



***SECO/WARWICK***  
[www.secowarwick.com](http://www.secowarwick.com)

**DIRECTORS' REPORT  
ON THE SECO/WARWICK GROUP'S OPERATIONS**

**December 31st 2016**

The Management Board of SECO/WARWICK S.A. presents the Directors' Report on the SECO/WARWICK Group's operations in the period January 1st–December 31st 2016, prepared in accordance with the Minister of Finance's Regulation on current and periodic information to be published by issuers of securities and conditions for recognition as equivalent of information whose disclosure is required under the laws of a non-member state, dated February 19th 2009 (Dz.U. of 2014, item 133, as amended) (the "Regulation").

The consolidated financial statements of the SECO/WARWICK Group (the "Group" or the "SECO/WARWICK Group") were prepared in accordance with the International Financial Reporting Standards (IFRS) endorsed by the EU, and their scope is compliant with the Regulation. The financial statements cover the period January 1st–December 31st 2016 and the comparative period January 1st–December 31st 2015.

## 1. Introduction

SECO/WARWICK S.A. (the "Company" or the "Parent") was entered in the Business Register of the National Court Register on January 2nd 2007, by virtue of a decision issued by the District Court of Zielona Góra, 8th Commercial Division of the National Court Register, under No. KRS 0000271014.

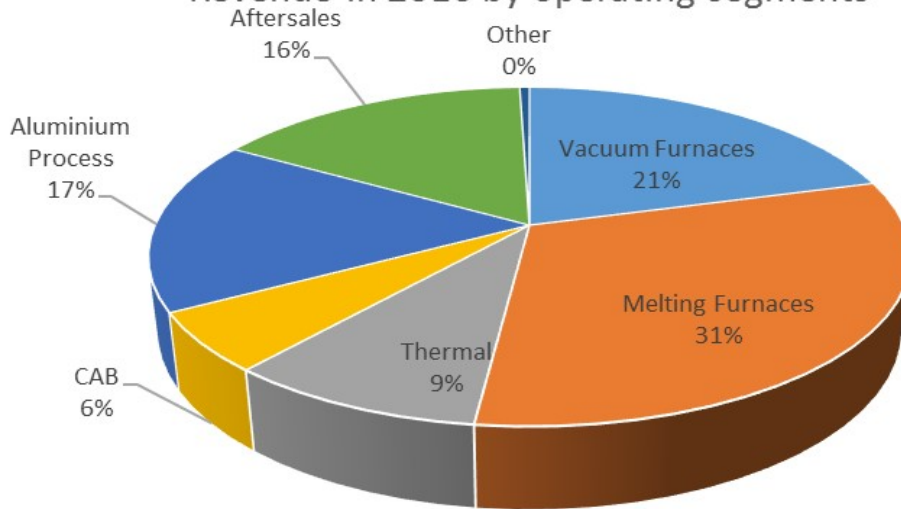
The Group's core business consists in manufacture of five key groups of products: vacuum furnaces, aluminium heat exchanger brazing systems, aluminium heat treatment systems and metallurgy equipment used for melting and vacuum casting of metals and specialty alloys. The Group's operations are divided into five business segments according to product groups: vacuum furnaces (Vacuum), aluminium heat exchanger brazing systems (Controlled Atmosphere Brazing - CAB), aluminium heat treatment systems (Aluminium Process), metallurgy equipment used for melting and vacuum casting of metals and specialty alloys (Melting Furnaces), and other. Also, in accordance with the Company's management accounts, a separate aftersales segment has been established.

The table below presents the Group's revenue.

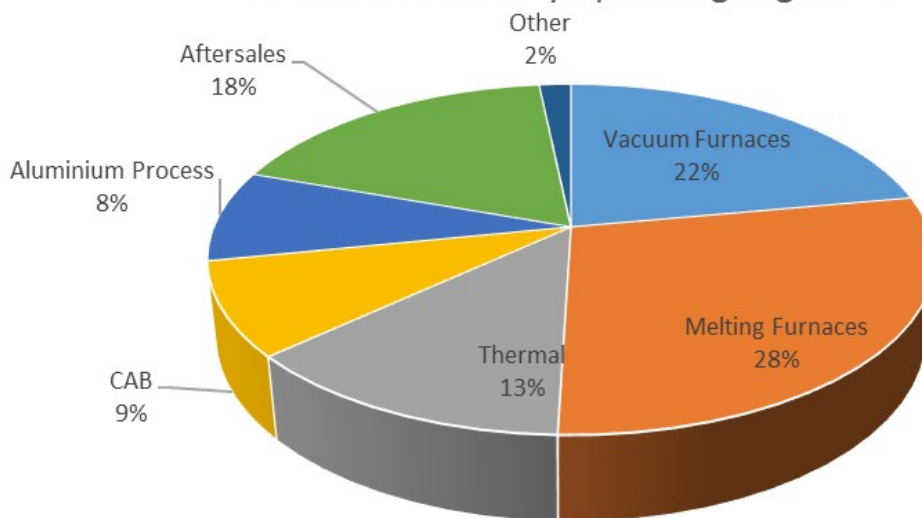
**Table: Revenue (PLN '000)**

Item	Continuing operations							Total
	Vacuum Furnaces	Melting Furnaces	Thermal	CAB	Aluminium Process	Aftersales	Other	
<b>Jan 1-Dec 31 2016</b>	117,111	176,983	52,791	32,017	93,768	90,888	2,806	<b>566,364</b>
<b>Jan 1-Dec 31 2015</b>	104,390	133,373	60,248	40,605	39,813	84,586	7,948	<b>470,964</b>

Revenue in 2016 by operating segments



Revenue in 2015 by operating segments



2. Organisational and equity links between the SECO/WARWICK Group companies and other entities; information on key domestic and foreign equity investments (securities, financial instruments, intangible assets and property), including equity investments outside of the group of related entities; financing of the investments

Table: As at December 31st 2016, the structure of the SECO/WARWICK Group was as follows:

Company	Registered office	Business profile	Method of consolidation / accounting for equity interest	Group's ownership interest
<b>Parent</b>				
SECO/WARWICK S.A.	Świebodzin	Holding company of the SECO/WARWICK Group. Holding equity interests and providing strategic management services	N.A.	N.A.
<b>Direct and indirect subsidiaries</b>				
SECO/WARWICK EUROPE Sp. z o.o.	Świebodzin	Manufacture of metal heat treatment equipment	Full	100%
SECO/WARWICK Corp.	Meadville (USA)	Manufacture of metal heat treatment equipment	Full	100%
SECO/WARWICK of Delaware, Inc.	Wilmington (USA)	Holding company; registration of trademarks and patents, and granting licences for use of the trademarks and patents by SECO/WARWICK Corp.	Full	100%
SECO/WARWICK Rus	Moscow (Russia)	Distribution of the SECO/WARWICK Group's products	Full	100%
Retech Systems LLC	Ukiah (USA)	Trade and services; manufacture of metallurgy equipment used for melting and vacuum casting of metals and specialty alloys	Full	100%
SECO/WARWICK Retech Thermal Equipment Manufacturing Tianjin Co., Ltd.	Tianjin (China)	Manufacture of metal heat treatment equipment	Full	90%
Retech Tianjin Holdings LLC	(USA)	A holding company	Full	80%
SECO/WARWICK Allied Pvt. Ltd.	Mumbai (India)	Manufacture of metal heat treatment equipment	Full	98%
ALLIED FURNACES PVT. LTD.	Mumbai (India)	Manufacture of metal heat treatment equipment	Full	98%
SECO/WARWICK GmbH	Bedburg-Hau (Germany)	Intermediation in the sale of furnaces and spare parts manufactured by SECO/WARWICK EUROPE Sp. z o.o., and provision of technical support to customers in Germany, Austria, the Netherlands, Switzerland, Liechtenstein and Slovenia	Full	100%
OOO SCT	Solnechnogorsk (Russia)	Provision of metal heat treatment services in Russia	Equity	50%

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SECO/WARWICK Germany GmbH	Bedburg-Hau (Germany)	Provision of metal heat treatment services in Germany	Full	100%
SECO/WARWICK France	Roissy-en-Brie (France)	Commercial and technical representation of SECO/WARWICK Europe in France, French-speaking countries and their neighbouring countries	Full	100%
SECO/WARWICK Services Sp. z o.o.	Świebodzin	Repair and maintenance services	Full	100%
SECO WARWICK USA HOLDING LLC	Wilmington (USA)	A holding company	Full	100%
SECO VACUUM TECHNOLOGIES LLC	Wilmington (USA)	Sale and distribution of vacuum furnaces	Full	100%

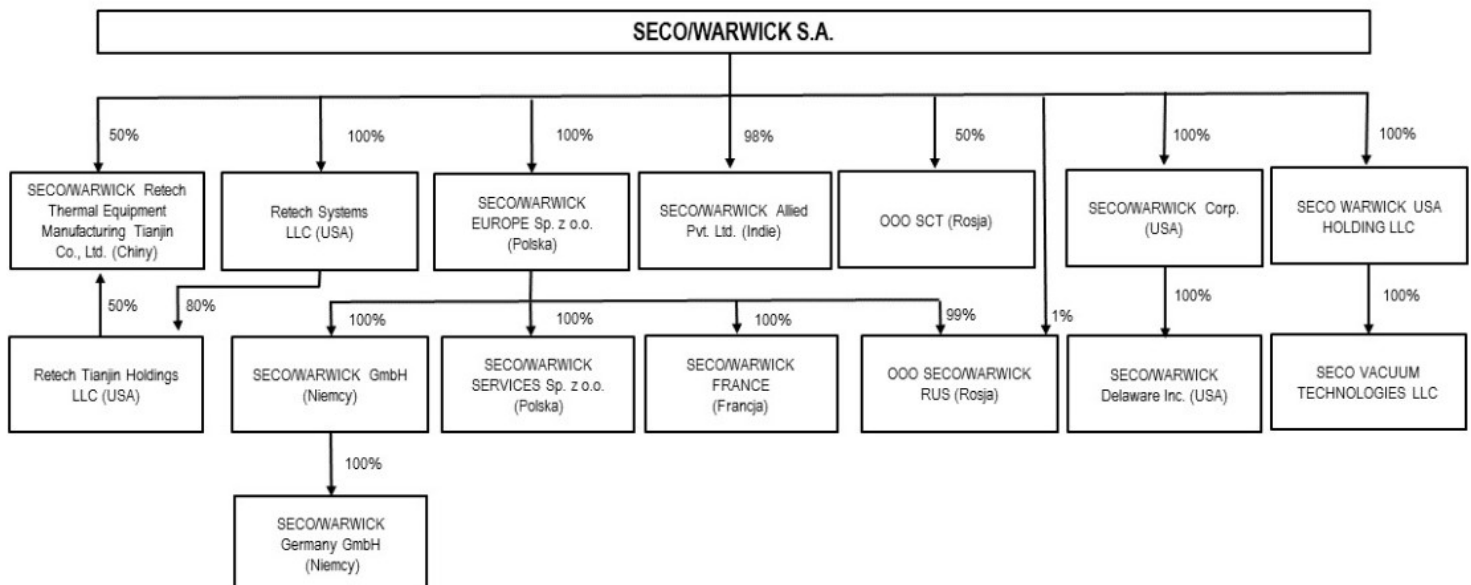
**Changes in the composition of the SECO/WARWICK Group in the analysed period**

On July 12th 2016, SECO WARWICK USA HOLDING LLC of Wilmington (USA), in which SECO/WARWICK S.A. holds 100% of shares, was registered. The company is a holding company.

On July 12th 2016, SECO VACUUM TECHNOLOGIES of Wilmington (USA), in which SECO WARWICK USA HOLDING LLC holds 100% of shares, was registered. The company's business consists in the sale and distribution of vacuum furnaces.

On July 14th 2016, a conditional agreement for the sale of shares in SECO/WARWICK do Brasil Indústria de Fornos Ltda. of Jundai, Brasil, was signed. The company was sold after all conditions stipulated in the agreement were met, on September 1st 2016.

**SECO/WARWICK Group's structure as at December 31st 2016:**



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**Composition of the SECO/WARWICK Group as at the date of issue of this Report**

In Current Report No. 1/2017, referring to Current Report No. 26/2016 of October 31st 2016, the Management Board of SECO/WARWICK S.A. announced that on January 2nd 2017 the District Court in Zielona Góra, 8th Commercial Division of the National Court Register, registered the merger of the Company with its subsidiary, SECO/WARWICK EUROPE sp. z o.o. of Świebodzin.

The merger was effected pursuant to Art. 492.1.1 of the Commercial Companies Code, i.e. through the transfer of all assets of SECO/WARWICK EUROPE Sp. z o.o. to SECO/WARWICK S.A. by way of universal succession. As a result of the merger, SECO/WARWICK S.A., as the acquirer, assumed all the rights and obligations of SECO/WARWICK EUROPE Sp. z o.o., which was dissolved without liquidation proceedings, as of the date of its deletion from the register.

