Directors' Report of the BFF Polska Group Activity for the six months ended 30 June 2018

SPIS TREŚCI

1. Legal status and description of the BFF Polska Group

1.1.General information

The BFF Polska Group (the Group) is an international financial institution which focuses on providing financial products and services to entities operating in the medical and local government markets. The Group offers a wide range of services involving the financing of operating and investing activities. It provides off-the-shelf or tailored financial services which enable medical and local government market entities to optimally and effectively manage their funds.

The Group has a strong market position and high growth potential due to the fact that it has many years of experience, offers solutions tailored to its customers' current needs and liquidity position, ensures superior quality Group management and wins investors' confidence, which translates into a high and stable level of external financing.

Since June 2016 BFF Polska S.A. (previously: Magellan S.A.) and its subsidiaries have been part of an Italian banking group, BFF Banking Group (BFF) and together they form one of the largest and fastest-growing institutions providing financial solutions to the public and healthcare sectors in Europe.

1.2.Composition of the Group and capital and organizational relationships

The composition of the BFF Polska Group as at 30 June 2018:
- **BFF Polska S.A.** (previously: Magellan S.A.) — the parent;
- **BFF MEDFinance S.A.** (previously: MEDFinance S.A.) — a subsidiary; 100% of shares held by BFF Polska S.A.;
- **BFF Česká republika s.r.o.** (previously: Magellan Česká republika s.r.o.) — a subsidiary; 100% of shares held by BFF Polska S.A.;
- **BFF Central Europe s.r.o.** (previously: Magellan Central Europe s.r.o.) — a subsidiary; 100% of shares held by BFF Polska S.A.;
- **DEBT-RNT Sp. z o.o.** — a subsidiary; 100% of shares held by BFF Polska S.A.;
- **Komunalny Fundusz Inwestycyjny Zamknięty** — an investment fund; 100% of certificates held by BFF Polska S.A.;
- **MEDICO Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty** — an investment fund; 100% of certificates held by BFF Polska S.A.

Associates as at 30 June 2018:
- Kancelaria Prawnicza Karnowski i Wspólnik Spółka Komandytowa;
- Restrukturyzacyjna Kancelaria Prawnicza Karnowski i Wspólnik spółka komandytowa spółka komandytowa (since 8 April 2016, the law firm has been operating as an indirectly associated undertaking, via DEBT-RNT Sp. z o.o., a subsidiary of BFF Polska S.A).

Details of the BFF Polska Group companies and the individuals managing and supervising them, and changes in the companies' names made in 2018, are presented in Note 1 to the interim consolidated financial report for the six months ended 30 June 2018.

BFF Polska S.A., as the parent, carries out a full consolidation of the financial statements of BFF MEDFinance S.A., BFF Česká republika s.r.o., BFF Central Europe s.r.o., DEBT-RNT sp. z o.o., Komunalny FIZ and MEDICO NSFIZ.

2. Shareholding structure of the Parent

Banca Farmafactoring S.p.A. is the parent and the sole shareholder of BFF Polska S.A., holding 128,291,677 shares in the Company. Details of the Company's parent are presented in Note 1.3 to the interim consolidated financial report for the six months ended 30 June 2018.

In the reporting period, there were no changes in the shareholding structure of BFF Polska S.A.

3. Corporate bonds on the Catalyst market

Since 2016 BFF Polska S.A. corporate bonds have been quoted on the Catalyst market alternative trading system. The Company's corporate bonds, both zloty- and euro-denominated, were introduced onto the Catalyst market, into the Alternative Trading System operated by BondSpot S.A., and into the Alternative Trading System operated by the Warsaw Stock Exchange. The first bond series in the Catalyst alternative trading system was introduced in December 2016 and listed on 28 December 2016 for the first time. Further 16 bond series were introduced in February 2017 and their first date of listing was 17 March 2017.

Details of the bonds introduced for trading on the Catalyst market are presented in Note 12 to the interim consolidated financial report for the six months ended 30 June 2018.

4. Financial position of the Group

4.1. Sales and markets

In the six months ended 30 June 2018, the BFF Polska Group continued the provision of financial, financial intermediation and investment financing services for healthcare and local government entities.

The BFF Polska Group operates in the Polish market (BFF Polska S.A., BFF MEDFinance S.A., DEBT-RNT Sp. z o.o., Komunalny Fundusz Inwestycyjny Zamknięty, MEDICO Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty), the Czech market (BFF Česká republika s.r.o.), and the Slovak market (BFF Central Europe s.r.o.).

In the six months ended 30 June 2018, the BFF Polska Group executed contracts in a total amount of PLN 1,487,288 thousand, up PLN 164,483 thousand, i.e. 12%, compared with the six months ended 30 June 2017. The executed contracts were for the financing of investing and operating activities of entities operating in the medical market in Poland and in the Czech Republic and Slovakia, and the financing of operating and investing activities of local government entities and their suppliers.

In the six months ended 30 June 2018, the total value of on-balance sheet contracts executed by the Group amounted to PLN 1,176,389 thousand, compared with PLN 1,011,253 thousand in on-balance sheet contracts executed in the six months ended 30 June 2017, which denotes an increase of PLN 165,136 thousand, i.e. 16%. In the six months ended 30 June 2018, the total value of executed off-balance sheet contracts amounted to PLN 310,899 thousand – a decrease by PLN 653 thousand compared with the total value of off-balance sheet contracts executed in the comparative period.

On-balance sheet contracts performed correspond to financial assets which, as a result of contracts executed, were recognized in the Group's assets in the respective periods. Whereas, off-balance sheet contracts include framework and conditional agreements concerning the products offered by the Group, which do not increase the value of the Group's assets as at the date of signing.

The Group's contracts performed in the six months ended 30 June 2018 and in the comparative period of 2017 are presented in the following table:

Product type (PLN '000)	Performance 01/01/2018 — 30/06/2018	Performance 01/01/2017 — 30/06/2017*)	Change	Change %
On-balance sheet contracts	1,176,389	1,011,253	165,136	16%
Off-balance sheet contracts	310,899	311,552	-653	-
Total contracts	**1,487,288**	**1,322,805**	**164,483**	**12%**

*) The amounts for the comparative period presented in this table take into account amendments and annexes to the contracts executed until 30 June 2018.

