



**MANAGEMENT  
REPORT  
CIECH S.A.  
2005**

## 1 GENERAL INFORMATION

### 1.1 Ciech S.A. Overview.

Ciech S.A. has been active in business for more than 60 years. It has been operating as a public limited company since September 1, 1995. At the beginning, CIECH SA's business operations focused on trade in chemical products in the domestic market, as well as exports and imports.

In the 90s, the Company acquired controlling interests in the chemical companies focused predominantly on manufacturing and established the CIECH Group, which in turn became one of the largest chemical manufacturers in Poland.

The Company's primary business, as specified in the Articles of Association, consists of trading, investment, manufacturing, service, and financial activities, particularly trading in chemicals and related business. The Company is also licensed to act as an agent for Polish and foreign companies.

CIECH SA sells chemicals in the Polish market, and is a major contributor to Poland's foreign trade in chemical industry products (export and import). CIECH SA intermediates in the sales of such key products as soda ash, yellow phosphorus, phosphorites, salt, ethylene, and toluene. CIECH SA's leading export products include soda ash, phosphatic fertilisers and mixed fertilisers, sulphur, salt, isocyanates (TDI), baking soda, sodium water glass, epichlorohydrin and PVC. The Company's largest markets are Western European countries, Central, and Eastern Europe.

At 31.12.2005, the composition of the CIECH SA Management Board was as follows:

Ludwik Klinkosz	CEO, Managing Director
Jerzy Golis	Board Member
Stefan Rojewski	Board Member

The Company's Proxy is its Financial Director, Kazimierz Przełomski.

At the day of the statement publication, the composition of the CIECH SA Supervisory Board was as follows:

Edmund Pietrzak - President of the Supervisory Board  
 Maksymilian Klank – Vice-President of the Supervisory Board  
 Krystyna Dziworska – Secretary to the Supervisory Board  
 Magdalena Bąkowska - Member of the Supervisory Board  
 Wiesław Piosik – Member of the Supervisory Board  
 Maciej Rudnicki – Member of the Supervisory Board  
 Zbigniew Markowski – Member of the Supervisory Board  
 Marek Konopczyński – Member of the Supervisory Board  
 Dariusz Krajowski-Kukiel - Member of the Supervisory Board

### 1.2 Ciech SA's Financial Performance.

The table below shows selected items of CIECH SA's balance sheet and profit and loss account, as well as the key financial indicators recorded in 2005, compared to 2004.

**Table 1.2.1. Selected financial information (thousands PLN)**

	Jan-Dec 2005	Jan-Dec 2004	2005/2004 dynamics
Sales revenue	1 588 892	1 470 007	8.09%
Costs of product, goods and materials sold	1 346 569	1 318 757	2.11%
Gross sales profit	242 323	151 250	60.21%
Net sales profit	61 248	28 019	118.59%
Operating profit (EBIT)	58 395	33 920	72.16%
Gross profit (loss)	43 479	21 383	103.33%
Net profit (loss)	41 900	19 445	115.48%
EBITDA ( <i>operating profit+ amortisation</i> )	65 546	42 837	53.01%

	31.12.2005	31.12.2004	2005/2004 dynamics
Fixed assets	492 865	496 448	-0,72%
Current assets	410 311	333 172	23,15%
including			
reserves	10 987	18 460	-40.48%
receivables	310 688	310 103	0.19%
short-term investments	88 212	3 644	-
Value of assets	903 176	829 620	8.87%
Equity	584 079	356 022	64.06%
Provisions	20 736	19 955	3.91%
Long-term liabilities	18 527	35 185	-47.34%
Short-term liabilities	271 314	413 339	-34.36%

	Jan-Dec 2005	Jan-Dec 2004	2005/2004 dynamics
Sales profitability ratio <i>profit from sales / revenue from sales</i>	3.9%	1.9%	101.6%
Return on sales (ROS) <i>net profit / revenue from sales</i>	2.6%	1.3%	100.0%
Return on equity (ROE) <i>net profit / equity</i>	7.2%	5.5%	31.3%
Current ratio <i>current assets / short-term liabilities</i>	1.51	0.81	86.4%
Quick ratio <i>(current assets - reserves) / short-term liabilities</i>	1.47	0.76	93.4%
Equity to assets ratio <i>equity / assets</i>	64.7%	42.9%	50.8%
Debt ratio <i>(long-term liabilities + short-term liabilities) / assets</i>	32.1%	54.1%	-40.7%

**Source: Ciech SA**

### Sales revenue

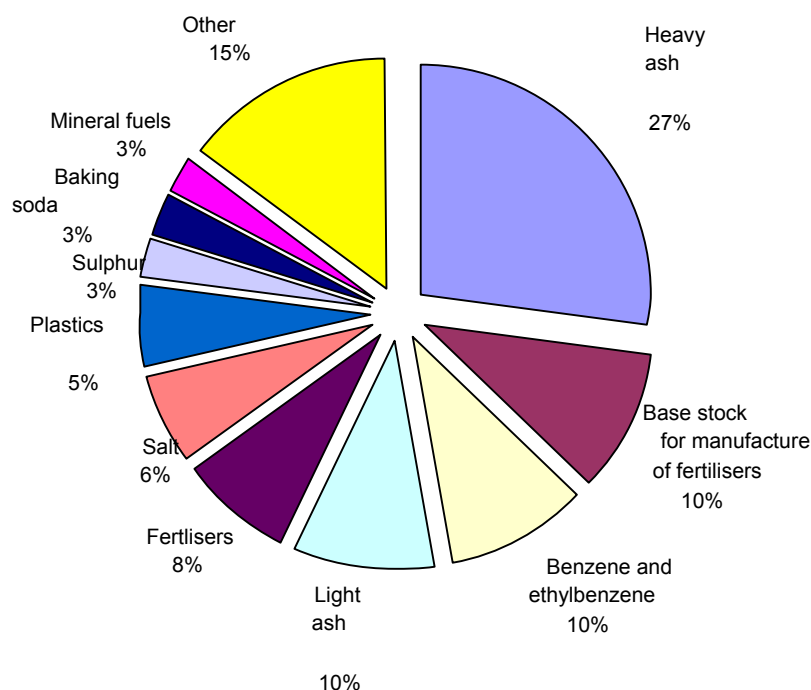
CIECH SA's 2005 sales revenue totalled **1 588 892 000 PLN** which was over 8% greater than in 2004. The increase concerned mainly home sales and resulted mainly from restructuring of the CIECH Group with regard to trade in soda products (outsourcing of the sales service, purchase of raw materials and logistics from soda companies to Ciech SA) and favourable prices of soda products.

### Geographic structure of sales revenue

Ciech SA's product portfolio is characterised by a high degree of maturity, and its sales are founded on long-lasting relationships with its customers. The local market continues to be the major market, whilst the European market continues to be the major export market. The geographical proximity and the lack of trade barriers make EU countries the natural markets for Ciech SA. This means that the return on export sales is strictly dependent on the economic situation in that area and on the EURO exchange-rate fluctuations. In 2005 home sales constituted almost 58% of total sales in the revenue structure, and amounted to 920 069 000 PLN. Export sales amounted to 668 823 000 PLN.

### Commodity structure of the sales revenue

The revenue structure of Ciech SA reflects largely the structure of sales of the CIECH Group. A considerable share of the products manufactured by the Group's member companies is sold through Ciech SA. As a result, CIECH SA derives its revenue mostly from sales of the leading products of the Group, such as soda ash and ethylbenzene. Due to operating relations between Ciech SA and its subsidiaries, including among others co-ordination of purchasing policy, an important position in the Ciech SA sales structure belongs to the supply of raw materials to subsidiaries of Ciech SA (base stock for manufacture of fertilisers, ethylene). Ciech SA acts as a commission agent for goods manufactured outside the Group.

**Figure 1. Breakdown of sales revenue by leading products**

Source: Ciech SA

The 2005 revenue by business segments was as follows:

**Table 1.2.2 CIECH SA's revenue by business segments (thousands PLN)**

	Sales revenue	Share in sales (%)
Soda Segment	774 127	49
Agrochemical Segment	300 059	18
Petrochemical Segment	326 879	21
Inorganic Chemical Segment	84 651	5
Organic Chemical Segment	46 805	3
Segment of Silicates and Glass Products	42 692	3
Pharmaceutical Segment	220	0
Power Engineering Segment	0	0
Other	13 459	1
<b>TOTAL</b>	<b>1 588 892</b>	<b>100</b>

Source: Ciech SA

### **Net sales profit**

The Company's **net sales profit** reached **61 248 000 PLN**. The result from the previous year was less than half the current one (lower by 33 229 000 PLN). The immediate cause of the increase of sales profit in 2005 was the restructuring of the activity of the CIECH Chemical Group in the field of trade in soda products.

### **Operating profit (EBIT)**

In 2005, the **operating profit** amounted to **58 395 000 PLN** and was higher than 2004 figure by 24 475 000 PLN (i.e. by 72%). As in the last year, the operating profit was derived mainly from the core business activity (profit on sales of 61 248 000 PLN). EBIT was also positively influenced by profit on sales of non-financial fixed assets in the amount of 7 308 000 PLN (sales of the fuel station in Dąbrowa and the right of perpetual usufruct to the land in Blachownia) as well as the profit on rental in the amount of 1 833 000 PLN. Operating profit was negatively influenced by the increase in provisions for potential claims related to the pending court proceedings (in the total amount of 7 500 000 PLN) and debts forgiven in the amount of 6 766 000 PLN (mainly as part of the reorganisation in the subsidiary Cheman).

**Gross profit**

In 2005, the Company's gross profit amounted to **43 479 000 PLN**, which was 22 096 000 PLN more than in 2004. The main source of the gross profit was the core business activity.

The Company's **financial activities** in 2005 generated a loss of **-14 916 000 PLN** (in 2004, the loss equalled -12 537 000 PLN). The **financial revenue (23 453 000 PLN)** was mainly made up of dividends received from the affiliates (15 064 000 PLN) and interest (6 514 000 PLN, mainly accrued on past due payments). The **financial costs** amounted to **38 369 000 PLN** and were mainly made up of (a) revaluation of investments – 23 539 000 PLN (mainly write-downs on the value of shares in Cheman SA and Boruta Kolor SA) and (b) interest – 4 274 000 PLN (including 3 648 000 PLN against long-term loans).

The Company recorded no extraordinary gains or losses in 2005.

**Net result**

In 2005, the Company's net profit amounted to **41 900 000 PLN**, which was 22 455 000 PLN more than in 2004. The table below shows the key business activities shaping the net result, and the comparative information concerning 2004.

**Table 1.2.3. Financial performance by type of business operations (thousands PLN)**

	Jan-Dec 2005	Jan-Dec 2004	2005/2004 dynamics
1. sales profit/loss	61 248	28 019	118.6%
2. profit/loss on other operating activities	-2 853	5 901	-148.4%
3. profit/loss on financial activities	-14 916	-12 537	19.0%
<b>4. gross profit/loss (1+2+3)</b>	<b>43 479</b>	<b>21 383</b>	<b>103.3%</b>
5. income tax	1 579	1 938	-18.5%
<b>6. net profit/loss (4-5)</b>	<b>41 900</b>	<b>19 445</b>	<b>115.5%</b>

Source: Ciech SA

**Balance sheet****Capital structure**

In 2005, the equities increased by 228 057 000 PLN, i.e. by approx. 64% in comparison to December 31, 2004. The decisive impact on the increase of equity of Ciech SA had: (a) issue of shares in February 2005 (192 347 000 PLN) and (b) net profit generated in 2005 (41 900 000 PLN).