Between December 31st 2016 and the issue date of this Report, there were no other changes in the composition of the SECO/WARWICK Group.

For information on key domestic and foreign investments (financial instruments, intangible assets and property), see the Notes to the full-year separate financial statements of SECO/WARWICK S.A. No equity investments outside the group of related entities were made.

**3. Changes in significant management policies at the Company and the Group.**

In the reporting period, there were no changes in significant management policies at the Company or the Group.

**4. Amount of remuneration, bonuses and benefits, benefits under share-based incentive and bonus schemes, including schemes based on bonds with pre-emptive rights, convertible bonds or subscription warrants, paid, payable or potentially payable, presented separately for each member of the management and supervisory staff of the SECO/WARWICK Group.****MANAGEMENT BOARD**

Members of the Management Board receive remuneration based on their respective employment contracts. Any severance or compensation payments are governed by the Labour Code. The amount of remuneration payable to the Management Board members is defined in the resolutions passed by the Company's Supervisory Board on January 12th 2012, December 13th 2012, December 5th 2013, and April 23rd 2015.

**Table: Remuneration of SECO/WARWICK S.A. Management Board members in 2016 (PLN '000)**

<b>Name and surname</b>	<b>Remuneration</b>
Paweł Wyrzykowski – President of the Management Board	774
Jarosław Talerzak – Vice President of the Management Board	413
Wojciech Peret – Member of the Management Board.	403
<b>Total</b>	<b>1,590</b>

**SUPERVISORY BOARD**

The Supervisory Board members are entitled to monthly remuneration in the amount specified by the General Meeting, payable on or before the 15th day of the month following the month for which the remuneration is due. The remuneration covers all expenses related to the performance of duties of a Supervisory Board member. Supervisory Board members are not entitled to severance payments.

**Table: Remuneration of SECO/WARWICK S.A. Supervisory Board members for 2016 (PLN '000)**

Name and surname	Remuneration
Andrzej Zawistowski, including:	223
- for his service as Chairman of the Supervisory Board	120
- under agreement for advisory services <sup>(1)</sup>	103
Jeffrey Boswell, including:	161
- for his service as Member of the Supervisory Board	-
- under employment contract <sup>(2)</sup>	161
James A. Goltz, including:	840
- for his service as Member of the Supervisory Board	-
- under employment contract <sup>(3)</sup>	840
Dr Gutmann Habig <sup>(4)</sup>	46
Henryk Pilarski	54
Witold Klinowski, including:	196
- for his service as Member of the Supervisory Board <sup>(5)</sup>	20
- under agreement for advisory services <sup>(6)</sup>	176
Marcin Murawski	44
Paweł Tamborski <sup>(7)</sup>	22
<b>Total</b>	<b>1,586</b>

<sup>(1)</sup> Under a service agreement between SECO/WARWICK S.A. and Mr Andrzej Zawistowski, who conducts business activities under the name USŁUGI DORADCZE Andrzej Zawistowski. The agreement of July 2nd 2012 is for the provision of technical and product development advisory services.

<sup>(2)</sup> Under an employment contract between SECO/WARWICK Corp. and Mr Jeffrey Boswell.

<sup>(3)</sup> Under an employment contract between Retech Systems LLC and Mr James A. Goltz.

<sup>(4)</sup> Mr Gutmann Habig was removed from his position of Member of the Supervisory Board by Resolution No. 28 of the General Meeting of June 24th 2016.

<sup>(5)</sup> Mr Witold Klinowski tendered his resignation as member of the Supervisory Board, with effect from June 24th 2016.

<sup>(6)</sup> Under an agreement for the provision of technical and product development advisory services of October 3rd 2013, executed between SECO/WARWICK EUROPE Sp. z o.o. and Mr Witold Klinowski.

<sup>(7)</sup> Mr Paweł Tamborski was appointed as Member of the Supervisory Board by Resolution No. 29 of the General Meeting of June 24th 2016.

**5. Agreements between the SECO/WARWICK Group companies and their management staff, providing for compensation in the event of resignation or removal from office without a good reason or following acquisition of the Company by another company**

Employment contracts between the Company and its management staff do not provide for any compensation in the event of resignation or removal from office. Any severance or compensation payments are governed by the Labour Code, and the employment contracts do not contain any other specific provisions in this respect. Similarly, the contracts do not provide for severance payments in the event of removal from office or termination of contract caused by acquisition of SECO/WARWICK S.A. by another company.

6. Par value and number of SECO/WARWICK S.A. shares and shares in related entities held by the management and supervisory staff (separately for each person).

	Jan 1 2016				Dec 31 2016				Total par value of shares (PLN)
	Number of S/W shares held	Ownership interest	% of total vote	Decrease/increase	Number of S/W shares held	Ownership interest	% of total vote		
<b>Management Board</b>									
Paweł Wyrzykowski	254,558	2.37%	2.37%	-	254,558	2.47%	2.47%	50,912	
Jarosław Talerzak	29,558	0.28%	0.28%	-	29,558	0.29%	0.29%	5,912	
Wojciech Peret	-	-	-	4,000	4,000	0.04%	0.04%	800	
<b>Supervisory Board</b>									
Andrzej Zawistowski	65,000	0.61%	0.61%	-	65,000	0.63%	0.63%	13,000	
Jeffrey Boswell	9,776	0.09%	0.09%	-	9,776	0.09%	0.09%	1,955	
Henryk Pilarski	10	0.0001%	0.0001%	-	10	0.0001%	0.0001%	2	
Witold Klinowski	-	-	-	-	-	-	-	-	
James A. Goltz	-	-	-	-	-	-	-	-	
Dr Gutmann Habig	-	-	-	-	-	-	-	-	
Marcin Murawski	-	-	-	-	-	-	-	-	
Paweł Tamborski	-	-	-	-	-	-	-	-	
<b>Commercial proxies</b>									
Piotr Walasek	19,335	0.18%	0.18%	-	19,335	0.19%	0.19%	3,867	
<b>Total</b>	<b>378,237</b>	<b>3.52%</b>	<b>3.52%</b>	<b>4,000</b>	<b>382,237</b>	<b>3.71%</b>	<b>3.71%</b>	<b>76,447</b>	

Item	Jan 1 2016	Item	Dec 31 2016
Number of shares	10,737,837	Number of shares	10,298,554
Par value per share	0.20	Par value per share	0.20
<b>Share capital</b>	<b>2,147,567.40</b>	<b>Share capital</b>	<b>2,059,710.80</b>

The Management Board of SECO/WARWICK S.A. ("Company") announced that on May 24th 2016 it received a notification given by a Management Board Member under Art. 160 of the Act on Trading in Financial Instruments (the "Notification"). According to the Notification, on May 23rd 2016 the Management Board Member purchased 4,000 Company shares for PLN 17.90 per share. The shares were acquired outside of the regulated market.

As a result of cancellation of treasury shares and registration of share capital reduction, the percentage shares of these holdings in the share capital and total voting rights at the General Meeting changed.

By the issue date of this Report, members of SECO/WARWICK S.A.'s Management and Supervisory Boards did not enter into any other transactions that would involve their holdings of Company shares.



Members of the Management Board and Supervisory Board of SECO/WARWICK S.A. do not hold any shares in related entities.

**7. Agreements (including agreements executed after the end of the reporting period) known to the SECO/WARWICK Group, which may result in changes in the proportions of shares held by the current shareholders and bondholders.**

With a view to providing additional incentives to the Company's management staff to continue work on the development and consolidation of the SECO/WARWICK Group, and to further increase the value of SECO/WARWICK shares, on April 23rd 2015 the Supervisory Board approved the key objectives of the 2016–2018 Incentive Scheme for members of the SECO/WARWICK Group's management staff (the "2016–2018 Incentive Scheme").

General objectives of the Incentive Scheme of SECO/WARWICK S.A.

- The Incentive Scheme is effective for 2016, 2017 and 2018.
- The Incentive Scheme covers 995,750 Company shares which may be distributed to Eligible Persons.
- Scheme Participants include key members of the Group's management staff who are identified as Scheme Participants in the relevant resolution of the Supervisory Board, and in the period between February 1st 2015 and August 15th 2015 acquire with their own funds, in their own name and for their own account no less than 4,000 and no more than 11,500 Company shares. In the case of the President of the Management Board of SECO/WARWICK SA, the number of shares to be acquired is 100,000. In the case of the President of the Management Board of SECOWARWICK Europe, the largest company of the Group, the number of shares to be acquired is 35,000. The price per share is PLN 25.
- The number of acquired shares and the 3.5 multiple defines the number of potential options which may be granted under the Scheme subject to fulfilment of the conditions specified below.
- Shares for a participant's own account must be acquired no later than on August 15th 2015, and may not be sold before June 30th 2022.
- The persons specified in the Supervisory Board's resolution are to declare their intention to participate in the Incentive Scheme by August 31st 2015.
- Participants of the scheme will be assigned individual objectives and a joint objective, the achievement of which is a precondition for a Scheme Participant to become eligible for benefits under the Scheme.
- Achievement of individual objectives is a pre-condition for acquiring rights to 15% of the options in each of the years 2016, 2017 and 2018.
- Achievement of the joint objective is a pre-condition for acquiring rights to 55% of the options in 2016, 2017 and 2018.
- Achievement of the Individual Objectives will be revised on the basis of the Company's audited financial information.
- Achievement of the Individual Objectives will be verified by the Audit Committee by April 30th of each consecutive financial year for the previous financial year.
- Achievement of the Joint Objective will be verified on the basis of the Company's audited financial information for all the financial years between 2016 and 2018.
- Achievement of the Joint Objective will be verified by the Audit Committee by April 30th 2019.
- If a Scheme Participant achieves the Individual Objectives or the Joint Objective, such participant will become eligible to acquire Company Shares in the number and on the terms and conditions specified in the Scheme Rules, and to obtain a Capital Bonus (the "Option").
- Options will vest in accordance with the provisions of agreements to be entered into between the Company and the individual Scheme Participants (the "Option Agreement").
- Rights under Options may not be transferred or encumbered. Such rights are attached to a Scheme Participant and expire upon his/her death.
- An Option entitles a Scheme Participant to purchase Shares at nominal price, in the number specified in the Option Agreement.

- An Option also entitles a Scheme Participant to receive from the Company annual payments whose amount will depend on the amount of dividend paid by the Company for a preceding financial year (the “Capital Bonus”).
- The Capital Bonus for a given financial year will be calculated by July 31st of a given financial year, on the basis of a resolution on distribution of the Company’s profit and the Company’s audited financial information for the previous financial year, based on the following formula:

$$PK_t = \frac{Div_t}{LA} \times LAUP$$

where:

PK <sub>t</sub>	–	the Capital Bonus to be paid in a given financial year,
Div <sub>t</sub>	–	the amount of dividend to be paid in a given financial year,
LA	–	the total number of Company shares participating in dividend payment,
LAUP–		the number of Company shares that a Scheme Participant is entitled to acquire in the exercise of an Option; Shares already delivered to a Scheme Participant are not taken into account in this calculation;

- The right to obtain the Capital Bonus expires on or before the last Distribution Date.
- Date of settlement of the acquisition by a Scheme Participant of Company Shares in the exercise of an Option (Distribution Date)
  - in the case of Scheme Participants other than the President of the Management Board, the Distribution Date will be: June 30th 2020 – in respect of 33% of Shares receivable by a Scheme Participant, June 30th 2021 – in respect of another 33% of Shares receivable by a Scheme Participant, and June 30th 2022 – in respect of the remaining 33% of Shares receivable by a Scheme Participant;
  - in the case of the Management Board President, the Distribution Date will be August 31st 2019 in respect of all Shares receivable by him.

The Supervisory Board determined the Individual Objectives and the Joint Objective for the Incentive Scheme Participants, the achievement of which is a precondition for a Scheme Participant to become eligible for benefits under the Scheme for the financial year 2016. The Objectives cover financial and operating ratios of the individual subsidiaries, the organisational units related to particular technologies, or the entire Group, depending on the position of a Scheme Participant. For the entire Group, the Individual Objective for the President of the Management Board, Chief Financial Officer and Chief Operating Officer at SECO/WARWICK S.A., the Parent, is the consolidated net profit of the Group. For 2016 and 2017, the Objective is set at PLN 18m.

## 8. Control systems for employee stock option plans

With a view to providing additional incentives to the Company’s management staff to continue work on the development and consolidation of the SECO/WARWICK Group, and to further increase the value of SECO/WARWICK shares, on April 23rd 2015 the Annual General Meeting approved the key objectives of the 2016–2018 Incentive Scheme for members of the SECO/WARWICK Group’s management staff (the “2016–2018 Incentive Scheme”). For a detailed description of the key objectives of the Incentive Scheme, see Section 7.

