

REPORT

**of the Management Board of CIECH S.A. with its registered office in Warsaw ("CIECH" or the "Company"),
prepared on 27 May 2011
in connection with an increase in the Company's share capital
and acquisition of the Company's new shares in consideration of contributions in kind
(the "Report")**

GOAL AND LEGAL BASIS OF THE REPORT

This Report has been drawn up in accordance with Article 311 in conjunction with Article 431 § 7 of the act of 15 September 2000, Commercial Companies Code (Journal of Laws No 94, item 1037 as amended) ("CCC"), in connection with the planned increase in the Company's share capital (the "**Increase in the Share Capital**") by issue of 1,885,090 (in words: one million eight hundred eighty-five thousand ninety) E series ordinary shares for bearer with a nominal value of PLN 5.00 (in words: five zloty) each and the total nominal value of PLN 9,425,450 (in words: nine million four hundred twenty-five thousand four hundred fifty zloty) (the "**New Issue Shares**").

The Company is going to offer all New Issue Shares to the State Treasury of the Republic of Poland (the "**State Treasury**") by private subscription referred to in Article 431 § 2 (1) CCC, with exclusion of the pre-emptive rights with respect to the New Issue Shares.

In view of the fact that the New Issue Shares are to be covered by the State Treasury with contributions in kind (described in Part II hereof), the Management Board of the Company is obliged to prepare this Report, in accordance with Article 311 in conjunction with Article 431 § 7 CCC.

SUBJECT MATTER OF THE CONTRIBUTIONS IN KIND

1. Description of the Contributions in Kind

The New Issue Shares will be paid for with contributions in kind (the "**Contributions in Kind**") comprising:

- 1) 571,826 (in words: five hundred seventy one thousand eight hundred and twenty six) A series ordinary bearer shares with a nominal value of PLN 2.30 (in words: two zloty and thirty grosz) each, with the total nominal value of PLN 1,315,199.80 (in words: one million three hundred fifteen thousand one hundred and ninety nine zloty eighty grosz) in Zakłady Chemiczne Alwernia S.A. having its registered office in Alwernia (hereinafter, "**Alwernia**" and "**Alwernia Shares**", respectively); and
- 2) 762,224 (in words: seven hundred sixty two thousand two hundred and twenty four) A series ordinary registered shares with a nominal value of PLN 10.00 (in words: ten zloty) each, with the total nominal value of PLN 7,622,240.00 (in words: seven million six hundred twenty two thousand two hundred and forty zloty) in Zakłady Chemiczne "ZACHEM" S.A. having its registered office in Bydgoszcz (hereinafter, "**Zachem**" and "**Zachem Shares**", respectively); and
- 3) 429,388 (in words: four hundred twenty nine thousand three hundred and eighty eight) A series ordinary

registered shares with a nominal value of PLN 10.00 (in words: ten zloty) each, with the total nominal value of PLN 4,293,880.00 (in words: four million two hundred ninety three thousand eight hundred and eighty zloty) in Zakłady Chemiczne "Organika- Sarzyna" S.A. having its registered office in Nowa Sarzyna (hereinafter, "Organika Sarzyna" and "Organika-Sarzyna Shares", respectively).

Alwernia Shares, Zachem Shares and Organika-Sarzyna Shares (hereinafter jointly referred to as the "**Shares of the State Treasury**") are paid up in full, free from any encumbrances and third parties' rights.

2. Information about the companies whose shares make up the Contributions in Kind

Alwernia

Alwernia is a subsidiary of CIECH. The company is a holder of 1,686,047 Alwernia shares, representing a total of 73.75% of the share capital of Alwernia and carrying 73.75% of the total number of votes at the general meeting of Alwernia.

The share capital of Alwernia accounts for PLN 5,258,168 (in words: five million two hundred fifty eight thousand one hundred and sixty eight zloty) and is divided into 2,286,160 (in words: two million two hundred eighty six thousand one hundred and sixty) A series ordinary shares for bearer numbered 000 000 001 to 002 286 160 with a nominal value of PLN 2.30 (in words: two zloty and thirty grosz) each.

Zachem

Zachem is a subsidiary of CIECH. The company is a holder of 13,659,026 Zachem shares, representing a total of 92.29% of the share capital of Zachem and carrying 92.29% of the total number of votes at the general meeting of Zachem.

