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Polskie Górnictwo Naftowe
i Gazownictwo SA

Financial Performance of PGNiG Group
Q2 2011 and H1 2011

August 31st, 2011

Financial highlights

PGNiG Group (PLN m)	H1 2010	H1 2011	*change (value)*	Q2 2010	Q2 2011	*change (value)*
Sales revenue	10,762	**11,523**	*761*	4,129	**4,478**	*349*
Operating expenses	(9,560)	**(10,451)**	*891*	(4,154)	**(4,585)**	*431*
EBITDA	1,947	**1,850**	*(97)*	354	**281**	*(73)*
EBIT	1,202	**1,073**	*(129)*	(25)	**(106)**	*(81)*
Result on financial activity	15	**167**	*152*	6	**104**	*98*
Net result	994	**1,005**	*11*	(2)	**(20)**	*(18)*
Hi-methane gas sales margin	4%	**(1%)**	*(5 pp)*	(3%)	**(4%)**	*(1 pp)*

- As regards its operating activities in H1 2011, the PGNiG Group recorded a PLN 129m drop in EBIT, following from a **5 pp** decline in the profitability of high-methane gas sales. The strong performance of the Exploration and Production segment helped the Group to soften the decline in its operating profit.
- The profitability of high-methane gas sales deteriorated in H1 2011. A **13%** increase in the unit purchase price of imported gas was the main cause of the profitability decline. The protracting tariff procedures and postponed introduction of a new tariff resulted in the Group losing on margins on natural gas sales.
- Net profit for the periods was helped primarily by a year-on-year **improvement** of the result on financing activities, by PLN 152m in H1 2011 and PLN 98m in Q2 2011. The improvement was attributable to considerably higher foreign exchange gains and the disposal of **Zakłady Azotowe of Tarnów-Mościce** shares in Q2 2011.
- In Q2 2011 alone, the sales margin on high-methane gas was **negative at -4%**.

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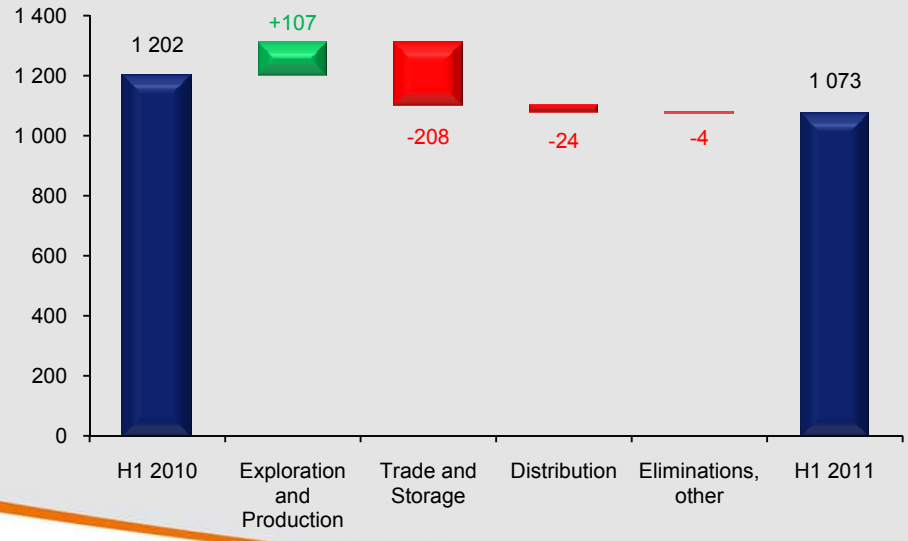
Segments – H1 2011

EBIT (PLN m)	H1 2010	H1 2011	*change*
Exploration and Production	339.8	**446.5**	*31%*
Trade and Storage	342.6	**135.1**	*(61%)*
Distribution	526.1	**502.0**	*(5%)*
Eliminations, other	(6.8)	**(10.8)**	*(57%)*
TOTAL	**1,201.7**	**1,072.8**	***(11%)***

Segments influence on the operating result in H1 2010 and H1 2011(PLN m)



