

## **Letter from the President of the Management Board of PKN ORLEN S.A.**

Ladies and Gentlemen,

2005 was one of the most important years in the history of the PKN ORLEN. For over 14 months, we have been implementing a strategy whose target is to ensure the doubling of the Company's value by 2009. We would like to achieve that goal by fundamentally changing our corporate culture, modernising our management processes, improving efficiency, and executing new projects, which also includes our plan for further expansion in Central, Eastern and Southern Europe.

In 2005, we assumed control over Unipetrol, a fuel and petrochemicals holding company, and the third largest Czech company in terms of revenue. This has been not only our largest investment, but also the largest foreign acquisition by a Polish company, unprecedented in the history of the Polish economy. Immediately upon completion of the acquisition, we took measures aimed at increasing the value of Unipetrol. The Partnership Programme implemented in the autumn of 2005 covered the key business, functional and support areas of both partners. Twenty-six teams, comprising Czech and Polish experts, developed almost 200 initiatives. The targets set for 2005 were achieved, and the first effects of the Partnership Programme produced EUR 28m in additional revenue and savings. Our activities as the strategic investor were appreciated by the capital markets. From May 24th 2005, the day of acquiring the shares in the Czech company, to April 27th 2006, Unipetrol's share price grew by 86.68%, from CZK 144,10 to CZK 269.

At the beginning of 2005, we adopted the "Company Value Creation Strategy for 2005–2009". We based the assumptions of the strategy on three pillars: the continuation of the efficiency-enhancing measures, strengthening of the core operations in our home markets, and an active search for development opportunities in new markets, including M&A opportunities.

In the first pillar, which is pivotal for the value creation process, during the initial phase of the strategy implementation we placed particular emphasis on the restructuring of our retail network. We launched a new, economy station network, BLISKA, and also introduced a new fuel brand, Verva, to be sold throughout the ORLEN premium network. We thoroughly reorganised the regional retail structures by implementing a sales management programme, centralising and improving the auxiliary functions, as well as optimising employment. As a result of our determined actions, we managed to halt the decline of our market share at a level of 27%. At the same time, relative to the previous year, non-fuel sales grew by 1.4% and the number of participants in the FLOTA loyalty programme increased by 20%.

We completed a number of key investment projects in the petrochemicals business, including the modernisation of the Olefin II Production Plant and the construction of new polyethylene and polypropylene units at Basell Orlen Polyolefins, a member of the ORLEN Group. Our production plant processed 12,569m tonnes of crude oil, up by 3.1% over 2004. October marked a momentous event for the Company as we processed the 400 millionth tonne of crude oil. That number is a symbol of 42 years of the Plock refinery's activities; it also represents our significant share in the Polish oil industry.

Last year, for the first time ever, we performed an independent, professional assessment of the Plock production plant through a study by Salomon, which was designed to evaluate the refinery's performance against its competitors. PKN ORLEN was ranked among the top companies in the world (the first quartile), among both the participants in the Study and the Company's competitors from Western Europe in the following fields: return on investment, net margin, and the maintenance and repair index. As far as operating expenses are concerned, we were ranked in the second quartile. In other fields, including utilisation of refinery's throughput capacity, mechanical availability, and the staff and power indices, the Company was classified in the fourth quartile against all other participants of the study and its Western European peers. The results of the study provided an incentive to undertake activities aimed at improving those indices.

Last year, we began implementation of new projects, which were designed to ensure continued growth and further improvement in the Company's efficiency. Measures in that field included the OPTIMA cost reduction programme, further stages of the retail network development and tasks related to the optimisation of the Group's activities, including the launch of the management by segment system.

From 2005, the key members of the ORLEN Group now apply a uniform, consistent and transparent remuneration and incentive system for members of the Management Boards and management staff based on the MBO system (management by objectives). As in the case of the most highly rated corporations, the key parameter in the management assessment system is considered to be Shareholder Value Added, as established for the entire ORLEN Group. This specific measure can be used to evaluate the results achieved by the management staff acting as a team; it also encourages managers to look at their decisions and projects in the context of the entire enterprise.

As part of the implementation of the strategy's second pillar, we are planning to increase capital expenditure in the coming years; it will amount to as much as PLN 3,4bn on average each year until 2009. The ROACE for the Company will increase to over 18.5%, assuming constant 2004 macroeconomic conditions. This capital spending is planned to be invested in high yield ventures, including ventures in the petrochemicals business; we plan to construct propylene (PX) and purified terephthalic acid (PTA) units and to increase the throughput capacity of the olefin unit at Chemopetrol. Refining investments are to include the following projects: Diesel Oil Hydrotreatment (HON VII) project, the product pipeline connecting Ostrów Wlk. and Wrocław, and efficiency improvement at Unipetrol's hydrocracker unit. Other projects include the construction, modernisation and re-branding of service stations in Poland as well as implementation of the restructuring plan for Orlen Deutschland.

