MANAGEMENT BOARD REPORT
ON OPERATIONS OF
POLSKI KONCERN NAFTOWY
ORLEN SPÓŁKA AKCYJNA
FOR THE YEAR 2006

Index

I. CHANGES IN THE COMPANY'S ORGANISATION AND MANAGEMENT

The Organizational Rules and Regulations of PKN ORLEN S.A. approved by the Management Board on 22 December 2005 had entered into force on 1 January 2006. Under the new Regulations, the duties of particular Members of the Management Board have been assigned in the following manner:

- President of the Management Board, Chief Executive Officer;
- Vice-President of the Management Board, Chief Investment Officer;
- Vice-President of the Management Board, Cost Management;
- Vice-President of the Management Board, Upstream and Crude Procurement;
- Vice-President of the Management Board, Chief Sales Officer;
- Member of the Management Board, Chief Financial Officer;
- Member of the Management Board, Organization and Capital Group.

Duties of the Deputy Executive Officer for Operational Activities covered the areas of production, maintenance of technical operations, production development, and technology and property investment.

As of 1 January 2006, a team of 11 Executive Directors was appointed. The newly appointed Directors have accepted liability for the results, coordination of segments or supportive functions, as well as synergy implementation within the whole Concern. Moreover, Executive Directors within particular organisational units were assigned particular companies from the Capital Group, in accordance with the expert supervision over a given area within PKN ORLEN S.A.

Executive Directors carry out their duties within their organizational units. The Chief Executive Director is responsible for the realization of tasks which require the coordination of several organizational units within the Concern. The Chief Executive Director accomplishes tasks in cooperation with other Executive Directors. The duties of Executive Directors consist in achieving targets through a decision-making process concerning the strategy to be adopted, plans to be made and day-to-day operations, including the implementation of uniform standards and procedures within the whole Concern. In addition, the Directors recommend the representatives of PKN ORLEN S.A. to sit in supervisory bodies of the companies belonging to the Capital Group in accordance with the assignment of those companies to particular Executive Directors. They also influence the staffing of key positions with the Group's companies. In order to improve the system of segment management, the following committees were formed: Budget Committee, Capital Expenditure Committee, Margin Optimization Committee, Capital Investment Committee, Marketing Committee, MBO Committee (Management by Objectives), Financial Risk Committee and Operational Risk Committee. The committees listed above are to develop opinions to support the decision-making process with respect to issues requiring the agreed approach to the management of particular areas of business of PKN ORLEN S.A. and coordinating, monitoring and evaluation of major operational processes.

Additionally, the position of an Expert was introduced under the implementation process of segment management. The Experts, i.e. Executive Directors responsible for segments, were appointed to the Supervisory Boards of particular companies allocated within given segments.

As of 1 January 2006, ORLEN Administracja Sp. z o.o. in organization has taken over certain duties previously preformed by the Administrative Unit, Business Equipment Unit in Płock and 12 Regional Administrative Units.

As at 1 July 2006, the restructuring of the following services was carried out: prevention services were transferred to the newly established ORLEN Prewencja Sp. z o.o.; financial services were transferred to the newly established ORLEN Księgowość Sp. z o.o. and Forwarding Department with the logistic services was transferred to the existing ORLEN KolTrans Sp. z o.o.

As of the beginning of July the Unit of Non-Fuel Products and Category Management underwent restructuring. A new structure was implemented within that Unit, aimed at centralization of following functions: administration of merchandise ordering, merchandising and management of store sales and services.

The new Organizational Rules and Regulations of PKN ORLEN S.A. entered into force on 24 October 2006. Under the new Regulations, the duties of particular Members of the Management Board have been assigned in the following manner:

- President of the Management Board, Chief Executive Officer;
- Vice-President of the Management Board, Chief Capital Investment Officer;
- Vice-President of the Management Board, Cost Management;
- Vice-President of the Management Board, Upstream and Crude Procurement;
- Vice-President of the Management Board, Audit and Regulations;
- Vice-President of the Management Board, Sales;
- Member of the Management Board, Chief Financial Officer;
- Member of the Management Board, Organization and Capital Group.

The unit controlled by the President of the Management Board and CEO was made up of the following offices: Control and Security Office, Public Relations Office, Investor Relations Office, Strategy Office, Management Board Office, Executive Human Resources Director and Information Security Officer.

The unit overseen by the Vice-President of the Management Board in charge of Capital Investments was composed of the Office for Integration with Unipetrol and Capital Investments Office.

The unit overseen by the Vice-President of the Management Board in charge of Cost Management was composed of IT Office, Executive Director for Purchase and Costs and Executive Logistics Director.

The unit overseen by the Member of the Management Board in charge of Organization and Capital Group was composed of the Capital Group Office, Legal Department and Executive Director for Organization.

The unit overseen by the Vice-President of the Management Board in charge of Sales was divided into the Retail Sales Executive Director for Poland, Wholesale Executive Director, Retail Sales – Germany, Marketing Department and Planning and Sales Analyses Department.

The unit overseen by the Vice-President of the Management Board in charge of Audit and Regulations was divided into Audit Department, Alternative Energy Sources Department, and office of the Proxy in charge of the European Union.

The unit overseen by the Member of the Management Board in charge of Finances was divided into Financial Management Department and Executive Director for Planning and Controlling.

The unit overseen by the Vice-President of the Management Board for Upstream and Crude Procurement was made up of the Exploration and Extraction Department and Crude Oil Trade Department.

As of 24 November 2006, the scope of competence was altered in the following manner: the unit controlled by the

Vice-President of the Management Board in charge of Audit and Regulations comprised: Audit Department, Regulatory Risk Department, Alternative Energy Sources Department whereas the unit controlled by the Member of the Management Board in charge of Finance comprised Financial Management Department, Central Margin Optimization Management and Coordination Office, Tax Department and Executive Director in charge of Planning and Controlling.

As of 1 November 2006, the wholesale unit was restructured and consequently eleven Regional Wholesale Offices were replaced by five new Wholesale Departments located in Płock, Poznań, Trzebinia, Lublin and Gdańsk. The implementation of the above-mentioned changes aimed at:

- establishment of a uniform policy within the structures of wholesale trade in the whole PKN ORLEN S.A Capital Group which will assure cohesion of trade activities between Wholesale Regions and Regional Market Operators through market segmentation aiming at reducing internal competition;
- increased goodwill and better market positioning of PKN ORLEN S.A. through the creation of a modern market-oriented wholesale management structure;
- reaching customers in a more effective manner, providing a more competitive offer of PKN ORLEN S.A.;
- increase of market share;
- more efficient management of the distribution channels.

Furthermore, by the end of 2006, activities aiming at preparing the restructuring of financial services planned for 2007 were undertaken.

Moreover, changes to the composition of the Management Board of PKN ORLEN S.A were made in the course of 2006. At the meeting held on 21 December 2005, the Supervisory Board of PKN ORLEN S.A. appointed Cezary Stanisław Filipowicz to the position of the Vice-President of the Management Board of PKN ORLEN S.A., effective 2 January 2006. On 31 March 2006, the Supervisory Board dismissed Dariusz Witkowski from the position of the Member of the Management Board of PKN ORLEN S.A., effective 31 March 2006. Simultaneously, Krzysztof Szwedowski was appointed to the position of the Member of the Management Board. In addition, at the meeting held on 18 January 2007, the Supervisory Board of PKN ORLEN S.A. dismissed Igor Chalupec from the position of the President of the Management Board and appointed Piotr Kownacki, previously holding the position of the Vice-President of the Management Board of PKN ORLEN S.A. in charge of Audit and Regulations from 23 October 2006. At the subsequent meeting held on 15 March 2007, the Supervisory Board dismissed Jan Maciejewicz from the position of the Vice-President of the Management Board in charge of Cost Management and Cezary Smorszczewski from the position of the Vice-President of the Management Board for Capital Investments. At the same meeting, Krystian Pater was appointed to the position of a Member of the Management Board of PKN ORLEN S.A.

II. CURRENT AND PROJECTED FINANCIAL STANDING OF THE COMPANY

2.1 Description of significant risk factors

The most important risk factors having an impact on the performance of the PKN ORLEN S.A. included as follows:

- **Fluctuations in crude oil and refinery products prices and margins**

Fluctuations in crude oil prices and considerable fluctuations in finished goods prices on world markets cause significant variations in margins generated by the Company. In the second and third quarter of 2006, crude margins on quotations increased, as compared to the first quarter of 2006 as a consequence of information about risks pertaining to supplies. Both the Iranian issues – relating to the uranium enrichment program – and the Nigerian issues, i.e. disruptions in the crude oil production, had the greatest impact on the prices of crude in 2006. Quotations of Brent DTD fell in the fourth quarter, which was mainly due to the unusually warm winter which caused a significant fall in demand for oil products. In 2006, the average quotations price of Brent barrel increased in comparison with the prices in 2005 by 19.4% to the level of USD 65.15/bbl. In the course of 2006 there was an increase in gasoline margin on quotations (crack) by 11.2% to the level of USD 140.72/tonne and on Jet A-1 fuel by 2.3% to the level of USD 159.66/tonne. However, a decrease was recorded for margins on quotations of diesel oil, i.e. decrease by 9.7% to the level of USD 123.33/tonne and on Ekoterm: a decrease of margins by 4.2% to the level of USD 97.58/tonne. A significant improvement was recorded in case of margins on the ethylene and propylene, which have increased in comparison with the figures recorded in 2005 by 17.2% and 15.1% respectively, to the level of USD 594.70/ tonne and USD 547.80/ tonne, respectively. A decrease on refined products margins was also recorded from the level of USD 5.11/ bbl in 2005 to USD 3.70 /bbl in 2006 (according to an analysis carried out by PVM).

- **Fluctuations of foreign exchange rates**

Exchange rate fluctuations have significant impact on the sales revenues of the Company (by means of adjusting prices at the Company on the basis of import parity), costs of crude oil and other raw materials, and financial costs related to debt denominated in foreign currencies. As a result of the above-mentioned tendencies, the fluctuations of PLN exchange rate to other currencies have a significant impact on the result generated by the Company. In 2006 the average PLN/ USD exchange rate decreased by 4.0% to the level of PLN 3.10 as compared to the similar period of the year 2005 (calculated as the arithmetic average of daily exchange rates published by NBP within the period from 1 January to 31 December). At the same time, the average PLN/ EUR exchange rate has fallen by 3.0% to the level of PLN 3.90/ EUR.

- **Economic growth and unemployment ratio**

Year 2006 brought a dynamic economic growth of the GDP up to the level of 5.8%, as compared to 3.5% in 2005. National demand remained the main growth engine for the GDP, which increased by 5.8% in 2006, in comparison to 2.4% growth in 2005. High economic growth resulted also from a more than 20% increase on exports and 16.7% increase on investments. The improvement of main economic indexes was favorable to the economic revival and improvement of competitiveness of Polish companies. The maintenance of a dynamic growth of GDP had a positive impact on the creation of new job positions. The unemployment ratio fell from the level of 17.6% in 2005 to the level of

14.9% in 2006 (year to year). The level of unemployment ratio in Poland is conditioned by the progress of the restructuring processes, increase of work productivity and legal solutions governing the job market. Improved situation on the job market and favorable macroeconomic tendencies have a significant impact on the level of sales of the Company's products.

- **Inflation**

In the end of 2006, GUS (Central Statistical Office) recorded an increase in the level of inflation from 0.7% to 1.4% as at the end of 2006 (year to year). However, the annual average inflation rate decreased from 2.1% to the level of 1.0%.

- **Interest rates**

Stable inflation rate recorded in 2006 permitted the reduction of reference interest rates twice in the course of 2006. As at the end of 2006, pawn loan interest rates have reached the level of 5.50%, whereas rediscount of bills amounted to 4.25% (6.00% and 4.75% respectively at the end of 2005). WIBOR 3M rate has decreased from 4.60% in 2005 to 4.20% as at the end of 2006. The level of interest rates directly affects the cost of debt.

- **Mandatory reserves**

The Act on the Amendment of State Reserves and Mandatory Reserves has entered into force as of 12 May 2006. The Act regulates the issues related to the Poland's accession to the European Union. At present, reserves are established on the basis production, intra-Community acquisitions and import less intra-Community supplies and export made by an entrepreneur in the previous year. From 1999 on, the required level of mandatory reserves has been increasing by 7 days on a yearly basis, so as to reach the number of 76 days by the end of 2008. Moreover, the Material Reserves Agency is to maintain state reserves of liquid fuels in the amount equal to 14-day consumption of fuels in a given year. PKN ORLEN S.A. establishes and maintains mandatory reserves of fuels, semi-products and crude oil.

In March 2007, the President has signed a new Act on reserves of crude oil, oil products and natural gas and on rules of conduct in situations where the state fuel safety is at risk and disruptions on oil markets occur, which introduces additional elements that are part of the International Energy Agency, including:

- unavailable stocks, i.e. increase of the mandatory emergency reserves by 10%, which generates additional cost of financing increased volume of stock;
- change of the base serving for calculation of the mandatory emergency reserves from the internal consumption within the Republic of Poland index to the rate of net imports of oil – there is a risk that PKN ORLEN will have to additionally increase its stocks of crude oil in comparison with the reserves that resulted from the previous regulations;
- maintenance of emergency reserves of LPG - this regulation was previously not binding in Poland, and now it constitutes an additional burden to the Company.

In consideration of the recommendations arising from the new Act, an increase of reserves' maintenance costs should be expected, in particular as regards the stock financing costs. Cost of logistics, i.e. warehousing, transportation and reloading should remain unaffected.

Positive aspects of the new Act provide for the principle of equality as regards all undertakings operating on the oil market. Previously, entities starting their activity were granted a privilege which allowed them to maintain emergency reserves of 7 days throughout the first year, whereas other companies had to maintain reserves in accordance with the schedule, i.e. by few tens days more.

- **Domestic fuel consumption**

The total domestic consumption of fuels in 2006 estimated on the basis of data provided by Nafta Polska S.A. and Agencja Rynku Energii S.A., including gasoline, Diesel oil (“DO”) and light heating oil (“LHO”) reached 14,508 thousand tonnes, which represents an increase by approximately 8% in relation to figure recorded in 2005.

Gasoline consumption remained at the level recorded in 2005, which results mainly from a dynamic economic growth and an important number of imported vehicles, i.e. comparable with last year’s figures. Moreover, LPG market became weaker and grew only by 4% which positively influenced the domestic consumption of gasoline. Despite this fact, Polska continues to be the world leader in the number of gas stations with LPG modules. Fuel analysts claim that the activities aiming at regulating the LPG market will cause this market to curb, or even reverse the upward trend of the LPG consumption.

The consumption of Diesel oil in 2006 was higher by 24% compared to figures recorded in 2005. Dynamic growth of this market is mainly caused by the decrease in the consumption of the light heating oil, which is illegally used for traction purposes and constitutes a substitute of DO. Other important growth factors as regards DO consumption included a nearly 6% increase of GDP, introduction, as of 2006, of the reimbursement of excise tax for farmers calculated on Diesel oil used for agricultural machinery, and a tendency to change the structure of vehicle fleets for vehicles powered with compression-ignition engines.

Consumption of the light heating oil decreased by 23 % compared to 2005. An important drop in the consumption of LHO in 2006 was caused by, among others, uncertainty present on the market, in connection with the publication of a bill, which finally failed to be adapted, which provided for equaling excise tax rates for LHO with the excise tax rate for DO. Consequently, some consumers withdrew from investments consisting in replacing the existing heating installations for those using LHO. The drop in the LHO consumption was also caused by its limited use for powering motor vehicles, which was due to strict controls of fuel quality at gasoline stations and introduction of excise tax reimbursement calculated on fuels used for agriculture purposes, starting from 2006. The decrease in the use of LHO for heating purposes resulted from an exceptionally warm fourth quarter of the year.

Due to the fact that it was necessary to increase the volume of the emergency reserves in 2006 by entities carrying out business activity at the Polish fuel market, a part of the registered fuel consumption was allocated for reserves and not consumed by the market.

- **Import of fuels**

In accordance with the estimates provided by Nafta Polska S.A., the total import of fuels to Poland in the first 9 months of 2006 has increased by 361 thousand tonnes (i.e. by 11%) as compared to 2005.

In accordance with preliminary estimates, the total import of gasoline decreased by 25% and reached the level of 449 thousand tonnes and represented approx. only 12% of total fuel import. According to Agencja Rynku Energii S.A., the highest gasoline import in 2006 originated from Germany (approx. 50%), Slovakia (approx. 37%) and Czech Republic (approx. 8%).

In accordance with preliminary data, an approximate volume of 2,828 tonnes of diesel oil were imported to Poland in 2006, i.e. 20% more than in the previous year. Import of diesel oil in 2006 constituted nearly 76% of the overall volume of fuel import (approx. 70% in 2005). The majority of diesel oil was imported from Germany (38%, compared to 31% in 2005), Belorussia (25%, compared to 26% in 2005), Slovakia (13%, compared to 13% in 2005) and Lithuania (11%, compared to 13% in 2005). A significant increase of the diesel oil import was mainly due to a major increase of consumption and consequently, insufficient domestic supply of DO.

In accordance with preliminary estimates, the total import of light heating oil in 2006 amounted to 457 thousand tonnes compared to 419 thousand tonnes a year earlier, which gives an increase of approx. 9%. In 2006, the majority of light heating oil was imported from Lithuania (60%, compared to 23% in 2005) and Germany (40% of the total LHO import, compared to 32% in 2005).

- **Amendments to the binding legal regulations**

In realisation of its proecological policy, PKN ORLEN S.A. gradually increases the contents of biocomponents in the fuels produced and simultaneously continues to adhere to the highest international quality standards for fuels introduced into the market. The new Act on biocomponents and liquid biofuels from September 2006 puts an obligation on fuel producers to introduce an annually growing number of biocomponents in accordance with the *National Target Ratio*. The obligation to introduce greater numbers of biocomponents has an impact on the components of the production and logistics chain due to the fact that additional capital expenditures are to be borne for building biocomponents dispensing facilities at pipelines extremities and at warehousing bases.

Moreover, in accordance with the provisions of the Act, entities which introduce liquid fuels to the market on at least 10 gasoline stations owned by the said entity, 10 own-brand stations or partner stations are obliged to place detailed information on the availability of liquid biofuels at the said stations. It will be difficult to implement the provisions of the Act in a situation where biofuels are sold within a distribution network consisting of several hundreds of gasoline stations. Under the provisions of the Act on biocomponents and liquid biofuels, there is a significant risk relating to the fines imposed on fuel producers for non-complying with the National Target Ratio starting from January 2008. If an entity fails to fulfil the National Target Ratio as set for the number of biocomponents added to liquid fuels and biofuels, the amount of fine may even reach PLN 862 million, in case of a total negligence of the National Target Ratio in 2010 in the amount of 5.75%. Fluctuations of prices of biocomponents in situations of natural disasters, such as drought, constitute another threat.

Effective implementation of the Act on liquid biofuels and biocomponents is possible only if tax regulations are amended at the same time, namely, the Act on excise tax and secondary decrees to the latter. However, on 1 January 2007 the decree of the Minster of Finance dated 22 December 2006 on amending the decree on the exemption from the excise tax entered into force resulting in the fall in profitability of esters' production and decrease in profitability of the Polish biofuel market, in general. Application of a lower rate of excise tax exemption for adding biocomponents to liquid fuels and biofuels resulted in a situation where the production of biocomponents, including in particular esters, does not yield any profits. The limitations put on the level of tax exemption caused stagnation of biofuel market, (i.e. methyl esters), which can result in failure to fulfil the National Target Ratio by the national fuel producers as regards the use of biocomponents in subsequent years. This situation may cause payment of substantial fines starting 2008 and potential increases in prices of liquid fuels, which will be particularly burden the end-users, i.e. the consumers.

It is a top priority in the future for the Council of Ministers to adopt long-lasting programs on excise tax exemption for adding biocomponents to liquid fuels and liquid biofuels and stating the level of the said exemptions. Tax relieves should be determined at such a level which will make the prices of liquid fuels with biocomponent additives competitive with prices of liquid fuels without biocomponent additives. Future introduction of an order to use biocomponents or liquid biofuels in Poland, with a simultaneous decrease of the excise tax relieves may cause sudden increase of prices of ethanol and esters, as well as disruptions in the agricultural sector.

- **Regulatory Risk**

The Company has formed the Regulatory Risk Department within its organisational structure. The Department is to actively participate in legislative processes both on national and European Union level, evaluate the effects of the regulations on the Concern, outline the standpoint to be adopted by the Concern and propose actions to be undertaken. At present, the Regulatory Risk Department has been working on the Map of Legal Risks at PKN ORLEN S.A..

