

16 March 2011

Update


Fuels
Poland

Current price	PLN 50.00
Target price	PLN 41.60
Market cap	PLN 21.4bn
Free float	PLN 15.5bn
Avg daily trading volume (3M)	PLN 117.2m

Shareholder Structure

State Treasury	27.52%
AVIVA OFE	5.08%

Others	67.40%
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Sector Outlook

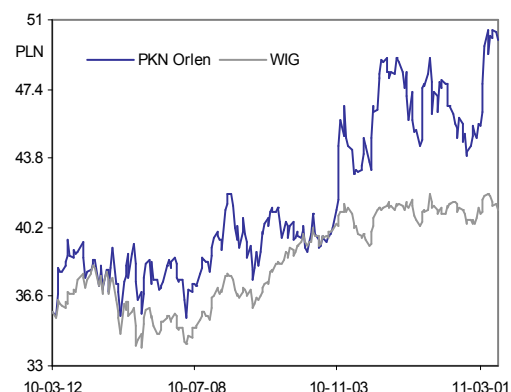
Refining margins have returned to their pre-crisis levels, however, OECD demand remains weak while refiners across the world are about to launch new capacities, making for grim prospects for oil refiners in the next few years. Speculative hikes in oil prices are putting an additional squeeze on refining margins.

Company Profile

PKN Orlen is the largest refinery in the CEE region, with 28 million tons of annual capacity. In addition to crude refining, PKN Orlen is also active in the chemicals industry via its subsidiary Anwil, and in petrochemicals through BOP. In 2005, PKN Orlen took over the Czech "Unipetrol" group, followed by the acquisition of Lithuania's Mazeikiu Nafta in 2006.

Important dates

21.04 - Q1'11 earnings estimate
29.04 - Q1'11 earnings report

PKN Orlen vs. WIG

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PKN Orlen

PKNA.WA; PKN PW

Sell

(Downgraded)

Market Optimism in a Weak Environment

Since we issued our negative rating for Orlen, the stock price has risen by 7% despite a clear turn for the worse in the macroeconomic environment. The market seems to be ignoring the very unfavorable crack spreads, the rising cost of petroleum use for internal needs and the announcement of maintenance downtimes at the Plock refinery, which will depress the profits for H1'11. Investor optimism may soon be cooled down, however, by the publication of LIFO earnings for Q1, which are expected to be weak, also because of the decline in the "inland margin" due to intensifying domestic competition. A high gain on inventory revaluation will hardly compensate for this, all the more so that without another sale of mandatory reserves it will be charged against operating cash flows in full. Note also that the clear reduction in net debt attained at the end of 2010 thanks to working-capital changes is not sustainable in the medium term and is equivalent to the reclassification of loans as another category of liabilities. We are downgrading our rating to sell while increasing our target price slightly to PLN 41.6 per share (the impact of Polkomtel valuation).

Very disadvantageous macroeconomic trends, downtimes

The current optimism in the petroleum market is not paired with positive trends in the refining segment. Product margins are considerably lower than last year, which is not offset by the higher Urals/Brent pricing differential stemming from a short-term disequilibrium in the market for light crude caused by downtimes on Shell's rigs and lack of supplies from Libya. In the two initial months of the year, Orlen's integrated benchmark margin was 7% lower than in the same period of 2010 and a whopping 25% lower than the average for 2010. These calculations are even more worrying if we remember that they ignore the rising cost of petroleum use for own energy use, the very low crack spreads on asphalts and the weakening inland premium (estimated at PLN 990m in 2010). In addition, the Management's maintenance plans for 2011 cannot be ignored, as they are more extensive than last year's (additional 100 "maintenance days", plus the fact that the work will be carried on key refining installations, which may be particularly painful at the time of high negative crack spreads on HSFO).

True impact of the new mandatory reserve law

As work on the new mandatory reserve law is nearing its end, expectations that the frozen cash will be freed have been rekindled. However, what government's proposals really mean for Orlen is that instead of maintaining the property required for operations on its own balance sheet it will become a "lessee"; instead of maintaining and financing the property, it will pay a "lease". Therefore, from the point of DCF valuation the impact of the new law is close to the current stock ticket contract, and it is not possible to simply add the discounted stocks (taking into account the fact that they will be gradually bought out) to the Company's valuation.

(PLN m)	2008	2009	2010	2011F	2012F
Revenue	79 533.0	67 928.0	83 547.4	99 520.8	96 665.0
EBITDA	888.4	3 665.0	5 545.7	4 847.5	4 933.3
EBITDA margin	1.1%	5.4%	6.6%	4.9%	5.1%
EBIT	-1 603.0	1 097.0	3 123.0	2 164.6	2 191.6
Net income	-2 505.2	1 308.7	2 371.7	1 737.0	1 843.5
DPS	1.62	0.00	0.00	1.15	0.87
P/E	-	16.3	9.0	12.3	11.6
P/CE	-	5.5	4.5	4.8	4.7
P/BV	1.2	1.1	1.0	0.9	0.9
EV/EBITDA*	41.3	9.4	5.7	6.8	6.6
DYield	3.2%	0.0%	0.0%	2.3%	1.7%

*excluding Polkomtel and strategic reserves

Q4 2010 Results and 2011 Outlook

PKN Orlen's Q4 2010 consolidated operating profit of PLN 747m added to the full-year EBIT figure of PLN 3.1 billion. Before discussing segmental contributions, we want to point out that this result was owed largely to LIFO effects which amounted to PLN 1.4bn for the full year and PLN 499m in the fourth quarter. PKN's financial operations in the fourth quarter (including PLN 37m dividends from Polkomtel) generated a PLN 49m loss which included net interest expenses in the amount of PLN 70m and negative F/X differences (related to euro loans and other balance-sheet items). The full-year financial losses resulted in a small, PLN 53m charge against pre-tax profit as interest expenses (PLN 325m net) were offset by positive F/X differences (PLN 34m) and the profits of Polkomtel consolidated using the equity method (PLN 252m). After tax paid at an effective rate of 20% and PLN 84m minority interests, the full-year consolidated bottom-line profit amounted to PLN 2.37bn, implying a P/E ratio of 9.1 estimated based on the current market cap (after adjustment for inventory revaluations, the ratio is 17.6).

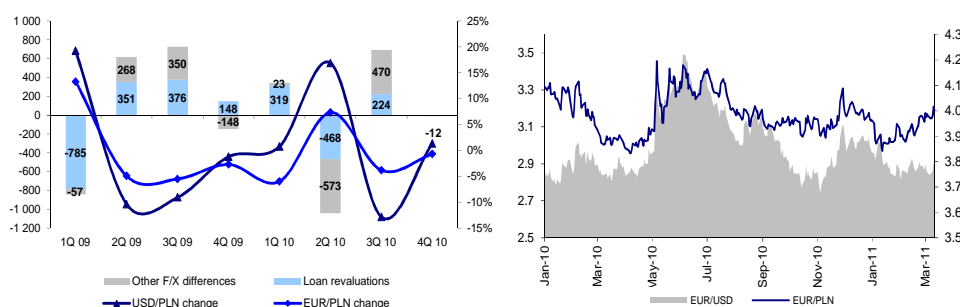
Consolidated historical quarterly results

	1Q 08	2Q 08	3Q 08	4Q 08	1Q 09	2Q 09	3Q 09	4Q 09	1Q 10	2Q 10	3Q 10	4Q 10
Revenue	17 938	22 093	23 057	16 445	14 702	16 770	18 649	17 807	17 442	21 068	22 106	22 931
EBIT	565	1 646	512	-1 965	-320	661	423	334	464	1 123	789	747
Refineries	330	1 407	184	-1 778	-116	770	137	333	426	983	462	610
LIFO effect for refineries	355	845	-316	-2 713	-292	890	271	160	375	453	60	469
Retail	70	109	247	165	87	223	363	207	75	216	309	224
Petrochemicals	187	35	104	-97	-162	-180	32	17	85	84	132	175
LIFO effect for petchem	-17	9	1	-112	46	38	36	3	40	-12	-7	30
Chemicals	91	73	87	33	90	8	34	-34	20	38	10	-58
Other	0	74	29	33	0	0	0	0	0	0	0	0
Unattributed	-113	-52	-139	-321	-219	-160	-142	-189	-142	-198	-124	-204
LIFO EBIT	227	792	827	860	-74	-267	116	171	49	682	736	248
D&A	587	607	607	690	651	656	627	633	601	612	614	596
EBITDA	1 152	2 253	1 119	-1 275	331	1 317	1 050	967	1 065	1 735	1 403	1 343
Financial operations	225	491	-388	-1641	-951	674	685	-65	327	-1005	675	-49
Pre-tax profit	790	2 137	124	-5 968	-1 271	1 335	1 108	269	791	118	1 463	698
Net profit	626	1 740	21	-4 893	-1 095	1 171	931	302	593	-5	1 242	541

Source: PKN Orlen, estimates by BRE Bank Securities

As mentioned, forex volatility had little impact on PKN Orlen's financial income in 2010. This does not mean, however, that the refiner's earnings are not sensitive to USD/PLN and EUR/PLN trends. The euro exposures are mainly loans which, at 31 December 2010, approximated EUR 1 billion. A 10 groszy change in any direction in the Polish currency's value relative to the euro implies negative or positive exchange differences totaling PLN 100m. As for dollar exposures, on dollar debt incurred toward investment in Orlen Lietuva, P&L impacts come mainly from working-capital adjustments, specifically accounts receivable and payable. Since PKN's crude oil payables are much higher than current trade credits extended to customers, any increase in the USD/PLN exchange rate entails negative FX differences. In its 2009 financial statements, PKN estimated that a change by 10 groszys in the zloty's value relative to the dollar results in exchange differences to the tune of PLN 121m. This sensitivity may be even greater in 2011 because of payment extensions which drove the excess of payables over receivables from PLN 6.1bn at December 2009 to PLN 7.3bn at December 2010. If we apply these considerations to the current situation in forex markets, we can say that the impact of FX differences on PKN's profits in the first quarter of 2011 will be slightly positive as any losses on FCY loan translations should be offset by gains on working capital.

