MANAGEMENT BOARD COMMENTARY
ON THE COMPANY'S OPERATIONS OF
POLSKI KONCERN NAFTOWY
ORLEN SPÓŁKA AKCYJNA
FOR THE YEAR 2005

Table of contents

I. CHANGES IN ORGANIZATION AND MANAGEMENT OF THE COMPANY

In the first months of 2005, the Organizational Rules and Regulations of PKN ORLEN S.A. ("the Company", "the Concern") approved by the Management Board on 6 December 2004 was in force. Under the Regulations, the organizational structure of PKN ORLEN S.A. consisted of Head Offices in Płock and Warszawa, Production Plant in Płock and 12 Regional Organizational Offices in Białystok, Gdańsk, Katowice, Kraków, Lublin, Nowa Wieś Wielka, Płock, Poznań, Rzeszów, Szczecin, Warszawa and Wrocław, having the status of an employer as defined by Art. 3 of the Labor Code. Regional Organizational Offices were composed of Regional Wholesale Offices, Regional Retail Trade Offices, Regional Investment and Maintenance Offices, Regional Financial Offices and Financial Offices.

In 2005, within the preparations for the process of integration of capital assets of PKN ORLEN S.A. and UNIPETROL a.s., particular Reporting Directors commenced analytical research on the integration process within the scope of certain aspects of their competencies in order to achieve the resulting effect of synergy. Moreover, activities aiming at developing trade-effective structures ensuring maximum of sales and economic result within the restructuring project for regional offices in the area of retail sales, investments and maintenance of gasoline stations and finance were conducted. Therefore, on 1 July 2005 the new Organizational Rules and Regulations of PKN ORLEN S.A. were adopted. The Regulations introduced a new regional structure of the Company. In place of Regional Retail Trade Offices operating at eleven locations, three regions were determined, i.e. East Retail Trade Region based in Kielce, South Retail Trade Region based in Katowice and West Retail Trade Region based in Poznań. Former Regional Investments and Maintenance Offices operating at six locations were reduced to three units, i.e. East Investment and Maintenance Unit based in Lublin, South Investment and Maintenance Unit based in Katowice and West Investment and Maintenance Unit based in Poznań. In addition, in place of eleven regional Financial Offices and three Financial Offices, three regions were determined, i.e. East Finance and Accounting Office based in Lublin, South Finance and Accounting Office based in Katowice and West Finance and Accounting Office based in Poznań. Regional Wholesale Offices and regional logistics, administrative, prevention and human resources offices remained unaffected.

The Organizational Rules and Regulations were subsequently amended on 22 August 2005. Till this date, the status of the employer, as defined by Art. 3 of the Labor Code, was assigned to Regional Organizational Offices within PKN ORLEN S.A. and the Head Office in Płock. In connection with a resolution of the Extraordinary Shareholders Meeting of 25 June 2005 on the removal of item 5 § 2 from PKN ORLEN S.A. Statutes and registration of this amendment in the Commercial Court, regulations relating to the employer were amended accordingly. Currently, on behalf of PKN ORLEN S.A., which is defined by Art. 3 of the Labor Code as the employer, the activities pertaining to the labor law are performed by the President of the Management Board as the General Executive or persons authorized by him.

Furthermore, in 2005 extensive activities have been carried out in connection with the implementation of the segment management as of 1 January 2006. On 10 November 2005, the implementation process was communicated to the managing staff of the PKN ORLEN S.A. Group and trade unions operating within the Company. Projected applications will allow to determine precisely the scope of duties of particular executive directors in terms of segment coordination and their supportive function within the operations of the whole Company. The segment management results also in the transfer of certain decision-making process to the middle management level, simplification of procedures, clearly defined responsibility for decisions made and focusing on key objectives. Consequently, the said activities will produce a number of benefits for all the companies from the Capital Group, including optimization of investment expenses, synergy of production and sales as a result of optimization of operational planning, coordination of purchasing policy within the Group, centralization and cost savings within the support function, including cost cutting in particular companies. In accordance with the assumptions made, as of 1 January 2007, the implementation of the segment management process will involve the Czech capital group of Unipetrol a.s.

On 18 November 2005, the Management Bard has approved the new Organizational Rules and Regulations which became binding on 1 January 2006. The said Regulations have introduced a new allocation of duties between particular Members of the Management Board and have authorized the implementation of the segment management process. Moreover, new components of the organizational structure have been introduced, i.e. segment and support function, and rules of segment management and segment separation criteria have been defined and identified together with manner of appropriating individual companies from the Capital Group to specific segments. Executive Directors within particular organizational departments were allocated companies from the Capital Group, in accordance with the factual supervision over a given area (segment) within the Company.

On 22 December 2005, the Supervisory Board of PKN ORLEN S.A. has decided to increase the number of the Members of the Management Board from 6 to 7. Consequently, on 22 December 2005, the new Organizational Rules and Regulations of the Company was adopted and entered into force on 1 January 2006. In accordance with the said Regulations, the duties of Members of the Management Board have been assigned in the following manner:

- President of the Management Board, General Director;
- Vice-President of the Management Board, Chief Investment Officer;

- Vice-President of the Management Board, Cost Management;
- Vice-President of the Management Board, Crude Oil Mining and Trading;
- Vice-President of the Management Board, Chief Sales Officer;
- Member of the Management Board, Financial Officer;
- Member of the Management Board, Organizational Structure and Capital Group.

Duties of the Deputy Executive Officer for Operational Activities include the areas of production, maintenance of technical operations, production development, technology and property investment. The new organization unit formed as of 22 December 2005, supervised by the Vice-President of the Management Board for Crude Oil Mining and Trading comprises Crude Oil Trading Unit and Upstream Unit which supervise the activities within the sector of crude oil and natural gas prospecting and upstream.

On 1 January 2006 11 Reporting Directors were appointed, who take over the responsibility for results and coordination of particular segments or support functions within the Concern, including the realization of the synergy, especially through the unification of strategies, plans and daily operating activities and implementation of unique standards and procedures within the Concern. The range of responsibilities of Reporting Directors covers also daily operating activities of an allocated segment and a support function.

The Supervisory Board of PKN ORLEN S.A. at the meeting held on 31 March 2006 has dismissed as of 31 March 2006 Dariusz Witkowski from the position of the Member of the Management Board of PKN ORLEN S.A. At the same time, Krzysztof Szwedowski was appointed as the Member of the Management Board.

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 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 2005, the average quotations price of Brent barrel increased by 42.5% in comparison with the prices in 2004 to the level of USD 54.56/bbl. Additionally, in the course of 2005 there were considerable increases in refinery product margins on quotations (crack), which positively influenced the result of PKN ORLEN S.A. and the Capital Group companies producing and trading in fuels. Margins on diesel oil increased by 29.2% to the level of USD 132.78/tonne, on Ekoterm by 48.9% to the level of USD 101.79/tonne, and on Jet A-1 by 41.3% to the level of USD 156.04/tonne. The lowest increase was recorded for margins on quotations of gasoline, i.e. increase by 11.0% to the level of USD 126.55/tonne. The margins on petrochemical products have considerably dropped, i.e. on benzene by 22.8% to the level of USD 422.03/tonne, on glycols by 48.3% to the level of USD 131.14/tonne and on ethylene by 0.4% to the level of USD 507.26/tonne; however, the margins on propylene in 2005 have increased by 15.8% to the level of USD 476.02/tonne.

- **Fluctuations of foreign exchange rates**

Exchange rate fluctuations have significant impact on sales revenue and result of PKN ORLEN S.A. (by means of adjusting the fuel prices on the basis of import parity), costs of crude oil and other raw materials as well as financial costs related to debt denominated in foreign currencies. Purchases of crude oil and other raw materials realized by PKN ORLEN S.A. are denominated in US dollars and Euro. The majority of revenues from sale are collected in Polish zloty, whereas product prices are fixed on the basis of price formulas of products denominated in US dollars. As a result of the above trends, fluctuations in the exchange rate of PLN in relation to foreign currencies have a significant impact on the result generated by PKN ORLEN S.A. The average PLN/USD exchange rate decreased by 11.3% to the level of 3.23 (by arithmetic average of daily exchange rates published by NBP within the period from 1 January to 31 December 2005). At the same time, EUR against PLN exchange rate has fallen by 11.2% to the level of PLN/EUR 4.02.

- **Changes in fiscal policy and binding legal regulations**

Restrictive fiscal policy with regard to excise duty and VAT tax is of great importance for the economic situation of the Company. Fiscal policy consists in enlarging its subject range and increasing excise duty rates for crude oil products. While prices of products are at high level, it creates an additional barrier preventing the Company from transferring of all its operating costs on products' selling prices. Moreover, frequent amendments of fiscal regulations make them unclear and ambiguous, and produce different legal interpretations within administrative bodies themselves and between those bodies and tax payers.

The year 2005 proved to be another year of changes in the demand structure in case of engine fuels due to increased demand for automotive liquid gas and diesel oil, while the gasoline market has seen stagnation. From 1 January 2005, gasoline and diesel oil quality requirements became stricter. In case of gasoline, sulphur content was reduced from 150 ppm to 50 ppm and aromatic compound content was reduced from 42% to 32% of the volume. In case of diesel oil, the permissible content of sulphur was limited to 50 ppm (from 350 ppm previously) and excise duty allowance was introduced for sulphur-free diesel oil (sulphur content <10 ppm).

The above changes have had an impact on limitation of flexibility in the engine fuels production and increase of unit production costs. The introduction of the excise duty allowance for sulphur-free diesel oil enabled PKN ORLEN S.A. to boost its production in this area. Consequently, some investment decisions have been made in order to improve low-sulphur engine fuels production flexibility and lower the production costs.

- **Economic growth**

GDP increase estimate for 2005 was reported at the level of 3.2% in comparison with 5.3% in 2004 (fixed prices). GDP has recorded an increase mostly due to increase of exports and domestic demand. In accordance with preliminary data calculations, domestic demand in 2005 has increased by 1.9%, while in 2004 it increased by 5,9%. Slower economic growth and low domestic demand in Poland have resulted in a reduced consumption of liquid fuels.

- **Unemployment ratio**

The unemployment ratio has slightly improved in the year 2005. At the end of 2005, the unemployment ratio amounted to 17.6% compared to 19.0% at the end of 2004. High unemployment rate in Poland continues to be one of the factors which limit internal demand and affects the level of the Company's sales.

- **Inflation**

According to data published by the Central Statistical Office ("GUS"), the average annual increase in prices of consumer goods and services in 2005 was lower than in 2004 (2.1% compared to 3.5% respectively). Changes in prices of consumer goods and services cause fluctuations of fuels, which on the other hand, limits the demand among consumers.

- **Mandatory reserves**

The Act on the Amendment of State Reserves and Mandatory Reserves (Journal of Laws No. 266, item 2240) came into force as of 19 December 2005. The Act regulates the issues related to the Poland's accession to the European Union. At present, reserves are made on the basis of production volume, purchases within EU and imports made by an entrepreneur in the previous year, decreased by supplies within EU and exports. From 1999, 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 Ministry 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. makes and maintains mandatory reserves of fuels, semi-products and crude oil.

- **Domestic fuel consumption**

In accordance with estimates, fuel consumption in Poland in 2005, including sales by local refineries and import, reached 13,398 thousand tonnes, which represents a drop by approximately 1% in relation to 2004. In 2005, gasoline consumption has fallen by 5% due to the steadily increasing consumption of LPG (increase by approx. 18%) and significant increase of fuel prices on world markets. Poland is one of the European leaders on liquid gas market, considering the number of vehicles powered with LPG. The development of this market relies mostly on the competitiveness of LPG retail price in relation to gasoline price.

The increase in the consumption of diesel oil (DO) in 2005 is estimated at approx. 6%, which corresponds to the tendency established in May 2003 and is a sign of increased economic activity of local business entities and foreign forwarders in transit through Poland. The increase in the consumption of DO results also from a general European tendency to change the structure of vehicle fleets for vehicles powered with compression-ignition engines. The consumption of DO in 2005 could rise even more, however, high prices of fuels on world markets and in Poland, as well as illegal use of light heating oil (LHO) for traction purposes have a negative impact on this figure.

The consumption of light heating oil in 2005 has dropped by 9%. The main factor which generated the decrease in the LHO demand is gradual removal from use of heat furnaces powered by LHO and low competitiveness of the latter in relation to liquid gas used for heating purposes; the proportion of LHO price to LPG price which amounted to 82% in 2004 has risen to 94% in 2005.

- **Imports of fuels**

The estimated import of fuels to Poland in 2005 has increased in case of diesel oil and light heating oil, whereas import of gasoline has decreased.

It is estimated that imports of all gasoline in 2005 constituted 18% of fuel imports in general, which amounts to 602 thousand tonnes, where imports of domestic refineries amounted to 8% only, the remaining figure representing imports by other entities. According to Agencja Rynku Energii S.A., the biggest imports of gasoline was recorded in Slovakia (43%), then in Germany (41%) and Lithuania (9%).
In accordance with preliminary calculations, an approximate volume of 2,340 tonnes of diesel oil were imported to Poland in 2005, i.e. 14% more then in the previous year. DO imports by local refineries constitute 18%, the remaining figure being imported by independent entities. Imports of diesel oil in 2005 constituted 69% of the overall volume of fuel imports (67% in 2004). The majority of diesel oil was imported from Germany (31%, compared to 16% in 2004), Belorussia (26%, compared to 41% in 2004), Lithuania (13%, compared to 17% in 2004) and Slovakia (13%, compared to 6% in 2004).

In accordance with preliminary estimates, the total imports of light heating oil in 2005 amounted to 437 thousand tonnes compared to 338 thousand tonnes a year earlier, which gives an increase of approx. 29%. Local refineries have imported only 16 thousand tonnes, while the remaining volume was imported by independent operators. In 2005, the majority of light heating oil was imported from Germany (32% of the total LHO, compared to 71% in 2004), Latvia (27%, compared to 0% in 2004), Lithuania (23%, compared to 1% in 2004) and Russia (18%, compared to 12% in 2004).

- **Interest rates**

Exceptionally low inflation rate recorded in 2005 and desirable stimulus for the revival of economy have positively affected the reduction of reference interest rates. At the end of 2005, pawn loan interest rates have reached the level of 6.0%, whereas rediscount of bills amounted to 4.75% (8.0% and 7.0% respectively at the end of 2004).

The LIBOR 3M rate for US dollars has increased by 1.0 pp in comparison to the end of 2004, whereas EURIBOR 3M rate for Euro increased by 0.3 pp. The level of interest rates affects the cost of debt.

- **Characteristic of Polish gasoline retail market**

Polish gasoline retail market in 2005 was influenced by the following factors:

- stabilization within the segment of price-sensitive customers, i.e. those, who look for the best price offers irrespective of the quality and source of the product with a simultaneous development of the quality-sensitive client segment, i.e. those customers, who look for prime quality products against an attractive price, which results from the vehicle fleet renewal;
- further development of gasoline stations located by shopping centers and supermarkets;
- limited share in the market of privately-owned and independent gas stations in connection with the development of network stations (own stations and franchise stations) and introduction of strict environmental regulations, i.e. necessary adjustment investments as regards fuel storage within gas stations;
- stabilization of the segment of non-committed clients, i.e. those, who choose the nearest station when fuel is needed, which corresponds to approx. 10% of the market, as elsewhere in Europe.