The Company issued opinions with respect to the folowing bills:

- Act on use of emission units granted, reduction of emission and certified emission reduction, management of absorbtion units, estblishing levels of emission, national stocktaking, development of prognosis of emission and on trading in the rights to atmospheric emissions of greenhous gasses and other substances (the legislative procedures are pending);
- REACH system (regulation by the EU Council and EU Parliament - in force since 18 December 2006).
- Act on biocomponents and liquid biofuels, including the secondary regulations The Act is in force since September 2006.
- Act on reserves of crude oil, refinery products and natural gas, rules of conduct in situations where the country's fuel security is at risk and on execution of international obligations in situation of disturbed deliveries and crisis on crude oil market. The Act is in force since September 2006.
- Regulation by the Ministry of Finance on the excise tax The Act is in force since September 2006.
- Introduction of excise tax on heating oil in the amount equal to the excise tax payable on motor fuels (not adopted).
- Introduction of limitations under the National Emission Reduction Plan as of 1 January 2008 (legislative process pending);
- Act amending the Energy Law Act, Act amending Environmental Protection Law Act and Compliance Evaluation System Act.

Risk relating to the amendment or introduction of new legal regulations is being monitored by the Regulatory Risk Department. As at the day of preparation of the foregoing report, the risk was not apprised, however, new regulations, in particular with respect to the biofuels, excise tax and emissions of SO2, NOx and dust may have a significant impact on the operations of the Company.

- **Acquisition of AB Mazeikiu Nafta (the "Mazeikiu Refinery")**

Year 2006 was marked by the completion of AB Mazeikiu Nafta acquisition process and takeover of the crude oil supplies of the unit. Mazeiku Refinery was supplied through the Druzhba (Friendship) pipeline. As a result of the

breakdown at the pipeline in the end of July, the supply system to Mazeikiu Refinery was considerably disturbed. It became indispensable to launch deliveries through Butynga harbor. At present, the demand of the refinery for crude oil is covered entirely by sea deliveries. The takeover of supplies to Mazeikiu Refinery from January 2007 constitutes another stage of centralization of supplies to refineries belonging to PKN ORLEN S.A. The main objective to be achieved in that respect is ensuring security and stability of supplies.
As a result of suspension of deliveries through pipeline to Mazeikiu, the Logistics Office of PKN ORLEN S.A. has undertaken activities timing at developing and optimal use of alternative delivery manners and crude oil warehousing, in particular, with respect to the implementation of the planned construction of reverse pipeline connecting Klaipeda seaport with the base in Butinge, which, in conjunction with securing of additional warehousing capacity, will allow for a significant improvement of the security, as regards the supplies of raw material to the refinery, and reduce operational costs of deliveries. Additionally, high rail transportation costs, (i.e. costs of transportation by the Lithuanian Railways and lease of rail tank cars), in conjunction with the lack of alternative or cheaper distribution manners of Mazeikiu refined products to the reloading harbors, call for a necessity to intensify the activities within the concept of construction of pipeline connection with Klaipeda harbor. Pipeline connection with Klaipeda could bring significant reduction of logistics-connected charges in addition to an improved security of shipping conditions. The scope of works undertaken was enlarged by the concept of launching the Company's rail transportation services in order to further reduce the costs incurred, including the renegotiation of the present rates within the remaining itineraries and activities aiming at securing the interest of Mazeikiu at Klaipeda harbor.

Significant risk factors and threats for the operation of PKN ORLEN S.A. have also been referred to and described in Note 30 to the financial statements for 2006.

2.2 Production

In 2006, crude oil processing by PKN ORLEN S.A. amounted to 13,612 thousand tonnes and was by 8.3% higher in comparison with 2005. In 2006, the yield from refined products (gasoline, fuel and diesel fractions and liquid gas) amounted to 78.1%, i.e. it dropped by 1.74 pp. below the level recorded in 2005. Main factors responsible for the decrease in the yield from refined products were the planned rest of soft asphalt Hydrodesulphurization installation in the brake of April and May 2006 and a significantly higher processing of crude oil.

The most important events in 2006 within the refinery production at PKN ORLEN S.A., included:

1. Processing of a record volume of crude oil at the level of 13,612 thousand tonnes, i.e. 8.3% above the figures recorded in 2005. Processing such an amount was possible due to loading down of all installations. The increased processing resulted directly from market demand and production capacities of Olefin II Installation.
2. Launching of a new Cracking Gasoline Desulphurization Installation in June 2006. The installation allows producing a full range of low-sulphur gasoline, in accordance with the EU requirements on the quality of fuels, which will become binding after 2009. The capacity of the new production unit amounts to 145 tonnes of desulphurised gasoline per hour. The selected technology allows carrying out desulphurization process with a minimum reduction of gasoline octane numbers.
3. Termination in May 2006 of the first stage of modernization of Diesel Oil Hydrodesulphurization VI Installation.

The second stage of works was terminated in October 2006. The aim of the modernization was to prepare the said installation for a more thorough desulphurization of loadings for the production of Diesel oil with the sulphur contents of less then 10 mg/kg. The contract for the modernization, including technological project and supply of equipment was executed with the licensor of the installation, i.e. ABB Lumus.

4. Signing in August 2006 of an agreement with Technip Italy for a technical project, delivery of equipment and materials for the Diesel Oil Hydrodesulphurization VII Installation of a designed production capacity of 2.2 million tonnes of Diesel oil. The urge to build the installation results from the requirements which will enter into force in 2009 and which refer to the requirement of delivery of Diesel oil with the sulphur contents lower then 10 ppm, with an increased level of crude oil processing.
5. Signing in October 2006 of an agreement with Technip for a new Hydrogen Installation of a production capacity of 5 T H2/h (technical project, license and delivery of equipment). The new Hydrogen Installation will produce hydrogen for the purposes of desulphurization of Diesel oil fractions from Diesel Oil Hydrodesulphurization VII and Diesel oil fraction stabilization centre from the Soft Asphalt Hydrodesulphurization Installation in accordance with the EU requirements on the quality of fuels. The installation is planned for opening in the first quarter of 2009.
6. Starting the construction of the Diesel oil fraction stabilization centre from Soft Asphalt Hydrodesulphurization Installation which is designed to denitrate, desulphurise and remove resin, which will increase the possibilities of using the fraction for Ekoterm light heating oil. The centre is planned for opening in the end of 2007.
7. Exchange and extension of the analytical equipment for Gasoline Blending in order to optimize the gasoline composition process and assure an appropriate quality of gasoline.
8. Decision on the Modernization and intensification of Alkylation (HF) Installation. Production capacities after the modernization will reach 280 thousand tonnes per year. The modernization is aimed at reducing environmental risks connected with the AHF technological process by diminishing the level of HF acid within the installation up to a required minimum amount, i.e. 55 tonnes and to improve of technical safety and quality of alkylate, which will make the gasoline composition process more flexible.

Important events within the petrochemical production include:

1. Modernization works at Olefin II Installation and Aromatics Extraction Unit carried out in 2005 resulted in a significant increase of petrochemical production.
2. Decision on the construction of Paraxylene (PX) and terephthalatic acid (PTA) installations in order to make use of the reserve of gasoline resulting from an increased level of crude oil processing after 2009 (approx. 15 million tonnes). The centre is planned for opening in the first quarter of 2009. In April 2006, a contract with Mitsubishi Chemical Engineering Corporation was signed for the license and base project for a production technology of terephthalatic acid. The construction of the installation will commence within the Zakłady Azotowe Anwil S.A. in autumn 2007. The installation with production capacity of 600 thousand tonnes per year of PTA is planned for opening in the fourth quarter of 2010.

2.3 Sales

Net revenue from sales of finished goods, merchandise and raw materials at PKN ORLEN S.A in 2006 amounted to PLN 33,501,034 thousand, which represents 147.0% of the sales revenue generated in 2005. Net revenue from sales of finished goods amounted to PLN 24,391,083 thousand and were higher by 19.5% then in the previous year, whereas net revenue from sales of merchandise and raw materials have reached the level of PLN 9,109,951 thousand, i.e. by 282.9 % more then in 2005.

In 2006, PKN ORLEN S.A. has sold 13,016 thousand tonnes of finished goods and merchandise through the wholesale and retail network, i.e. by 11% more then in 2005.

In the area of refinery products sales, the increased sales of Diesel oil by 845 thousand tonnes (by 23%) and Jet A1 aviation fuel by 31 thousand tonnes (by 8%) were partially compensated by lower sales of gasoline, i.e. decrease by 125.5 thousand tonnes (by 4%) and light heating oil by 297 thousand tonnes (by 19%) recorded in 2006. Sales of refinery finished goods and merchandise reached the level of 11,233 thousand tonnes and was higher by 7% then the sales recorded in 2005.

The sales of petrochemical products have increased by 51% to the level of 1,783 thousand tonnes owing to, among others, opening of new installations in 2006. The products with the highest growth of sales were: ethylene (increase of 264 thousand tonnes), propylene (increase of 166 thousand tonnes), benzene (increase of 52 thousand tonnes) and other petrochemical products (increase of 45 thousand tonnes).

2.3.1 Retail sales

In 2006, retail sales of PKN ORLEN S.A. have risen by 11% as compared to 2005. The main growth factor was the network of the Company's brand gasoline stations. The sales of the brand stations have noted, for the first time since 2004, a positive dynamics and reached a record growth of 15%. Such a high level of sales was due to a full realization of an ambitious investment program (including the introduction to the network of 48 new stations and total refurbishment of 76 stations) and increased effectiveness of the existing stations. In comparable conditions, with regard to sales of the same products at the particular number of fuel stations and after elimination of investment activities, the increase in sales on CODO stations amounted to 10%. The network of Bliska stations has also seen a higher growth of sales then planned, i.e. by 30%.

In connection with a dynamic development of the brand network and franchise network (network entirely controlled by PKN ORLEN S.A.) the negative trend of average sales per station was overcome in 2006. Consequently, average sales per station amounted to 2.3 million liters, which signifies an increase of 10% compared to the previous year. The said ratio significantly outnumbers the ratio of average sales per station of all major competitors by approx. 6 pp.

Sales by quantity (million liters)*	Realization		Variance	
	2006	2005	million liters	%
Gasoline	1,745.2	1,775.5	- 30.3	- 1.7
Diesel Oil	1,971.2	1,637.4	333.8	20.4
LPG	403.1	300.6	102.5	34.1
Total fuels	4,119.5	3,713.5	406.0	10.9

*) Sales through CODO, DOFO, DODO

In 2006 a further increase of Diesel oil and LPG gas share in the general volume of fuels sold was noted. Such changes are in line with retail consumption trends in Poland, i.e. increased consumption of diesel oil and LPG with a simultaneous reduction of demand for gasoline. Due to the maintenance costs, more and more clients buy LPG gas for their vehicles. In addition, PKN ORLEN S.A. has realized an ambitious investment plan in 2006 with respect to the construction of new LPG modules at gasoline stations. Both results had a positive impact of the sales of that fuel.

As a consequence of a number of marketing activities undertaken and active sales at stations, the share of sales of Verva fuel at Premium stations recorded high growth. In December 2006, Verva share in sales exceeded the level recorded in December 2005 by 3.1 pp (it is impossible to compare the whole 2005, as this fuel was not offered in sales throughout the whole 2005).

Margin on the retail sales of fuels in 2006 amounted to PLN 1,095.4 million and was by PLN 160.9 million higher then the margin realized in 2005. Such good result was possible due to the sales of all distribution channels, i.e. CODO, DODO and DOFO stations. Main positive factors having an impact on the fuel margin included: high volume of sales, (i.e. a total impact on margin of PLN 102.1 million), and higher average margin per station within DOFO and DODO channels (total positive impact on the margin by PLN 14.3 million and 21.8 million, respectively). However, the sales of Diesel oil had the biggest impact on the increase in fuel margin.

Positive dynamics of fuel margin resulted mainly from the implementation of the assumptions of the retail sales strategy within the integrated management of all sales channels initiated in 2005, including among others central retail price management procedure, changes to the transfer settlements and synergy relating to the elimination of ineffective decision-making processes.

Fuel margin (PLN million)*	Realisation		Variance	
	2006	2005	PLN million	%
Gasoline	524.7	524.0	0.7	0.1
Diesel oil	483.9	341.1	142.8	41.9
LPG	86.8	69.4	17.4	25.1
Total gross margin of fuels	1,095.4	934.5	160.9	17.2

*) Gross margin on the sales of fuels for CODO, DOFO DODO networks

Margin on the sales of non-fuel products and services increased in 2006 by 17.0% as compared to the previous year and reached the level of PLN 297 million.

The growth of non-fuel margin in 2006 in comparison to figures recorded in 2005 results from the implementation of activities outlined in the retail sale strategy launched in 2005, which focuses on the optimization of merchandise categories within the existing trade conditions and selection of the range of products in accordance with the needs and expectations of customers. Active sales at gasoline stations and implementation of an ambitious plan concerning the development of food corners and construction of car wash sites are also of importance. At present, new formula for category management is being developed, shop visualization prepared and new offer of bistro-bars made, which will certainly bring a positive results in 2007.

Non-fuel margina (PLN million)	Realisation		Variance	
	2006	2005	PLN million	%
Shop margin	256.2	224.5	31.7	14.1
Bistro Bar margin	10.3	3.9	6.4	164.1
Car wash	22.5	16.7	5.8	34.7
Other, including lease	8.1	8.7	- 0.6	- 6.9
Total non-fuel margin	297.0	253.7	43.3	17.1

*) margin on the sale of non-fuel products (shop margin, bistro-bar margin, car-wash margin and margin on other services).

From 2006, PKN ORLEN S.A. calculates its retail sales market share based on information on sales from 100 the biggest retail players. The said sales constitute approx. 70% of the retail sales market. PKN ORLEN S.A. share in the sale of 100 biggest players increased from 37.4% at the end January 2006 to an estimate of 39.6% at the end of 2006.

2.3.2 Wholesale trade

Sales volume (thousand tonnes)	Realization		Variance	
	2006	2005	Thousand of tones	%
Gasoline	1,476	1,579	- 103	- 6.5
Diesel oil	2,824	2,261	563	24.9
Light heating oil	1,266	1,562	- 296	- 19.0
JET A-1 aviation fuel	403	372	31	8.3
Heating oil III	735	624	111	17.8
Sulphur	124	110	14	12.7
Other refinery products	1,196	1,097	99	9.0
Total refinery products	8,024	7,605	419	5.5
Liquid gas	215	235	- 20	- 8.5
Phenol	45	43	2	4.7
Acetone	28	27	1	3.7
Ethylene	509	245	264	107.8
Prophylene	387	221	166	75.1
Glycols	113	90	23	25.6
Ethylene oxide	16	14	2	14.3
Butadiene	62	40	22	55.0

Benzene	115	63	52	82.5
Orthoxylene	20	18	2	11.1
Paraxylene	30	28	2	7.1
Other petrochemical products	243	161	82	50.9
Total petrochemical products	1,783	1,185	598	50.5
Total sales	9,807	8,790	1,017	11.6

The wholesale of refinery products reached the level of 8,023 thousand tonnes and was higher by 5.5% from the figures recorded in 2005. The products with a positive sales dynamics were:

- Diesel oil: despite limited supplies, a significant increase of 25% was recorded, mainly owing to the high quality of the fuel, good price offer and high consumption level;
- Heating oil III: very good stock management adequate to the market conditions (stocking of product in the periods of low/ negative profitability and selling in the remaining periods) allowed minimizing the negative financial result and reaching 18% growth of sales;
- JET A1; significant growth of sales (8%) mainly due to the meeting of the demand caused by increased air traffic.

At the same time, the following products recorded lower sales:

- Gasoline: drop of 6.5% as a result of downward trend in gasoline consumption, attractive alternative of LPG and lack of possibilities to counterbalance the lost sales to Exxon and Conoco Philips (total sales of 180.5 thousand tonnes in 2005);
- Light heating oil: drop of 19% caused by clients switching for alternative sources of energy and plans of introducing the same level of excise tax for LHO as for Diesel oil.

The sales of petrochemical products have increased by 51% owing to the rewamping of Olefin installation, including ethylene (increase of 264 thousand tonnes), propylene (increase of 166 thousand tonnes), benzene (increase of 52 thousand tonnes) and other petrochemical products (increase of 83 thousand tonnes)

2.4 Sales markets and supply sources

In 2006, PKN ORLEN S.A. has continued the process of centralization of supplies to PKN ORLEN S.A. refineries and by virtue of the agreements concluded, it have been delivering crude oil to all its refineries starting from the second quarter of 2006. Deliveries of crude oil to Poland and Czech Republic in the past year were operating without disruptions and according to the agreed schedule. Crude oil purchased by PKN ORLEN S.A. in 2006 was delivered to Płock mainly from Russia (97.5%). Additional purchases of 348,334 tonnes of low-sulphur oil were made in Great Britain (1.2%) and in Norway (0.7%) and also in Poland, i.e. 85,650 tonnes (0.6%). The suppliers of crude oil belong to the group of companies operating on the Russian crude oil market and traders operating on the international crude oil market. In the case of domestic purchases, crude oil is delivered by Polskie Górnictwo Naftowe i Gazownictwo S.A., a company operating on the Polish natural gas upstream market. J&S and Petraco share in the raw materials supply to PKN ORLEN S.A. exceeded 10% of revenues from the total sales in 2006.

In accordance with the concluded agreements, in 2006, PKN ORLEN S.A. has been delivering crude oil to the Czech

Unipetrol holding. The suppliers recruit themselves from the group of companies operating on the Russian crude oil market delivering to Czech Republic and traders operating on the international refinery market. Fisotra's share in the raw materials supply to Unipetrol exceeded 10% of revenues from the total sales in 2006.

In 2006, as in 2005, the group of domestic customers with the biggest share, i.e. over 5%, in the total revenues, including excise tax and fuel charge but exclusive of Vat, was composed of foreign concerns: BP Polska Sp. z o.o., SHELL Polska Sp. z o.o. and a subsidiary, ORLEN PetroCentrum Sp. z o.o. The share in the total revenues from sales of the above-mentioned entities in 2006 was lower then 10%. In the group of domestic customers whose share in the revenues structure exceeds 0.5%, the most significant changes in the period in question refer to the following events:

- increase of the share in total revenues of Basell ORLEN Polyolefins Sp. z o.o. (of 2.2 pp), ORLEN PetroCentrum Sp. z o.o. (of 0.8 pp) and J&S ENERGY S.A. (conclusion of an agreement for contractual deliveries of fuels for the benefit of that partner, no deliveries in 2005).
- lack of sales to Conoco Philips Poland. Sp. z o.o. in 2006 (in 2005, the deliveries to that customer represented a share of 2.9 %).

A comparative analysis of the value structure of sales in 2006, as per domestic customers in 2006 and in 2005 is presented in Enclosure No. 3 to this report.

As regards certain oil-derived and petrochemical products there are dominating customers, however, the share of product sales to individual customers in the total revenues from sales is not significant. The above applies to the following products:

- Evaporated waste – ORLEN Asfalt Sp. z o.o. – 100%;
- Propan-butan gas – ORLEN Gaz Sp. z o.o. – 99%;
- P-21 fraction - ORLEN Oil Sp. z o. o. - 98%;
- Butadiene – Firma Chemiczna Dwory S.A.– 94%;
- Postpyrolysis oil – Warter Sp. z o.o. – 66%.

Minor changes in the structure of the domestic and foreign market share in the total revenues from sales have occurred in 2006 as compared to 2005. The value of export share in the total revenues from sales has slightly fallen from 8.5% to 7.8%.

Sales of crude oil to Unipetrol a.s. represent a significant share in the total revenues from sales in 2006. The share of that merchandise in the total revenues in 2006 amounted to 16.1%.

The structure of sales revenues within the domestic and foreign markets is presented in Note 21 to the Unconsolidated Financial Statements for the year 2006.

2.5 The Company's indebtedness structure

As at the end of 2006, the level of the Company's financial indebtedness increased by PLN 5,208 million as compared to the end of 2005.

The amount of the Company's net financial liabilities according to their maturity and currency in which loans and borrowings, as well cash and its equivalents are denominated, i.e. net debt, as at the end of 2005 and 2006 were as follows:

Specification (in PLN million)	Loans and borrowings		Cash and Cash Equivalents		Net debt	
	2006	2005	2006	2005	2006	2005
According to currency:						
USD	1,252	713	-	-		
EUR	5,338	665	-	-		
PLN	45	26	307	284		
Total	6,635	1,404	307	284		
According to maturity:						
Long-term	3,495	1,374	-	-		
Short-term	3,140	30	307	284		
Total	6,635	1,404	307	284	6,328	1,120

Despite a significant increase of the indebtedness as at the end of 2006, the in the opinion of the Company, the liquidity remains at a safe level. As at 31 December 2006, the following financial resources were available:

- PLN 560 million under short-term loan agreements;
- PLN 3 419 million (i.e. EUR 892 million) million under long-term loan agreements;
- PLN 307 million in cash and cash equivalents.

The Company is a party to 11 credit loan facility agreements, 9 of which are of short-term type and 2 long-term credit facilities.

The Company is a party to a long-term multicurrency credit facility agreement in the amount of EUR 1 billion, granted by a consortium of Polish and foreign banks, signed in December 2005. The term of the agreement is 5 years from its execution with a possibility of extension by two yearly periods, and therefore in December 2006, the Company extended the credit facility by a one-year period. The credit facility can be utilized in four different currencies, i.e. euro, US dollars, Polish zlotys, and Czech coronas. Part of resources granted under this credit facility was used in the first half of 2006 to repay a long-term two-currency credit facility granted by a consortium of banks, granted on the basis of an agreement dating from 2003 and another part was utilized for the acquisition of AB Mazeikiu Nafta shares. The remaining part of the credit facility will be allocated for financing the Company's current operations.

