

**Report of the Supervisory Board of CD PROJEKT S.A.  
on its activities in the 2014 financial year, along with assessment of the operations of the  
Supervisory Board and summary assessment of the condition of the Company, including  
its internal control system and management of key risk factors relevant to the Company**

**1. Composition of the Supervisory Board in the 2014 financial year**

In the 2014 financial year the Supervisory Board consisted of the following persons:

Between 1 January 2014 and 31 December 2014:

- Katarzyna Szwarz – Chairwoman of the Supervisory Board
- Cezary Iwański – Deputy Chairman of the Supervisory Board
- Maciej Majewski – Supervisory Board Member
- Grzegorz Kujawski – Supervisory Board Member
- Piotr Pagowski – Supervisory Board Member

**2. Scope of the Supervisory Board's activities in the reporting period**

In the course of discharging its legal and statutory obligations in 2014 the Supervisory Board conducted active oversight of all matters related to the Company activities. In particular, the Supervisory Board performed analyses of the Management Board's plans concerning the strategy of the Company and its Capital Group, and provided ongoing assessment of the Company's operating and financial status.

In 2014 the Supervisory Board of CD PROJEKT S.A. properly discharged all duties incumbent upon the supervisory board of a public company under the relevant legislation, the Company Articles of Association and the Supervisory Board Regulations. In line with its prerogatives, in 2014 the Supervisory Board furthermore observed a significant portion of the Best Practices for WSE Listed Companies insofar as such practices apply to supervisory board of public companies.

Given that the Supervisory Board consisted of five members, the duties of the Audit Committee as specified in the Act of 7 May 2011 on certified auditors and their self-government, audit firms, entities authorized to perform audits of financial statements and public supervision, were discharge by the full Supervisory Board.

In the Supervisory Board's opinion, the current composition of the Supervisory Board enables fulfillment of all tasks incumbent upon the control organ of a public company.

In 2014 the supervisory activities of the Supervisory Board of CD PROJEKT S.A. were exercised on an ongoing basis and with due diligence. The Supervisory Board carefully monitored all significant matters related to the Company's activities. As requested by the Supervisory Board, the Management Board provided up-to-date reports regarding the legal condition of the Company and activities undertaken in all of the Company's activity areas.

In discharging its supervisory duties, the Supervisory Board relied on written documentation submitted by the Management Board as well as current information and explanations provided by Board Members during Supervisory Board meetings. As a rule, Supervisory Board meetings were attended by the Management Board except in matters related to assessment of the Management Board's performance and other personal matters involving members of the

Management Board. The Supervisory Board made extensive use of remote communication tools, enabling better control and day-to-day supervision of the Company's matters.

### **3. Summary assessment of the Company's condition, including its internal control system and management of key risk factors relevant to the Company:**

Based on analysis of financial statements of the Company and its Capital Group for the year 2014 and the Management Board report concerning the internal control system and management of key risk factors relevant to the Company for 2014, submitted on 19 March 2015, in addition to information received directly from the Management Board, the Supervisory Board has determined that the Company had achieved the goals set by the Management Board with regard to development of its operating activities, i.e. development, publishing and digital distribution of videogames. Current activities of CD PROJEKT S.A. are governed by its long-term strategy of establishing a global Group on the digital entertainment market. Activities of the CD PROJEKT Capital Group are divided into the following activity segments:

- Distribution and publishing activities in Poland
- Videogame development
- Global digital videogame distribution

In 2014 the Company carried out its activities in compliance with rules applicable to public companies, including the declared corporate governance principles.

Internal control and risk management systems at the Company are fully controlled by the Management Board, which, in the course of publishing its periodic reports, conducts periodic assessment of risk factors relevant to the Company during each financial year. The Management Board is responsible for the effectiveness of the internal control system in the process of preparing financial statements. Control over the subject matter of the Company's financial statements and periodic reports is exercised directly by the Management Board. The Management Board is furthermore directly responsible for scheduling work related to the preparation of the legally required financial statements. Financial data which comprises the basis of such statements is derived from the Company's accounting system which records transactions in accordance with the Company's accounting policy, itself consistent with the International Financial Reporting Standards.