The **value of assets** as of December 31, 2005 amounted to **903 176 000 PLN**. In comparison with the situation at the end of 2004, the value of assets increased by 73 556 000 PLN. The increase of assets resulted from changes in current assets. Fixed assets dominated the overall asset structure, accounting for 55% of the total assets at the end of December. The major portion of the fixed assets was comprised of long-term financial assets worth 433 829 000 PLN whose value remained similar to the level from December 31, 2004. The general amount of current assets was 410 311 000 PLN. In 2005, the current assets increased by 77 139 000 PLN. The main reason for the growth was the increase of the amount of short-term investments, caused by an inflow of funds from the issue of shares. Because of the commercial nature of the Company's operations, its current assets are mostly comprised of receivables. As of December 31, 2005, the receivables stood at 310 688 000 PLN.

**Liabilities and the Company's debt**

Ciech SA's total short- and long-term liabilities as of December 31, 2005 amounted to 289 841 000 PLN, which was 158 683 000 PLN less than December 31, 2004. The decisive reason for a decrease of liabilities was repayment of short-term loans, following the receipt of cash ensuing from issue of shares (to date of commencement of scheduled acquisitions, the cash ensuing from issue of shares have been applied to repayment of current bank liabilities). A less important factor that contributed to a lower level of liabilities was the repayment of investment loans taken in previous years.

The amount of cash as of December 31, 2005 was higher than the amount of financial liabilities by 13 772 000 PLN. In the previous year the leverage ratio (defined as the net debt as compared to the net debt and equity) was 34.1%, and net debt amounted to 184 474 000 PLN.

The total debt ratio (the ratio of long- and short-term debt to total assets) dropped in 2005 from 54.1% to 32.1%.

**Financial ratios**

**Sales profitability ratio**, calculated as the ratio of net sales profit to sales revenue, stood at 3.85% at the end of December 2005, and was twice as high as the one recorded in the previous year. The increase of the ratio resulted mainly from restructuring of the CIECH Group with regard to trade in soda products (outsourcing of the sales service, purchase of raw materials and logistics from soda companies to Ciech SA).

**Return on sales (ROS)**, calculated as the quotient of the net result and the sales revenue stood at 2.64% and was considerably higher than the figure recorded on December 31, 2004 (when it equalled 1.32%).

**Return on equity (ROE)**, calculated as the quotient of the net result and equity stood at 7.17% (5.46% in the previous year).

**Current ratio**, calculated as the quotient of total current assets and short-term liabilities, amounted to 1.51 at December 31, 2005, which constitutes 86% improvement as compared to the end of 2004. This shows that the Company has considerably improved its liquidity.

**Quick ratio**, calculated as the ratio of the current assets less reserves to short-term liabilities, was 1.47 (0.76 as of December 31, 2004). That ratio was higher than the recommended safety level (1.0).

### **Cash flow statement**

Operating cash flows in 2005 amounted to +49 226 000 PLN. In 2004, operating cash flows were negative and amounted to -2 222 000 PLN. In 2005, the main source of cash in this area was profit generated on sales of 61 248 000 PLN.

The excess of capital expenditure over investment inflows amounted in 2005 to 34 324 000 PLN. Negative balance was mainly the result of the deposit and investment activity. Ciech SA used the funds obtained from the issue of shares to purchase securities and grant loans to the companies belonging to the CIECH Group (until those funds were used to finance strategic investments).

Financial cash flows amounted to +30 346 000 PLN. The main source of cash flow was the proceeds from the issue of shares. The biggest expense was repayment of current loans, which was financed from the funds obtained from the issue till the start of strategic investments.

## **1.3 Explanations Regarding Seasonal or Periodical Character of the Company's Business.**

The trading activity of Ciech SA involves largely the chemicals that are raw materials. The raw-material markets are characterised by high cyclicity, prompted by trade fluctuations in the world economy.

With regard to inorganic chemicals, which are dominating items in the turnover of Ciech S.A. (soda ash, soda-derived products, mixed and phosphatic fertilisers) the differences in market prices are slight (up to 10% a year). Changes in prices of soda ash are mainly connected with annual contracts, whose terms and conditions are usually determined at the end of the calendar year and are binding from the start of the following year.

The biggest fluctuations of market prices connected with these cycles concern oil-derived products such as benzene, toluene, and ethylbenzene. In their case, the periods of several years (3-5 years) see the price differences ranging from 50% to over 100%. The prices of many chemicals belonging to that group increased considerably in 2004. In 2005, their market prices fluctuated considerably too, yet at the end of the period they stabilised at a lower level in comparison to the record prices in 2004.

As for plastics, their prices are also heavily dependent on the oil prices. Due to a jump in the price of crude oil in Q3 2005, the price of plastics increased again to lower a bit, as late as at the end of the year.

Volume of sales in the mineral fertilisers market fluctuates in annual cycles. Every year, the sales peak comes typically at the end of Q1 and in Q3, which was the case in 2005 too.

Seasonality in sales occurs within some groups of products, but its scale is insignificant, considering its impact on the overall revenue of Ciech SA.

Seasonality connected with periodical fluctuations of demand and supply clearly influenced the volume of sales in 2005 as regards:

- mineral fertilisers
- base stock for manufacture of fertilisers
- plant protectants

Q2 witnessed concentration of sales of plant protectants. Due to the delayed vegetation period, there was an increase in sales of raw materials for manufacture of plant protectants at the expense of the ready-made plant protectants. A decisive factor for the increase of sales of fertilisers was the delayed increase in domestic demand for fertilisers due to bad weather conditions and low prices of crops, which reduced farmers' investment

opportunities as regards means of production. Low domestic demand brought additional volume of export fertilisers from the key supplier.

#### 1.4 Commentary on the Differences between the Actual Financial Result and Previously Published Forecast Publications.

The Company did not publish any forecasts concerning individual results

#### 1.5 Factors Shaping CIECH SA's Financial Performance.

##### Positive factors

- Continuing prosperity of the European glass-making industry (main consumer of soda ash)
- Soda ash price increased, compared to the previous year
- Boom in the construction industry, which is an indirect consumer of many chemical products
- Continuing prosperity in the artificial fertiliser industry: growth in production and export volumes plus higher prices
- Considerable drop in the coke prices compared to the record prices in the previous year (coke is an important ingredient in manufacturing of soda ash)

##### Negative factors

- Increase in value of the Polish currency in 2005 (particularly towards Euro) adversely affecting the profitability of exports of Ciech SA
- Lower dynamics as regards manufacturing and sales in the national chemical industry as a whole (slight increase in comparison with the high baseline: very good results in the previous year)
- 
- Decrease in market prices of ethylbenzene, which has been manufactured so far by the CIECH Chemical Group

#### 1.6 The Use of Funds Coming from the Issue of Shares by the Issuer.

The Ciech S.A. Prospectus was made public on January 6, 2005; on February 10, Ciech SA made its debut on the Warsaw Stock Exchange (GPW). In the Prospectus, the Issuer described its investment programme including a number of projects with the total outlays of 500-600 million PLN to be made in 2005 and 2006. To finance its own investment plan, Ciech SA is going to use the funds coming from the issue of shares, own funds and external financing in the form of long-term investment loans.

- Agrochemical Segment. The construction of the feed phosphate system in Alwernia subsidiary has been completed. In GZNF Fosfory subsidiary, the construction of the system is in progress. The stage of basic investment works has been completed. At the end of 2005, total outlays on the systems in both companies amounted to 11 368 000 PLN.

By way of the Agreement of 29 December 2005 Ciech S.A. acquired from "Provimi-Rolimpex" S.A. a block of 5 400 shares of its own subsidiary, GZNF Fosfory, accounting for 9.32% of share capital, for 6 500 000 PLN. Now, Ciech SA holds 89.04% shares of the GZNF Fosfory's stock.

- Silicates and Glass Products Segment. The hollow glass block production section in Vitrosilicon S.A. subsidiary in Iłowa is being modernised. The subsidiary is introducing the ecological manufacturing technology as regards hollow glass blocks. The modernisation works will be finished in May 2006, and will enable to double the annual output of 3.5 million to 7 million blocks. The aggregate investment value as regards the hollow glass section will reach 25 000 000 PLN.

As part of further development of the glass package manufacturing by Vitrosilicon S.A., the Company initiated the purchase procedure of Huta Szkła Pobiedziska (*Pobiedziska Glass-Works*) with a view to use its property for manufacturing of glass holders for memorial candles and non-standard jars. Vitrosilicon is going to sign the property purchase agreement with regard to Huta Szkła Pobiedziska in May 2006. Then, it plans to invest in the acquired assets in order to reorientate the manufacturing profile. The total investment value (property acquisition plus capital expenditure) is estimated at 25 000 000 PLN.

- Petrochemical Segment. On October 6, 2005, the Company signed the sales agreement concerning 100% of shares of its subsidiary, Petrochemia-Blachownia S.A., focused on benzene and ethylbenzene manufacturing, with the Hungarian concern BorsodChem Rt. Following the approval of the Office of Competition and Consumer Protection, the Company concluded the agreement on January 10, 2006. The funds allocated for investment in this segment have been transferred to the organic segment.

- Organic Segment. The Company took part in a bid for purchase of majority blocks of shares in ZCh Zachem and ZCh Organika Sarzyna. On March 29, 2006 Ciech concluded the purchase agreement with Nafta Polska concerning 80% of shares in ZCh Zachem for 68 500 000 PLN and ZCh Organika Sarzyna for 244 500 000 PLN. What is more, Ciech undertook to invest 176 100 000 PLN in Zachem and 130 000 000 PLN in Sarzyna over a 5-year period.
- Soda Segment. The construction of the monohydrate system has been started in Soda Mątwy SA. The system will enable production of heavy "monohydrate" soda, which displays improved physical properties than the soda currently produced in the Company, and which meets market expectations reported by the customers buying this product. Implementation of the project will enable the CIECH Group to strengthen its position as regards main customers interested in the product. The project is planned to be completed by the end of Q1 2007. The estimated cost of the construction of the monohydrate system is about 47 200 000 PLN.  
Now, the Company is marketing evaporated salt under its own brand "Sól Kujawska." It is to reach the end-customer by changing the manner of distribution and promoting an own, distinctive brand. As a result, the Group's profit margin on evaporated salt should increase.

On October 18, 2005, the State Treasury exercised the put option for Ciech S.A. with regard to owned shares of the Soda Companies. The transaction involved 399 567 shares in Janikosoda S.A., accounting for 8.94% of the share capital and worth 17.69 million PLN and 622 761 shares in Soda Mątwy S.A., accounting for 8.4% of the share capital and worth 16 million PLN. Now, Ciech S.A. holds 99.26% shares in Janikosoda S.A. and 99.77% shares in Soda Mątwy S.A.

Funds obtained from the issue amounted to 192 million PLN. The Ciech Groups disposes of own funds to implement its investment plans. In need, its creditworthiness will allow the Company to take long-term investment loans.

## 2 DETAILED INFORMATION

### 2.1 Main Products, Goods and Services.

See the Table in Annex 4.1

### 2.2 Changes in the Markets

For information on the markets, see Annex 4.2.

The Company has no customers whose share in the total sales exceeds 10%.