- **Agreements for disposal of a portion of assets and liabilities related to purchase of Unipetrol shares**

In 2003-2004, the former Management Board of PKN ORLEN concluded agreements with Agrofert Holding a.s. and ConocoPhillips Central and Eastern Europe Holdings B.V. concerning sale of part of assets and liabilities of the Unipetrol Group companies.

In 2005, the present Management Board, having analyzed all eventual consequences resulting from the above agreements and having consulted recognized independent experts, adopted and presented to the Supervisory Board a proceeding strategy related to execution of the agreements, taking into account the best interest of the Company and its shareholders.

In relation to the agreements concluded with Agrofert Holding a.s., in the second quarter 2005 the Management Board of PKN ORLEN created provisions to cover the potential negative financial effects related to execution of the agreements.

Agrofert Holding a.s. agreed to disclose only portions of the agreements which it also presented at the press conference on 13 September 2005.

On 25 January 2006 PKN Orlen received a copy of a law suit issued by Agrofert Holding a.s. regarding the payment of contractual penalty of EUR 77,266,500. The court proceeding in front of Court of Arbitration by the Czech Chamber of Commerce and Czech Chamber of Agriculture in Prague is currently in progress. The risk related to the above described proceeding has been recognized in these consolidated financial statements.

On 20 February 2006 the Management Board of PKN Orlen has decided to withdraw (in the understanding of Czech commercial code) from the agreements concluded with Agrofert Holding a.s. The reason for such withdrawal was breaching by Agrofert Holding a.s. the terms of the Agreements by allowing DEZA a.s. to execute the share purchase option on AGROBOHEMIE, a.s and ALIACHEM, a.s. shares.

On 3 April 2006 Agrofert Holding a.s. informed via the mass media that it filed another suit against PKN ORLEN to the Court of Arbitration of the Czech Chamber of Commerce and Czech Chamber of Agriculture in Prague. Until the date of preparation of the foregoing financial statements, PKN ORLEN did not receive a copy of the suit. Consequently, both the subject and legal justification of the suit submitted by Agrofert Holding a.s. is unknown to the Company.

In respect of the agreement with ConocoPhillips Central and Eastern Europe Holdings B.V., as at the date of preparation of the report the parties are conducting mediations aimed at amicable settlement of the dispute

- **Sale of shares in NOM Sp. z o.o.**

On 20 May 2003, the Management Board of the Company submitted a put option execution declaration for all Niezależny Operator Międzystrefowy Sp. z o.o. ("NOM") shares owned by PKN ORLEN S.A. to Polskie Sieci Elektroenergetyczne S.A. ("PSE"). The "put" price amounted to PLN 111,500 thousand and was calculated as a sum of nominal value of the shares sold and a cumulative investment premium calculated according to the Agreement dated 8 June 2000 regulating the cooperation between NOM shareholders.

On 20 October 2003, PSE filed a suit to the Court of Arbitration of the Polish Chamber of Commerce (PCC) in Warsaw, regarding the determination of the invalidity of the sale of shares agreement.

On 26 April 2005 the Company received a verdict of the Court of Arbitration of the Polish Chamber of Commerce in Warsaw. The verdict of the arbitration court is unfavorable for the Company. As a consequence the estimations of the Management Board in relation to the assessment of the risk of non-collection of the above receivable were changed. The Company provided an allowance for the receivable in the amount of PLN 111,500 thousand presented in the financial statements for the year 2004.

On 20 May 2005 the Company issued a complaint to the District Court in Warsaw regarding waiving of the above verdict of the Court of Arbitration together with a motion to suspend execution of the verdict. On 26 June 2005 the District Court issued a decision to dismiss the motion to suspend execution.

The District Court set a trial date on 23 March 2006. On 6 April the District Court in Warsaw, XX Commercial Department, issued a verdict in respect of PKN ORLEN S.A. complaint against the verdict of Court of Arbitration of the Polish Chamber of Commerce in Warsaw, dated 14 April 2005, in the case against PSE S.A. regarding sale of shares in NOM. The District Court dismissed PKN ORLEN's complaint and adjudged the return of proceeding's expenses of PLN 7 thousand for the benefit of PSE. The verdict is not legally binding and may be appealed against. The attorney of PKN ORLEN in the described case has issued a motion in respect of preparation and submission of justification of the verdict.

On 29 July 2005, PKN ORLEN demanded that PSE would repay within a week the contractual penalty of PLN 111,500 thousand.
On 8 August 2005 PKN ORLEN received a letter from PSE where PSE stated it was not bound to settle the penalty.
On 15 September 2005 PKN ORLEN filed at the Court of Arbitration of PCC in Warsaw a suit for adjudication of the contractual penalty of PLN 33,453 thousand.
According to the declaration of the Court of Arbitration of 7 December 2005, PKN ORLEN submitted a letter with motions of evidence and the statement regarding eventual suspension of the proceedings. PKN ORLEN's attorney received analogous letter from PSE. The Court of Arbitration did not declare the date of next seating.
As of 31 December 2005, shares in NOM were presented in the financial statements as investments in associates in the net amount of PLN 18 million, after consideration of an impairment of shares allowance based on independent expert's valuation.

Risk factors essential for the operation of PKN ORLEN S.A. are also listed and described in Note 30 and Note 35 in the financial statements.

2.2 Production

In 2005, crude oil processing amounted to 12,569 thousand tonnes and was by 3.1% higher in comparison with the respective figures in 2004. The volume of crude oil processing has increased due to a possibility of raw-material production for the modernized installation of Olefin II plant. In 2005, the yield from fuels amounted to 68.1% in proportion to the crude oil processed, i.e. it dropped by 0.3 pp. in comparison with 2004, whereas the yield from refined products (gasoline, oil, fuel, oil and liquid gas fractions) amounted to 79.8%, i.e. it dropped by 0.8 pp. below the level recorded in 2004. Main factors responsible for the decrease in the yield from fuels and refined products were as follows:

- planned rests of the Soft Asphalt Hydrodesulphurization installation;
- planned rest of the Hydrocracking installation;
- directing gasoline fractions to the modernized installation of Olefin II plant.

The most important events in 2005 in the area of PKN ORLEN S.A. production included:

1. Production of unleaded fuels in compliance with EN 228:2004 requirements for engine fuels effective from 1 January 2005. Permissible levels of two parameters were restricted, i.e. aromatic compound content was reduced from 42% of the volume to 35% of the volume and sulphur content was reduced from 150 mg/kg to 50 mg/kg. In September 2005, the production of new motor gasoline "VERVA 98"

was launched with sulphur content at the level of 10 ppm and special enriching additives was launched.

2. Production of Ekodiesel Ultra diesel oil with sulphur content below 10 mg/kg, which was included in PKN ORLEN S.A. offer from 1 January 2005. The oil meets the highest quality and environmental standards for fuels used in compression-ignition engines in EU countries. Such a low level of sulphur in diesel oil will be imposed as binding in the EU countries in 2009. In September 2005, the production of a new type of diesel oil VERVA ON with cetene number 55 and special enriching additives was launched.
3. Agreement with AXENS (basic design, license and catalyst delivery) for diesel oil stabilizing unit installation from Hydrodesulphurization of Soft Asphalt was concluded in January 2005. The opening of the installation is planned for the end of 2007.
4. The necessity to process the mixture of Rebco crude oil and low-sulphur oil for the purposes of the low-sulphur fuel production for the Power Plant due to the planned rest of HOG installation. The share of low-sulphur oil in the total processed raw material amounted to 1.4% in 2005.
5. In connection with the modernization of petrochemical installations (Olefin II, Butadiene II, Gasoline Hydrogenation and Pyrotol plants) and maintenance rests at other installations: Ethylene Oxide I and II, Glycol I and II and Phenol, the production of petrochemical products was reduced in the period from May to July 2005.
6. In June 2005, technological start-up of the modernized Fragrance Extraction Plant producing benzene and toluene based on raw materials from Reforming V and Olefin II. Production capacity of the modernized Plant is 27.4 t /h for toluene and 22.4 t/h for benzene.
7. In July 2005, start-up of the modernized installation of Olefin II (WOII). Production capacity of the intensified and newly constructed installation system WO II amounts to 702 thousand tonnes of ethylene and 380 thousand tonnes of propylene.
8. Processing of the 400-million tonnes of crude oil on 11 October 2005 in the Main Production Plan in Płock.
9. Completion of all mechanical and installation works, including pressure tests of piping system at the installation of Desulphurization (Sweetening) of Cracked Gasoline in November 2005. In December, all devices were installed and DCS control system was put up. The launching of the installation is planned in the first half of 2006.
10. The Management Board of PKN ORLEN S.A. has decided and the Supervisory Board has approved the decision to built a new Paraxylene installation in Płock with production capacity of 400 thousand tonnes of paraxylene per year and a PTA installation in Włocławek with production capacity of 600 thousand tonnes of PTA per year.
11. Participation in Solomon Benchmarking, Fuel Evaluation Study, and Product Quality Control

Evaluation. The aim of this task was the comparison of the operation of the refinery to operation of competitors. PKN ORLEN S.A. was placed in the world top, i.e in I quartile, comparing to all competitors of the Study and to competitors located in Eastern Europe in the following areas: return on investment, net margin, maintenance index.

2.3 Sales

Net revenue from sales of products, goods and materials at PKN ORLEN S.A. in 2005 amounted to PLN 22,789,106 thousand, which represents 120.3% of the sales revenue generated in 2004. Net revenue from sales of products amounted to PLN 20,409,867 thousand and were higher by 20.9% then in the previous year, whereas net revenue from sales of goods and materials have reached the level of PLN 2,379,239 thousand, i.e. by 15.8 % more then in 2004.

In 2005, PKN ORLEN S.A. has sold 11,657 thousand tonnes of its own products and goods through the wholesale and retail network, i.e. by 2.6% more then in 2004.

The highest volume and share in the total sales of products and goods, including wholesale and retail sale, was recorded for the following products and goods:

- Diesel oil – 3,644 thousand tonnes (31.3%) – increase of the share by 1.2 pp compared to 2004;
- Gasoline – 2,919 thousand tonnes (25.0%) – reduction of the share by 0.3 pp in comparison with the result in 2004;
- Light heating oil – 1,562 thousand tonnes (13.4%) – reduction of the share by 1.6 pp;
- Heating oil III – 624 thousand tonnes (5.4%) – reduction of the share by 0.9 pp;
- Liquid gas – 379 thousand tonnes (3.3%) – increase of the share by 0,5 pp;
- Aircraft fuel JET – 372 thousand tonnes (3.2%) – increase of the share by 0,2 pp.

In 2005, the refined products group has seen an increase of the total sales volumes by 3.7% in comparison with the previous year, including the increased sales of light products by 1.9%.
The sales of the following products has risen:

- Gasoline (by 1.7%) as a result of an increase in the wholesale trade by 8.2%. The increase in wholesale trade of gasoline has resulted from superior export contracts (by 60%) as compared to the previous year, and bigger domestic orders (by 2.6%) in particular, higher orders by franchise gas stations and Concerns;
- Diesel oil (by 6.5%) as a result of increased wholesale network sales. Increase of sales by 8.5% within this area was recorded due to bigger orders from local business partners by 10.3%;
- Aircraft fuel (by 7.8%) in connection with big orders by export clients (increase by 19.7%);
- Liquid gas (by 19.6%) in connection with the increase of retail sales by 21.7% and wholesale trading by 18.3%. The increase within the area of wholesale trading results from a higher supply of liquid gas.

In 2005, PKN ORLEN S.A. has recorded a decrease by 8.0% in the total sales of petrochemical products in connection with the rest of Olefin and Fragrances installations in the analyzed period of time. The most significant drop of sales in comparison with the previous year was recorded in case of the following products: Ethylene Oxide (by 22.2%), Orthoxylene (by 21.7%), acetonnee (by 20.6 %), Phenol (by 18.9%), benzene (by 18.2%).

In 2005, PKN ORLEN S.A has sold 2,038.1 thousand tonnes of fuels (gasoline, diesel oil and LPG) at its own stations, i.e. 3.0 % less then the sales volume in 2004.
In 2005, the volume of retail sales of particular types of fuel amounted to:

- Gasoline – 1,021.0 thousand tonnes;
- Diesel oil – 873.7 thousand tonnes;
- LPG – 143.4 thousand tonnes.

Dynamic growth of the retail sales realized at the stations owned by PKN ORLEN S.A. in 2005 with respect to particular fuels and LPG is illustrated in comparison to the figures realized in 2004 in the table below:

Products and goods	Dynamics 2005 / 2004
Unleaded gasoline	91.6 %
Diesel oil	100.5 %
LPG	121.7 %

In 2005, average annual sales of a single station owned by PKN ORLEN S.A. have dropped by 2.5% compared with 2004 and amounted to 1,968 thousand liters. The reduction fuel sales results from insufficient number of LPG installations at gas stations that would satisfy the steadily growing demand for this type of fuel.

The share of diesel oil and LPG in the total volume of fuels sold has risen in 2005. Those changes reflect fuel retail consumption tendencies in Poland, i.e. increased consumption of diesel oil and LPG with a simultaneous reduction of gasoline demand. At the same time, more and more clients buy LPG gas for vehicles due to lower maintenance costs. Consequently, the share of diesel oil sales has increased from 43% in 2004 to 44% in 2005, whereas the share of LPG has increased from 6% to 8%. The share of fuel sales in the total retail sales has fallen from 51% recorded in 2004 to 48% in 2005.

In 2005, PKN ORLEN S.A. has generated a total margin of PLN 1,194 million through the sales at its own gas stations, i.e. an increase of 10.6% in comparison with the level of margin recorded in 2004. The margin on retail sales of fuels amounted to PLN 942 million and was higher by 10.8% compared to the previous year. The margin on the sales of non-fuel products and services has increased by 10.0% compared to the previous year and amounted PLN 253 million.

Growing dynamics of margin on retail sales results mainly from the realization of assumptions adopted in the retail sales strategy within the area of integrated management of all sales channels, including without limitation, a centralized retail prices management process, changes into the system of transfer settlements and synergy produced as a result of elimination of ineffective decision-making processes. Unfortunately, positive result of the high unit retail margin has been limited by the decline of the volume of sales in comparison with figures recorded in 2004. The increase of the margin realized in 2005 on non-fuel products in comparison with the margin generated in 2004 results from the implementation of guidelines outlined in the retail sales strategy which focuses on the optimization of categories of goods within the scope of trade terms and conditions and selection of the range of products to suit best client requirements and expectations.