In 2014 the accounts of CD PROJEKT S.A. were managed by the Company's internal accounting department. The accounts of GOG Ltd., a foreign subsidiary, were managed by EKAVI LIMITED. The accounts of CD PROJEKT Inc., a foreign subsidiary incorporated on 4 August 2014, were managed by Armanino LLP. The CD PROJEKT S.A. accounting department provided paid accounting services for the Company's subsidiaries – GOG Poland sp. z o.o., Brand Projekt sp. z o.o. and CD PROJEKT Brands S.A., and furthermore provided HR and payroll services to CDP.pl sp. z o.o., GOG Poland sp. z o.o., Brand Projekt sp. z o.o. and CD PROJEKT Brands S.A. The accounts of CDP.pl sp. z o.o. were managed internally by the subsidiary over which CD PROJEKT S.A. relinquished control as a result of transactions carried out on 26 November 2014.

Throughout 2014 the core accounting system in use at CD PROJEKT S.A., GOG Poland sp. z o.o., Brand Projekt sp. z o.o. and CD PROJEKT Brands S.A. was Symfonia Forte. The accounts of CDP.pl sp. z o.o. were managed by the Microsoft Dynamics AX system, deployed in 2012. Additionally, in the second part of the year the Company commenced deployment of a modern IT package consisting of the following systems:

- IFS Applications (ERP system)
- Tagetik (BI/CPM system)
- Workflow Plus (BPM system)

IFS Applications (Sweden) is among the world's most advanced Enterprise Resource Planning (ERP) systems, handling all aspects of company management (Finances, Accounting, HR, Payroll, Production and Distribution, Warehousing and Project Management). The deployment of IFS Applications at CD PROJEKT was done in order to ensure greater cohesion, reliability and level of detail of data required in managing the Company. It was also coupled with streamlining of business workflows in place at the Company. Integration of services is handled by IFS Industrial and Financial Systems Poland. The system began operation in January 2015.

Tagetik (Italy) is among the most advanced CPM (Corporate Performance Management) systems supporting corporate decision-making processes. The Company has decided to deploy the following modules: Budgeting, Financial Consolidation, Liquidity Management and Reporting and Economic Analyses. The aim of this deployment is to provide easier and faster access to reliable financial data, required in order to make accurate managerial decisions. Integration of services is handled by ITMAGINATION sp. z o.o. The system is scheduled to begin operating in the second half of 2015.

Workflow Plus is a system which supports document flow through digitization. The system is in use at several dozen large Polish and foreign companies. At CD PROJEKT S.A. it will be used to handle invoice processing, ingoing and outgoing mail and contract management. It will provide fully electronic document flow and access to an electronic document archive. The deployment of Workflow Plus will minimize the need for paper documents, accelerate document processing, improve control over the flow of information within the Company and enable financial data to be promptly fed into the ERP system. Integration of services is handled by SUNCODE s.c. The system is scheduled to begin operating in the second quarter of 2015.

The separate and consolidated financial statement of CD PROJEKT S.A. are subject to reviews and audits conducted by an independent auditor, in line with the applicable legislation.

Regarding financials, the internal control system mandates monthly assessment of results against the background of earlier projections within each activity segment/member company of the CD PROJEKT Capital Group. In justifiable cases, financial plans comprise several variants:

- "Conservative" plans – used in order to safely plan for allocation of the available monetary assets and sources of funding
- "Target" plans – communicated to managers of each business segment as desirable goals, characterized by ambitious and aggressive projections whose realization calls for multiple advantageous circumstances.

As part of its reporting and review scheme, instituted in 2010, the Management Board of CD PROJEKT S.A. performs monthly analysis of results and how they compare to earlier estimates. These analyses are conducted in collaboration with managers of each segment. The meetings also provide an opportunity to discuss important developments affecting each segment and the likelihood of meeting projections in further months.