The objective of the BFF Polska Group is to maintain business relationships with the largest possible number of business partners. During the reporting period, the Group was not dependent on any one business partner. With a view to ensuring the security of its assets, the Group diversifies its portfolio of financial assets and maintains the single client exposure at a safe level relative to the value of the portfolio of financial assets.

The Group believes that its markets have potential for growth. Mismatch in cash flows in the healthcare system generates constant demand for the services provided by the Group. Additionally, the Group is active in the market for financial services intended for local government entities. The Group believes that there is a growing demand for the financing of both operating and investment activities also in this market, which translates directly into increased interest in the products offered by the Group. A big potential for further growth is also associated with the Group's operation in foreign markets.

The public sector, in which the Group carries out its core activities, is characterized by limited risk of impairment of the financial assets acquired. The Group's financial asset portfolio is mainly composed of assets from public healthcare and local government entities which are not subject to bankruptcy law and whose debts are the responsibility of their founding institutions in the event of liquidation.

4.2. Proceeds and revenue

Proceeds, commission and commission equivalents comprise:

- proceeds, offsets and deductions concerning the realization of the portfolio of financial assets held — principal repayments (excluding proceeds from loans and finance leases);
- commission income and discount realized on each product;
- interest income from each product, classified as part of the core business activities.

	01/01/2018 to 30/06/2018	01/01/2017 to 30/06/2017
	(PLN '000)	(PLN '000)
Proceeds, commission and commission equivalents	411,630	451,936
Cost of realized proceeds	(315,567)	(365,066)
Realized sales of services	**96,063**	**86,870**
Realized sales of goods for resale	3,495	1,025
Total sales	**99,558**	**87,895**
Proceeds from the repayment of originated loans and leases	505,570	354,412
Total proceeds	**920,695**	**807,373**

In the six months ended 30 June 2018, the Group's turnover defined as the total proceeds from the portfolio of financial assets held (excluding proceeds from the repayment of originated loans and finance leases, and realized sales of goods for resale) was PLN 411,630 thousand, which denotes a decrease of PLN 40,306 thousand, i.e. 9%, compared with the turnover of the corresponding period of 2017. The cost of realized proceeds corresponds to realized financial assets stated at cost.

In the six months ended 30 June 2018, proceeds (including offsets, deductions and accrued income), plus repayments of loans originated by the Group, finance lease proceeds, and sales of goods for resale, amounted to PLN 920,695 thousand, which denotes an increase of PLN 113,322 thousand, i.e. 14%, compared with the comparative period.

In the six months ended 30 June 2018, the Group's revenue amounted to PLN 99,558 thousand, up PLN 11,663 thousand, i.e. 13%, compared with the revenue for the six months ended 30 June 2017.

4.3.Results of operations

In the six months ended 30 June 2018, the BFF Polska Group generated a net profit of PLN 27,474 thousand. The net profit for the six months ended 30 June 2018 was PLN 3,177 thousand, i.e. 13%, higher than the net profit generated in the comparative period.

Selected key financial information is presented below.

Category	**01/01/2018 - 30/06/2018 PLN '000**	**01/01/2017 — 30/06/2017 PLN '000**	**Change (H1 2018 — H1 2017)**	**Change as % of actual for 2017**
Proceeds, commission and commission equivalents, together with repayments of loans originated by the Group and leases	920,695	807,373	113,322	14%
Total sales	99,558	87,895	11,663	13%
Cost of financing of the portfolio	37,650	32,186	5,464	17%
Cost margin (sales less cost of goods sold and cost of financing)	58,654	54,723	3,931	7%
Costs by nature of expense	26,682	21,917	4,765	22%
Net profit	**27,474**	**24,297**	3,177	13%
Earnings per share (in PLN)	**0.21**	**0.19**	0.02	11%
On-balance sheet contracts – financial assets	1,176,389	1,011,253	165,136	16%
Value of the portfolio of financial assets (as at the end of the reporting period)[1]	2,862,687	2,144,998	717,689	33%
Operating margin (EBIT/sales)	33%	38%	-5 pp	-13%
Net profit margin (net profit/total sales)	28%	28%	-	-
Current ratio (current assets/current liabilities)	0.52	0.78	-0.26	-33%
Liabilities to assets ratio (total liabilities/total assets)	85%	81%	4 pp	5%
Financial leverage (interest liabilities/equity)	5.33	4.07	1.26	31%
Book value per ordinary share (in PLN)	3.46	3.22	0.24	7%

[1] Assets are presented at fair value equal to their cost of purchase, as adjusted for the measurement of financial instruments using the effective interest method.

Contracts performed in the six months ended 30 June 2018 made it possible for the Group to build a portfolio of financial assets of PLN 2,862,687 thousand as at 30 June 2018, which denotes an increase of PLN 717,689 thousand, i.e. 33%, compared with the comparative period.

The growing value of the Group's portfolio of financial assets translated into an increase in sales in the six months ended 30 June 2018 of PLN 11,663 thousand, i.e. 13%, compared with the six months ended 30 June 2017.

In the six months ended 30 June 2018, the cost of financing of the portfolio of financial assets amounted to PLN 37,650 thousand and it was PLN 5,464 thousand, i.e. 17%, higher than the cost incurred in the six months ended 30 June 2017. The increase in the cost of financing of the portfolio was directly attributable to an increase in the average level of external financing used — in the six months ended 30 June 2018, the average level of financing was PLN 1,989,046 thousand and it was PLN 408,534 thousand, i.e. 26%, higher than in the comparative period.

In the six months ended 30 June 2018, operating expenses involved in the Group's core business activities amounted to PLN 26,682 thousand, i.e. they were PLN 4,765 thousand, i.e. 22%, higher than in the comparative period.

As a result, an increase in sales of 13% and an increase in costs of core operating activities of 22%, translated into a 3% decrease of operating expenses and an 13% increase of net profit.

In the six months ended 30 June 2018, the Group's net profit margin, calculated as the ratio of realized net profit to sales, was 28%, which denotes the same level as in the comparable period. At the same time the operating margin, calculated as the ratio of EBIT to sales, amounted to 33% in the six months ended 30 June 2018, which denotes a decrease of 5 pp, i.e. 13%, compared with the comparative period.