The share capital of Zachem accounts for PLN 148,000,000 (in words: one hundred and forty eight million zloty) and is divided into 14,800,000 (in words: fourteen million and eight hundred) A series registered shares numbered 000 000 001 to 014 800 000 with a nominal value of PLN 10.00 (in words: ten zloty) each.

Organika-Sarzyna

Organika-Sarzyna is a subsidiary of CIECH. The company is a holder of 7,900,147 Organika-Sarzyna shares, representing a total of 93.05% of the share capital of Organika-Sarzyna and carrying 93.05% of the total number of votes at the general meeting of Organika-Sarzyna.

The share capital of Organika-Sarzyna accounts for PLN 84,900,000 (in words: eighty four million and nine hundred thousand zloty) and is divided into 8,490,000 (in words: eight million and four hundred and ninety thousand) A series registered shares numbered 000 000 001 to 008 490 000 with a nominal value of PLN 10.00 (in words: ten zloty) each.

NUMBER AND TYPE OF SHARES TO BE ISSUED IN EXCHANGE FOR THE CONTRIBUTIONS IN KIND

In exchange for the Contributions in Kind, CIECH will issue 1,885,090 (in words: one million eight hundred eighty five thousand and ninety) E series ordinary New Issue Shares for bearer with a nominal value of PLN 5.00 (in words: five zloty) each and the total nominal value of PLN 9,425,450 (in words: nine million four hundred twenty-five thousand four hundred fifty zloty).

The New Issue Shares will be issued as shares for bearer, in accordance with Article 336 § 3 CCC as the Company and the State Treasury are going to apply for admission and introduction of the New Issue Shares into trading in the regulated market - basic market operated by Giełda Papierów Wartościowych w Warszawie S.A. ("Warsaw Stock Exchange", "WSE") and the related dematerialisation of the New Issue Shares.

ISSUE PRICE AND ITS JUSTIFICATION

The issue price of the New Issue Shares accounts for PLN 23.50 (twenty three zloty and fifty grosz) for one New Issue Share.

The total issue price of the shares issued by CIECH in connection with the Increase in the Share Capital in consideration of the Contributions in Kind will account for 44,299,615 (in words: forty-four million two hundred ninety-nine thousand six hundred fifteen zloty). The difference between the total issue price of the New Issue Shares and their nominal value constitutes agio, which will be allocated to the Company's supplementary capital in accordance with Art. 396 § 2 CCC.

The Issue Price of the New Issue Shares has been determined on arm's length basis by using the average price from historical quotations of CIECH shares in the public market ("WSE"). The average price constitute the arithmetic mean of average daily prices of CIECH shares weighed by the volume for the period of three months until 30 April 2011, i.e. as at the date of calculation of the value of the Contributions in Kind. The application of the average from the aforementioned period (three months) was aimed at assumption of a period equivalent to the period assumed to calculate the average market price paid by investors in the case of takeover of companies traded in the regulated market. The aforementioned procedure reduces the impact of short-term trends and accidental fluctuations of quotations of share prices on the results of estimation of the fair market value. The issue price of the New Issue Shares was determined based on the aforementioned criteria by BRE Corporate Finance S.A. having its registered office in Warsaw (the "**Financial Adviser**") at the request of the Company.

The number of the New Issue Shares has been established on the basis of the following formula:

$$L_{ANE} = \frac{WA}{CE_{ANE}}$$

where:

L_{ANE} means the number of the New Issue Shares (but if L_{ANE} constitutes a number different than an integral number, L_{ANE} will be rounded down to an integral number);

WA means the value of the Shares of the State Treasury;

CE_{ANE} means the Issue price of the New Issue Shares.

ENTITIES MAKING THE CONTRIBUTIONS IN KIND

The Contributions in Kind to cover the New Issue Shares shall be made by the State Treasury.

In exchange for the Contributions in Kind, the State Treasury will acquire all New Issue Shares. The acquisition of the New Issue Shares and the transfer of the Shares of the State Treasury as a contribution in kind to cover the New Issue Shares will take place on the basis of a contract (contracts) entered into between CIECH and the State Treasury.

DETERMINATION OF THE VALUE OF THE CONTRIBUTIONS IN KIND AND THE EVALUATION METHOD APPLIED

The value of the Contributions in Kind has been determined on the basis of evaluation of the Shares of the State Treasury (the "**Evaluation**") made by the Financial Adviser upon request of the Company.