### 2.3 Changes in Suppliers of Manufacturing Materials, Goods and Services.

See the Table in Annex 4.3

### 2.4 Contracts Material to the Company's Operations.

**Table 2.4.1. Material contracts concluded by Ciech S.A. /GK CIECH (including contracts between shareholders, insurance agreements and co-operation agreements)**

Agreement Date	Parties	Subject	Material Terms and Conditions	Criterion of Materiality
18.07.2005	Petrochemia Blachownia S.A. (affiliate)	Sales of benzene purchased from the Hungarian company	Agreement concluded on 18 July 2005 for deliveries in July 2005; subsequent monthly deliveries (by December '05 inclusive) were regulated by annexes. Contract No. N/P12/05/1162. The price agreed monthly, based on the spot deliveries. Payment date: 30 days following the dispatch; no credits	Total contractual value (with annexes) approx. 2.4 million EUR
1.01.2005	Vitrosilicon S.A. (affiliate)	Purchase of silicates for export sales	Annex to the Agreement specifies product quantities and prices for individual customers and payment conditions	Purchase value regulated by Annex to the Agreement (approx. 33.6 million PLN).
1.01.2005	Vitrosilicon S.A. (affiliate)	Purchase of silicates for domestic sales	Annex to the Agreement specifies product quantities and prices for individual customers and payment conditions	Purchase value regulated by Annex to the Agreement



Agreement Date	Parties	Subject	Material Terms and Conditions	Criterion of Materiality
				(approx. 6.2 million PLN).
27.04.2005	Alwernia S.A.	Purchase/sales of raw materials: extractive phosphoric acid (EKF) and yellow phosphorus	Permanent agreement. Regulates co-operation of both entities concerning the raw materials' area	Strategic
27.04.2005	Alwernia S.A.	Export / DWT/domestic market of phosphoric and chromic products	Permanent agreement. Regulates co-operation of both entities concerning export, CE deliveries and local (domestic) market deliveries	Strategic
18.01.2005	Thermphos Trading GmbH	Purchase of yellow phosphorus	Guarantees regular deliveries of raw materials for manufacturing of phosphoric products by ZCh Alwernia S.A.	Value: USD 23.400.000
18.01.2005	Yunphos International Trading Co.Ltd	Purchase of yellow phosphorus	Purchase of additional quantities of yellow phosphorus for ZCh Alwernia S.A. to secure manufacturing of phosphoric products	Value: USD 14.370.000
6.05.2005	Kemphos OY (Kemira) Finland	Trade contract	Purchase and deliveries of phosphoric acid for S. Ch. Alwernia	News report
	PŻM	Transport agreement	Transport of phosphate rocks from Morocco to Poland in 2005 and transport of sulphur from Morocco in 2005	News report
	GZNF Fosfory	Handling agreement	4-year co-operation agreement concerning forwarding and port services with regard to hydrochloric acid at the GZNF handling terminal	News report
20.01.2005 r	Soda Małty S.A.	Purchase of soda ash	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
20.01.2005 r	Janikosoda S.A.	Purchase of soda ash, chalk and carbon dioxide	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
20.01.2005 r	Soda Małty S.A.	Purchase of soda-derived products	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
20.01.2005 r	Janikosoda S.A.	Purchase of evaporated salt	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
20.01.2005 r.	EC Kujawskie Sp. z o.o.	Logistic services as for purchases for EC's own account	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
18.02.2005 r.	Soda Małty S.A.	Logistic services as for purchases for Soda Małty's own account	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
20.01.2005 r.	Janikosoda S.A.	Logistic services as for purchases for Janikosody's own account	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
16.02.2005 r.	Janikosoda S.A.	Permanent trade intermediation	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
18.02.2005 r.	Soda Małty S.A.	Permanent trade intermediation	Range and terms and conditions of co-operation	Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
16.02.2005 r.	EC Kujawskie	Permanent trade	Range and terms and conditions of co-operation	Implementation of

Agreement Date	Parties	Subject	Material Terms and Conditions	Criterion of Materiality
	Sp. z o.o.	intermediation		Ciech's strategy as regards organisation of the Soda Division in Kujawy
19.01.2005 r.	IKS SOLINO S.A. JZS Janikosoda S.A.	Transfer of rights and obligations from the Multi-year Framework Agreement (Annex 3)		Implementation of Ciech's strategy as regards organisation of the Soda Division in Kujawy
24.03.2005 r.	IKS SOLINO S.A.	Brine deliveries by IKS Solino under the Multi-year Framework Agreement	Provision of the strategic raw material in 2005	
31.01.2005 r.	Jantrans-Janikowo Sp. z o.o.	Rental and maintenance of carriages in good repair (Agreement No. 03/JT/2005)	Range and terms and conditions of co-operation	Annual contract value: over 4.2 million PLN (subsidiary)
31.01.2005 r.	Transoda Sp. s o. o.	Rental and maintenance of carriages in good repair (Agreement No. 9/01/2005)	Range and terms and conditions of co-operation	Annual contract value: over 4.05 million PLN (Subsidiary)
31.01.2005 r.	Transoda Sp. s o. o.	Transport services with regard to deliveries of heavy ash to the ports of Gdańsk and Gdynia (Agreement No. 5/01/2005)	Range and terms and conditions of co-operation	Annual contract value: over 4.09 million PLN (Subsidiary)
11.02.2005 r.	CTL Logistics S.A.	Freight transport, in particular fines for EC Kujawskie ( <i>Kujawy Heat and Power Generating Plants</i> ) with the use of rolling stock (Agreement No. 012317503/2005-0001)	Effective from 1.02.2005 to 31.12.2006. Obligatory delivery of at least 90 % of the bulk declared for transport.	Contract value in the contractual term: approx. 63 million PLN.
10.03.2005 r.	CTL Logistics S.A.	Transport and shipment of salt and soda for export with the use of rolling stock (Agreement No. 012317503/2005-0002)	Effective from 1.02.2005 to 31.12.2005 for soda transport and to 31.12.2006 for salt transport. Obligatory delivery of at least 95 % of the bulk declared for transport.	Shipment services as regards transport of 325.700 tons of soda, chloride and precipitated chalk.
05.01.2005 r.	Vitrosilicon S.A.	Sales of light soda ash	Quantities and prices	Agreement with the affiliated company; contractual value: 16.6 million PLN
07.04.2005 r.	Alwernia S.A.	Sales of soda ash	Quantities and prices	Agreement with affiliated company; contractual value: approx. 112 million PLN in the 5-year period
10.03.2005 r.	Petro Carbo Chem Rokita S.A.	Sales of evaporated salt	Term of agreement: 01.01.2005 - 31.12.2009	Contract value in the contractual term: approx. 62 million PLN.
08.03.2005 r.	SPOLANA a.s. Neratovice	Sales of evaporated salt	Term of agreement: 01.01.2005 - 31.12.2006	Contract value in the contractual term: approx. 37.5 million PLN.
16.03.2005 r.	SPOLANA a.s. Neratovice	Sales and distribution of soda products	Term of agreement: 01.01.2005 - 31.12.2005	Agreement with the affiliated company; contractual value: 24.4 million PLN
24.08.2005	Petrochemia - Blachownia S.A.	Sales of property with building improvements located in Kędzierzyn-Koźle	The Agreement results from invitation to tender. The contractual price was affected upon the signing of the sales agreement.	Agreement with the affiliated company
07.12.2005	Ciech S.A. – General Directorate of National Roads	Sales of land property located in Dąbrowa, the gmina of Kamieńsk	The public tender was not effective. As a result, the sale was carried out without tender in a manner specified in Art. 26 of the Regulation of the Council of Ministers of 26.08.1997. The	Sales of property

Agreement Date	Parties	Subject	Material Terms and Conditions	Criterion of Materiality
	and Motorways acting on behalf of the State Treasury		Agreement became effective upon payment of the sales price by money transfer by 30.12.2005.	

Source: Ciech S.A.

## 2.5 Significant R&D Achievements of CIECH.

- General conceptual development of IT security and electronic signature
- Conceptual development of the common system platform to support business processes

## 2.6 Information concerning Protection of the Natural Environment.

### Implementation of statutory requirements concerning recovery and recycling of the packaging introduced into the environment

In Poland, handling packaging and packaging waste as well as related obligations of entrepreneurs are specified in the following acts:

- \* The Act of 11 May 2001 on packaging and packaging waste
- \* The Act of 11 May 2001 on Entrepreneurs' Obligations with regard to Waste Management and on the Product and Deposit Fee (J. of Laws No. 63, item 638 and 639, as amended and relevant regulations)

As an importer and exporter of packaged goods, Ciech SA is bound by the aforementioned laws. Consequently, it is obliged to provide for waste recovery, in particular for recycling of packaging waste and post-consumption waste. According to Art. 4, Chapter 2 of the Act on Entrepreneurs' Obligations with regard to Waste Management and on the Product and Deposit Fee, the obligation can be exercised via recovery organisations whose sole business is organisation, management and operation of recovery-related undertakings, especially waste recycling ones. Ciech SA co-operates in this respect with 'EKO-PUNKT-Organizacja Odzysku SA'. According to statutory requirements, Ciech SA systematically monitors packaging marketed in Poland and effects monthly payments for such packaging as part of its obligation to provide for packaging waste recovery and recycling.

Recovery and recycling of waste packaging in the above manner guarantees reliable compliance with the existing laws and gives confidence that the Company's operations do not adversely effect the natural environment in Poland.

### Implementation of the REACH system (Registration, Evaluation and Authorisation of Chemicals)

REACH (Registration Evaluation and Authorisation of Chemicals) is an acronym for the chemical control and supervision system to be implemented in the EU Member States in 2008.

Its regulatory framework will be the Regulation of the European Parliament and of the Council concerning Registration, Evaluation, Authorisation and Restriction of Chemicals which is to replace over 40 existing laws and introduce a uniform system for registration and evaluation of chemicals which are marketed in EU in volumes exceeding 1 ton a year. It is estimated that there are over 100 000 chemical products on the European market now, most of which have never been tested as for their long-term effect on humans and environment.

Each substance marketed within the Community in volume exceeding 1 ton will require registration in the European Chemical Agency, which will be established for REACH-related tasks. If a registering party does not dispose of all required information on the substance, they will be obliged to carry out its toxicological, ecotoxicological and physicochemical tests. It is estimated that within 11 years it will be necessary to register approx. 30 000 substances and test approx. 5 000 ones.

Marketed substances will undergo environmental risk testing by both industry and competent authorities of the Member States.

Marketing or use of certain substances will require authorisation by the European Commission. The procedure shall include the following substances:

- CMR substances (Carcinogenic, Mutagenic or Toxic to reproduction)
- PBT substances (Persistent, Bioaccumulative and Toxic)
- vPvB substances (very Persistent and very Bioaccumulative)
- Persistent Organic Pollutants (POP)

Some dangerous substances and preparations may be subject to manufacturing, use and/or trade limits. The list of substances subject to limits will be given in the relevant Annex to the Regulation.

For the chemical industry, implementation of the REACH Regulation entails financial expenditure, varying among different manufacturers, depending on product characteristics and possible testing obligations. Maximum cost of basic tests for one substance (i.e. it is physicochemical, toxicological and ecotoxicological properties) will fluctuate around 40 000 for substances marketed in volumes up to 10 tons and even 1 000 000 PLN for substances marketed in large quantities (100 – 1000 tons).

According to the European Commission's estimates, the REACH implementation cost for European manufacturers of chemicals may exceed 5 billion EURO within 10 years. For Poland, the cost may even reach 600 million PLN.

The CIECH Group has already taken appropriate steps with a view to implementation of the new system. Acting in liaison with the Industrial Chemistry Research Institute, the Group compiles preliminary cost analyses for products of each of the manufacturing companies and CIECH S.A. itself, which will be bound by the Regulation as an importer of substances from outside of the European Union.

Works on the draft Regulation of the European Commission concerning REACH are currently monitored by the Risk Committee of the Ciech Group.

## **2.7 Investment Operations.**

### **2.7.1 Investment in Progress in 2005.**

The investment projects in 2005 concerned mainly streamlining of IT services provided for the Company, with the most important element being implementation of the common business platform for the Soda Division of CIECH.

### **2.7.2 Investment Plans for the Next 12 Months.**

For the next 12 months, the Company plans to invest mainly in IT services provided for the Company. It is going to implement the following projects:

1. Streamlining IT solutions
2. Development of a support solution for budgeting and automation of the financial consolidation
3. Creation of the corporate knowledge base and the Intranet network for the Ciech Chemical Group
4. Preparation of the security monitoring system plus IT security audit

## **2.8 Major Equity Investments and their Funding Methods.**

### **2.8.1 Equity Investments and Divestments in 2005.**

In 2005, CIECH SA continued its investment and divestment activities started in the preceding year in accordance with the overall CIECH Group's development strategy, by consolidating its interest and organising the Group's structure with a view to equity investment plans.