2.4 Sales markets and supply sources

Crude oil purchased by PKN ORLEN S.A. in 2005 has been supplied to Płock from Russia. An additional purchase of 217 thousand tonnes of low-sulphur oil was made in connection with the rest of one of the installations at the Production Plant in Płock. The suppliers of crude oil with high sulphur content belong to the group of companies operating on the Russian crude oil market and traders operating on the international refinery market. The share in the raw materials supply to the Company of J&S, BMP and Petraco has exceeded 10% of revenues from the total sales in 2005.

The client structure of PKN ORLEN S.A. has not undergone any significant changes (see Enclosure No.3). As in 2004, two foreign concerns take the leading positions in 2005, i.e. BP Polska (9.0%) and SHELL Polska (6.3%), followed by ORLEN PetroCentrum (5.9%). Moreover, the group of key clients of PKN ORLEN S.A. in 2005 included also: CONOCO Philips (2.9%) and BASELL ORLEN POLYOLEFINS Sp. z o.o. (2.6%). It should be emphasized that in case of all the above-mentioned clients, the share in the total revenues from PKN ORLEN S.A. sales has not exceeded the level of 10%.

As regards oil-derived products 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. – 97 %,
- Butadiene – F.Ch. Dwory – 90%,
- Paraxylene – Boryszew S.A. – 79%,
- Pyrolysis oil waste – Warter – 75%.
- Orthoxylene – Z.A. Kędzierzyn – 67%.

Minor changes in the export sales were recorded in 2005. The value of export share in the total revenues from sales has slightly risen from approx. 4% to 5%.

The structure of sales revenues within the domestic and foreign markets is described in Note 21 to the Company's Financial Statements for the year 2005.

2.5 Structure of the Company's debt

As at the end of 2005, the level of net financial indebtedness of the Company has increased by PLN 1,010 million in comparison to the figure reported on 31 December 2004. As at 31 December 2005, the amount and structure of financial liabilities, which make up the net debt, in terms of their maturity and currency in which they are denominated, including cash and cash equivalents was as follows:

(in PLN million)	Loans and borrowings		Cash and cash equivalents		Net debt	
	2004	2005	2004	2005	2004	2005
Currency (in PLN million)						
USD	709	713				
EUR	702	665				
PLN	3	26	1,303	284		
Total	1,414	1,404	1,303	284	-134	1,120
Maturity:						
Long-term	1,408	1,374				
Short-term	6	30	1,303	284		

Capital expenditures (of PLN 2,794 million) and the dividend paid to the benefit of PKN ORLEN shareholders (of PLN 911 million) amounting to the total of PLN 3.705 million were financed in the following manner:

- excess from current operating activity(PLN 2,312);
- funds from interest calculated and dividend received (PLN 222 million, including PLN 177 million from the dividend);
- funds from repayment of the loan granted by the Company in 2004 to its subsidiary ORLEN Deutschland (PLN 240 million);

- funds from deposits and liquid assets (PLN 931 million).

The Company's most significant investment expense items in 2005 included the acquisition of 62.99% of shares in Unipetrol, a stake of 9.76% of shares in Spolana, purchase of debt of companies from the Unipetrol Group and the related price correction and MTO (minority shareholders buyout) in the total amount of PLN 2 031 million.

The Company's liquidity as a the end of 2005 remains at a secure level. As at 31 December 2005, the following financial resources have been available:

- PLN 479 million under short-term loan agreements;
- PLN 2,509 million (EUR 650 million) under long-term loan agreements;
- PLN 700 million under the Bond Issue Program;
- PLN 284 million in cash and short-term securities.

The Company is a party to 9 loan agreements, 7 of which are of a short-term type (6 in current accounts) and 2 are long-term loan agreements. All the above-mentioned short-term loan agreements in current accounts will be continued.

Long-term loans were granted in foreign currency by consortia of banks, both Polish and foreign. In 2005, the Company has executed another Multicurrency Syndicated Loan Facility Agreement (club-deal) in the amount of EUR 1 billion. The loan was granted for a period of 5 years from the date of execution of the loan facility agreement, with a possibility of extension by two yearly periods. The loan may be paid in four currencies, i.e. in Euro, US dollars, Polish zlotys and Czech crowns.

After the balance sheet date of 31 December 2005, a portion of the financial resources from the recently drawn loan facility was allocated for the repayment of the long-term loan granted in two currencies by a consortium (the recently executed agreement has replaced the previous agreement) used under the agreement dating form 2003 (PLN 1,374 million in accordance with the balance as at 31 December 2005). The remaining available portion of the new long-term loan facility, (i.e. EUR 650 million) will be allocated for financing general operating needs.

Detailed information on maturity dates of loan facilities and debt financial instruments issued by the Company are listed in Note 14 of the financial statements of PKN ORLEN S.A. for the year 2005.

2.5.1 Loans, sureties and guarantees

In 2005, PKN ORLEN has granted a long-term loan facility to its subsidiary ORLEN Transport Kraków in the amount of PLN 2.7 million until 31 July 2009. ORLEN Transport Kraków has allocated the resources from the said loan for the repayment of its financial liabilities towards other subsidiaries from the PKN ORLEN Capital Group and for financing its current operating activity. The loan is repaid in equal monthly installments. As at 31 December 2005, the balance of the said loan facility amounted to PLN 2.4 million.

In the analyzed period, the loan of EUR 60 million extended in 2004 to the benefit of a subsidiary, i.e. ORLEN Deutschland, was repaid with the due interest.

In accordance with the IFRS, the assets and liabilities relating to the Company's Social Fund are included in the financial statements at their net value. As at 31 December 2005, the balance of borrowings granted to the employees and pensioners from the Company's Social Fund amounted to PLN 12,232 thousand, whereas the balance of borrowings granted to the employees of the consolidated Group companies, which have signed the agreement with PKN ORLEN S.A. on conducting common social activity, amounted to PLN 6,115 thousand.

As at 31 December 2005, the Company did not grant any loans to the members of the managing and supervisory bodies or their relatives.

As at the end of 2005, the total value of contingent liabilities for the benefit of related and other entities amounted to PLN 2,222,591 thousand.
The total value of guarantees and sureties granted amounted to PLN 1,354,357 thousand as at 31 December 2005.

The aforementioned contractual penalties result from guarantees and sureties granted by PKN ORLEN S.A. to the benefit of consolidated subsidiaries in the amount of PLN 1,317,417 thousand and to third parties, in the amount of PLN 36,940 thousand. The remaining portion of the short-term liabilities results from the establishment of excise duty security for the transfer of excise duty under the suspended procedure and excise duty calculated on products on stock in the amount of PLN 820,197 thousand and from pending court lawsuits and letters of credit in the amount of PLN 48,037 thousand.

In 2005, a registered pledge on the shares held by the Company in Basell ORLEN Polyolefin of a value of PLN 454 million continued in force. The said pledge was established by the Company in order to secure the repayment by BOP of the current and future contingent financial claims resulting from the loans granted by banks in the amount of EUR 380 million.

2.5.2 Issue of bonds

Under the Bond Issue Program, the Company can issue debt securities until May 2006 up to the total amount of PLN 700 million. In 2005, the Company issue any bonds, and therefore, as at 31 December 2005 the Company did not hold any active issues.

2.5.3 Cash management

The Company's high borrowing power which presents it with a possibility of drawing additional external resources in an inexpensive and relatively quick way, has a positive impact on the Company's financial security.

The Company makes a considerable effort in order to effectively manage cash flows between its bank accounts. In February 2001, a financial resources concentration system has been introduced within the Capital Group. As at 31 December 2005, the Company was using cash-pooling systems for Polish zloty at three banks and cash-pooling system in foreign currency at one bank. The cash-pooling system covers 19 companies from the Capital Group, whereas the whole Group obtains measurable financial benefits while optimizing its financial costs and day-to-day liquidity. Ultimately, certain activities will be carried out in order to cover all Companies from the Capital Group where the Company has a dominating position with the above-mentioned system.

The Company uses comprehensive services of five 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 current structure of banking services, and finally, to cover all companies from the Capital Group by a uniform banking services system and centralized cash management system.

Available cash, secured sources of financing and high borrowing power which characterize the Company secure all short-term financial needs in connection with the capital and property investments. The above-mentioned factors reflect the balance-sheet power characteristic for entities with investment rating.

At present, 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 credit lines;
- deferred payment and debt recovery management;
- financial risk management;
- insurance of transaction risk.

2.5.4 Financial instruments

Financial results of the Company may be subject to fluctuations of market factors, including in particular, quotations of products, foreign exchange rates and interest rates. The Company manages the risk to which it is exposed, limits variability of future cash flows and limits potential economic loss arising in connection with the occurrence events that may have a negative impact on the result of the Company. The policy and strategy for using derivates has been determined and overseen by the Management Board.

In the event of USD/PLN exposition related to operating activity there is a natural hedging, i.e. foreign exchange rate risk on purchase of crude oil is offset against the revenues from the sale of products, the prices of which depend on the USD/PLN exchange rate. As regards other risk exposure, the Company makes decisions as to the appropriate manner and level of securing them.

In the event of EUR/PLN exposition, there were swap transactions concluded in the year 2003 stabilizing cash flows generated by the sales of petrochemical products, the prices of which depend on the EUR/ PLN exchange rate. Maturity date of the above-mentioned hedging transactions falls in 2006. The Company applies the cash flow hedge accounting for the said swap transactions. In connection with the purchase of shares in Unipetrol a.s., it was necessary to secure the CZK exposition with foreign exchange forward contracts. The hedge accounting was not applied in case of those instruments due to their short term of maturity.

The risk management process within the Company operates on the basis of the relevant procedures that have been implemented and the Risk Committee that was set up to control the Company's exposure to risk and to make decisions on recommendations and concluding hedging transactions. In January 2005, the Company's Management Board has approved the revised market risk management policy and it has specified the parameters which determine the level of hedging, its holding period and financial instruments applied.

2.6 Changes of the financial assets held by PKN ORLEN S.A.

As at 31 December 2005, PKN ORLEN S.A. held shares directly and indirectly in the following entities, which it controls, jointly controls or the operation of which it considerably influences:

- 130 subsidiaries;
- 5 joint-venture companies;
- 22 associated companies.

In comparison with the figures recorded in 2004, the number of subsidiaries, jointly controlled companies and associated companies belonging to the Capital Group has increased from 107 to 157 companies in 2005. The total increase in the number of companies and companies subject to consolidation resulted from the take-over of the Czech holding, i.e. Unipetrol a.s.

The structure of the PKN ORLEN S.A. Capital Group in terms of significant stakes of shares held in subsidiaries and other related entities has been outlined in Note 7 to the Company's Financial Statements for the year 2005.

Major changes in structural and capital relations within the PKN ORLEN S.A. Capital Group in 2005 and as at the preparation of this report, include the following events which have occurred in the entitles listed below:

- **Rafineria Trzebinia S.A.**

On 28 January 2005, a change in the amount and structure of the share capital of Rafineria Trzebinia S.A. with its registered office in Trzebinia was registered. The share capital was reduced from PLN 43,042 thousand to PLN 42,995 thousand. The decrease in the share capital of Rafineria Trzebinia S.A. resulted from the Resolution No. 1 of 28 January 2005 adopted by the Extraordinary General Meeting of the company's Shareholders on the redemption of 4,654 own shares of Rafineria Trzebinia S.A. After the decrease of the share capital of Rafineria Trzebinia S.A., the share of PKN ORLEN S.A in the share capital of the company amounts to 77.15%

- **ORLEN Transport Płock Sp. z o.o.**

On 13 April 2005, the incorporation of ORLEN Transport Płock Sp. z o.o with its registered office in Płock (the ”bidder”) with ORLEN Transport Poznań Sp. z o.o. with its registered office in Poznań and ORLEN

Transport Warszawa Sp. z o.o. with its registered office in Mościska (the "target companies") was registered as a result of the transfer of all assets of the target companies to ORLEN Transport Płock Sp. z o.o. (merger).

Consequently, the share capital of ORLEN Transport Płock Sp. z o.o. was increased from PLN 26,420 thousand to PLN 26,430 thousand.

As a result of the above transaction, the share of 97.59 % of shares held by PKN ORLEN S.A. in ORLEN Transport Płock Sp. z o.o. decreased to 97.55 %.

- **NOM Sp. z o.o.**

In April 2005, PKN ORLEN S.A. has received a decision of the Arbitration Court in Warsaw stating that the agreement on the acquisition by Polskie Sieci Elektroenergetyczne S.A. in Warsaw of 168,000 shares in the capital of Niezależny Operator Międzystrefowy Sp. z o.o. from PKN ORLEN S.A. was not legally binding due to the non-performance of the condition precedent, i.e. lack of approval of PSE corporate bodies for the transaction. At the same time, the counter-claim filed by PKN ORLEN SA for the payment of the price for the shares in question was dismissed. Consequently, PKN ORLEN S.A. still holds 168,000 shares in NOM of the total nominal value of PLN 84,000,000, which constitutes 35 % of NOM's share capital. In the financial statements as of 31 December 2005, the shares in NOM were recognized as financial assets at the net value of PLN 18 million, including of the impairment of the said assets assessed on the basis of the valuations carried out by an independent expert.

- **Płocki Park Przemysłowo – Technologiczny S.A.**

On 12 September 2005 the share capital of Płocki Park Przemysłowo – Technologiczny Spółka Akcyjna ("PPPT S.A.") was increased by PLN 7,230 thousand up to the value of PLN 8,230 thousand through a private placement of 723,043 registered shares preferred as to the voting rights intended for the existing shareholder and founding father of the company, i.e. the city of Płock.

Moreover, on 23 August 2005, the Extraordinary Meeting of Shareholders of PPPT S. A. with its registered office in Płock has made a decision on the increase on the share capital by an amount of PLN 7,230 thousand up to PLN 15,461 thousand through a private placement of shares intended for the promoter and shareholder, i.e. PKN ORLEN S.A. in Płock. The increase in the share capital was registered on 23 February 2006.

On 16 March 2006, a subsequent increase in the company's share capital was registered, i.e. from the amount of PLN 15,461 thousand to PLN 25,461 thousand, i.e. by the amount of PLN 10,000 thousand through a private placement of 1,000,000 registered shares preferred with respect to voting rights, 2 votes per 1 share of D series intended in equal parts of 500,000 shares for the existing shareholders – founding fathers – of PPPT, i.e. the City of Pock and PKN ORLEN S.A. Consequently, as a result of the increase in the share capital, the company has the following capital structure:

- the City of Płock, as the founder of the stock company holds 12,730,430.00 shares constituting 50% of the share capital;
- PKN ORLEN S.A., as the founder of the stock company holds 12,730,430.00 thousand shares constituting 50% of the share capital.

- **ORLEN Medica Sp. z o.o.**

On 29 November 2005, the share capital of ORLEN Medica Sp. z o.o. with its registered office in Płock, a subsidiary of PKN ORLEN S.A., was decreased from PLN 13,273 thousand to PLN 8,992 thousand. The decrease in the company's share capital was carried out through the redemption of 8,563 shares of a nominal value of PLN 500 each in order to cover the net loss of ORLEN Medica Sp. z o.o. incurred in 2004 as a result of asset revaluation due to the adoption of International Financial Reporting Standards in place of the previously binding Polish Accounting Standards.