The Scheme is overseen by the Supervisory Board and the Management Board of SECO/WARWICK S.A. Its detailed rules were approved by the Supervisory Board on April 23rd 2015.

## 9. Information on acquisition of own shares, including information on the purpose of the acquisition, number and par value of the shares and percentage of the share capital they represent, acquisition price and selling price (in the case of sale).

In 2016, the Company did not acquire its own shares.

**10. Discussion of key financial and economic data contained in the full-year consolidated financial statements and of factors and events, including non-recurring ones, with a material effect on the Group's operations and profits earned or losses incurred in the financial year; discussion of development prospects in a period covering at least the next financial year**

**STATEMENT OF COMPREHENSIVE INCOME**

In 2016, the SECO/WARWICK Group recorded revenue growth. Sales reported by the Group's key foreign subsidiaries changed as follows: SW Corporation +46.2% (2015: PLN 67.4m, 2016: PLN 98.5m), SW Rus +29.8% (2015: PLN 6.9m, 2016: PLN 9.0m), SW Retech +14.1% (2015: PLN 14.9m, 2016: PLN 17.0m), Retech LLC +2.9% (2015: PLN 124.7m, 2016: PLN 128.3m). Revenue generated by SW Europe also rose, by 26.1% (2015: PLN 254.1m, 2016: PLN 320.4m). The changes were partly offset by lower revenue generated by SW Allied (India) -52.2% (2015: PLN 33.9m, 2016: PLN 16.2m) and SW Germany -31.0% (2015: PLN 22.2m, 2016: PLN 15.3m). Revenue generated in 2016 by SW France and SW Service, the new members of the SECO/WARWICK Group, stood at PLN 1.8m and 23.7m, respectively.

The Group reported total revenue of PLN 566.4m, up PLN 84.9m (17.6%) year on year.

In 2016, the Group companies secured new orders with an aggregate value of PLN 594m, down 6.3% on the previous year (PLN 634m). Despite this decline, the Group's order book at the end of 2016 expanded relative to the end of the previous year, to PLN 490m (end of 2015: PLN 422m).

2016 saw significant changes in the sales structure (by operating segment). The Group reported higher sales in the segments of Aluminium Process (+130%), Melting Furnaces (+33%), Vacuum Furnaces (+12%), and lower sales in the Atmosphere Furnaces (-19%) and CAB (-24%) segments. Sales of spare parts and maintenance services remained broadly unchanged relative to the previous year.

Geographically, in 2016 the EU market accounted for the largest share of the SECO/WARWICK Group's sales (43.3% of total sales). Sales on this market grew 16.2% on 2015, which indicates the market's increased absorptive capacity and higher effectiveness of the Company's sales efforts. It should be also noted that, geographically, the Group posted the strongest sales increase in Russia, Belarus, and Ukraine (+99.9%). In the reporting year, sales also increased in the US (+22.7%), and slightly dropped in Asia (-2.4%).

In 2016, the Company posted a record gross profit of PLN 128.0m, up 28.5% on 2015.

As disclosed in the Company's 2016 consolidated financial data, distribution costs and administrative expenses fell PLN 1.8m compared with 2015.

In 2016, the Company reported net other expenses of PLN -3.9m. Despite this item's negative effect on the results, it should be noted that the figure is much lower compared with PLN -45.8m reported for 2015.

In 2016, the SECO/WARWICK Group posted EBIT of PLN 31.8m compared with the loss of PLN -40.3m in 2015.

Taking into account the above figures, finance costs, as well as tax expenses and profit or loss attributable to non-controlling interests, in 2016 the SECO/WARWICK Group posted a net profit of PLN 19.8m, compared with a net loss of PLN -49.7m in 2015.

**STATEMENT OF FINANCIAL POSITION**

In 2016, total assets grew by 4.9% year on year, from PLN 494.5m in 2015 to PLN 518.7m in 2016. Non-current assets grew 4.8% between December 31st 2015 and December 31st 2016, mostly on the back of increases in intangible assets and long-term receivables. Over the same period, current assets grew 4.9%, and the ratio of non-current to current assets increased slightly year on year, to 59%. Under current assets, the items which recorded the highest increases were prepayments and accrued income, cash and (trade and other) receivables, while contract settlement declined.

Under equity and liabilities, equity increased by 13.5% and current liabilities grew slightly, by 2.8%, while non-current liabilities dropped by 10% year on year in 2016. The only item of non-current liabilities which increased in 2016 relative to 2015 was deferred tax liabilities. Under current liabilities, the largest increase was recorded for bank and other borrowings (up PLN 16.7m or 50.5%). The change in equity was materially driven by the net profit of PLN 19.8m recorded in 2016, compared with the net loss of PLN 49.7m in 2015.

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The structure of equity and liabilities did not change materially year on year. The share of equity in total equity and liabilities was 38.5% at the end of 2016, having increased from 35.6% at the end of 2015. The equity to liabilities ratio grew from 55.3% in 2015 to 63.3% in 2016.

The current ratio rose slightly year on year, to 1.3 from 1.2 in 2015. The quick ratio remained unchanged at 1.1, while the cash ratio increased year on year, from 0.2 in 2015 to 0.4 in w 2016. The ratios indicate that the Company is operationally stable and able to pay its liabilities when due.

Higher sales brought about changes in the efficiency ratios in 2016. The average collection period lengthened from 75 days to 76 days. Inventory turnover improved from 34 days to 31 days, while the average payment period was 213 days. The asset turnover ratio of 5.5 (the non-current asset turnover ratio in particular) confirms the effective use of the Group's production potential.

#### **STATEMENT OF CASH FLOWS**

In 2016, the Group generated negative operating cash flows of PLN -8.0m (2015: PLN 44.1m). The largest items of operating cash flows were the change in accruals, deferrals and contracts (PLN -34.0m), change in receivables (PLN -27.8m), and change in current liabilities, except financial liabilities (PLN 29.1m).

In 2016, cash flows from investing activities were PLN -9.6m (2015: PLN -24.1m), of which PLN 12.4m was spent on investment in non-current assets and intangible assets, mainly at SW Europe.

Cash flows from financing activities included mainly increases in, and repayments of, bank and other borrowings, and dividend distributions. In 2016, cash provided by financing activities exceeded that used in financing activities, thus net cash flows from financing activities totalled PLN 1.4m (2015: PLN -8.7m).

All in all, at the end of 2016 cash amounted to PLN 41.2m and was lower than in 2015.

Given the size of the Group's order book at the end of 2016 (up 16% year on year), the budgets of the individual companies, the market outlook, and the adjustments for 2016, the Management Board has a positive view of the Company's performance in 2016 and its prospects for the coming years. To achieve its long-term strategic goals, the Group needs to continue the efforts undertaken in 2016, especially considering the effect of the Group's key project in the Melting Furnaces segment on the financial performance.

#### **11. Assessment of factors and non-recurring events with a bearing on the Group's results for the financial year; the extent to which such factors or non-recurring events affected the results**

For an analysis and assessment of factors and non-recurring events and their effect on the Group's results, see Section 10 of this Report.

#### **12. Information on the Company's markets, broken down into domestic and foreign markets, on the Company's supply sources for production materials, goods and services, including information on dependence, if any, on any single customer or supplier, or a group of customers or suppliers, and where the share of a single customer or supplier in total revenue equals or exceeds 10% – the company name of such customer or supplier, its share in total sales or purchases, and its formal links with SECO/WARWICK S.A.**

Geographical segments are based on the Company's markets. The Company has identified the following segments:

- the EU market,
- Russian, Belarusian and Ukrainian markets,
- the US market,
- the Asian market,
- other countries.

The Group purchases the majority of materials used in the production of heat treatment equipment on three main markets.

The first and the largest market supplying production materials for the SECO/WARWICK Group is the domestic market. It is followed by the EU (with Germany as the largest supplier). The US market is the third supply market for the Group in terms of both importance and volume.

In addition to these three main supply markets, the Group also purchases production materials in India, China and Japan.

With a broad supplier base and access to numerous markets, the Group does not depend on any single supplier (there is no single supplier whose sales to the Group would account for more than 10% of the Group's total revenue) and is able to ensure uninterrupted production of heat treatment equipment.

Customers buying the Group's products operate in the automotive, aviation, power, machine-tool, medical equipment, electrical engineering and machine-building industries. The economic situation on those markets affects the situation of many other associated markets. The Group supplies its products both to manufacturers from the abovementioned industries and to their suppliers. The Group's customers include both automotive and aircraft manufacturers as well as producers of components and machine spare parts. The machine-building industry, understood as a group of customers purchasing the Group's products, encompasses a wide variety of business activities whose development is driven by GDP growth. In 2016, the Group's revenue from sales to Ecotitanium of France represented 12% of the Group's total revenue.

### **13. Agreements significant to the Group's business, including shareholder agreements known to the Group, insurance, partnership or cooperation agreements**

In Current Report No. 31/2016 the Management Board of SECO/WARWICK S.A. announced that it was notified that on November 8th 2016 the following shareholders of the Company:

- (i) SW Holding sp. z o.o. ("SWH"), holding 3,387,139 Company shares,
- (ii) Spruce Holding LLC ("SHLLC"), holding 1,123,337 Company shares,
- (iii) Paweł Wyrzykowski ("PW"), holding 255,000 Company shares,
- (iv) Andrzej Zawistowski ("AZ"), holding 65,000 Company shares,
- (v) Bartosz Klinowski ("BK"), holding 35,000 Company shares,

(SWH, SHLLC, PW, AZ and BK, jointly the "Shareholders") signed of a share lock-up agreement (the "Agreement").

Pursuant to the Agreement, the Shareholders agreed not to dispose of, offer or pledge the following holdings of Company shares:

- (i) 3,387,139 Company shares held by SWH,
- (ii) 1,123,337 Company shares held by SHLLC,
- (iii) 255,000 Company shares held by PW,
- (iv) 65,000 Company shares held by AZ, and
- (v) 35,000 Company shares held by BK.

The lock-up restrictions imposed under the Agreement remain in effect until December 31st 2019, but they may expire before that date in certain circumstances agreed by the Parties in the Agreement.

In 2016, neither SECO/WARWICK S.A. nor its Group companies entered into any significant insurance, partnership or cooperation agreements. Likewise, SECO/WARWICK S.A. has no knowledge of any other significant shareholder agreements.

### **14. Related-party transactions concluded by the SECO/WARWICK Group other than arm's length transactions**

In 2016, SECO/WARWICK S.A. and its subsidiaries did not enter into any transactions with related entities other than transactions executed on an arms' length basis.

**15. Information on agreements on bank and other borrowings executed or terminated in the financial year, including at least information on the types, amounts and interest rates, as well as currencies and repayment dates**

**Short-term and long-term bank and other borrowings as at December 31st 2016**

Lender	Borrowing amount		Repayment date	Security	Interest rate	Type
	PLN ('000)	Foreign currency ('000)				
HSBC Bank	1,866	USD 500	-	SBLC	fixed	Overdraft facility
HSBC Bank	784	CNY 1,303	Mar 2017	Guarantee	fixed	Overdraft facility
HSBC Bank	12	USD 3	Jun 2017	Guarantee	fixed	Overdraft facility
CITI BANK	3,355	CNY 5,578	Jan 2017	SBLC	fixed	Overdraft facility
CITI BANK	171	USD 41	Nov 2017	SBLC	fixed	Overdraft facility
Toyota Kreditbank	73	EUR 17	Nov 1 2018	-	fixed	Overdraft facility
BNP Paribas	19	EUR 4	Nov 15 2017	-	fixed	Overdraft facility
Mercedes Benz	5	EUR 1	May 30 2017	-	fixed	Overdraft facility
Commerzbank	1,327	EUR 300	Oct 31 2017	-	fixed	Overdraft facility
Commerzbank	601	EUR 136	Oct 31 2017	-	fixed	Overdraft facility
Toyota	46	EUR 10	Feb 15 2021	-	fixed	Overdraft facility
Toyota	86	EUR 20	May 15 2021	-	fixed	Overdraft facility
Toyota	88	EUR 20	May 15 2021	-	fixed	Overdraft facility
Toyota	90	EUR 20	Jun 15 2021	-	fixed	Overdraft facility
Union Bank of India	1,566	INR 25,450	Sep 13 2021	-	fixed	Overdraft facility
Union Bank of India	5,524	INR 89,747	-	-	fixed	Overdraft facility
Union Bank of India	4,016	INR 65,247	-	-	fixed	Overdraft facility
Citi Bank N.A.	3,670	INR 59,618	-	SBLC	fixed	Overdraft facility
Kotak Mahindra Bank	624	INR 10,144	Oct 10 2018	-	fixed	Overdraft facility
Union Bank of India	31	INR 501	Aug 30 2020	-	fixed	Overdraft facility