FX differences vs. exchange-rate trends

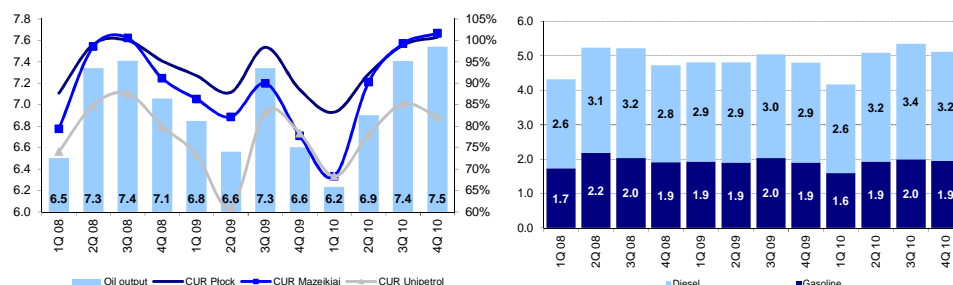


Source: PKN Orlen, estimates by BRE Bank Securities

Refinery

PKN Orlen's refining business generated a LIFO EBIT of a whopping PLN 1.1bn in 2010 compared to just PLN 95m posted in 2009, and the figure would have been even higher if it had not been for a PLN 180m impairment loss recognized on the assets of Orlen Lietuva. Such impressive year-on-year growth was achieved thanks to a wider Urals/Brent differential (a PLN 347m increase) and higher crack spreads on the different products (a PLN 637m increase). Looking at the operations making up the Refinery segment, as always, the biggest contributions came from the refinery in Plock which generated a PLN 1.3bn LIFO EBIT (marking an increase by PLN 921m from 2009), but better-than-a-year-ago performance was also achieved by Unipetrol (with an EBIT loss of PLN 85m vs. PLN 374m a year earlier) and Orlen Lietuva (which posted an adjusted EBIT loss of PLN 122m vs. PLN 390m in 2009). Other refining operations (including Orlen Asphalt and Rafineria Trzebinia) reported deteriorated profitability, with LIFO EBIT down to PLN 191m from PLN 460m a year earlier, caused by high oil prices which depressed asphalt margins (which had peaked in 2009), and by a structural oversupply of biofuels on the CEE market combined with much higher rapeseed prices.

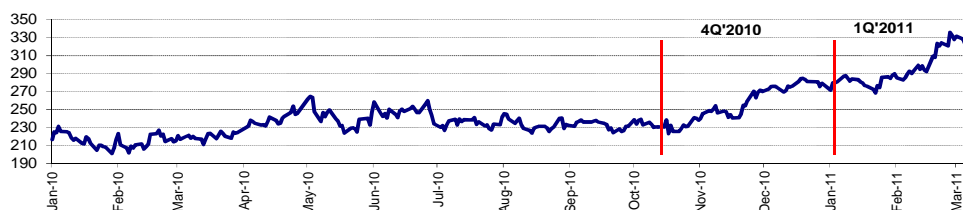
PKN Orlen's oil output and refinery CUR, basic fuel wholesale volumes (millions of tons)*



Source: Source: PKN Orlen, BRE Bank Securities; *including external wholesale and sales to PKN Orlen fuel stations

LIFO inventory adjustments provided a huge, PLN 1.4bn boost to PKN's 2010 EBIT, thus creating a high comparable base for 2011. If oil prices were to continue rallying throughout the year, 2011 LIFO effects could match those achieved last year. However, we do not think it likely that the current high prices of Brent crude are sustainable. According to our estimates, a high positive LIFO effect reported in Q1 2011 (which may reach PLN 1.2-1.4bn) will be largely offset by charges incurred in the following quarters, resulting in a full-year effect of about PLN 500m (assuming that oil prices drop to US \$95/Bbl by December).

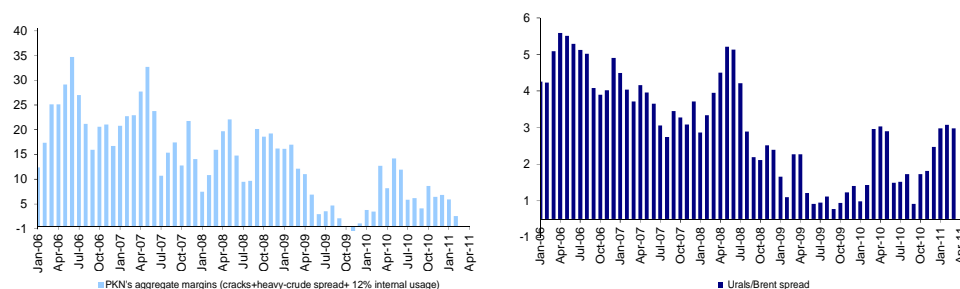
Urals crude prices (PLN/Bbl)



Source: BRE Bank Securities based on Bloomberg data

As for LIFO EBIT, we expect it to decrease to PLN 0.8bn in 2011 from PLN 1.1bn in 2010, due to factors including a narrower geographic premium which is under pressure from growing domestic competition and high costs of extended maintenance downtime at the Plock refinery scheduled for Q1 and Q2 (hydrogen, hydrocracking and residue desulfurization units) – contrary to earlier predictions, the downtime will cause a year-on-year decline in the refinery's output. Refining margins are set to rebuild in the course of the year assuming a downward shift in oil prices, though from levels which are a far cry from the 2010 averages at the moment, and which are not fully offset by the Urals/Brent differential. Other factors affecting this year's profits of the Refining segment will include decreasing asphalt margins, possible downward pressure on biofuel margins, and growing costs of internal oil usage.

PKN Orlen's refining margins, Ural/Brent spread (USD/Bbl)

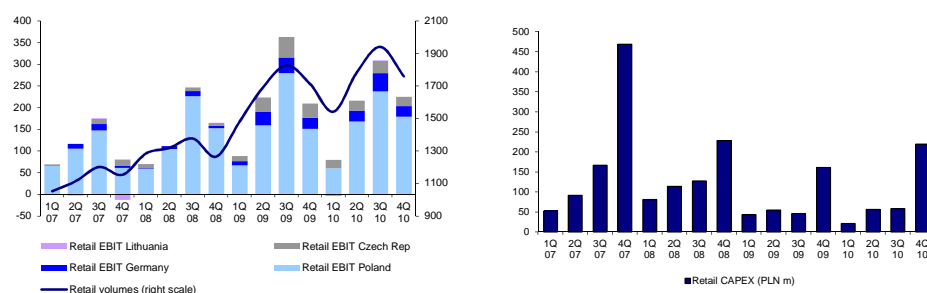


Source: Bloomberg, estimates by BRE Bank Securities

Retail

PKN Orlen's 2010 retail fuel sales achieved record volumes after 4.6% year-on-year expansion, led by Polish and German service stations. In the Czech Republic, a rise in black market sales led to volume losses last year (ranging between 6% and 16% depending on the quarter and type of fuel). Unfortunately, expanded sales volumes went hand in hand with contracting margins caused by high retail prices (stemming from rallying crude and an increase in the diesel tax from PLN 98 to PLN 234 per cubic meter as of January 2010) and aggressive competition. As a consequence, the Retail segment's earnings fell from PLN 880m to PLN 825m. PKN estimates that lower fuel margins alone drove the 2010 EBIT down by as much as PLN 215m versus the year before, confirming that rising wholesale prices cannot be immediately offset at the pump. The ultimate EBIT loss was reduced to PLN 55m thanks to lower costs (with D&A expenses down PLN 34m), a PLN 62m increase in other operating income (which amounted to PLN 24m vs. other operating expenses of PLN 38m reported a year earlier), and higher volumes.

Retail EBIT vs. retail volumes by country, CAPEX



Source: PKN Orlen

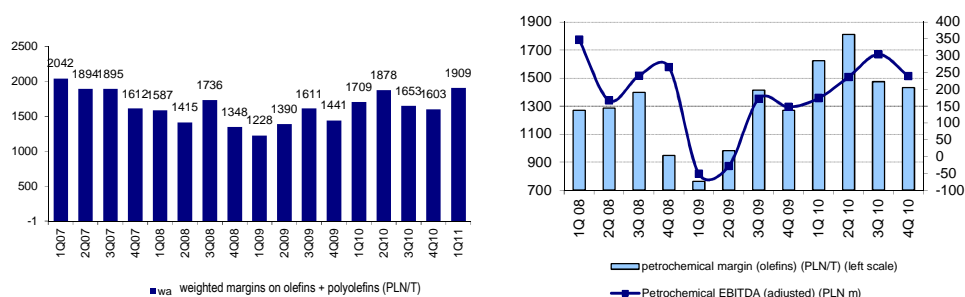
2011 is looking to be a year of continued profit erosion for PKN's Retail business caused by record-high fuel prices which are depressing margins and affecting demand (January fuel sales volumes were reportedly 10% lower than in the same month a year ago). Added to this are the decreasing contributions of non-fuel sales generated by the PKN Orlen service stations which added just PLN 43m to the 2010 EBIT compared to a PLN 110m boost in 2009 and PLN 108m generated in 2008. This trend may be further exacerbated by the Polish government's plans to ban alcohol sales at service stations. Note that alcohol sales were the main reason behind the structural improvement in the earnings of the Retail segment, and EBIT growth from PLN 439m in 2006 to over PLN 800m (the non-fuel sales margins generated between 2007 and 2010 were nearly PLN 300m higher than in 2006). Against this backdrop, we expect PKN's Retail EBIT to decrease to PLN 783m in 2011, to again cross the PLN 800m mark in 2012 assuming a downward

correction in petroleum prices. These estimates include the 56 German service stations bought in Q4 from OMV resulting in a PLN 58m addition to CAPEX.