- The General Meeting of Zach-Ciech Sp. z o.o. on March 11, 2005 adopted a resolution concerning the start of liquidation proceedings of the Company. On January 24, 2006, the District Court in Katowice accepted the bankruptcy motion filed by the company's creditors
- On June 6, 2005 Ciech S.A., IZCh Soda Małty S.A. and JZS Janikosoda S.A. became holders of 100% of equity and votes in Vitrosilicon S.A., because of compulsory buy-out of minority shareholders. The total transaction value was 64 800 PLN
- By way of the agreement of 16 June 2005, Ciech S.A. sold 100% of shares in Polcommerce Kft with its registered office in Budapest to Ciech-Polfa Sp. z o.o. for the amount of 203 000 PLN. Polcommerce Kft is a company that operates mainly in the pharmaceutical sector. The transaction is a consequence of separating the pharmaceutical activity from the structures of Ciech S.A., and its taking over by a separate company, Ciech Polfa Sp. z o.o. as well as transferring a part of the commercial network of Ciech SA connected with the pharmaceutical industry to Ciech Polfa Sp. z o.o.
- On July 8 2005 the Company purchased 128 000 shares of ZCh Police SA at the issue price of 10.30 PLN per share
- On October 6, 2005, the Company signed the sales agreement concerning 100% of shares of its subsidiary, Petrochemia-Blachownia S.A., focused on benzene and ethylbenzene manufacturing, with the Hungarian concern BorsodChem Rt. Following the approval of the Office of Competition and Consumer Protection, the Company concluded the agreement on January 10, 2006. The transaction amount totalled 104 000 000 PLN
- On October 18, 2005, the State Treasury exercised the put option for Ciech S.A. with regard to owned shares of the Soda Companies. The transaction involved 399 567 shares in Janikosoda S.A., accounting for 8.94%

of the share capital and worth 17.69 million PLN and 622 761 shares in Soda Mątwy S.A., accounting for 8.4% of the share capital and worth 16 million PLN. Now, Ciech S.A. holds 99.26% shares in Janikosoda S.A. and 99.77% shares in Soda Mątwy S.A.

- By way of the Agreement of 29 December 2005 Ciech S.A. acquired from "Provimi-RolimpeX" S.A. a block of 5 400 shares of its own subsidiary, GZNF Fosfory, accounting for 9.32% of the share capital, for 6 500 000 PLN. At the moment, Ciech SA holds 89.04% shares of the GZNF Fosfory's stock

### 2.8.2 Equity Investment and Divestment Plans for the Next 12 Months.

Investments and divestments planned for the next 12 months will be implemented according to the adopted development strategy, which aims at increasing the Company's goodwill. Efforts are underway to conclude new equity investment projects and acquire new investment projects, both in Poland and abroad.

The aim is to take over domestic and foreign manufacturers of selected chemical products, thereby reinforcing the CIECH Group's standing in its current markets and providing opportunities for development of the Group's operations in other segments.

Within the implementation of the projects adopted for the next 12 months, Ciech S.A. intends:

- to continue the process of investment analyses of soda manufacturing companies in CEE countries in order to consolidate the Soda Division
- to continue the process of investment analyses of silicate manufacturing companies in CEE countries in order to develop the Inorganic Division
- to finalise the purchase transaction of 80% shares of ZCh Zachem SA and ZCh Organika Sarzyna SA from Nafta Polska SA, which is conditioned by the approval of UOKiK (*Office of Competition and Consumer Protection*) and the consent given to Nafta Polska SA by the Council of the Minister of Treasury, acting as the General Meeting of Shareholders of Nafta Polska SA. On March 29, 2006, the Company concluded the purchase agreement with Nafta Polska concerning 80% of shares in ZCh Zachem for 68 500 000 PLN and ZCh Organika Sarzyna for 244 500 000 PLN.

### 2.9 Changes in Organisation Relationships within the CIECH Group.

As for organisational changes within the CIECH Chemical Group in 2005, they involved the following areas:

#### Acquisitions

##### Jantrans-Janikowo Sp. z o.o. and Transoda Sp. z o.o.

By way of a decision of the District Court in Bydgoszcz as of March 10, 2006, the merger of Transoda Sp. z o.o. with its registered office in Inowrocław, as the acquiring company, and Jantrans-Janikowo Sp. z o.o. with its registered office in Janikowo, as the company being acquired, was registered. Following the merger, the share capital of Transoda Sp. z o.o. amounts to 27 652 500 PLN and may be divided into 55 305 shares of 500 PLN each. Share capital has been divided into:

- 35 797 shares for Soda-Mątwy S.A., constituting 64.73% of the total share capital ;
- 19 508 shares for Janikosoda S.A., constituting 35.27% of the total share capital.

#### Investments:

##### CHEMAN S.A.

By way of a decision of the Court of Registration in Warsaw, on February 9 2005, changes in the Company's share capital were registered. These changes resulted from resolutions of NWZA (*Extraordinary General Meeting of Shareholders*) of 9 December 2004 on a decrease of share capital by decreasing par value of all the Company's shares (from 10 PLN to 9 PLN per share) and on an increase of share capital by issuing shares of H series, wholly subscribed to and paid for in cash by Ciech S.A. The excess of the difference between the issue price and the nominal price was allocated to replenish the Company's share premium against the losses brought forward. The increased share capital amounts to 16 774 776 PLN.

As part of further capital restructuring of the Company, on December 29, 2005 NWZ CHEMAN S.A. adopted a resolution to increase share capital by issuing 17 000 shares of a par value 9 PLN per share at the issue price of 50 PLN per share. The difference between the issue and nominal price should replenish the Company's share premium. The issue was to raise funds for acquisition of the right to the integrated computer system. The share capital increase was registered in the National Court Register (KRS) as of March 15, 2006.

##### VITROSILICON S.A.

On June 6 2005, the buyout from minority shareholders of VITROSILICON S.A. was completed. As a result, CIECH S.A. became a holder of 2 171 065 shares, constituting 60.4% of the Company's share capital. The

remaining shareholders (IZCh SODA-MAŁY S.A. and JZS JANIKOSODA S.A.) hold the blocks of 712 240 shares each, both constituting 19.8% of the share capital. The decision on compulsory buyout of shares from shareholders with the interest lower than 5% of the share capital was made by the General Meeting of Shareholders of VITROSILICON S.A. in line with Art. 418 of the Code of Commercial Companies on April 29, 2004. Negotiated purchase terms were finally approved by the CIECH S.A. Management Board by way of the Resolution of 14 January 2005.

### **SODA COMPANIES**

As part of the concentration process with regard to shares/stocks of the strategic companies, the Company endeavoured to purchase from the State Treasury, shares of these soda companies where CIECH S.A. is a majority shareholder. The talks ended up on October 18, 2005 with the conclusion of the following agreements:

- Purchase agreement with regard to 622 761 shares of Soda Mały S.A. for 4 944 722.34 USD, constituting 8.40% of the share stock, resulting in CIECH S.A.'s ownership of 7 399 161 of shares, constituting 99.77% of the share capital
- Purchase agreement with regard to 399 567 shares of Janikosoda S.A. for 5 466 076.56 USD, constituting 8.94% of the share capital. The transaction has made CIECH S.A. a holder of 4 434 448 shares, constituting 99.26% of the share capital

### **CIECH FINANCE Sp. z o.o.**

With a view to concentrate and streamline current divestment processes involving redundant financial assets, on December 1, 2005 a special purpose company under the name of CIECH FINANCE Sp. z o.o. was established. The company will be responsible for management of divestment processes. The Company's share capital amounts to 50 000 PLN and may be divided into 100 shares of 500 PLN each. All shares in the share capital were subscribed to by CIECH S.A. On December 16, 2005, the Company was entered into the Register of Entrepreneurs under the number of 0000246747.

### **GZNF FOSFORO Sp. z o.o.**

On December 29, 2005, CIECH S.A. signed the purchase agreement with regard to shares of Gdańskie Zakłady Nawozów Fosforowych Fosfory Sp. z o.o. and purchased from Provimi-Rolimpeks S.A. a block of 5400 shares, constituting 9.32% of the Company's share capital. Now, Ciech SA holds 89.04% interest in GZNF Fosfory Sp. z o.o. The Company's products belong to the core portfolio of the CIECH Chemical Group.

### **Divestments:**

#### **ZACH-Ciech Sp. z o.o.**

Attempts to withdraw capital from Zach-Ciech Sp. z o.o. due to lack of interest in the Company's shares, even by its main shareholder, have failed. Among the reasons, one could mention bad financial and economic situation, which has been lasting for 3 years, and no re-organisation programme, which could hold promise for the Company's improvement. On March 11, 2005, the Extraordinary General Meeting of Shareholders adopted a resolution No. 3/2005 to dissolve ZACH-Ciech Sp. z o.o. and initiate its liquidation proceedings. On January 24, 2006, the District Court in Katowice accepted the bankruptcy motion filed by the company's creditors.

#### **PETROCHEMIA-BLACHOWNIA S.A.**

To advance the accepted strategic directions, which assume focusing on the core portfolio products from soda, phosphorus, silicate and glass segments, CIECH S.A., concluded an agreement with BorsodChem Rt. The agreement, signed on October 6, 2005 provided for sales of 100% shares in Petrochemia-Blachownia S.A. (which specialises in benzene and ethylbenzene manufacturing). The agreement entered into force in January 2006, following the approval of the Office of Competition and Consumer Protection (UOKiK).

#### **InChem Sp. z o.o.**

Due to a decrease of the share capital as of October 21, 2005, CIECH S.A. became a sole shareholder in InChem Sp. z o.o. Decrease of the share capital results from redemption of shares owned by Organika Sp. z o.o. accounting for 50% of the Company's share capital. The shareholder requested to withdraw from the Company by the voluntary redemption scheme.

#### **Alwernia-Chrom Sp. z o.o.**

In January 2006, the Sales Agreement concerning shares of Alwernia-Chrom Sp. z o.o. came into force. The agreement had been concluded between Alwernia S.A. and First Hungarian Natural Gas and Energy Trading and Service Provider Ltd. on December 8, 2005. The Company was 100% owned by ZCh Alwernia S.A. and was categorised as a short-term investment.

#### **CIECH-SERVICE Sp. z o.o.**

CIECH S.A. has initiated withdrawing capital from the Company. On November 17, 2005, the Extraordinary General Meeting of Shareholders resolved to redeem 600 shares by the voluntary redemption scheme, upon consent of the shareholder, for consideration and by purchase by the Company. Voluntary redemption of shares necessitates a decrease of the share capital. It will become effective upon registration of changes in the share capital by the Court of Registration. On December 2, 2005, the Company Management announced its decision on redemption of shares and called the Company's creditors to raise any objections within 3 months. We anticipate that registration of the share capital decrease may take place at the end of May 2006.