In the six months ended 30 June 2018 earnings per share were higher than in the corresponding period of 2017: PLN 0.21 in the six months ended 30 June 2018 vs. PLN 0.19 in the six months ended 30 June 2017. At the same time the book value per ordinary share increased from PLN 3.22 as at 30 June 2017 to PLN 3.46 as at 30 June 2018.

4.4. Structure of the Group's balance sheet assets and liabilities and material off-balance sheet items

As at 30 June 2018, the Group's assets were composed of:

- non-current assets — PLN 1,708,873 thousand (59%);
- current assets — PLN 1,204,389 thousand (41%).

As at the balance sheet date, cash and cash equivalents amounted to PLN 16,953 thousand, which accounted for 1% of total assets.

As at 30 June 2018, PLN 443,533 thousand, i.e. 15%, of the Group's assets were equity-financed. The remaining liabilities and equity, of PLN 2,469,729 thousand, i.e. 85%, were liabilities and provisions for liabilities, including:

PLN 1,460,826 thousand, i.e. 59% — bank loans and advances;
PLN 90,693 thousand, i.e. 4% — own bonds;
PLN 812,849 thousand, i.e. 33% — loans from related entities;
PLN 105,361 thousand, i.e. 4% — other.

As at 30 June 2018, the financial leverage used, calculated as the ratio of external interest-bearing financing (bank loans, advances and own bonds) to equity, amounted to 5.33 vs. 5.05 as at 31 December 2017 and 4.07 as at 30 June 2017.

As at 30 June 2018, off-balance sheet liabilities arising, among other things, from framework agreements and conditional agreements in place, amounted to PLN 575,689 thousand vs. PLN 670,504 thousand as at the end of the comparative period. A detailed list of off-balance sheet items is presented in Note 16 to the interim, abbreviated consolidated financial statements.

4.5. Cash flows

In the six months ended 30 June 2018, the Group's net cash used in operating activities amounted to PLN (203,869) thousand, net cash from investing activities amounted to PLN 1,440 thousand and net cash from financing activities amounted to PLN 191,906 thousand.

	01/01/2018 to 30/06/2018	01/01/2017 to 30/06/2017
	(PLN '000)	(PLN '000)
Net cash used in operating activities	(203,869)	(133,391)
Net cash from/(used in) investing activities	1,440	3,785
Net cash from financing activities	191,906	128,493
Change in cash and cash equivalents	**(10,523)**	**(1,113)**

4.6. Investments

The Group's core business activities involve the financing and modification (restructuring) of assets classified as financial instruments, including principal and interest receivables and loans - Note 9 to the interim consolidated financial statements.

As at 30 June 2018, the Group held no derivative instruments. As at the end of comparable period, the Group held derivative instruments: forward contracts and an interest rate swap (IRS) transaction, only for the purpose of operating hedging of the risk involved in the core operating activities and not as investments.
The Group does not use or trade in financial instruments — including derivatives — for speculative purposes.

Assets included in the category of financial assets are measured at amortized cost using the effective interest method, less impairment losses, whereas derivative financial instruments are measured at fair value through profit or loss. Detailed description of Business Model identified for the group and method of financial assets classification according to IFRS9 regulation can be found in interim consolidated financial statement – Note 2 "Description of adopted accounting policies" and in the point 6.5 of this report.
In the reporting period, no changes other than related to IFRS9 implementation were made in the classification of financial assets or the manner and method or their measurement.

BFF Polska S.A. (the Group's parent) held investment certificates of Skarbiec — Zdrowie Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych of PLN 163 thousand as at 30 June 2018 with comparison to PLN 2,280 thousand as at 31 December 2017 and PLN 5,180 thousand as at 30 June 2017.

The Group's investments made in the six months ended 30 June 2018 are loans made to subsidiaries by the parent BFF Polska S.A. and loans made to BFF Polska S.A. by its subsidiaries.

In the six months ended 30 June 2018, BFF Polska S.A. granted loans to subsidiaries. The total balance of outstanding principal on loans originated in the six months ended 30 June 2018 and in previous periods to all subsidiaries of BFF Polska S.A. was PLN 28,000 as at 30 June 2018. All loans were granted on market terms, at the cost corresponding to the borrowing cost incurred by BFF Polska S.A., and they were used to finance the core business of the Group companies.

In the reporting period BFF Polska S.A. made use of loans made by its subsidiary Komunalny FIZ. The outstanding balance of principal amounts of the loans made to BFF Polska S.A. by its subsidiaries amounted to PLN 38,843 thousand as at 30 June 2018. The loans were made on market terms.
In the reporting period BFF Polska S.A. made bill of exchange agreements with its subsidiary MEDICO Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty. The total amount of bills of exchange issued by the Company as at 30 June 2018 was PLN 8,538 thousand (nominal value). The

bills of exchange were issued on market terms. The liabilities from this category are presented in other financial liabilities.

4.7.Anticipated growth areas

The Group assumes that it will continue its core business activities in the near future. The Company believes that changes in the financing of the healthcare system in Poland initiated with the enactment of amendments to the Act on Publicly Funded Healthcare Services, the so called Hospital Network Act, did not bring about any fundamental change in the liquidity position of hospitals, which is the source of demand for the Company’s services. At the same time, the Group conducts development work on expanding its product range and seeking new markets (in Poland and abroad).

The Group believes that despite growing competition, in the first instance on the market for direct financing of hospitals in Poland, demand for the Group’s services will remain stable. At the same time, further growth in the area of financing of local government entities in Poland and abroad is envisaged (both in the area of direct financing and in the area of financing of suppliers’ receivables).

Due to its membership of the BFF Banking Group, the Group intends to take advantage of market synergies more actively and intensify its partnering with multinational corporations for the purpose of meeting their liquidity needs.

4.8. External and internal factors material to the development of the Group

External factors affecting the Group’s environment and operating conditions and exerting a major influence on its growth prospects include:

- The current political situation and official statements regarding proposed healthcare system changes;
- Changing macroeconomic indicators and the general situation on the financial markets;
- General economic situation in Poland — in the first instance, changing the liquidity of the healthcare and local government sector entities;
- Changes in the business strategies of competitors and banks;
- Changes in reference interest rates and cost of external financing used by the Group;
- The regulatory environment, in the first instance court decisions involving the Group’s products.