Petrochemicals

As predicted, PKN's Petrochemical business enjoyed robust growth in Q4 2010 fueled by a recovering economy and strong demand from China. The segment saw an expansion in margins as well as sales volumes (rising 0.4% in polyolefins and 2.6% in olefins) which would have been even higher if it had not been for long maintenance downtime in Plock and at Unipetrol and Anwil. An EBIT of PLN 486m was a marked improvement from the PLN 196m loss reported a year earlier (adjusted for LIFO effects, EBIT growth was even more impressive at PLN 435m vs. PLN -319m). The 2011 outlook for the Petrochemical segment is also good (we expect EBIT to increase to PLN 762m, of which PLN 206m will be contributed by Anwil) – the downtrend in olefin margins has reversed in Q1, and Anwil is poised to benefit from improved fertilizer margins in H1 (the recovery of the soda lye unit after a failure will not have an impact on this year's profits because PKN recognized insurance compensation for the damage in 2010). Additional contributions to EBIT may come from the newly launched PX/PTA unit (though the company conservatively predicts zero contributions in the first year of the unit's operation). One factor which can potentially undermine our positive predictions for the Petrochemical segment is if the rally on oil prices continues throughout the year.

PKN's petrochemical margins vs. EBITDA*

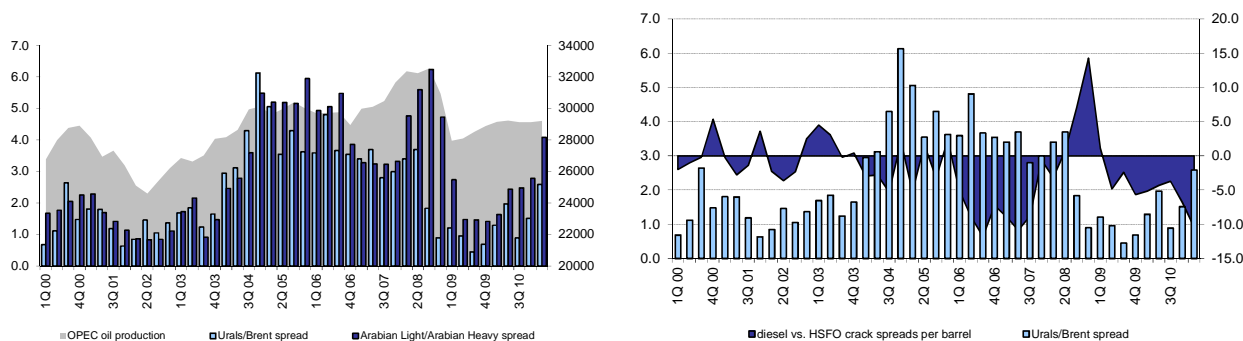


Source: Bloomberg, PKN Orlen, estimates by BRE Bank Securities; *adjusted for other operating income and excluding Anwil

Can Urals/Brent Spread Stay High?

As margins contract and energy costs increase, the Urals/Brent spread is the only driver of PKN's refining profits in Q1 2011. The spread has widened from \$1.8/Bbl in mid-January to over \$3/Bbl, thanks mainly to Shell's announcement that it was closing four of its Brent platforms. This was supported by Russia putting a hold on supplies to Belarus which created a temporary Urals pileup at the Primorsk harbor (once the two countries reached an agreement, the spread narrowed to \$2.4/Bbl). The political unrest in North Africa, in particular the war in Libya which threatened supply disruptions, rattled the European markets in February and March, pushing the spread back to \$3.5/Bbl in mid-March (the Japan earthquake probably also played a role).

Heavy-Light crude price spreads vs. OPEC production, diesel / HSFO margin gaps



Source: Bloomberg, estimates by BRE Bank Securities

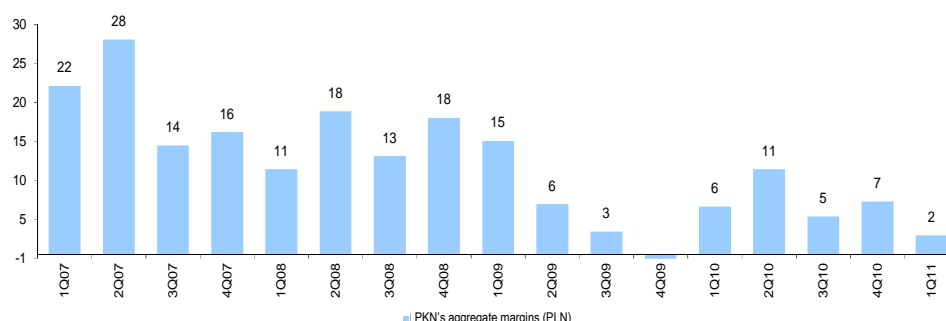
We expect the Urals/Brent spread to remain volatile in the coming weeks, followed by an eventual contraction from the current highs. Resumed supplies from Libya and resumed drilling in the North Sea will prompt OPEC to withdraw some of the balancing supplies of heavy crude oil, following

which the only source of discount in Urals quotes will be the unfavorable HSFO crack spread, not offset by diesel margins. Based on these predictions, we are raising our 2011 Urals/Brent spread estimate by \$0.7 to \$2/Bbl. In the long term, the spread will be kept low by new refineries in Asia focused on production of heavy crude.

Declining Margins, Rising Costs

Refining margins in Europe have been on a decline since the beginning of 2011, suppressed by soaring oil prices which are increasingly harder to offset against wholesale prices, especially given the pressure on volumes. Competition from cheaper natural gas, combined with more stringent sulfur content restrictions, have had particularly severe consequences for the crack spreads on heavy fuel oil, bringing them to acute negative territory of \$-240/T vs. an average \$-142/T in 2010. With gasoline margins also on a decline, only middle distillates provide somewhat of a cushion against deteriorating refining margins. In the long run, however, demand for diesel, which is currently being fueled by Chinese manufacturers who are bypassing new energy consumption limits by generating their own energy from light fuel oil, is bound to slow down amid rallying crude prices.

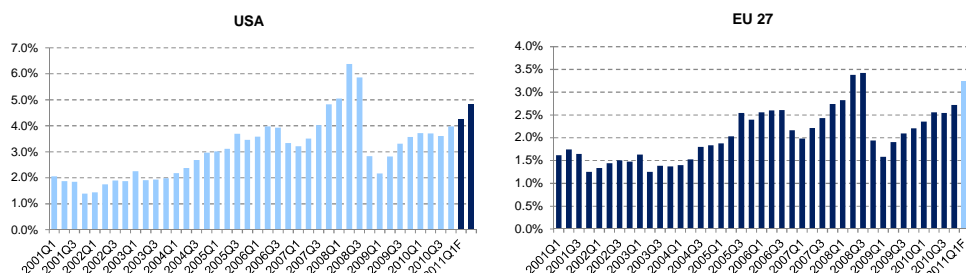
PKN's aggregate refining margins (PLN/Bbl) (cracks+heavy-light spread)



Source: Bloomberg, estimates by BRE Bank Securities

In addition to exchange-traded oil products, PKN Orlen's profit margins also come from asphalts (read on for more details) and are influenced by internal oil-fueled energy-generating assets. In 2010, internal oil consumption was 13.3%, which gives an idea of the severity of the cash impact of high crude prices on the company's profits. Since internal consumption is not taken into account in the calculations of benchmark margins, this may result in a misleading assessment of the current refining industry fundamentals. The diagrams below show our calculations of PKN Orlen's aggregate zloty margins (cracks+heavy-light spread+internal consumption) which confirm that current market conditions are much less favorable than in Q1 2010 or during last year as a whole, in spite of higher Urals/Brent spreads. This conclusion is consistent with PKN's own assessments as published on its Website (which, however, show benchmark margin calculations assuming internal oil consumption of just 6.5%).

Oil costs as percentage of GDP in USA and EU

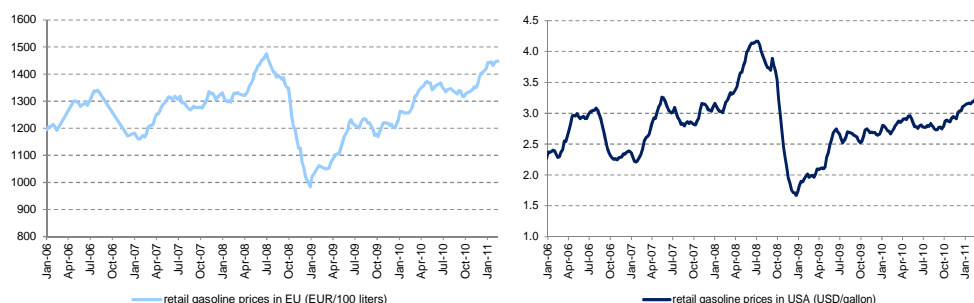


Source: Eurostat, EIA, Bloomberg, IEA, forecasts by BRE Bank Securities

Looking at the global oil market, we must note that current margin levels (which have clearly rebounded from their H2 2009 lows), though lower than the record highs seen in 2006-2008, are hovering close to their long-term averages. The same goes for capacity utilization rates which are a key medium-term profitability driver for the oil industry. Between 2000 and 2008, global fuel demand increased 11.1% while the refining capacity increased 7.5%, and the lag supported refinery margins and encouraged capacity expansion. According to predictions by the IEA, by 2015,

the world will have additional refining capacity of 7.5 million barrels per day. To match this increased supply, demand between 2011 and 2015 should grow at an annual rate of 1.7%. Meanwhile, at current crude prices, it seems that demand is more likely to decline than rise going forward. The diagrams below show that gasoline prices in Europe and the USA are approaching their 2008 highs, affecting especially the European economy (due to a strong dollar and Brent price premium). The impact of oil on GDP growth may be even stronger in case of China (which, according to IEA's 2011 forecast, will consume 6% more of oil this year than last compared to a 3.7% increase expected in developing countries). Summing up, high prices of crude oil can slow down economic growth by generating additional costs for countries which subsidize energy (India, China) and for consumers who are paying dearly at the pump.