Between its monthly meetings, the Management Board of CD PROJEKT S.A. participates in day-to-day business activities of the Company and its subsidiaries.

Liquidity planning at the CD PROJEKT Capital Group is also carried out in monthly cycles, subdivided into weekly periods, which permits optimization of the use of cash assets available to the CD PROJEKT Capital Group via a cash pooling agreement, in collaboration with a bank from which CD PROJEKT Capital Group member companies procure financial services.

All payments remitted by CD PROJEKT S.A. are based on properly filed accounting documents. A document may only be filed if it meets all the applicable accuracy and justifiability criteria, and has been approved by persons authorized for this purpose. Validation of the above and the actual filing of the document is the responsibility of the assigned accountant. On a day-to-day basis, payments are handled by the financial department in collaboration with the accounting department. Any deviations from this rule require Management Board approval.

As part of the corporate governance scheme and formal and legal supervision principles in force at CD PROJEKT S.A., subsidiaries are able to solicit advice from experts employed by the parent company.

## **Key risk factors affecting current activities and the corresponding mitigation strategies**

### **Risks associated with clients**

In the videogame development activity segment the pool of customers consists of distributors and publishers who purchase licenses to publish and distribute Company products. Efficient cooperation with customers is dependent on a number of factors, including the appeal of the product, customers' own publishing plans, customers' preferences in specific countries and the financial terms offered by each customer. CD PROJEKT S.A. makes every effort to ensure high quality of its products, rendering them more desirable and attractive to final customers and increasing licensee and distributor retention.

In the scope of products and services offered by the CD PROJEKT Capital Group the final customers are natural persons with access to the retail market. Demand for products and services may fluctuate depending on market trends or sudden changes in perception among key demographics. Internet discussion forums and other social media provide customers with the ability to easily communicate with one another and influence one another's opinions. Unforeseen changes in perception among final customers and trendsetters are beyond the control of CD PROJEKT S.A. and its subsidiaries. CD PROJEKT Capital Group member companies strive to maintain open channels of communication with final customers. In line with the Group's mission statement, the Company and its subsidiaries emphasize open, honest and diligent communications as a foundation for mutual trust and long-term customer relations.

### **Risk of losing key suppliers**

The operations of GOG Ltd. depend on cooperation with developers, producers and publishers who supply final products and with whom publishing, distribution and retail sale agreements are negotiated. The Company mitigates the risk of losing suppliers by maintaining good trade relations and by working to diversify its supply chains and attract new suppliers.

In the videogame development segment CD PROJEKT S.A. relies on external suppliers for certain components required in the development of games, such as physics systems, audio libraries and other specialized software. Given that a wide range of commercial development

tools is available the Company actively monitors the market and may take steps to replace selected components or tools used in the production process, should such changes become necessary.

### **Risk of incorrectly estimating demand and future sales**

Developing, publishing and distributing products, whether proprietary or licensed, requires that their sales volume be estimated before the given product is released. In practice, individual products differ greatly with respect to their revenue generation potential. Member companies of the CD PROJEKT Capital Group draw upon their experience to determine the commercial potential of each product they release; however the risk of incorrectly estimating demand and sales volume cannot be entirely eliminated.

### **Risk of delays in videogame development**

Postponed releases are a commonplace occurrence in the videogame industry. Developing games is a highly complex and costly activity, based – to a large extent – on creative effort. This raises the likelihood of incorrect estimation of the required workload, delays due to technical issues in the programming layer (e.g. failure to meet quality assurance criteria or technical glitches), or problems caused by insufficient funding.

With respect to products purchased by GOG Ltd. Group members have no control over delays arising on the supplier side. With respect to development of proprietary products by CD PROJEKT S.A. the company actively manages its development schedule in order to minimize the likelihood of delays.

