



# **ASSESSMENT BY THE SUPERVISORY BOARD OF DOM DEVELOPMENT S.A. ON THE POSITION OF THE COMPANY IN 2013**

## **INCLUDING EVALUATION OF THE INTERNAL CONTROL SYSTEM AND THE SIGNIFICANT RISK MANAGEMENT SYSTEM**

Pursuant to Rule III 1.1) of the Code of Best Practice for  
WSE Listed Companies

## **1. GENERAL INFORMATION ON THE POSITION OF THE COMPANY**

The Supervisory Board has approved the financial statements of Dom Development S.A. (the "Company") for the accounting year 2013 and the Management Board's report of activities of the Company for the accounting year 2013, having examined them.

In the assessment of the Company's position and results, the Supervisory Board took into account the overall situation in the Polish economy and the condition of the real estate market. As the Act on the protection of the rights of dwelling unit and house buyers entered into force on 29 April 2012, developers significantly increased the number of projects that were started which resulted in a major oversupply of apartments. In 2012 the residential market deteriorated somewhat compared to the previous year due to the oversupply of apartments as mentioned above, the deteriorating outlook for the Polish economy which negatively impacted the labour market and household earnings as well as tighter conditions for mortgages. In 2013, despite the pessimistic expectations, the conditions in the primary apartment market has gradually improved. Sales volumes in 2013 outstripped those achieved in 2012 with volumes particularly strong in the 4th quarter providing evidence that the market is continuing its recovery towards pre-crisis volumes, driven by attractive pricing and historically low interest rates.

In the context of general macroeconomic factors, in particular the situation in the residential property market in Poland as outlined above, the financial position of the Company remained strong and stable. The assessment carried out by the Supervisory Board has also been based on the quantitative results achieved by the Company from its operating activities.

The results of the Company for 2013, just as in previous years, have been impacted by the number of residential projects completed, and in turn by an adequate volume of deliveries. The timelines for execution and completion of specific housing developments has been conditioned on the land purchase decisions of the Management Board made in previous years, in particular the decision to commence further residential projects.

In 2013, the Company:

- commenced construction of 1 830 apartments on 10 project (in 2012: 1 701 apartments on 10 projects),
- sold 1 605 apartments (in 2012: 1 436 apartments),
- completed construction of 1 007 apartments on 7 projects (in 2012: 2 499 apartments on 14 projects),
- handed over 1 562 apartments to customers (in 2012: 1 970 apartments).

In 2013, the activities of the Company generated a positive result at each level of the income statement. In 2013, the Company generated a consolidated net profit in the amount of PLN 54.5 million, which represents around a 40% decrease from 2012. This result may be considered good, taking into consideration the number of deliveries and the sales margin earned. The lower results in 2013 were influenced by the smaller number of deliveries in 2013 compared to the previous year which translated into a decline in the profitability ratio for operating activity ("operating profit margin" fell from 13.7% in 2012 down to 11.3% in 2013).

In 2013, the Company's financial management in respect of construction of residential buildings was focused on seeking sources of long-term external financing for the projects under construction and on maintaining a more-than-adequate level of liquidity. The Management Board regularly analyses both the current financing structure and makes plans for the future optimum financing structure in order to achieve satisfactory financial ratios and financial results over the medium term, and at the same time, to ensure liquidity and maintain the financial security of the Company.



It should be expected that in 2014 the residential real estate market will be impacted mostly by macroeconomic factors, such as interest rate policy. The Supervisory Board is of the opinion that the actions undertaken in 2013 proved once again the competence of the Management Board in preparing the Company for the rapidly changing situation in the real estate market. The major responsibility of the Management Board is not only to ensure the Company is prepared to react quickly to new challenges but most of all to maintain a leading position in the rapidly changing residential market. The major steps undertaken in this respect included:

- ensuring that adequate sources of finance are available to the Company, both for current and future development projects;
- co-operation with banks, and assisting customers in obtaining mortgages for the purchase of apartments;
- adjusting the Company's sales offer to the market demand, with particular attention to utilising any potential government-subsidised programmes that support purchases of apartments;
- aligning land purchases to the Company's existing and future needs;
- utilizing the existing land bank in the most appropriate manner;
- generating sales by improving the sales and marketing processes;
- maintaining customer confidence in the 'Dom Development' brand by maintaining quality;
- restructuring the organization and employment levels to the anticipated level of operational activities;
- optimising overhead efficiency.

The current operating activity of Dom Development S.A. is carried out only through the Company. Previously, some projects were developed through subsidiaries or special purpose joint-venture vehicles. It is possible that in the future some projects may again be developed through subsidiaries, joint-ventures or through more branches of the Company being established in other cities in Poland.

The Supervisory Board believes that the key business processes in the Company are well established and professional.

The Land Department specialists employed by the Company identify land that is attractive and available for purchase to enable future development, they assess the potential profitability of such land (in cooperation with specialists from other departments) and finalise the purchase having obtained approval from the Management Board.