Retail prices of gasoline in EU and USA



Source: Eurostat, Bloomberg

Strategic Reserve Laws

The Polish Ministry of the Economy has been working on amendments to our country's strategic petroleum reserve policy since early 2009. With public and industry consultations now over, it seems that the bill is on track to come under parliamentary debate. Under EU laws, the amended law must come into force by 1 January 2013 (though we can imagine that it could be implemented earlier, in 2012). The new policy provides that maintenance of strategic reserves will eventually be taken over by the Material Reserves Agency (ARM) in exchange for a fee charged from oil companies. The fee (which will be subject to quarterly adjustments) will include costs of storage and inventory turnover, insurance, and service of the debt incurred on petroleum purchases. The takeover process is expected to take 10 years during which the ARM will be gradually buying up the reserves currently kept by oil companies. These purchases are to be executed in such a way as not to increase national debt.

As the legislative process moves ahead, it is worth considering how the new policy will influence PKN Orlen which, at 31 December 2010, had PLN 5bn-worth of strategic reserves sitting on its balance sheet (PLN 4.6bn in Poland and PLN 0.4bn in Lithuania), plus a further PLN 2bn-worth in off-balance sheet liabilities (under ticketed option contracts). Some analysts have been saying recently that strategic reserves (after appropriate discounting) should be added to PKN's value. We tended to agree with this during earlier stages of the legislative process, but we changed our mind after analyzing all the aspects of the proposed changes. Today, we argue that the new rules will be neutral to PKN's valuation, based on the following rationale:

- The unloading of strategic reserves means lower debt and interest expenses, but on the other hand it will generate additional operating expenses stemming from the ARM fees which cannot be ignored when performing a DCF analysis – to consider just the discounted value of the reserves in the analysis would be a mistake;
- Since maintenance of strategic reserves is mandatory for all companies marketing fuel in Poland, it seems obvious that the costs incurred to comply with this requirement are reflected in the retail sales prices (analyses by the Economy Ministry indicate that this is indeed the case);
- It follows that the costs offset against the sales prices are the full costs of mandatory reserve maintenance, that is costs of financing as well as storage and logistics. Consequently, PKN Orlen's earnings as owner of the storage infrastructure (salt caverns with ca. 4.4MT storage capacity) include the full margins returned by those assets, that is the returns on the leased space as well as the space used for internal purposes (3.4MT);
- If storage costs decrease under the new policy for Polish market players across the board, in a fiercely competitive market, we think we can safely assume that all of these players will use this as an opportunity to lower their retail prices – which means that lower costs do not automatically mean higher margins for PKN;

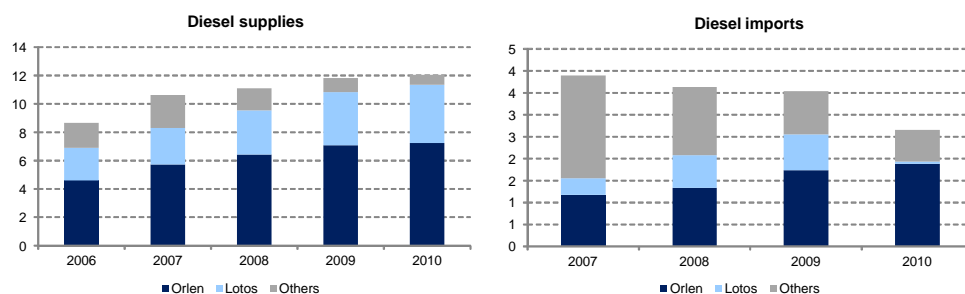
- The lower debt recognized on PKN's balance sheet will only be an apparent improvement – the actual effect of the changes will be similar to the effect now seen under the ticketed option contracts which result in debt hidden off-balance sheet that still needs to be serviced (bank and ARM charges).

To put it another way, the impact of the new strategic reserve policy on PKN Orlen can be compared to a transition from ownership to leasing of a business-critical property where maintenance and financing costs are replaced by rental costs. From the point of view of the end consumer, the change is that the heretofore hidden 'tax' included in fuel prices to protect Poland's energy security will be replaced by an official tax.

Inland Premium: Downside Risk Materializing

The unprecedented competition between Orlen and Lotos for new wholesale contracts in late 2010 and early 2011 has confirmed that the risk of a decline in the "inland" (geographic) premium that we signaled in our last research report may materialize. To be sure, supplies ended up divided between the two concerns in similar proportions as in 2010 (with a slight decline in Orlen's share), but more intense competition did lead to more aggressive bidding, one example of which was Lotos's taking over of Orlen's contract with Shell Poland back in December, an event which must have made Orlen nervous as it was sitting down at the negotiating table with its other customers. Note that in order to secure exclusivity of supplies to Shell, Lotos must have outbid Orlen on the financial terms of the contract, because it has no logistic or geographical advantage. Although Lotos must sell some 2Mt of additional products from its new "10+" installation this year, we expected that it would export this surplus rather than engage in price wars. Still, with the inland premium at a record-high level, an attempt to maximize domestic market share is sensible even if it entails a reduction in average margins to a certain level. It should be remembered that prices obtainable in seaborne trade are much lower than domestic prices, and that exports entail additional selling costs. One could argue at this point that the strength of the demand for diesel in Poland and the degree to which this market depends on imports should limit the impact of additional volumes on margins, all the more so that in 2011 Lotos will mostly increase gasoline and aircraft fuel sales (new diesel output will replace imports and production based on unfinished derivatives), while maintenance work at the Plock refinery will prevent Orlen from supplying the promised additional 1Mt of diesel. While this is true to a certain extent, note that Lotos will not yet be able to sell aircraft fuel in Poland (the liberalization of supplies to the Warsaw airport is a process which has begun only recently), which may induce it to change its product mix towards diesel (the technology used in middle distillate manufacturing is flexible enough to allow for this). In addition, recall that Orlen and Lotos control over 90% of the Polish diesel market at this time, i.e. most of its imports as well. Therefore, in order to replace imports with domestic output, they would have to squeeze the competing volumes out of the market (volumes which also provide the attractive "inland premium"). All this is not just theoretical speculation: at the post-earnings conference call, the Management of Orlen admitted that margins were under pressure.

Orlen's and Lotos's shares in the Polish market for diesel and in imports (PLN m)

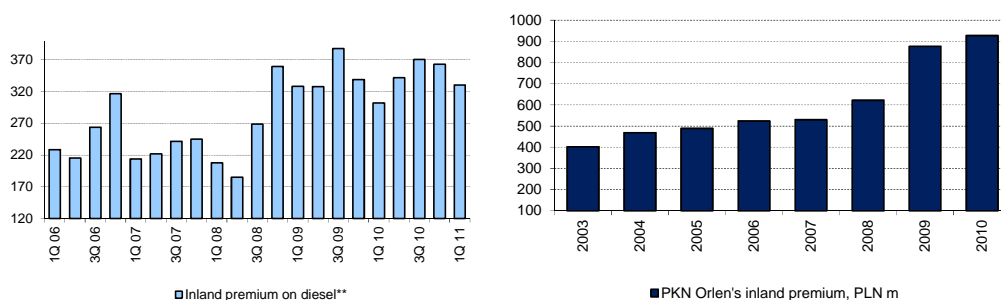


Source: Polish Organization of Oil Industry and Trade, estimates by BRE Bank Securities: *Orlen's and Lotos's shares include imports controlled by them.

The discussion on the inland premium is an important one, because the additional revenue it provides has a material impact on the earnings of Polish refineries. Of course, we do not know the value, but an estimate is possible based on fuel price quotes in Bloomberg, PKN Orlen's wholesale prices and its inland premium from 2004-2005 (the Company used to report this value in PLN million until 2005). Our calculations, presented on the chart below, suggest that the impact of the inland premium on the Company's earnings in 2009-2010 may have approached PLN 800-900m, representing a considerable increase vs. the preceding years, a development which we attribute to the economic crisis, which weakened the importers' position and made it possible for Polish concerns to increase their shares. Deteriorating macroeconomic conditions led industry players to

concentrate on their home markets, as a result of which arbitrage failed to work as expected. Since the start of 2011, we have been observing a decline in the inland premium calculated this way, which is all the more significant given the rising prices of crude oil, which affect transportation costs, i.e. one of the factors underlying the difference between wholesale prices in Poland and international benchmarks. In our opinion, this factor should be taken into account when forecasts are constructed on the basis on benchmark margins estimated from data provided by Bloomberg and similar agencies.