The following evaluation methods were used in order to prepare the Evaluation:

- 1) Income-based method — method of discounted cash flows
- 2) Comparative method — method of market multipliers

The income-based method is based on the evaluation of the forecasted free cash flows for owners of (own and foreign) capital brought to the current value using the weighted average cost of capital after tax. The method is oriented at future cash flows generated by a company, which enables to reflect the company's potential and characteristics of the market in which it operates. The method enables to take into account the specific features of a company being evaluated, i.e. factors taken into account by shareholders when deciding on whether to acquire the shares and on the price offered for them. The Evaluation uses long-term financial projections and cost of capital adequate to the risk of a given entity.

The evaluation made by the comparative method consists in determination of the value of a company being evaluated by determining the relations between the market evaluations (exchange quotations) of comparable companies and their financial parameters and use of the relations (multipliers) in relation to the financial parameters of the company being evaluated. The comparative method uses typical market multipliers based on the sales revenues, operating result before depreciation and amortisation, operating result, net financial result and equity. The comparative method enables to reflect the situation in the capital market and forecasts of investors regarding entities of the industry, i.e. factors taken into account by shareholders when deciding on whether to acquire the shares and on the price offered for them. The analysis covered historical multipliers, current multipliers and forecasted multipliers for domestic and foreign entities.

The results of the Evaluation are presented in the tables below.

1) Evaluation of total values of the Shares of the State Treasury (rounded down):

in PLN million for blocks of shares	<u>Alwernia Shares</u>	<u>Zachem Shares</u>	<u>Organika-Sarzyna Shares</u>
Income-based evaluation	18.3	5.9	19.0
Comparative evaluation (multiplier method)	19.0	7.3	20.1
Average evaluation by both methods	18.6	6.6	19.5

2) Evaluation of individual shares included in the Shares of the State Treasury (rounded down):

in PLN for one share	<u>Alwernia Shares</u>	<u>Zachem Shares</u>	<u>Organika-Sarzyna Shares</u>
Income-based evaluation	32.0	7.8	44.1
Comparative evaluation (multiplier method)	33.2	9.6	46.9
Average evaluation by both methods	32.6	8.7	45.5

In the analysis of financial conditions of the transaction, the Financial Adviser took into account the provisions of agreements between the State Treasury and CIECH concerning the adjustment of the price of purchase by CIECH of Zachem and Organika-Sarzyna Shares from the State Treasury, and provisions of the draft Agreement III between CIECH and State Treasury concluded on 26 May 2011.

Taking into account of the economic conditions of the transaction mentioned in this Report in the part entitled "Substantiation of the intended transaction", based on the comparison of the Evaluation results obtained and the value of the Shares of the State Treasury arising from the Agreement, the Financial Adviser suggested to the Management Board of the Company, in its letter dated 25 May 2011 (the "**Recommendation of the Financial Adviser**"), to determine the value of the Contributions in Kind in accordance with the draft Agreement III, defining a condition for the above in the form of maintaining the level of these prices in Agreement III agreed and signed finally by the Parties. In the opinion of the Financial Adviser, the prices of the Shares of the State Treasury arising from the Agreement do not deviate from fair evaluations determined in the Evaluation. The Recommendation of the Financial Adviser forms **Appendix 1** to this Report.

Based on the Evaluation and the Recommendation of the Financial Adviser, the Management Board of the Company has determined the total value of the Contribution in Kind comprising the Shares of the State Treasury at PLN 44,299,635.84 (in words: forty four million two hundred ninety nine thousand six hundred and thirty five zloty eighty four grosz), including:

- 1) the total value of Alwernia Shares has been established at PLN 18,332,741.56 (in words: eighteen million three hundred thirty two thousand seven hundred and forty one zloty fifty six grosz), i.e. PLN 32.06 (in words:

thirty two zloty and six grosz) for one Alwernia Share;

- 2) the total value of Zachem Shares has been established at PLN 6,494,148.48 (in words: six million four hundred ninety four thousand one hundred and forty eight zloty forty eight grosz), i.e. PLN 8.52 (in words: eight zloty and fifty two grosz) for one Zachem Share;
- 3) the total value of Organika-Sarzyna Shares has been established at PLN 19,472,745.80 (in words: nineteen million four hundred seventy two thousand seven hundred and forty five zloty eighty grosz), i.e. PLN 45.35 (in words: forty five zloty and thirty five grosz) for one Organika-Sarzyna Share.