Internal factors on which the Group’s steady growth rate is conditional include:

- Continuation of the existing business line and growth strategy;
- Rapid business development in foreign markets and further development of the business line dedicated to the financing of investment processes in the healthcare sector;
- Development of the business line dedicated to the financing of local government entities;
- Retention of and further cooperation with key accounts;
- Joining of the international BFF Banking Group by BFF Polska S.A. and its subsidiaries and the resulting opportunities:
  (i) change of the structure and availability of financing by using the parent’s financing;
  (ii) possible increase in the scale of the Company’s business in the Polish market due to the use of financial leverage effects;
  (iii) economies of scale of the newly established group, based on relationships with suppliers to healthcare entities;
  (iv) benefits of risk diversification and optimized use of resources as a result of the integration of BFF and the Company.

5. External financing

As at 30 June 2018, the BFF Polska Group's external financing amounted to PLN 2,364,368 thousand, compared with PLN 2,139,036 thousand as at 31 December 2017 and PLN 1,682,996 thousand as at 30 June 2017. The fact that the level of external financing was higher as at 30 June 2018 was mainly attributable to an increase in the value of bank loans and advances (an increase of PLN 936,197 thousand compared with the value as at 30 June 2017).

In the six months ended 30 June 2018, the average level of external financing was PLN 1,989,046 thousand, PLN 408,534 thousand, i.e. 26%, higher than the average level of external financing in the comparative period.

5.1.Bond issue schemes

As of 30 June 2018 and 31 December 2017, the Group's parent BFF Polska S.A. had one active bond programme valued at PLN 750 million in mBank S.A., allowing the issue of coupon bonds with a maturity of 360 days to 5 years.

As at 30 June 2017, the Company was running three bond issue schemes:

- the Raiffeisen Bank S.A. scheme — discount bonds maturing within one to 12 months; scheme value: PLN 90 million;
- the Alior Bank S.A. scheme — coupon or discount bonds maturing within one to 12 months; scheme value: PLN 110 million;
- the mBank S.A. scheme — coupon bonds maturing within 360 days to five years; scheme value: PLN 750 million.

The value and structure of bonds issued by the Company depends on the current and forecast need for cash and the maturities of the financial assets financed with the bond issues.

As at 30 June 2018, the value of bonds issued was PLN 90.693 thousand vs. PLN 257,014 thousand as at 30 June 2017, which denotes a decrease of PLN 166,321 thousand, i.e. 65%, in the level of financing with bonds.
In the six months ended 30 June 2018, the average level of bond financing was PLN 132,546 thousand and it was PLN 218,169 thousand, i.e. 62%, lower than the average level of bond financing in the corresponding period of 2017.

In the six months ended 30 June 2018 and in the comparable period, the Company did not make any bond issues.

In the six months ended 30 June 2018, bonds repaid amounted to PLN 35,000 thousand and EUR 6,100 thousand (PLN 61,606 thousand in total). Bonds repaid in the comparable period amounted to PLN 118,900 thousand and EUR 9,725 thousand (PLN 159,521 thousand in total).

Limit utilization (par values) as at 30 June 2018:

- as part of the mBank S.A. scheme:
  PLN 750,000 thousand — limit granted;
  PLN 89,600 thousand — bonds issued;
  PLN 660,400 thousand — unused limit.

5.2. Bank credit facilities and loans

As at 30 June 2018, the BFF Polska Group was making use of bank credit facilities and loans in a total amount of PLN 1,460,826 thousand, compared with PLN 1,055,031 thousand as at 31 December 2017 (an increase of PLN 405,795 thousand, i.e. 38%), and PLN 524,629 thousand as at 30 June 2017 (an increase of PLN 936,197 thousand, i.e. 178%).

In the six months ended 30 June 2018, the average level of financing with bank credit facilities and loans from non-related entities amounted to PLN 1,201,135 thousand and it was PLN 700,050 thousand, i.e. 140%, higher than the average level of such financing in the comparative period.

As at 30 June 2018, the following Group entities had outstanding bank credit facilities and loans from non-related entities:

- the parent BFF Polska S.A. — working capital loans and overdraft facilities – the limits available: PLN 1,285,183 thousand;
- a subsidiary BFF MEDFinance S.A. — loans made by non-related entities and bank credits – the limits available: PLN 315,000 thousand;
- a subsidiary BFF Central Europe s.r.o. — overdraft facilities – the limits available: EUR 28,000 thousand (PLN 122,125 thousand);
- a subsidiary BFF Česká republika s.r.o. — overdraft facilities – the limits available: EUR 2,000 thousand denominated in CZK (PLN 8,723 thousand);

5.3. Loans from related entities

As at 30 June 2018, the BFF Polska Group had liabilities for loans made by a related party, Banca Farmafactoring S.p.A. (the parent of BFF Polska S.A.), in the carrying amount of PLN 812,849 thousand, compared with PLN 901,353 thousand in loans received as at 30 June 2017 (a decrease of PLN 88,504 thousand, i.e. 10%).

In the six months ended 30 June 2018, the average level of financing with loans from related entities amounted to PLN 655,365 thousand and it was PLN 73,347 thousand, i.e. 10%, lower than the average level of such financing in the comparative period.

6. Risk management

The Group provides financial services using available sources of funds in the form of credits, loans and own bond issues. The Group monitors the financial risk related to its operations on an ongoing basis and manages it using internal risk reports analysing the risk exposure and level. The Group is exposed to:

- market risk (including currency, interest rate and price risk);
- credit risk;
- liquidity risk;
- legal risk.

6.1. Market risk

Market risk is the risk that the market will be lost, i.e. that the demand for the financial services provided by the Group will decline. The Group believes that such risk is limited. Depending on the current liquidity of the sector, the Group is prepared to operate both in low liquidity conditions (receivables financing) and high liquidity conditions (working capital financing, current and future receivables financing and investment financing).

6.2. Financial risk and capital management

Considering the nature of the Group's operations, and in particular its development, a significant portion of equity and liabilities is made up of debt capital, which comprises in particular liabilities due to issued bonds, loans taken out, bank loans and trade liabilities (trade credit). As at 30 June 2018 the ratio of interest-bearing borrowings (bank loans, loans from third parties and issued bonds) to equity was 5.33 in comparison with 5.05 as at the end of 2017 and compared to 4.07 as at the end of IH 2017. The Group maintains sufficient reserve capital using offers of banking services and reserve credit facilities, it monitors projected and actual cash flows on an ongoing basis and matches maturity profiles of financial assets and financial liabilities.