- The operating profit recorded by the Exploration and Production segment **grew by PLN 107m** relative to H1 2010, as a result of an improved profitability of crude oil sales driven mainly by the rising crude prices on global markets, on average by 43%. The segment's EBIT advanced also on higher revenue from sales of geophysical/geological and drilling services, related to the intensified exploration for shale gas in Poland.
- The Trade and Storage segment recorded the largest decline in productivity; the segment's operating profit was down by PLN 208m year on year. This was a result of a significant deterioration of high-methane gas sales profitability, caused mainly by a **13%** rise in the unit purchase price of imported gas. Moreover, the Group increased the volume of gas imports and reduced the amount of gas drawn from storage facilities, thus building up the gas stocks.
- The operating result reported by the Distribution segment was down by PLN 24m year on year, mainly due to a **3%** decline in the volume of distributed gas. The segment's profitability was down despite the higher rates and charges for network services, introduced in June 2010.

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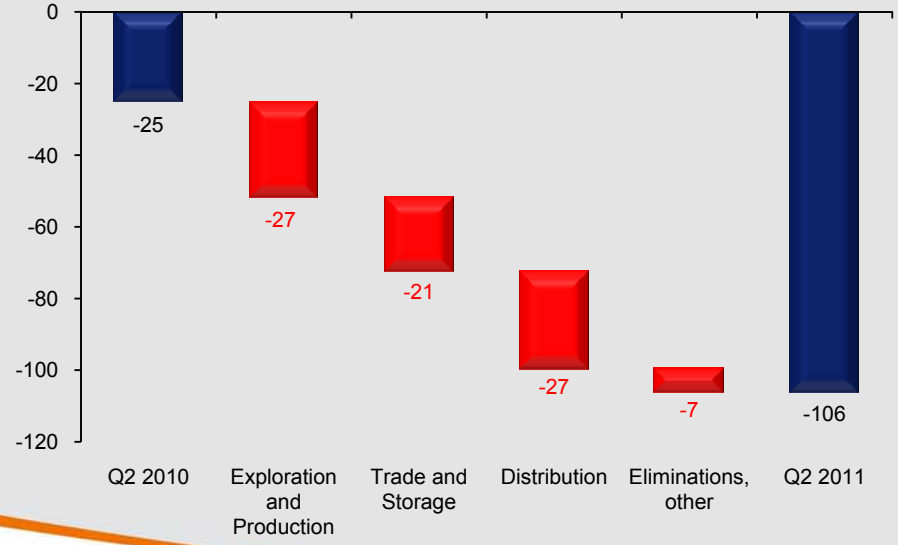
Segments – Q2 2011

EBIT (PLN m)	Q2 2010	Q2 2011	*change*
Exploration and Production	98.3	**71.7**	*(27%)*
Trade and Storage	(103.0)	**(123.7)**	*(20%)*
Distribution	(20.4)	**(47.3)**	*(132%)*
Eliminations, other	0.1	**(6.8)**	*(7,095%)*
TOTAL	**(25.2)**	**(106.2)**	***(321%)***

Segments influence on the operating result in Q2 2010 and Q2 2011 (PLN m)



- Although revenues on crude sales and on geophysical/geological services were on the rise, the Exploration and Production segment reported a PLN 27m decline of its operating profit. The segment's weaker EBIT is attributable to a NOK 150m (**approx. PLN 76m**) impairment loss recognised on tangible assets under construction held in PGNiG Norway. The impairment loss relates to the Gro field; the first portion of the loss was recognised in Q4 2010. The exit from the licence necessitated recognition of full impairment loss. Unless the necessity of impairment recognition on assets in Gro field, the segment's EBIT would be PLN 148m, ie. ca 50% higher than in Q2 2010.
- Despite a PLN 261m rise in revenue from gas sales, the operating result of Trade and Storage segment deteriorated as costs of gas sold grew by 12% (PLN 255m) between the quarters under review.
- In Q2 2011, the Distribution segment's EBIT fell by PLN 27m year on year on the back of a 4% decrease in the volume of distributed gas.