## 2.10 Transactions with Affiliates of CIECH.

**Table 2.10.1. Transactions with affiliates**

Transaction party	Affiliation with the party to the transaction	Subject of the transaction	Material terms and conditions (thousands PLN)		Additional information
			Financial terms	Characteristic features deviating from terms and conditions generally applicable to similar agreements	
<b>Ciech SA</b>					
Chemia.com	Subsidiary	Organisation and co-operation as regards implementation of the ERP system in IZCH Soda Mątwy	900 PLN	none	Agreement is valid for the period from 01.06.2005 to 31.03.2006
Chemman SA	Subsidiary	Trade transactions for plastics and semi-finished-products for and on behalf of Ciech SA.	135 PLN	none	Agreement is valid for the period from 01.04.2005 to 31.12.2005
Chemman SA	Subsidiary	Sales agreement for various chemical goods between Ciech SA as the Seller and Chemman SA as the Buyer	1 106 PLN	none	Agreement concluded on 15.04.2005
Chemman SA	Subsidiary	Sales agreement for various chemical goods between Ciech SA as the Seller and Chemman SA as the Buyer	1 043 PLN	none	Agreement concluded on 18.04.2005
Petrochemia Blachownia	Subsidiary	Sale of fixed assets	3 500 PLN	none	Sale of the right of perpetual usufruct of land, ownership right to the buildings located on that land, as well as the right to chattels related to the real estate property
Ciech Polfa Sp. z o.o	Subsidiary	Sale of tangible fixed assets	326 PLN	none	The sale was made in January and March
Soda Mątwy S.A	Subsidiary	Agreement concerning co-operation with regard to implementation of the ERP system based on the Oracle's platform. Ciech SA as an investor will make the system implemented in Soda Mątwy by 31.05.2006	4 777 PLN	none	Agreement concluded on 06.06.2005

Transaction party	Affiliation with the party to the transaction	Subject of the transaction	Material terms and conditions (thousands PLN)		Additional information
			Financial terms	Characteristic features deviating from terms and conditions generally applicable to similar agreements	
Ciech Polfa Sp. z o.o.	Subsidiary	Sale of shares in Polcommerce Kft. Budapest	Sales price: 203 PLN	none	
Janikosoda SA	Subsidiary	Agreement concerning co-operation with regard to the implementation of the ERP system based on the Oracle's platform. Ciech SA as an investor will make the system implemented in Janikosoda by 31.10.2006	3 006 PLN	none	Agreement concluded on 25.10.2005

## 2.11 Borrowings, Loan Agreements and Sureties and Guarantees Granted.

See the Table in Annex 4.4

## 2.12 Loans Granted in 2005.

Table 2.12.1. Loans granted

Borrower	Period	Loan amount plus capitalised interest	Conditions	Affiliation with CIECH S.A.
<b>Janikosoda S.A.</b>	Repayment date: 28.06.2005	4 000	Annual interest rate of 6.6%	Subsidiary
<b>Soda Mątwy S.A.</b>	Repayment date: 30.06.2005	4 500	Annual interest rate of 6.6%	Subsidiary
<b>Z.Ch. Alwernia S.A.</b>	Repayment date: 31.03.2006	4 500	Annual interest rate of 6.0%	Subsidiary
<b>GZNF Fosfory S.A.</b>	Repayment date: 30.06.2006	4 500	Annual interest rate of 6.54%	Subsidiary
<b>GZNF Fosfory S.A.</b>	Repayment date: 30.06.2006	4 500	Annual interest rate of 6.54%	Subsidiary



<b>TOTAL</b>		<b>22 000</b>		
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All loans due and payable by the date of this report have been repaid on time.

### 2.13 Information on Security Issues in CIECH

An increase of the share capital took place on February 16, 2005 by the amount of 41 020 000 PLN, which resulted from issue of C series shares of a par value 5 PLN each.

No redemption of shares occurred in the period concerned.

On March 22, 2005, i.e. the pre-determined maturity date, CIECH SA redeemed its previously issued commercial notes of a par value of 15 000 000 PLN.

In 2005, the Company did not issue any debt securities.

### 2.14 Purchase of Treasury Shares by the Parent.

In the fiscal year 2005, the Company did not purchase any treasury shares

### 2.15 Financial Resource Management in CIECH.

2005 saw an increase in the sales revenue, which was mainly caused by the restructuring of sales of the soda products in the CIECH Chemical Group. This resulted in an increase of profit on sales and profit on operating activity and contributed to an increase of return on sales and return on operating activity.

The tables below show the main figures concerning financial performance and profitability:

**Table 2.15.1. Profitability ratios in CIECH S. A.**

Specification	Jan-Dec 2005	Jan-Dec 2004
Net sales revenue	1 588 892	1 470 007
Sales profit	61 248	28 019
Operating profit	58 395	33 920
Net profit	41 900	19 445
Sales profitability	3.85%	1.91%
Return on operating activity	3.68%	2.31%
Return on sales (ROS)	2.64%	1.32%
Total return on assets (ROA)	4.64%	2.34%
Return on equity (ROE)	7.17%	5.46%

Source: Ciech SA

Calculation principles:

Sales profitability – sales profit for a given period / net income from sales of products, services, goods and materials

Return on operating activity - profit on operating activity for a given period / net income from sales of products, services, goods and materials

Return on sales (ROS) – sales profit for a given period / net income from sales of products, services, goods and materials

Return on assets (ROA) – net profit / assets as of the end of the period

Return on equity (ROE) – net profit / equity as of the end of the period

- CIECH SA's liquidity assessment

Ciech SA's financial liquidity position in 2005 clearly improved, and the liquidity ratios met the recommended safety standards. The most important reason for improvement of liquidity was the issue of shares. Due to the issue funds, the amount of short-term financial assets increased, while the level of short-term credit liabilities decreased. The key liquidity ratios are shown in the table below:

**Table 2.15.2. Liquidity ratios**

Specification	31.12.2005	31.12.2004
Current ratio	1.51	0.81
Quick ratio	1.47	0.76

Source: Ciech SA

Calculation principles:

*current ratio* – the ratio of the current assets to the total current liabilities at the end of the period; the current ratio reflects the company's ability to repay its current liabilities using its current assets.

*quick ratio* – the ratio of the current assets less reserves to the total current liabilities at the end of the period; the quick ratio reflects the company's ability to accumulate cash in a short time to finance its liabilities with a short due date.

- Working capital and turnover ratios in Ciech SA

How the Company finances its operations is the direct effect of the commercial nature of its business. Commercial companies finance most of their working assets with trade debt, and the remaining ones, with short-term loans. The decrease in demand for working capital in 2005 resulted mainly from the decrease in reserves (which was mainly the consequence of the decrease in advanced payments settled gradually over 2005).

**Table 2.15.3. Working capital of Ciech SA (thousands PLN)**

Specification	31.12.2005	31.12.2004
1. Current assets	410 311	333 172
2. Cash and other short-term investments	88 212	3 644
3. Adjusted current assets (1-2)	322 099	329 528
4. Short-term liabilities	271 314	413 339
5. Short-term loans and other financial liabilities	16 840	138 198
6. Adjusted short-term liabilities (4-5)	254 474	275 141
7. Working capital (1-4)	138 997	-80 167
8. Working capital demand (3-6)	67 625	54 387
9. Net cash balance (7-8)	71 372	-134 554

Source: Ciech SA

Extension of the cash conversion period in 2005 resulted mainly from the decrease in liabilities turnover ratio due to: (a) decrease in foreign purchase in the last months of 2005 (compared to the same period of the previous year) and (b) settlement of advanced payments for supplies.

**Table 2.15.4. Turnover cycles for Ciech SA's main working capital items (days)**

Specification	2005	2004
Inventory turnover	3	5
Trade receivables turnover	62	61
Trade liabilities turnover	57	62
Operating cycle	65	66
Cash conversion cycle	8	4

Source: Ciech SA

Calculation principles:

*inventory turnover – the ratio of inventories at the end of a given period to the operating cost for the period, multiplied by the number of days in the period;*

*trade receivables turnover – the ratio of receivables against deliveries and services at the end of a given period to the net sales income for the period, multiplied by the number of days in the period;*

*trade liabilities turnover – the ratio of liabilities against deliveries and services at the end of a given period to the operating expense in the period, multiplied by the number of days in the period;*

*operating cycle - total inventory turnover and trade receivables turnover;*

*cash conversion cycle – the difference between the operating cycle and the turnover of liabilities against deliveries and services.*

- CIECH SA's debt assessment

In 2005, Ciech SA recorded a substantial decrease in the level of debt. The value of all liabilities constituted about 32% of the value of assets (about 54% at the beginning of the year). The current asset financing structure makes it possible to take advantage of third party financing when fulfilling the planned equity investments. The table below shows the key debt ratios.

**Table 2.15.5. Debt ratios**

Specification	31.12.2005	31.12.2004
Total debt ratio	32.1%	54.1%
Long-term debt ratio	2.1%	4.2%
Debt to equity ratio	49.6%	126.0%
Equity to assets ratio	64.7%	42.9%

Source: Ciech SA

Calculation principles:

*total debt ratio – the ratio of long- and short-term liabilities to total assets; the ratio reflects the share of external financing sources in the Company's operations.*

*long-term debt ratio – the ratio of long-term liabilities to total assets; it reflects the share of long-term liabilities in the overall financing of operations.*

*debt to equity ratio – the ratio of total liabilities to equity.*

*equity to assets ratio – the ratio of equity to total assets; it reflects the share of equity in the financing of operations.*

The Company does not predict any substantial changes in its financial situation in the near future, but the actions taken in order to improve operating activity may lead to further improvement of the Company's financial situation in the end. 2006, can possibly see some significant changes in the financing structure due to the Company's acquisition operations. It is expected that financing of equity investments will be fixed to make efficient use of funds obtained from the issue and optimise the Company's indebtedness.

## **2.16 Assessment of the Possibilities to Implement Investment Assumptions Compared to the Funds Held, Taking into Consideration Possible Changes in the Structure of Financing of Such Operations.**

All planned capital expenditure will be financed with own funds. The Company is planning to use long-term bank loans only for a part of more extensive equity investments (acquisitions).

The Company is not planning to finance capital expenditure by means of issuing of debt securities.

## **2.17 Financial Risk Management in CIECH.**

Ciech S.A. actively manages its operating and financial risk, in an attempt to optimise cash flows and maximise the Company's market value. To provide for constant risk monitoring, the Management Board of Ciech SA appointed the Risk Committee, which implements procedures of the risk management system. While working, the Risk Committee has managed to identify and evaluate financial and operating risks to which the Ciech Group is exposed. In the current operations, risk management lies with risk owners reporting periodically to the Risk Committee. The Risk Committee decides on management strategies as regards individual risks and submits quarterly reports to the Management Board of Ciech SA as regards efficiency of the risk management system.

As for financial risks, the Company is exposed to the following ones:

- foreign exchange risk
- credit risk
- interest rate risk

**Foreign exchange risk**

Foreign exchange risk is an inherent part of commercial transactions denominated in foreign currencies. CIECH SA faces foreign exchange exposure as part of its import and export activity. The exposure stems from significant predominance of export over import.

Thanks to its internal security procedures, the Company is able to limit its exchange risk to a minimum, thus increasing the stability of its core operations. CIECH SA consistently enters into hedge transactions to limit the impact of exchange rate fluctuations on its profit.

The Company uses natural hedging, by balancing its import and export flows, and utilises derivative instruments to reduce the foreign exchange risk.

The transactions used to hedge cash flows included the following hedge transactions:

- Forward, allowing the Company to hedge its cash flows at a fixed exchange rate
- Par forward, allowing the Company to hedge numerous petty cash flows at an average exchange rate for a given period
- Average Strike Option, allowing the Company to hedge numerous cash flows effected in a short period of time
- The currency and interest rate swaps aimed at eliminating the impact of foreign exchange risk on valuation of the long-term loans taken by the Company

Detailed information on financial instruments is presented in Section 1.2.1. a) of the additional explanatory notes to the financial statement.

**Credit risk**

Ciech SA is exposed to credit risk related to creditworthiness of its customers who are involved in the Company's sales transactions of products and goods. The risk is reduced by applying internal procedures for managing the amounts receivable from the customers. Risk assessments are made prior to conclusion of each agreement, and then again periodically, for each supply of goods, in accordance with the internal procedures. A profitability calculation is carried out for each contract, shipment, or shipment batch, taking into account both the potential costs of the trade credit, and the contractor's payment history. The calculation serves as a basis for decisions to conclude the contract or send goods.

**Interest rate risk**

Ciech SA is exposed to interest rate risk because of its existing indebtedness. In 2005, the Company concluded no hedging transactions against interest rate risk. Detailed information about the interest rate risk exposure is presented in Section 1.2.1. e) of the additional explanatory notes to the financial statement.

The Company does not apply hedge accounting. Application of hedge accounting would not materially influence the Company's financial statements.

**2.18 Changes in the Basic Management Principles of the Company/Capital Group.**

In 2005, there were no material changes in the management principles of the Company and its Group.