In November 2006, the Company signed two credit facility agreements in view of the acquisition of AB Mazeikiu Nafta. The first agreement was signed with a consortium of eight banks for revolving loan and the other one with a consortium of six banks for a bridging loan. The total limit of both agreements amounts to EUR 1.6 billion. The transaction is the largest financing program in the history of the Company, and also the biggest lump-sum financing transaction ever carried out for the benefit of a Polish entity. It consists of a five-year revolving credit facility, with a possibility of extension by two one-year periods, i.e. an open-end credit available on demand that can be used repeatedly, in the amount of EUR 800 million and a 12-month bridging loan, granted for a period until the launching of the planned emission of Eurobonds, in the amount of EUR 800 million. The funds obtained from the above credit facilities, together with the Company's own resources and undrawn lines of credit assured a sufficient amount for the Company to acquire from Yukos International UK B.V. with its registered office in the Netherlands, and from the Government of the Republic of Lithuania the shares in the Lithuanian AB Mazeikiu Nafta.

After the balance sheet date, a portion of the obtained pool of funds was allocated for another undertaking planned within the aforementioned acquisition, i.e. purchase of shares offered by minority shareholders in response to the mandatory tender offer published by the Company.
The consortium which granted the financing to the Company for the acquisition of the Lithuanian refinery is composed of the following entities: ABN AMRO Bank, Bank Handlowy w Warszawie, The Bank of Tokyo-Mitsubishi, BNP Paribas, ING Bank/ ING Bank Śląski, KBC BANK/Kredyt Bank, Polish branch of Société Générale and UniCredit Group. The support provided by the largest banking institutions guarantees to the Company that financing costs will be advantageous. The bridging loan provides sufficient time for organising the issue of Eurobonds.
When selecting the structure for financing the acquisition in question, the Company made the following assumptions: of minimizing the costs of financing, diversification of investors and optimizing the maturity period of an instrument (tenor) in order to minimize the refinancing risk.
At present, the Company prepares the issue of Eurobonds in cooperation with the banks being party to the bridging loan facility. Funds to be obtained from the issue will be allocated for the repayment of the consortium bridging loan. Eurobond market will be used in order to diversify the investors and extend the tenor of financial liabilities.

Detailed information on maturity dates of loans granted and debt securities issued by the Company are set forth in Note 14 to the financial statements of PKN ORLEN S.A. for the year ended 2006.

2.5.1 Loans. sureties and guarantees

In 2006 a long-term loan facility concluded in the second half of 2005 between PKN ORLEN S.A. and its subsidiary ORLEN Transport Kraków in the amount of PLN 2,700 thousand continued in force. In the period in question, loan instalments have been dully repaid by ORLEN Transport Kraków.
In the second half of 2006, PKN ORLEN S.A. has granted a long-term loan to its subsidiary ORLEN Budonaft for an amount of PLN 7,232 thousand with a final maturity date on 30 November 2008. The loan received by Orlen Budonaft will be allocated for the repayment of debts and for financing of current operations. The amount of the loan will be paid and paid back in instalments. Interest will be calculated in accordance with a floating interest rate determined on market conditions.
The total value of contingent liabilities as at 31 December 2006 increased by PLN 1,424,395 thousand, to the level of PLN 2,329,569 thousand comparing to the end of 2005. The total value of the guarantees and sureties issued at the end of 2006 increased by PLN 1,266,006 thousand, up to a total amount of PLN 1,302,946 thousand, mainly due to payments guarantee in the amount of PLN 1,283,452 thousand. The guarantee had to be deposited to the benefit of SEB, the Lithuanian bank in respect of the mandatory tender offer (MTO) published after the AB Mazeikiu Nafta acquisition. For shares purchased after MTO PKN ORLEN S.A. financed from previously obtained credit facilities, the guarantee was released on 29 January 2007. In 2006 the guarantees issued by PKN ORLEN S.A. for private persons securing the fulfilment of liabilities decreased by PLN 18,929 thousand. Other positions of guarantees changed insignificantly.
Other contingent liabilities at the end of 2006 reached PLN 1,026,623 thousand and increased by PLN 158,389 thousand, mainly due to collaterals submitted in respect of excise tax duty calculated on harmonized goods kept on warehouses under the excise tax suspension procedure.
Detailed information on maturity dates of loans granted and debt securities issued by the Company are set forth in

Note 30 to the financial statements of PKN ORLEN S.A. for the year ended 2006.
As at 31 December 2006 the Company did not grant any loans to managing and supervising persons and their relatives.

2.5.2 Bonds issued

In November 2006, the Company executed the agreement on the bond issue program for the amount of maximum indebtedness of PLN 2 billion with the following banks: Bank BPH, Polska Kasa Opieki, BRE Bank, ING Bank Śląski, PKO Bank Polski and Polish branch of Societe Generale.
Under the above-mentioned agreement, the Company will issue unsecured bearer's bonds. The offer will be directed to institutional investors and will not be offered to public. The information on the intention to issue bonds will not be notified to the publics. The banks will choose those entities from among the investors that they are familiar with to whom they will present the offer. The offer may be presented to a maximum of 99 investors. Under the program, deferred interest bonds (zero-coupon bonds) and interest-bearing bonds (with a coupon) will be issued. The deferred interest bonds will be issued with a discount for a term of 7 days to 1 year. Fixed interest rate or floating interest rate will be calculated on the interest-bearing bonds with a maturity period from 1 to 7 years. The program is a multicurrency issue program, i.e. the issues may be denominated in the following four currencies: Polish zloty, euro, US dollar and Czech corona, which will allow for issues to be directed to foreign companies from the PKN ORLEN Capital Group.
Funds obtained under the issue can by allocated by the Company for any business-related purpose, both ongoing operations and investing activities. Under the program, the Company is allowed to divide the issue into blocks and additionally determine dates on which they will be released. It gives an opportunity to manage the funds with which the Company intends to finance its ongoing operations. The issues made under the program make it possible to finance working capital at an attractive cost, diversify the sources of the Company's financing, and optimise liquidity management in companies belonging to the PKN ORLEN Capital Group.
After the balance sheet date, in February 2007, the Company has issued 5-year bonds in the amount of PLN 750 million.

2.5.3 Cash management

Efficient management of cash flow between its bank accounts is of high importance for the Company. From February 2001, a cash pooling system has been introduced within the Capital Group. As at 31 December 2006, the Company was using cash-pooling systems for Polish zloty three at banks (in addition to the Company, 28 companies from the Capital Group are covered by cash pooling system in PLN) and foreign currency cash-pooling system at one bank (in addition to the Company, two companies from the Capital Group are covered by the foreign currency system). Activities aiming at covering by the system those companies from the Capital Group in which the Company has a dominating position are in process.
In its day-to-day operations, the Company uses comprehensive services of highly credible banks, with a considerable equity capital and strong market position, which have gained extensive expertise in cash management on the Polish and foreign markets. This approach has made it possible for the Company to reduce costs of banking services and

improve the structure of banking services, and finally, to cover the companies from the Capital Group by a uniform banking services system and centralized cash management system. Further activities aiming at better integration and improved conditions of banking services for all companies from the Capital Group are still being discussed.
Available cash, secured sources of financing and high borrowing power secure all short-term financial needs in connection with the capital and property investments.

The Company aims to further optimize the financing within the whole PKN ORLEN Capital Group through the introduction of segment management system, consisting of:

- cash management, liquidity planning and securing;
- obtaining financing, issuing guarantees and opening letters of credit;
- trade credit and debt enforcement management;
- financial risk management;
- insurance of transaction risk.

2.5.4 Financial instruments

Financial results of the companies belonging to the Company may fluctuate due to changes of various market factors, in particular, product quotations, exchange rates and interest rates. PKN ORLEN S.A. manages the risk to which it is exposed, limits the fluctuation of future cash flow and controls potential economic loss resulting from changes of market factors. The policy and strategy of using derivatives is determined and monitored by the Management Board. The realization of the adopted by the Management Board policy is supervised by PKN ORLEN S.A. financial risk committee
In January 2006, the Management Board of PKN ORLEN S.A. has approved the revised market risk management policy and set forth fixed parameters for the level of necessary hedging, its time span and financial instruments used. The policy adopted by PKN ORLEN S.A. provides for a hedging up to 50% of exposure to foreign currency rates fluctuations. Cross-currency interest rate swap and foreign currency forward contracts were the instruments most commonly used for the implementation of the said policy.
The sources of foreign exchange risk to which PKN ORLEN S.A. is exposed include: raw material purchase transactions, sale of refined and petrochemical products, property and capital investments index-linked to foreign currencies or denominated in other currencies then the functional currency of PKN ORLEN S.A., as well as credits and loans drawn and cash held in foreign currencies.
In 2006, the portfolio of PKN ORLEN S.A. included cross currency interest rate swap (EUR/ PLN) instruments securing revenues from the sale of petrochemical products concluded in 2003, and thus the Company has significantly limited the fluctuations of the revenues from the sale of the above-mentioned group of products. The above-mentioned transactions were settled in 2006.
In accordance with the revised market risk management policy, PKN ORLEN S.A. has engaged in a systematic hedging of the net operational exposure in EUR and USD. The exposition referred to above are hedged by forward foreign currency contracts. In the event of the instruments contracted and settled within the same quarter the hedge accounting was not applied. However, hedge accounting was used in relation to the remaining group of instruments.
In September 2006, the Management Board of PKN ORLEN S.A. approved the revised policy on the interest rate risk

management. The revised policy sets forth IaR parameters (Interest at Risk) and fixed-to-floating rate basis as tools for managing interest rate risk. Hedging of interest rate risk is based on the identification of cash flows exposed to interest rate fluctuations, resulting from the Company's current map of exposure to risk.

Hedging transactions are referred to in the financial report on the side of financial assets or financial liabilities at fair value. As at 31 December 2006, fair value amounted to PLN 28.7 million, whereas the effective portion of the hedging is recorded at hedging reserve, and the non-effective portion of the hedging in the income statement. Flows resulting from the settlement of instruments hedging net operational risk exposure EUR/PLN and USD/PLN in 2006 amounted to PLN 126.6 million.

In connection with the execution of the agreement on the acquisition of shares in AB Mazeikiu Nafta with Yukos International UK B.V. and the Lithuanian Government, financed in majority with credit facilities denominated in euro, since August 2006, PKN ORLEN S.A. has been concluding forward contracts for the sale of EUR and purchase of USD necessary for the settlement of the transaction. Hedge accounting rules were not applied with respect to the above-mentioned group of instruments. Due to a decrease of USD exchange rate in November and December, the final settlement of the instruments resulted in a loss in the amount PLN 104.1 million.

The executed hedging transactions are aimed at stabilizing financial results and minimizing market risks to which the Company is exposed, and therefore do not bear the characteristics of speculative transactions and are not entered into with a view of making profit. PKN ORLEN S.A. values derivates at fair value with the use of financial instrument valuation models using the generally available data from active markets.

Risk management process is carried out based on implemented procedures and operation of the Risk Committee which monitors the Company’s exposure to risk, as well as the contents of the portfolio of hedge transactions.

2.6 Changes to the financial assets of PKN ORLEN S.A.

As at 31 December 2006, Polski Koncern Naftowy ORLEN S.A. (PKN ORLEN S.A.) held directly or indirectly shares in the following companies, which it controls, jointly controls, or the operation of which it considerably influences:

– 114 subsidiaries;
– 4 jointly controlled companies;
– 22 associate companies.

As compared to the data recorded as at the end of 2006, the number of subsidiaries, jointly controlled entities, as well as associate companies of the Capital Group has decreased from 157 to 140.

Major changes in structural and capital relations within the PKN ORLEN S.A. Capital Group in 2006 and until the preparation of this report refer to the following events:

- on 2 January 2006, the acquisition by ORLEN Centrum Serwisowe Sp. z o.o. with its registered office in Opole (the bidder) of the following businesses (the target companies) was registered:
  - Serwis Mazowsze Sp. z o.o. with its registered office in Warsaw;
  - Serwis Nowa Wieś Wielka Sp. z o.o. with its registered office in Nowa Wieś Wielka,

  by way of transfer of all assets of the target companies to ORLEN Centrum Serwisowe Sp. z o.o. (combination by way of acquisition).

In connection with the aforementioned, the articles of association of ORLEN Centrum Serwisowe Sp. z o.o. were amended as regards the increase of the company's share capital, consisting in the increase of the company's share capital from PLN 6,759 thousand to PLN 6,818 thousand, i.e. by the amount of PLN 59 thousand. The shares in the increased share capital of the nominal value of PLN 50 each were subscribed to by the current shareholders of the target companies.
As a result of the above increase of the share capital of ORLEN Centrum Serwisowe Sp. z o.o., PKN ORLEN S.A. participation of 96.65 % decreased to 95.82%.
With the registration of the said combination of businesses of ORLEN Centrum Serwisowe Sp. z o.o. with Serwis Mazowsze Sp. z o.o. and Serwis Nowa Wieś Wielka Sp. z o.o, the target companies were stricken off the register.

- On 16 February 2006 an increase of the share capital of ORLEN Powiernik Sp. z o.o. from PLN 25 thousand to PLN 50 thousand was registered. The shares in the increased share capital were subscribed to by the sole shareholder, i.e. PKN ORLEN S.A.

- The Guaranteed Sale Agreement for the sale of 165,924 shares in AWSA Holland II B.V., i.e. a company incorporated under the laws of the Netherlands, to the benefit of Kulczyk Holding was signed on 27 February 2006. The shares being disposed of by PKN ORLEN represent 9.218% of the share capital of AWSA Holland II B.V. In consideration for the stake of shares in AWSA Holland II B.V., Kulczyk Holding has paid an amount of PLN 73,007 thousand by wire transfer to the bank account of PKN ORLEN. On 7 June 2006, PKN and Kulczyk Holding have executed the Agreement on the Disposal of Shares, by virtue of which the ownership to 165,924 shares in AWSA Holland II B.V., i.e. the company incorporated under the laws of the Netherlands, to the benefit of Kulczyk Holding. The transaction was completed due to the fulfillment of the condition precedent (with binding effects) set forth in the Sale Agreement concluded on 27 February 2006 between PKN ORLEN and Kulczyk Holding in the form of the Guaranteed Sale Agreement in execution of the obligations resulting from the Additional Agreement, concluded on 14 November 2002. The shares sold by PKN ORLEN represent 9.218% of the share capital of AWSA Holland II B.V. Consequently, after the completion of the transaction, PKN ORLEN does not hold any shares in AWSA Holland II B.V.

- On 23 February 2006 an increase of the share capital of Płocki Park Przemysłowo – Technologiczny S.A. (PPPT) by the amount of PLN 7,231 thousand from PLN 8,230 thousand to the amount of PLN 15,461 was registered; the increase was carried out through a private issue of 723,043 registered shares preferred as to their voting rights, giving right to 2 votes per one share of C issue, intended for the existing promoter shareholder, i.e. PKN ORLEN S.A. On 16 March 2006, an increase of the share capital of PPPT from PLN 15,461 thousand to PLN 25,461 thousand was registered. The increase was carried out through a private issue of 1,000,000 D series registered shares preferred with respect to voting rights, giving right to 2 votes cast per one share of a par value of PLN 10 each, intended in equal parts of 500,000 shares for the existing promoter shareholders of the company, i.e. the City of Płock and PKN ORLEN S.A. each.

On 31 August 2006 another increase in the share capital from the amount of PLN 25,461 thousand to the amount of PLN 50,461 thousand was registered. The increase was carried out through an issue of 2,500 thousand registered shares preferred as to the voting rights, giving right to 2 votes cast per 1 share, of a par value of PLN 10 each, intended in equal parts of 1,250 thousand shares for the promoter shareholders, i.e. the City of Płock and PKN ORLEN each. All of the newly issued shares were subscribed for in cash. As a result of the increase in the share capital, PPPT has the following capital structure:

- the City of Płock, as the promoter shareholder, holds PLN 25,230 thousand, constituting 50% of the share capital;
- PKN ORLEN, as the promoter shareholder, holds PLN 25,230 thousand, constituting 50% of the share capital.

- On 16 March 2006, the District Court in Warsaw has registered a company under the registered name of ORLEN Administracja Sp. z o.o. with its registered office in Płock. All of the 3,000 shares representing 100% of the share capital in the above-mentioned company were subscribed for by PKN ORLEN S.A. The shares subscribed to were paid for by PKN ORLEN S.A. in cash, i.e. PLN 1,500 thousand.
- On 20 March 2006 PKN ORLEN S.A. has acquired from BGW Sp. z o.o. with its registered office in Poznań a stake of 8,549 shares in ORLEN PetroZachód Sp. z o.o. against the payment of PLN 21,012 thousand with a reservation that a potential price correction to increase the purchase price cannot exceed PLN 3,000 thousand. The price adjustment is conditioned upon the fulfillment of condition precedent, as set forth in the Agreement. The shares acquired represent a share of 48.17% in the share capital of ORLEN PetroZachód Sp. z o.o. Consequently, PKN ORLEN S.A. has become the sole shareholder in ORLEN PetroZachód Sp. z o.o.
- On 21 March 2006, sales of 13,449 shares in SAMRELAKS Mąchocice Sp. z o.o. with its registered office in Mąchocice Kapitulne, constituting 100% of its share capital for the total amount of PLN 4,000 thousand. The book value of the shares recognized in PKN ORLEN S.A. books as at 31 December 2005 amounted to PLN 2,505 thousand.
- ORLEN Upstream Sp. z o.o. with its registered office in Warsaw was registered with the District Court for the capital city of Warsaw on 26 April 2006. PKN ORLEN S.A. has subscribed to 100 shares in the newly created company, which represented 100% of the share capital, of the nominal value of PLN 500 each share, giving right to 100% votes cast at the shareholders' meeting. The shares subscribed to in that way were paid for by PKN ORLEN S.A. in cash in the amount of PLN 50 thousand. The main business activities of ORLEN Upstream Sp. z o.o. include oil mining, gas mining, as well as geological activity, and prospecting and researching oil and gas.
- On 2 June 2006, the merger of ORLEN Transport Kraków Sp. z o.o. (the „bidder") with the subsidiary, i.e. RafTrans Sp. z o.o. (the „target company") was registered. It was carried out by way of transfer of all RafTrans Sp. z o.o. assets to the benefit of ORLEN Transport Kraków Sp. z o.o. (combination by way of acquisition). Due to the fact that ORLEN Transport Kraków Sp. z o.o. has held 100% of shares in RafTrans Sp. z o.o., the said combination took place without an increase of the Bidder's share capital;
- Transfer of 173,830 ordinary shares in Zakład Budowy Aparatury S.A. ("ZBA") with its registered office in Płock,

of the nominal value of PLN 100 each, representing 96.57% of the share capital of ZBA S.A. and 96.57% of votes cast at ZBA shareholders' meeting, for a total price of PLN 15,888 thousand i.e. PLN 91.40 per single share, where:

- a number of 52,149 shares were transferred to the benefit of PETRO Remont Sp. z o.o. against the payment of PLN 4,766 thousand;
- a number of 52,149 shares to the benefit of PETRO Mechanika Sp. z o.o. against the payment of PLN 4,766 thousand;
- a number of 52,149 shares to the benefit of PETRO EnergoRem Sp. z o.o. against the payment of PLN 4,766 thousand;
- a number of 17,383 shares to the benefit of PETRO Eltech Sp. z o.o. against the payment of PLN 1,589 thousand.

The transaction was carried out on 25 July 2006. As a result of the transaction, PKN ORLEN S.A. does not hold any shares in ZBA S.A.

- On 9 August 2006, the District Court for the capital city of Warsaw has registered a company under the business name ORLEN Prewencja Sp. z o.o. with its registered office in Płock. PKN ORLEN S.A. has subscribed to 3,000 shares constituting 100% of the share capital of ORLEN Prewencja Sp. z o.o., of the nominal value of PLN 500 each share, representing 100% of votes cast at the shareholders meeting. The shares subscribed to were paid for by PKN ORLEN S.A. in cash in the amount of PLN 1,500 thousand. The object of activity of ORLEN Prewencja Sp. z o.o. includes activities consisting in providing security and proper sanitation conditions at work place, fire protection, protection of people and environment protection.

- On 22 August 2006, a company under the business name ORLEN Księgowość Sp. z o.o. with its registered office in Płock was registered. PKN ORLEN S.A. has subscribed to 5,000 shares in the newly created company representing 100% of the share capital of the nominal value of PLN 500 each share, constituting 100% of votes cast at the shareholders meeting. The shares subscribed to were paid for by PKN ORLEN S.A. in cash in the amount of PLN 2,500 thousand.

- On 13 September 2006 ORLEN GAZ has acquired a stake of 15,000 shares in ORLEN PetroGaz Wrocław, representing 48.39% of the share capital of ORLEN PetroGaz Wrocław, of nominal value of PLN 100 per each share, constituting 48.39% of votes cast at the shareholders meeting. The shares subscribed to were paid for by ORLEN GAZ in cash in the amount of PLN 930 thousand.