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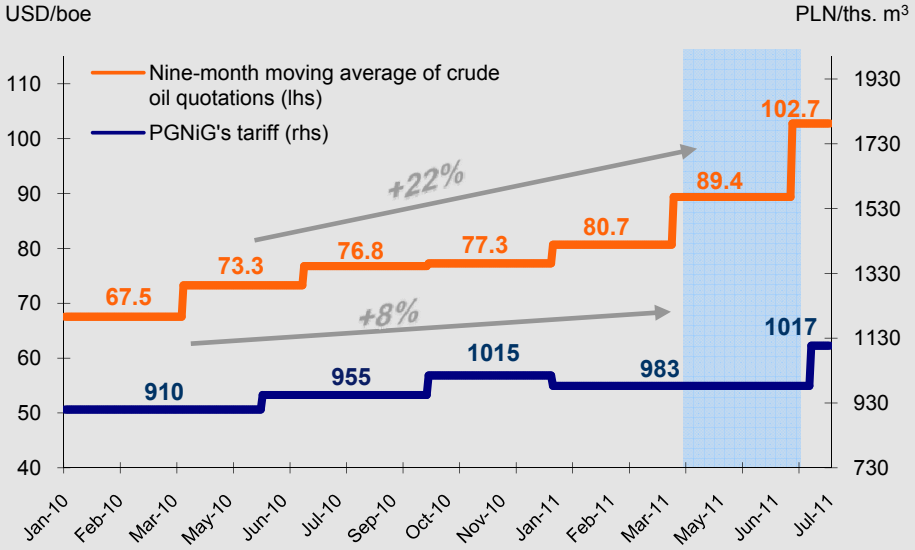
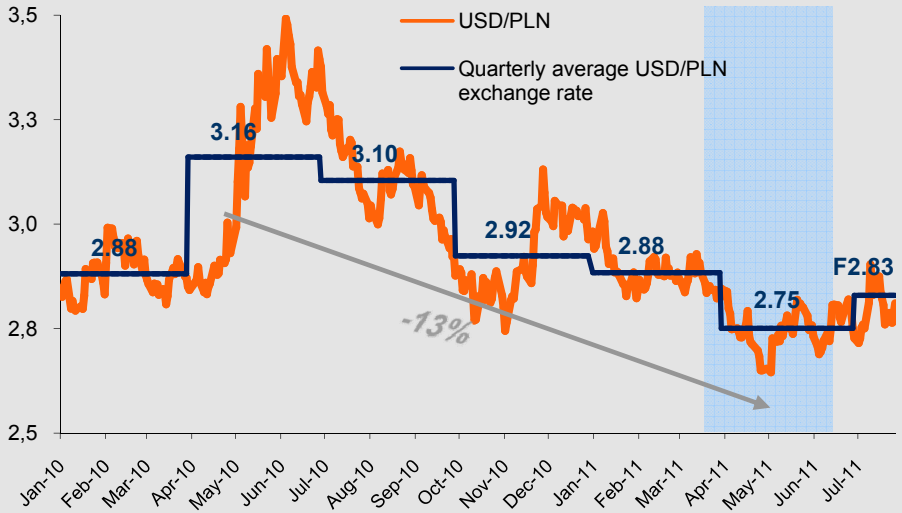
Financial performance drivers

Crude oil quoted prices* vs tariff price of gas



- The price of imported gas is linked to the oil price. The formula used to calculate the price of imported gas is based on a nine-month moving average price of oil derivative products, which has an almost 100% correlation with crude oil prices.
- Due to the wave of political unrest in North Africa, the prices of crude oil remain high, having exceeded USD 100 per barrel since February. In Q2 2011, the value of the nine-month average price reached 89 USD/boe, having grown by **11%** relative to Q1 2011.

USD/PLN exchange rate**



- The imported gas purchase is mainly denominated in the dollar, similarly to the crude oil sale price.
- In Q2 2011, the average USD/PLN exchange rate was 2.75, down by almost **5%** relative to Q1 2011 (2.88), and by **13%** year on year.
- Taking into account the average USD/PLN exchange rate in the analysed periods, in Q2 2011 the nine-month moving average price of petroleum products was 246 PLN/boe, having grown by **6.2%** relative to Q2 2010 and by **5.6%** relative to Q1 2011.

* European Dated Brent Forties Oseberg (BFO), source: Bloomberg.
** Source: National Bank of Poland (NBP).