### **Risks associated with development of games for consoles and iOS devices**

Development of games for gaming consoles or iOS devices requires direct cooperation with the proprietors of each hardware platform. Before a game can be released on the open market it must first undergo certification. This requirement also applies to new versions of any game, as well as to expansion packs. Termination of cooperation between the developer and the platform proprietor is a significant risk, as are delays in the certification process or denial of certification. Each of those events may adversely impact the revenue stream for a given game. CD PROJEKT S.A. devotes substantial effort to meeting its contractual obligations due to platform proprietors and consistently prioritizes the quality of its videogames.

### **Risk of losing key employees**

Losing key employees may significantly impact the operations and financial status of the CD PROJEKT Capital Group. The activities of Group member companies and their growth prospects are greatly dependent on the skill, experience and knowledge of key Management Board members, middle managers, employees and collaborators. Group member companies offer competitive employment conditions and benefits to their employees. In 2012 the Capital Group instituted a long-term incentive program through which persons regarded as crucial for the Capital Group and its individual member companies may be rewarded with Company stock options.

### **Risk of insolvency and credit risk**

The CD PROJEKT Capital Group compares its results to annual plans which include liquidity goals. Such evaluation is performed on a monthly basis.

In order to minimize the risk of customer insolvency the Company performs ongoing monitoring of the collection of receivables. Debt collection is subcontracted to specialized third parties. The Group identifies key customers whose total share in the Group's revenues from sales of products exceeds 10%.

The CD PROJEKT Capital Group actively manages all other working assets, while monitoring the level of financial liabilities in relation to its equity and financial results, both current and projected.

As of the publication date of this report the CD PROJEKT Capital Group has access to external financing sources, i.e. bank credit agreements, and has set aside provisions in cash and shares in PKO TFI investment funds which invest in low-risk debt instruments and can be liquidated on short notice. Cash management on the level of the Group is performed in such a way that excess cash in one subsidiary may be loaned to other subsidiaries. The Group relies on this mechanism to perform day-to-day management of its liquid assets, ensure sufficient liquidity, meet any liabilities arising from its ordinary activities and permit unhindered continuation of videogame development projects.

### **Risks associated with credit agreements and interest rate risks**

In order to carry out their activities, Group member companies may require access to sources of financing, including credit and lease agreements. Termination of credit and lease agreements may necessitate finding other sources of financing. Credit and lease agreements concluded by Group member companies are based on variable interest rates. Increases in the cost of capital acquisition may negatively affect the Group's financial standing.

Group member companies perform day-to-day monitoring of financing costs and analyze their impact on the Group's financial condition. Refinancing, prolongation of existing agreements and acquisition of additional financing sources are all taken into account when considering the mitigation of financing and collateral risks. Interest rate hikes may impose an additional financial burden on the Group.

The Group invests its surplus cash in short-term bank deposits and shares in low-risk PKO investment funds which can be liquidated on short notice. In this context lower interest rates may have a negative impact on the financial revenue from investing in investment fund shares and bank deposits.

### **Risks associated with sureties**

The credit and cash-pooling agreements concluded within the CD PROJEKT Capital Group involve CD PROJEKT S.A., GOG Ltd., GOG Poland sp. z o.o., CDP.pl sp. z o.o., Brand Projekt sp. z o.o., CD PROJEKT Brands S.A. and CD PROJEKT Inc. acting as guarantors. These provisions may potentially compel each guarantor to cover the liabilities of other parties to whom guarantees have been contractually provided.

### **Risks associated with industry consolidation trends**

There is a notable global tendency for developers and publishers of videogames and motion pictures to consolidate. These trends may ultimately strengthen the market position of several global suppliers, publishers and distributors. Consolidation trends may cause the Company to lose key suppliers due to decisions imposed by the acquiree, or reduce the number of publishers/distributors who carry Company products.

The Group mitigates this risk by implementing an active publishing policy and maintaining good relations with its business partners. Additionally, Group member companies work to diversify their suppliers and sales channels.