- On 19 September 2006, the District Court for the capital city of Warsaw registered the increase in the share capital of ORLEN Eko Sp. z o.o. through an issue of 40,000 new, equal and undivided shares of PLN 500 each, of the total value of PLN 20,000 thousand. After the registration of the increase, the share capital of ORLEN Eko Sp. z o.o. amounts to PLN 22,000 thousand. All of the newly issued shares were subscribed for in cash by PKN ORLEN S.A. in the amount of PLN 20,000 thousand.

- On 16 October 2006, PKN ORLEN S.A. with Firma Chemiczna "DWORY" S.A. has drawn up articles of association of ETYLOBENZEN Płock Sp. z o.o. The share capital of ETYLOBENZEN Płock Sp. z o.o. amounts to PLN 12,000 thousand and is divided into 1,200 equal and undivided shares of PLN 10,000 each. PKN ORLEN

S.A. subscribed to 612 shares in ETYLOBENZEN Płock Sp. z o.o. for a total amount of PLN 6,120 thousand, representing 51% of the share capital and giving right to 51% votes cast at the company's Shareholders Meeting. Shares acquired by PKN ORLEN S.A. were paid for in cash in the amount of PLN 5,850 thousand and covered by in-kind contribution in the amount of PLN 270 thousand.

- Registering in the Registrar of Companies Malta Financial Services Authority of the following entities:
  - ORLEN Holding Malta Limited with its registered office in Silema, Malta as of 13 November 2006;
  - ORLEN Insurance Ltd with its registered office in Sliema, Malta as of 16 November 2006.

  PKN ORLEN S.A. subscribed to shares in the above companies in the following manner:

  - 201 shares in ORLEN Holding Malta Limited of a nominal value of USD 25 thousand representing 99.5% of all Orlen Holding Malta Limited shares. 1 share in Orlen Holding Malta Limited of a nominal value of USD 25 thousand was subscribed to by Unipetrol a.s. The shares were subscribed for by PKN ORLEN S.A. in cash in the amount of USD 5,025 thousand.
  - 1 share in Orlen Insurance Ltd of the nominal value of USD 1. The remaining 4,999,999 shares of a nominal value of 1 USD per each share were subscribed to by Orlen Holding Malta Limited. The share was subscribed for by PKN ORLEN S.A. in cash in the amount of USD 1, whereas Orlen Holding Malta Limited covered the shares subscribed to in cash in the amount of USD 4,999,999.

  The value of shares purchased by PKN ORLEN S.A. in Orlen Holding Malta Limited amounts to USD 5,025 thousand, whereas the value of shares purchased by PKN ORLEN S.A. in Orlen Insurance Ltd amounts to USD 1 in the books of PKN ORLEN S.A.,

  Main objectives of the companies' activity include as follows:

  - Orlen Holding Malta Limited, *inter alia*, investment activities and holding shares in other entities, companies, joint-ventures, consortia and syndicates;
  - Orlen Insurance Ltd, *inter alia*, conducting insurance activity within property insurance of the PKN ORLEN S.A. Capital Group.
- On 15 December 2006, the acquisition by PKN ORLEN S.A. of 596,834,352 shares in AB Mazeikiu Nafta from Yukos International UK B.V. with its registered office in the Netherlands and from the Government of the Republic of Lithuania was settled. The nominal value of a single share in Mazeikiu Nafta amounts to LTL 1. Shares in Mazeikiu held by PKN ORLEN S.A. represent 84.36% of the share capital of AB Mazeikiu Nafta and give right to 596,834,352 votes cast at the General Meeting of Shareholders, which represents 84.36% of the total votes cast at the General Meeting of Shareholders. The price for the shares in Mazeikiu purchased from Yukos International amounted to USD 1,492,000,000, whereas an amount of USD 851,828,900.31 was paid for the shares purchased from the Government of the Republic of Lithuania. The value of shares in Mazeikiu acquired by PKN ORLEN S.A. was recognized in PKN ORLEN S.A. books at cost i.e. in the purchase price, including costs of transaction.
- On 5 March 2007, an increase of the share capital of Płocki Park Przemysłowo-Technologiczny S.A. (PPP-T) by the amount of PLN 2,978.7 thousand from PLN 50,460.9 thousand to the amount of PLN 53,439.5 thousand was registered. The increase of PPP-T share capital was carried out through an issue of 297,868 new shares of F Series of a nominal value of PLN 10, each. F series shares are registered and preferred as to their voting rights, giving right to two votes per one share, intended for subscription in equal amounts for the existing shareholders,

i.e. 148,934 shares for PKN ORLEN S.A. and 148,934 shares for the City of Płock. As a result of the increase in the share capital, PPP-T has the following capital structure:

- the City of Płock holds a share of PLN 26,719.8 thousand constituting 50% of the share capital;

PKN ORLEN holds a share of PLN 26,719.8 thousand, constituting 50% of the share capital.

2.7 Income statement

2.7.1 Revenues

In 2006, PKN ORLEN S.A. has generated total sales revenues, i.e. revenues from sales of finished goods, merchandise and raw materials, in the amount of PLN 33,501,034 thousand, which is by 47.0% more than in a corresponding period of 2005. The increase of the value of sales resulted from an increase in the volume of sales of the Company's finished goods by 11.4% (incl. increase in the volume of sales of light products by 5.4%, ethylene by 107.6%, propylene by 75.0%) and high crack margins from quotations of fuels on world markets (i.e. increase in margins from quotations of gasoline by 17.3%, diesel oil by 12.0%, Ekoterm by 14.6% and Jet-A aviation fuel by 14.6% in comparison to 2005). Additionally, the resale of crude oil to Unipetrol against the amount of PLN 5,396 million resulted in an increase in the revenues from sales of merchandise and raw materials by 282.9% compared to 2005.

2.7.2 EBIT

Gross profit on sales of the PKN ORLEN S.A. in 2006 amounted to PLN 4,058,331 thousand and was lower by 22.2% in comparison to the gross profit on sales generated in 2005. The decrease in the gross profit from sales arose from the increase in the cost of finished goods, merchandise and raw materials by 67.5%, including especially costs of crude oil by 22.0%. Moreover, the cost of processed crude increased in 2006 due to the decrease in Ural to Brent differential from /-4.15/ to /-3.91/ USD/bbl. At the same time, the decrease in margins on Diesel oil by 9.7% and Ekoterm by 4.2% in 2006 as compared to 2005 had a negative impact on the result. However, margins on gasoline and JET A-1 aviation fuel have increased by 11.2% and 2.3%, respectively. The implementation of OPTIMA operating costs reduction program has had a very significant impact on the Company's result in 2006: it generated savings of PLN 299 million in 2006. It represents 103.5% of the 2006 target that was set at the level of 289 million. In 2006, the Company recorded an increase in the volume of wholesale trade and retail sales (gasoline, Diesel oil, Ekoterm, Jet A-1 aviation fuel) by 3.4% and 10.9%, respectively. Moreover, a significant rise of 17.1% was recorded in 2006 with respect to margins on the sale of non-fuel products and services. It arises from the pursuance of activities focused on the optimization of merchandise categories within the terms and conditions of trade and selection of the range of products in accordance with client needs expectations.

In 2006, the Company has incurred loss on other operating activities in the amount of PLN (-) 50,186 thousand, i.e. by

PLN 455,448 thousand less than in 2005. Such significant disproportions stemmed from the recognition of business risk provision of PLN 312,164 thousand and restructuring provision in the amount of PLN 166,000 thousand in other operating costs of 2005. In 2006, profit from operations (EBIT) amounted to PLN 2,001,006 thousand and was lower by 25.7% than the profit from operations generated in the prior year.

2.7.3 Net financial revenues and expenses

In 2006, the net financial revenues and expenses amounted to PLN 601,223 thousand, and were by PLN 136,331 thousand higher then the profit from financial activity generated in 2005. Financial revenues in 2006 amounted to PLN 891,903 thousand and increased by PLN 236,922 thousand in comparison to 2005. The increase in the revenues resulted from, *inter alia*, the receipt of dividends in the total amount of PLN 579.6 million, compared to 177.3 million in 2005, including PLN 461 million paid by Polkomtel and PLN 51 million paid by ORLEN Asfalt, and in connection with the excess of foreign exchange gains over the losses in the amount of PLN 150 million. At the same time, the Company recorded in 2006 an increase in financial costs by PLN 100,591 thousand as compared to 2005, which was mainly due to higher interest expense (increase by PLN 45,895.5 thousand) and increase in derivatives valuation expense by PLN 111.634.0 thousand.

2.7.4 Profit before tax. income tax expense and net result

In 2006, PKN ORLEN S.A. has generated profit before tax of PLN 2,602,229 which was a decrease of 17.6 % in comparison to 2005. The increase in profit before tax was accompanied by a decrease in income tax expense by 36.3%. The effective tax rate deteriorated by 5 percentage points and equaled 15% in 2006. The deterioration was primarily due to the tax paid with regard to dividends received, that amounted to PLN (-) 110,096 thousand in 2006 whereas it amounted to PLN (-) 33,686 thousand in 2005.
In 2006, the Company has generated net profit in the amount of PLN 2,199,876 thousand, which was lower by 13.0% compared with the result in the previous year.

2.8 Balance Sheet

2.8.1 Total assets

As at 31 December 2006, total assets of PKN ORLEN S.A. amounted to PLN 27,471,879 thousand and increased by PLN 8,260,881 thousand, i.e. by 43.0% in comparison to total assets recorded as at 31 December 2005. Property, plant and equipment constitute the main caption, amounting to 69.1% of total assets (compared to 62.1% as at 31 December 2005). With respect to equity and liabilities, equity has the highest share, standing for 54.6% of total equity and liabilities (compared to 67.0% as at 31 December 2005). When comparing certain balance sheet items as at the end of 2006 and end of 2005, the following issues should be brought to the attention:

– increase in non-current assets by 59.3% to the level of PLN 18,996,554 thousand as a result of an increase in shares held in subsidiaries by 175.6%, i.e. acquisition of Mazeikiu against the price of PLN 6,759.7 million,

– increase in current assets by PLN 1,186,189 thousand, i.e. by 16.3%, to the level of PLN 8,474,447 thousand. It was stimulated by an increased level of trade and other receivables caused by increase in product prices, i.e. an increase of PLN 749,531 thousand. Moreover, the increase in current assets resulted from growth of inventories by PLN 494,673 thousand caused by bigger volume of crude oil inventories, bigger quantity of finished product stock and the increase in crude oil and finished products unitary prices,
– increase in equity by PLN 2,144,883 thousand to the level of PLN 15,009,586 thousand resulted primarily from the net profit generated by the Company in the course of 2006. The dividend for 2005 was not paid in 2006,
– increase in long-term liabilities by PLN 1,947,064 thousand to the level of 4,249,852 thousand arose in connection with an increased level of interest-bearing loans and borrowings drawn, i.e. by 2,121,465 thousand,
– increase in short-term liabilities by PLN 4,168,934 thousand to the level of PLN 8,211,563 thousand resulted mainly from an increase in liabilities stemming from interest-bearing loans drawn, i.e. by PLN 3,109,835 thousand, and trade and other liabilities and accrued expenses by PLN 1,020,359 thousand.

2.8.2 Net financial indebtedness

As at the end of 2006, the level of long-term and short-term interest-bearing loans and borrowings and debt securities issued amounted to PLN 6,635,472 thousand and was higher by PLN 5,231,300 thousand in comparison to the level recorded at the end of 2005. The net financial indebtedness as at 31 December 2006 (calculated as interest-bearing loans and borrowings and issued debt securities less cash and cash equivalents less short-term securities) increased by PLN 5,207,494 thousand to the level of PLN 6,328,157 thousand in comparison to the figures recorded as at 31 December 2005. The net financial indebtedness ratio increased due to an increase of the level of short-term and long-term loans for financing the acquisition of Mazeikiu. The increase in net financial indebtedness has led to the growth of the Company's financial debt to equity ratio (interest-bearing loans and borrowings and debt securities less cash and cash equivalents less short-term securities, to equity) to the level of 42.2% as at the end of 2006 compared to 8.7% as at the end of 2005.

2.9 Cash Flow Statement

2.9.1 Operating activities

In the year 2006, net cash flow from operating activities amounted to PLN 1,859,752 thousand and was lower by 19.6% than analogous cash flow recorded in 2005.

The most important factors which have influenced the level of cash flows from operating activities in 2006 included the following:

– net profit increasing the level of cash by PLN 2,199,876 thousand;
– depreciation and amortization at the level of PLN 901,548 thousand compared to PLN 893,043 thousand in 2005;
– increase of inventories by PLN 494,673 thousand compared to an increase by PLN 1,399,088 thousand in 2005;
– increase in trade and other liabilities and accrued expenses by PLN 907,731 thousand, compared to an increase

of the same by PLN 898,521 thousand in 2005;

- increase in receivables by PLN 948,316 thousand compared to an increase by PLN 619,755 thousand in 2005.

As at 31 December 2006, the net working capital (current assets less short-term liabilities) amounted to PLN 262,884 thousand, as compared to the level of the same at PLN 3,245,629 thousand as at 31 December 2005. This resulted from a stronger growth of interest-bearing loan liabilities in relation to growth of current assets.

2.9.2 Investing activities

The level of cash flow from investing activities was shaped by higher costs connected with the acquisition of shares. The increase of investing activities-related expenditures in 2006 was mainly due to the acquisition of shares in Mazeikiu against the amount of PLN 6,759.7 million, whereas in 2005 the expenditure for investments in associates amounted to PLN 1,802 million and referred to the acquisition of Unipetrol a.s. The net cash flows from investing activities in 2006 amounted to PLN (-) 6,945,423 thousand, whereas in 2005 it reached the level of PLN (-) 1,319,192 thousand.

2.9.3 Financing activities

In 2006, the net cash flow from financing activities amounted to PLN 5,109,647 thousand, whereas in 2005 the same amounted to PLN (-) 995,273 thousand. The level of net cash from financing activities in 2006 as compared to 2005 is featured in by higher proceeds from long and short-term interest-bearing loans and borrowings, i.e. increase by PLN 6,383,688 thousand and similarly, higher outflows related to the repayment of the latter, i.e. by PLN 1,172,694 thousand. At the same time, there were no dividends paid in 2006, whereas in 2005 PLN 911,020 thousand was distributed as dividend

2.10 Employment

As at the end of 2006, there were 4,780 persons employed at the Company, which means a decrease by 589 employees compared to the level recorded as the end of 2005. The employment has fallen mainly due to the restructuring of the Company and natural changes of the personnel.

2.11 Publication of the financial result forecast

PKN ORLEN S.A. did not publish any forecasts of financial results concerning 2006. Changes introduced in relation to the financial data published in condensed financial statements on 1 March 2007 that have had an impact on the financial result and equity are referred to in the note 37 to the Company’s unconsolidated financial statements.

2.12 Projected financial standing

The following factors should be considered at the assessment of the future financial standing of the Company:

– fluctuations of crude oil prices which have an impact on expenses incurred by the Company and result in considerable fluctuations in margins realized on particular products;

– fluctuations in prices of finished products on global markets, which shape prices of fuel and level of margins through an import parity;

– trends of fuel consumption in Poland which are conditioned by the dynamics of economic growth and unemployment ratio;

– fluctuations of foreign exchange rates which could have an impact on the costs of external financing, crude oil purchase costs and purchases of other raw materials denominated in foreign currencies, as well as fluctuations in prices, margins and inland premium;

– economic benefits achieved due to the continued and newly-introduced optimization programs, i.e. Development of Retail Sales in Poland Plan for years 2005 to 2009, Restructuring of the wholesale trade, Logistics development plan for the years 2006 to 2009, SAP Oil&Gas Central Operating System, as well as benefits from the implemented cost-cutting and effectiveness-oriented programs, including OPTIMA Operating Costs Reduction Program, BONUS Project and Partnership Program;

– fiscal policy adopted by the State as regards the Act on biocomponents and liquid biofuels and the decree on the exemption from excise duty;

– further increase of PKN ORLEN S.A. indebtedness (Bond Issue Program) in connection with, *inter alia*, the acquisition process of Mazeikiu, planned restructuring process of the Lithuanian refinery and integration of both companies.

III. MAJOR ACHIEVEMENTS IN RESEARCH AND TECHNOLOGICAL DEVELOPMENT

In 2006, PKN ORLEN S.A. carried out a number of studies relating to the development of new product technologies, improvement of the quality of products manufactured, and reduction of production impact on environment. PKN ORLEN S.A. does not carry out any R&D activities on its own; those are subcontracted to external institutions, such as research centers and institutes, universities and polytechnics, and business entities carrying out R&D activity.

The most important studies and developments at PKN ORLEN S.A. within the scope of R&D in 2006 include as follows:

- „Development of a technology for the production of heavy heating oil with low sulphur content in consideration of the new technological conditions" performed by the Institute of Petroleum Processing in Cracow.
- "Examination of microbiological purity of light heating oil and Diesel oil kept in tanks within Płock refinery and within the distribution system of PKN ORLEN S.A." carried out by the Institute of Petroleum Processing in Cracow.
- "Modification of the Unit for Treating and Neutralizing of Used Lye and suggesting other possible measures and solutions for recycling the product of used lye". Study performed by The Institute of Chemistry at the Warsaw University of Technology in Płock.
- "Comparative study of four types of diesel oil with respect to emission of harmful fume compounds, fuel consumption and characteristic parameters of engine operation" carried out by the Automotive Research and Development Center "BOSMAL" Bielsko – Biała.
- "Evaluation of selected features of Diesel oil containing 5% (V/V) FAME, methyl esters of fatty acids, produced in PKN ORLEN S.A." performed by the Institute of Petroleum Processing in Cracow.
- "Comprehensive analysis of REBCO crude oil" carried out by the Institute of Petroleum Processing in Cracow.
- "Increasing the reserve of Ekodiesel oil and/ or Ekoterm heating oil by changing the manner of recycling of post-pyrolysis oil fraction," carried out by the R&D Centre for Refinery Industry in Płock.
- "Modification of 1-E-10 air capacitor at Hydrocracking installation in order to protect it against freezing of condensate water in the pipes" carried out by the Warsaw University of Technology; Civil Engineering, Mechanics and Petrochemistry Faculty; Civil Engineering Institute.
- "Development of a system protecting the soil against penetration of oil products and detecting leakage in warehousing tanks with single bottom and without leak-proof foundations" carried out by the Warsaw Institute Technology, Faculty of Materials Science and Engineering in Warsaw.
- „Evaluation of the risk concerning the presence of pyrophoric substances in PKN ORLEN S.A., including an inventory of required preventive measures" carried out by The Main School of Fire Science in Warsaw.

IV. DESCRIPTION OF FACTORS CRUCIAL FOR THE DEVELOPMENT OF THE CAPITAL GROUP

The most important factors that have conditioned the development of PKN ORLEN S.A. in the course of 2006 include:

- **Revision of PKN ORLEN S.A. development strategy.**

In January 2006, PKN ORLEN S.A. has revised the strategy for the years 2006 - 2009 which maintains the objective of activities aiming at improving the efficiency, however, with a special emphasis on the enhancement of the core business on domestic markets and monitoring of development opportunities on new markets, including the area of mergers and acquisitions in the following years.

The most important assumptions of the revised development strategy of PKN ORLEN S.A. include as follows:

1. Financial goals to be reached in 2009, provided the level of macro-economic conditions recorded in 2004:

• EBITDA	PLN 10 billion
• annual average CAPEX rate in the amount of	PLN 3.4 billion
• ROACE ratio forecast at a minimum level of	18.5%
• financial gearing at the approx. level of	30-40%

2. Establishment, in April 2006, of ORLEN Upstream Sp. z o.o., whose main activities are analysis of acquisition possibilities of crude oil reserves and reaching its own raw materials base. As a result, it will be possible for the Company to mark a significant increase of the market value and improve its advantageous market position. The strategy of upstream segment development has been divided into two stages: 1st stage until 2009 and the 2nd stage until 2015. The required capital expenditures have been estimated at an annual amount of USD 130 million in the period from 2007 to 2009, and an annual amount of USD 438 million in the subsequent five-year period.

3. The rate of dividend to be paid is conditioned on the engagement in mergers and acquisitions and maintenance of the most advantageous capital structure. The implementation of this guideline is planned for the year 2007, in order to cover the dividend to be paid for 2006. The objective of the Concern is to pay to the benefit of the shareholders a dividend at a level not lower then 50% of the volume of free cash flow to equity (FCFE). However, in a situation of considerable acquisitions, the Company will rather strive to return to safe levels of indebtedness, which according to FCFE approach, may result in a limited payment of dividend. On the other hand, in the event of sale of Polkomtel, provided there will be no other long-term liabilities, PKN ORLEN S.A. plans to create a special Dividend Fund for higher dividend payments in the future.