Union Bank of India	34	INR 550	Aug 30 2020	-	fixed	Overdraft facility
SW Allied shareholders	3,293	INR 53,503	-	-	-	Preference shares (1)
HSBC Bank	8,985	USD 2,150	-	-	fixed	Overdraft facility
BZ WBK	1,994	-	Jun 30 2017	-	variable	Overdraft facility
mBank	36	-	-	-	-	Credit card limit
mBank	3	EUR 1	-	-	-	Credit card limit
BRE	50	-	-	-	-	Credit card limit
BRE	7	USD 2	-	-	-	Credit card limit
BRE	185	EUR 42	-	-	-	Credit card limit
BZ WBK	14,418	-	Jul 21 2017	promissory note	variable	Overdraft facility
mBANK S.A.	20,524	-	Jan 31 2020	mortgage, SECO/WARWICK EUROPE Sp. z o.o.'s surety under civil law, hold on securities mortgage of up to USD 3,750 thousand,	variable	Investment overdraft facility
Bank Handlowy	3,954	USD 946	Apr 27 2018	SECO/WARWICK EUROPE Sp. z o.o.'s surety under civil law	variable	Investment overdraft facility
<b>Total:</b>	<b>77,441</b>					

## 16. Sureties and guarantees issued and received in the financial year

Contingent liabilities under guarantees and sureties issued amounted to PLN 68,429 thousand as at the end of 2016 and PLN 75,507 thousand as at the end of 2015. The guarantees were issued in respect of:

- APG → advance payment guarantee
- BB → bid bond
- CRG → credit repayment guarantee
- PBG → performance bond guarantee
- SBLC → stand-by letter of credit
- WAD → bid bond guarantee
- CRB → credit repayment bond

**17. Information on loans advanced in the financial year, in particular loans to related entities, including at least information on the types, amounts and interest rates, as well as the currencies and repayment dates**

No loans were advanced by SECO/WARWICK S.A. to members of the Management or the Supervisory Board, or any non-related parties in 2016.

On March 3rd 2016, SECO/WARWICK S.A. advanced a USD 230.8 thousand loan to its subsidiary, SECO/WARWICK Corporation. The loan amount in PLN was PLN 912 thousand. The loan was cancelled in 2016.

On November 14th 2016, SECO/WARWICK S.A. advanced a PLN 1m loan to its subsidiary, SECO/WARWICK Europe.

On April 14th 2016, SECO/WARWICK Europe Sp. z o.o. advanced a EUR 470 thousand loan to its related party, SECO/WARWICK Germany GmbH.

On December 9th 2016, SECO/WARWICK Europe Sp. z o.o. advanced a PLN 1m loan to its related party, SECO/WARWICK Services Sp. z o.o.

**18. Assessment (and grounds for the assessment) of financial resources management, including in particular an assessment of the Group's ability to repay its liabilities, as well as an identification of threats, if any, and measures used or intended to be used by the Group to mitigate such threats; feasibility of planned investments, including equity investments, in view of the funds available to the Group; possible changes in the financing of the investments**

As at December 31st 2016, the SECO/WARWICK Group's outstanding debt under investment facilities and overdraft facilities was PLN 77,441 thousand, having increased from PLN 69,319 thousand at the end of 2015.

The funds and credit facilities available to the Group were sufficient to finance investments and capital expenditure planned for and executed in 2016.

In the Parent Management Board's opinion, as at the end of the reporting period there was no threat of the Company's failure to meet its liabilities.

The table below presents the liquidity ratios of the SECO/WARWICK Group.

<b>LIQUIDITY RATIOS</b>	<b>Dec 31 2016</b>	<b>Dec 31 2015</b>
Current ratio	1.3	1.2
Quick ratio	1.1	1.1
Cash ratio	0.4	0.2

**19. Issue of securities and use of issue proceeds by SECO/WARWICK S.A.**

No such events occurred in 2016.

**20. Explanation of discrepancies between the financial results disclosed in the annual report and the previously released forecasts for the year, if any**

The SECO/WARWICK Management Board did not publish any forecasts of the Company's or the Group's financial performance in 2016.



**21. Description of material risk factors and threats, including information on the degree of the Group's exposure to such risks or threats**

In the course of its operating and financing activities, the SECO/WARWICK Group is exposed to risks arising mainly in connection with the financial instruments held. Those risks may be broadly defined as market risk, comprising currency risk, interest rate risk, liquidity risk and credit risk. The objective behind the Group's financial risk management is to mitigate any adverse movements in foreign exchange and interest rates, stabilise cash flows and ensure an adequate level of liquidity and financial flexibility. The rules of financial risk management within the Group are determined by the Parent's Management Board. As part of the risk management process, an expert management accounting system has been developed and implemented. The key risk parameters at the level of operating and financing activities are monitored through monthly reports for the Group companies.

**21.1 Currency risk**

Its active international presence and a broad geographical reach require the Group to enter into transactions denominated in foreign currencies. Some of the Group's borrowings and other financial liabilities are also denominated in foreign currencies. This exposes the Company to the risk of exchange rate fluctuations.

Foreign-currency financial assets and liabilities translated into PLN using the closing exchange rate prevailing at the reporting date:

	As at <u>31/12/2016</u> in foreign currency	As at <u>31/12/2016</u> in PLN	As at <u>31/12/2015</u> in foreign currency	As at <u>31/12/2015</u> in PLN
<b>Liabilities</b>				
EUR	2,906	12,854	1,874	7,987
USD	4,547	19,005	4,202	16,391
<b>Assets</b>				
EUR	15,459	68,390	17,311	73,769
USD	5,479	22,899	9,087	35,451
<b>Notional amount of hedging instrument</b>				
EUR	22,127	97,890	21,990	93,710
USD	14,114	58,987	21,666	84,521
<b>Goodwill</b>				
EUR	391	1,730	406	1,730
USD	9,204	38,464	9,860	38,464

The Group is mainly exposed to foreign currency risk related to EUR and USD, and – due to its operations in India – to INR.

Presented below is a sensitivity analysis for financial assets and liabilities, showing the effect of movements in the EUR/PLN, USD/PLN, and INR/PLN exchange rates on the Company's profit or loss and other comprehensive income.

## Assumptions:

- exchange rate at reporting date Dec 31 2016
- + 10% increase in exchange rate
- 10% decrease in exchange rate

Exchange rate at Dec 31 2016	Exchange rate	+ 10% increase in exchange rate	- 10% decrease in exchange rate
USD	4.1793	0.4179	-0.4179
EUR	4.4240	0.4424	-0.4424

Exchange rate at Dec 31 2015	Exchange rate	+ 10% increase in exchange rate	- 10% decrease in exchange rate
USD	3.9011	0.3901	-0.3901
EUR	4.2615	0.4262	-0.4262

The currency risk exposure changes over the year, depending on the volume of transactions executed in foreign currencies. Nevertheless, the following sensitivity analysis is considered to be representative of the Company's exposure to foreign currency risk.

Effect on equity		Effect of USD	Effect of USD	Effect of EUR	Effect of EUR
		Period ended 31/12/2016	Period ended 31/12/2015	Period ended 31/12/2016	Period ended 31/12/2015
<b>ASSETS</b>					
Increase in exchange rate	10%	6,136	7,392	7,012	7,550
Decrease in exchange rate	-10%	-6,136	-7,392	-7,012	-7,550
<b>LIABILITIES AND BORROWINGS</b>					
Increase in exchange rate	10%	-7,799	-10,091	-11,074	-10,170
Decrease in exchange rate	-10%	7,799	10,091	11,074	10,170
<b>TOTAL</b>					
Increase in exchange rate	10%	-1,663	-2,700	-4,062	-2,620
Decrease in exchange rate	-10%	1,663	2,700	4,062	2,620
<b>Effect on profit/loss</b>		<b>Effect of USD</b>	<b>Effect of USD</b>	<b>Effect of EUR</b>	<b>Effect of EUR</b>
		<b>Period ended 31/12/2016</b>	<b>Period ended 31/12/2015</b>	<b>Period ended 31/12/2016</b>	<b>Period ended 31/12/2015</b>
<b>ASSETS</b>					
Increase in exchange rate	10%	2,290	3,545	6,839	7,377
Decrease in exchange rate	-10%	-2,290	-3,545	-6,839	-7,377
<b>LIABILITIES AND BORROWINGS</b>					
Increase in exchange rate	10%	-7,799	-10,091	-11,074	-10,170
Decrease in exchange rate	-10%	7,799	10,091	11,074	10,170
<b>TOTAL</b>					
Increase in exchange rate	10%	-5,509	-6,546	-4,235	-2,793
Decrease in exchange rate	-10%	5,509	6,546	4,235	2,793

## 21.2 Interest rate risk

The Group companies use interest-bearing liabilities. Therefore, the Group is exposed to interest rate risk, with the risk assessment presented based on a 1% increase/decrease in interest rates.

	Effect on net profit/loss	Effect on equity	Effect on profit/loss before tax	Effect on equity
	+ 1%/- 1%		+ 1%/- 1%	
	Year ended Dec 31 2016		Year ended Dec 31 2015	
Lease liabilities	+/- 28	+/- 28	+/- 20	+/- 20
Other financial liabilities at amortised cost	+/- 774	+/- 774	+/- 693	+/- 693

For the purposes of the assessment the average interest rate was assumed at 5.4% for 2016 and 7.4% for 2015. In 2016, total borrowings amounted to PLN 77,441 thousand (2015: PLN 69,319 thousand) and financial liabilities totalled PLN 2,762 thousand (2015: PLN 1,928 thousand). The effect of interest rate movements on profit or loss and equity was calculated by adding/deducting 1pp to/from the average interest rate.

The purpose of interest rate risk management is to maintain the adverse effect of fluctuations in market interest rates on cash flows at the level acceptable to the Group.

## 21.3 Liquidity risk

Liquidity risk is the risk that the Company may face problems with meeting its financial liabilities. Liquidity risk is managed by projecting future cash flows, analysing the relation of liquid assets to cash flows, monitoring liquidity ratios based on items of the statement of financial position and ensuring constant access to various sources of financing at the level of individual Group companies.

The Group also manages its liquidity risk by maintaining available unused credit facilities which serve as a liquidity reserve securing solvency and financial flexibility. The Company considers its bank borrowings as financial instruments that may potentially lead to a concentration of liquidity risk as the Company enters into cooperation with selected financial institutions only. As at December 31st 2016, bank borrowings represented 19% of total current liabilities (December 31st 2015: 13%).

The table below presents the Group's financial liabilities by maturity as at December 31st 2016 and December 31st 2015, based on contractual undiscounted payments.

Dec 31 2016	Payable on demand	up to 1 year	1–5 years	Over 5 years	Total Dec 31 2016
Trade payables	-	67,712	244	-	<b>67,957</b>
Leases	-	656	2,106	-	<b>2,762</b>
Derivative instruments	-	6,135	559	-	<b>6,694</b>
Interest-bearing bank and other borrowings	-	49,978	27,462	-	<b>77,441</b>
Other liabilities	-	13,527	80	-	<b>13,607</b>
<b>TOTAL</b>	-	<b>138,008</b>	<b>30,452</b>	-	<b>168,216</b>

Dec 31 2015	Payable on demand	up to 1 year	1–5 years	Over 5 years	Total as at Dec 31 2015
Trade payables	-	53,899	-	-	53,899
Leases	-	737	1,191	-	1,928
Derivative instruments	-	3,197	1,699	-	4,896
Interest-bearing bank and other borrowings	-	33,218	36,102	-	69,319
Other liabilities	-	15,052	394	-	15,445
<b>TOTAL</b>	-	<b>106,102</b>	<b>39,385</b>	-	<b>145,487</b>

#### 21.4 Credit risk

The Group operates a policy of selling its products and services only to customers whose credibility has been verified. Management believes that thanks to this policy there is no additional credit risk beyond the level defined by the impairment losses recognised with respect to uncollectible trade receivables. The Group discloses no past due receivables which would not have been deemed uncollectible.

The Group defines its exposure to credit risk as the total amount of outstanding receivables and monitors the balances owed by each customer on a regular basis. As at December 31st 2016, the share of receivables from one of the customers was in the range 10%–15% of total net trade receivables.

The maturity structure of receivables is presented in Note 19 to the consolidated financial statements.

The Group manages counterparty credit risk using mainly the following mechanisms and techniques:

- assessment of a counterparty's financial standing and assignment of a credit limit;
- application of uniform contractual provisions regarding credit risk;
- system of ongoing monitoring of payments;
- ongoing monitoring of a counterparty's financial standing.