### **Risks associated with illegal distribution of CD PROJEKT Capital Group products**

CD PROJEKT Capital Group revenues are negatively affected by the actions of parties who distribute its products – either directly or over the Internet – without the owner’s consent, thus violating intellectual property laws. Group members have no direct control over the scale of such illegal distribution. Insofar as it is possible, Group members try to attract customers by releasing products in various price brackets, published in an appealing manner and therefore providing good value for money – for example within the scope of activities carried out by GOG Ltd.

### **Risks associated with the emergence of new technologies**

The digital entertainment segment which is the Group’s primary area of activity is characterized by dynamic changes in the applied technologies and IT solutions. This rapid pace of development necessitates frequent corrective actions, development of novel systems and increasing sophistication of the products offered. Technological changes may also influence the means by which games and other products are delivered to the final customer, as well as the capabilities of gaming platforms.

The eighth generation of gaming consoles was unveiled in late 2013, approximately 8 years after the debut of the preceding generation. The latest version of the Company’s proprietary technology – REDengine 3 – used in the development of the Witcher 3: Wild Hunt and Cyberpunk 2077, supports the PC and the newest generation of consoles. Developing games for new consoles carries clear advantages but also introduces certain risks due to the relative immaturity of the underlying technologies and the time it may take to fully exploit their commercial potential. Of note is the fact that early sales of the new generation of consoles compare favorably to the previous generation over an equivalent period.

Member companies of the CD PROJEKT Capital Group work to monitor technological changes which may affect their operations and take steps to adapt their strategy to such changes.

### **Asset impairment tests**

In accordance with the International Financial Reporting Standards the Company performs asset impairment tests. Positive results of future tests cannot be guaranteed.

### **Exchange rate risks**

### **Risks associated with PLN strengthening against EUR and USD**

Due to the global character of its activities the CD PROJEKT Capital Group is subject to risks associated with sudden exchange rate changes involving PLN and foreign currencies, particularly EUR and USD.

A significant portion of publishing and distribution agreements to which CD PROJEKT S.A. is party (as a videogame developer) is denominated in foreign currencies. Accordingly, the strengthening of PLN against foreign currencies is viewed as an unfavorable circumstance by the Group, reducing its revenues from distribution and licensing contracts.

GOG Ltd. revenues are denominated primarily in USD, while costs are borne in USD, EUR and PLN. Accordingly, the strengthening of PLN or EUR against USD is viewed as an unfavorable circumstance by the Group, reducing the profitability of GOG Ltd.

### **Risks associated with PLN weakening against EUR and USD**

The licensing and distribution agreements to which the Company is party stipulate that the Company shall receive advance payments for future royalties. These advances, denominated in foreign currencies, are listed in the “Other liabilities” line item in the Company’s financial statement. Any weakening of PLN against foreign currencies may result in additional negative exchange rate differences associated with these liabilities.

In order to mitigate exchange rate risks CD PROJEKT S.A. performs hedging as part of its business activities.

### **Risks associated with major shareholders’ actions**

As of the date of preparation of this report CD PROJEKT S.A. has several major shareholders. Owing to the quantity of stock admitted to trading at the Warsaw Stock Exchange and the total number of votes at the General Meeting the major shareholders, when acting in concert, exercise effective control over the Company. They may use their majority at the General Meeting to effect significant decisions – for example introduce changes in the Company Articles, issue new stock, reduce the Company share capital, issue convertible bonds, pay out dividends and perform other actions which, according to the Commercial Company Code, require a majority or supermajority of votes at the General Meeting. The major shareholders acting in concert also possess a sufficient number of votes to exercise *de facto* control over the composition of the Supervisory Board by directly appointing all or most of its members (depending on whether group voting is instituted). In turn, the Supervisory Board may appoint the President of the Management Board as well as other members of the Management Board in accordance with the major shareholders’ wishes. Due to the above listed prerogatives investors should not assume that the major shareholders will always act in the interest of other shareholders of the Company.

### **Risks associated with changes in macroeconomic conditions**

The overall condition of the global economy, including global crises and deterioration of economic conditions both in Poland and worldwide, may have a negative impact on the activities, financial standing and results of the CD PROJEKT Capital Group.