- **ORLEN Laboratorium Sp. z o.o.**

On 1 December 2005, Rafineria Nafty Jedlicze S.A. has transferred to the benefit of ORLEN Laboratorium Sp. z o. o. an amount of 5,000 shares in RAF-LAB Sp. z o.o. constituting 100% of the share capital of RAF-LAB Sp. z o.o. against the payment of the nominal share price of PLN 2,500 thousand in connection with a sale agreement.

- **ORLEN Oil Sp. z o.o.**

On 2 December 2005, PKN ORLEN S.A. has acquired from Rafineria Czechowice S.A. a number of 3,360 shares in ORLEN Oil Sp. z o.o. with its registered office in Kraków in connection with a share sale agreement. Consequently, PKN ORLEN S.A. has increased its share stake from 47.21% to 51.69%.

Moreover, the works aiming at disinvestment from 19 companies belonging to the Capital Group were continued. The latter included mostly leisure-related companies, forwarding companies, servicing and telecommunications entities. Until the date of preparation of this report, stakes of shares in the following entities were sold:

- **ORLEN Centrum Serwisowe Sp. z o.o (former Zakład Urządzeń Dystrybucyjnych Sp. z o.o.)**

On 3 January 2005, the District Court in Opole, VIII Economic Division of the National Court Register, has registered a merger of Zakład Urządzeń Dystrybucyjnych Sp. z o.o. with its registered office in Opole (the "bidder") with the following companies (the "target companies"):

- Serwis Katowice Sp. z o.o. in Katowice;
- Serwis Kędzierzyn - Koźle Sp. z o.o. in Kędzierzyn – Koźle;
- Serwis Kielce Sp. z o.o. in Kielce;
- Serwis Łódź Sp. z o.o. in Łódź, and
- Serwis Rzeszów Sp. z o.o. in Rzeszów,

by way of the take over of the total assets of the target companies by Zakład Urządzeń Dystrybucyjnych Sp. z o.o. Consequently, the share capital of Zakład Urządzeń Dystrybucyjnych Sp. z o.o. has increased from PLN 6,537 thousand to PLN 6,759 thousand. Shares in the increased capital share of the nominal value of PLN 50 each were subscribed to by the existing shareholders of the target companies.
As a result of the increase in the share capital of Zakład Urządzeń Dystrybucyjnych Sp. z o.o., PKN ORLEN S.A. stake decreased from 99.94 % to 96.65% of shares. The registration of the merger of Zakład Urządzeń Dystrybucyjnych Sp. z o.o. with Serwis Katowice Sp. z o.o., Serwis Kędzierzyn - Koźle Sp. z o.o., Serwis Kielce Sp. z o.o., Serwis Łódź Sp. z o.o. and Serwis Rzeszów Sp. z o.o. has resulted in the target companies being stricken off the register.

On 7 April 2005, under a share sale agreement, PKN ORLEN S.A. has transferred the shares in two maintenance companies for a total amount of PLN 1,980 thousand, including:

- 6,974 shares in Serwis Mazowsze Sp. z o.o. of a nominal value of PLN 100 each, constituting 88.5% of its share capital and 88.5% of votes at the shareholders meeting, for the total amount of PLN 700 thousand;
- 12,608 shares in Serwis Nowa Wieś Wielka Sp. z o.o. of a nominal value of PLN 100 each, constituting 99.32% of its share capital and 99.32% of votes at the shareholders meeting, for the total amount of PLN 1,280 thousand.

In case of both transactions, ORLEN Centrum Serwisowe Sp. z o.o. has acquired both companies.
As a result of the sale of shares in the above two companies, PKN ORLEN S.A. no longer holds shares in those entities. It should be noted that PKN ORLEN S.A. holds 99.94% of shares in the share capital of ORLEN Centrum Serwisowe Sp. z o.o.

The above transaction is another stage of the process of share disposal carried out by PKN ORLEN S.A. with respect to companies carrying out auxiliary activities. The scope of activity of the said companies includes the provision of maintenance services. As at the date of transfer of shares, the companies have been employing 89 persons.

- **DW Mazowsze Sp. z o.o.**

On 25 March 2005, under a share sale agreement, PKN ORLEN S.A. has transferred a number of 2,714 shares in Dom Wczasowy "Mazowsze" Sp. z o.o. with its registered office in Ustroń of the nominal value of PLN 600 each, constituting 98.73% of its share capital and 98.73% of votes at the shareholders' meeting for a total price of PLN 1,333 thousand, i.e. PLN 491 per share.
As a result of the sale of shares, PKN ORLEN S.A. no longer holds shares in DW Mazowsze.

- **Naftoport Sp. z o.o.**

On 14 April 2005, an agreement for the sale of 24 shares with a nominal value of PLN 589 thousand each and the total nominal value of PLN 14,136 thousand which, as at the agreement date accounted for 30.77% of the share capital of Przedsiębiorstwo Przeładunku Paliw Płynnych "Naftoport" Sp. z o.o. was concluded between PKN ORLEN, as the seller and PERN "Przyjaźń" S.A., as the buyer.
Consequently, PKN ORLEN holds 17.95% of shares in the share capital of Naftoport. The remaining stakes of shares are held by the following entities:

- PERN "Przyjaźń" S.A. holds 67.95% of shares;
- LOTOS Group S.A. holds 8.97 % of shares;
- Port Północny holds 3.85% of shares;
- J & S Services holds 1.28 % of shares.

- **ZW Mazowsze Sp. z o.o.**

On 20 April 2005, based on the share sale agreement, PKN ORLEN S.A. has transferred a number of 3,932 shares in Zespół Wypoczynkowy "Mazowsze" Sp. z o.o. with its registered office in Łeba, of a nominal value of PLN 1,000 each, constituting 100% of its share capital and 100% of votes cast at the shareholders meeting, for the total value of PLN 3,008 thousand, i.e. PLN 765 per share to the benefit of Przedsiębiorstwo Turystyczne "MAZOWSZE" Sp. z o.o. with its registered office in Łeba.

The ownership of shares was transferred on the purchasers on 16 May 2006. As a result of the above transaction, PKN ORLEN does not hold any shares in ZW Mazowsze.

- **Zawitaj Świnoujście Sp. z o.o.**

On 2 June 2005, based on the share sale agreement, PKN ORLEN S.A. has transferred a number of 8,219 shares in ZAWITAJ Świnoujście Sp. z o.o. with its registered office in Świnoujście, of a nominal value of PLN 500 each, constituting 100% of its share capital and 100% of votes cast at the shareholders meeting, for the total value of PLN 2,900 thousand, i.e. PLN 352.84 per share to the benefit of Grażyna Grabowska, who has been carrying out business activity under the same business name with a registered office in Świnoujście. The ownership of shares was transferred on the purchaser on 30 June 2006. As a result of the above transaction, PKN ORLEN does not hold any shares in ZAWITAJ Świnoujście.

- **Polimex Mostostal Siedlce S.A.**

In September 2005, PKN ORLEN S.A. has sold through a brokerage house a number of 26,455 ordinary bearer shares of F series in Polimex Mostostal Siedlce S.A. with its registered office in Warsaw, a company listed at the stock exchange, of a nominal value of PLN 1 each, representing 0.14% of the company's share capital for the total value of PLN 1,190 thousand.
As a result of the above transfer, PKN ORLEN does not hold any shares in Polimex Mostostal Siedlce S.A.

- **Petrotel Sp. z o.o.**

On 24 October 2005, based on sales agreements, PKN ORLEN S.A. has transferred to Petrotel's employees 463 shares in Petrotel Sp. z o.o. with its registered office in Płock, of a nominal value of PLN 1,000 each, for the total value of PLN 463 thousand. As a result of the above transaction, PKN ORLEN S.A. has reduced its share from 80.65 % to 75.00%.

- **SAMRELAKS Mąchocice Sp. z o.o.**

Under the sale agreement dated 21 March 2006, PKN ORLEN S.A. has transferred 13,449 shares in SAMRELAKS Mąchocice Sp. Z o.o. of a nominal value of PLN 500 each, constituting 100% of its share capital and 100% of votes cast at the shareholders meeting, for the total value of PLN 4,000 thousand, i.e. approx. PLN 297.42 per share, to the benefit of the following natural persons: Bogdan Buczek (6,725 shares) and Józef Porębski (6,724 shares). The ownership of the shares was transferred on the purchasers on 3 April 2006. The book value of the shares recognized in PKN ORLEN S.A. books as f 31 December 2005 amounted to PLN 2,505 thousand shares. As a result of the above transaction, PKN ORLEN S.A. does not hold any shares in SAMRELAKS.

2.7 Profit and Loss Statement

2.7.1 Revenues

In 2005, PKN ORLEN SA has generated a revenue from sales of finished products, goods and materials in the amount of PLN 22,789,106 thousand, which is by 20.3% more than in 2004. The rise by 2.6% in the volume of sales (including the increase of sales of light products by 1.9%, of liquid gas by 19.6% and propylene by 1.4%) was accompanied by an increase in the value of revenues from sales due to a high level of fuel prices quotations on world stock exchanges (an increase of quotation of gasoline by 28.1%, diesel by 14.9%, Ekoterm by 23.3% and air fuel Jet A-1 by 24.6.1%).

2.7.2 EBIT

Gross profit on sales of PKN ORLEN in 2005 amounted to PLN 5,216,617 thousand and it was higher by 10.3% in comparison to the profit on sales recorded in 2004. The increase of EBIT was achieved through skillful adaptation to the favorable market conditions. The increase in margins from quotations of major refining segment products, i.e. increase by 11.0% in quotations of gasoline, by 29.2% in quotations of diesel oil, by o 48.9% in quotations of Ekoterm and by 41.3% in quotations of Jet A-1 aircraft fuel, and increase in the Ural/ Brent oil discount quotation from USD/bbl (-4.12) to (-4.15) have also considerably contributed to the increase of results. The Comprehensive Operating Cost Cutting Program has played an extremely important role in generating the result in 2005, in particular within the area of production and logistics, which resulted in PLN 882 million of savings in 2005 compared to PLN 637 million in 2004 (in comparison with the reference volume, i.e. costs recorded in 2002). In 2005, the Company has seen an increase in the volume of fuel sales through the wholesale network (gasoline, diesel oil, Ekoterm, Jet A-1) by 3.7%. On the other hand, lower (by 3.0%) growth of fuel retail sales was compensated by a 10.5% increase of the total margin generated through gas stations owned by the Company, which has risen to the level of PLN 1,194 million.

The Company has suffered loss on other operating activity in the amount of PLN 505,634 thousand, i.e. by PLN 277,786 thousand more then in 2004). Such significant disproportions are due to the recognition of reserves created towards economic risks on other operating costs for 2005 in the amount of PLN 312,164 thousand. In 2005, the operating profit (EBIT) amounted to PLN 2,693,771 thousand and was higher by 10.3% then the profit generated in the previous year.

2.7.3 Financial activity

In 2005, the profit on financial activity amounted to PLN 464,892 thousand, and was by PLN 270,847 thousand higher then the profit from financial activity generated in 2004. Financial revenues in 2005 amounted to PLN 654,981 thousand and increased in comparison to 2004 by PLN 109,859 thousand. The increase in the revenues resulted from the payment of the dividends in the amount of PLN 177 million (including, PLN 83 million paid by Polkomtel, advance on dividend of PLN 52 million paid by Anwil, PLN 16 million paid by ORLEN Asfalt, and PLN 4 million paid by Koltrans) and PLN 245,696 thousand of discount on Unipetrol a.s. debts acquired by the Company, as well as interest rates on short-term securities, which were higher by PLN 41 million. Moreover, in 2005 the Company has recorded a decrease in financial costs by PLN 160,988 thousand, compared to 2004, which was due to the recognition of PLN 112 million provision for NOM in 2004.

2.7.4 Profit before tax, income tax and net result

In 2005, PKN ORLEN S.A. has generated profit before tax of PLN 3,158,663 (an increase by 19.8% in comparison with 2004). The increase in the profit before tax was accompanied by an increase in advances towards income tax by 21.4%.

In 2005, the Company has generated net profit in the amount of PLN 2,527,214 thousand, which was higher by 19.4% compared with the result in the previous year. In connection with the growing tendency of crude oil prices, the LIFO method in 2005 amounted to PLN (-) 890 million and shaped the net result of the Company calculated in accordance with this accounting method at the level of PLN 1,637 million.

2.8 Balance Sheet

2.8.1 Balance sheet total

As at 31 December 2005, total assets of PKN ORLEN S.A. amounted to PLN 19,210,120 thousand and increased by PLN 2,996,507 thousand, i.e. by 18.5%, in comparison to the figures recorded as at 31 December 2004. On the asset account, property, plant and equipment constitute the main caption amounting to 62.0% of total assets (compared to 61.1% as at 31 December 2004). In equity and liabilities, equity capital represents the biggest figure with 67.0% of total liabilities (compared to 69.5% as at 31 December 2004). When comparing certain balance sheet items as at the end of 2005 and end of 2004, the following issues should be brought to the attention:

– increase in non-current assets by 20.2% to the level of PLN 11,921,862 thousand as a result of an increase by 85.7% in level of shares held in the subsidiaries, i.e. acquisition of Unipetrol against the price of PLN 1,813 million;
– increase in current assets by PLN 996,247 thousand, i.e. by 15.8%, to the level of PLN 7,288,258 thousand resulted mainly from a significant growth by PLN 1,399,088 thousand of inventories caused by bigger volume of crude oil reserves, bigger quantity of finished product stock and the increase in unit crude oil prices and finished products prices. Moreover, the increase in current assets was stimulated by the increased level of trade receivables and other receivables caused by increase of product prices. At the same time, the level of current assets has significantly fallen in connection with the acquisition of Unipetrol a.s. and the related sale of short-term securities;
– increase in equity capital by PLN 1,590,035 thousand to the level of PLN 12,864,703 thousand was mainly connected to the increased net profit generated by the Company in the course of 2005. The distribution of profit for 2004 was carried out in 2005, i.e. a dividend amounting to PLN 911,020 thousand was paid, compared to PLN 278,011 thousand in 2004;
– increase of short-term liabilities by PLN 1,326,347 thousand to the level of PLN 4,042,629 thousand resulted mainly from significant growth of trade and other liabilities and accrued expenses by PLN 989,368 thousand, i.e. by 40.4%; At the same period, the level of provisions has increased by PLN 339,025 thousand, i.e. by 144,0%.

2.8.2 Net financial indebtedness

At the end of 2005, the level of long-term and short-term loans, borrowings and debt securities issued by PKN ORLEN amounted to PLN 1,404,172 thousand and was lower by PLN 9,398 thousand in comparison to the level recorded at the end of the year 2004. The net financial indebtedness as at the end of 2005 (calculated as loans, borrowings and issued debt securities less cash less short-term investments) has increased by PLN 1,009,944 thousand to the level of PLN 1,120,663 thousand in comparison to the figures recorded as at 31 December 2004. The ratio of indebtedness has increased as a result of sale of short-term securities carried out in the course of 2005 and allocation of those funds for the acquisition of Unipetrol a.s. The increase in net financial indebtedness has led to the growth of financial debt to equity ratio (loans, borrowings and debt securities less cash less short-term investments to equity) to the level of 8.7% as at the end of the year 2005, compared to (-) 1.0% as at the end of 2004 (incredibly high level of debt securities). Nonetheless, the said ratio remains at a safe level.