## 22. Statement of compliance with corporate governance principles by the SECO/WARWICK Group in 2016

### a. Identification of the set of corporate governance principles followed by the Parent of the SECO/WARWICK Group and place where the text of the rules is publicly available

SECO/WARWICK S.A. is subject to the Code of Best Practice for GPW Listed Companies 2016 implemented under Resolution No. 26/1413/2015 passed by the Supervisory Board of Giełda Papierów Wartościowych w Warszawie S.A. (WSE) on October 13th 2015.

The Code is available to the public at [www.corp-gov.gpw.pl](http://www.corp-gov.gpw.pl) and [www.secowarwick.com](http://www.secowarwick.com).

The Company did not observe any corporate governance principles going beyond the requirements stipulated by Polish law.

### b. Scope of non-compliance with the corporate governance rules referred to above, specification of the rules not complied with, and explanation of why they were not complied with and how the company intends to eliminate the effects (if any) of non-compliance with a given rule or measures it intends to take to reduce the risk of non-compliance with a given rule in the future

In 2016, acting under Par. 29.3 of the WSE Rules, the Company submitted a report on the Company's compliance with the recommendations and principles laid down in the Code of Best Practice for GPW Listed Companies 2016. The report is available at [www.secowarwick.com](http://www.secowarwick.com).

According to the report, SECO/WARWICK S.A. did not comply with the following principles and recommendations:

- **I.Z.1.19.** A company should operate a corporate website and publish on it shareholders' questions asked to the management board pursuant to Article 428.1 or 428.6 of the Commercial Companies Code together with answers of the management board to those questions, or a detailed explanation of the reasons why no answer is provided, pursuant to principle IV.Z.13.
  - The Company's commentary: The Company complies with this principle where it obliges the Company to publish shareholders' questions asked to the management board pursuant to Article 428.1 or 428.6 of the Commercial Companies Code together with the management board's answers to those questions by fulfilling the obligation set forth in Par. 38.1.12 of the Minister of Finance's Regulation on current and periodic information of February 19th 2009. However, the Company believes that publishing shareholders' questions which the Company refused to answer pursuant to Article 428.2 or 428.3 of the Commercial Companies Code, which would mean full compliance with the principle discussed, could be detrimental to the Company's interests. Having no control over the contents, scope and wording of such questions, the Company would be obliged to publish them even if their publication were detrimental to the Company's interests or cause the Company to incur liability to third parties.
- **I.Z.1.20.** A company should operate a corporate website and publish on it a record of the General Meeting in audio or video format.
  - The Company's commentary: Given the Company's concentrated ownership structure, the Company does not record its General Meetings in electronic form. General Meetings are attended by shareholders representing over 50% of the share capital. Each General Meeting is broadcast live on the Company's corporate website.
- **III.Z.3.** The independence rules defined in generally accepted international standards of the professional internal audit practice apply to the person heading the internal audit function and other persons responsible for such tasks.
  - The Company's commentary: Given the scale and profile of its business, the Company has not designated an independent internal audit function and thus does not apply this principle. The Company has implemented appropriate internal systems suitable for the scale and profile of its business.
- **III.Z.4.** At least once a year, the person responsible for the internal audit function (if such function is designated within the Company) and the Management Board shall present to the Supervisory Board their own evaluation of the effectiveness of systems and functions referred to in Principle III.Z.1, together with an appropriate report.
  - The Company's commentary: Given the scale and profile of its business, the Company has not designated an independent internal audit function and thus does not apply this principle.
- **IV.R.2.** If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through:
  - real-life broadcast of the general meeting;
  - real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting;
  - exercise of the right to vote during a general meeting either in person or through a plenipotentiary.
  - The Company's commentary: The Company's general meetings are not held with the use of electronic communication means. The Company believes that considering its concentrated ownership structure and financial aspects the use of electronic communication would not be reasonable. However, the Company declares that it will make an effort to implement the principle at the Company if a wider group of shareholders so request.

- **IV.Z.13.** If a shareholder requests information about the company, the management board of the company should provide an answer to the shareholder's request within 30 days or inform the shareholder of its refusal to provide such information where the management board has made such decision pursuant to Art. 428.2 or Art. 428.3 of the Commercial Companies Code.
  - The Company's commentary: The Company seeks to comply with this principle in full, yet this may prove difficult or impossible in practice. In certain cases it may happen that in order to answer shareholder questions exhaustively the Company needs more than the 30-day time limit set by the principle, especially if to give an answer the Company is required to conduct additional analyses or ask employees or members of the Company's governing bodies for clarifications.
  
- **VI.Z.4.** In the activity report, the company should report on the remuneration policy including at least the following:
  - 1) general information about the company's remuneration system;
  - 2) information about the conditions and amounts of remuneration of each management board member broken down by fixed and variable remuneration components, including the key parameters of setting the variable remuneration components and the terms of payment of severance allowances and other amounts due on termination of employment, contract or other similar legal relationship, separately for the company and each member of its group;
  - 3) information about non-financial remuneration components due to each management board member and key manager;
  - 4) significant amendments of the remuneration policy in the last financial year or information about their absence;
  - 5) assessment of the implementation of the remuneration policy in terms of achievement of its goals, in particular long-term shareholder value creation and the company's stability.
  - The Company's commentary: This principle is not applied as the Company has not adopted any a remuneration policy. Remuneration of the Management Board Members is defined by the Company's Supervisory Board, while the Supervisory Board Members receive monthly lump-sum remuneration in amounts defined by resolution the Company General Meeting. The amounts of remuneration paid to the Management Board Members are disclosed in the Directors' Report on the Company's operations.

### **c. Main characteristics of the SECO/WARWICK Group's systems of internal control and risk management with respect to preparation of financial statements and consolidated financial statements**

The Management Board of the Parent is responsible for the Group's internal control system and its effectiveness in the process of preparation of periodic reports and financial statements prepared and published in accordance with the Regulation on current and periodic information to be published by issuers of securities of February 19th 2009.

The main objective of the Group's internal control system applied to financial reporting is to ensure adequacy, reliability, and accuracy of financial information presented in periodic reports and financial statements. The Group's effective internal control and risk management system applied to financial reporting was developed based on:

- **Clear division of responsibilities and organisation of work in the financial reporting process**

Responsibility for the preparation of the Group's financial statements, current management reports, and periodic financial reports lies with the Parent's Financial Department, headed by the Chief Financial Officer.

Financial statements of the SECO/WARWICK Group are prepared by the staff of the Parent's Financial Department, based on financial data contained in the financial and accounting system, as approved by the Chief Financial Officer, and on other additional data provided by designated employees from other departments in the Group. Prior to being handed over to an external auditor, complete financial statements are reviewed by the Head of the Accounting Department and then by the Chief Financial Officer.

Periodic reports of the Group are prepared by the staff of the Financial Department, based on financial data contained in the financial and accounting system, as approved by the Chief Financial Officer, and on other

additional data provided by designated employees of other departments. Prior to being handed over to an external auditor, complete periodic reports are reviewed by the Head of the Accounting Department and then by the Chief Financial Officer.

- **Precise definition of the scope of the Group's financial reporting**

The Group reviews its strategy and business plans annually, in cooperation with its senior and middle management. Based on the outcome of the review, the Group carries out a budgeting process covering all areas of its operations. During the year, the Parent's Management Board analyses current financial performance and compares it against the adopted budget in accordance with the management reporting system adopted by the Group and based on the Group's accounting policies (International Financial Reporting Standards), taking into account the format and level of detail of the financial data presented in periodic financial statements of the SECO/WARWICK Group.

The accounting policies applied to statutory reporting are included in the budgeting process and in the Group's management reporting system.

The Group makes every effort to ensure that the financial statements, periodic reports, and other reports presented to investors are based on consistently applied accounting policies.

- **Regular reviews of the Group's performance, based on the financial reporting system used by the Group**

Financial data used to prepare financial statements and periodic reports is sourced from the financial and operational reports prepared by the SECO/WARWICK Group. After the closing of accounts for each calendar month, the employees of the Financial Department, acting under the direction of the Chief Financial Officer, analyse the Group's financial results by business segments in the context of original objectives.

Any errors revealed during the analysis are corrected immediately in accordance with the adopted accounting policies.

The work on financial statements and periodic reports starts only after the results recorded in a closed month (reporting period) have been approved by the Chief Financial Officer.

- **Requirement to submit financial statements for approval prior to their publication**

Periodic reports and financial statements, once reviewed or audited by the auditor, are submitted to the members of the Parent's Supervisory Board.

All members of the Supervisory Board are offered an opportunity to get acquainted with the financial statements or auditor's report. All queries can be discussed with Chief Financial Officer, who is available for this purpose to the members of the Supervisory Board.

- **Audit/review of financial statements by an external auditor**

In accordance with the applicable legal regulations, the SECO/WARWICK Group submits its financial statements for a review or audit, as appropriate, by a qualified external auditor.

- **Engaging the Parent's internal audit functions in the assessment of the control mechanisms in place at the SECO/WARWICK Group**

SECO/WARWICK EUROPE appoints a CEO Proxy for Quality Assurance and Turnover Control, who participates in the analysis of processes and, through internal audits, in the assessment of the control mechanisms. The programme of half-year internal audits is created based on an analysis of the findings of the previous audits, taking into account the significance of particular processes in place. The audit programme is approved by the CEO, member of the Management Board, and is implemented by a team of auditors. Apart from scheduled audits, there are also audits reviewing the conclusions of previous audits, and unscheduled audits conducted at the request of the Management Board.



Internal auditors prepare reports that include their comments and information on any identified inconsistencies. Auditors' reports may also include determinations reflecting changes made in a given area. The audit results are used by the managers of organisational units to introduce improvements to control mechanism in the processes they supervise. If changes apply to the company as a whole, they are introduced, if necessary, by the Proxy in the system documentation.

**d. Shareholders holding, directly or indirectly, major holdings of shares**

**Table: Shareholders holding – directly or indirectly through subsidiaries – 5% or more of the total vote at the General Meeting as at December 31st 2016 and as at the date of release of this Report:**

Shareholder	Number of shares	Ownership interest (%)	Number of votes	% of total vote at General Meeting
SW Holding	3,387,139	32.89%	3,387,139	32.89%
Spruce Holding Limited Liability Company (USA)	1,123,337	10.91%	1,123,337	10.91%
Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK	1,046,573	10.16%	1,046,573	10.16%
Bleauhard Holdings LLC	637,028	6.19%	637,028	6.19%
Nationale-Nederlanden Otwarty Fundusz Emerytalny	600,000	5.83%	600,000	5.83%
Metlife OFE	577,470	5.61%	577,470	5.61%

The data presented in the table is based on notifications received from the shareholders.

SECO / WARWICK S.A. holds 598,500 treasury shares representing 5.81% of the share capital. The Company does not exercise voting rights in respect of its treasury shares.

From the date of issue of the Q3 2016 report to the date of issue of the full-year report for 2016, there were no changes in large holdings of Company shares.

**e. Holders of any securities that confer special control powers, and description of such powers**

SECO/WARWICK S.A. (Parent) has not issued any securities conferring special control powers with respect to SECO/WARWICK S.A.

**f. Restrictions on the exercise of voting rights such as restrictions on the exercise of voting rights by holders of a certain portion or number of votes, time limits for exercising voting rights, and provisions under which, with the Company's cooperation, the financial rights attaching to securities are separated from the holding of the securities**

There are no restrictions at the Parent on the exercise of voting rights such as restrictions on the exercise of voting rights by holders of a certain portion or number of votes, time limits for exercising voting rights, or provisions under which, with the Company's cooperation, the financial rights attaching to securities are separated from the holding of the securities.

**g. Restrictions on transferability of the Company securities**

In Current Report No. 31/2016 the Management Board of SECO/WARWICK S.A. announced that it was notified that on November 8th 2016 the following shareholders of the Company:

- (i) SW Holding sp. z o.o. ("SWH"), holding 3,387,139 Company shares,
- (ii) Spruce Holding LLC ("SHLLC"), holding 1,123,337 Company shares,
- (iii) Paweł Wyrzykowski ("PW"), holding 255,000 Company shares,
- (iv) Andrzej Zawistowski ("AZ"), holding 65,000 Company shares,
- (v) Bartosz Klinowski ("BK"), holding 35,000 Company shares,

(SWH, SHLLC, PW, AZ and BK, jointly the “Shareholders”) signed of a share lock-up agreement (the “Agreement”).

Pursuant to the Agreement, the Shareholders agreed not to dispose of, offer or pledge the following holdings of Company shares:

- (i) 3,387,139 Company shares held by SWH,
- (ii) 1,123,337 Company shares held by SHLLC,
- (iii) 255,000 Company shares held by PW,
- (iv) 65,000 Company shares held by AZ, and
- (v) 35,000 Company shares held by BK.

