a slowdown in GDP growth, uncontrolled inflation growth, an increase in the restrictive fiscal and monetary policy of the state.

This risk is minimized by the strategy of diversification of gas supply sources adopted by Poland and restrictive regulations imposed by the European Union in the field of environmental protection and CO2 emissions. The confirmation of new investments in the gas industry is the "Development plan to meet current and future demand for gaseous fuels for the period 2020-2029" adopted by O.G.P. Gaz-System S.A."

4. Risk of changes in prices of production factors

Profitability of anti-corrosive coating services provided by the Company depends on changes in the prices of production factors, including in particular the prices of chemical components, mainly polyethylene and polypropylene. The share of these factors in the cost structure is about 20%. Chemical raw material prices are highly correlated with oil prices in global markets, which, due to the current global political and economic

situation, may be subject to strong fluctuations. The above cost factors may affect the periodical deterioration of the Company's financial results and the level of profitability achieved.

In order to minimize the risk of changes in the prices of production factors, the Company's activity is guided by the strategy of diversification of their sources through cooperation with several entities at each stage of production. The Company's large financial potential also allows it to make purchases of materials for stocking in periods when their prices are at a low level.

#### 5. Risk related to price volatility of steel pipes

The price of steel pipe in the product "coated steel pipe" depending on the conditions is about 70% of the value. The high volatility of prices on the steel pipes market observed in recent years has an impact on the revenues and margins achieved by the Company. Izostal S.A., in order to avoid the risk related to the fluctuation of steel pipe prices, optimizes the stock levels by adjusting them to the scope of business activity. In special cases, steel pipes are purchased for stocking at current prices to supplement the assortment in quantities allowing for profitable sale of goods. When purchasing pipes for significant projects, Izostal S.A. negotiates prices with suppliers and concludes contracts allowing to maintain the negotiated price regardless of the situation on the steel market. Changes in pipe prices may affect revenues and profitability of Izostal S.A. both in the main coating segment and trade in goods. The Company secures itself against price changes in individual contracts; short-term changes in pipe prices have a limited impact on the profitability of individual contracts. However, in the long term, high pipe prices are favourable to the Company (at the level of revenues and margins), while a decrease in pipe prices may result in a decrease in revenues and profit on pipe sales.

#### 6. Foreign exchange rate risk

In connection with their export and import activities, the companies of the Capital Group are exposed to the risk of changes in foreign exchange rates. The dominant currency (after PLN) in commercial transactions is EUR. The companies of the Capital Group hedge the currency risk by concluding adequate currency transactions with deferred execution date.

#### 7. Trade credit risk

The companies of the Capital Group sell on deferred payment terms, which exposes them to the risk of insolvency of their customers. Recent years have shown the financial difficulties of companies operating in the general construction industry and road construction. In order to limit the risk to the maximum extent, the Group companies insure receivables and sell within the limits set by the insurance corporation. The exception is the sale to O.G.P. Gaz-System S.A., which Izostal S.A. decided to exclude from the insurance policy. The stable situation of this recipient guarantees no risk of insolvency and the exclusion significantly reduces the costs of the insurance policy.

In addition, the Supervisory Board, as recommended by the Audit Committee, with a view to limiting the risks of irregularities in the Company's operations, in particular such as susceptibility to actions constituting violations of law or ethical principles, authorized the Management Board to adopt and apply in the Company the Policy entitled "Rules of conduct in the event of material irregularities in the activities of IZOSTAL S.A." and "Procedures for reporting violations of law, procedures and ethical standards in IZOSTAL S.A."

In the opinion of the Supervisory Board, the management of the risk significant for the Company and internal control consisting in periodical control of risk management principles and compliance of this process with the adopted standards, as well as constant analysis of risk management in terms of opportunities for improvement in this area are appropriate and serve the purpose of developing mechanisms eliminating or minimizing the resulting risks. The main risk factors identified for the Company are monitored on an ongoing basis to determine whether their identification and measures taken to minimize individual risk areas are working properly and whether appropriate measures and solutions are in place.

Based on the analyses performed, the Supervisory Board considers that the risk management process in the Company, carried out by the Management Board of the Company within the scope of its operating activity together with the Company's managerial staff participating in the process of risk identification and prevention of its effects, is effected properly.

The Supervisory Board also positively assessed the compliance system operated by the Management Board and the Company's management. The Management Board, managers of organizational units and specialists have access to the Legalis legal information system and specialist press and available industry studies from

where they obtain information on changes in the law, applicable standards and get acquainted with the applicable legal interpretations. Cooperation with the legal office is undertaken on an ongoing basis, and in special cases the Company uses the opinions of external, specialized units. The company has signed a contract with a law firm to provide day-to-day services.