A negative macroeconomic or political outlook may force consumers to adopt a conservative stance, or result in limitations upon the sale of products as a result of economic sanctions, thereby negatively affecting product sales through official distribution channels. Additionally,



negative macroeconomic conditions may hinder access to sources of financing, reducing the scope of game development projects.

CD PROJEKT Capital Group member companies monitor the impact of global economic conditions on their respective markets and adjust their actions accordingly.

### **Risks associated with legislative changes and conflicts of jurisdiction**

Legal regulations, both in Poland and abroad, are subject to frequent changes. These changes, as well as the variability in the interpretation of existing law, constitute a risk which manifests itself e.g. with regard to taxation, trade regulations, intellectual property law, labor law and capital market law. Any change in legislation has the potential to negatively impact Group activities, either by increasing their costs or invalidating projections concerning future events. Legislative changes may also impact the legal environment in which the Group conducts its operations. Introduction of new regulations may be associated with inconsistent case law and conflicting or outright unfavorable interpretations by public administration bodies (including tax authorities).

Member companies of the CD PROJEKT Capital Group are subject to legal regulations in countries where they distribute their products as well as – to some extent – in countries in which they purchase or license products for publication, or acquire technologies used in the game development process. Large portions of sale, purchase and licensing agreements concluded with foreign parties are governed by foreign law. This creates the risk of incorrect interpretations by Group members of contractual provisions governed by foreign jurisdictions. In order to mitigate this risk Group members employ the services of foreign legal consultants who specialize in the relevant fields.

The CD PROJEKT Capital Group has no influence on the legislative process either in Poland or abroad.

### **Risks associated with competitors' actions**

The Group's performance is affected by its competition's strategy, financial standing and the ability to procure financing on favorable terms. The Group mitigates this risk by implementing an active publishing policy and maintaining good relations with its business partners. Additionally, Group members work to diversify their suppliers and sales channels.

### **Insurance policies**

An active insurance strategy, implemented in collaboration with an insurance broker, constitutes an important part of the Company's overall risk management strategy. In 2014, in the course of their business activities both the parent Company and its subsidiaries, made use of the following (significant) insurance policies:

- “all risks” coverage of fixed assets against random acts, including specialized insurance of electronic hardware and insurance against additional expenses resulting from events covered by the insurance agreement;
- general civil liability insurance, including product liability;
- corporate liability insurance for members of the governing bodies of the Company and its subsidiaries, covering potential claims related to the actions of members of the Management Board, their proxies and members of the Supervisory Board;

- motor insurance (civil liability/casco/accident liability) for cars operated by the Company and its subsidiaries;
- mandatory civil liability insurance for providers of accounting services;
- travel insurance for employees traveling abroad.

The Company is currently working to institute a new form of insurance coverage – professional civil liability insurance related to videogame development.

### **Physical security**

The premises of CD PROJEKT S.A., Brand Projekt sp. z o.o., CD PROJEKT Brands S.A. and GOG Poland sp. z o.o. are situated in Warsaw, at Jagiellońska 74. They are equipped with an access control system, with different security clearances for each part of the building. At night, on weekends and during holidays the premises are patrolled by employees of an external security firm. Vacant offices are electronically secured and a centralized security post is automatically notified of any breach attempts. The main entrance and major hallways are equipped with CCTV cameras. All offices are part of a closed commercial/industrial complex which is independently secured by the property owner.

### **Summary**

The Supervisory Board regards the previously described internal control and key risk management procedures as consistent. The Supervisory Board furthermore believes that throughout 2014 the Company's internal control system and key risk management system operated in a satisfactory manner, significantly mitigating key risk factors faced by the Company in the course of its business activities.

In the Supervisory Board's opinion, the structure of the Company's Capital Group has been optimized in such a way as to permit dynamic growth in its core areas of activity. The condition of the Company is stable while the projects it currently pursues carry the promise of a commercial success on a global scale.