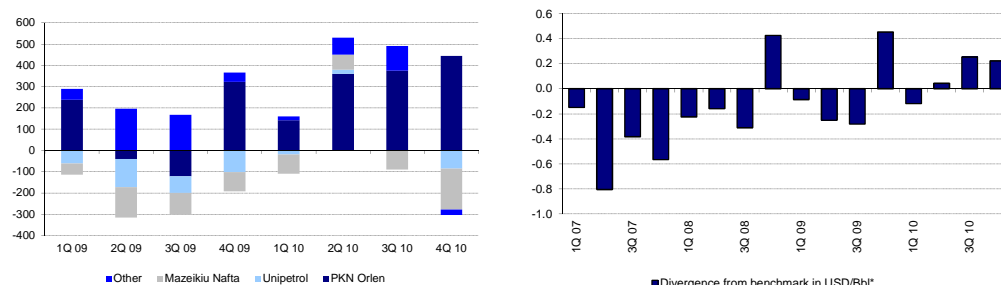
Inland premium on diesel, PKN Orlen's estimated inland premium*



Source: Orlen, estimates by BRE Bank Securities; *data for 2003-2005 as reported by PKN Orlen, for the following years as estimated by BRE Bank Securities; **the theoretical inland premium is estimated from prices reported by Bloomberg and PKN Orlen's wholesale prices for smaller buyers.

These estimates seem to be confirmed by an analysis of the standalone EBITDA of the Plock refinery and the benchmark margins calculated for its product slate (crack spreads plus Urals/Brent spread), which have converged significantly since Q3 2008. Moreover, in some quarters, PKN has reported better earnings than would have been implied by benchmark margins. One thing worth noting is the major discrepancy in quarterly earnings between the Plock refinery and Orlen's other refineries (Mazeikiu Nafta, Unipetrol), which are unable to secure such a high "inland premiums" in their own domestic markets.

PKN Orlen: LIFO EBIT by refinery, divergence vs. benchmarks at the Plock refinery



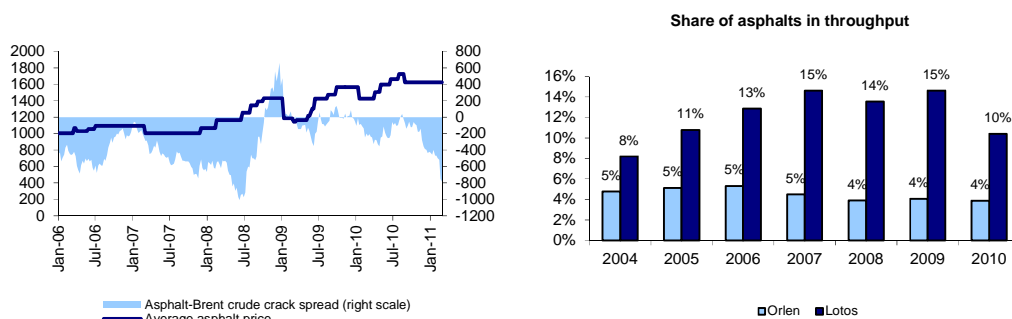
Source: PKN Orlen, estimates by BRE Bank Securities

Asphalts: Margins Could Plunge in Poland

Last year was not as good for asphalt production as 2009, when the rapid growth of road construction in Poland combined with relatively low crude oil prices allowed for a significant improvement in the profitability of this product. The average cracks spreads vs. the price of Brent crude (ignoring sales in Q1 due to strong seasonal patterns) have fallen from -PLN 53/t to -PLN 183/t (compared to the 2004-2008 average of -PLN 447m), which, with sales volumes at 1Mt, translates into a PLN 150m y/y reduction in the consolidated gross margin, a development that is consistent with the 2010 decline in the earnings of Orlen's "other" operations by a whopping -PLN 269m. A deterioration in this area is of course a consequence of the fact that there is no mechanism linking end-product prices to crude oil prices, which makes it more difficult to transfer the rising expenses onto customers. This was particularly clear towards the end of the year, as illustrated by the chart below. The early months of 2011 have also given little ground for optimism, because, while asphalt prices have practically not budged since September 2010, the price of petroleum has been rising fast, with the average crack spread exceeding -PLN 500/t in Q1'11. This is not yet a high sales season for asphalts and Orlen Asphalt might still decide to implement price hikes in the spring, but just as in 2008 we should expect weak margins. If crude oil does not depreciate significantly, Orlen's earnings on asphalts might resemble its 2008 performance. We do

not have access to the income statement of Orlen's asphalt maker subsidiary, but we believe that the integrated margin in this area could decline by over PLN 100-150m this year, a possibility worth remembering, all the more so that asphalts are not taken into account in the calculation of the benchmark refining margin.

Asphalt margins, asphalt shares in Lotos's and PKN's refinery slates

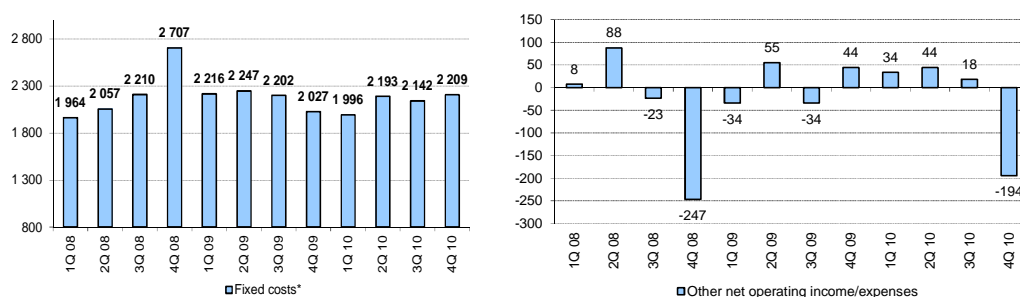


Source: PKN Orlen, Lotos, estimates by BRE Bank Securities

Fixed Costs: Overview of 2010, Outlook for 2011

In our previous research report, we paid more attention than usual to fixed expenses, whose reduction was one of the drivers of the major y/y improvement in Orlen's earnings in Q1-Q3 2010. Now that we know the full-year earnings, it is worth looking at the individual areas, because we believe a correct interpretation of these savings and an assessment of how lasting they are going to be are a prerequisite for more precise forecasts of 2011 earnings. To be sure, the consolidated G&A expenses fell by PLN 141m y/y, unattributed expenses declined by PLN 42m, and, according to a simplified calculation, overall fixed costs have diminished by close to PLN 153m. The question is, however, to what extent these reductions were owed to streamlining, and to what extent they were achieved thanks to one-time events and external factors.

Consolidated fixed costs* and other operating income/expenses**



Source: PKN Orlen, analysis by BRE Bank Securities; *the category includes depreciation and amortization, payroll and outsourcing expenses and taxes and fees; **data for Q4 2008 adjusted for a write-down on Mazeikiu Nafta in the amount of PLN 2.2bn.

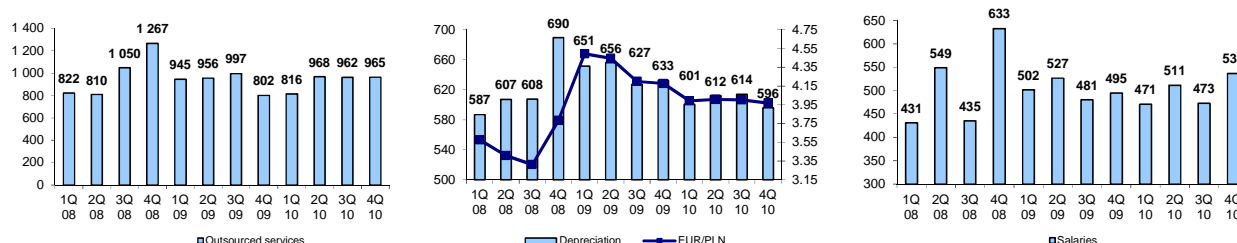
PKN's other operating income, which can be said to be the main source of one-time impacts on earnings, figured to -PLN 98m in 2010 vs. +PLN 31m one year before. The main driver of the y/y deterioration were write-downs on the assets of Mazeikiu Nafta and the Czech Spolana, which were only partially offset through claims paid (including for the failure of the lye-making installation and subsidies on account of NOx emission reduction in the amount of +PLN 100m y/y). In addition, Orlen created PLN 40m worth of provisions more (including provisions for employee benefits), but reduced write-downs on receivables by PLN 38m. Needless to say, it is difficult to forecast the individual components of other net operating income, but it seems that the Company should no longer generate negative surprises in its asset write-downs (and should post lower costs of post-maintenance clean-up, although this will coincide with lower claim payments and lower gains on asset divestment, which amounted to a total of PLN 115m last year), which is why we expect that income and costs will balance each other out in this position, leading to a ca. PLN 100m improvement in EBIT.

In terms of individual cost categories in the three initial quarters of last year, the biggest drop (-PLN 151m) was observed for outsourced services, but, as we have pointed out before, most of this cut applied to Q1'10 and must have been caused by tough weather conditions and a decline in

maintenance work. These savings from the early months of the year were fully offset by higher expenses in Q4 (PLN 965m vs. PLN 802m one year earlier), when we saw accumulation of maintenance downtimes (28 days off on the reforming facility at Mazeikiu Nafta, and a 15-day downtime for Unipetrol's hydrocracking installation coupled with a 10-day downtime in the petrochemical division). As a reminder, in Q4'09 Orlen did not conduct any major maintenance work, which explains why the y/y change is big. The outlook for the key cost categories in 2011 gives little ground for optimism, because even more maintenance work has been planned for this year, including on key refining installations. This is difficult to quantify, but one exercise that might illustrate the increase in expenses in this area is a calculation of the total number of maintenance days (ca. 445 days vs. 316 days in 2010, excluding Anwil's nearly six-month downtime on the soda lye installation, whose length was not caused by actual maintenance work but delayed supplies of requisite spare parts).

Give the abovementioned increase in outsourcing costs in Q4, the decline in FY10 fixed expenses was primarily a consequence of a PLN 145m reduction in D&A charges, however, this decrease was partly owed to a stronger zloty which influenced translations of the euro-nominated D&A charges incurred by the German fuel stations and Orlen Lietuva (the Lithuanian lita is pegged to the euro). The FX market is currently much more volatile than in the third quarter, making it hard to predict whether the D&A charges can be kept lower in the periods ahead. Note also that depreciation of the new PX/PTA unit is scheduled to start next year.