Moreover, the Supervisory Board positively assessed the functioning of internal control in the Company. In Izostal S.A., internal control is exercised by the Management Board, managerial staff and other employees within the scope of their assigned duties. The Company has an Investor Relations and Internal Audit Department. Internal control mechanisms ensure compliance of conducted activities with the rules and procedures developed for particular areas, including financial reporting, with the applicable regulations on accounting principles. The division of tasks related to the preparation of financial statements in the Company, control of the prepared statements by the auditor, as well as monitoring the process of preparing and verifying the statements by the Audit Committee and evaluation of the statements by the Supervisory Board, ensure the reliability and correctness of the information presented in the financial statements.

All important issues discussed by the Supervisory Board and not requiring the adoption of resolutions were included in the minutes of the Board meeting in the form of motions and recommendations.

In the opinion of the Supervisory Board, the Board fulfilled its duties with due diligence, exercising its statutory and statutory competences. The Supervisory Board exercised constant supervision over the Company's activity, reviewing the matters reported by the Management Board of the Company as important and necessary for the efficient functioning of the Company and the effecting of its development.

#### **4. ASSESSMENT OF THE MANNER IN WHICH THE COMPANY FULFILS ITS DISCLOSURE OBLIGATIONS CONCERNING THE APPLICATION OF CORPORATE GOVERNANCE SET OUT IN THE STOCK EXCHANGE REGULATIONS AND REGULATIONS CONCERNING CURRENT AND PERIODIC INFORMATION TO BE PROVIDED BY ISSUERS OF SECURITIES**

Izostal S.A. applies the corporate governance rules contained in the "Code of Best Practice for WSE Listed Companies 2016" adopted by the Exchange Supervisory Board by resolution of 13 October 2015.

In 2019 there were no changes in the application of corporate governance rules by Izostal S.A. According to the information provided by the Company in the report no. 1/2016 of 1 January 2016, in 2019 Izostal S.A. abstained from applying one recommendation: IV.R.2. and two specific rules: I.Z.1.20., IV.Z.2. listed in the "Code of Best Practice for WSE Listed Companies 2016".

In 2019, Izostal S.A. published current and periodic reports in accordance with the Regulation of the Minister of Finance of 29 March 2018 on current and periodic information provided by issuers of securities and conditions for recognising as equivalent information required by the laws of a non-member state. The Company complied with the adopted Regulations and Procedures, including:

- Regulations of the Insider Information Circulation in Izostal S.A,
- Procedure of restrictions on the purchase and sale of securities of Izostal S.A. in relation to persons performing managerial duties and persons closely related,
- Procedure of preparing and publishing current reports in Izostal S.A.
- Procedures of preparing and publishing separate and consolidated periodic reports.

On the basis of the information available to the Supervisory Board, the Supervisory Board has not found any violations of the regulations in this respect and positively assesses the manner in which the Company fulfils its disclosure obligations concerning the application of corporate governance and regulations concerning current and periodic information provided by issuers of securities.

## 5. ASSESSMENT OF THE RATIONALITY OF THE COMPANY'S SPONSORSHIP, CHARITY OR OTHER SIMILAR ACTIVITIES

The company, feeling a part of the local community, supports the region in which it operates and pursues social objectives by engaging in initiatives aimed at supporting education, sports and culture, as well as helping people in need.

The Company pursues the following objectives in the area of charity and sponsorship activities:

- building lasting relations with the community in order to increase recognition and trust towards the Company both as a company responsible for the local community and as a solid and honest employer;
- creating the best possible educational conditions for children and youth from Kolonowskie and the surrounding area;
- support for the lonely and disabled.

In the opinion of the Supervisory Board, social involvement of the company and the ethical way of conducting business bring benefits to both the society and the Company.

Therefore, the Supervisory Board positively assessed the rationality of the Company's sponsorship and charity policy.

Kolonowskie, 26.03.2020.

### Signatures of the Supervisory Board Members:

Jerzy Bernhard	- Chairman of the Supervisory Board	<i>/illegible signature/</i>
Andrzej Baranek	- Deputy Chairman of the Supervisory Board	<i>/illegible signature/</i>
Grażyna Kowalewska	- Secretary of the Supervisory Board	<i>/illegible signature/</i>
Jan Kruczak	- Member of the Supervisory Board	<i>/illegible signature/</i>
Lech Majchrzak	- Member of the Supervisory Board	<i>/illegible signature/</i>
Adam Matkowski	- Member of the Supervisory Board	<i>/illegible signature/</i>