The lock-up restrictions imposed under the Agreement remain in effect until December 31st 2019, but they may expire before that date in certain circumstances agreed by the Parties in the Agreement.

#### **h. Description of the rules governing the appointment and removal from office of the management staff, and of their powers, including in particular the power to decide on an issue or buyback of shares**

The Parent’s Management Board consists of two to five members and is appointed and removed from office by the Supervisory Board, which has the power to appoint any number of Vice-Presidents. Members of the Management Board are appointed for a joint three-year term of office. The Management Board comprises the President of the Management Board, Vice-Presidents and members. When appointing the members of the Management Board, the Supervisory Board decides who will be appointed to the positions of the President and Vice-Presidents of the Management Board. The mandate of a member of the Management Board expires on the date of the General Meeting approving the report on the Management Board’s operations, the statement of financial position and the statement of comprehensive income for the last full financial year in which the member held the office. Members of the Management Board may be re-appointed for another term of office. The Management Board may appoint one or more commercial proxies

The Management Board has all powers to manage the Company’s affairs other than those which fall within the exclusive scope of competence of the other governing bodies of the Company. The Management Board defines the overall organisation structure of the Company and the principles of its operation. For this purpose it may issue relevant rules and other internal regulations. Every member of the Management Board may, without a prior resolution of the Management Board, manage any affairs of the Company falling within the scope of the day-to-day management, except where, before the matter is settled, at least one member objects to it. Each Management Board member may individually incur a liability or dispose of a right for an amount of up to PLN 200,000.00 (two hundred thousand). Assuming an obligation or disposing of a right in excess of PLN 200,000.00 (two hundred thousand zloty) requires two Management Board members acting jointly or a Management Board member acting jointly with a commercial proxy authorised to act individually, or a Management Board member acting jointly with a commercial proxy holding joint powers of proxy. Any issues which fall beyond the scope of the day-to-day management of the Company’s affairs require a resolution of the Management Board.

The Company shares may be cancelled upon the shareholder’s consent through the acquisition of the shares by the Company (“voluntary cancellation”) or without the shareholder’s consent (“compulsory cancellation”), in compliance with the provisions of the Commercial Companies Code. Shares may be cancelled without the shareholder’s consent on the basis of a resolution of the General Meeting if: the shareholder is declared bankrupt; an enforcement procedure has been instituted with respect to the shares; a court of general jurisdiction has declared in civil proceedings that the shareholder acted to the detriment of the Company; a final ruling has been issued convicting the shareholder of a crime connected with acting to the detriment of the Company.

Compulsory cancellation is effected against compensation, which may not be lower than the value of net assets attributable to the shares, as disclosed in the financial statements for the previous financial year, less the amount allocated for distribution among the shareholders. The General Meeting may cancel all or part of a shareholder’s shares at the shareholder’s written request. In such a case, the value of the cancelled shares is determined by a resolution of the Company’s General Meeting, with a proviso that the resolution is valid only if the shareholder requesting the cancellation of the shares votes in favour of the resolution. The Company may acquire its own shares for the purpose of retiring them or for other purposes set forth in Art. 362.1 of the

Commercial Companies Code. The General Meeting may authorise the Management Board to acquire the Company shares from the shareholders with a view to retiring them.

**i. Rules governing amendments to the Parent's Articles of Association**

In accordance with Art. 430.1 of the Commercial Companies Code, any amendment to SECO/WARWICK S.A.'s Articles of Association requires a resolution by the General Meeting and must be entered in the relevant court register. Amendments to the Articles of Associations are notified to the registry court by the Management Board of SECO/WARWICK S.A. The General Meeting of the Company may authorise the Supervisory Board to prepare a consolidated text of the amended Articles of Association or to make other editorial changes specified in the General Meeting's resolution.

**j. Manner of operation of the General Meeting, its basic powers and description of the shareholder rights, along with the procedure for their exercise, including in particular rules provided for in the Rules of Procedure for the General Meeting, if any, unless such information follows directly from the provisions of law**

The General Meeting operates according to the Rules of Procedure for the General Meeting of SECO/WARWICK S.A., adopted by virtue of Resolution No. 32 of the SECO/WARWICK S.A. General Meeting of June 24th 2016. The General Meeting may only be attended by persons who are the Company's shareholders sixteen days prior to the date of the General Meeting. The record date for participation in the General Meeting is the same for the holders of rights under bearer and under registered shares. (Art. 406 [1] of the Commercial Companies Code) Holders of rights under registered shares and provisional certificates, as well as pledgees and usufructuaries holding voting rights, are entitled to participate in the General Meeting of a public company only if they are entered in the share register as at the record date (Art. 406 [2] of the Commercial Companies Code) The General Meeting may be attended by persons whose presence is considered indispensable by the Supervisory Board or Management Board (Par. 4 of the Rules of Procedure for the General Meeting).

After presentation of each item on the agenda, the Chairman of the General Meeting opens the discussion and gives floor in the order in which the participants requested to speak. While taking the floor, the shareholder may speak only on the matters included in the agenda and discussed at a given moment. With respect to each agenda item being discussed, a shareholder is entitled to give one speech and one reply (Par. 14 of the Rules of Procedure for the General Meeting).

Depending on their subject matter, resolutions of the General Meeting are adopted by the majority of votes required by the Company's Articles of Association, the Commercial Companies Code, or other generally applicable laws (Par. 18 of the Rules of Procedure for the General Meeting).

Resolutions of the General Meeting are adopted in an open ballot, subject to the provisions of Par. 17.2 on voting by secret ballot in the following cases: elections; proposals to remove a member of the Company's governing body or its liquidator; proposals to bring a member of the Company's governing body or its liquidator to account; proposals concerning personnel matters, at the request of at least one shareholder present or represented at the General Meeting; in any other cases provided for in generally applicable laws (Par. 16 of the Rules of Procedure for the General Meeting).

The Chairman of the General Meeting presents the agenda of the Meeting and submits it for approval by the General Meeting. If no objections are raised, the agenda is deemed approved by the General Meeting (Par. 9 of the Rules of Procedure for the General Meeting). After the Chairman of the General Meeting closes the list of speakers, no speakers may be added to the list, and after the discussion is declared closed, no speakers may take the floor and no proposals referred to in Par. 15 of Rules and Procedure for the General Meeting may be submitted.

In 2016, the Annual General Meeting of SECO/WARWICK S.A., formally convened, was held on June 24th 2016. The General Meeting was convened at the request of the Management Board. No requests to convene a General Meeting were submitted by shareholders in 2016.

The General Meeting was held in accordance with the Commercial Companies Code, the Rules of Procedure for the General Meeting of SECO/WARWICK S.A. and the Code of Best Practice for WSE-Listed Companies. The shareholders were afforded the opportunity to read draft resolutions for the General Meeting as these were

published on the Company's website and in Current Report No. 18/2016 of May 24th 2016 at least 26 days prior to the General Meeting. The Company approved the documents submitted by the shareholders and their proxies, and recognised the validity of the powers of proxy, right to represent and participate in the General Meeting.

Within its powers, the Annual General Meeting adopted resolutions essential for proper operation of the Company, including a resolution on the approval of the Directors' Report on the Company's operations and the financial statements for the financial year 2015, allocation of profit for the financial year 2015, approval of the Directors' Report on the Group's operations and the consolidated financial statements of the SECO/WARWICK Group for the financial year 2015, and granting discharge in respect of performance of duties to members of the Company's governing bodies. The General Meeting also passed resolutions on: share cancellation, share capital reduction, and amendment of the Company's Articles of Association; adopting the consolidated text of the Company's Articles of Association; removal of Mr Gutmann Habig from his position of Member of the Supervisory Board; appointment of Mr Paweł Tamborski as Member of the Supervisory Board of the current term of office; approval of the new Rules of Procedure for the Supervisory Board of SECO/WARWICK S.A. and the new Rules of Procedure for the General Meeting of SECO/WARWICK S.A.

The Chairman of the General Meeting ensured procedural efficiency and respect for the rights and interests of all shareholders. The General Meeting was not adjourned or interrupted. Members of the Management Board and Supervisory Board were available to the shareholders and proxies, ready to provide explanations to the extent permitted by their knowledge and required by the provisions of law. None of the resolutions adopted at the General Meeting was challenged in court proceedings.

In 2016, an Extraordinary General Meeting of SECO/WARWICK S.A. was held on December 2nd 2016. The Extraordinary General Meeting was convened at the request of the Management Board.

The General Meeting was held in accordance with the Commercial Companies Code, the Rules of Procedure for the General Meeting of SECO/WARWICK S.A. and the Code of Best Practice for WSE-Listed Companies. The shareholders were afforded the opportunity to read draft resolutions for the General Meeting as these were published on the Company's website and in Current Report No. 28/2016 of October 31st 2016 at least 26 days prior to the General Meeting. The Company approved the documents submitted by the shareholders and their proxies, and recognised the validity of the powers of proxy, right to represent and participate in the General Meeting.

Within its powers, the Extraordinary General Meeting passed resolutions material to the Company's operations, including a resolution to approve the plan to merge SECO/WARWICK Spółka Akcyjna and SECO/WARWICK Europe Spółka z ograniczoną odpowiedzialnością, and to merge the Company, as the Acquirer, and SECO/WARWICK Europe Spółka z ograniczoną odpowiedzialnością, as the Acquiree.

All resolutions adopted in 2016 by the General Meeting are aimed at serving the interest of the Company, with due consideration given to other stakeholders' rights. The resolutions adopted by the General Meeting were published on the Company's website at: [www.secowarwick.com](http://www.secowarwick.com)

**k. Composition and changes in the composition of the Company's management, supervisory and administrative bodies and their committees, which took place in the last financial year; description of their activities**

**Management Board**

**Composition of the Management Board**

As at December 31st 2016, the Company's Management Board was composed of:

Paweł Wyrzykowski – President of the Management Board  
Jarosław Talerzak – Vice President of the Management Board  
Wojciech Peret – Member of the Management Board.

On December 30th 2016, Mr Jarosław Talerzak resigned as Vice President of the Management Board, with effect from January 2nd 2017.

### **Operation of the Management Board**

The Management Board operated under the regulations of the Commercial Companies Code, the Rules of Procedure for the Management Board, approved by the resolution of the Supervisory Board and available to the public, and in accordance with the Code of Best Practice for WSE-Listed Companies. The Rules of Procedure for the Management Board stipulate the division of responsibilities, tasks and authority among the members.

The Management Board is the executive body of the Company, managing its current operations and representing it in relations with third parties. The powers of the Management Board include all matters which do not fall within the exclusive scope of competence of the General Meeting or the Supervisory Board. A decision to acquire or dispose of property, perpetual usufruct right to or an interest in property, rests exclusively with the Management Board and requires approval by the General Meeting.

The Management Board is composed of 2 (two) to 5 (five) members appointed by the Supervisory Board, including President, Vice President and members of the Management Board. The Supervisory Board may appoint any number of Vice-Presidents. The Management Board members are appointed by the Supervisory Board for a joint three-year term of office. Each Management Board member may individually incur a liability or dispose of a right for up to the equivalent of PLN 200,000.00 (two hundred thousand). Assuming an obligation or disposing of a right in excess of PLN 200,000.00 (two hundred thousand złoty) requires two Management Board members acting jointly or a Management Board member acting jointly with a commercial proxy authorised to act individually, or a Management Board member acting jointly with a commercial proxy holding joint powers of proxy. The Management Board acts in accordance with its Rules of Procedure, approved by the Supervisory Board at the request of the Management Board.

When formulating strategic objectives and setting current tasks, the Management Board was primarily guided by the Company's best interest and the provisions of law, while also protecting the interests of shareholders, employees and creditors.

In order to ensure the clarity and efficiency of the management system, the Management Board observed the rules of professional conduct within the limits of reasonable economic risk, using a wide range of information, opinions and analyses available.

The Supervisory Board decides on the remuneration of the members of the Management Board based on clearly defined procedures. The remuneration for serving as members of the Management Board was granted taking into account the economic results achieved on the basis of competence and responsibility of the individual members of the Board. The amount of remuneration payable to the Management Board members is defined in the resolutions passed by the Company's Supervisory Board on January 12th 2012, December 13th 2012, December 5th 2013, and April 23rd 2015. Remuneration paid to the members of the Management Board did not vary from the level of remuneration paid to members of management boards at electromechanical industry companies of comparable size.

### **Supervisory Board**

#### **Composition of the Supervisory Board**

The Supervisory Board is composed of five to seven members.