6.3. Currency risk

The Group's activities are exposed to limited financial risk arising from fluctuations in foreign exchange rates. The currency risk involves changes in the value of assets, equity and liabilities of the Group as a result of changes in foreign exchange rates. The Group carries out and expands its activities involving the provision of receivables financing services by its subsidiaries in the Czech and Slovak market. Such business activities and obtaining loans and bank credits are carried out mainly in the local currencies. Thus, each foreign operation has closed currency positions and does not generate currency risk. What is exposed to currency risk is the value of the Group's shareholdings in the Czech and Slovak subsidiaries.
The Group pursues a currency risk management policy whereby positions exposed to currency risk can be hedged with forward contracts.

6.4. Interest rate risk

Market conditions and the ever changing shape of the yield curve, as well as the level of market interest rates, are the source of interest rate risk. The Group mitigates the risk using an active asset profitability maintenance policy to ensure an appropriate margin on transactions to cover the risk of changes in the cost of financing.

6.5. Credit risk

Credit risk is the risk that a counterparty will fail to pay its liabilities, which will expose the Group to financial losses. The objective of credit risk management is to build a stable and balanced portfolio of financial assets and to minimize the risk of occurrence of credit exposures threatened with impairment, while maintaining the expected levels of profitability and value of the loan portfolio at the same time.

The Group follows a policy of entering into transactions exclusively with parties with proven creditworthiness; if necessary, appropriate collateral is obtained as a tool for reducing the risk of financial losses due to default on contractual terms and conditions. The Group's exposure to counterparty credit risk is monitored on a continuous basis.
Credit risk management also involves monitoring the portfolio — both the economic and financial position of debtors, factors indicating a risk of transformation of medical entities into commercial companies, entrusting operating activities with an external entity, as well as timeliness of payments. The Group monitors the timeliness of payments on a current basis — before the maturity dates of instalments — and, in the event of delays, it takes measures to improve portfolio performance or collect dues from the debtor.

Starting from 1 January 2018 according to IFRS 9 regulation, the Group implemented a new model for determining impairment losses - the model of expected credit losses, which assumes calculation of portfolio depreciation based on expected credit losses and taking into account forecasts and expected future economic conditions in the context of assessing the credit risk of exposures.
The new impairment losses model is applied to financial assets classified, in accordance with IFRS 9, as financial assets measured at amortized cost or at fair value through other comprehensive income, except for equity instruments.

The depreciation model in accordance with IFRS 9 is based on a division into 3 stages, depending on the changes concerning the credit quality as compared to the initial recognition of assets in the books. Impairment losses from depreciation are recognized in the following categories:

Category	**Exposure type**	**Method of calculating the impairment loss**
Stage 1	exposures for which no significant increase in credit risk was identified from the initial recognition to the balance sheet date and for which no depreciation was found	12-month expected credit loss
Stage 2	exposures for which a significant increase in credit risk was identified from the initial recognition to the balance sheet date	expected credit loss during the life of a financial asset
Stage 3	exposures for which depreciation was found	

Portfolio credit losses assessment process:

1. Assets with recognized portfolio value impairment:
   - Portfolio overview as at the reporting date aimed at identification of assets for which credit impairment should be considered;
   - For exposures with identified credit impairment prerequisites an assessment of future expected cash flows is prepared; present value of future expected cash flows is calculated using the initial effective interest rate of the exposure as a discount ratio;
   - In case the present value of future expected cash flows to be generated on the named exposure are lower that the exposure balance value as at reporting date an allowance (specific provision) is recognized in the maximum value equal to the difference of the exposure balance value and the net present value of future expected cash flows.
2. Assets with identified deterioration of credit risk:
   - All assets for which a credit impairment prerequisites' have not been recognized are analyzed taking into account changes in their credit risk;
   - Main factors and triggers of credit risk deterioration are:
     - Delay in debtors payments higher than 30 days,
     - Giving the asset forborne status,
   - For assets with identified credit risk deterioration a provision is recognized equal to expected credit losses on specific exposures during the whole asset lifetime up to its maturity;
3. Assets without identified credit risk deterioration – for all exposures without credit risk deterioration provisions are recognized in the value of expected credit losses in the time of nearest 12 months.

Assets acquired or originated credit impaired on the date of their first recognition (POCI assets)
For each reporting date the Group supervises and analyses assets acquired or modified during the last period to identify all assets which were acquired or originated credit impaired. Main features resulting in such an asset recognition are:

- Significant deterioration of debtors financial standing;
- Significant probability of debtor's bankruptcy or of starting of restructuring procedure;
- Lack of efficient and active market for the asset;
- Asset modification for example prolongation of repayments dates, because of debtor's financial standing deterioration;
- Acquisition of an asset with the high discount being the price for asset credit impairment as on the acquisition date.

POCI assets at the date of their first recognition are presented in fair value and later are valuated according to Amortized Cost Method using credit adjusted effective interest rate (CEIR).
For POCI assets provisions are always recognized in the whole asset life time.

Collateral for financial assets

At the stage of concluding an agreement, the Group assesses the credit risk relating to the transaction in question. The basis for assessing this risk is, on the one hand, an evaluation of the economic and financial position of the debtor and, on the other hand, the record of cooperation to date, current exposure level and proposed collateral. For assets with an increased risk level, the Group requires establishing collateral. The forms of collateral used include assignment under a hospital's contract with the National Health Fund (NFZ), tangible fixed assets, movables and a blank promissory note.

The Group may use the collateral in the event of delays in payment provided for in a repayment schedule.

6.6.Liquidity risk

Liquidity risk is managed by the Group through the application of payment schedules confirmed by the debtors to the major part of its portfolio of financial assets, maintenance of an appropriate level of free cash, use of banking services and standby lines of credit, ongoing monitoring of forecast and actual cash flows and matching the maturity profiles of its financial assets and liabilities. The joining of the BFF Group has consolidated the Group's liquidity position and provided it with access to stable financing from the parent.