Key fixed-cost components



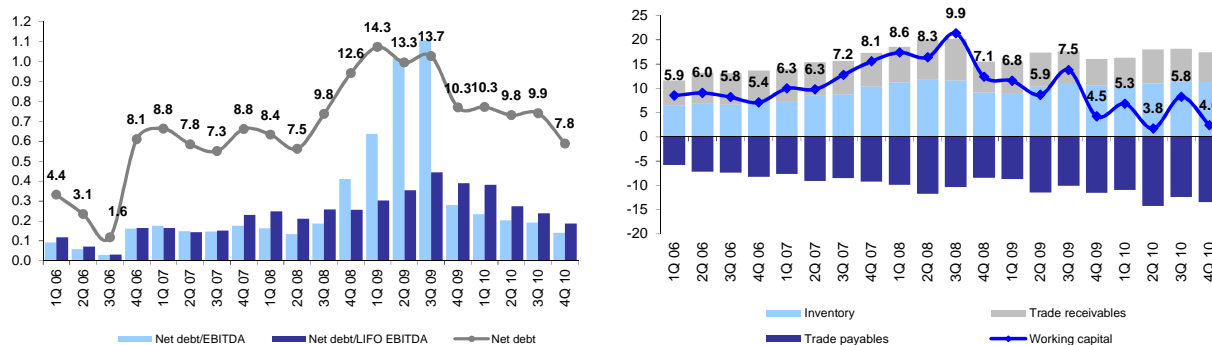
Source: PKN Orlen, BRE Bank Securities

With regard to payroll expenses in FY11, Orlen was unable to keep its savings at the Q1-Q3 level (-PLN 54m y/y), and posted a nominal reduction in costs (-PLN 13m). We do not know detailed employment data as of the end of the year, but it seems that restructuring efforts undertaken so far (layoffs at Mazeikiu Nafta, voluntary redundancy program) have been offset by higher severance payments, annual bonuses and additional costs for the employees working on the new PX/PTA installation (the pay of these 220 people will not be shown in its full amount until this year, estimated at PLN 19m). We are taking a cautious approach to predicting future payroll expenses (on top of the reasons described above, the Company may be pressured for raises by its employees next year after a 2009 salary freeze and the minimum raises awarded in 2010). According to recent newspaper reports, trade unions are demanding 10% salary growth across the Group. It is hard to imagine the Management acceding to this, but were it approve a 5% hike, consolidated expenses would increase by PLN 100m.

Net debt: Changes in working capital

Last year brought about a further contraction in Orlen's net debt, which amounted to just PLN 7.85bn at the end of December. Most of this reduction happened in the preceding quarter, when operating cash flows amounted to a staggering PLN 2.8bn, which, in addition to EBITDA, were drive by strong working capital (+PLN 1.44bn), which comprised a decline in receivables (PLN 592m) and an increase in payables (PLN 832m), with no impact from inventories (the rise in prices was offset by the sale of PLN 910m worth of mandatory reserves). For quite a while, the Company has been managing these positions in a very apt way, but if we look at these working capital changes more closely, we will see that not all of them are likely to be lasting and some merely entail shifting some of the debt to other categories of liabilities. As far as inventories are concerned, the main reason why their cash impact at the time of rising prices was limited were the sales of mandatory reserves (which we discuss at more depth elsewhere in this report; here let us only stress that the economic sense of these transactions lies in shifting interest expenses to operating expenses stemming from the ticket agreement). If Orlen does not sign further agreements of this type in 2011 (so far, it has sold 1Mt of its mandatory reserves out of the 3.4Mt total), and it seems that in the current economic environment this solution is becoming much less attractive due to the rising hedging costs, we can expect the forecasted high Q1'11 LIFO effect to be offset at the working-capital level.

Net debt/EBITDA (PLN bn), working-capital turnover ratios

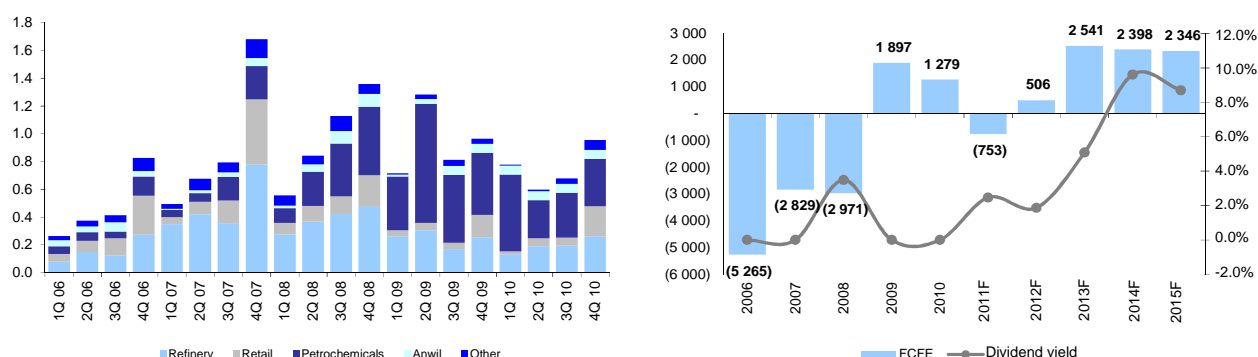


Source: PKN Orlen, estimates by BRE Bank Securities

Payables turnover is now at 59 days, which is four days lower than the average for the past five years and is primarily a consequence of deferred payments for petroleum and deferred investment outlays (estimated at ca. PLN 650m at the end of December). It is hard to day for how long the Russian suppliers will be able to continue extending credit to Orlen on the same - or better - terms as the banks (delayed invoice payment leads to interest charges as well), but were the ratio to return to average levels, we would see working-capital outflows of some PLN 900m. The situation looks similar as far as receivables are concerned, where the turnover is 8 days lower than the 5-year average thanks to the active use of factoring. In our opinion, these efforts to improve the net debt position, which can be seen as shifting debt from banks onto trade creditors, might represent Orlen's preparations for the process of rolling over some of its debt in 2012. A better balance sheet might give Orlen better terms in new loan agreements and make it easier to regain investment-grade rating, but a valuation model needs to take such shifts into account. Our net debt estimate for the end of 2010 includes PLN 650m on account of investment payables and provisions for the repurchase of PLN 644m of CO₂ emission credits.

Another important factor shaping PKN's balance-sheet position in the coming quarters will be completion of ongoing investment projects, most notably in the petrochemical segment. Both the PX/PTA unit, and the "HON VII" diesel desulfurization system in Plock, are scheduled to start operations still this year. In the upcoming years, we can therefore expect a reduction in CAPEX. PKN's 2012-13 strategy pegs the annual CAPEX budgets at PLN 1.3bn, much less than our conservative assumptions made for valuation purposes. If the CAPEX targets are really achieved, with more strategic-reserve sales, the free cash flow to shareholders will be much more generous than would follow from our assumptions shown in the diagram below. Meanwhile, we stand by the scenario where PKN starts generating significant amounts of free cash (after CAPEX and debt service costs) in 2012, and pays its first significant dividend (with yield at 6.7%) in 2013 (the Company aims to make shareholder distributions equivalent to at least 50% of FCFE starting in 2013).

Quarterly CAPEX by business segment, FCFE and dividend yield forecast



Source: PKN Orlen, estimates by BRE Bank Securities

PKN intends to update its growth strategy next year, and we are looking forward to hearing the Management's plans with respect to upstream development and expansion into power generation. The Company has already started the process of selection of a supplier of a gas turbine for a planned 400-500 MWe CCGT plant in Włocławek. PKN intends this to be a joint venture, but we

can assume that it is going to participate to some extent in the costs of this project, which can be estimated at PLN 1.4-1.7bn in total. The power plant is tentatively scheduled for a launch in early 2014, so the bulk of the expenses would be incurred in 2012 and 2013. In addition to the new project, PKN may have to incur replacement expenditure on existing power-generating assets to bring them up to more stringent emission standards (the replacements will include a new boiler for the combined-cycle plant in Płock, and flue-gas desulfurization and denitrogenation units, including at Mazeikiu Nafta). As for upstream development, PKN has suggested that, in the initial stages, it would like to acquire drilling projects in politically stable locations. On the basis of the experience gained there, the company will take the next step of prospecting. While safer and more reasonable, in the near term this approach means that PKN's upstream purchases will have zero positive impact on its value, while reducing its dividend-paying potential. In the strategy plan announced in 2008, PKN stated that it would not spend more than PLN 700m on upstream building until 2013, however, the divestment of Polkomtel (PLN 3.8bn) and the cash freed through mandatory reserve sales may give it potential to fast-track the development of upstream.

Macroeconomic Assumptions

The table below outlines the macroeconomic assumptions underlying DCF valuation.