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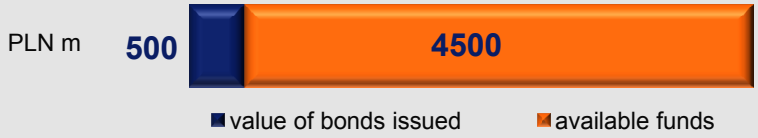
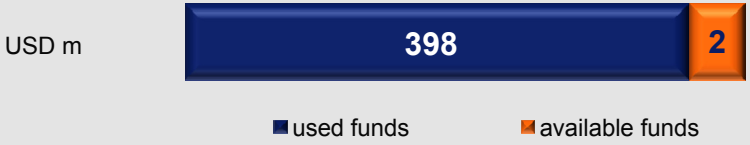
Financial indebtness

Use of debt under the financing programmes as at June 30th, 2011

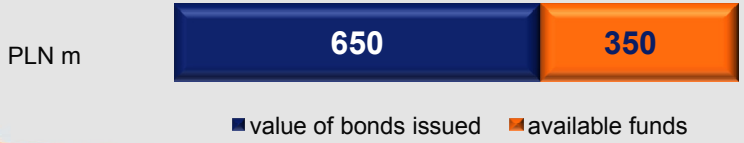
- Domestic bond issue programme – up to **PLN 5bn**



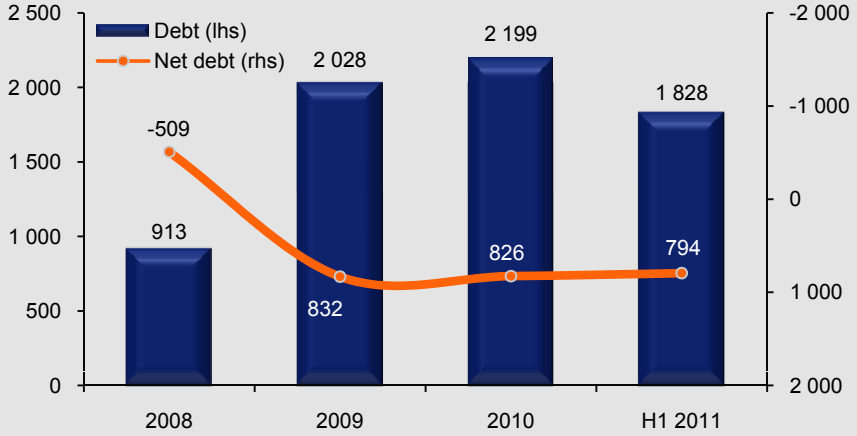
- Reserve Based Loan (PGNiG Norway) – up to **USD 400m**



- Note issuance programme acquired by the distribution companies – up to **PLN 1bn** (subject to elimination in consolidated financial statement)



PGNiG Group debt (PLN m)



- The amount of debt as at June 30th 2011 was down on the end of 2010, as the Company issued **PLN 600m** less bonds during the period, while PGNiG Norway increased the use of the RBL facility by **PLN 174m**.
- In July 2011, the maximum value of the domestic bond issue programme was increased **from PLN 3bn to PLN 5bn**, and the maturity was extended by two years, i.e. until **July 31st 2015**.
- In Q2 2011, the maximum value of short-term bonds issued to the distribution companies was increased to **PLN 1bn**.

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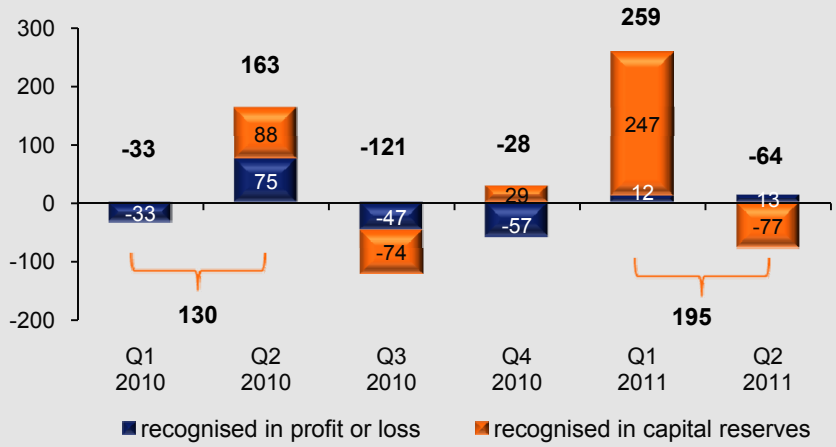
Market risk hedging policy