In order to minimize liquidity risk, the Group follows a policy of conservative financing of assets, which consists of:

- close monitoring of proceeds and a pro-active policy for managing delays, implemented by a specialized and experienced team;
- ongoing forecasting and day-to-day realignment of forecasted proceeds in the short-term, medium-term and long-term;
- managing the structure of the equity and liabilities side of the balance sheet by selecting appropriate sources of finance, taking into account the structure of the assets side of the balance sheet and the nature of individual products, in particular the stability and predictability of financial proceeds from these products;
- limiting the values of liability ratios (e.g. equity/borrowings, equity/EBIT, etc.) to a level, which guarantee the development of business activities but which also ensure the security of the Group's liquidity;
- maintaining stand-by sources of finance for current payment purposes.

In addition, a high level of cash flows into the Group's accounts guarantees a stable liquidity position in spite of temporary irregularities and delays in repayments made by debtors.

6.7.Legal risk

Legal risks - analysis of the market situation in Poland

The Group parent – BFF Polska S.A. company - operates in a market niche and offers non-standard products and services the structure of which, in the absence of detailed legal solutions, is based on general legal principles, that is freedom of contracts laid down in art. 353^1 of the Polish Civil Code. The consequence is market concentration and the dependence of revenue on the situation and changes in the healthcare sector, the acts governing the system and functioning of local government units. Thus, any change in the said legislation has a material effect on the Company's operations.

Legal risks in the area of financing entities providing medical services

Notably, on the account of the Act on medical activity, the risk of conversion of public healthcare entities (SPZOZ) into commercial-law companies with bankruptcy capacity within the meaning of the Bankruptcy Law from 28 February 2003 (Journal of Laws of 2017, item 2344) remains valid in 2018. The conversion of a healthcare entity into a company is preceded by the determination by the founding entity, on the basis of the financial statements of the SPZOZ for the last financial year, of the debt ratio which reflects the relation of all long-term and short-term liabilities reduced by short-term investments up to the total of its revenue; in line with Article 70-72 of the Act on medical activity in the case of a healthcare entity being converted into a company, the take-over of liabilities by the so-called founding entity is mandatory only if the debt ratio exceeds 0.5. The take-over only applies to the liabilities of the SPZOZ of such a value that the debt ratio determined as at the conversion date for the company formed through conversion does not exceed 0.5. If the value of the ratio is 0.5 or less, the founding entity may but is not required to take over the liabilities of the public institution. At the same time, the liabilities taken over by the founding entity in the first place are oldest payables, encompassing the principal and interest. A company formed through the conversion of SPZOZ will then acquire bankruptcy capacity.

Notably, the rules governing take-over of liabilities of SPZOZ by the founding entity, in particular Articles 70-72 of the Act on medical activity, pertaining to determining the indebtedness ratio for SPZOZ and take-over of liabilities of SPZOZ by the founding entity have been structured in a general manner, without referring to detailed secondary legislation, which, in the event of a take-over of liabilities of SPZOZ by the founding entity described in Articles 70-72, means a risk of arbitrary interpretations of the provisions named herein in favour of the founding entity The said arbitrary interpretations of the aforementioned provisions by the founding entity, with no dedicated supervision procedure in place of either administrative or judicial nature, can be detrimental to the Company acting as the creditor of SPZOZ.

Moreover, as discussed above, the Company operates in a market niche and offers non-standard products and services the structure of which, in the absence of detailed legal solutions, is based on general legal principles, that is the freedom of contracts stipulated in the Article 353^1 of the Civil Code; thus, it is material to the Company's operations that the interpretation of some of the legal issues and the surrounding controversies is usually settled in court proceedings, with - after exhausting all procedures - final and legally binding effects. Frequently amended legislation governing medical activity and differences in its interpretation by courts are also of major importance, as they affect products offered by the Group, most importantly the expansive interpretation of the Article 54(5) of the Act on medical activity.

At present, the products offered by the Company are not based on the Company's status as a creditor in relation to SPZOZs, therefore, in the Company's view Article 54(5) of the Act on medical activity should not apply. This position is reflected in the Supreme Court's judicial decisions; in all cases indirectly concerning the products offered by the Company, such as fiduciary factoring or financing standard receivables, the Supreme Court ruled against accepting for review complaints in cassation filed by SPZOZs, i.a.:

1) the party bringing the complaint (SPZOZ) referred to the need to interpret legal provisions raising significant doubts, that is Article 54(5) of the Act on medical activity, in order to explain whether the **limitations of admitting change in the public hospital creditor excludes the possibility of effective fulfilment of an obligation by a third party** (Article 356(2) of the Civil Code) to the benefit of the creditor of the public hospital. In the opinion of the complainer, the Article 921^1 of the Civil Code also requires interpretation with regard to whether it constitutes merely a billing form or, in light of Article 54(5) of the Act of medical activity and fiduciary factoring agreements, points at the fact of performance by a third party to the benefit of the public hospital creditor with the intent of fulfilling the obligation. In the assessment of the Supreme Court, the legal issue presented by the complainer in the application for admitting the complaint, can be interesting from the theoretical perspective, however, are separate from the main motif for admitting the claim, which comes down to respecting the main principle of law of obligations, imposing on the debtor the obligation to render performance due to the creditor, especially as the counterparty has already rendered his performance. Furthermore, they relate to legal relationship between the claimant and the intervenor, not the one between the claimant and the defendant, which gave rise to this claim (order of the Supreme Court of 4 October 2017, file ref. no. I CSK 175/17);

2) in the opinion of the Supreme Court, the legal issues presented in the application for admitting the complaint do not fulfil the requirements set forth in Article 398^9(1) items 1 and 2 of the Code of Civil Proceedings, as they refer to issues with no conclusive meaning to the result of the case, taking into account the factual merit and legal basis of the judgement of the Court of

Appeal appealed against, which awarded payment of the unpaid price of goods from the buyer (the defendant SPZOZ) to the benefit of the Seller (the claimant). The legal issues presented by the complainer in the application for admitting the complaint, can be interesting from the theoretical perspective, however, are separate from the main premise for admitting the claim, which comes down to respecting the main principle of law of obligations, imposing on the debtor the obligation to render performance due to the creditor, especially as the counterparty has already rendered his performance (order of the Supreme Court from 10 November 2017, file ref. no I CSK 378/17).

Legal risks in the area of financing local government units

In the area of financing local government units, the Company offers financial services which supplement traditional forms of bank financing. With the instruments proposed by BFF Polska S.A., local government units can obtain funds for the implementation of EU projects and continuation of ongoing investment projects. In contrast to classic products offered by banks (e.g. loans), the Company proposes products developed on the basis of various civil-law provisions based on the principle of freedom of contract (e.g. subrogation, equity financing, etc.). The definitions of operations are contained in various provisions of law (the Civil Code, the Accounting Act, the tax law, etc.).