**2.19 Information on Employment.**

In 2005, Ciech S.A. continued its employment restructuring as part of the new strategy directed at increasing the Company's performance and competitive edge.

As a result, the total employment in Ciech S.A. as of 31 December 2005 is 247.75 jobs. Compared to December 31, 2004, the figure has decreased by 9.2%.

Employment restructuring was not limited to the reduction of staff, but has increased the Company's performance too.

**2.20 Changes in the Managing and Supervisory Bodies in the Last Year.**

Until December 31, 2005, the composition of the Management Board of CIECH S.A. remained unchanged and comprised the following members:

- Ludwik Klinkosz – President of the Management Board
- Jerzy Golis – Member of the Management Board
- Stefan Rojewski – Member of the Management Board

Until June 29, 2005, the composition of the Supervisory Board of CIECH S.A. was as follows:

1. Mr Zygmunt Bosiakowski – President of the Supervisory Board;
2. Mr Andrzej Buczak – Vice-President of the Supervisory Board;
3. Ms Agnieszka Małocha – Secretary to the Supervisory Board;
4. Mr Dariusz Krajowski-Kukiel – Member of the Supervisory Board;
5. Mr Janusz Wiśniewski – Member of the Supervisory Board;
6. Mr Olgierd Cieślak – Member of the Supervisory Board;
7. Ms Bożena Dyjak – Member of the Supervisory Board;
8. Mr Krzysztof Jasiński – Member of the Supervisory Board;
9. Mr Edmund Kozak – Member of the Supervisory Board.

On June 29, 2005, the Ordinary General Meeting of Shareholders of CIECH S.A. dismissed the following of the CIECH S.A. Supervisory Board Members:

- Ms Bożena Dyjak
- Mr Olgierd Cieślak
- Mr Krzysztof Jasiński
- Mr Edmund Kozak

The 3-year term of office to which the remaining Members of the CIECH S.A. Supervisory Board were elected expired. As of the date of the Ordinary General Meeting of Shareholders, all mandates of the Board's members expired.

In view of the foregoing, on June 29, 2005, the Ordinary General Meeting of Shareholders of CIECH S.A. elected the new CIECH S.A. Supervisory Board, 5<sup>th</sup> term, composed of:

- |                             |                                         |
|-----------------------------|-----------------------------------------|
| 1. Edmund Pietrzak          | President of the Supervisory Board      |
| 2. Elżbieta Boniuszko       | Vice-President of the Supervisory Board |
| 3. Edmund Kozak             | Secretary to the Supervisory Board      |
| 4. Zygmunt Bosiakowski      | Member of the Supervisory Board         |
| 5. Magdalena Bąkowska       | Member of the Supervisory Board         |
| 6. Andrzej Buczak           | Member of the Supervisory Board         |
| 7. Dariusz Krajowski-Kukiel | Member of the Supervisory Board         |
| 8. Ireneusz Król            | Member of the Supervisory Board         |

On July 21, 2005, the Supervisory Board elected Professor Edmund Pietrzak as President of the Board, and Ms Elżbieta Boniuszko as Vice-President of the Board.

On February 17, 2006, the Extraordinary General Meeting of Shareholders of CIECH SA dismissed the following members of the Supervisory Board:

1. Ms Elżbieta Boniuszko – Vice-President of the Board
2. Mr Edmund Kozak – Secretary to the Board
3. Mr. Zygmunt Bosiakowski
4. Mr. Andrzej Buczak
5. Mr Ireneusz Król

At the same time, on February 17, 2006, the Extraordinary General Meeting of Shareholders of CIECH S.A. appointed the following Members of the Company's Supervisory Board:

1. Ms Krystyna Dziworska
2. Mr Maksymilian Klank
3. Mr Marek Konopczyński
4. Mr Maciej Rudnicki
5. Mr Wiesław Piosik
6. Mr Zbigniew Markowski

## **2.21 Policies Governing, the Appointment and Dismissal of the Management and the Management Staff's Powers, Especially the Right to Decide on Issue/Redemption of Shares.**

According to the Articles of Association of CIECH S.A., powers to appoint and dismiss members of the Management Board, including President of the Board, lie with the General Meeting of Shareholders. The Management staff's powers are specified in the Code of Commercial Companies and the Company's Articles of Association. The management staff has no specific powers to decide on issue/redemption of shares.

## **2.22 Information on Agreements between the Issuer and the Management Providing for Compensation in case of Resignation or Dismissal without Good Reasons or when Dismissal is caused by the Issuer's Incorporation by Acquisition.**

If a person is dismissed during the term of office without good reasons or in the case of resignation, the employment contract provides for a severance pay of three monthly remunerations.

The Non-Compete Agreement with the Management Board Members states that upon termination of employment, they are entitled for 12-month compensation of 80% of the average remuneration paid during 12 whole calendar months preceding the termination date.

## **2.23 Total Number and a Par Value of the Company's Shares and Stakes in Affiliates Held by Members of the Managing and Supervisory Bodies**

As it follows from statements submitted by members of the Company's Management and Supervisory Boards, the number of shares of CIECH S.A. owned by members of the managing and supervisory bodies as of 31 December 2005 is as follows:

Ludwik Klinkosz, President of CIECH S.A., holds 390 641 shares in the Company with a par value of 5 PLN each.

No other members of CIECH S.A.'s Management Board or Supervisory Board hold any shares in the Company.

## **2.24 Shareholders Empowered to Cast at least 5% of Votes at the General Meeting of Shareholders of CIECH SA.**

As the Company's Management Board, acting in a manner specified in Art. 69 of the *Act on Public Offering and Terms of Introducing Financial Instruments to Organised Trading and on Public Companies of 29 July 2005*, has found out, the following entities are empowered to cast at least 5% of votes at the Company's General Meetings of Shareholders:

- Kompania Węglowa SA – 10 270 800 shares equal to 36.68 % of Ciech S.A.'s share capital; votes: 10 270 800, which constitutes 36.68% of the total number of votes at the General Meeting
- Franklin Templeton Investments, UK – 2 000 000 shares equal to 7.14% of Ciech S.A.' share capital; votes: 2 000 000, which constitutes 7.14% of the total number of votes at the General Meeting
- Otwarty Fundusz Emerytalny PZU 'Złota Jesień' – 1 712 732 shares equal to 6.12% of Ciech S.A.'s share capital; votes: 1 712 732, which constitutes 6.12% of the total number of votes at the General Meeting
- Commercial Union Investment Management S.A. (CUIM) Poland – 1 504 961 shares equal to 5.37% of Ciech SA's share capital; votes: 1 504 961 which constitutes 5.37% of the total number of votes at the General Meeting

## **2.25 Contracts that May Potentially Change the Proportion of Interest Held by the Current Shareholders and Bond Holders.**

The Company has no information about contracts that may potentially change the proportion of interest held by the existing shareholders.

## 2.26 Information on Holders of any Securities which Give Special Rights of Control over the Issuer and their Description.

There are no securities in the Company, which give special rights of control over the issuer.

## 2.27 Information on All Limitations on Transfer of the Issuer Securities' Ownership and Limitations on the Use of the Voting Rights Originating from the Issuer's Shares

There are no limitations on transfer of securities' ownership in Ciech. There are no limitations on the use of the voting rights originating from Ciech SA's shares.

## 2.28 Information on the Control System of the Employee Stock Plan.

There is no employee stock plan in Ciech.

## 2.29 Information on Agreements with the Authorised Auditor of Financial Statements.

**Table 2.29.1 Agreements with the Authorised Auditor of Financial Statements**

	Entity Authorised to Review/Audit Financial Statements	Contract Date	Content	Value
1a	DELOITTE AUDYT SP.Z O.O. WARSAW ul. Fredry 6	04-07-2005	Verification of appraisals and implementation of IAS/IFRS	123 000 Euro + 10% cost refund;
1b	DELOITTE AUDYT SP.Z O.O. WARSAW ul. Piękna 18	15-11-2005	Audit of financial statements and the consolidation package as of 31-12-2005	39 500 Euro + 10% cost refund;
1c	DELOITTE AUDYT SP.Z O.O. WARSAW ul. Piękna 18	14-12-2005	Consultancy concerning the proposed purchase transaction of Zachem S.A.'s shares	70 000 Euro+ expenses
2a	DELOITTE & TOUCHE AUDIT SERVICES SP. Z O.O. WARSAW ul. Fredry 6	01-10-2004	Audit of the financial statement as of 31-12-2004	42 500 Euro plus 10% cost refund
2b	DELOITTE & TOUCHE AUDIT SERVICES SP. Z O.O. WARSAW ul. Fredry 6	30-06-2005	Review of the individual and consolidated financial statement as of 30-06-2005	29 700 Euro plus 10% cost refund
2c	DELOITTE & TOUCHE AUDIT SERVICES SP. Z O.O. WARSAW ul. Fredry 6	29-11-2004	Advisory services concerning implementation of IFRS	7 800 Euro plus 100 EUR/h
2d	DELOITTE & TOUCHE AUDIT SERVICES SP. Z O.O. WARSAW ul. Fredry 6	05-01-2005	Training on IFRS	6 100 Euro

2e	DELOITTE & TOUCHE AUDIT SERVICES SP. Z O.O. WARSAW ul. Fredry 6	24-01-2005	Advisory services concerning implementation of IFRS	4 500 Euro
3a	KPMG Polska Audyt Sp. z o.o. Warsaw ul. Chłodna 51	16-06-2004	Review of statements as of 30-06-2004	15 000 USD plus 1 500 USD
3b	KPMG Polska Audyt Sp. Z o.o. Warsaw ul. Chłodna 51	28-10-2004	Review of statements as of 30-06-2004	23 300 Euro plus 1 500 Euro
3c	KPMG Polska Audyt Sp. Z o.o. Warsaw ul. Chłodna 51	31-12-2003	Compliance of the Oracle Financials system with the Polish Accounting/VAT/CIT Acts	14 000 Euro plus consultancy charged per hour
3d	KPMG Polska Audyt Sp. Z o.o. Warsaw ul. Chłodna 51	16-06-2004 annex: 15-04-2005	Accounting consultancy (IFRS standards)	62 000 Euro plus cost refund
3e	KPMG Polska Audyt Sp. Z o.o. Warsaw ul. Chłodna 52	12-03-2004	Compilation of the Prospectus	28 000 USD plus meetings charged per hour

### 2.30 Material Events that Affected the Company's Operations and Financial Results in 2005 or are Likely to Affect them in Future

- Continuing prosperity in the glass-making industry in CEE countries and the domestic construction industry, which are important target markets for Ciech S.A.
- Purchase by Ciech SA of the Polish chemical works Zachem SA and Organika Sarzyna SA whose privatisation by Nafta Polska will bring about significant changes to the domestic chemical market. Ciech SA takes part in this process
- Tendency in price changes of coke, which is an important raw material for production of soda ash. These prices decreased significantly during 2005
- Closing of the Solvay soda ash production plant in Austria, whose production capacity at the end of 2005 exceeded 150 000 tons a year, may improve the competitive position of other European suppliers, including Ciech SA.
- Equity investments of the Indian manufacturers of soda ash in European factories (Brunner Mond, UK acquired by TATA Chemicals Ltd. and Bega UPSOM Ocna Mures, Romania acquired by Gujarat Heavy Chemicals Ltd.) at the end of 2005. These acquisitions will change the balance of power in the European and world market of soda ash
- Sale of 100% of shares of Ciech SA's subsidiary, Petrochemia-Blachownia S.A. in Kędzierzyn-Koźle, which specialises in manufacturing of benzene and ethylbenzene to the Hungarian concern, BorsodChem Rt
- Changes with regard to the ownership structure of the petrochemical industry in Central and Eastern Europe (Orlen-Unipetrol) and launching in Q3 2005 of new domestic installations for production of plastics in Płock (Basell Orlen Polyolefins), changing the situation on these markets

## 3 PROSPECTS FOR DEVELOPMENT OF THE COMPANY/ CAPITAL GROUP

Prospects of development of Ciech S.A. are related to both the pace of implementation of the assumed development strategy of the Company and the CIECH Group, as well as external factors, which include:

- large potential growth of demand for chemicals in Poland (where their per capita use is slightly over 300 EURO and still remains approx. 4-times lower than in Western Europe)
- interest of the foreign capital in investments in the domestic chemical industry
- competitiveness of Polish chemical products on foreign markets, proved by high export dynamics

CIECH S.A. believes that the positive macroeconomic trends and the assumed parameters of key investment projects of the Group will be the driving force for achieving the critical strategic targets, including in particular higher operating profitability in the next 2-3 years.