On 26 May 2011, the statutory auditor, i.e. PKF AUDYT Sp. z o.o. (the "**Statutory Auditor**") issued an opinion concerning the fair value of the Contributions in Kind comprising the Shares of the State Treasury (the "Opinion of the Statutory Auditor") showing that the value of the Shares of the State Treasury assumed in this Report by the Management Board of the Company corresponds to their fair value. The Opinion of the Statutory Auditor forms **Appendix 2** to this Report.

SUBSTANTIATION OF THE INTENDED TRANSACTION

The contribution of the Shares of the State Treasury to cover the New Issue Shares implements the transaction agreed between the Company and the State Treasury based on the following circumstances:

- 1) Pursuant to the contracts entered into on 29 March 2006 between CIECH and Nafta Polska S.A. having its registered office in Warsaw (the "**Contracts for the Sale of Shares**"), CIECH acquired from Nafta Polska S.A.: (i) 11,840,000 Zachem shares with a nominal value of PLN 10,00 each, representing a total of 80% of the share capital of Zachem and (ii) 6,792,00 Organika-Sarzyna shares with a nominal value of PLN 10,00 each, representing a total of 80% of the share capital of Organika-Sarzyna;
- 2) Pursuant to the Contracts for the Sale of Shares, CIECH made to the State Treasury irrevocable offers for acquisition of all other Zachem shares and all Organika-Sarzyna shares held by the State Treasury (the "**Share Acquisition Offers**"). The State Treasury is entitled to accept the Share Acquisition Offers by the expiry of their validity, i.e. by 20 December 2016.
- 3) On 5 January 2010, CIECH entered into agreements with the State Treasury pursuant to which the Share Acquisition Offers were changed in respect of indexation of the price of acquisition by CIECH from the State Treasury of Zachem shares and Organika-Sarzyna shares by determination of the indexation rate of prices payable in the case of acceptance of the Share Acquisition Offers, where the price indexation took place until 20 December 2010. Later, on 28 December 2010 CIECH entered into agreements with the State Treasury pursuant to which the indexation period was prolonged until 20 December 2011;
- 4) The acquisition of the New Issue Shares in exchange for a contribution in kind comprising Zachem Shares and Organika-Sarzyna Shares forms an alternative to the acquisition by CIECH from the State Treasury of Zachem Shares and Organika-Sarzyna Shares pursuant to sales contracts which could be entered into (irrespective of CIECH's will) by way of acceptance of the Share Acquisition Offers by the State Treasury;
- 5) The validity of the Share Acquisition Offers for CIECH causes a negative uncertainty for the Company and its shareholders regarding the possibility and date of acceptance of the Share Acquisition Offers by the State Treasury, as well as financial consequences of the necessity to pay by CIECH of the sale price. As a result of the Increase in the share capital and paying for the New Issue Shares with a contribution in kind comprising the Shares of the State Treasury, the Company will not experience such uncertainty and at the same time, CIECH will not have to pay the price of Zachem Shares and Organika-Sarzyna Shares in cash;
- 6) Furthermore, in connection with the intention of the State Treasury to sell Alwernia Shares and the divestment of Alwernia conducted by CIECH, within the framework of which CIECH allows for a temporary increase in the involvement in Alwernia, the Parties agreed to issue the New Issue Shares also for a contribution in kind comprising Alwernia Shares. Due to the contribution by the State Treasury of Alwernia Shares to CIECH, CIECH will acquire nearly one hundred percent of shares in the share capital of Alwernia, which will enable it to freely decide on the operations of the company and use its shares.

The aforementioned circumstances, as well as the fact that the value of the Shares of the State Treasury assumed by the Management Board of CIECH as a result of the evaluation does not deviate from the fair value established by the Statutory Auditor in the Opinion of the Statutory Auditor show that the contribution of the Shares of the State Treasury to CIECH to cover the New Issue Shares is justified.

In view of the foregoing, pursuant to Art. 312¹ § 1 (2) in conjunction with Art. 431 § 7 CCC, on 27 May 2011, the Management Board of CIECH adopted a resolution concerning resignation from examination of this report by a statutory auditor referred to in Art. 312 § 1 and the following ones CCC.

Signatures of the members of the Management Board of CIECH S.A.:

PRESIDENT OF THE MANAGEMENT
BOARD
Ryszard Kunicki

Member of the Management Board
Rafał Rybkowski

Member of the Management Board
Andrzej Bąbaś