- **Acquisition of Mazeikiu Refinery**

The takeover of Mazeikiu has strengthened and widened the position of PKN ORLEN S.A. in Central and Eastern Europe, especially on the Polish, Czech and German markets and permitted the expansion over new markets such as: Lithuania, Latvia and Estonia. The enlarged PKN ORLEN Capital Group became a leader in the Central Europe as regards the volume of crude oil throughput, exceeding capital groups OMV and MOL in that respect. It has also become a leader for the number of possessed gasoline stations - 2,732 gasoline stations. The primary objective to be pursued in the nearest future is the restoration of production capacities at the Lithuanian refinery and assuring uninterrupted supplies of the raw material. After the breakdown of the Druzhba (Friendship) pipeline in July and fire at Mazeikiu in October 2006, the two above-mentioned issues constitute top priority for an efficient operation of the Company. Full integration of the two companies constitutes a complex process, to be spread over a period of two – three years.

- **Development of Retail Sales**

In March 2005, the Parent Company has announced "Retail Sales Development Plan in Poland 2005-2009" which assumes at least 30% share in the Polish fuel market. The Development Plan is founded on the basis of three key elements:

- strengthening of the market position in Poland;
- increasing operational effectiveness and
- establishing an efficient organization.

In 2006, the downward trend in sale of fuels at ORLEN brand stations got reversed which is confirmed in a 15 percent increase in volume of sales in comparison with figure recorded in 2005. PKN ORLEN S.A. market position is gradually being strengthened due to the development of the stations' network. By the end of 2006, the network consisted of 176 BLISKA economy stations and 726 ORLEN premium stations (CODO stations and DOFO stations). Moreover, good results in retail sales were possible thanks to the implementation of the new strategy within FLOTA program, where an offer Twój Lokalny Rabat (Your Local Discount) was introduced and two new products for the Truck Fleet segment were tried: Twoja Lokalna Stacja (*Your Local Station)* and Złoty Szlak (*Golden Trail*). Also the implementation of CRT (Commercial Road Transport) is under process. The above-mentioned activities have already generated effects in 2006, i.e. 40% increase in the volume generated under FLOTA program. In 2006, new solutions were developed under the non-fuel offer. At present, a new formula for category-management is being prepared, new shop visualization developed and new offer of bistro bars planned. In 2006, the Company carried out several image-oriented advertising campaigns and marketing actions supportive of the realization of the sales target.
In 2006, the competitiveness of the PKN ORLEN S.A. gasoline stations' network has significantly risen. It is confirmed by a high ratio of sales dynamics, as regards fuels and non-fuel products, and a significantly higher then dynamics of general sales and sales per individual station then recorded at competitive stations. The increase of effectiveness was possible thanks to the continuous construction and modernization of stations in accordance with offer segmentation, conclusion of 193 franchise contracts and purchase of 59 stations from RMO (Regional Market Operators). In 2006, a pilot implementation of the application for optimizing sales forecast and retail price management took place. Due to many changes with respect to the improvement of VITAY program effectiveness basing on an introduction of a new formula for premium points calculation a significant costs decrease was recorded.
In 2006, the area of non-fuel goods and services management was reorganized. The concentration of the function in charge of commodity purchase order process administration and ensuring a central function of an expert support with respect to merchandising and category management resulted with the improvement in activities and in effectiveness of decision making process at the level of shop. It was possible to build up an effective organization owing to the completion of the centralization process with respect to managerial areas and functions, reduction of employment and implementation of the „Segment Management" approach for optimizing the cooperation within the Capital Group. At

present, efforts are made in order to speed up the processes and facilitate processes within the Company.

The most important activities still to be undertaken in order to achieve the targets referred to in the 2006-2009 strategy include as follows:

- introduction of the new shop and bistro-bar concept;
- implementation of management by category system;
- implementation of new product offers and prices for fleet customers;
- diversification of fuel prices at ORLEN and BLISKA stations;
- further investments within the area of stations;
- further growth of the number of franchise stations;
- further increase in profitability of CODO stations;
- implementation of new solutions for optimizing sales forecast and retail price management;
- further development of VITAY program (introduction of the new strategy);
- implementation of the Retail Sale platform;
- optimization of the segment management.

Under the strategy plan, PKN ORLEN S.A. intends to hold about 900 stations in premium standard (ORLEN) and approx. 1000 stations run under Bliska Brand by the end of 2009. Both brands are also offered to private gas stations under franchise agreements.

- **Restructuring of wholesale trade and sales**

In August 2006, PKN ORLEN S.A. has launched restructuring process with respect to wholesale trade structures. The aim of the process was to increase sales results and to create a coherent policy in wholesale trade structures within the whole PKN ORLEN Capital Group. Development of a modern, market-oriented wholesale management structure will increase the market value and improve PKN ORLEN S.A. market positioning. It was necessary to destroy the old and build a new wholesale trade structure and restructure the Company’s sales forces. Consequently, changes were introduced to Non-fuel Products and Category Management Office, Retail Sale Investment Office, Fleet Card Unit and Team for the Cooperation with Franchise Stations and Patron Stations. Within the first Office, three Regional Offices got closed and their functions were transferred to Płock. The change aimed at concentrating the function of commodities purchase administration, centralization of merchandising and shop sales and services management and shortening of the decision-making process.

Changes introduced within the sales area in 2006 covered also reorganization of the Marketing Office. It resulted from the necessity of adapting the organization of the Marketing Office to the realization of tasks for retail and wholesale areas and to oversee the marketing policy within the companies belonging to the Capital Group. On the other hand, the changes in the office of Planning and Sales’ Analysis aimed at the centralization of the planning function and Management accounting, as well as analyses for the whole Sales Department, in respect of the consolidation of analytical data, managerial information, key effectiveness ratio, and reporting functions for state entities.

The internal reorganization took also place within the Support Team for Accounting Processes and General Purchase Office. In case of the Support Team for Accounting Processes the aim was to eradicate the functions which were not related with the invoicing process and thus, avoiding a risk that tasks be doubled in other organizational structures. In case of the General Purchase Office, the aim of the reorganization was to shift some purchase function to ORLEN Administracja Company.

From the beginning of November 2006, after several months of preparatory works, the operation of five new PKN ORLEN S.A. Wholesale Trade Offices were launched. The headquarters of the new wholesale centers are in Płock, Poznań, Trzebinia, Lublin and Gdańsk. The reduction of the number of regions from 11 to 5 made the management more efficient and reduced the operation costs. It has also made commercial activities between the regions and RMOs more coherent, through concurrent location of both commercial structures within new regions.

The implemented structure reacts more efficiently to the market needs, facilitates new customer-soliciting process and improves the standard of services offered. New structures will allow for more efficient competing with other fuel producers. „West" Region will compete with German refineries, „North" with refinery in Gdańsk, „East" with Byelorussian refineries and South with the Slovak Slovnaft. In the Central Region, considering the location of our refinery and excellent logistics, i.e. warehousing bases, PKN ORLEN S.A. will hold the most competitive position. Moreover, five macro regions present a better opportunity for cooperation with five Regional Market Operators. Clear task and competence allocation will allow for a better use of the commercial potential within a given region, eliminate internal competition and improve the flow of information between the two centers.

- **SAP Oil&Gas central operational system**

By the end of August 2006 a central operational system SAP Oil&Gas was launched at PKN ORLEN S.A. It is a specialist it solution dedicated for fuel industry. It extends the possibilities of SAP R/3 system that has been operating at PKN ORLEN S.A. from 1996. The new system covers both the existing users of SAP system and employees using the forwarding and recording systems. Using an industry-dedicated solution within logistics allows a better use of stock or sealing the logistic chain. Moreover, it gives a possibility to integrate forwarding systems at bases with the central system and provides detailed data on the performance of logistics and sales. The new version introduced a significant improvement into the operation of the fuel wholesale sales process. At the same time, the project will allow a better control over excise duty securities and make price-management processes more flexible. The implementation of the full system functionality SAP Oil&Gas system will assure automatic calculation of excise duty tax on the basis of product material movements and entries of excise duty documents recorded in accounting books, as well as in the excise duty register. The new application operates within processes specific for the branch of industry, i.e. computation between measurement units for fuel and non-fuel products, parallel register of operations in different units, e.g. mass and volume, excise duty tax calculation, tracking documents and reports. Preparation and implementation of new functionality developments is carried out at the following two stages: a major part of applications was launched at the beginning of 2007 and the remaining parts are to be launched in the first half of 2007. The implementation of SAP Oil&Gas becomes a part of organizational adjustments carried out at PKN ORLEN and harmonizes with other IT projects being implemented at the Company, i.e. comprehensive margin optimization.

- **Implementation of segment management**

On 18 November 2005, the Management Board of the PKN ORLEN S.A. has approved the New Organizational Rules and Regulations, which authorize the implementation of segment management system as of 1 January 2006. It is a classic organization structure for Capital Group composed of many entities that assures an appropriate coordination of both business area and support function within very large structures.

Segment management covers such areas as:

- exercising coherent strategy and investment coordination within the Concern;
- harmonized planning and controlling;
- integrated operational management, including maintaining harmonized standards within the whole Concern and obtaining synergy by setting of coherent goals and effectiveness parameters (Key performance Indicators);
- coordination of support function, i.e. purchases, logistics, finance management, PR and marketing policy, HR management systems and organization.

Under the adopted model of segment management, the following six business segments were determined: Refinery, Oils, Wholesale Trade, Retail Trade, Petrochemical and Chemical with assigned companies from the PKN ORLEN Capital Group. The above-mentioned segments are supervised within the Concern by specific Executive Director, directly subordinate to a Member of the Management Board.

Moreover, areas of support activities were determined. The latter support the areas of the Company's operating activity.

- **OPTIMA. operating costs reduction program**

OPTIMA, the program for improving the effectiveness of operating costs and optimization of investment outlays replaced the previous COCCP program that had been operating in years 2004-2005. In comparison to the COCCP, OPTIMA is to embrace more operating areas in PKN ORLEN S.A. and it was also introduced in particular companies of the Capital Group.

Within 12 months of 2006, OPTIMA generated PLN 299 million savings within the area of operating costs. It constitutes 120% of the target for 2006, which was set at the level of PLN 250 million. The surplus achieved over the targeted savings, i.e. PLN 49 million, was generated streams in production, logistics and subsidiaries where the effects obtained proved to be higher then the goals set. In the second main area of application of OPTIMA program, i.e. optimization of investment outlays, PLN 211 million savings were achieved, including PLN 20 million savings on the reduction of investment purchases, provided the yearly target of PLN 210 million, i.e. 100% realization of the yearly target. The results obtained refer mainly to the investments planned and being in progress at the Parent Company, although investments realized within the Capital Group were also covered by the optimization process.

Analysis of the results obtained from particular projects carried out under OPTIMA program shows the following areas where savings were achieved: subsidiaries, retail sales, production and purchases. PLN 86 million savings were achieved by stream “subsidiaries”, PLN 80 million in retail sales, PLN 46 million in production and PLN 70 million in purchases. (PLN 50 million on operating costs and PLN 20 million on investment outlays).

- **BONUS project**

In April 2005, BONUS project was launched. Its main objective was to reduce considerably the costs related to external purchases and to improve the whole purchase process. Within the duration of the project, a completely new purchase procedure was introduced. It describes the process from the moment a demand is registered, through the selection of a supplier, and the conclusion of a contract to the making of an order and delivery. Simultaneously, more then ten purchase functions previously divided between various organizational units were centralized. An approximate value of savings in the amount of PLN 210 million was recorded under the project in purchase area within the PKN ORLEN Capital Group. All ideas and prospective were approved by a special team, composed of representatives from the finance area and Cost Management Office of PKN ORLEN S.A. Due to the fact that the result of this project operation is a stream within OPTMIA program, it is necessary to closely supervise and monitor the result of savings originating from BONUS project. BONUS project reported to OPTIMA within the Purchases stream for 2006 savings in the amount of:

- PLN 50 million on operating costs;
- PLN 20 million on investment outlays.

- **Integration with Unipetrol**

The developments connected with the Partnership Program, which resulted in a mutual transfer of knowledge, were continued in 2006. As a result of teamwork, specific projects were implemented both within Czech companies and in the Production Unit in Płock. Owing to the Partnership Program, the intended target of all assumed savings was achieved. In 2006, business and management segmentation project based on the “New corporate Governance” was approved. It made the simplification of the management model, unification of PKN ORLEN S.A. and Unipetrol structures and standardization of processes, as well as harmonization of business stream possible. The establishment of the Shared Service Centre allowed for standardizing business processes in connection with the provision of bookkeeping services, payroll calculations, IT support and purchases for the benefit of companies belonging to the Unipetrol Capital Group. In October 2006, a strategy for the years 2006 to 2009 for Benzina retail sales network was announced and Benzina Plus premium brand was introduced. Achieving total harmonization will be based on the segment management, which was introduced on 1 January 2007.

- **Logistics development plan for the years 2006 -2009**

In May 2006, the Management Board has presented and the Supervisory Board has accepted the *Logistics Development Plan for the years 2006–2009*.

The most important elements of the *Logistics development plan for the years 2006-2009*, include:

- strengthening of the market advantage in the wholesale and retail sale through the development and modernization of the logistic infrastructure and significant improvement of productivity and “tightness” of the logistic system;
- in rail transport – development of forwarding system organized by PKN ORLEN S.A. in order to achieve the market share of 40% in the total of rail transport as at 2009;
- restructuring of transportation companies in order to improve the efficiency of road transportation of fuels and allowing the Concern to influence on an effective operation of this market through its own companies;
- increasing the possibility of warehousing crude oil and fuels at salt mine cavities for the purposes of the Concern and making the reserves available to external operators in order to generate additional revenues; carrying out analysis of the functionality and usefulness of the enlargement of the cavities for warehousing other products;
- further investments in pipelines for transporting product, in particular, the pipeline connecting Ostrów Wielkopolski with Wrocław.

In August 2006, the "Model of Transportation Companies from the PKN ORLEN S.A. Capital Group" was approved. Under the adopted restructuring model, seven companies will undergo consolidation and one transportation company will be established by the end of 2007 to operate within the whole PKN ORLEN S.A. Capital Group.

The strong points of the adopted solution include:

- maintenance of rates at the present level;
- great potential to lower the costs as a result of minimization of duplicative activities;
- possibility to maintain current level of deliveries' security and standard of services;
- simplified organizational structure.

- **Investment program at PKN ORLEN S.A.**

The development plan for the Refinery of the Parent Company for years 2005-2010 provides for the implementation of the following investments of key importance for the development:

- Paraxylene and PTA complex;
- Hydrodesulphurization VII (HON VII) complex together with Hydrogen Installation;
- ethylbenzene installation;
- modernization and intensification of Butadiene Installation;
- modernization and intensification of Alkylation (HF) installation

and a number of minor projects connected with adjusting the plant's infrastructure to new legal and ecological regulations and requirements.

The most important new investments and projects continued in 2006 include:

- Construction of Hydrodesulphurization VII (HON VII) installation together with the adjacent infrastructure. The aim of the investment is to produce in PKN ORLEN S.A. entire Diesel oil with sulphur contents less then 10 ppm.
- Construction of Hydrogen II Installation with production capacities of 5 tonnes/ h, i.e. 40 000 tonnes/ year together with infrastructure. The aim of the investment is to increase the production of hydrogen for the needs of hydrodesulphurization.
- Modernization and intensification of Alkylation (HF) Installation. The aim of the investment is to increase alkylae production capacities from 150 thousand T/ year to 280 thousand T/ year, reduce environmental risks connected with the AHF technological process by diminishing the level of HF acid within the installation up to a required minimal amount, i.e. 55 tonnes and to improve of technical safety and quality of alkylate, which will make the gasoline composition process more flexible.
- Construction of Paraxylene (PX) installation with a nominal production capacity of 400 thousand T/ year together with the infrastructure. The aim of the investment is to produce 400 thousand T/ year of paraxylene (PX) for a further processing into 600 thousand T/ year of terephthalatic acid (PTA) as a base raw material for the production of polyesters.
- Construction of terephthalatic acid (PTA) installation with production capacity of 600 thousand T/ year together with infrastructure. The aim of the project is to produce PTA which is used as a raw material for the production of polyethylene terephthalate (PET).
- Construction of Installation for Diesel Oil Hydrorefining from HOG installation. The investment aims at improving the stability of oil fraction from HOG installation in order to assure such a quality of the oil that it could be always

used as an efficient component of Ekoterm Plus light heating oil.

- Construction of 17 A, B, C and 18 A and B warehouse tanks for the Composition Unit. The objective of the investment is to increase gasoline storage capacities by 28,000 m^3 in order to increase the production capacities by approx. 270 thousand tonnes/ year, i.e. by approx. 10% of gasoline and adapting the warehousing facilities to the technical requirements resulting from the decree of the Minister of Economy dated 20 December 2002, as well as increasing hygiene and fire protection and environmental safety;
- Modernization of warehousing bases in Świnoujście, Bolesławiec, Kraków Olszanica and Żurawica.

The most important investments put into service in 2006 include:

- Desulphurization of Cracked Gasoline. The investment ensures an optimal use of vacuum distillate.
- Construction of tanks no. 43 A, B, C and D within the Composition Unit: adjustment to the volume of production and growing range of oil.
- Adapting HON VI Installation to the production of Diesel oil with sulphur contents below 10 ppm: enhanced desulphurization of heavy diesel oil fractions down to the sulphur contents below the level of 10 ppm by way of exchanging catalytic agents, adding new equipment and tools to the installation and modifications to the existing equipment.
- Exchange and expansion of analytical equipment for Gasoline Blending: gasoline composition process was optimized in order to obtain new quality of gasoline.
- Improvement of C8+ aromatics production at PKN ORLEN S.A.: securing continuous production of orthoxylene.
- Exchange of ethylene oxide shipment pipeline: a risk of potential industrial accident as a result of leakage of ethylene oxide to the atmosphere and the related threats for human beings and environment was minimized.
- Modernization of warehousing bases in Szczecin, Lublin, Gutkowo, Nowa Sól, Sokółka and Gdańsk.

- **Loyalty programs at PKN ORLEN S.A.**

VITAY program is a loyalty scheme aimed at individual customers shopping at ORLEN gasoline stations on a regular basis. As at 31 December 2006, *VITAY* program had a group of 6.3 million participants, with 1683 gasoline stations covered by the program, including 1429 own gasoline stations, 96 partner stations and 158 franchise gasoline stations. In 2006, a number of approx. 477 thousand *VITAY* loyalty cards were issued, as compared to over 648 thousand in 2005, whereas the average daily sales amounted to over 5 million liters per day. *Super VITAY* is a program supporting the loyalty of the existing PKN ORLEN S.A network users that obtain the biggest number of points within *VITAY* program. *Super VITAY* gives customers a possibility of enjoying further benefits and carry the prestige of holding a golden, bearer's card. As at the end of 2006, nearly 105 thousand customers participated.

FLOTA Polska Program is designed for institutional customers operating their own means of transport. The most numerous participants of the program include: forwarding companies, production and trading companies, banks, offices of central and local administration and foreign branch offices. In 2006, a number of approx. 130 thousand FLOTA loyalty cards were issued, and the share of sales with FLOTA cards in the total sales of fuels within the network of ORLEN brand stations increased in 2006 to 11.6%, as compared to 10.4% in 2005. Fleet fuel cards allow cardholder to proceed with cashless purchase transactions of fuels and other goods and services at gasoline stations belonging to PKN ORLEN. Under FLOTA program, two new services were introduced, i.e. "Złoty Szlak" (*Golden Trail*) and "Twoja Lokalna Stacja" (*Your Local Station*). Both services are addressed to companies from transportation and industrial sector holding large fleets which have specific requirements as regards fuel purchase and which refuel a minimum amount of 1,000 liters per month. The systems offer a simple, friendly and profitable system of refueling, as well as basic vehicles road service/ assistance. In March 2006, a new product was introduced. It is directed to the small and medium fleet segment and referred to as “Twój Lokalny Rabat” (Your Local Discount). It is a form of cash agreement concluded at the Concern’s brand own gasoline station based on which clients obtain a discount and one invoice per month. As at the end of 2006, over 17 thousand agreements were concluded. This product is designed for institutional clients whose monthly fuel demand equals to at least 500 liters.

At present, fleet cards are accepted at nearly 1,700 gasoline stations of ORLEN and BLISKA network which means that fleet transactions are carried out in every corner of Poland.

In September 2004, PKN ORLEN S.A. and DKV EURO SERVICE GmbH + Co introduced a new fuel card into the European market. DKV/ORLEN card is the first fuel card in Europe which combines a microchip technology of the FLOTA card with magnetic card of DKV network. Therefore, it represents means of payment for the drivers and cost control and settlement tools for companies. DKV/ORLEN card is dedicated for institutional client, such as forwarding companies, trade and production companies. In 2006, there were 375 cards issued and they are recognized at 20,000 stations and at 6,000 vehicle service points in Europe.

- **Restructuring activities carried out within PKN ORLEN S.A.**

On 20 September 2005, the Management Board of the PKN ORLEN S.A. adopted a strategy of activities relating to the 2006 restructuring process. The execution of a new restructuring agreement with trade unions constituted a significant element of the above-mentioned strategy. The above agreement was to replace the former agreement regulating the situation of employees in case of undertaking restructuring activities and participation of trade unions in the PKN ORLEN S.A. restructuring process, dated 23 December 2002. The new restructuring agreement was aimed at improving consulting procedures with trade unions, eliminating doubts as to the interpretation of the previous agreement and establishing the list of employees’ benefits under the restructuring program. The last element of regulations improves the implementation of particular processes and allows giving a more precise estimate of employee-related expenses with respect to the planned initiatives.
On 27 March 2006, after three-month negotiations, the agreement on the principles of cooperation between social partners in the restructuring processes to be carried out within PKN ORLEN S.A., and on employees’ rights regarding these processes was finally reached.