CIECH SA's and the CIECH Group's short-term goal is to strengthen their current market position in their core business segments and key product sales. CIECH S.A.'s range of products also includes many "mature" products (soda ash, evaporated salt, baking soda), with an established market standing and stable market growth dynamics. CIECH SA's activity with respect to this product group will include:



- further reorganisation of base-stock purchases and product sales and logistics
- cutting in manufacturing costs by enhancing operational excellence
- employing market niches to develop the Group's core portfolio
- acquisition of cheap base-stock to reduce the cost per piece

With respect to products with higher growth dynamics (such as hollow glass block, glass holders for memorial candles, TDI and epoxy resins), Ciech SA is planning to increase its sales of these products and their market share.

CIECH SA's and the CIECH Group's long-term strategy will focus on:

- strengthening of the leading position in the core product markets
- vertical concentration of the manufacturing processes (from securing cheap base stock sources and concluding long-term agreements to reaching the end consumer, using its own distribution network where it is economically sound)
- manufacturing of ultimately processed products with prospective application markets

### 3.1 Material Risk Factors and Threats and Degree of Exposure of the Company/Capital Group

#### **Risk of reversal of the positive economic growth rate trends in Poland**

Ciech S.A.'s business is connected with many segments of the broadly understood Polish chemical industry that are directly correlated with the general economic situation. Now, Polish economic growth in terms of GDP equals several percent a year. In spite of the fact that long-term forecasts indicate that the high economic growth will remain stable, the risk of a temporary economic slump in Poland cannot be ruled out (for instance due to slow growth of internal demand and the export slump). The chemical sector may suffer indirect consequences of a possible downturn in the economy. Weaker demand for chemical products may adversely affect Ciech S.A.'s revenues, and impair its financial performance.

#### **Risk of economic stagnation in Europe and worldwide**

Ciech S.A.'s commercial activities rely largely on chemical product exports, whose level and profitability depend on the global economic situation in Europe and worldwide. A global downturn in the world economy could affect the export trade volumes achieved in international markets, thus reducing the sales income in the individual segments of Ciech S.A.'s operations.

#### **Increase of competition in the soda segment**

The main products of the CIECH Group include soda products manufactured in subsidiaries: JZS Janikosoda S.A. and IZCh Soda Mątwy S.A. The processes of concentration of production, which can be more and more often observed in Europe, contribute to the increase of competition from big, over-regional chemical concerns that manufacture soda ash. Ciech S.A. is going to participate in these processes by acquisitions of new entities.

#### **Foreign exchange risk**

Approximately a half of Ciech SA's revenue comes from exports, mainly denominated in EUR. Low EUR/PLN exchange rate decreases profitability of the product sales in foreign markets. Moreover, low EUR/PLN exchange rate favours export sales by Ciech SA's trade partners, which can translate into a decrease in the Company's turnover. The export denominated in USD is of much lower importance for the results of the Company. The exchange rate of USD has no impact on the Company's profit, because it is naturally hedged by a similar volume of import denominated in USD. The Company constantly monitors its foreign exchange risk, and hedges large transactions denominated in foreign currencies with the use of forward transactions.

### 3.2 Internal and External Factors Significant to the Company's Growth

#### **External factors**

##### **Economic situation in Europe and worldwide**

Ciech SA's commercial activities rely largely on chemical product exports, whose level and profitability depend on the global economic situation in Europe and worldwide. A global economic slump could affect the demand for raw materials in international markets, thus reducing the exports turnover of Ciech SA.

It is estimated that in 2006, global economy will grow at the existing pace of 4% a year (with the euro zone's growth figure being 2%).

As for 2006, the European Chemical Industry Council (CEFIC) predicts slight and short lasting improvement of the chemical production dynamics in EU2005 (to 2.3% from 1.9% in 2005).

##### **Situation in the industries of the Company's customers in Poland**

Ciech SA supplies most of its products to the following Polish industries: the chemical industry, the plastics industry, and the glass-making industry.

How these industries expand depends on the general economic situation in Poland. In 2005, the industrial output at fixed prices increased by a mere 4% (11.7% throughout 2004). Similarly, the dynamics of the chemical industry was 3.2% (9.8% in 2004) with regard to the manufacture of chemical products, and 9.1% (12.1% in 2004) with regard to the manufacture of rubber and plastics products.

Lower increase in GDP in Poland, which has been predicted to occur in 2005 (3.2%) in comparison with 5.3% in 2004, is reflected in lower dynamics of sales in the chemical sector. One should remember, however, that the situation results from the so-called high base: exceptionally good economic results in 2004, connected largely to the accession of Poland to the EU. On the other hand, recent economic analyses indicate that the economic growth in Poland will be quicker in 2006. (GDP forecasts at the level of 4.3-4.4).

**Financial standing of the agricultural industry** CIECH S.A. derives a certain portion of their income from the agricultural sector, mainly from mineral fertilizers and plant protectants. CIECH S.A. estimates that the demand for mineral fertilizers in Poland should remain stable, with growing significance of mixed fertilizers. The factors that will most likely benefit the demand for agrochemical products and consequently, the demand for the CIECH Capital Group's products will be the efforts aimed at improving the condition and profitability of agricultural production, including production quotas and direct payments. The above should translate into and an increase of Ciech SA's revenues. If no purchasing-power improvement is recorded in the agricultural sector, the demand for fertilizers and plant protectants will stagnate, as will the Ciech SA's income from agrochemical product sales.

#### **Ownership changes in the sector of Great Chemical Synthesis (Wielka Synteza Chemiczna (WSCh))**

The process of privatising WSCh sector companies involves several important trade partners of Ciech S.A. The change in ownership structure of these entities will probably lead to the change of terms and conditions of cooperation of these companies with Ciech S.A. The restructuring may have negative impact on the Company in the case of entities in which Ciech will not acquire controlling interests. Ciech S.A. takes part in privatisation processes of ZCh Zachem and ZCh Organika Sarzyna according to the adopted development strategy of the CIECH Chemical Group, which assumes the achievement of the top position in the selected market segments, in order to decrease the risk of possible unfavourable ownership changes in the WSCh sector.

#### **Situation in the raw materials market**

A major portion of Ciech S.A.'s turnover is generated from imports of chemical raw materials to Poland. The raw-material markets are characterised by high cyclicity, prompted by fluctuations in the world economy. On the one hand, the growing prices of raw materials force the trading agents to lower their mark-ups and decrease customers' demand. Declining prices, on the other hand, are usually a sign of weakening demand and the onset of an economic slump. If the stable growth rate and steady prices of chemical raw materials continue, this will benefit the Company's imports of chemical raw materials. Large fluctuations in demand and prices caused either by high economic growth rate or by economic stagnation, will adversely affect Ciech S.A.'s trade in chemical raw materials.

#### **Draft EU law on registration and evaluation of chemicals (REACH system)**

Ciech S.A. currently monitors works on the draft Regulation concerning REACH. Efforts were undertaken to prepare a preliminary effect analysis with regard to the system implementation in Ciech S.A. and its subsidiaries. Relevant works are underway.

On November 17, 2005, the European Parliament in the first reading adopted the draft Regulation concerning REACH, introducing to it several hundred amendments. The chemical industry must yet wait for the second reading in the European Parliament, which may spell another year or two spent struggling for provisions that are more favourable.

#### **Sea freight rates**

2005 saw a considerable decrease in sea freight rights which influence the Company's trade in raw materials and fertilizers (in 2004 the rates increased by several dozen to several hundred per cent), It should improve Ciech S.A.'s competitive edge in terms of trade using sea transport.

#### **PLN/EUR exchange rates**

The majority of Ciech S.A.'s export sales are settled in EUR. Strong Euro means higher profitability of exports, both for Ciech S.A. and other chemical industry players in Poland. It also increases Ciech S.A.'s trade volumes with other manufacturers. As a result, EUR/PLN exchange rate affects Ciech S.A.'s return on sales. If the Polish zloty becomes stronger against Euro, profitability of exports will probably decline, and Ciech S.A.'s export volumes will decrease.

#### **Commodity markets material to the Company's operations**

TDI – Global manufacturing of TDI records with the annual growth of 5%. Similar growth is forecasted for 2006. The main reason for the increase is growth of the Chinese economy and continuous expansion of the product's range of applications. The end of 2005 saw a jump in prices. Despite of strong market pressure on prices to lower, we expect them to stabilise.

Sulphur – for a long time the sulphur market has remained stable. Yet, in 2005, its prices soared. As for 2006, we do not expect the prices to rise further. On the contrary, we expect their slight decrease. Ciech has already concluded the agreements, which guarantee stability of supplies and markets in 2006.

Epoxy resins – we expect further increase in demand in 2006. The related economic situation in Poland and Europe is good and the prices are high. There is a possibility to increase export volumes, if some necessary investment is made at the supplier's premises.

Epichlorohydrin – it is actually feasible to increase epichlorohydrin exports. Yet, the increase is conditioned by updating of installations at the manufacturer's premises, which will lower manufacturing costs. Ciech is currently negotiating with customers for whom it will be a sole supplier.

Fertilizers and plant protectants – Poland's accession to the European Union increased the demand for fertilizers and plant protectants during the 2004/2005 season. As for the 2005/2006 season, we expect the prices

and demand to stabilise at a new, higher level. The existing situation triggers off high demand for base stock for fertilizers imported by Ciech. The increase in demand affected in particular the phosphoric acid market, both local and global (continuing consumption growth in China). At the same time, the demand for potassium stabilised due to lower demand in South America

**Caustic soda** – noticeable growth is observed. The forecasts show a stable, yet slight increase in the annual demand in both Western and Eastern Europe, 1.8-2% and 2.7-2.9% respectively. For the last 2 years, the prices have increased significantly. Warehouse inventories have decreased due to the increased demand combined with insignificant increase in chlorine manufacturing. Last year's limited volumes of goods (due to technological changes in Anwil's manufacturing process) has limited Ciech S.A.'s own sales. At the same time, Ciech saw migration of some customers due to the increased activity of competitors. Now it can be a barrier to re-enter the market.

**PVC** – we observe gradual consolidation of PVC manufacturers and stable growth in the global demand of 4-6% a year. We also expect to see the demand increase in eastern markets (mainly Russia and Ukraine). We also see strengthening of Anwil's position in the European market due to updating of the PVC manufacturing complex. In the near future, we expect a revival of trade and the growth in investment in the construction industry. Consequently, the use of PVC will grow too.

**Sodium silicate** – its market is mature, similarly to other industries, which use sodium silicate as a raw material. The recession in the industries using sodium water glass has been stopped; the detergent industry, being the top consumer of sodium silicate, has stabilised. A great opportunity for sodium water glass manufacturers will be a new application: precipitated silica used as a substitute of soot in tyre manufacturing, as an agent in quick-drying cements, in compounds and in the paper industry, where it can replace much more expensive titanium dioxide. In Europe, we expect higher demand for precipitated silica at an annual level of 2-2.5%. Over the next few years, precipitated silica is expected to be used on a larger scale in Poland too (18% growth). We also expect further investment in the tyre industry in the CEE countries.