In 2013, the Management Board demonstrated again that its policy regarding the Company's operating capacity and land purchase expenditure was adjusted to meet the existing and projected market conditions.

Other operating activities of the Company are assigned (during design and construction stages) to project development specialists from various departments, namely, sales, customer service, fit-out, and property management.

The market position of the Company at the end of 2013 is good with the Company maintaining its position as the largest developer in the Warsaw market. This results from the well-established position of the Company in the housing market, appropriate operational experience, both in terms of execution of residential development projects, and the marketing, sales and financing of these projects.

The strong financial position of the Company and the capital group in which it operates is reflected in the balance of its net assets and cash balance. As at 31 December 2013, the aggregate amount of "cash and cash equivalents" and "short-term financial assets" disclosed in the consolidated balance sheet of Dom Development S.A. was PLN 327 million (at the end of 2012: PLN 411 million). The interest bearing liabilities of the Company increased by PLN 14 million to PLN 444 million as at 31 December 2013. The net borrowings to equity ratio was maintained at a low level for the Company, and amounted to only 14% as at



31 December 2013 (against 3% as at 31 December 2012). The Supervisory Board is of the opinion that such financial leverage is satisfactory for the Company and should ensure the continuing activities of the business in the foreseeable future. This low level of current financial leverage will allow further expansion in the scale of the Company's operating activities as and when justified by growth in market demand.

The Company is the leader in the Warsaw residential development market and as such is well placed to grow in the Polish residential property market as the opportunities arise. The Supervisory Board welcomes the positive sales results generated by the Company in 2013, which demonstrate that the Company effectively seized the opportunities in the real estate market that emerged in 2013.

The Supervisory Board is also pleased to see that the Company observes the principles of strong business ethics and corporate governance principles. The reputation which the Company has built is a valuable asset which should contribute to the further development of the Company for the benefit of all its stakeholders.

## **2. EVALUATION OF THE INTERNAL CONTROL SYSTEM AND SIGNIFICANT RISK MANAGEMENT SYSTEM**

The internal control system in Dom Development S.A. is comprised of institutional control, which is operated by means of internal audits managed by the Internal Audit Department under the guidance of the Audit Committee as well as functional control, such as procedures, instructions, segregation of duties, allocation of responsibilities, etc. The Audit Committee operates within the Supervisory Board, whose objective is to monitor and review issues relating to the Company's internal and external audit. This Committee supervises the Risk Management system and the Internal Audit Department, in addition to its duties concerning external audits.

The Supervisory Board is of the opinion that the institutional control has not materially changed and remains at a similar level to 2012. In particular, in respect to the risk management processes in the Company, the Internal Audit Department has been monitoring the operation and efficiency of the most important internal control processes. This helps to limit risk and improve the operating performance of the Company. The scope and quality of the audits performed by the Internal Audit Department was monitored by the Audit Committee on a regular basis. The Supervisory Board believes that the cooperation between the Internal Audit Department and the Quality System and Data Security Manager remained good during 2013.

The functional control is managed through the implementation of appropriately standardised and documented descriptions for all key operating processes in the Company, and through the accurate determination of the responsibilities for individual employees. These processes are structured and standardised as instructions, procedures and controls recorded in the Company's Quality Manual. The manner and quality of the implementation of these instructions, procedures and controls is subject to both, the internal audits conducted within the Company and the external audits. The Company has also been operating based on the Quality Management System in line with ISO 9001:2008 and Information Security Management System in line with ISO/IEC 27001:2005.

The Supervisory Board has a positive opinion of the functional controls currently applied in the Company and is pleased to note the improvements achieved through the implementation of the findings of internal audits. The Supervisory Board believes that the cooperation between the Internal Audit Department and the Quality System and Data Security Manager, who is responsible for keeping and updating Quality Manuals in the Company, remained good during 2013.

The Supervisory Board would like to express its appreciation to the Management Board of the Company for its commitment to the matters relating to risk management and the internal control system. Moreover, the Supervisory Board has a positive opinion on the operation of the Internal Audit Department and the methods used to address business risks associated with operations of the Company.



In accordance with the judgement of the Supervisory Board the risk management system in place in Dom Development S.A. is appropriate for the Company. There has been a formalised risk management procedure in operation within the Company since 2000. Under this procedure the risk is managed through the identification and assessment of the risk areas for all aspects of the activities, in which the Company and the Group are involved, followed by a determination of actions, which must be undertaken in order to reduce the risk (inter alia through procedures and the internal audit system specified in the Quality Manual of the Company). The risk management procedure is subject to annual revision and is updated by the Management Board jointly with key management staff. The risk management review and update was also performed in 2013.

In the opinion of the Supervisory Board the key processes and controls applied by the Company to reduce its exposure to business risks are operated efficiently and benefit from being supervised by the Company's Management Board and the Audit Committee.