The formation of Accounting Services’ Centre, i.e. ORLEN Księgowość Sp. z o.o., was commenced under the restructuring activities in 2006. The project consists in creating a modern Shared Service Centre for PKN ORLEN S.A. and the Capital Group in the area of accounting-related services through the transfer of transactions into one shares centre. The objective of this project is to standardize all above processes at the Capital Group level with the use of the newest technologies and achieve cost savings.

The formation process of ORLEN Księgowość Sp. z o.o. was divided into several stages, where the first was accomplished on 1 July 2006. At that date, payroll-related services and functions of bookkeeping services previously carried out within PKN ORLEN S.A. as regards the companies belonging to the Capital Group were transferred to the company. As of 1 September 2006, the stock-taking process was also integrated with the newly established company. Within the next two years, the company will take over the servicing of other processes.

Restructuring activities in 2006 were also carried out within the areas of Prevention Office, Train Transportation Office and additionally, within Environmental Analyses' Office, Logistics Support Team from Purchase Office and Non-Fuel Office and Category Management. The restructuring covered also sales structures, i.e. restructuring of the regional network within wholesale trade area and organizational changes within retail sales.

Under the above-mentioned restructuring projects, the following three types of activities were undertaken:

- Transfer of employees from PKN ORLEN S.A. to the existing or newly-created entities from the Capital Group in connection with reduction of employment and proposals of adequately formed packages of benefits, i.e. voluntary leave program, training program, job-activation program.
- Reduction of employment at PKN ORLEN S.A. combined with an offer of adequate benefit packages.
- Relocation of employees with a simultaneous proposal of an adequate benefit package, i.e. relocation package.

- **Risk management system at PKN ORLEN S.A.**

Financial results of the Company may fluctuate due to changes of various market factors, in particular, product quotations, exchange rates and interest rates. The Company manages the risk to which it is exposed, limits the fluctuation of future cash flow and reduces potential economic loss resulting from events which could have a negative impact on the Company's result. A more detailed description of financial instruments used by the Company is provided in item 2.5.4 of this Management Board Report on the Company's operation.

- **Management by Objectives (MBO)**

On 31 December 2006, the Management by Objectives (the "MBO") system has been operating for 18 months. It was created for key employees of PKN ORLEN S.A. and Capital Group. It represents one of the most popular and proven business management systems. Companies with different business profile ranging from service and trade to consulting and production ones use this system. Its popularity stems from the fact that it allows to allocate tasks to managers in a very clear manner, and to link the said tasks to be achieved by the said managers with remuneration system by valuating each single task. The system is allocated to a given position and not to an individual person. It is to support the realization of strategy of the increase of the Company's value. The system provides basis for employees' evaluation and remuneration based on the realization of the goals adopted within the said strategy and by the same, reinforce the feeling of responsibility for the result generated by the Company.

On 5 December 2006, the Management Board of PKN ORLEN S.A. approved amendments to the MBO Rules and Regulations aiming at redefining the solutions used in 2005 and 2006. The new Rules and Regulations became binding in January 2007.

Mini MBO was also introduced in 2006, i.e. bonus paid on a quarterly basis for targets achieved at trade positions within the area of competence of the Executive Director for Retail Sales – Poland. A similar bonus system was implemented within the Wholesale Trade and IT.

New groups of positions were covered by MBO in 2006. The yearly system covered a total of 355 persons. The quarterly system within retail sales covered 149 persons and 82 persons within wholesale, whereas in IT, 93 employees.

The settlement of MBO bonuses in relation to employees covered by the MBO system in 2005 was carried out in July 2006. Financial results for the year 2005 are backed not only by thriving economy but also by exceptional engagement of managers in achieving targets. The joint target in the form of budgeted SVA on the level of PLN 649 million was significantly exceeded and reached PLN 908 million.

In August 2006, an IT system for supporting MBO from the creation of target sets (the "Target List") to the payment of the bonus was implemented. The newly-created application improves the whole process, allows eliminating errors made in the course of creation of Target Lists, harmonizes the nomenclature, and assures day-to-day monitoring of target realization assigned to particular employees on Target Lists.

- **HR management strategy**

The personnel management strategy pursued in 2006 by the Human Resources Department resulted from PKN ORLEN S.A. strategy adopted for the years 2005 to 2009 and encompassed the following goals:

- Developing clear principles of corporate governance - clear recruitment, evaluation, promotion and remuneration procedures.
- Rational selection of qualified staff which can assure the realization of strategic goals, including expansion abroad.
- Development of appropriate communication within the Concern and the Capital Group, evaluation of resources and their development.
- Integration of the Capital Group in Poland and abroad, common HR policy.
- Further implementation of motivation system linked with achieved results (MBO).
- Personnel restructuring.

The undertakings of the HR Department concentrated not only on recruiting and training employees but also on their development; they were offered to participate in the following projects: Competence Development Program, Feedback 360 or carrier path planning.

- **Competence Development Program (the "CDP")**

In 2006, the employee evaluation process was carried out for the first time from the establishment of PKN ORLEN S.A. CDP constitutes an evaluation and professional competence development process, where the competence is based on the Concern's values. The program aims at developing professional competence of employees working at PKN ORLEN S.A. in such a manner that they possessed knowledge and skills that will allow them to perform the tasks assigned, in accordance with the highest quality standards.

Participation in the Competence Development Program gives the employee return information on how his/ her work viewed by the superior, what behavior is expected from him and what kind of developmental support he' she can expect from the superior. The project focuses on the employee, his/ her knowledge, skills, needs and aspirations, and therefore, supports current and future business goals of PKN ORLEN S.A.

Implementation of the Competence Development Program made it possible to create a map of competence which stand for the Company's resources, define competence deficits and general training requirements and plan position succession.

In 2006, both persons holding specialist positions and middle and high level managers took part in competence evaluation program under CDP. Managers from among the key corporate executives, i.e. Members of the Management Board, Executive Directors and Office Directors, have participated in the evaluation and competence development process based on 360˚ Feedback.

- **Feedback 360˚**

Feedback 360 Project constitutes the continuation of activities connected with the implementation of the Competence Development Program, which covers employees participating in the Management by Objectives Program (MBO) and selected key personnel. The aim of this Project is to identify the manner of operation of the Company's executive management and develop specialist training course programs, in consideration of the real needs and expectations in that area.

The aim of the project carried out by the HR Department in 2006 was to develop key managerial competence which influence the quality and effectiveness of strategic business goals pursued by PKN ORLEN S.A. Feedback 360˚ was addressed to the highest corporate executives at PKN ORLEN S.A., however, in addition to the managers, also employees, superiors and subordinates of he evaluated managers were engaged in the evaluation process due its specificity of the project. An approximate number of 400 employees took part in the program.

Feedback 360˚ allowed for identifying strong and weak sides of evaluated employees, defining developmental goals and giving an estimate of managers' unused potential. Project implementation gives an easy access to information on competence of employees, raises self-consciousness of project participants, increases the level of personnel identification with the Company and enhances of motivation for an even more effective work.

- **Talent Management**

In 2006, the concept of substitute personnel of PKN ORLEN S.A. was continued within the Talent Management project. The aim of the project is to select and educate future middle-level managers. The participants of the project are tested in the direction of professional potential on the basis of which individual career paths are developed and the participants are offered a possibility to take part in a number of specially drawn up development-oriented projects, i.e. *Business Academy* or to participate in training projects based on strategic games. Development of an up-to-date career path management system connected with the fulfillment of business needs can serve as an example of practical implementation of the HR policy principles and making use of the results obtained in potential evaluations.

- **Implementation of the strategy within the area of mergers and acquisitions**

In 2006, acquisition undertakings of PKN ORLEN were mainly focused on the completion of the acquisition process of Mazeikiu refinery. The acquisition of the above shares resulted from the provisions made in the PKN ORLEN S.A. strategy, in particular, as regards the regional expansion and investments in entities belonging to the crude oil processing sector. After the fulfillment of agreements' conditions, including the obtaining of necessary antimonopoly approvals and permits, on 15 December 2006, PKN ORLEN S.A. acquired 84.36% share in the share capital of Mazeikiu Refinery. Under the Lithuanian law, PKN ORLEN S.A. was obliged to make a takeover bid for the company's shares addressed to other minority shareholders. Acting in agreement with the Lithuanian Government, PKN ORLEN S.A. has launched the procedure of mandatory share buyout from the remaining minority shareholders at the beginning of 2007, with the exception of shares held by the Lithuanian Government. Subscriptions under the mandatory share buyout will be accepted until 21 May 2007.

On 10 March 2006, PKN ORLEN S.A. accepted the offer for the sale of 980,486 shares in Polkomtel S.A. made by TDC Mobile International A/S. The execution of the agreement has been suspended due to an action pending with the International Arbitration Court at the Federal Chamber of Commerce in Vienna, instituted by Vodafone Americas Inc, a shareholder of Polkomtel S.A. and pledge established on the shares by the Regional Court in Warsaw. At the time of execution of the agreement on the acceptance of the offer, Polish shareholders on Polkomtel S.A. and TDC Mobile International A/S also undertook to cast vote on the subject of dividend payment at an agreed level for particular years. In fulfillment of the above undertaking, PKN ORLEN S.A. received in 2006 a dividend amounting to PLN 461.3 million gross.

In 2006, analyses of acquisition projects in upstream sector were continued. On 26 April 2006, ORLEN Upstream Sp. z o.o. was registered, an entity created with the objective of carrying out acquisition projects within upstream area. Disinvestment process in non-core business assets constituted an important component of capital strategy adopted by PKN ORLEN S.A. Under the disinvestment strategy, the following six entities were sold in 2006: SAMRELAKS Mąchocice Sp. z o.o., Zakład Budowy Aparatury S.A. and AWSA Holland II B.V.

V. DECLARATION OF THE MANAGEMENT BOARD ON THE APPLICATION OF CORPORATE GOVERNANCE

PKN ORLEN S.A. has adopted all principles recommended by Giełda Papierów Wartościowych w Warszawie S.A. (hereinafter the "Warsaw Stock Exchange") excluding the rule no. 20, which refers to independent members of supervisory boards. The declaration on adhering to the principles of corporate governance was approved by the General Meeting of PKN ORLEN S.A. held on 29 June 2005. Under the decision of the General Meeting and pursuant to § 27 (currently §29) of the Rules and Regulations governing the operation of the Warsaw Stock Exchange and the Resolution passed by the Council of the Stock Exchange on adopting the principles of corporate governance which are binding for joint stock companies admitted to trading at stock exchange and issuing shares, convertible bonds or senior bonds – on 30 June 2005, the Management Board of PKN ORLEN S.A. has made a declaration on applying the corporate governance principles.

An updated declaration on PKN ORLEN S.A. adherence to the principles of corporate governance was made public in a regulatory announcement no. 43/2006 on 28 June 2006. In accordance with the announcements published in the declaration dated 30 June 2005 on the Company's adherence to the principles of corporate governance, the following amendments were introduced:

- in the Articles of Association governing PKN ORLEN S.A. – unified text adopted on 7 October 2005 by virtue of resolution passed by the Supervisory Board of PKN ORLEN S.A.;
- in the Rules and Regulations of the General Meeting of PKN ORLEN S.A., adopted on 29 June 2005 by the resolution of the Ordinary Meeting of Shareholders of PKN ORLEN S.A.;
- in the Rules and Regulations of PKN ORLEN S.A. Management Board, adopted on 7 October 2005 by the resolution of PKN ORLEN S.A. Supervisory Board;
- in the Rules and Regulations of the Supervisory Board of PKN ORLEN S.A, adopted on 7 October 2005 by the resolution of PKN ORLEN S.A. Supervisory Board.

As a result of the above-mentioned amendments, the Company's notes to each particular principle of corporate governance were revised and updated. PKN ORLEN S.A. declares it has been adhering to the principles of corporate governance, with the exception of the principle no. 20, to which it does not adhere. The Management Board of PKN ORLEN S.A. made a recommendation to the Company's General Meeting on 29 June 2005 to adopt the entire set of principles of the corporate governance, however, the principle no. 20 did not meet with the approval of the Company's Shareholders.

The Management Board of PKN ORLEN S.A. sustains its standpoint, as expressed in the declaration dated 28 June 2006.

An updated declaration on PKN ORLEN S.A. adherence to the principles of corporate governance, as adopted by the Warsaw Stock Exchange, will be published by the Company on or before 1 June 2007, after the said document is approved by the forthcoming General Meeting of PKN ORLEN S.A.

ADDITIONAL INFORMATION

1. Information on significant agreements

In 2006, PKN ORLEN S.A. entered into a number of significant agreements, as listed herein below:

1. On 4 January 2006, PKN ORLEN S.A. executed two agreements on the sale of gasoline and diesel oil to ORLEN PetroCentrum in 2006. The estimated value of the transactions amounts to:
   - approximately PLN 1,934,000 thousand, as regards the first agreement;
   - approximately PLN 376,000 thousand, as regards the second agreement;
   The total value of both transactions amounts to approximately PLN 2,310,000 thousand.
2. On 4 January 2006, PKN ORLEN S.A. concluded an annual contract with Shell Polska Sp. z o.o. The object of the contract was the sale of gasoline and diesel oil to Shell Polska Sp. z o.o. in 2006. The estimated value of the transaction amounted to approximately PLN 2,831,000 thousand.
3. On 4 January 2006, PKN ORLEN S.A. concluded an annual contract with BP Polska Sp. z o.o. The object of the contract was the sale of gasoline and diesel oil to BP Polska Sp. z o.o. in 2006. The estimated value of the transaction amounts to approximately PLN 3,951,000 thousand.
4. On 27 February 2006, PKN ORLEN S.A. concluded with Kulczyk Holding S.A. (hereinafter “Kulczyk Holding”) the Final Agreement for the Sale of 165,924 shares in a company incorporated under the laws of the Netherlands, namely AWSA Holland II B.V. to the benefit of Kulczyk Holding. The Guaranteed Sale Agreement was concluded as a result of exercise of the put option by PKN ORLEN S.A., in accordance with the Supplementary Agreement dated 14 November 2002. The shares sold by PKN ORLEN S.A. constitute 9.218% of the share capital of AWSA Holland II B.V. In consideration for the stake of shares in AWSA Holland II B.V., Kulczyk Holding has paid an amount of PLN 73,007 thousand by wire transfer to the bank account of PKN ORLEN. The ownership of shares in AWSA Holland II B.V. sold by PKN ORLEN S.A. to the benefit of Kulczyk Holding was transferred through the execution of the Share Disposal Agreement which took place after the fulfillment of the condition precedent set forth in the Guaranteed Sale Agreement, in particular after the shareholders’ meeting of AWSA Holland II B.V. granted its consent for the said transaction by the date of 28 July 2006, at the latest.

   Under the Supplementary Agreement dated 14 November 2002, concluded between PKN ORLEN and Kulczyk Holding, in the event PKN ORLEN S.A. disposed of the shares in AWSA Holland II B.V., Kulczyk Holding was obliged to obtain all necessary permits and consents and assume all liabilities of PKN ORLEN S.A. that PKN ORLEN S.A. has contracted or took over as the shareholder of AWSA Holland S.A. II B.V.
   On 7 June 2006, PKN ORLEN and Kulczyk Holding S.A. concluded the Share Disposal Agreement, by virtue of which the ownership to 165,924 shares in AWSA Holland II B.V., a company incorporated under the laws of the Netherlands, was transferred by PKN ORLEN to the benefit of Kulczyk Holding. The transaction resulted from the fulfillment of the condition precedent (with binding effects) set forth in the Sale Agreement concluded on 27 February 2006 between PKN ORLEN and Kulczyk Holding in the form of the Guaranteed Sale Agreement in execution of the obligations resulting from the Supplementary Agreement, concluded on 14 November 2002. The shares sold by PKN ORLEN represent 9.218% of the share capital of AWSA Holland II B.V. Consequently, after the completion of the transaction, PKN ORLEN does not hold any shares in AWSA Holland II B.V.
5. On 10 March 2006, PKN ORLEN S.A., KGHM Polska Miedź S.A., PSE S.A. and Węglokoks S.A. (the “Buyers”) and TDC Mobile International A/S (the “Seller”) concluded the “Agreement on the approval of the offer and conditional sale of shares in Polkomtel S.A.”. The above transaction was preceded by the execution of the “Shareholders’ Agreement on the purchase of shares in Polkomtel S.A. from TDC Mobile International A/S and engaging in joint activities in order to dispose of all shares held in Polkomtel S.A." by KGHM Polska Miedź S.A., PKN ORLEN, PSE S.A. and Węglokoks S.A., as the shareholders of Polkomtel S.A. As a result of the so called *Change of the Ownership Title* with respect to TDC Mobile International A/S, the remaining shareholders of Polkomtel S.A. including Vodafone Americas Inc., have obtained, in accordance with §12.14 of the Articles of Association governing Polkomtel S.A., the right to acquire a total of 4,019,780 shares in Polkomtel S.A. being held by TDC Mobile International A/S, in a proportion equal to the percentage of shares held by each of the shareholders of Polkomtel S.A., excluding the shares held by TDC Mobile International A/S. The offer to buy was directed by TDC Mobile International A/S to the remaining shareholders of Polkomtel S.A. on 8 February 2006. The Agreement was concluded in execution of the right vested in KGHM Polska Miedź S.A., PKN ORLEN, PSE S.A. and Węglokoks S.A. to purchase shares covered by the offer of TDC Mobile International A/S. The said offer resulted in a dispute between Vodafone Americas Inc. and TDC Mobile International A/S. In connection with the above-mentioned dispute, a security, referred to herein below was set on 24 February 2006. Under the

Agreement, PKN ORLEN could acquire a number of 980,486 shares in Polkomtel S.A., representing approx. 4.78% of Polkomtel S.A. share capital, against the maximum price of EUR 214.04 per share (an equivalent of PLN 832.72, in accordance with the exchange rate published by the NBP on 10 March 2006; table 50/A/NBP/2006), i.e. the maximum total price of EUR 209,863.2 thousand (an equivalent of PLN 816,472.9 thousand). In the event of the share purchase by KGHM Polska Miedź S.A., PKN ORLEN, PSE S.A. and Węglokoks S.A. by virtue of the Agreement, the said entities would jointly hold, including the shares they have already held, over 75% of the total number of the shares of Polkomtel S.A. After the settlement of the transaction, PKN ORLEN would hold a 24.4% share in the share capital of Polkomtel S.A.

6. On 20 March 2006, PKN ORLEN S.A. signed an agreement with BGW Sp. z o.o. with its registered office in Poznań. The agreement regarded transfer of 8,549 shares in ORLEN PetroZachód Sp. z o.o. against the total amount of PLN 21,012 thousand with the reservation that the purchase price may be increased by the amount not exceeding PLN 3,000 thousand. The price adjustment is conditional with regard to provisions of the agreement. The acquired shares represent 48.17% of the share capital of ORLEN PetroZachód Sp. z o.o. As a result of the above transaction, PKN ORLEN S.A. is a sole shareholder in ORLEN PetroZachód Sp. z o.o.

7. On 21 March 2006, an agreement on transfer of 13,449 shares in Samrelaks Mąchocice Sp. z o.o. with its registered office in Mąchocice Kapitulne representing 100% of its share capital for the price of PLN 4,000 thousand. The carrying value of shares as at 31 December 2005 amounted to PLN 2,505 thousand.

8. On 27 April 2006, PKN ORLEN S.A. signed an agreement with Mitsubishi Chemical Corporation, with its registered office in Tokyo, Japan. Under the said agreement, PKN ORLEN will supply Mitsubishi Chemical Corporation with up to 150 thousand tonnes of terephthalic acid per year with a possibility of changing the volume of deliveries by +/- 10 per cent in the period from 1 July 2010 to 31 December 2014. The total value of the object of the Agreement for the entire period of its duration is estimated at approx. PLN 2,800 million. The Agreement enters into force as of its date of concluding. PKN ORLEN shall have the right to a single postponement of a delivery term by no more than 9 months. After the lapse of 5 years from the date of the first delivery, the parties shall have the right to extend the term of the Agreement. The term of payment for each delivery shall be 14 days from the receipt of an invoice; the deliveries shall be invoiced on a monthly basis. In the event of failure to perform the commitments to deliver or accept PTA (purified terephthalic acid) resulting from the fault resting with one of the parties, the Agreement provides for the payment of contractual penalties in the amount of unit margin multiplied by the non-accepted or non-delivered volume of the product in a given calendar year.