## Internal factors

### **Feasibility of technology investments such as: construction of a monohydrate system, construction of the second assembly line for hollow glass blocks, development of a countrywide distribution system for evaporated salt.**

The purpose of the technology investments planned at the CIECH Group is to enhance the quality and properties of its products (the monohydrate project), increase the production capacity for high-yield products (hollow glass blocks), and introduce new products with potential for becoming the market leaders (feed phosphates). The evaporated salt project is aimed at introducing the CIECH Group to evaporated salt distribution market as well as creation of its own product brand. Completion of the salt project will also result in increased opportunities of salt packaging and customising, thanks to equity or fixed-asset investments. CIECH SA expects that its technology investments will enable the Company to maintain its leading position in the Polish soda ash market, boost sales and profitability of hollow glass products, reinforce its standing in the agrochemical sector, and achieve a leading position in the evaporated salt retail market. Achievement of the project targets should bring about an increase in net income and return on sales. Failure to carry through the technology investments might lead to a gradual decline in the CIECH Group's position in the markets concerned and a lack of improvement in return on sales.

### **Effective internal consolidation of the soda segment**

The consolidation of the soda division will consist in: (i) acquiring 100% of shares in both soda companies by purchase of the remaining shares from minor shareholders, (ii) continued cost streamlining. The internal consolidation and implementation of operational excellence projects will enable further cuts of the costs per piece in manufacturing of soda ash, leading to an increase in the Capital Group's competitive edge in the soda segment. In October 2005, Ciech S.A. became a holder of almost 100% interest in the soda companies (99.26% in JZS Janikosoda and 99.77% in IZCh Soda Mątwy). Once the purchase is concluded in full, the Company will analyse feasibility and advisability of incorporation of the soda companies in Ciech SA's structure.

### **Growth strategy advancement opportunities, with a focus on new division building**

As part of its growth strategy, the CIECH Group plans to build three new divisions (complementary to the existing soda division) to handle three key areas of the chemical sector: a phosphorus division, organic division and inorganic division. From early 2006, Ciech SA has been organising the Organic Division. Once the purchase of ZCh Zachem and ZCh Organika Sarzyna is completed, the division will be fully operational under the same name. Acquisitions are expected to be completed by the end of June 2006. Completion of Ciech S.A.'s equity investments should bring about a considerable growth of net income and financial results in the CIECH Group.

### **Quality and continuity of the management staff and employees**

The market position of the CIECH Group's products is largely owed to the high level of expertise of its top and middle management. The Group's HR policy guarantees stability and career and growth opportunities to its staff. Some efforts have been taken to update remuneration and motivation tools and systems. The Company embarked on new solutions to regulate collective employment issues. In the first place, the Company developed assumptions of the Management by Objectives system (MBO), now it is implementing the concept. Once successfully completed, it will be of key importance to motivate Ciech S.A.'s employees, thus contributing to the Company's development.

### 3.3 Anticipated Development of the Company

The CIECH Group's strategy aims at maximisation of the Group's goodwill by creating a strong chemical concern of a regional character, focused on some specific market segments, namely on products which offer high added value, considerable potential for market growth and complementary nature.

Once the strategic vision is fulfilled, the Group will be transformed into a chemical concern composed of separate divisions handling the key areas of the chemical sector. Each division will manage a specific product portfolio with parameters guaranteeing a net income level for the Capital Group of approximately 1 billion EUR per year, and EBITDA of more than 12%.

Growth strategy advancement will involve the following:

- increasing the added value in the soda sector by means of further internal consolidation of the soda sector, technology investments and possible acquisitions
- working toward a leading position in the Polish markets of phosphoric fertilizers and products, as well as mixed fertilisers, by expanding the phosphorus division through fixed-asset investments in GZNF Fosfory Sp. z o.o. and equity investments in the phosphoric fertilizer industry
- expanding the Organic Division and increasing the CIECH Group's role in creating a value chain for organic products through equity investments in ZCh Zachem and ZCh Organika Sarzyna
- expanding the inorganic division through fixed-asset investments in Vitrosilicon S.A. subsidiary to increase its manufacturing capacity and through equity investments in the chemical industry manufacturers

Ultimately, the CIECH Group's operations will comprise almost exclusively the manufacture of and trade in the products of the so-called "core portfolio," meeting the predefined added-value requirements. The process of reorganising the portfolio will be carried out on two levels: on the one hand, the share of non-core products and goods in the CIECH Group's portfolio will be gradually decreasing, and, on the other hand, the portfolio will be enriched with attractive non-Group products. At the same time, the CIECH Group's members will be implementing their own investment programmes to increase their volumes of the core-product manufacturing (organic growth).

While gradually abandoning the non-core portfolio, Ciech SA will be making divestments from selected manufacturing and commercial Group companies. The divestments are necessary, first, to be able to focus on the core business (core portfolio), and, second, to gain funds to finance the planned acquisitions and investments. Ciech SA's trade in non-core low-yield products will also be gradually reduced.

## 4 ANNEXES

### 4.1 Main Products, Goods and Services of Ciech SA.

**Table 4.1.1. Sales of goods and materials between 1 January 2005 and 31 December 2005**

1 January 2005 – 31 December 2005			
Name of the product, product group, good or service	Quantity in thousands of tons	Net sales	Percentage share
Heavy soda ash	818.4	430 858	27.12%
Aromatic hydrocarbons	58.6	158 800	9.99%
Light soda ash	284.8	156 980	9.88%
Fertilizers	174.4	126 329	7.95%
Salt	332.3	99 935	6.29%
PVC	22.5	68 551	4.31%
Yellow phosphorus	6.5	51 040	3.21%
Phosphorites	263.6	49 047	3.09%
Silicates	73.6	42 692	2.69%
Other		404 660	25.47%
<b>TOTAL</b>		<b>1 588 892</b>	<b>100,00%</b>

### 4.2 Changes in the Markets.

**Table 4.2.1. Geographic structure of sales of goods, materials and services**

1 January 2005 – 31 December 2005		
Net sales in thousands PLN	Goods	Products
domestic	908 277	11 792
export	601 655	67 168
- EU	581 105	67 168
- Other Europe	16 267	
- Africa	1 001	
- Asia	1 547	
- Other	1 735	

**Table 4.2.2. Major customers of Ciech SA**

1 January 2005 – 31 December 2005			
Customer	Net sales in thousands PLN	Share	Affiliation with Ciech S.A
DWORY SA	129 674	8.16%	no affiliation
Z-DY CHEMICZNE ALWERNIA SA	101 763	6.40%	subsidiary
FOSFORY SP. Z O.O., GDANSK	64 155	4.04%	subsidiary
FERTICHIM N.V.	58 195	3.66%	no affiliation
PETROCHEMIA-BLACHOWNIA S.A.	54 263	3.42%	subsidiary
OWENS-ILLINOIS POLSKA S.A.	50 275	3.16%	

"SIARKOPOL" SA W GRZYBOWIE"	47 625	3.00%	no affiliation
INTERORE S.A.	45 716	2.88%	no affiliation
CHEMAN S.A.	32 849	2.07%	subsidiary
LANDHANDEL	31 741	2.00%	no affiliation
SUOMEN UNIPOL OY	25 734	1.62%	no affiliation
POZOSTALI	946 902	59.60%	
<b>TOTAL</b>	<b>1 588 892</b>	<b>100.00%</b>	

#### 4.3 Changes in Suppliers of Manufacturing Materials, Goods and Services.

**Table 4.3.1. Geographic structure of purchase**

1 January 2005 – 31 December 2005	
Net purchase in thousands PLN	Goods
domestic	1 120 351.10
import:	225 835.74
- EU	128 560.64
- Other Europe	35 863.30
- Africa	45 784.30
- Asia	15 627.50
- Other	8.4

**Table 4.3.2. Suppliers accounting for more than 10% of the total supplies**

Supplier	1 January 2005 – 31 December 2005		Affiliation with Ciech S.A.
	Net purchase	Share	
Soda Mątwy S.A.	312 016.1	23.18%	subsidiary
Janikosoda	334 810.1	24.87%	subsidiary
Petrochemia Blachownia SA	148 149.4	11.01%	subsidiary
Other	464 704.7	34.52%	
Total	1 346 186.8	100.00%	

#### 4.4 Sureties and Guarantees Granted

**Table 4.4.1. Sureties and guarantees granted**

Obligor's name	Amount of loan covered by surety		Surety period	Financial terms: surety fee due to the company	Principal	Affiliation between Ciech SA and the borrower
	Currency	In thousands PLN				
Ciech SA						
National Fund for Environmental Protection and Water Management (NFOSiGW) in Warsaw		4 185	until 31.03.2006	As part of the surety agreement, Ciech S.A. also stands surety for interest on a loan of 16 740 000 PLN. According to the repayment schedule, the outstanding loan balance as at 31.12.2005 is 1 580 000 PLN	IZCH. Soda Mątwy SA	Subsidiary

Obligor's name	Amount of loan covered by surety		Surety period	Financial terms: surety fee due to the company	Principal	Affiliation between Ciech SA and the borrower
	Currency	In thousands PLN				
KREDYT BANK SA Sieradz Branch		4 500	until 31.08.2006	Payment to Ciech SA equal to 1% of the surety value	Chemana S.A - Warsaw	Subsidiary
KREDYT BANK SA Sieradz Branch		3 750	until 31.08.2006	Payment to Ciech SA equal to 1% of the surety value	Chemana S.A - Warsaw	Subsidiary
BANK HANDLOWY SA		4 800	until 01.05.2006	Payment to Ciech SA equal to 1% of the surety value	Ciech-Polfa Sp. z o. o.	Subsidiary
PKN ORLEN SA		1 200	no fixed term	Payment to Ciech SA equal to 1% of the surety value	Chemana S.A - Warsaw	Subsidiary
BRE - MULTIBANK SA		136	no fixed term – the surety expires on final loan settlement		Ciech S.A. employees	
BANK PKO SA I Warsaw Branch		6 000	until 31.08.2006	Payment to Ciech SA equal to 1% of the surety value (2 million PLN and up) + 10 000 PLN on increase + 400 000 PLN	Chemana SA	Subsidiary
BANK PKO SA I Warsaw Branch		2 000	until 20.01.2006	Payment of 10 000 PLN to Ciech SA	Chemana SA	Subsidiary
<b>Total Ciech SA</b>		<b>26 571</b>				
<b>Petrochemia Blachownia SA</b>						
Bank PKO BP S.A		300	30.08.2004 - 05.07. 2010	none	BL-Trans Sp. z o.o.	Indirect lower-tier subsidiary
<b>Total Petrochemia Blachownia SA</b>		<b>300</b>				
<b>Soda Mątwy SA</b>						
ING BSK Leasing SA		826	until 31.03.2007	None (leasing agreement)	Transoda Sp. z o. o.	Indirect lower-tier subsidiary
<b>Total Soda Mątwy SA</b>		<b>826</b>				
<b>Janikosoda SA</b>						
BOŚ Poznań	EUR 2 268	8 754	until 16.11.2009	no fee	Vitrosilicon SA	Subsidiary
<b>Total Janikosoda SA</b>		<b>8 754</b>				
<b>Total loans guaranteed</b>		<b>36 451</b>				

Obligee's name	Amount of loan covered by surety		Surety period	Financial terms: surety fee due to the company	Principal	Affiliation between Ciech SA and the borrower
	currency	in thousands PLN				
Soda Mątwy SA						
National Fund for Environmental Protection and Water Management (NFOŚiGW)		800	until 31.12.2006	Real-estate taxes payable to the Inowrocław Town Office constitute a collateral of the granted surety	Inowrocław Town Office	no affiliation
<b>Total Soda Mątwy SA</b>		<b>800</b>				

**Warsaw, 12 April 2006**

.....  
**Ludwik Klinkosz – President of the Management Board of Ciech SA**

.....  
**Stefan Rojewski – Member of the Management Board of Ciech SA**

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**Jerzy Golis – Member of the Management Board of Ciech SA**