2.9 Cash Flow Statement

2.9.1 Operating activity

In the year 2005, net cash flows from operating activities amounted to PLN 2,311,982 thousand and were lower by 21.0% than cash flows from operating activities recorded in 2004.

The most important factors having a positive impact of cash flows from operating activities in 2005, as compared to the 2004 were as follows:

- increase of the net profit by PLN 410,047 thousand;
- increase in the level of liabilities and accrued expenses by PLN 898,521 thousand, compared to a decrease of the same by PLN 119,021 thousand in 2004;
- increase of provisions by PLN 248,078 thousand in comparison with the figures recorded in 2004.

At the same time, the level of cash flow from operating activities in 2005, as compared to the figures recorded in 2004, was negatively influenced by the following factors:

- considerable increase in the level of inventories by PLN 1,284,621 thousand compared to figures recorded in 2004;
- increase in the level of interest and dividend paid by PLN 109,092 thousand;
- increase of the receivables by PLN 492,427 thousand.

As at 31 December 2005, the net working capital (current assets less short-term investments) amounted to PLN 3,245,629 thousand, as compared to the level of the same at PLN 3,575,729 thousand as at the end of 2004. This resulted from a stronger growth of trade and other liabilities and accrued expenses in comparison with current assets of the Company.

2.9.2 Investing activity

The level of cash flow from investing activity in 2005 was shaped by higher costs of long-term financial investments, i.e. of bonds and treasury bills. The increase of investing activity was mainly due to the acquisition of shares in Unipetrol a.s., the value of which amounted to PLN 1,802 million, whereas in 2004, the financial asset expenditure related mainly to short-term investments of PLN 1,011 million. The net cash flow from the investing activity in the year 2005 amounted to PLN (-) 1,319,192 thousand, whereas in 2004, they achieved the level of PLN (-) 1,827,501 thousand.

2.9.3 Financing activity

In 2005, the net cash flow from the financing activity amounted to PLN (-) 995,273 thousand, whereas in 2004 he same amounted to PLN (-) 873,875 thousand. Cashflow from financing activity In 2005 features higher dividend expenditures (by PLN 633,009 thousand), lower inflow from loans and borrowings (by PLN 463,528 thousand) and lower of repayment of loans and borrowings (by PLN 971,247 thousand).

2.10 Employment

The average employment in 2005 at PKN ORLEN amounted to 5.369 persons, i.e. by 332 persons less then in the previous year. The employment has fallen mainly due to the restructuring of the Company and natural changes of the personnel.

2.11 Publication of financial result forecast

PKN ORLEN S.A. did not publish any forecasts of financial result for the year 2005. Changes introduced in comparison with the financial data published in the condensed financial statements as at 28 February 2006 which have an impact on the financial result and equity capital are included in Note 37 to the unconsolidated Financial Statements.

2.12 Anticipated financial standing

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

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

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

– tendencies of fuel consumption in Poland which is conditioned by the dynamics of economic growth, unemployment ratio, and other factors;

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

– implementation of the strategy announced by PKN ORLEN S.A. and development of the retail sector;
– economic benefits achieved due to implemented and newly introduced optimization programs and benefits from the newly introduced of cost-cutting programs, including Comprehensive Operating Cost Cutting Program, System of Margin Optimization, Risk Management System, Value Based Management, Capex Optimization System;
– effective operation of gas stations in Germany;
– anticipated effects of the optimization of operations implemented at UNIPETROL a.s.;
– expected amendments in fiscal policy with respect to the corporate income tax and excise duty.

III. MAJOR ACHIEVEMENTS IN RESEARCH AND TECHNOLOGICAL DEVELOPMENT

In the year 2005, PKN ORLEN S.A. has carried out a number of research works related to the development of new products technologies, improvement of the quality of products currently manufactured, improvement of production technology and more efficient use of the set of components available for the production. This drive to carry our research was inspired by the Company's high consideration of its clients with respect to the enlargement of the range and improvement of the quality of products and services offered.

The most important achievements include as follows:

- "Analysis of potentials and development of technology for the production of heavy heating oil with low sulphur content" performed by the Institute of Oil Technology in Kraków. The object of the analyses was heavy heating oil with low sulphur content which complies with the requirements previously made, with a particular emphasis on the stability.
- "Development and implementation of technology for the production of a new generation of Power Diesel with enhanced ecological and functional properties" performed by the Institute of Oil Technology in Kraków. Within the framework of the above analysis, physical, chemical and functional properties of the Power Diesel base oil were tested. As a result of the research carried out, production technology of new Power Diesel oil was designed for Płock refinery plant. Power Diesel oil is characterized by cetene number equal or higher then 55 and it is to replace the currently produced ONM Super fuel.
- "Development of technology of production of 98-octane unleaded gasoline characterized by the operation of lower temperature (below 195 centigrade) at the end of the distillation process (TKD) and determination of requirements for gasoline components which could guarantee a temperature below 195 centigrade at the end of the distillation process for all gasoline types". The study was carried out by the Institute of Oil Technology in Kraków. In the course of the analysis, the researchers have developed a technology of gasoline production with the temperature reaching less then 195 centigrade at the end of the distillation process and LOB/LOM 98/88 octane numbers, adapted to the technical facilities of PKN ORLEN S.A. installations.
- "Development and implementation of production technology of aircraft fuel JET A-1 containing a component from Hydrocracking installation, considered present technological facilities of the refining plant" carried out by the Institute of Oil Technology in Kraków. Within the framework of this analysis, properties of two aviation fuel components were examined, i.e. Jet fraction from hydrocracking and HON II hydrorefined component. As a result of the research carried out, a production technology was designed for Płock Production Plant of aviation fuel Jet A-1 where Jet fraction from hydrocracking installation can be used as a production component. The new fuel complies with all parameters of the

ZN-ORLEN-18:2005 norm.

– "Examination of microbiological purity of diesel oil and light heating oil in accordance with new preventive measures for dispensing biocides" carried out by the Institute of Oil Technology in Kraków.
– "Examination of the aspect of mutual relations between engine gas produced by PKN ORLEN S.A., which contains bioethanol and refining additives, with engine gas produced by ORLEN Oil Spólka z o.o. in engine testing" carried out by the Institute of Oil Technology in Kraków.
– "Development of a application for the management of a solvent from AROSOLVAN section of Fragrance Extraction Plant" carried out by the Industrial Chemistry Institute in Warsaw.
– "Optimization of energy at DRW III distillation installation of PKN ORLEN SA" carried out by the Research and Development Centre of the Refinery Industry in Płock.
– "Improvement of production recipes and technology at the laboratory and industrial level PETRYGO Q" carried out by the Warsaw Technical University, Institute of Chemistry in Płock.

IV. DESCRIPTION OF FACTORS CRUCIAL FOR THE DEVELOPMENT OF THE COMPANY

The most important factors that have conditioned the development of PKN ORLEN S.A. in the course of 2005 and had an impact on the financial result include:

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

In February 2005, the Supervisory Board of PKN ORLEN S.A. has presented and the Supervisory Board has approved a new development strategy of the Concern setting new directions for activities until 2009, referred to as "Strategy Based on Creating PKN ORLEN own Value". It was based on achieving three basic targets, i.e. improving internal efficiency and investments, enhancing core business on the domestic markets and monitoring opportunities for development on new markets and areas of activity.
The increase in internal efficiency and generating maximum return on equity invested in the currently held assets are listed among the Company's priorities. The investments in the core business of the Company (refining and retail sales), identification of activities in the petrochemical sector and development of the retail sales network are designed for achieving those priorities. The increase of production potential in refining sector will ensure higher production of diesel oil, which has good business forecast, and will constitute basis for strengthening the petrochemical segment. As for the retail sales, the strategy is aimed at achieving the position of a regional retail sales leader, i.e. at least 30% share in the Polish market until 2009. The restructuring plan of the Capital Group assumes selling entities carrying out non-core activity, simplification and introduction of a transparent structure and implementing segment management system.
Searching for opportunities to develop in new areas will focus mainly on regions with a high potential of growth and all possible investments will be subject to strict financial analyses in view of financial effectiveness achieve profitability ensuring long-term growth of the Company's value.
The strategy determines financial goals to be achieved at the end of 2009:

- EBITDA over PLN 6 billion
- ROACE 17.5%
- CAPEX in years 2005-2009 PLN 1.7 billion (annual average)
- Financial gearing 30-40%
- The rate of dividend paid 30%

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

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, with assumption of macro-economic conditions recorded in 2004:

    a) EBITDA of PLN 10 billion
    b) annual average CAPEX rate in the amount of PLN 3.4 billion
    c) ROACE ratio at a minimum level of 18.5%
    d) financial gearing at the approx. level of 30 to 40%.

2. Launching of upstream activity by PKN ORLEN with a goal of reaching its own raw material base. Consequently, it will be possible for the Company to mark a significant increase of market value and improve its competitive 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 estimated volume of raw material upstream provide for a gradual increase of the raw material from 0.4 million tonnes in 2007 to the level of at least 4.3 million tonnes in 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 next five-year period.

3. The rate of dividend to be paid is conditioned on the Company's engagement in mergers and acquisitions and maintenance of the optimal capital structure. The implementation of this guideline is planned for the year 2007, so as to apply to 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 investment liabilities, PKN ORLEN S.A. plans to create a special Dividend Fund for higher dividend payments in the future.

- **Development of retail sales**

In March 2005, PKN ORLEN S.A. has announced "PKN ORLEN 2005-2009 Retail Sales Development Plan in Poland" which assumes at least 30% share in the Polish fuel market. The principal guideline of the strategy plan is the restructuring of retail network until 2009 and potential acquisitions to strengthen the market position. Another priority objective in 2005 assumed meticulous adjustment of the offer to the needs of each client groups. When working on the new retail sales strategy, the Management Board has listed the maximum adjustment of the offer to the expectations of each client group In the last couple of years, changes shaping the Polish fuel market have introduced a clear segmentation of the market in accordance with the level the client requirements. At the same time, the necessity to introduce two categories of gas stations at a premium and economy standard levels has arisen. Premium offer under ORLEN brand is addressed to the value and quality-sensitive customers. Clients, who look for competitive fuel prices of renown quality were presented in November 2005 with a new network of BLISKA economy standard stations. In the coming 4 years, the Company intends to open a network of about 1,000 economy stations. As at the end of 2005, 30 economy stations were already operating.

As a result, in the third quarter of 2005, PKN ORLEN S.A. has introduced to sales the newest generation of VERVA fuels. The said fuels are produced from carefully selected components in ultra modern installations at the Production Plant in Płock. The quality of those fuels is verified on a continuous basis at each stage of the production. The new offer is available only at ORLEN gas stations and includes both octane-rich gasoline and diesel oil. It represents the Company's exceptional approach to satisfy even the most demanding and quality-sensitive clients who also appreciate high standard of services. It is worth noticing that from the moment of the introduction of the newest generation of fuel its share in the total sales of fuels on Premium gas stations was gradually increasing from 13.9% in October 2005 to 15.5% in December 2005. In the same period, the share of sales of Verva fuel on DODO stations has increased from 16.3% to 19.2% in case of DO and from 12.5% to 13.8% in case of gasoline.

In 2005, intensive works have been carried out in order to outline a new offer for the Company's brand stations, i.e. Petrochemia Płock S.A. The offer includes a proposal for a cooperation on the basis of a franchise agreement under ORLEN and BLISKA brands. In 2005, the DODO station network grew by 40 new gas stations operating under the Company's brand, whereas 7 stations were closed.

PKN ORLEN S.A plans to increase its share of non-fuel products in total margin in the future. Moreover, works on more attractive offers for institutional customers and individual clients within the framework of FLOTA and VITAY program have been launched. In order to evaluate strategic decisions and produce recommendations for future activities, client satisfaction surveys are carried out.

- **Implementation of segment management**

On 18 November 2005, the Management Board of PKN ORLEN S.A. has approved the New

Organizational Rules and Regulations, effective as of 1 January 2006. The New Rules have authorized the implementation of segment management within the Concern and have introduced new elements of the organizational structure, such as segment, support function. Moreover, the Rules have determined the principles of segment management, and defined the criteria for segment separation and segment appropriation of respective companies from the Capital Group. The objective of the above-mentioned changes is further improvement of efficiency on operations within the enlarging and gradually developing Capital Group. Segment management is mostly based on the rule of consistent operation/ cooperation of various companies within the Capital Group, realization of goals and joint liability for the Capital Group results. Segment management means also a considerably higher level of the Concern integration with the Capital Group. The program is aimed at facilitating the coordination of operations of separate business segments. It creates favorable conditions for increasing efficiency on operations and investments and for making use of the scale and synergy between the Capital Group Companies.

New management principles should provide the Company with measurable benefits, such as the optimization of investing and activities planning within the framework of multi-plant production, cost savings within the whole Group through a decrease of unit purchase costs, reduction of a certain support functions in particular companies. In addition, the new concept of segment management will assure the coordination of marketing and PR activities and influence the harmonization of strategic decision and decentralization of operations, as well as optimization of human resources within the Group. From the beginning of 2006, the following six business segments have been separated: Refinery, Oils, Wholesale, Retail, Petrochemical and Chemical. The said segments are managed by executive directors, who took over the task of coordination of operations of a given activity within the Capital Group. As of 1 January 2007, the segment management rules will apply with respect to the Czech capital group.

- **Integration with Unipetrol**

In 2005, PKN ORLEN S.A. has announced the integration strategy with Unipetrol a.s., including the anticipated effects of the implemented optimization of the company's operations and the result for the first period of the strategy implementation. The operating activity optimization program assumes an increase in efficiency and realization of precisely selected targets that will result in the EBITDA increase of no less then 45% in 2008 compared to 2004, provided that the macroeconomic market conditions are similar to those recorded in 2004. The strategy adopted by Unipetrol provides also for the restructuring of the capital group through the sale of particular business activities, which do not fall within the core business activity, i.e. in Aliachem a.s., Lovochemie a.s., Agrobohemie a.s. and Kaucuk a.s.

In order to realize the targets of efficient integration in refinery, petrochemical, chemical and retail segments, 26 Polish-Czech teams have been appointed in order overlook the realization of the tasks defined.

The following guidelines for financial targets have been made:

IRR for the purchase of Unipetrol a.s. shares at the level of	> 33.9%
Consolidated level of EBITDA for Unipetrol a.s. in 2008	> EUR 442 million, including
Result on the Partnership Program	> EUR 138 million

- **Discontinuation of the Comprehensive Operating Cost Cutting Program**

The Comprehensive Operating Cost Cutting Program (COCCP) was running until the end of 2005. The last stage of the Program focused on the reduction in a significant part of operating expenses in all areas of PKN ORLEN S.A. activity. As at the end of the year 2005, the target value of repeated savings determined for COCCP at the amount of PLN 800 million produced additional savings of more then PLN 80 million. Moreover, starting from 1 January 2006, the Company has launched the implementation of OPTIMA Program, focusing on the appropriation of the new savings potential within the operating costs activities and investment outlays until 2009.