9. On 26 May 2006, PKN ORLEN S.A. and Yukos International UK B.V. (a limited liability company) with its registered office in the Netherlands, concluded an agreement on the sale of shares with respect to the acquisition by PKN ORLEN S.A. of a stake of shares representing 53.7% in the share capital of AB Mazeikiu Nafta (a public limited company with its registered office in Lithuania). On 18 May 2006, PKN ORLEN S.A. signed the Agreement and it delivered the Agreement to the other party for signing. The Agreement with Yukos was signed by Yukos International on 26 May 2006 after the bankruptcy court in New York has overturned an interim injunction previously barring Yukos International from selling the shares in Mazeikiu. Moreover, on 19 May 2006, PKN ORLEN S.A. signed and delivered to the Government of the Republic of Lithuania the following documents: (a) Share Purchase Agreement (hereinafter the “Agreement with the Lithuanian Government”) on the acquisition by PKN ORLEN S.A. from the Lithuanian Government of an additional stake of shares representing 30.7% of Mazeikiu share capital and (b) Put Option Agreement with respect to 10.0% of Mazeikiu shares which shall remain the property of the Lithuanian Government after the sale of 30.7% stake to the benefit of PKN ORLEN S.A. The Agreement with the Lithuanian Government and the Put Option Agreement were signed by the Lithuanian Government after obtaining the approval of the Lithuanian Parliament for executing the transaction with PKN ORLEN S.A. After the purchase of shares from Yukos International, PKN ORLEN S.A. was to announce, within 30 days from the said purchase of Mazeikiu shares from Yukos International, a public call for the remaining Mazeikiu shares. The price of a single share in the statutory public call shall be at least equal to the maximum price paid by PKN ORLEN S.A. in exchange for Mazeikiu shares within the period of 12 months preceding the announcement of the public call.
   On 9 June 2006, the Government of Lithuania signed the documents referred to herein below, in connection with the transfer of shares held by the Lithuanian Government in AB Mazeikiu Nafta to the benefit of PKN ORLEN S.A.: i.e. (a) Share Purchase Agreement (b) Put Option Agreement, (c) Shareholders’ Agreement and (d) Agreement on the termination and release form obligations. The Lithuanian Government signed the said Documents on 1 June 2006, after the approval of the Lithuanian Parliament for the execution of the transaction between the Lithuanian Government and PKN ORLEN S.A.

10. On 31 May 2006, PKN ORLEN S.A. concluded an agreement with SK EUROCHEM Sp. z o.o. with its registered office in Włocławek, Poland. Under the Agreement, PKN ORLEN S.A. will supply SK EUROCHEM Sp. z o.o. in

the period from 1 July 2010 to 31 December 2014 with 25 to 50 thousand tonnes of terephthalic acid in the course of the first year of the Agreement duration, and 100 to 120 thousand tonnes of terephthalic acid annually throughout the following years of the Agreement duration. The total value of the object of the Agreement throughout its duration is estimated at approx. PLN 2,100 million. The Agreement has entered into force as of its date of concluding. The day of commencement of deliveries/ acceptance was set for 1 July 2010. PKN ORLEN S.A. shall have the right to a single postponement of commencement of deliveries by a maximum period of 9 months. After the lapse of 5 years from the date of the first delivery, the parties may agree on the extension of the period of the Agreement.

11. On 25 July 2006, 173,830 shares held by PKN ORLEN in Zakład Budowy Aparatury S.A. ("ZBA S.A.") with a nominal value of PLN 100 per share representing 96.57% of the share capital of ZBA S.A. and standing for 96.57% of total voting rights were sold for the total amount of PLN 15,888 thousand (equal to PLN 91.40 per share) to the following parties:

    - PETRO Remont Sp. z o.o. purchased 52,149 shares for the total amount of PLN 4,766 thousand,
    - PETRO Mechanika Sp. z o.o. purchased 52,149 shares for the total amount of PLN 4,766 thousand,
    - PETRO EnergoRem Sp. z o.o. purchased 52,149 shares for the total amount of PLN 4,766 thousand,
    - PETRO Eltech Sp. z o.o. purchased 17,383 shares for the total amount of PLN 1,589 thousand,

    After the completion of the transaction, PKN ORLEN does not hold any shares in ZBA S.A.

12. On 27 November 2006, an Agreement on the Bond Issue Program was signed. The parties to the Agreement are: PKN ORLEN S.A. as the Issuer, BANK BPH S.A. as the Issue Agent, Payment Agent, Documentation Agent, Program Partner and Dealer, whereas BANK POLSKA KASA OPIEKI S.A., BRE BANK S.A., ING BANK ŚLĄSKI S.A., PKO BANK POLSKI S.A., SOCIETE GENERALE S.A. ODDZIAŁ W POLSCE, as Agents, Program Partners and Dealers.
    Under the Program, the bonds may be repeatedly issued to a bearer in a dematerialized form, in accordance with the Act on Bonds dated 29 June 1995. Bond issue will be based on Article 9 section 3 of the Act on Bonds and shall have the nature of non-public issues.
    Within the scope of the Program, PKN ORLEN S.A. may issue zero-coupon bonds bearing no interest, which are however discounted and bear maturity period from at least seven days to a maximum of three hundred sixty five days, in addition to variable-interest coupon bonds and fixed-interest coupon bonds with a maturity date varying from one year to seven years. The maximum indebtedness of the Issuer under the Program is set at the level of PLN 2,000,000 thousand or its equivalent in other currencies. The aforementioned amount represents the maximum total value of non-redeemed issued bonds at each moment of the Program duration, whereas the said amount does not include the interest payable.
    The Bonds issued under the Program may be made in four currencies, i.e. Polish zloty (PLN), Euro (EUR), US dollars (USD) and Czech koruna (CZK).
    The issue price may be equal to the par value of a Bond or the par value diminished by a discount. The issue price shall be determined before the issue of Bonds in question.
    In the case of zero-coupon Bonds redeemed at discount, the discount shall be paid once, i.e. on the date of redemption. The discount shall depend on conditions dominating the monetary market and shall be determined before the issue of the Bonds. It shall be calculated on the par value for the period running from the day of issue until the day preceding the redemption of Bonds, inclusive of that day.
    In case of coupon-bonds, the interest due for the interest-bearing period shall be calculated on the par value of Bonds in accordance with the basis determined in terms and conditions of the issue of a given series of Bonds, bearing fixed or variable interest rate and payable on dates set in the terms and conditions of the issue.
    The payment of benefits payable on Bonds shall be made to the benefit of persons entered into the records maintained by the depositary or a relevant sub-depositary on the day specified in the terms and conditions of an issue of a given series of Bonds as the day for determining the rights to benefits from the Bonds.

13. On 29 November 2006, PKN ORLEN S.A. signed two credit facility agreements of a total value of EUR 1.6 billion for financing the transaction of acquisition of the Lithuanian company, i.e. AB Mazeikiu Nafta. The object of one of the agreements is a five-year revolving credit facility amounting to EUR 800 million, whereas the object of the second Agreement is a EUR 800 million Bridge Loan Facility with a maturity date of 12 months.
    Therefore, including its own resources and available credit lines, PKN ORLEN will have sufficient resources for purchasing the shares in AB Mazeikiu Nafta, being object of the agreements executed with the Government of the Republic of Lithuania and Yukos International B.V. The agreement for the Revolving Credit Facility was signed by PKN ORLEN S.A. with a consortium of eight Polish and foreign banks, including: ABN AMRO Bank N.V., Bank Handlowy w Warszawie S.A., The Bank of Tokyo-Mitsubishi UFJ, Ltd., BNP Paribas, ING Bank N.V. / ING Bank Śląski S.A., KBC BANK NV /Kredyt Bank S.A., Société Générale SA Oddział w Polsce and UniCredit

Group.
The agreement for the Bridge Loan Facility was executed by PKN ORLEN S.A. with a consortium of six Polish and foreign banks, including: ABN AMRO Bank N.V., Bank Handlowy w Warszawie S.A., BNP Paribas, ING Bank N.V. / ING Bank Śląski S.A., Société Générale SA Oddział w Polsce and UniCredit Group.
The resulting financing structure will allow PKN ORLEN S.A. to maintain reasonable financing costs and simultaneously facilitate the issue of Eurobonds, planned for 2007. PKN ORLEN S.A. intends to obtain at least EUR 800 million for the repayment of the Bridge Loan Facility through this manner of financing. On 28 November 2006, PKN ORLEN S.A. has signed a contract for preparing the issue of Eurobonds, with the same group of banks with which it has signed the agreement for the Bridge Loan Facility.
The Revolving Credit Facility provides for a possibility of prolongation by a two one-year periods.
This pool of financial resources will also allow for financing other potential future undertakings within the scope of acquisition of AB Mazeikiu Nafta, i.e. purchasing of shares offered by the minority shareholders in AB Mazeikiu Nafta in response the mandatory tender offer announced by PKN ORLEN S.A., as well as a potential acquisition by PKN ORLEN S.A. of 70,750,000 shares in AB Mazeikiu Nafta, representing approx. 10% of AB Mazeikiu Nafta share capital from the Lithuanian Government.

14. On 28 December 2006, PKN ORLEN S.A. signed two agreements with ORLEN PetroCentrum Sp. z o.o. for a period of one year each. Under the said agreements, PKN ORLEN S.A. shall sell to ORLEN PetroCentrum gasoline and diesel oil in the period from 1 January 2007 to 31 December 2007. The value of the object of the first Agreement amounts to approx. PLN 3,604,000 thousand, whereas the estimated value of the second agreement amounts to approx. PLN 522,000 thousand.

15. On 29 December 2006, PKN ORLEN S.A. signed an agreement with BP Polska Sp. z o.o. for a period of one year. Under the said agreement, PKN ORLEN S.A. shall sell to BP Polska gasoline and diesel oil in the period from 1 January 2007 to 31 December 2007. The value of the object of the Agreement within its duration is estimated at approx. PLN 4,404,000 thousand.

16. On 29 December 2006, PKN ORLEN S.A. signed an agreement with Shell Polska Sp. z o.o. for a period of one year. Under the said agreement, PKN ORLEN S.A. shall sell to Shell Polska gasoline and diesel oil in the period from 1 January 2007 to 31 December 2007. The value of the object of the Agreement within its duration is estimated at approx. PLN 3,883,000 thousand.

2. Production

No.	Raw Materials (in thousand tonnes)	Throughput		Dynamics %
		2006	2005	2006/2005
1.	REBCO	13,242	12,397	6.8
2.	Low-sulphur crude oils	370	173	113.9
	Total	13,612	12,570	8.3

No.	Raw Materials (in thousand tonnes)	Production		Dynamics %
		2006	2005	2006/2005
1.	Total gasoline	2,723	2,861	-4.8
2.	Total diesel oils	3,995	3,521	13.5
	Total fuels	6,718	6,382	5.3
3.	Liquid gas	216	238	-9.2
4.	Aviation fuel	402	370	8.6
5.	Ekoterm	1,207	1,570	-23.1
	Total	8,543	8,560	-0.2

No.	Raw Materials (in thousand tonnes)	Production		Dynamics %
		2006	2005	2006/2005
1.	Heating Oil III	756	625	21.0
2.	Solvents	19	15	26.7
3.	Pharbasole	13	12	8.3
	Total	788	652	20.9

No.	Raw Materials (in thousand tonnes)	Production		Dynamics %
		2006	2005	2006/2005
1.	Ethylene	593	245	142.0
2.	Propylene	403	220	83.2
3.	Butadiene	61	41	48.8
4.	Benzene	114	65	75.4
5.	Toluene	117	79	48.1
6.	Orthoxylene	18	19	-5.3
7.	Paraxylene	31	28	10.7
8.	Xylene	23	15	53.3
	Total aromatics (items 4-8)	303	206	47.1
9.	Phenol	45	44	2.3
10.	Acetone	28	28	0.0
11.	MEG	99	79	25.3
12.	DEG, TEG	12	9	33.3
13.	Petrygo Q, Qal fluid, Qal concentrate	16	13	23.1
	Total glycols + radiator fluids (items 11-13)	127	101	25.7
14.	Sulphur	124	111	11.7
15.	Ethylene oxide	16	14	14.3
	Total	1,700	1,010	68.3

3. Sale

Configuration per volume of products and goods sold.

Volume sale	Performance (thousand of tonnes)		Configuration %		Dynamics %
	2006	2005	2006	2005	2006/2005
Gasoline	2,794	2,919	21.5	25.0	- 4.3
Diesel oil	4,489	3,644	34.5	31.2	23.2
Light heating oils	1,266	1,562	9.7	13.4	- 19.0
JET A-1 aviation fuel	403	372	3.1	3.2	8.3
Heating oil III	735	624	5.6	5.3	17.8
Sulphur	124	110	1.0	0.9	12.7
Other refinery products	1,422	1,266	10.9	10.8	12.3
Total refinery products	11,233	10,498	86.3	89.9	7.0
Liquid gas	215	235	1.7	2.0	- 8.5
Phenol	45	43	0.3	0.4	4.7
Acetone	28	27	0.2	0.2	3.7
Ethylene	509	245	3.9	2.1	107.8
Propylene	387	221	3.0	1.9	75.1
Glycols	113	90	0.9	0.8	25.6
Ethylene oxide	16	14	0.1	0.1	14.3
Butadiene	62	40	0.5	0.3	55.0
Benzene	115	63	0.9	0.5	82.5
Orthoxylene	20	18	0.2	0.2	11.1
Paraxylene	30	28	0.2	0.2	7.1
Toluene	118	80	0.9	0.7	47.5
Other petrochemical products	125	80	1.0	0.7	56.3
Total petrochemical products	1,783	1,184	13.7	10.1	50.6
Total sales	13,016	11,683	100.0	100.0	11.4
Including exports	1,020	989	7.8	8.5	3.1

Presentation by value of sales as per key customers

Major customers	Share in total sale revenues (percentage) (inclusive of excise duty and fuel charge, exclusive of VAT)	
	2006	2005
BP Polska Sp. Z o.o.	8.3%	9.0%
ORLEN PetroCentrum Sp. z o.o.	6.7%	5.9%
SHELL Polska Sp. z o.o.	5.7%	6.3%
BASELL ORLEN POLYOLEFINS Sp. z o.o.	4.8%	2.6%
PETROLOT Sp. z o.o.	1.6%	1.3%
J&S ENERGY S.A.	1.5%	0.0%
ANWIM Sp. z o.o.	1.3%	0.6%
Rafineria Trzebinia S.A.	1.2%	1.3%
ORLEN Asfalt Sp.z o.o.	1.2%	1.1%
ORLEN Oil Sp. z o.o.	1.0%	1.0%
ANWIL S.A.	0.9%	0.8%
ORLEN Gaz Sp. z o.o.	0.8%	1.0%

The participation in the total sale revenues of other customers did not exceed 0.5% on individual basis.

4. Supplies

Supplies of crude oil (percentage share of delivered volumes)

List of entities	2006	2005
Arkadia	0.58	0.68
J&S	44.07	50.02
BMP	2.49	16.02
KD Petrotrade	14.13	0.33
Litasco	1.99	-
Petraco	21.12	18.02
PGNiG	0.62	-
Shell	1.33	-
Statoil	-	1.01
Totsa	6.23	6.07
Wincor	7.44	7.85
Total	100.00	100.00

Supplies of crude oil (percentage share of delivered values)

List of entities	2006	2005
Arkadia	0.61	0.71
J&S	44.12	50.03
BMP	2.33	16.00
KD Petrotrade	14.30	0.34
Litasco	2.01	-
Petraco	20.82	18.09
PGNiG	0.64	-
Shell	1.58	-
Statoil	-	1.17
Totsa	6.14	6.07
Wincor	7.45	7.59
Total	100.00	100.00

5. Transactions with related entities

Transactions with related entities where the value of a single transaction or the total value of transactions in 2006 has exceeded a PLN equivalent of EUR 500 thousand:

No.	Party to a transaction	Sales in PLN thousand	Purchases in PLN thousand
1.	ORLEN Gaz Sp. z o.o.	365,200	538,728
2.	ORLEN PetroProfit Sp. z o.o.	75,007	19,773
3.	ORLEN PetroTank Sp. z o.o.	91,684	30,724
4.	Inowrocławskie Kopalnie Soli "SOLINO" S.A.	1,147	30,961
5.	ORLEN PetroCentrum Sp. z o.o.	2,937,878	2,287
6.	PETROLOT Sp. z o.o.	702,768	3,529
7.	Petrotel Sp. z o.o.	665	7,743
8.	Rafineria Trzebinia S.A.	539,938	45,049
9.	ORLEN Medica Sp. z o.o	157	5,131
10.	ORLEN PetroZachód Sp. z o.o.	38,722	10,727
11.	ORLEN Projekt S.A.	122	15,413
12.	ORLEN Ochrona Sp. z o.o.	2,423	33,755
13.	Wisła Płock Sportowa S.A.	15	6,783
14.	Zakład Budowy Aparatury S.A.	1,232	4,777
15.	ORLEN Transport Płock Sp. Z o.o.	72,039	33,446
16.	ORLEN Automatyka Sp. z o.o.	392	19,112
17.	ORLEN Wir Sp. z o.o.	509	7,990
18.	ORLEN Budonaft Sp. z o.o.	1,001	25,079
19.	ORLEN Administracja	2,615	10,939
20.	Rafineria Nafty Jedlicze S.A.	57,478	127,865
21.	SHIP-SERVICE S.A.	103,398	136
22.	ANWIL S.A.	408,613	5,932
23.	ORLEN Oil Sp. z o.o.	424,818	129,371
24.	ORLEN Transport Olsztyn Sp. z o.o.	7,241	6,161
25.	ORLEN Transport Kędzierzyn-Koźle Sp. z o.o.	3,926	7,491
26.	ORLEN Transport Słupsk Sp. z o.o.	24,186	6,610
27.	ORLEN Transport Kraków Sp. z o.o.	5,010	8,571
28.	ORLEN Transport Szczecin Sp. z o.o.	902	3,511
29.	ORLEN Transport Nowa Sól Sp. z o.o.	929	13,028
30.	ORLEN Centrum Serwisowe (former Zakład Urządzeń Dystrybucyjnych)	1,455	34,452
31.	ORLEN KolTrans Sp. z o.o.	8,927	63,192
32.	ORLEN Asfalt Sp.z o.o. (former Bitrex Sp. z o.o.)	525,354	3,552
33.	ORLEN Morena Sp. z o.o.	63,840	378
34.	BASELL ORLEN POLYOLEFINS Sp. z o.o.	2,124,732	22,032
35.	ORLEN Laboratorium Sp. z o.o.	2,261	34,932
36.	ORLEN Eko Sp. z o.o.	3,951	13,295

No.	Party to a transaction	Sales in PLN thousand	Purchases in PLN thousand
37.	ORLEN Prewencja Sp. z o.o.	880	3,941
38.	ORLEN Insurance	0	30,008
39.	Petro-Oil Lubelskie Centrum Sprzedaży Sp. z o.o.	3,868	30,088
41.	Petro-Oil Wielkopolskie Centrum Sprzedaży Sp. z o.o.	9,150	31,609
42.	Petro-Oil Dolnośląskie Centrum Sprzedaży Sp. z o.o.	101	19,389
43.	Petro-Oil Małopolskie Centrum Sprzedaży Sp. z o.o.	4,673	17
44.	KAUČUK, a.s.	33,173	0
45.	UNIPETROL RAFINÉRIE a.s.	5,732,148	56,542
46.	PARAMO, a.s.	10,484	1,387
47.	UNIPETROL, a.s	0	0
48.	Polkomtel S.A.	10,238	39,336
	Total	14,405,250	1,544,772

Transactions with related entities were translated at the exchange rate representing arithmetic average of average exchange rates published by the National Bank of Poland as at the last day of each ended month within the period from 1 January 2006 to 30 December 2006, namely of 3.8991 PLN/EUR.

a. Transactions with members of the Management Board of the Company, their spouses, siblings, ascendants, descendants or other close relatives

As at 31 December 2006 and 31 December 2005 the Company did not grant any loans to the managing or supervising management or their relatives.
During the year ended 31 December 2006 and 31 December 2005 there were no significant transactions carried out with members of the Management Board or Supervisory Board of the Company, their spouses, siblings, ascendants, descendants or other close relatives.

b. Transitions with related entities carried out by the supervising persons of the Company (in thousand PLN)

In 2006, the Company obtained statements on transactions concluded in 2006 effected with related entities in accordance with the requirements of the amended IAS 24 "Related Party Disclosures".

	Sale	Purchase	Receivables	Liabilities
Legal persons *	34,542	138,687	617	33,668
Natural persons	-	-	-	-

* Transactions in the period where a person acted as a member of the Company's supervisory bodies.

In the period in question, 19 persons held positions as members of the Supervisory Board.

c. Transactions with related parties through the members of the Management Board of the Company

In 2006, members of the Management Board did not execute any transactions with related entities in the meaning of IAS 24 „ Related Party Disclosures".

d. Transactions of key management personnel of the Company with related parties (in thousand PLN)

In 2006 the Company obtained on transactions concluded with related parties in accordance with the requirements of the amended IAS 24 “Related Party Disclosures”.

	Sale	Purchase	Receivables	Liabilities
Legal persons *	-	-	-	-
Natural persons	26	-	-	-

* Transactions in the period where a person acted as a key management personnel.