In the period January 1st–June 24th 2016, the composition of the SECO/WARWICK Supervisory Board was as follows:

Andrzej Zawistowski – Chairman of the Supervisory Board  
Henryk Pilarski – Deputy Chairman of the Supervisory Board  
Witold Klinowski – Member of the Supervisory Board  
Jeffrey Boswell – Member of the Supervisory Board  
James A.Goltz – Member of the Supervisory Board  
Marcin Murawski – Member of the Supervisory Board  
Gutmann Habig – Member of the Supervisory Board

On June 24th 2016, the General Meeting of the Company removed Mr Gutmann Habig from his position of Member of the Supervisory Board and appointed Mr Paweł Tamborski to the Supervisory Board.

Mr Witold Klinowski tendered his resignation as member of the Supervisory Board, with effect from June 24th 2016.

In the period June 24th–December 31st 2016, the composition of the SECO/WARWICK Supervisory Board was as follows:

Andrzej Zawistowski – Chairman of the Supervisory Board  
Henryk Pilarski – Deputy Chairman of the Supervisory Board  
Jeffrey Boswell – Member of the Supervisory Board  
James A.Goltz – Member of the Supervisory Board  
Marcin Murawski – Member of the Supervisory Board  
Paweł Tamborski – Member of the Supervisory Board

#### **Operation of the Supervisory Board**

The Supervisory Board of SECO/WARWICK S.A. operates under the regulations of the Commercial Companies Code, the Rules of Procedure for the Supervisory Board, approved by the General Meeting and available to the public, and in accordance with the Code of Best Practice for WSE-Listed Companies. The Rules of Procedure for the Supervisory Board stipulate the division of responsibilities, tasks and authority among the members.

The Supervisory Board of SECO/WARWICK S.A. adopts resolutions and issues opinions on the matters falling within its exclusive scope of competence under the provisions of the Articles of Association, and in a manner provided for in the Articles of Association and applicable laws.

The Supervisory Board complied with the requirement of having at least two independent members, meeting the independence criteria specified in the Company's Articles of Association.

In 2016, the Supervisory Board meetings were held on a regular basis, and were attended by members of the Management Board, who provided the Supervisory Board with reliable and complete information on material issues relating to the operation of the Company. The Supervisory Board held five meetings, at which resolutions were adopted with respect to the matters included in the meeting agendas. The resolutions were sent to the members of the Supervisory Board in the notices of the meetings.

Provision of any benefits by the Company or related parties to members of the Management Board was approved by virtue of a resolution adopted by a majority of members of the Supervisory Board.

The General Meeting decides on the remuneration of the members of the Supervisory Board based on clearly defined procedures. The remuneration for serving as members of the Supervisory Board was granted taking into account the economic results achieved on the basis of competence and responsibility of the individual members of the Supervisory Board. Remuneration paid to the members of the Supervisory Board did not vary from the level of remuneration paid to members of supervisory boards at electromechanical industry companies of comparable size. Throughout 2016, members of the Supervisory Board informed the Company's Management Board of their acquisition or disposal of SECO/WARWICK S.A. shares.

In 2016, in its work the Supervisory Board focused primarily on the matters material to the Company's operations.

Within its powers to define the development strategy for the Company, the Supervisory Board made a number of analyses of the directions for long-term growth of the SECO/WARWICK S.A. Group in the context of the changes taking place in the market of manufacturers of heat treatment furnaces, including technological changes and growing competition.

The Supervisory Board, within its powers to supervise the Company's and the Group's operations, conducted an analysis and carried out periodic assessments of the financial statements of SECO/WARWICK S.A. and the Group, as well as of the Directors' Reports on the Company's operations.

The Supervisory Board will provide the Annual General Meeting with an assessment of the Company's situation, including an assessment of the system for internal control and management of risk material to the Company, assessment of the Company's fulfilment of disclosure requirements, assessment of the

reasonableness of the Company's policy for sponsorship and charitable activities, as well as evaluation of the operation of the Supervisory Board, prepared in accordance with the Code of Best Practice for WSE-Listed companies.

### **Committees of the Supervisory Board**

In 2016, an Audit Committee operated within the Supervisory Board, as the analytical and controlling body, according to the Rules of Procedure of the Supervisory Board and the guidelines set out in the Code of Best Practice for GPW Listed Companies. The Committee's responsibilities included:

1. monitoring of the financial reporting process;
2. monitoring of risk management systems used to control key risks to which the Company was exposed;
3. monitoring of the operating risks of the Group's foreign companies (India, China, Brazil, and the US);
4. monitoring of compliance with the auditor's recommendations;
5. review of information which concerns the Company and is intended for publication;
6. recommending auditor appointments; and
7. meeting with auditing firms.

In the period January 1st–June 24th 2016, the composition of the Audit Committee was as follows:

1. Marcin Murawski – Chairman of the Audit Committee
2. Witold Klinowski – Secretary of the Audit Committee
3. Henryk Pilarski – Member of the Audit Committee

In the period June 24th–December 31st 2016, the composition of the Audit Committee was as follows:

1. Marcin Murawski – Chairman of the Audit Committee
2. Henryk Pilarski – Secretary of the Audit Committee
3. Paweł Tamborski – Member of the Audit Committee

### **I. Policy for sponsorship, charitable and similar activities**

The subsidiary SECO/WARWICK Europe Sp. z o.o. undertook the following activities and incurred the following expenses connected with sponsorship and charitable activities:

In 2016, SECO/WARWICK Europe Sp. z o.o. undertook the following activities and incurred the following expenses connected with sponsorship and charitable activities:

- The Parish of St. Michael the Archangel in Świebodzin,
- The Parish of the Birth of the Blessed Virgin Mary in Wilków,
- Świebodzin Municipality,
- Children's Home No. 4 in Świebodzin,
- Residential Care Home in Jordanów,
- Children's Home No. 2 in Świebodzin,
- County Centre for Family Support in Świebodzin,
- Electronic and Automotive School Complex in Zielona Góra,
- The "Błękit" Singing Ensemble of Ołobok,
- The Zygmunt Nosowski 1st degree State Music School in Świebodzin.

The expenses connected with sponsorship and charitable activities totalled PLN 40 thousand.

### **23. Court, arbitration and administrative proceedings**

Seco/Warwick Corporation (SWC), a subsidiary of the Issuer, with its registered office in Pennsylvania, USA, along with a third party not associated with the Issuer ("Third Party"), are parties to a court dispute with Liberty Mutual Insurance (LMI), in which they claim from LMI additional insurance limits for continued product liability insurance coverage under insurance policies issued to the Third Party in 1982-1986. SWC and the Third

Party are seeking coverage for the claims being raised against SWC and the Third Party in connection with product liability personal injury lawsuits filed by individuals alleging injury from asbestos as a result of their exposure to the Third Party's products manufactured by legal predecessors of SWC and the Third Party in 1958-1984 (the Asbestos Claims). SWC was not established until 1984, and was not a part of the Issuer's Group until 2006.

SWC and the Third Party have alleged in court that the insurance policy contract entered into by LMI extends additional coverage to the Asbestos Claims, including the costs of settlements entered into with injured parties and the legal costs in connection with verifying the legitimacy of such claims and negotiating such settlements. LMI claims that the policy limits have been exhausted, citing certain special provisions of the insurance policy. SWC and the Third Party disagree with LMI's contract interpretation.

To the best of the Issuer's knowledge, by the date of these financial statements, 602 Asbestos Claims had been filed against SWC, of which 194 Claims were dismissed, 39 Claims ended in settlement with insurance companies for a total amount of USD 3,175 thousand, and with respect to 369 Claims review procedures are underway or the terms of potential settlement with the injured parties are being negotiated.

Should no agreement be reached with LMI on continued insurance coverage for SWC or should the lawsuit against LMI be dismissed in this respect, there arises the risk that SWC will be forced to bear the costs relating to the Asbestos Claims while SWC and the Third Party pursue the excess carriers to take over the asbestos product liability claims.

To the best of the Issuer's knowledge, the risk of SWC being forced to bear further costs relating to the Asbestos Claims is not significant, as the Third Party holds other excess insurance policies contracted with other insurance companies, which policies can, according to the information received from SWC, cover the Asbestos Claims.

As at the date of this Report, the Issuer is not able to reliably estimate the total amount of its contingent liability related to the claims discussed above. The Issuer will publish any important information regarding the matter.

**24. External and internal factors relevant to the growth of the SECO/WARWICK Group; description of development prospects for the Group's operations in the period at least until the end of the financial year immediately following the financial year for which the financial statements contained in the annual report were prepared, including elements of the Group's market strategy**

External factors:

- The Group's financial performance will be driven to a large extent by the macroeconomic conditions prevailing on the markets where the Group companies operate or which they plan to enter. The Group's growth will depend on key economic indicators reported for the markets where the Group is present, such as the demand for capital goods, GDP growth rate, inflation rate, unemployment rate, and capital expenditure.
- The achievement of the SECO/WARWICK Group's strategic objectives may be hindered by competition. If competitive pressures intensify, especially in Asian markets, they may adversely affect the Group's ability to meet its planned financial results.
- Foreign exchange rates, particularly the EUR/PLN rate, are a significant factor for the development of the Group's business. However, the Group actively mitigates currency risk by changing the reference rates used to calculate the price of the equipment it manufactures, executing hedging transactions on the futures market, and making purchases in the euro and US dollars.

Internal factors:

- The achievement of the financial targets set by the SECO/WARWICK Group depends on its ability to retain highly-skilled professionals in managerial and specialist positions at the Group. In the sector where the Parent operates, as in many other sectors of the Polish economy, remuneration of highly qualified staff is lower compared with other EU countries, which may encourage employees to seek



employment abroad. The Parent is actively trying to mitigate this risk by implementing such measures as a share-based incentive scheme or a financial assistance programme designed to help finance the costs of university and specialist courses. Retention of the highly-qualified staff in the mid- and long-term perspective may result in an increase in employment costs, which in turn may reduce the profitability of the Group's business.

## 25. Major achievements in research and development

In 2016, the Research and Development division of the SECO/WARWICK Group worked on the following projects:

In 2016, four applications (concerning three subjects) for grants for the following research and development projects were filed:

- "Compact, energy-saving and ecological system for plasma-refining and poly-crystallization of silicon for photovoltaic industry applications" – Plasma-SiRefiner. Institution: National Centre for Research and Development. 2014–2020 Smart Growth Operational Programme. Priority axis: support for R&D efforts in enterprises. Measure: R&D projects by enterprises. Sub-measure: R&D work related to the construction of a pilot/demonstration installation. No. of grant application: POIR.01.01.02-00-0067/16. Application filing date: February 29th 2016. No. of call: 2/1.1.2/2015. Application refused following assessment.
- "Compact, energy-saving and ecological system for plasma-refining and poly-crystallization of silicon for photovoltaic industry applications" – Plasma-SiRefiner. Institution: National Centre for Research and Development. 2014–2020 Smart Growth Operational Programme. Priority axis: support for R&D efforts in enterprises. Measure: R&D projects by enterprises. Sub-measure: industrial research and development work conducted by enterprises. No. of grant application: POIR.01.01.01-00-0661/16. Application filing date: October 31st 2016. No. of call: 2/1.1.1/2016. Application refused following assessment.
- "Development of a new generation of ZeroFlow Feedback Control technology-based nitriding furnaces". Institution: National Centre for Research and Development. 2014–2020 Smart Growth Operational Programme. Priority axis: Increasing the research potential. Measure: Research and development. Sub-measure: Application projects. No. of grant application: POIR.04.01.04-00-0010/16. Application filing date: October 31st 2016. No. of call: 1/4.1.4/2016. Application under assessment.
- "Development of energy- and material-saving technology to manufacture high-strength tools for plastic working, with hard and abrasion-resistant top coat and nanocrystalline core" – Inno4Tools. Institution: National Centre for Research and Development. 1st competition as part of the "Modern Material Technologies", a strategic scientific research and development programme – TECHMATSTRATEG. Date of application filing by the Warsaw University of Technology, the consortium leader: November 10th 2016. ID: 346892. Application under assessment.

The following final reports were prepared in 2016:

- Final report on tests and research concerning a three-chamber gas heated vacuum furnace. The research was carried out under the grant agreement for Project No. UDA-POIG.04.02.00-08-003/10-00 "Development and implementation of equipment to work using the FineCarb® technology with the support of the PreNitLPC® process". The project was implemented under the Innovative Economy operational programme run by the Polish Agency for Enterprise Development (PARP).
- Final report on tests and research concerning the possibility of producing nanostructures in a gas-cooled vacuum furnace. Project financed with the Group's own funds.
- Final report on tests and research concerning comparison of consumption of electricity and other utilities by vacuum furnaces with oil quench. The comparative study was carried out for a CME vacuum furnace and an atmosphere furnace (AFS). Project financed with the Group's own funds.