USD/Bbl	2008	2009	2010	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F
Brent crude	98.0	62.0	79.7	98.5	95.0	95.0	95.0	95.0	95.0	95.0	95.0	95.0
Urals crude	95.1	61.2	78.3	96.5	93.0	93.0	93.0	93.0	93.0	93.0	93.0	93.0
Urals-Brent spread	2.9	0.8	1.4	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
PKN's product margins	4.9	2.8	3.6	3.7	4.1	4.2	4.3	4.4	4.5	4.9	4.9	4.9
Orlen Lietuva's product margins	2.7	2.2	2.1	2.2	2.3	2.5	2.6	2.8	2.9	3.1	3.1	3.1
Unipetrol's product margins	9.7	4.4	5.1	5.2	5.3	5.4	5.5	5.7	5.8	5.9	5.9	5.9
Oil throughput (Mt)												
Orlen	14.2	14.5	14.5	14.5	15.7	15.7	15.7	15.7	15.7	15.7	15.7	15.7
Unipetrol	4.5	4.1	4.4	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Mazeikiu Nafta	9.2	8.4	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Petrochemicals output (kt)	2956	2927	2962	3362	3562	3562	3562	3562	3562	3562	3562	3562
Chemicals output (kt)	1759	1892	1771	1867	1947	1947	1947	1947	1947	1947	1947	1947
Chemicals & Petrochemicals												
Margin on chemicals (EUR/t)	619	545	533	569	518	518	525	525	525	525	525	525
Margin on petrochemicals (USD/t)	553	389	548	638	543	543	525	525	525	525	525	525
Margin on HDPE+LDPE (USD/t)	653	477	605	701	590	590	568	568	568	568	568	568
Margin on PP (USD/t)	738	423	470	539	443	443	423	423	423	423	423	423
Margin on PTA (USD/t)	192	379	380	387	356	356	340	340	340	340	340	340
Other macro assumptions												
USD/PLN	2.42	3.12	3.02	3.00	2.90	2.80	2.70	2.70	2.70	2.70	2.70	2.70
EUR/PLN	3.48	4.33	3.99	4.00	3.80	3.70	3.50	3.50	3.50	3.50	3.50	3.50

Source: Bloomberg, PKN, BRE Bank Securities



Earnings Forecast and Valuation

Our DCF model (which factors in PKN's interests in Polkomtel) produced a nine-month per-share target price of PLN 41.6.

DCF Valuation

DCF Model Assumptions

1. Cash flows are discounted to their present value as at 31 March 2011. When calculating enterprise value, we used the net debt amount as at 31 December 2009 increased by a PLN 644m provision for a repurchase of carbon emission credits sold in Q4 2009.
2. The model relies on macroeconomic assumptions as laid out above, taking into account the impact of the new mandatory reserve law which is currently under preparation (their purchase by a state agency, which will then charge a special fee).
3. We increase enterprise value by the net after-tax value of the stake in Polkomtel, which we estimate at PLN 3.8bn.
4. The amortization and depreciation expense projected for 2020 is higher than CAPEX, which is unsustainable over the long term, prompting us to revise the D&A expense to PLN 2.0 billion for terminal value calculation purposes.
5. When calculating FCF_{TV} , we based the terminal value calculations on the sales growth rate and EBITDA margins projected for 2020.
6. We assume that FCF will grow at a rate of 1% after 2019. The risk-free rate is 6.3%, and beta is 1.0.



DCF Valuation Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenues	99 521	96 665	94 172	91 470	92 206	92 957	93 785	94 488	95 207	95 940	96 678
Change	19.1%	-2.9%	-2.6%	-2.9%	0.8%	0.8%	0.9%	0.7%	0.8%	0.8%	0.8%
EBITDA	4 847.5	4 933.3	5 112.0	4 702.1	4 721.9	4 802.5	4 961.0	4 939.7	4 933.5	4 934.5	4 972.4
EBITDA margin	4.9%	5.1%	5.4%	5.1%	5.1%	5.2%	5.3%	5.2%	5.2%	5.1%	5.1%
D&A expenses	2 682.9	2 741.7	2 784.3	2 581.5	2 465.9	2 417.0	2 353.3	2 366.4	2 396.4	2 345.4	2 032.4
EBIT	2 164.6	2 191.6	2 327.6	2 120.7	2 256.0	2 385.5	2 607.7	2 573.3	2 537.1	2 589.1	2 940.1
EBIT margin	2.2%	2.3%	2.5%	2.3%	2.4%	2.6%	2.8%	2.7%	2.7%	2.7%	3.0%
Tax on EBIT	411.3	416.4	442.2	402.9	428.6	453.2	495.5	488.9	482.0	491.9	558.6
NOPLAT	1 753.3	1 775.2	1 885.4	1 717.7	1 827.3	1 932.3	2 112.2	2 084.4	2 055.0	2 097.2	2 381.5
CAPEX	-2 914	-2 627	-2 382	-2 032	-2 032	-2 032	-2 032	-2 032	-2 032	-2 033	-2 032
Working capital	-2 006	-930	602	444	370	368	359	374	372	370	370
Capital investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	-484	960	2 889	2 711	2 631	2 685	2 792	2 792	2 791	2 779	2 752
WACC	9.8%	9.9%	10.2%	10.3%	10.4%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
discount factor	93.2%	84.9%	77.0%	69.9%	63.3%	57.3%	51.9%	46.9%	42.5%	38.4%	38.4%
PV FCF	-451	815	2 225	1 894	1 665	1 538	1 448	1 311	1 186	1 069	
WACC	9.8%	9.9%	10.2%	10.3%	10.4%	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%
Cost of debt	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%	7.30%
Risk-free rate	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%	6.30%
Risk premium	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	28.4%	26.2%	21.3%	19.5%	17.4%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%
Cost of equity	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

FCF growth after the forecast horizon

1.0%

Sensitivity Analysis

Terminal value

28 995

FCF growth in perpetuity

Present value of terminal value (PV TV)

11 148

0.0% 1.0% 2.0% 3.0% 4.0%

Present value of FCF in the forecast horizon

12 700

Net debt

8 491

WACC +1.0pp

36.7 38.9 41.6 44.9 49.1

Minority interests

2 612

WACC +0.5pp

37.7 40.2 43.2 46.9 51.7

Provisions for Agrofert claims

-164

WACC

38.9 41.6 44.9 49.1 54.6

Equity value

12 581

WACC -0.5pp

40.2 43.2 46.9 51.7 58.1

Number of shares (millions)

427.7

Value per share (PLN)

29.4

Per-share value of investment in Polkomtel

9.0

Equity value per share (PLN)

38.4

9M cost of equity

8.4%

Target Price

41.6

EV/EBITDA for the target price

6.0

P/E for the target price

10.2

TV to EV

39%



Relative Valuation

	Price	P/E				EV/EBITDA			
		2010	2011F	2012F	2013F	2010	2011F	2012F	2013F
MOL	22620	13.4	10.0	8.8	7.8	6.9	5.9	5.3	4.9
OMV	28.6	7.2	5.9	5.6	5.3	3.6	3.0	2.9	2.9
Lotos*	41.2	8.2	10.6	5.7	8.0	10.3	6.3	5.1	6.0
Tupras	41.7	12.3	10.7	10.1	11.0	7.0	6.6	5.9	5.9
Hellenic	7.6	13.0	10.4	6.8	6.5	9.5	8.6	6.4	6.5
Unipetrol (CZK)	173.0	21.3	29.3	21.7	25.0	6.0	5.7	5.0	4.6
SNP Petrom	0.4	10.0	7.8	6.7	7.3	4.6	4.0	3.6	3.3
ERG	9.5	-116.3	22.2	12.8	13.2	9.4	6.6	5.5	6.0
Neste	12.1	25.7	11.8	8.5	7.5	11.8	7.7	6.4	6.0
Motor Oil	8.7	10.1	7.7	7.1	6.1	8.3	6.5	6.1	6.1
INA	3955.1	27.7	12.1	9.2	9.8	11.5	8.2	6.2	6.6
Maximum		27.7	29.3	21.7	25.0	11.8	8.6	6.4	6.6
Minimum		-116.3	5.9	5.6	5.3	3.6	3.0	2.9	2.9
Median		12.3	10.6	8.5	7.8	8.3	6.5	5.5	6.0
PKN	50.0	9.0	12.3	11.6	11.0	5.3	6.1	6.0	5.7
(Premium / discount)		-26.6%	16.3%	36.3%	40.5%	-36.1%	-6.9%	7.7%	-3.9%
Implied value									
Median		12.3	10.6	8.5	7.8	8.3	6.5	5.5	6.0
Multiple weight			50.0%				50.0%		
Year weight		0.0%	33.3%	33.3%	33.3%	0.0%	33.3%	33.3%	33.3%
Value per share (PLN)		44.7							

EV/EBITDA based on net debt at year-end 2010 (for PKN, net debt is adjusted for temporary changes working capital and the sale of carbon emission credits)

PKN's net debt adjusted for the value of its stake in Polkomtel

Lotos's multiples calculated for net debt from 2010-2013, respectively.