6. Remuneration, including profit distribution paid and due or potentially due to the Management Board, Supervisory Board and members of key management, in accordance with IAS 24

Remuneration of the Management Board, Supervisory Board and key management personnel cover short-term benefits, benefits payable after the termination of the employment, other long-term benefits and payments made in connection with the termination of employment relationship paid, due or potentially due within the period in question.

a. Remuneration of the Members of the Management Board and Supervisory Board, including key management personnel of the Company in 2006 (in thousand PLN)

	2006
Remuneration of the Members of the Company's Management Board	19,437
incl. remuneration paid to the Members of the Board remaining in office as at 31 December 2006	14,081
potential remuneration payable to Members of the Board remaining in office as at 31 December 2006	5,357
Remuneration paid to the Members of the Company's Supervisory Board	739
Remuneration paid to the Company's key management personnel:	28,992
incl. remuneration paid	18,953
remuneration due	10,039

Remuneration paid to the Members of the Company's Supervisory Board	**2006**
Konstanty Brochwicz-Donimirski	9
Robert Czapla	9
Dariusz Dąbski	54
Marek Drac-Tatoń	32
Raimondo Eggink	106
Maciej Gierej	9
Zbigniew Macioszek	100
Maciej Mataczyński	93
Krzysztof Obłój	9
Małgorzata Okońska – Zaremba	9
Andrzej Olechowski	52
Wojciech Pawlak	97
Adam Pawłowicz	25
Krzysztof Rajczewski	9
Wiesław Rozłucki	54
Adam Sęk	9
Ryszard Sowiński	54
Ireneusz Wesołowski	9

Total remuneration of the Members of the Management Board	**739**
	====

Remuneration paid, due and potentially due in 2006 to the Company's Management Board Members remaining in office in 2006

	Remuneration	Bonus for 2005	Insurance Policy	Potentially payable*	Severance pay, non-competition clause and compensation	**Total**
Igor Chalupec	1,939	1,250	98	1,247	-	4,534
Cezary Filipowicz	842	-	73	506	-	1,421
Wojciech Heydel	1,160	1,033	76	1,154	-	3,423
Piotr Kownacki	185	-	-	-	-	185
Jan Maciejewicz	1,091	776	43	600	-	2,510
Cezary Smorszczewski	1,328	626	80	643	-	2,677
Krzysztof Szwedowski	635	-	43	408	-	1,086
Paweł Szymański	854	609	51	604	-	2,118
Dariusz Witkowski	216	196	37	194	840	1,483
Total	**8,250**	**4,490**	**501**	**5,356**	**840**	**19,437**

* The potentially payable yet unpaid remuneration is due to the Management Board Members in connection with the new rules and regulations of bonus-awarding system, i.e. Management by Objectives (MBO) in force from 1 January 2005. The bonus was calculated on the basis of a preliminary evaluation of realization of MBO targets of the Management Board Members carried out by the Company's Supervisory Board.

In 2005, a new motivation system for key management personnel of PKN ORLEN S.A. and the Capital Group was introduced. The system consists in the motivation through objectives, i.e. Management by Objectives (the MBO). The new system covers the Management Board and key management personnel. Managers covered by the MBO system are remunerated for the realization of individual targets, set forth at the beginning of the settlement period, and on the basis of the joint target, i.e. shareholders' value added (SVA). The Supervisory Board sets targets for particular Members of the Management Board. The targets refer either to quality or quantity (measurable) and are settled in accordance with the rules adopted in the Rules and Regulations of the Bonus-awarding System after the termination of the year for which they were set.

In 2005, a new motivation system for key executive management of PKN ORLEN S.A. and the Capital Group was introduced. The system consists in the motivation through objectives, i.e. Management by Objectives (the MBO). The new system covers the Management Board and key executive management. Individuals covered by the MBO system are remunerated for the realization of individual targets, set forth at the beginning of the settlement period, and on the basis of the joint target, i.e. shareholders' value added (SVA). The Supervisory Board sets targets for particular Members of the Management Board. There are either qualitative or quantitative (measurable) targets which are settled in accordance with the rules adopted in the Rules and Regulations of the Bonus-awarding System after the end of the year for which they were set.

The management covered by the MBO system is rewarded for the realization of 4 to 8 bonus targets, which are set individually for each Employee and registered in the Target Record. They can be either quantitative or qualitative. Quantitative targets are measurable, where both the target value and the realization value are assessable, e.g. EBIT or amount of contracts executed. Each quantitative target is attributed the value of realization representing the target realization at the level of 80, 100 and 120 points accordingly. The said values are set through the Financial Department on the basis of budgets and plans adopted. When assessing the realization of particular quantitative targets, partial points are awarded in the 80-to-100 point range and 100-to-120 point range. Realization under 80 points represents „0" points value.

Qualitative targets cannot be represented in numbers, however, they can be determined in the outcome of the resulting activities. The assessment of the qualitative target realization is carried out on the basis of the Qualitative Target Realization Report submitted to a superior after the end of the year in which they were to be achieved. The realization of targets can be rewarded: 0 points (unsatisfactory), 60 points (average), 80 points (satisfactory), 100

points (very well) and 120 points (outstanding). Particular targets are attributed certain weight. The weight of a single bonus target cannot be lower then 5% or exceed 40%; the total weight of targets must equal 100%.
The value of the bonus awarded is also conditioned by the realization of the joint target, i.e. the Concern's consolidated SVA. In a case the planned SVA is realized, each employee receives a bonus in full amount. However, when the joint target fails to be realized, all employees receive half of the generated bonus. This system enhances cooperation between the employees in order to achieve the best possible result within the whole Concern.

Remuneration of the Management Board and Supervisory Board in connection with holding positions in Supervisory Boards and Management Boards of subsidiaries, jointly controlled entities and associate companies in 2006

In 2006, Members of the Management Board of PKN ORLEN S.A. holding positions of Management Board or Supervisory Board Members in subsidiaries, jointly controlled entities or associate companies belonging to the PKN ORLEN Capital Group did not receive any remuneration for holding the above-mentioned positions, except for UNIPETROL, where the remuneration due was transferred to the benefit of ORLEN Foundation "Dar Serca".
In 2006, Members of the Supervisory Board did not hold positions in Management Boards or Supervisory Boards of subsidiaries, jointly controlled entities or associate companies belonging to the PKN ORLEN Capital Group.

Remuneration of the Company's Management Board in 2006 include potential bonuses payable to the Members of the Management Board not recognized as costs in 2006, as well as include benefits paid to a former Member of the Management Board in the amount of PLN 1,289 thousand.

The position of the Company's key executive management in the period of 12 months of 2006 was held by 30 persons, including executive management personnel changes, as opposed to 40 persons in 2005. This change results from transformations of the Company's organizational structure. Under comparable conditions, the remuneration of the key executive management of PKN ORLEN S.A. for the period of 12 months of 2006 amounts to PLN 36,291 thousand.

b. Remuneration of the Members of the Management Board and of the Supervisory Board and the key management personnel of the Company for the year 2005 (in thousand PLN)

	2005
Remuneration of the Company's Management Board Members	**26,147**
incl. remuneration paid to the Members of the Management Board remaining in office as at 31 December 2005	7,422
potential remuneration payable to Members of the Board remaining in office as at 31 December 2005	4,597
remuneration paid to other members of the Management Board	14,128
Remuneration paid to the Members of the Company's Supervisory Board	**854**
Remuneration paid to the Company's key management personnel:	**26,212**
incl. remuneration paid	18,604
remuneration due	7,608

Remuneration of the Company's Supervisory Board Members	**2005**
Jacek Bartkiewicz	118
Raimondo Eggink	101
Maciej Gierej	101
Krzysztof Lis	8
Krzysztof Obłój	22
Małgorzata Okońska – Zaremba	101
Andrzej Olechowski	51
Piotr Osiecki	79
Adam Pawłowicz	8
Adam Sęk	51
Michał Stępniewski	88
Ireneusz Wesołowski	101
Krzysztof Żyndul	25

Total remuneration of the Company's Supervisory Board Members	**854**
	====

Remuneration paid, due and potentially due in 2005 to the Company's Management Board Members remaining in office as at 31 December 2005

	Remuneration	Bonuses	Insurance policy	Potentially due*	**Total**
Igor Chalupec	1,939	315	107	1,250	**3,611**
Wojciech Heydel	1,162	-	76	1,140	**2,378**
Jan Maciejewicz	1,093	-	42	776	**1,911**
Cezary Smorszczewski	1,335	-	80	626	**2,041**
Paweł Szymański	863	-	55	609	**1,527**
Dariusz Witkowski	355	-	-	196	**551**
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Total	**6,747**	**315**	**360**	**4,597**	**12,019**
	=======	=======	=======	=======	=======

* The potentially payable yet unpaid remuneration due to the Management Board Members in connection with the new rules and regulations of bonus-awarding system, i.e. Management by Objectives (MBO) in force from 1 January 2005. The bonus was calculated on the basis of a preliminary evaluation of realization of MBO targets of the Management Board Members carried out by the Company's Supervisory Board

Remuneration paid in 2005 to other members of the Company's Management Board

	Remuneration	Bonus	Insurance policy	Severance pay, non-competition clause and compensation	**Total**
Sławomir Golonka	-	1,500	-	1,325	**2,825**
Krzysztof Kluzek	-	824	-	513	**1,337**
Andrzej Macenowicz*	420	1,752	103	490	**2,765**
Andrzej Modrzejewski	112	-	-	-	**112**
Jacek Strzelecki	-	1,500	-	1,234	**2,734**
Janusz Wiśniewski*	703	1,752	100	1,800	**4,355**
Total	**1,235**	**7,328**	**203**	**5,362**	**14,128**

* Potential bonus was not estimated due to the fact that the assessment of targets was not carried out.

Remuneration of the Management Board and Supervisory Board in connection with holding positions in Supervisory Boards and Management Boards of subsidiaries, jointly controlled entities and associated companies in 2005

In 2005, Members of the Management Board of PKN ORLEN S.A. holding positions of Management Board or Supervisory Board Members in subsidiaries, jointly controlled entities or associate companies belonging to the PKN ORLEN Capital Group did not receive any remuneration for holding the above-mentioned positions, except for UNIPETROL, where the remuneration due was transferred to the benefit of ORLEN Foundation "Dar Serca".
In 2005, Members of the Supervisory Board did not hold positions in Management Boards or Supervisory Boards of subsidiaries, jointly controlled entities or associate companies belonging to the PKN ORLEN Capital Group.

Remuneration of the Company's Management Board in 2005 include potential bonuses payable to the Members of the Management Board that was not recognized as costs in 2005, as well as include remuneration paid together with an annual bonus to five former Members of the Management Board in the amount of PLN 12,802 thousand, including PLN 5,362 thousand severance pay (compensation stipulated for holding the position of the Management Board Member due after the termination or expiry of a contract in accordance with the provisions of the relevant contracts, including non-competition agreements). Part of remuneration packages, in the amount of PLN 10,500 thousand, paid to the former members of the Management Board in 2005 was recognized as costs in 2004.

7. Fee payable under an agreement with an entity authorized to audit financial statements, due or paid in connection with the audit and review of financial statements (in thousand PLN)

In the period covered by the foregoing report, KPMG KPMG Audyt Sp. z o.o. remains the Auditor of the Company. Under the agreement executed on 30 May 2005 for the period of 2005 to 2007, effective from the second quarter of 2005 the Auditor carries out interim reviews and audit of the Company's unconsolidated financial statements and the consolidated financial statements of the Capital Group.
The review of the Company's unconsolidated financial statements and the consolidated financial statements of the Capital Group for the first quarter of 2005 was carried out by Ernst & Young Audit Sp. z o.o. upon the agreement entered into on 18 January 2005.

	For the year ended 31 December 2006	For the year ended 31 December 2005
Fees payable for audit by KPMG Audyt Sp. z o.o.*	1,414	1,537
Fees payable for relates services by KPMG Audyt Sp. z o.o.**	1,282	811
Fees payable for audit by Ernst & Young Audit Sp. z o.o.*	-	1,285
Fees payable for relates services by Ernst & Young Audit Sp. z o.o.**	-	1,451
	-----------------	-----------------
	2,696	5,084
	=========	=========

* The audit fees include amounts payable to the entity authorized to audit financial statements in relation to professional services consisting in auditing financial statements of the Company's unconsolidated financial statements and the consolidated financial statements of the Capital Group, as well as in review of the quarterly and half-yearly financial statements of the same.

** The fees payable for related services include other amounts paid to the entity authorized to audit financial statements. The fees cover services connected with audit or review of the Company's unconsolidated financial statements and the consolidated financial statements of the Capital Group, other than covered by the item "Fees payable for the audit".

In 2005, a procedure on soliciting additional services with the chartered accountant and entities related with the latter was introduced at the Company. The Audit Committee of the Supervisory Board makes the decision on awarding contracts to the Auditor for additional services.

8. Contracts between the issuer and corporate executives stipulating compensation (golden handshake) in case the said executives resign or are dismissed from their positions without important reason

The contracts concluded between the issuer and the corporate executives provide for a specific severance pay in case of termination of those contracts as a result of dismissal from a position held or a non-competition clause binding after the termination or expiry of employment contract.

The issuer has signed contracts with the executive management, providing for the payment of remuneration in connection with:

- termination of employment contract as a result of dismissal of a management board member from his/ her position, where the amount of the severance pay does not exceed the amount of base remuneration due for a period of 12 months;
- non-competition clause binding after the termination or expiry of employment contract where the severance pay does not exceed the amount of base remuneration due for a period of 12 months.

9. Changes in the composition of the Managing and Supervisory Bodies of PKN ORLEN S.A. within the last financial year

Management Board Members of PKN ORLEN S.A. are appointed and dismissed by the Supervisory Board. In the period from 1 January 2006 to 31 December 2006, the following persons have been appointed as Members of the Management Board of Polski Koncern Naftowy ORLEN S.A.:

Igor Chalupec	President of the Management Board, Chief Executive Officer
Wojciech Heydel	Vice-President of the Management Board, Chief Sales Officer
Piotr Kownacki	Vice-President of the Management Board, Audit and Regulations Office from 23 October 2006
Jan Maciejewicz	Vice-President of the Management Board, Cost Management
Cezary Smorszczewski	Vice-President of the Management Board, Chief Investment Officer
Cezary Filipowicz	Vice-President of the Management Board, Upstream and Crude Procurement from 2 January 2006
Krzysztof Szwedowski	Member of the Management Board, Organization and Capital Group from 31 March 2006
Paweł Szymański	Member of the Management Board, Chief Financial Officer.
Dariusz Witkowski	Member of the Management Board, Organization until 31 March 2006

Supervisory Board Members of PKN ORLEN S.A. is appointed by the General Meeting of Shareholders. In 2006, the Company's Supervisory Board was composed of the following members:

Jacek Bartkiewicz	Chairman of the Supervisory Board until 31 January 2006
Dariusz Dąbski	Chairman of the Supervisory Board from 31 January 2006 to 24 June 2006
Maciej Mataczyński	Member of the Supervisory Board from 31 January 2006 to 9 November 2006 Secretary of the Supervisory Board from 14 February 2006 Chairman of the Supervisory Board from 27June 2006
Zbigniew Macioszek	Member of the Supervisory Board from 31 January 2006 Chairman of the Supervisory Board from 30 November 2006
Andrzej Olechowski	Deputy Chairman of the Supervisory Board until 27 June 2006

Wojciech Pawlak	Member of the Supervisory Board from 31 January 2006 Deputy Chairman of the Supervisory Board from 5 July 2006
Ryszard Sowiński	Member of the Supervisory Board form 27 June 2006 Secretary of the Supervisory Board from 5 July 2006
Ireneusz Wesołowski	Secretary of the Supervisory Board until 31 January 2006
Konstanty Brochwicz-Donimirski	Member of the Supervisory Board from 30 November 2006
Robert Czapla	Member of the Supervisory Board from 30 November 2006
Marek Drac-Tatoń	Member of the Supervisory Board from 11 September 2006
Raimondo Eggink	Member of the Supervisory Board
Maciej Gierej	Member of the Supervisory Board until 31 January 2006
Krzysztof Obłój	Member of the Supervisory Board until 31 January 2006
Małgorzata Okońska - Zaremba	Member of the Supervisory Board until 31 January 2006
Adam Maciej Pawłowicz	Member of the Supervisory Board until 28 March 2006
Krzysztof Rajczewski	Member of the Supervisory Board from 30 November 2006
Wiesław Rozłucki	Member of the Supervisory Board from 27June 2006
Adam Sęk	Member of the Supervisory Board until 31 January 2006

10. Number of shares in the Company and other entities belonging to the Capital Group held by persons holding positions within the supervisory and managing bodies

As at 31 December 2006, Raimondo Eggink, Member of the Supervisory Board, held 2,950 shares in PKN ORLEN S.A.

11. Shareholders of PKN ORLEN S.A.

Shareholding structure of PKN ORLEN S.A. as at 31 December 2006.

	Number of shares	Number of votes	Par value of the shares	Holding
Nafta Polska S.A.	74,076,299	74,076,299	92,595,374	17.32%
State Treasury	43,633,897	43,633,897	54,542,371	10.20%
Bank of New York (as a depositary)	23,919,466	23,919,466	29,899,333	5.59%
Other	286,079,399	286,079,399	357,599,249	66.89%
Total	427,709,061	427,709,061	534,636,326	100.00%

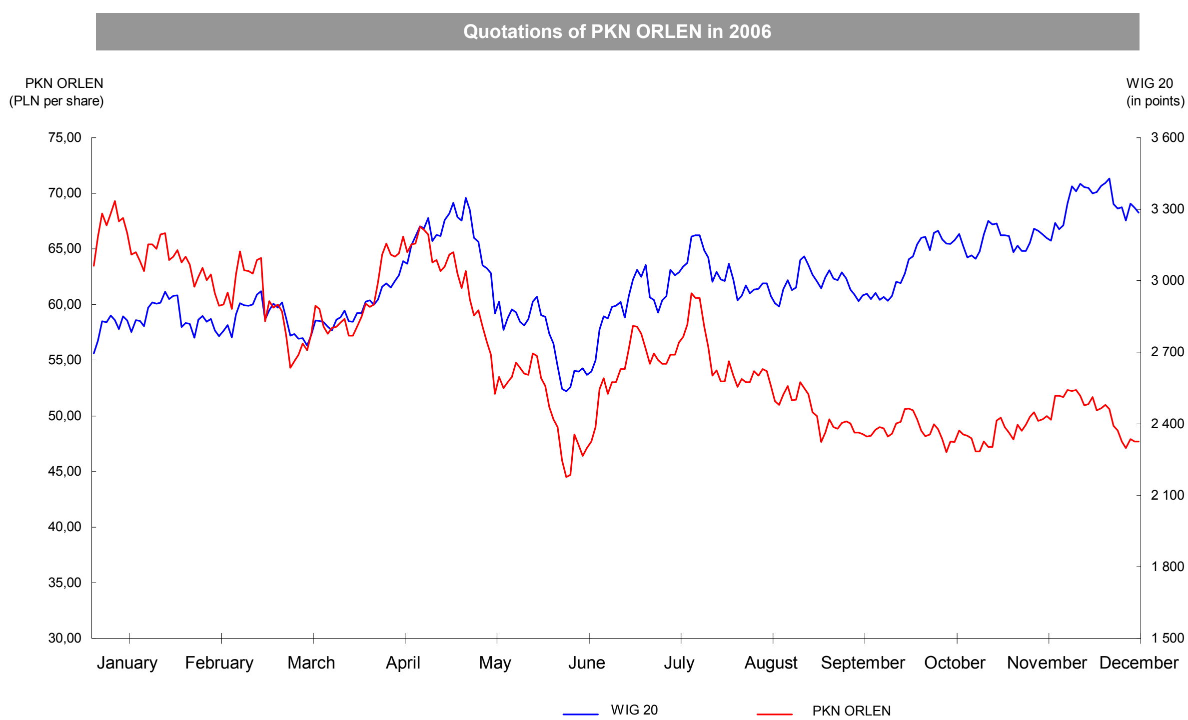
There are no agreements known according to which the proportions of shares held by the current shareholders could change in the future.

12. PKN in the Capital Market

PKN ORLEN shares are listed on Warszawska Giełda Papierów Wartościowych w Warszawie S.A. (the Warsaw Stock Exchange) and as Global Depositary Receipts (GDR) on the London Stock Exchange. Depositary receipts are also traded in the USA on the OTC market. The Company's share capital is divided into 427,709,061 ordinary bearer shares of the nominal value of PLN 1.25 each.

The depositary of the Company's depository receipts is The Bank of New York. A trading unit on the London Stock Exchange is 1 GDR, representing two shares in the Company.

In January 2006, the price of PKN ORLEN S.A. shares reached the highest value since they were first quoted in November 1999, and amounted to PLN 69.30 per single share. As at the end of 2006, the capitalization amounted to PLN 20.4 billion.



Management Board Report on Operations
of Polski Koncern Naftowy ORLEN Spółka Akcyjna
for the year 2006
submitted by the Management Board composed of:

…………………….
Management Board President
Piotr Kownacki

…………………………
Management Board Vice-President
Cezary Filipowicz

………………………..
Management Board Vice-President
Wojciech Heydel

…………………………
Management Board Member
Krystian Pater

………………………
Management Board Member
Krzysztof Szwedowski

………………………
Management Board Member
Paweł Szymański

Płock, 18 April 2007