One of the key elements of the third pillar in the updated strategy is the commencement of upstream activities with a view to ensuring our own feedstock supplies. Implementation of these plans and incorporation of the upstream business into the existing value chain of PKN ORLEN will help to significantly increase the Company's value and strengthen its competitive position.

As part of the execution of the actions provided for in the third pillar – i.e. searching for M&A opportunities in the European oil and fuel industry – we entered the competitive tender for a 53.7% equity interest in Lithuania's Mažeikių Nafta (MN) offered by Yukos International UK B.V. (the bid was submitted on January 27th 2006). On January 13th 2006, we also proposed to buy the 40.66% of MN shares held by the Lithuanian government. We are positive that our offering is ahead of the competition, and that it has all the necessary guarantees, and – if selected by the sellers – that it will ensure the long-term and efficient development of both companies and the two Baltic markets.

Our 2005 financial results were very good. In 2005 PKN ORLEN's net profit was PLN 2,527m.

Revenue rose by over 20% compared with 2004 as a result of higher sales, and favourable market environment for refinery and petrochemical products

We successfully completed our 2003–2005 cost savings programme, which brought savings of PLN 882m. In this way, we exceeded the planned targets by 10%. The fixed costs of our Company fell by almost 4% year on year, while personnel costs fell by over 17% (with staffing levels reduced by 5.8%).

Compared with the previous year's results, our 2005 EBITDA grew by 4.0%. Assuming the same general economic conditions as those prevailing in 2004, the figure would have shown an increase of 7.4%. A similarly good achievement was recorded with respect to ROACE, which stood at 16.7% in 2005, compared to 17.4% the year before.

Taking into account the results of programmes currently underway and of the new initiatives launched in 2005, we have updated the assumptions underlying our 2006–2009 strategy. Our financial targets have been set higher – we expect that the 2009 EBITDA, based on the stable macroeconomic conditions of 2004, will reach ca. PLN 10bn. Assuming the general economic conditions of 2004, ROACE will rise to over 18.5%.

When updating our strategy, we also formulated assumptions for a change in dividend policy, so that an optimum capital structure, reflecting our investment plans and capacity to provide for acquisitions, is maintained. The dividend will in future be calculated based on the ratio of free cash flow to equity (FCFE). We will seek to ensure dividend payments of the order of at least 50% of FCFE.

With the consistent and effective fulfilment of our declared objectives and intentions, as well as our ambitious plans for the future, PKN ORLEN is today the strongest Polish brand and one of the most desired employers, which is as good an indication of the extent and momentum of the implemented changes as any financial data.

This was proved, *inter alia*, by the fact that in 2005 PKN ORLEN was ranked among the leading companies in terms of compliance with the corporate governance standards recommended by the Warsaw Stock Exchange. In the ranking prepared as an initiative of the Polish Corporate Governance Forum, the Company received an A-rating.

We also received a special award in the prestigious annual ranking published by the *Parkiet* daily. The organisers of the ranking appreciated the very high quality of PKN's investor relations by awarding the Company the special *2005 Bull and Bear* title.

In 2005, the main plant in Płock received the title of *The Best Refinery of the Year in Central and Eastern Europe*, awarded by an international body for the Company's strategy, its infrastructure, technological innovativeness and development plans. It was a privilege and honour for us, even more so as such an honourable title was awarded by the representatives of our sector during the eighth Central and Eastern European Refining and Petrochemicals Conference.

Our active presence in the life of the local community, such as providing regular support for the Wisła Płock Sports Club and the Płock Industry and Technology Park or, through the *ORLEN Dar Serca* Foundation, for the charity organisations working for the poor, is a sign of our responsibility for the environment in which we operate. We also established the *Fundusz Grantowy dla Płocka* Foundation whose main objective is to provide support for non-governmental organisations operating in Płock. PKN ORLEN has also for many years acted as a patron for both cultural events and artists. In 2005, the Company granted a scholarship to Rafał Blechacz, the very talented Polish pianist and the winner of the 15th International Fryderyk Chopin Piano Competition.

We are satisfied with 2005 not only because of our financial performance. As a starting point for all our management efforts which commenced in the autumn of 2004, we adopted a plan for eliminating political interference with the affairs of the Company and its internal governance. The consistent changes in the management of human resources, the ORLEN Group, our external and internal communications and, most importantly, the beginning of the process for changing the corporate culture by taking such steps as the implementation of a simple and clear Code of Ethics, are a clear example of combining business objectives with ethical and social goals.

To conclude, I would like to thank all the employees of the PKN ORLEN for their everyday efforts contributing to the value of our Company. I would also like to thank the Supervisory Board for their intensive work, support and trust, which has allowed the Management Board to carry out the Company's mission.

I count on further support from our Shareholders, the Supervisory Board and our Employees, as well as on continued kind approach and loyalty of our Customers.

Igor Chalupec  
President of the Management Board  
PKN ORLEN S.A