- **OPTIMA, operating cost reduction program**

OPTIMA, a program of operating cost reduction has replaced the previously (2004-2005) operating COCCP program. In comparison to the COCCP, OPTIMA is to embrace more operating areas in PKN ORLEN S.A. and it will be introduced in particular companies of the Capital Group.

The implementation of this program will result in a reduction of the operating costs in 2009 by no less then PLN 600 million. Profits of PLN 250 million resulting from the implementation of the cost-saving program will be evident in 2006 already. Until the end of 2007, OPTIMA will guarantee the majority of savings planned, i.e. PLN 420 million, and by the end of 2008 and 2009, PLN 540 million, and no less then PLN 600 million, respectively.

Preliminary analyses show that further improvement of the effectiveness in terms of increased energy efficiency of production processes, or increased power use of key production installations are possible. In the logistics unit, the optimization of the supply schedule planning and monitoring, and optimization of trading inventories and warehousing network is planned. On the other hand, the improvements of retail effectiveness will consist in the limitation of unit retail sale costs. Significant benefits are also anticipated from the increased effectiveness of operation of selected support functions, including accounting services, administration, IT and other. A considerable portion of savings planned until the end of 2009 will consist in various activities within the companies of the PKN ORLEN Capital Group, i.e. approx. PLN 135 million.

The second objective of the OPTIMA Program will be optimization of investment outlays, which should result in no less then PLN 600 million savings in the years 2006-2009, subject to amendments of the investment program, in accordance with PKN ORLEN S.A. development strategy. The savings in this area will result from efficient expenditures, and not from limitations on the scope of the investment.

- **BONUS Project**

In April 2005, the Company has launched the BONUS project. Its objective is mainly to significantly reduce costs related to external purchases and to make the purchases more effective. The Project is carried out with advisory support from A.T. Kearney, which has advised the largest global companies at the implementation of similar projects. In June 2005, the Company has completed the first stage of the project consisting of the review of all external expenses of the Parent Company and selected companies of the Capital Group. Within the first stage of the Bonus Project, the PKN ORLEN Capital Group has resulted in more then PLN 100 million of savings. This result was possible due to the introduction of various innovative solutions in various purchase areas. The savings recorded were generated within basic purchase areas covered by the project, i.e. purchases performed with the technical, chemical, logistics, IT services and telecommunications services area, as well as within the general purchase area, i.e. vehicle fleet. Until October 2005, a group of selected companies from the Polish Capital Group has been engaged in the project implementation. Starting from November 2005, Unipetrol a.s. Group was also introduced to the project.

- **Risk Management System in PKN ORLEN S.A.**

Financial results of the Company may be subject to fluctuations in relation to variation of market factors, in particular, quotations of products, exchange rates and foreign interest rates. PKN ORLEN S.A. manages the risk, to which it is exposed, limits the variability of the future cash flows and reduces potential economic losses arising out of the events that may have a negative impact on the result of the Company. A detailed description on the policy and strategy of using financial instruments has been determined item 1.4.4.

- **Business Academy**

In 2005, human resources department in cooperation with "DOOR", an international consulting company, have drawn up a special training course for the executive management of the ORLEN Group, referred to as the Business Academy. The program assumes the development of managerial skills necessary for the realization of the Company's business strategy for building professional and motivated teams of people. A series of courses will guide all managers employed within PKN ORLEN S.A. and the Capital Group through issues and skills which are sought by modern companies, i.e. from the art of leadership through negotiations, communication, conversational skills with team members and teamwork. The training courses will continue for nearly 14 months from November 2005 to December 2006.

- **Introduction of the Corporate Code of Ethics**

In 2005, PKN ORLEN S.A. has carried out intensive activities timing at introducing changes to the corporate culture and improving the Company image. The objective of those activities was to create a positive image of a company that inspires respect and trust of its employees, customers and business partners and to establish a uniform corporate culture based on the rules of transparency and ethics. One of the tools made available for the establishment of the corporate culture is the Corporate Code of Ethics. It is a comprehensive set of rules of conduct for all employees of the PKN ORLEN Capital Group, covering various areas of the corporate reality.

The Corporate Code of Ethics is being created in connection with other projects running within PKN ORLEN, in particular, within the Human Resources area. The new Code will be binding for all the companies from the Capital Group and all persons employed by the Group, irrespective of their position in the Company. The Code sets forth The Company's targets and operation guidelines, and precisely describes the reality and day-to-day issues, provides rules of conduct for employees in specific, difficult situations and gives information where to he/she can seek assistance. The final contents of the Code is being shaped by a number of consultations. Observation of the rules listed in the Code will be overlooked by the Ethical Rules Ombudsman, who will be specifically appointed to this function. At the same time, the Ethical Committee has been appointed to supervise the selection procedure of the Ethical Rules Ombudsman, in compliance with the respective rules and regulations applicable for the appointment of the Ombudsman and to support the activities of the Ombudsman, including the supervision of the implementation of the Code and dealing with applications on the amendment of the Code with new provisions, based on comments motioned by the employees.

- **MBO**

MBO (management by objectives) is a motivation program that has been well-tried at many companies. It is based on the payment of annual (incentive) bonus depending on the realization of particular, countable annual goals that have been set and quality goals connected with the realization of strategic initiatives. The MBO program supports the realization of financial goals through a cascade-like system of targets set from the top management (the management board) down to the subordinate levels of the management staff. Previous system of discretionary bonuses did not fulfill its role as a motivation system with the management and professionals who are focused on results.

The new motivation program MBO was introduced within the PKN ORLEN S.A. in July 2005 for managers working at PKN ORLEN S.A. and within the Capital Group. Then, in September of the same year it was also introduced at Unipetrol a.s.. In the beginning of 2006, the Company passed on to the second stage of program implementation, where subsequent key positions for the realization of strategic plans of the Concern were set. In 2005, the new motivation program covered 181 employees of PKN ORLEN S.A. and companies from the Capital Group. It is assumed that 702 persons will be covered by MBO in 2006. In addition to the basic MBO program which covers managerial positions, two other processes consisting in the revision of the bonus awarding system within the retail sale and wholesale trading departments have been introduced, referred to as "mini MBO". The said processes bear all characteristics of the basic MBO, however, they offer different solutions in respect of the frequency of bonus payments and packages offered to the employees.

- **New recruitment system**

Being a dynamically developing Company, PKN ORLEN S.A. directs close attention to the recruitment processes carried out. Therefore, it seeks employees with extensive professional background, who are ambitious and persistent in attaining their goals. Due to the fact that the Company has entered on foreign markets, in 2005 PKN ORLEN S.A. was also actively present on the international job market, in particular, in the Czech Republic and in Germany. The above-mentioned activities require adapting the operation of each and every one of the three human resources areas, i.e. Polish, German and Czech, to new requirements in consideration of the requirements of the new participants of human resources-related.

In order to adapt recruitment activities to the principles of the Ethical Code binding at PKN ORLEN S.A., and in view of drawing up uniform principles of cooperation with business partners, both internal and external, works on the Book of Standards have been launched in 2005.

The implementation of Assessment Center methodology constituted an important elements of the human resources Policies of Polski Koncern Naftowy ORLEN S.A. in 2005, regarded both as a method supporting recruitment process, and as a set of tools for evaluating the potential of the Company's employees. The advanced Assessment Center methodology allows to determine the level of competencies analyzed, and therefore, on one side, it makes it possible to carry out an objective assessment with respect to the requirements set within the realized recruitment processes, whereas on the other hand, it allows to reveal the Candidate's strong points and areas which require further development.

- **Competence Development Program**

The Competence Development Program covers persons participating in MBO program and persons employed at offices of the Parent Company who have wished to participate in the project. The basis for planning further development activities is an appropriate identification of the current level of the employees' competence (skills). The evaluation is carried out independently by a senior employee and a subordinate. In the course of preparatory works, the Management Board of the Parent Company has identified four skills applicable to the whole Company, i.e. communication, reaching goals (results), cooperation with other employyes (teamwork) and willingness to develop. A full description of skills was created during workshops, at which employees from the above-mentioned levels of management and their superior have participated. The Parent Company has been cooperating with an external counseling company at the implementation of the program, i.e. ProFirma.

- **Value Based Management**

PKN ORLEN S.A. activities focus on the realization of the principal strategic aim which consists in creating value for shareholders through building and maintaining competitive and structural advantage and achieving the highest standards of operational activity. The tool for the realization of these plans is, among others, the implementation of the Va1ue Based Management (VBM) program. Main objectives of VBM program include: the establishment of a permanent platform for the performance of strategic goals, increase in the financial potential and operational efficiency, enhancing the competitiveness on the domestic market and in the region, and strengthening of the expertise and motivation of the management throughout the entire Capital Group. Value Based Management supports realization of PKN ORLEN S.A. strategy, in particular, the achievement of the leader position in the Central Europe and a constant increase in value for shareholders. VBM orders and facilitates the management of numerous programs being realized in PKN ORLEN S.A., such as margin optimization, wholesale increase and others. VBM implementation means introducing modern management methods at a global level. The central point of the program is that management systems are based on the SVA (Shareholders Value Added).

- **PKN ORLEN S.A. investment program**

Investment procedures carried out in the production and market segments have resulted in the increase of the Company' operational effectiveness in 2005. In 2005, in accordance with the Investment Operations Plan, the following investment projects were accepted, transferred for use and settled within the target budgets:

- Revamping at Olefin II, intensification of IFP, Pyrotol and Butadiene Emission installations. The objective of the project is to gradually launch technological units increasing installation efficiency and ethylene production capacity from 360 thousand tonnes/year to 700 thousand tonnes/year;
- Revamping Infrastructure at Olefin II in order to ensure supplies of raw materials, auxiliary utility products and electric power to Olefin II after revamping, and to ensure expedition of all product lines;
- Intensification of Fragrances Extraction Installation with facilities. The project will increase the capacity of the installation from 480 thousand tonnes/year to 550 tonnes/year, ensure the management of the

BT fraction line from II after revamping, remove benzene from the reformate stream which will produce a decrease of the benzene content in gasoline in accordance with the EU requirements, and increase the quality of the produced benzene and toluene in compliance with ASTM standards, which will increase the sale potential;

- Infrastructure of Polyethylene III and Polypropylene III. The objective of the project is to secure the supplies of raw materials, support products and electric power to the basic installations of Polyolefin III constructed by JV;
- Adaptation of technological furnaces F201 at installations HON II and HON III for their UDT supervision. The project was aimed at modernizing furnaces in order to subject them to UDT supervision, and ensuring further exploitation of the furnaces and installations HON II and HON III, increasing technical safety and decrease a negative impact on the environment by limitation of fumes emission;
- Modernization of H101 and H102 furnaces at Paraxylene Installation. The objective of the project was to modernize furnaces in order to subject them for UDT supervision; to allow further use of the furnaces and paraxylene installation; to increase the technical safety and reduce a negative impact on the environment by limitation of fumes emission;
- Improvement of separation of liquids from wet gas from 1-V-06 at installation DRW VI. The project was to improve the separation of liquids from wet gas at installation DRW VI, to reduce the amount of desalted crude oil and to limit the number of stoppages in the process;
- Construction of three feeding units for auto tanks for toluene, pharbasole and xylene in the Production Plant in Płock. The objective of the investment consisted in moving the sales of the above toluene, pharbasole and xylene solvents from Warehouse No. 13 to PKN ORLEN S. A. Vehicle Terminal.
- A unit for feeding auto tanks with heating oil. This project has enhanced technical, fire and ecological safety at loading of heavy heating oil to auto tanks.
- Development of the warehouse network for antifreeze liquids. The project was aimed to satisfy the market demand through the extension of the range of antifreeze liquids produced: PETRYGO liquid and concentrate, QAL liquid and concentrate;
- Modification of the soft asphalt cooling unit. The project will ensure the safety of installation HOG during its rest of the installation;
- Installation for gasoline feeding systems to railway tanks in the Warehouse No. 74 in Ostrów Wielkopolski. The project will decrease the transportation costs of gasoline on the routes between Płock and warehouses located in the south-western Poland, using the existing product pipeline Płock - Ostrów Wielkopolski;
- Construction of a tank No. 67 within the Blending Plant in order to rebuilt and increase the warehousing capacity for alkylate to 9,600m^3.

Development Program of the Production Plant in Płock provides for the implementation of the following key investments:

In the refinery segment:

- desulphurization of Cracked Gasoline. The aim of the investment is to reduce gasoline production costs per unit with the sulphur content below 50 ppm and to ensure the launching of sulphur-free gasoline (sulphur content below 10 ppm);
- modernization of HON VI (HON VI) installation for production optimization of “sulphur-free” diesel oil with the use of state-of-art catalyst. The modernization will contribute to the increase of reliability and reduction of production costs of diesel oil of sulphur content of 10 ppm,
- construction of reactor for denitrization of crude oil fraction at Soft Asphalt Hydrodesulphurization (HOG) installation. The project is aimed at increasing the quality of the component of Ecoterm light heating oil, reducing costs and increasing production capacity;
- construction of Hydrodesulphurization (HON VII) together with a Hydrogen II installation. A tender procedure has been instituted in order to obtain the relevant license and base project;
- modernization of the Warehouse No. 94 in Świnoujście, Warehouse No. 81 in Kraków–Olszanica, Warehouse No. 82 in Żurawica and Warehouse No. 112 in Bolesławiec. The objective of the investment is to maintain reloading capacities of the warehouses through the modernization of the existing infrastructure and adapting the warehouses to the requirements resulting from the binding regulations ;
- construction of the following warehouse tanks for gasoline: 17 A, B, C and 18 A, B. The deadline for the completion of the investment is scheduled for December 2007. The objective of the investment is to secure the production, blending and expedition of all categories of engine gasoline produced.

In the petrochemical segment:

- construction of a complex for paraxylene (PX) production with a nominal capacity of 400 thousand tonnes/year. The projected deadline for the completion of the investment is estimated for January 2009. The new installation will increase the production capacity of paraxylene (PX) to the level of 600 thousand tonnes/year for PTA terephthalic acid as the basic component for the production of polyesters;
- construction of a complex for terephthalic acid (PTA) production with a nominal capacity of 600 thousand tonnes/year. The objective of the investment is to extend the production chain towards petrochemical products with a high market value. The deadline for the project completion is scheduled for January 2009;

Moreover, the negotiations on the construction of the oil pipeline Odessa-Brody-Płock with a facility allowing to transfer semi-products, i.e. motive fraction have been renewed. A feasibility study financed from EU funds is being prepared by the consortium of SWECO PIC, ILF and Kantor. The insecurity connected with the continuity of natural gas supplies from Russia may influence the scope of investments planned by PKN ORLEN S.A.