Auditing authorities (Regional Accounting Chambers, the Supreme Audit Office) operating in the area of financing local government units make their own interpretation with respect to the products offered to local government entities by non-banking financial institutions. Those products are analysed by audit institutions for their effect on the amount of debt of local government units in view of the existing prudence mechanisms. Following the analyses of audit institutions, requests are made to introduce various legal regulations to enhance the control of contracting liabilities by local government units based on non-classic financial instruments, mainly in the context of the principle of disclosure and transparency of public funds. The audit authorities propose legislative changes aiming at modifying the methods of financial reporting with respect to non-banking financial products and at strengthening the monitoring of the amount of debt of local government units. In view of the foregoing, there is an ongoing discussion on the nature of expenses incurred by local governments within such non-classic financial services provided by non-banking institutions. The discussion is in line with the reflections on the change of widely defined procedures laying down the rules, conditions and methods of contracting debt obligations by local governments with the inclusion of each obligation to the classification of debt titles applicable in local government units. A wide use of non-classic financial operations is a relatively new experience for Polish local governments, therefore, audit authorities are initiating a debate on possible legislative changes to change the legal status with regard to the liability contracting procedure for local governments determined in the provisions governing public finances, and to also ensure more financial liquidity in that area. Audit authorities emphasise the need to strengthen financial discipline of local governments, in particular in terms of their expenses, which may translate into the scope of services offered by the Company on the local government market. There are calls for a reform in the area of financial autonomy of local government units, in particular as part of the discussion on systemic changes in the area of local governments.

The Supreme Audit Office recommends implementation of mechanisms to monitor, on an ongoing basis, the liabilities contracted by local governments resulting from non-standard financial operations. An increased debt of local governments with the use of non-standard financial operations — according to audit institutions — should be subjected to the same procedures as those applicable to local governments when contracting loans or credit facilities (Article 89(1) items 2–4 of the Act on public finance), including the obligation to consult the Regional Accounting Chamber on the possibility of repayment of such liability.

It should be emphasised that the use of civil-law solutions other than traditional financial instruments regulated in the provisions of the Civil Code or Commercial Companies and Partnerships Code and supplemented by the principle of freedom of contract must not be treated equally with sources of financing such as a loan, credit facility or issue of securities. The reasonable legislator did not apply the limit specified in the budgetary resolution of a local government unit to such other sources of financing or impose the obligation to consult the Regional Accounting Chamber on the possibility of repayment of such liability (Article 91 of the Act on public finance a contrario).

The catalogue of circumstances justifying the application of loans, credit facilities or securities under Article 89 of the Act on public finance does not cover other civil-law solutions based on general provisions. In view of the foregoing, opinions according to which the same approach is applied equally — without any clear legal basis — to the above-mentioned civil-law contracts and classic financial instruments in terms of their legal and economic effects raise justified concerns. Non-standard financial services on the market of local government units are included in the canon of applicable law, so the fact that those constructs are ignored in the provisions on public finance may not be viewed as a legal loophole. The view that the civil-law contracts other than classic financial instruments operate beyond the audit mechanisms of public institutions, which may lead a dangerous increase in the debt of local governments, must be considered as unfounded. The specific legal regime local governments are subjected to does not mean lack of control or possibility of monitoring such debt, but rather the need to consider the differences in the approach of audit authorities to the liabilities in question. The primary rule of autonomy of local governments' finances should therefore be respected, also in terms of the possibilities of local governments to use sources of financing other than traditional ones.

BFF Polska S.A. and General Data Protection Regulation (GDPR)

On 25 May 2018, Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (hereinafter: GDPR) came into force. Preparing for entry into force of the GDPR, BFF Polska S.A. has verified the existing procedures and implemented new procedures regarding the processing of personal data, in particular related to new obligations imposed by the GDPR on personal data administrators.

Legal risk - risks of selected contracts entered into in the Slovak market

For activity of BFF Central Europe s.r.o. on Slovak market still significant is Directive No. 7/2017 adopted by the Minister for Health of the Slovak Republic, effective as of 1 October 2017, which:

1) obliges the entities reporting to the Minister for Health (including public hospitals) to include in both their new, and existing agreements with their counterparties provisions excluding the possibility of assignment of liabilities subject to the aforementioned agreements without prior consent of the debtor and stipulating that any such assignment of liabilities performed in breach of the said conditions is invalid. The consent of the debtor needs prior written consent for assignment by the Minister for Health or is otherwise null and void (contractual non-assignability);
2) includes a draft of the stipulation of the aforementioned amendment of agreements entered into by the entities reporting to the Minister for Health and their counterparties, excluding the possibility of assignment of liabilities subject to the aforementioned agreements without prior consent of the debtor and stipulating that any such assignment of liabilities performed in breach of the said conditions is invalid. The consent of the debtor needs prior written consent for assignment by the Minister for Health or is otherwise null and void.
3) obliges the entities reporting to the Minister for Health to decline consent for assignment to creditors if the assignment of liabilities agreement lacks a stipulation that the assignment of claims can be exercised exclusively after prior consent of the debtor;
4) obliges the entities reporting to the Minister for Health not to enter into new agreements should they not include stipulations on non-assignability in line with conditions set forth in item 1) above;
5) obliges the entities reporting to the Minister for Health not to perform any payment of receivables to the claim purchaser that are subject to the assignment agreement made before the date of this Directive entering into force, without prior consultation with the competent general secretary in the Ministry of Health in respect thereof;
6) does not include any new agreements, including amendments to existing agreements, regardless of their type, the result whereof would be i) assignment of liabilities due to the creditor against an entity reporting to the Minister for Health to a third party or ii) establishing security on the liabilities against an entity reporting to the Minister for Health by means of executing an assignment of liabilities agreement for securities to the benefit of a third party or a creditor of an entity reporting to the Minister for Health.

In line with the conditions set forth in item 1) above, the entities reporting to the Minister for Health are obliged to prepare a draft of amendments to agreements and present it to the counterparty for acceptance, within 30 days from the date this Directive enters into force. If the draft of amendments is not accepted by the other party to the agreement, the entities reporting to the Minister for Health are obliged to act according to points 4) - 6) above.