The following projects were continued in 2016:

- UniCase Master® – work continued under the grant agreement for Project No. POIR.04.01.04-00-0087/15 “A system for highly efficient and precise heat treatment, with reduction of hardening distortion, for direct application in the straight-line production of parts of gears and bearings.” Project implemented under the Smart Growth Operational Programme 2014-2020. Institution: National Centre for Research and Development (NCBiR). Priority axis: Increasing the research potential. Measure: Research and development. Sub-measure: Application projects.
- ZeroFlow® Nitriding Database – entering new process data into an intranet database.
- SeCoil® Coil Temperature Control System – development of a new algorithm and solver in cooperation with Technische Universität Bergakademie Freiberg. Project financed with the Group’s own funds.
- PIT Vacuum Furnace with filamentary insulation and metal-lined work chamber – investigation into the impact of process gases (acetylene) on the operating life of the heating elements and the insulation. Project financed with the Group’s own funds.
- Further development of the FineCarb® and PreNitLPC® vacuum carburising technologies and improvement of the expert system for the design, simulation and optimisation of processes. Project financed with the Group’s own funds under a collaboration agreement with the Łódź University of Technology.
- Development of the vacuum nitrocarburizing technology. Project financed with the Group’s own funds.

In 2016, the Group took steps to actively promote its technological and engineering achievements at international seminars, conferences and industry fairs. Articles and presentations were prepared.

The Group successfully organised the 19th ‘Modern trends in heat treatment’ seminar, which is an annual industry event in Poland. The seminar was held in the Mierzęcin Palace in Poland, on September 14th and 15th 2016. The event was attended by some 130 guests, including customers and trade and research partners. The participants gave thirteen thematic lectures. The participants praised the seminar for its high quality, both in terms of content and organisation.

## **26. Environmental matters**

Given the scale and type of its operations, the SECO/WARWICK Group is subject to environmental protection regulations in different jurisdictions.

The SECO/WARWICK Group’s Polish operations are mainly regulated by the following laws:

1. the Environmental Protection Law of April 27th 2001 (consolidated text in Dz.U. of 2006, No. 129, item 902),
2. the Water Law of July 18th 2001 (consolidated text in Dz. U. of 2005, No. 239, item 2019) and
3. the Waste Act of April 27th 2001 (consolidated text in Dz. U. of 2007, No. 39, item 251).

In 2016, SECO/WARWICK EUROPE Sp. z o.o. used natural resources in the course of its production and trading activities in accordance with applicable laws and was charged with no penalties.

The company holds all relevant permits for waste generation and release of gas and dust into the air. In the case of SECO/WARWICK EUROPE Sp. z o.o. the permit for waste generation expires on October 31st 2018 and the permit for release of gas and dust into the air remains valid until January 5th 2023. The Company maintains a register of generated waste. In addition, the Company executed agreements with specialist companies which handle waste disposal, recycling and treatment (the companies hold relevant permits).

All fees due for the use of natural environment were paid to dedicated accounts of the Marshall Office of the Province of Zielona Góra / Gorzów Wielkopolski in a timely manner. Similarly, a summary report on the use of natural environment was submitted to the Marshall Office of the Province of Zielona Góra / Gorzów Wielkopolski by the prescribed date.

SECO/WARWICK Corp. and Retech Systems LLC are not obliged to obtain any environmental permits. The companies comply with environmental protection regulations applicable in the United States and submit waste disposal reports to appropriate public administration authorities.

Given the scope of their activities within the Group, SECO/WARWICK Retech Thermal Equipment Manufacturing (Tianjin) Co. Ltd., Allied Consulting Engineers Pvt. Ltd Mumbai (India), SECO/WARWICK GmbH, and OOO SECO/WARWICK Group do not need any special environmental permits, and the applicable environmental norms do not affect the use of property, plant and equipment by the companies.

In compliance with applicable laws as well as regulations issued by competent administrative authorities, the SECO/WARWICK Group strives to ensure that neither its operations nor its products have any negative environmental impact. To this end, the Group maintains and upgrades its production plants, in particular the equipment used for production and the equipment used for collection and safe storage of hazardous waste, in accordance with technical guidelines, and conducts research on mitigating the environmental impact of the process lines and furnaces it produces. On principle, the SECO/WARWICK Group companies comply with the terms of their environmental permits and fulfil the applicable disclosure requirements.

In view of the above, the Company is not aware of any circumstances that could give grounds for instigating against the Company or the other SECO/WARWICK Group companies any proceedings based on environmental protection regulations. Furthermore, to the best of the Group's knowledge, no proceedings related to environmental protection are underway or have been instituted against the Company or any other Group members. The SECO/WARWICK Group is not aware of any obligations which may be imposed on the Company or any other SECO/WARWICK Group member in connection with environmental protection regulations.

## **27. Workforce**

For information on the workforce of SECO/WARWICK S.A., see Note 30 to the full-year consolidated financial statements.

## **28. Structure of assets and liabilities in the consolidated statement of financial position, including from the perspective of the Group's liquidity**

For information on the structure of assets and liabilities in the consolidated statement of financial position, including from the perspective of the SECO/WARWICK Group's liquidity, as well as the key financial and economic data and indicators, see Section 10 of this Report.

## **29. Material off-balance sheet items by entity, type and value**

For material off-balance sheet items by entity, type and value, see Section 16 of this Report.

## **30. Key capital and equity investments within the Group in the financial year**

In 2016, the SECO/WARWICK Group made the following equity investments within the Group:

In 2016, the share capital of SECO WARWICK USA Holding LLC and SECO/WARWICK Allied was increased by USD 35 thousand and USD 2,299 thousand, respectively.

## **31. Major events which had a material impact on the operations and financial performance of the Group in the financial year or which may have a material impact on the operations and performance of the Group in the coming years**

Major events with a material bearing on the Group's business which occurred after the end of the financial year:

In Current Report No. 1/2017, referring to Current Report No. 26/2016 of October 31st 2016, the Management Board of SECO/WARWICK S.A. announced that on January 2nd 2017 the District Court in Zielona Góra, 8th Commercial Division of the National Court Register, registered the merger of the Company with its subsidiary, SECO/WARWICK EUROPE sp. z o.o. of Świebodzin.

The merger was effected pursuant to Art. 492.1.1 of the Commercial Companies Code, i.e. through the transfer of all assets of SECO/WARWICK EUROPE Sp. z o.o. to SECO/WARWICK S.A. by way of universal succession. As a result of the merger, SECO/WARWICK S.A., as the acquirer, assumed all the rights and obligations of SECO/WARWICK EUROPE Sp. z o.o., which was dissolved without liquidation proceedings, as of the date of its deletion from the register.

As SECO/WARWICK S.A. was the sole owner of SECO/WARWICK EUROPE sp. z o.o., the merger was effected under Art. 515.1 of the Commercial Companies Code, i.e. without a share capital increase at SECO/WARWICK S.A.

Details on the events occurring after the end of the reporting period are provided in current reports, available from the corporate website at:

[www.secowarwick.com](http://www.secowarwick.com)

### **32. Description of the policy on the development directions for the Group**

#### Key objectives of the Group's new growth strategy for 2017–2021:

In Current Report No. 26/2016 of October 31st 2016, the Management Board of SECO/WARWICK S.A. announced the decision not to pursue the financial objectives presented in 2012 (Current Report No. 28/2012 of October 23rd 2012) and updated in 2014 (Current Report No. 15/2014 of April 29th 2014). At the same time, the period covered by the strategy was changed to 2017–2021 and the strategy was modified mainly where it referred to the Group's structure and organisation. The plan to pay 50% or more of the profits as dividend was maintained.

The following measures are envisaged to implement the modified strategy for 2017–2021:

- Merger of SW S.A. and SW EUROPE covering their production and distribution activities, organisation, management and legal status,
- Adaptation of the subsidiaries' structure and costs to the current sales capabilities,
- Implementation of a new approach to regional management at the Group, with three areas (Europe, Asia & Pacific and the Americas) distinguished for the purposes of business supervision,
- Continued development of structures, sale and servicing competencies and aftersales services at the subsidiaries,
- Implementation of an integrated management support system (ERP),
- Standardisation of a part of the offering in terms of products, technologies and processes.

These measures are expected to facilitate the achievement of the following principal objectives:

- Implementation of a sustainable growth concept, providing for the merger of SW S.A. and SW EUROPE to create a competence, production and sales centre integrating the management and engineering staff. In line with this concept, the subsidiaries will implement their individual strategies on their local markets with strict supervision and selective support from SW S.A. The Management Board believes that the merger of SW S.A. and SW EUROPE will help to streamline management functions, optimise the asset base, and deliver tangible savings in general and administrative expenses.
- Reaching the break-even point by all the subsidiaries as soon as possible.

It is expected that all the subsidiaries will modify their product and organisational structure to achieve this objective. In addition, the rules of technology transfer to the subsidiaries will be changed.

Successful implementation of the modified business strategy for 2017–2021 will enable the Group to be more effective in pursuing its business objectives thanks to cost savings and creating foundations for further economic growth.

**33. Information on:**

- a) the date of the agreement concluded by the Company with a qualified auditor of financial statements for an audit or review of financial statements or consolidated financial statements, and the term of such agreement,
- b) the remuneration payable or paid to the qualified auditor of financial statements for the financial year, separately for:
  - audit of the full-year financial statements
  - other assurance services, including a review of financial statements,
  - tax advisory services,
  - other services,
- c) information specified in item b) above should also be disclosed for the previous financial year

On April 28th 2016, the Supervisory Board of the Company, acting under Art. 29.1.6 of the Articles of Association, which authorises it to appoint the Company's auditor, passed Resolution No. 12/2016 under which Ernst & Young Audyt Polska Sp. z o.o. Sp. K. of Warsaw, Rondo ONZ 1, Warsaw, Poland, audited the full-year separate financial statements of SECO/WARWICK S.A. and the consolidated financial statements of the SECO/WARWICK Group and reviewed the half-year separate and consolidated financial statements for 2016.

The agreement with the auditor was executed on July 15th 2016. Ernst & Young Audyt Polska Sp. z o.o. Sp. K. of Warsaw, Rondo ONZ 1, Warsaw, Poland, is entered in the list of qualified auditors of financial statements maintained by the National Council of Statutory Auditors under Reg. No. 130.

The table below lists the entities authorised to review half-year and audit full-year consolidation packages of the SECO/WARWICK Group companies for the purposes of consolidation.

**Table: Names of entities authorised to review half-year and audit full-year consolidation packages of the SECO/WARWICK Group companies for the purposes of consolidation.**

SECO/WARWICK Group company	Entity authorised to audit financial statements
SECO/WARWICK S.A.	Ernst & Young Audyt Polska Sp. z o.o. Sp. K.
SECO/WARWICK EUROPE Sp. z o.o.	Ernst & Young Audyt Polska Sp. z o.o. Sp. K.
SECO/WARWICK Corp.	Ernst & Young Audyt Polska Sp. z o.o. Sp. K.
Retech Systems LLC	Ernst & Young Audyt Polska Sp. z o.o. Sp. K.
SECO/WARWICK Retech Thermal Equipment Manufacturing Tianjin Co., Ltd.	Ernst & Young Hua Ming LLP
SECO/WARWICK Allied Pvt. Ltd.	SRBC & CO LLP
SECO/WARWICK Germany GmbH	Ernst & Young GmbH

The table below presents the total remuneration of the auditors for 2016 and 2015.

**Table: Total remuneration of the auditors for 2016 and 2015**

Service	Remuneration for 2016 (PLN '000)	Remuneration for 2015 (PLN '000)(1)
Audit of full-year financial statements	570	648
Review of financial statements	194	244
Tax advisory services	-	10
Other services	135	66
<b>Total</b>	<b>899</b>	<b>968</b>

- (1) In 2015, the entity responsible for the review and audit of the consolidated financial statements was Deloitte Polska Sp. z o.o. Sp.k. of Warsaw, Aleja Jana Pawła II 19, Warsaw, Poland.

The entities authorised to audit the separate financial statements of the SECO/WARWICK Group companies in 2015 were:

- Deloitte Polska Sp. z o.o. Sp.k. - SECO/WARWICK S.A., SECO/WARWICK EUROPE Sp. z o.o., SECO/WARWICK Corp., Retech Systems LLC,
- Deloitte Touche Tomatsu Certified Public Accountants LLP - SECO/WARWICK Retech Thermal Equipment Manufacturing Tianjin Co., Ltd.
- Deloitte Haskins & Sells LLP - SECO/WARWICK Allied Pvt. Ltd.
- Deloitte & Touche GmbH - SECO/WARWICK Germany GmbH
- Deloitte Touche Tohmatsu Auditores Independentes - SECO/WARWICK do Brasil Ltda.

Date: April 27th 2017

Paweł Wyrzykowski

Wojciech Peret

Sławomir Woźniak

Bartosz Klinowski

*President of the  
Management Board*

*Member of the  
Management Board*

*Member of the  
Management Board*

*Member of the  
Management Board*