- **Loyalty programs**

VITAY program is a loyalty scheme aimed at individual customers visiting ORLEN gas stations on a regular basis. VITAY program was launched on 14 February 2001. Customers making purchases within the program collect VITAY points, which may be subsequently exchanged for fuel or VITAY gifts. As at 31 December, VITAY program had a group of 5.7 million participants, with 1626 gas stations covered by the program, including 1309 stations owned by the Company, 222 brand stations and 95 franchise gas stations. In 2005, a number of more then 632 thousand VITAY loyalty cards has been issued, compared to over 700 thousand cards issued in 2004, whereas average daily sales amounted to 4.25 million liters.

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 service companies, banks, offices of central and local administration and foreign branch offices. PKN ORLEN S.A. offer two kinds of FLOTA cards to its clients, i.e. K-type cards, issued to the driver's name and S-type cards issued for a specific vehicle registration number. Each card can be loaded with individual limit for fuel volume as well as products and services value, and permissible frequency of transactions. Moreover, FLOTA managers can visit a personalized web-page, which provides tools assisting in FLOTA management.

In 2004, owing to cooperation of two strong partners and brands, a new co-branded card was introduced. ORLEN/DKV card is the first fuel card in Europe which combines a microchip technology of Polish FLOTA card with magnetic strip of DKV network. In 2005, there were 13,886 FLOTA cards issued (compared to 7,559 cards in 2004) and the share of FLOTA sales in the total fuel sales through the Company's own gasoline stations increased to 10.9% from 8.8% in 2004.

- **Pursuit of the strategy in the field of mergers and acquisitions**

In 2005, the quest for new, attractive investments in the area of refinery assets was continued. The Parent Company has actively participated in the privatization of the Turkish TÜPRAŞ refinery company. However, after a thorough analysis of the transaction terms of this public tender, on 12 September 2005, the Group has refused to increase financial terms and conditions of its final offer, deeming a higher price level unattractive from a perspective of building the Parent Company's value for shareholders.

In September 2005, PKN ORLEN S.A. was invited to participate in a tender procedure published by Yukos International UK B.V. for the purchase of a stake of 53.7% of shares in AB Mažeikių Nafta Lithuanian refining plant. Having carried out a due diligence report of the Lithuanian company, on 10 November 2005 the Parent Company has made a preliminary offer for the purchase of the shares. On 21 November 2005, PKN ORLEN was admitted to the second stage of the selection procedure and it presented its final offer. On 27 January 2006 PKN ORLEN S.A. submitted a binding offer for acquisition of 53.7% shares in Mažeikių Nafta offered by Yukos International UK BV. The offer included also the declaration for a possible acquisition of shares of Mažeikių Nafta held by Lithuanian Government on the same conditions. The offer was conditional and dependant upon fulfillment of several legal conditions, including formal and technical situation of logistic assets of Mažeikių Nafta.

On 13 April 2006 PKN ORLEN S.A. has submitted a complex offer to purchase 40.66% share in AB Mažeikiu Nafta from the Lithuanian government. In addition, should the Lithuanian government buy 53.7% share currently owned by Yukos International UK B.V., PKN ORLEN has offered to purchase these shares from the Lithuanian government for a price per share equal to the price offered for the 40.66% stake.

According to PKN ORLEN's assessment, the acquisition of MN would allow the Group to strengthen its position in the region and perform further optimization of current operations. Inclusion of MN into PKN ORLEN capital group would enable to utilize synergies from combining of activities performed in neighboring countries. In addition, the purchase of Lithuanian assets would allow development of production infrastructure and a significant increase in processing power of the Capital Group from 21.7 million tones to 31.7 million tonnes.

In accordance with the development strategy announced last year, PKN ORLEN S.A. has been continuously researching other investment possibilities in the area of crude oil processing. First initiatives in the development of expertise and the Company's presence on foreign markets in the area of crude oil prospecting and upstream are at preparatory stage.

Investment plans within domestic market are carried out concurrently. The project consisting in the establishment, together with chemical company DWORY S.A., of a company for the production of ethyl benzene has been resumed. Through its Capital Group, the Concern remains to be a potential participant of the "Great Chemical Synthesis" project for the purchase of shares in Zakłady Azotowe Tarnów S.A. and Zakłady Azotowe Kędzierzyn S.A.

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

Under § 27 (currently §29) of the Rules and Regulations of Giełda Papierów Wartościowych w Warszawie S.A. (the "Warsaw Stock Exchange") and the Resolution passed by the Council of the Stock Exchange on adopting the principles of corporate governance for joint stock companies admitted to trading at stock exchange being issuers of shares, convertible bonds or senior bonds – the Management Board of PKN ORLEN S.A. has made a declaration on 30 June 2005 on applying corporate governance principles. PKN ORLEN S.A. has adopted all principles recommended by the Warsaw Stock Exchange, excluding the rule No. 20, which is applied only in part. The said document was approved by the General Meeting of PKN ORLEN S.A. held on 29 June 2005.

The Management Bard of PKN ORLEN S.A. maintains its standpoint expressed in the declaration dated 30 June 2005.

An updated declaration on PKN ORLEN S.A. adhering to the principles of corporate governance, as adopted by the Warsaw Stock Exchange, will be made public by the Company on 1 July 2006, once the next General Meeting of PKN ORLEN S.A. adopts it.

ADDITIONAL INFORMATION

1. Information on significant agreements

In 2005, PKN ORLEN S.A. has executed the following important contracts:

1. On 3 January 2005, PKN ORLEN S.A. has concluded an annual contract with BP Polska Spółka z o.o. The object of the transaction was the sale of gasoline and diesel fuels to BP Polska Sp. z o.o in 2005. The estimated value of the transaction amounts to approximately PLN 2,377 million gross.

2. On 3 January 2005, PKN ORLEN S.A. has concluded an annual contract with SHELL Polska Spółka z o.o. The object of the transaction was the sale of gasoline and diesel fuels to SHELL Polska Sp. z o.o in 2005. The estimated value of the transaction amounts to approximately PLN 1,905 million gross.

3. On 3 January 2005, PKN ORLEN S.A. has concluded an annual contract with ORLEN PetroCentrum Sp. z o.o. The object of the transaction was the sale of gasoline and diesel fuels to ORLEN PetroCentrum Sp. z o.o in 2005. The estimated value of the transaction amounts to approximately PLN 1,173 million gross.

4. On 12 January 2005, PKN ORLEN S.A. has concluded an annual contract with Rafineria Trzebinia S.A. The object of the transaction was the sale of gasoline and diesel fuel to Rafineria Trzebinia S.A. in 2005. The estimated value of the transaction amounts to approximately PLN 343 million gross.

5. PKN ORLEN S.A. has concluded a contract with Rafineria Trzebinia S.A. The object of the contract was the sale of gasoline for thermal decomposition to Rafineria Trzebinia S.A. in the period form 11 January 2005 to 31 January 2005. The estimated value of the transaction amounted to USD 1,084,257 (approx. PLN 3,369,763).

6. On 14 April 2005, an agreement for the sale of 24 shares of a nominal value of PLN 589 thousand each, of a total nominal value of PLN 14,136 thousand, which as at the date of execution of the agreement represented 30.77% of the share capital of Przedsiębiorstwo Przeładunku Paliw Płynnych „Naftoport" Sp. z o.o. („Naftoport") has been concluded between PKN Orlen as the seller and PERN Przyjaźń S.A. ("PERN") as the buyer has been concluded. As a result of the transaction, PKN ORLEN S.A. holds 17.95% in the share capital of Naftoport. The remaining shares are held by following entities:

   a. PERN „Przyjaźń" S.A. 67.95%
   b. Grupa LOTOS S.A. 8.97%
   c. Port Północny 3.85%
   d. J & S Services Ltd. 1.28%

7. On 24 August 2005, PKN ORLEN S.A. has granted a long-term loan of PLN 2,7 million for a period ending on 31 July 2009 to its subsidiary, i.e. ORLEN Transport Kraków Sp z o.o. The loan is to finance current liabilities of ORLEN Transport Kraków Sp. z o.o. towards other entities from the PKN ORLEN Capital Group and to finance the subsidiary's working capital needs. The loan is to be repaid in equal 48 monthly installments. Interest is calculated at flexible interest rate established at market level. PKN ORLEN S.A. holds 98.41% of the shares in the share capital of ORLEN Transport Kraków Sp z o.o.

8. On 29 September 2005, PKN ORLEN S.A. has executed a contract with Unipetrol Rafinerie a.s. which has granted PKN ORLEN S.A. an exclusive right to supply Unipetrol Rafinerie a.s. with REBCO crude oil from 1 January 2006. The value of turnover from the sale of the material under this contract is estimated at approximately USD 1 billion per year, i.e. approx. PLN 3.239 billion, in accordance with the average US dollar exchange rate published by NBP on 29 September 2005. Moreover, the contract provides also that within two months, the parties will agree upon terms and conditions of

sales of sweet crude oil.

9. On 16 November 2005, PKN ORLEN S.A. has executed a contract with PETRACO Oil Company Limited with its registered office at Guernsey for supplying PKN ORLEN S.A. within the period from 1 December 2005 to 31 December 2006 with 2 700 thousand tonnes of REBCO crude oil from Rosnefti resources. The contract provides for a possibility of its extension by two consecutive yearly periods. Value of deliveries under the said contract until 31 December 2006 is estimated at approximately USD 1,000,000 thousand, i.e. approx. PLN 3,391,500 thousand, in accordance with the average USD exchange rate published by NBP on 16 November 2005

10. On 22 December 2005, PKN ORLEN S.A. has concluded the Multicurrency Syndicated Loan Facility Agreement (club deal) in the amount of EUR 1,000,000 thousand, i.e. PLN 3,833,300 thousand in accordance with the average Euro/PLN exchange rate published by NBP on 22 December 2005. The Agreement has been concluded by and between the following parties: PKN ORLEN S.A. as the borrower and ABN Amro Bank N.V., BNP Paribas, Bank BPH S.A., Bank Polska Kasa Opieki S.A., The Bank of Tokyo-Mitsubishi Ltd., CALYON S.A., Citibank International Plc., ING Bank Śląski S.A., Kredyt Bank S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Société Générale S.A. Oddział w Polsce, as the lenders. The loan was granted for a period of 5 years from the date of execution of the loan facility agreement with a possibility of extension by additional two terms of one year each. A portion of the funds from the newly drawn loan facility was allocated for the repayment of a two-currency syndicated land facility granted under an agreement dated 2003.

11. On 4 January 2006, PKN ORLEN S.A. has executed two contracts which have for the object the sale of gasoline and diesel fuels to Orlen PetroCentrum in 2006. The value of the transaction is estimated at approximately:
    - PLN 1,934,000 thousand in case of the first contract;
    - PLN 376,000 thousand in case of the first contract.

    The aggregate value of both transactions amounts to an approximate amount of PLN 2,310,000 thousand.

12. On 4 January 2006, PKN ORLEN S.A. has concluded an annual contract with BP Polska Sp. z o.o. The object of the said agreement is the sale of gasoline and diesel fuels to the benefit of BP Polska Sp. z o.o. in 2006. The estimated value of the transaction amounts to approximately PLN 3,951,000 thousand.

13. On 4 January 2006, PKN ORLEN S.A. has concluded an annual contract with Shell Polska Sp. z o.o. The object of the contract in the sale of gasoline and diesel fuels to Shell Polska in 2006. the estimated value of the transaction amounts to approximately PLN 2,831,000 thousand.

14. On 27 February 2006, PKN ORLEN has executed with Kulczyk Holding S.A. ("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 Final Sale Agreement was concluded as a result of exercise of the put option by PKN ORLEN, in accordance with the Additional Agreement dated 14 November 2002. The shares sold by PKN ORLEN 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 to the AWSA Holland II B.V. shares being sold by PKN ORLEN to the benefit of Kulczyk Holding will be transferred through the execution of the Share Disposal Agreement which will take place after the fulfillment of the condition precedent set forth in the Final Sale Agreement, in particular after the shareholders' meeting of AWSA Holland II B.V. grants its consent for the said transaction by the date of 28 July 2006, at the latest.
    Under the Additional Agreement dated 14 November 2002, concluded between PKN ORLEN and Kulczyk Holding, in the event PKN ORLEN sells the shares in AWSA Holland II B.V., Kulczyk Holding

is obliged to obtain all necessary permits and consents and assume all liabilities of PKN ORLEN that PKN ORLEN has contracted or took over as the shareholder of AWSA Holland S.A. II B.V.

2. Production

No.	Materials	Crude oil refining (in tonnes)		Dynamics %
		2004	2005	2005/2004
1.	REBCO	12 045 965	12 396 690	2,9
2.	Low-sulphur crude oils	148 103	172 700	16,6
	Total	**12 194 068**	**12 569 391**	**3,1**

No.	Products	Production (in tonnes)		Dynamics %
		2004	2005	2005/2004
1.	**Total benzenes**	2 753 075	2 860 980	3,9
2.	Total diesel oils	3 347 455	3 521 166	5,2
	Total fuels	**6 100 530**	**6 384 151**	**4,6**
3.	Liquid gas	202 925	238 427	17,5
4.	Aircraft fuel	336 607	369 888	9,9
5.	Ekoterm	1 706 332	1 570 383	-8,0
	Total	**8 346 394**	**8 562 849**	**2,6**

No.	Products	Production (in tonnes)		Dynamics %
		2004	2005	2005/2004
1.	Heating oil "3"	678 146	625 222	-7,8
2.	Solvents	17 461	14 916	-14,6
3.	Pharbasole	13 772	12 260	-11,0
	Total	**709 379**	**652 398**	**-8,0**

No.	Products	Production (in tonnes)		Dynamics %
		2004	2005	2005/2004
1.	Ethylene	265 350	245 001	-7,7
2.	Propylene	217 658	220 902	1,5
3.	Butadiene	45 997	40 880	-11,1
4.	Benzene	76 855	64 787	-15,7
5.	Toluene	73 449	79 017	7,6
6.	Orthoxylene	24 058	18 812	-21,8
7.	Paraxylene	31 550	27 673	-12,3
8.	Xylene	19 967	15 039	-24,7
	Total fragrances (items 4 to 8)	**225 879**	**205 328**	**-9,1**
9.	Phenol	52 967	43 511	-17,9
10.	Acetone	33 828	27 723	-18,0
11.	MEG	94 015	79 311	-15,6
12.	DEG	10 621	8 839	-16,8
13.	TEG	346	323	-6,6
14.	Petrygo Q	16 927	12 196	-27,9
15.	Qal liquid /Qal concentrate	379	399	5,3
	Total glycols + radiator liquids (items 11 to 15)	**122 288**	**101 068**	**-17,4**
16.	Sulphur	106 614	111 280	**4,4**
17.	Ethylene oxide	17 845	13 846	**-22,4**

	Total	**1 088 426**	**1 009 539**	**-7,2**

3. Sales

Quantity of products and goods sold:

Groups of products and goods	Sales (in thousand tonnes)		Structure %		Dynamics %
	2004	2005	2004	2005	2005/2004
Gasoline	2 869	2 919	25.3	25.0	101.7
Diesel oils	3 422	3 644	30.1	31.3	106.5
Light heating oil	1 702	1 562	15.0	13.4	91.8
Aircraft fuel JET A-1	345	372	3.0	3.2	107.8
Light products	**8 338**	**8 497**	**73.4**	**72.9**	**101.9**
Liquid gas	317	379	2.8	3.3	119.6
Heating oil III	719	624	6.3	5.4	86.8
Sulphur	106	110	0.9	0.9	103.8
Other refined products	817	1 072	7.2	9.2	131.2
Total refined products	**10 297**	**10 682**	**90.7**	**91.6**	**103.7**
Phenol	53	43	0.5	0.4	81.1
Acetonnee	34	27	0.3	0.2	79.4
Ethylene	265	245	2.3	2.1	92.5
Propylene	218	221	1.9	1.9	101.4
Glycol	106	90	0.9	0.8	84.9
Ethylene Oxide	18	14	0.2	0.1	77.8
Butadiene	45	40	0.4	0.3	88.9
Benzene	77	63	0.7	0.5	81.8
Orthoxylene	23	18	0.2	0.2	78.3
Paraxylene	31	28	0.3	0.2	90.3
Other petrochemical products	190	186	1.7	1.6	97.9
Total petrochemical products	**1 060**	**975**	**9.3**	**8.4**	**92.0**
Total	**11 357**	**11 657**	**100.0**	**100.0**	**102.6**

Sales value as per major clients

Major clients	**% share in income (exclusive of VAT)**	
	2004	2005
BP Polska Sp. z o.o.	8.5%	9.0%
SHELL Polska Sp. z o.o.	5.7%	6.3%
ORLEN PetroCentrum Sp. z o.o.	4.5%	5.9%
CONOCOPHILLIPS Poland Sp. z o.o.	2.0%	2.9%
BASELL ORLEN POLYOLEFINS Sp. z o.o.	2.6%	2.6%
Rafineria Trzebinia S.A.	0.1%	1.3%
PETROLOT Sp. z o.o.	1.4%	1.3%
ORLEN Asfalt Sp. z o.o.	1.0%	1.1%
ORLEN Oil Sp. z o.o.	1.0%	1.0%
ORLEN Gaz Sp. z o.o.	1.0%	1.0%
AGENCJA REZERW MATERIAŁOWYCH	0.3%	1.0%
ANWIL S.A.	1.3%	0.8%
ORLEN PetroTank Sp. z o.o.	2.8%	0.8%
LOTOS S.A.	1.3%	0.7%
ESPPOL Sp. z o.o.	0.6%	0.7%
ANWIM Sp. z o.o.	0.5%	0.6%
ORLEN Morena Sp. z o.o.	0.2%	0.5%
ORLEN PetroZachód Sp. z o.o.	0.7%	0.5%

Share of other clients did not exceed 0.5% in the total income from sales.

4. Supplies

Structure of crude oil suppliers in 2005:

Entity	Quantity (in tonnes)	Share (in percentage)
J&S	6 449 689	50.02
Petraco	2 324 100	18.02
BMP-total	2 065 181	16.02
Wincor	1 012 686	7.85
Totsa	782 905	6.07
Statoil - low-sulphur oil	130 234	1.01
Arkadia - low-sulphur oil	87 133	0.68
KD Petrotrade	42 500	0.33
Total	**12 894 428**	**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 2005 has exceeded a PLN equivalent of EUR 500 thousand:

No.	Name of a business partner	Sales in PLN thousand	Purchases in PLN thousand
1.	ORLEN Gaz Sp. z o.o.	336 503.3	368 622.6
2.	ORLEN PetroProfit Sp. z o.o.	99 206.6	27,117.1
3.	ORLEN PetroTank Sp. z o.o.	173 855.0	12 157.3
4.	Inowrocławskie Kopalnie Soli "SOLINO" S.A.	852.0	30 079.9
5.	ORLEN PetroCentrum Sp. z o.o.	1 142 906.8	26 101.9
6.	PETROLOT Sp. z o.o.	411 403.7	2 185.3
7.	Petrotel Sp. z o.o.	1 661.9	9 051.2
8.	Wisła Płock Sportowa S.A.	38.3	16 053.4
9.	Rafineria Trzebinia S.A.	398 010.6	5 175.3
10.	ORLEN Medica Sp. z o.o	164.7	5 463.2
11.	ORLEN PetroZachód Sp. z o.o.	115 737.5	19 345.2
12.	ORLEN Projekt S.A.	413.6	16 373.3
13.	ORLEN Ochrona Sp. z o.o.	2 155.5	31 983.8
14.	Zakład Budowy Aparatury S.A.	2 531.1	11 080.3
15.	ORLEN Transport Płock Sp. z o.o. (+ ORLEN Transport Warszawa ORLEN Transport Poznań)	45 386.3	24 983.8
16.	ORLEN Automatyka Sp.z o.o.	417.7	19 977.2
17.	ORLEN Wir Sp. z o.o.	505.0	5 742.4
18.	ORLEN Budonaft Sp. z o.o.	1 059.8	51 497.1
19.	Rafineria Nafty Jedlicze S.A.	57 145.8	1 524.2
20.	SHIP-SERVICE S.A.	121 391.3	0.0
21.	ANWIL S.A.	258 994.0	3 371.7
22.	ORLEN Oil Sp. z o.o.	343 002.5	125 147.5
23.	Serwis Mazowsze Sp. z o.o.	328.4	6 916.8
24.	Serwis Nowa Wieś Wielka Sp.z o.o.	259.5	2 487.3
25.	ORLEN Transport Olsztyn Sp. z o.o.	6 324.7	5 623.8
26.	ORLEN Transport Kędzierzyn-Koźle Sp. z o.o.	3 441.1	5 958.4
27.	ORLEN Transport Słupsk Sp. z o.o.	12 451.6	5 604.5
28.	ORLEN Transport Kraków Sp. z o.o.	5 320.3	6 927.8
29.	ORLEN Transport Szczecin Sp. z o.o.	157.2	3 885.9
30.	ORLEN Transport Nowa Sól Sp. z o.o.	780.1	12 287.7
31.	ORLEN Centrum Serwisowe (former Zakład Urządzeń Dystrybucyjnych)	794.4	16 827.1
32.	ORLEN KolTrans Sp. z o.o.	3 814.8	35 240.8
33.	ORLEN Asfalt Sp.z o.o. (former Bitrex Sp. z o.o.)	355 913.0	3 559.6
34.	ORLEN Morena Sp. z o.o.	121 251.2	0.0
35.	BASELL ORLEN POLYOLEFINS Sp. z o.o.	885 535.6	7 662.6
36.	ORLEN Laboratorium Sp. z o.o.	2 188.7	34 281.8

No.	Name of a business partner	Sales in PLN thousand	Purchases in PLN thousand
37.	ORLEN Eko Sp. z o.o.	3 936.7	14 535.8
38.	Unipetrol Rafinerie a.s.	197 347.7	55 224.6
39.	Petro-Oil Lubelskie Centrum Sprzedaży Sp. z o.o.	2 486.1	19 727.9
40.	Petro-Oil Małopolskie Centrum Sprzedaży Sp. z o.o.	3 066.8	3 643.1
41.	Petro-Oil Wielkopolskie Centrum Sprzedaży Sp. z o.o.	6 965.2	18 239.7
42.	Petro-Oil SEEWAX Sp. z o.o.	434.4	6 376.1
43.	Petro - Oil Śląskie Centrum Sprzedaży Sp. z o.o.	0.5	3 012.9
44.	Petro-Oil Dolnośląskie Centrum Sprzedaży Sp. z o.o.	100.1	14 797.6
45.	Petro-Oil Pomorskie Centrum Sprzedaży Sp. z o.o.	59.1	5 927.9
46.	Petro-Oil Łódzkie Centrum Sprzedaży	0.0	2 401.5
47.	EURONAFT Trzebinia Sp. z o.o. (former NaftoTransRem Sp. z o.o.)	1.6	3 070.3
48.	Polkomtel S.A.	10 308.1	40 811.9
	Total	5 136 609.9	1 148 067.1

Transactions with related entities were valuated in accordance with 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 2005 to 31 December 2005, namely of 4.0233 PLN/EUR

In 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.

In 2005, the Company has obtained extended statements on transactions effected with related entities in accordance with the requirements of the amended IAS 24 "Information disclosed with relation to related entities".

	Sales	Purchases	Receivables	Liabilities	Dividend paid
Legal persons *	221,823	411,028	38,103	49,437	-
Natural persons**	781	61	106	-	-

* Transactions in the period where a legal person acted as a member in the Company's supervisory organs.
** We have included transactions under EUR 500 thousand in the reporting period.

In the period covered by the report, 13 persons acted as members of the Supervisory Board.

In 2005, members of the key management did not enter into transactions with related entities within the meaning of IAS 24 "Related Party Disclosures".

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

Remuneration, including profit distribution paid to the Management Board, Supervisory Bard and members of key management in accordance with IAS 24 have been presented in Note 31 of the Financial Statements.

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

In the period covered in these financial statements change of an auditor took place in the Company. In 2004 presented remuneration relates to the agreement dated 10 July 2003 concluded between the Company and Ernst & Young Audit Sp. z o.o. for audit and review of interim stand-alone and consolidated financial statements for the period 2003-2004. On 18 January 2005 agreement with Ernst & Young Sp. z o.o. was concluded for review of stand-alone and consolidated financial statements for the first quarter of 2005.

Beginning from second quarter of 2005 interim reviews and audit of stand-alone and consolidated financial statements are performed by KPMG Audyt Sp. z o.o. according to the agreement dated 30 May 2005 for the period 2005-2007.

	for the year ended 31 December 2005	**for the year ended 31 December 2004**
Audit fees of Ernst & Young Audit Sp. z o.o.*	1,285	2,168
Fees for audit related services of Ernst & Young Audit Sp. z o.o.**	1,451	10,138
Audit fees of KPMG Audyt Sp. z o.o.*	1,537	-
Fees for audit related services of KPMG Audyt Sp. z o.o.**	811	-
	5,084	12,306

* Audit fees include amounts paid to an auditor for professional services related to an audit of the stand-alone and consolidated financial statements of the Parent Company and quarterly and half-year reviews of the consolidated financial statements.

** Fees for audit related services include other amounts paid to an auditor that include services performed in connection with audit or review of financial statements, but not disclosed under "Audit fees" position.

In 2005 the procedure for additional orders for an auditor and auditor's related parties was set up in the Parent Company. The Audit Committee of the Supervisory Board makes decisions about ordering additional services from an Auditor.

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

The Company has concluded contracts with the executive management which provide for the payment of compensation in case such executives are dismissed from their positions or the contract expires and they are obliged not to perform competitive activities.

The contracts concluded between the Issuer and the executive management foresees the payment of compensation in relation to:

- termination of the contract resulting from the dismissal of the Board member – the amount of the compensation do not exceed 18 basic monthly salaries,
- non-competitive activities obligation of the former Board member – the amount do not exceed 12 basic monthly salaries

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 the Parent Company are appointed and dismissed by the Supervisory Board. In the period from 1 January 2005 to 31 December 2005, 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, General Director from 1 October 2004.
Wojciech Heydel	Vice-President of the Management Board from 1 November 2004 Vice-President of the Management Board, Retail Sales Director from 2 November 2004 Vice-President of the Management Board, Sales Director from 1 July 2005
Cezary Smorszczewski	Vice-President of the Management Board from 1 November 2004. Vice-President of the Management Board, Strategy and Capital Investments Director from 2 November 2004 to 9 August 2005 Vice-President of the Management Board, Capital Investments Director from 9 August 2005
Paweł Szymański	Member of the Management Board from 18 October 2004 Member of the Management Board, Chief Financial Officer from 2 November 2004
Jan Maciejewicz	Vice-President of the Management Board, Cost Management and Information Technology Director from 1 December 2004
Dariusz Witkowski	Member of the Management Board from 1 June 2005 Member of the Management Board, Organizational Structure Director from 9 August 2005
Andrzej Macenowicz	Vice-President of the Management Board, Human Resources and Administrative Director from 2 November 2004 to 29 June 2005
Janusz Wiśniewski	Vice-President of the Management Board, Director of Operations form 2 November 2004 to 29 June 2005

Supervisory Board Members of the Parent Company are appointed by the General Meeting of Shareholders
In 2005, the Company's Supervisory Board was composed of the following members:

Maciej Gierej	Member of the Supervisory Board from 21 February 2002 to 28 June 2002 Chairman of the Supervisory Board from 28 June 2002 to 8 April 2004 Member of the Supervisory Board from 5 August 2004
Michał Stępniewski	Member of the Supervisory Board from 24 June 2004 to 14 November 2005 Vice- Chairman of the Supervisory Board from 12 April 2005 to 30 June 2005
Raimondo Eggink	Member of the Supervisory Board from 5 August 2004

Krzysztof Lis	Member of the Supervisory Board from 5 August 2004 to 31 January 2005
Małgorzata Okońska - Zaremba	Member of the Supervisory Board from 5 August 2004
Piotr Osiecki	Member of the Supervisory Board from 5 August 2004 to 14 October 2005
Ireneusz Wesołowski	Member of the Supervisory Board from 5 August 2004 Secretary of the Supervisory Board from 16 August 2004
Krzysztof Żyndul	Member of the Supervisory Board from 5 August 2004 to 30 March 2005 Vice- Chairman of the Supervisory Board from 16 August 2004 to 30 March 2005
Andrzej Olechowski	Member of the Supervisory Board from 29 June 2005 Vice- Chairman of the Supervisory Board from 7 July 2005
Adam Sęk	Member of the Supervisory Board from 29 June 2005
Adam Maciej Pawłowicz	Member of the Supervisory Board from 1 December 2005

10. Number of shares in the Company and other entities of the Capital Group held by members of the supervisory and managing bodies

As at 31 December 2005, Raimondo Eggink, Member of the Supervisory Board, held 2950 shares in PKN ORLEN S.A.
As at 31 December 2005, Adam Maciej Pawłowicz, Member of the Supervisory Board, held 365 shares in PKN ORLEN S.A.

11. Shareholders in PKN ORLEN S.A.

Shareholding structure of PKN ORLEN S.A. as at 31 December 2005:

	Number of shares	Number of votes	Par value of shares	Share in the share capital
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 depositary)	48 467 578	48 467 578	60 584 473	11.33%
Other	261 531 287	261 531 287	326 914 109	61.15%
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.

Management Board Report on Operations
of Polski Koncern Naftowy ORLEN Spółka Akcyjna
for the year 2005
submitted by the Management Board composed of:

....
Management Board President
Igor Chalupec

.... **Management Board Vice-President** Cezary Filipowicz	.... **Management Board Vice-President** Wojciech Heydel	.... **Management Board Vice-President** Jan Maciejewicz
.... **Management Board Vice-President** Cezary Smorszczewski	.... **Management Board Member** Krzysztof Szwedowski	.... **Management Board Member** Paweł Szymański

Płock, 27 April 2006