This Directive is also applicable to employees of the Ministry for Health who are members of non-profit organisations established or co-established by the Treasury, represented by the Minister for Health.

Notably, these provisions constitute a certain obstacle to the operations of BFF Central Europe s.r.o. in the Slovak Republic with respect to executing agreements on assignment of liabilities against public hospitals. The provisions of the aforementioned Directive not only extend the time of execution of agreements on assignment of liabilities against public hospitals (the need for consent to assignment by the debtor and the Minister of Health), but also pose a significant limitation for the company BFF Central Europe s.r.o. regarding the possibility to enter in agreements on assignment of liabilities against public hospitals, as it is not clear if the debtors or the Minister for Health will be prone to give consent to the assignment on the terms set forth in the Directive.
It needs to be emphasised that the BFF Polska Group, in particular on account of experiences from the Polish market, offers also products which are not based on Company status of creditor of the public hospitals.

6.8. Business environment risk

In 2017, the government adopted two important acts of law concerning the design of the hospital market and the service contracting approach (the 'Act on Hospital Networks') as well as the scale of health care financing from public funds (amendment to the Act on Health Care Financing from Public Funds).

In spring 2017, the Sejm passed an act of law establishing the System of Basic Hospital Provision of Medical Benefits, commonly called the hospital network. The system is expected to secure access to benefits such as hospital treatment, highly specialist services, or outpatient specialist care. Hospitals qualifying to the network obtain a guarantee for a 4-year contract with the National Health Fund (NFZ) and are financed on a lump-sum basis, with the amount of funding depending on the scope of services provided and reported in the preceding reporting period. The network includes almost all customers of the Company. Hospitals outside the network (some private establishments) might face difficulties in securing financing for their current activities from public funds. They will only be allowed to apply for contracts financed from funds allocated for treatment outside the network.

According to the Company, the aforementioned act significantly obstructs access to public funds for a number of smaller private hospitals that have been left outside the network. Practically all public hospitals have been included, which has a visible impact on market stability and allows hospitals to plan their activities in the long run. On the other hand, the upward pressure on competition and efficiency has been reduced.

In December 2017, the Act on Health Care Financing from Public Funds was revised. This instrument obligates the government to guarantee a certain level of health care funding and sets out the growth path for health care spending (in relation to GDP) to the level of 6%. The target level (6% GDP) is to be reached in 2025. In 2018, at least 4.67% of GDP will be allocated to health care, and 4.86% in 2019, respectively. The additional allocations are to be used, in the first place, to finance health care services (in the form of a subsidy for the NFZ). The list of services will be defined by the Minister for Health on an annual basis. These are meant to be, among others, the services with the longest queues.

The Company believes that the pool of funds in the health care system will undoubtedly increase, which should translate into more services being provided. Indirectly, this will drive hospital revenues. At the same time, hospitals will face a significant increase in payroll expenses, which, all in all, may cause their financial situation to improve only slightly.

7. Events with a significant effect on the Group's business activities and results of operations

On 20 February 2017, BFF Polska S.A. was refused an advance tax ruling on the merger of BFF Polska S.A. with Mediona Sp. z o.o. of 16 December 2016.

On 7 March 2017, BFF Polska S.A. filed two requests for the elimination of a law violation, one with the Development and Finance Minister and the other one with the Head of the National Revenue Administration.
On 28 April 2017, the Company received a reply from the Head of the National Revenue Administration to its request for the elimination of a law violation, filed in connection with the refusal to issue an advance tax ruling on the merger of BFF Polska S.A. with Mediona Sp. z o.o. of 16 December 2016. The Head of the National Revenue Administration upheld the position expressed in the said refusal to issue an advance tax ruling.

On 29 May 2017, BFF Polska S.A. filed a complaint against the refusal to issue an advance tax ruling with the Provincial Administrative Court in Warsaw via the Head of the National Revenue Administration.

On 30 May 2018 the Provincial Administrative Court in Warsaw delivered judgment negative for BFF Polska S.A.
On 5 June 2018 BFF Polska S.A. filed an application for delivery of the judgment with justification. After receiving the judgment with justification, the Company will consider taking any further legal steps.

There were no other events with a significant effect on the Group's business activities and results of operations other than as described above.

8. Additional information

8.1. Proceedings before courts or public administration bodies

As at 30 June 2018, the balance of receivables subject to court proceedings was PLN 236,044 thousand, which accounted for 8% of the value of the portfolio of financial assets, compared with PLN 170,753 thousand (8% of the portfolio) as at 30 June 2017 and PLN 194,021 thousand (7% of the portfolio) as at 31 December 2017.
Given the nature of the Group's activities, instituting legal proceedings with respect to an asset is one of the typical stages of recovering receivables as provided for by the Group's operating procedures. The credit risk of such assets is comparable to that related to other financial assets repayable by debtors without an agreed repayment schedule.

Amount of potential liabilities that may arise in connection with court proceedings against BFF Polska S.A. was presented in Note No. 16 of Interim condensed consolidated financial report of BFF Polska Capital Group for six months ended at 30 June 2018 – "Contingent liabilities and contingent assets".

8.2.Registered audit company

On 23 November 2016, the Company's Supervisory Board appointed an auditor to perform an audit of the financial statements of the Company and the BFF Polska Group, which was PricewaterhouseCoopers Spółka z ograniczoną odpowiedzialnością, with its registered office in Warsaw, ul. Lecha Kaczyńskiego 14, entered in the list of registered audit companies by the National Chamber of Statutory Auditors with the reference number 144.

The auditor's responsibilities include auditing the annual separate financial statements of the Company and the annual consolidated financial statements of the Group, as well as auditing and reviewing the Group's reports prepared in accordance with the standards applicable within the BFF Banking Group.

The registered auditor was appointed in accordance with the Company's Articles of Association and the applicable laws. The new auditor was appointed in accordance with the requirement to ensure consistency with regard to auditing the BFF Banking Group to which BFF Polska S.A. and its subsidiaries belong.

Łódź, 10 August 2018

Signatures

Krzysztof Kawalec – President of the Management Board

Rafał Karnowski – Vice-President of the Management Board

Michele Antognoli – Member of the Management Board

Urban Kielichowski – Member of the Management Board

Radosław Moks – Member of the Management Board

Wojciech Wolski – Member of the Management Board