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenues	63 793	79 533	67 928	83 547	99 521	96 665	94 172
<i>Change</i>	<i>20.7%</i>	<i>24.7%</i>	<i>-14.6%</i>	<i>23.0%</i>	<i>19.1%</i>	<i>-2.9%</i>	<i>-2.6%</i>
EBIT	2 603.9	-1 603.0	1 097.0	3 123.0	2 164.6	2 191.6	2 327.6
Refineries	1 672.0	-2 158.0	1 124.0	2 481.0	1 294.9	1 126.9	1 309.2
<i>LIFO effect</i>	<i>1 167.0</i>	<i>-1 724.0</i>	<i>1 030.0</i>	<i>1 357.0</i>	<i>509.6</i>	<i>-176.6</i>	<i>-88.3</i>
Retail	423.0	641.0	880.0	825.0	783.2	848.2	869.0
Petrochemicals	1 068.0	277.0	-293.9	476.0	556.2	754.3	698.8
<i>LIFO effect</i>	<i>0.0</i>	<i>-120.0</i>	<i>123.0</i>	<i>51.0</i>	<i>0.0</i>	<i>0.0</i>	<i>0.0</i>
Chemicals*	246.0	285.0	97.9	10.0	206.0	144.7	139.9
Other	-155.0	0.0	0.0	0.0	0.0	0.0	0.0
Unallocated expenses	-650.1	-648.0	-711.0	-669.0	-675.7	-682.4	-689.3
LIFO EBIT (adjusted)	1 436.9	2 483.0	67.0	1 766.0	1 655.0	2 368.2	2 415.9
Financial gains / losses	139.8	-1 579.0	71.0	-304.5	-125.1	-41.5	-42.7
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	267.4	267.0	273.0	252.0	252.0	252.0	252.0
Pre-tax profit	3 011.1	-2 915.0	1 441.0	3 070.5	2 291.5	2 402.1	2 536.9
Tax	530.6	-388.4	140.7	614.7	435.4	456.4	482.0
Minority interests	68.0	-21.4	-8.4	84.1	119.1	102.3	106.1
Net profit	2 412.4	-2 505.2	1 308.7	2 371.7	1 737.0	1 843.5	1 948.8
<i>Change</i>	<i>21.5%</i>	<i>-203.8%</i>	<i>-152.2%</i>	<i>81.2%</i>	<i>-26.8%</i>	<i>6.1%</i>	<i>5.7%</i>
<i>margin</i>	<i>3.8%</i>	<i>-3.1%</i>	<i>1.9%</i>	<i>2.8%</i>	<i>1.7%</i>	<i>1.9%</i>	<i>2.1%</i>
D&A expenses	2 431.4	2 491.4	2 568.0	2 422.7	2 682.9	2 741.7	2 784.3
EBITDA	5 035.3	888.4	3 665.0	5 545.7	4 847.5	4 933.3	5 112.0
<i>Change</i>	<i>7.5%</i>	<i>-82.4%</i>	<i>312.5%</i>	<i>51.3%</i>	<i>-12.6%</i>	<i>1.8%</i>	<i>3.6%</i>
<i>EBITDA margin</i>	<i>7.9%</i>	<i>1.1%</i>	<i>5.4%</i>	<i>6.6%</i>	<i>4.9%</i>	<i>5.1%</i>	<i>5.4%</i>
Shares at year-end (millions)	427.7	427.7	427.7	427.7	427.7	427.7	427.7
EPS	5.6	-5.9	3.1	5.5	4.1	4.3	4.6
CEPS	11.3	0.0	9.1	11.2	10.3	10.7	11.1
ROAE	12.4%	-13.3%	7.1%	11.7%	7.9%	7.9%	8.1%
ROAA	5.3%	-5.4%	2.7%	4.7%	3.3%	3.3%	3.6%

* We separate Anwil in the Chemical segment, the data are estimates

Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	46 103.3	46 975.8	49 088.1	51 149.8	54 903.6	55 225.6	53 691.0
Fixed assets	26 736.4	29 280.9	29 655.0	30 430.9	30 661.9	30 547.1	30 145.1
Property, plant and equipment	24 833.5	26 268.8	26 998.1	27 403.0	27 632.0	27 534.2	27 141.4
Intangible assets	531.0	557.0	690.4	1 102.7	1 104.7	1 087.7	1 078.5
Equity interests	700.3	1 561.1	1 401.6	1 501.0	1 501.0	1 501.0	1 501.0
Other fixed assets	671.5	893.9	564.9	424.1	424.1	424.1	424.1
Current assets	19 367.0	17 694.9	19 433.0	20 718.9	24 241.7	24 678.5	23 545.9
Inventories	10 365.4	9 089.0	10 619.9	11 294.9	13 484.8	12 395.5	11 567.0
Short-term receivables	6 884.5	6 356.2	5 417.5	6 108.8	7 276.7	8 888.4	8 659.2
Other current assets	618.9	905.4	454.7	494.5	494.5	494.5	494.5
Cash and cash equivalents	1 498.2	1 344.2	2 941.0	2 820.7	2 985.6	2 899.9	2 825.1
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	46 103.3	46 975.8	49 088.1	51 149.8	54 903.6	55 225.6	53 691.0
Equity	19 935.3	17 813.1	19 037.9	21 627.9	22 621.8	23 842.0	24 566.0
Share capital	1 057.6	1 057.6	1 057.6	1 057.6	1 057.6	1 057.6	1 057.6
Other equity	18 877.6	16 755.5	17 980.3	20 570.3	21 564.2	22 784.4	23 508.4
Minority interests	2 638.0	2 718.6	2 669.3	2 612.0	2 731.2	2 833.4	2 939.5
Long-term liabilities	11 091.4	4 634.2	13 206.5	10 667.9	12 057.3	11 535.9	9 857.8
Loans	8 602.7	2 610.7	11 610.5	9 124.0	10 513.4	9 992.0	8 313.9
Other	2 488.7	2 023.5	1 596.0	1 543.9	1 543.9	1 543.9	1 543.9
Short-term liabilities	12 438.7	21 809.9	14 174.4	16 242.0	17 493.4	17 014.2	16 327.7
Loans	1 719.2	11 282.1	1 593.7	1 543.7	1 443.1	1 371.5	1 141.2
Trade creditors	9 181.2	8 377.0	11 494.5	13 436.0	14 788.0	14 380.4	13 924.3
Other	1 538.2	2 150.8	1 086.1	1 262.2	1 262.2	1 262.2	1 262.2
Debt	10 321.9	13 892.8	13 204.2	10 667.7	11 956.5	11 363.6	9 455.1
Net debt	8 823.7	12 548.5	10 263.2	7 847.0	8 970.9	8 463.6	6 630.0
(Net debt / Equity)	44.3%	70.4%	53.9%	36.3%	39.7%	35.5%	27.0%
(Net debt / EBITDA)	1.8	14.1	2.8	1.4	1.9	1.7	1.3
BVPS	46.6	41.6	44.5	50.6	52.9	55.7	57.4

**Cash Flows**

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	1 965.1	3 617.0	5 161.8	6 110.2	2 406.3	3 546.9	5 231.6
Net income*	2 480.4	-2 526.6	1 300.3	2 455.5	1 856.1	1 945.7	2 054.9
D&A expenses	2 431.4	2 491.4	2 568.0	2 422.7	2 682.9	2 741.7	2 784.3
Working capital	-2 830.4	1 358.2	1 815.0	878.3	-2 005.9	-930.0	601.7
Other	-116.3	2294.0	-521.5	353.7	-126.9	-210.5	-209.3
Cash flows from investing activities	-2 845.1	-4 385.0	-2 540.0	-2 920.1	-2 913.9	-2 626.9	-2 382.4
CAPEX	-3 693.7	-3 969.4	-2 671.0	-3 724.4	-2 913.9	-2 626.9	-2 382.4
Capital investment	-539.5	-736.9	-1 019.0	-115.9	0.0	0.0	0.0
Other	1388.2	321.3	1150.0	920.2	0.0	0.0	0.0
Cash flows from financing activities	27.0	612.6	-1 021.6	-3 297.7	672.6	-1 005.7	-2 924.0
Stock issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	667.9	1 902.1	-269.0	-2 720.1	1 288.8	-592.9	-1 908.4
Dividend (buy-back)	0.0	-692.9	0.0	0.0	-491.1	-371.2	-972.9
Other	-640.9	-596.7	-752.6	-577.6	-125.1	-41.5	-42.7
Change in cash	-853.1	-155.4	1 600.2	-107.6	164.9	-85.7	-74.8
Cash at period-end	1 498.2	1 344.5	2 941.0	2 820.7	2 985.6	2 899.9	2 825.1
DPS (PLN)	0.00	1.62	0.00	0.00	1.15	0.87	2.27
FCF	-2 559.0	-2 071.3	1 649.3	1 969.0	-507.7	920.0	2 849.2
(CAPEX / Sales)	5.8%	5.0%	3.9%	4.5%	2.9%	2.7%	2.5%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	8.9	-	16.3	9.0	12.3	11.6	11.0
P/CE	4.4	-	5.5	4.5	4.8	4.7	4.5
P/BV	1.1	1.2	1.1	1.0	0.9	0.9	0.9
P/S	0.3	0.3	0.3	0.3	0.2	0.2	0.2
FCF/EV	-7.8%	-5.7%	4.8%	6.2%	-1.5%	2.8%	9.2%
EV/EBITDA	6.5	41.3	9.4	5.7	6.8	6.6	6.1
EV/EBIT	12.6	-	31.3	10.2	15.3	14.9	13.3
EV/S	0.5	0.5	0.5	0.4	0.3	0.3	0.3
DYield	0.0%	3.2%	0.0%	0.0%	2.3%	1.7%	4.5%
Price (PLN)	50.0						
Shares at year-end (millions)	427.7	427.7	427.7	427.7	427.7	427.7	427.7
MC (PLN m)	21 385	21 385	21 385	21 385	21 385	21 385	21 385
Equity attributable to minority shareholders (PLN m)	2 638	2 719	2 669	2 612	2 731	2 833	2 939
EV (PLN m)	32 847	36 653	34 318	31 844	33 087	32 682	30 955

*Inclusive of profits attributable to minority shareholders.



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**List of abbreviations and ratios contained in the report:***EV* – net debt + market value*EBIT* – Earnings Before Interest and Taxes*EBITDA* – EBIT + Depreciation and Amortisation*P/CE* – price to earnings with amortisation*MC/S* – market capitalisation to sales*EBIT/EV* – operating profit to economic value*P/E* – (Price/Earnings) – price divided by annual net profit per share*ROE* – (Return on Equity) – annual net profit divided by average equity*P/BV* – (Price/Book Value) – price divided by book value per share*Net debt* – credits + debt papers + interest bearing loans – cash and cash equivalents*EBITDA margin* – EBITDA/Sales**Recommendations of BRE Bank Securities**

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Rating	Hold	Reduce
Date issued	2010-11-02	2010-12-03
Price on rating day	40.21	46.49
WIG on rating day	46229.60	46481.15