- PGNiG SA is considerably exposed to the risk of fluctuations in the prices of commodities and to the foreign exchange and interest rate risks. The Company enters into the following derivatives transactions to hedge its currency risk:
  - purchase of European call option,
  - zero-cost collar option strategies (risk reversal),
  - cross-currency basis swap,
  - forward transactions.
- Since May 2010, PGNiG has also entered into transactions designed to hedge the prices at which it purchases natural gas and qualifying for hedge accounting. To hedge the risk, PGNiG executes transactions that hedge the primary drivers used to determine the prices of imported gas:
  - purchase of Asian commodity call options,
  - risk reversal zero-cost collar option strategies (Asian options),
  - commodity swaps.

Result on foreign exchange differences and derivative instruments (PLN m)



- In H1 2011, PGNiG Group recorded a positive result on derivative transactions (both realised and unrealised) and exchange differences of **PLN 195m**, of which PLN 191m was the net gain on derivative transactions related to operating activities (mainly gas purchases). To compare, in H1 2010 the Group reported a net loss on hedging transactions of PLN 130m.
- In Q2 2011 alone, the result on derivative transactions was negative at **PLN -64m** (PLN 163m in Q2 2010).

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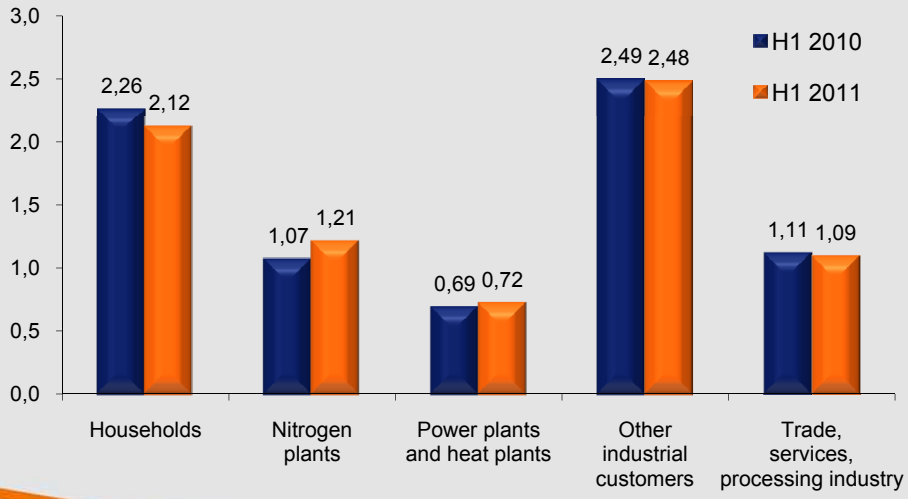
Natural gas

PGNiG Group*	H1 2010	H1 2011	*change*	Q2 2010	Q2 2011	*change*
Production volume (million m^3)	2,104	**2,126**	*1%*	966	**996**	*3%*
Import volume (million m^3)	5,498	**5,876**	*7%*	2,443	**2,743**	*12%*
Sales volume (million m^3)	7,622	**7,618**	*0%*	2,732	**2,812**	*3%*
Gas sales revenue (PLN m)	9,744	**10,298**	*6%*	3,625	**3,882**	*7%*
High-methane gas (E)	9,141	**9,671**	*6%*	3,397	**3,657**	*8%*
Nitrogen-rich gas (Ls, Lw)	603	**628**	*4%*	228	**225**	*(1%)*

Customers' share in gas sales volume (bn m^3)



- The **increase** in gas output resulted from a steady increase in production following from the implementation of the PGNiG Group's Strategy.
- The significant year-on-year increase in gas imports in the quarter under review was linked to a 36% higher volume of gas injected into the underground gas storage facilities. As at June 30th 2011, the underground storage facilities were filled with **1.2bn cubic metres** of gas.
- In the second quarter of 2011, the year-on-year **growth in revenue** from gas sales was driven not only by a higher sales volume, but also by a 3.4% increase in the average unit price of high-methane gas.

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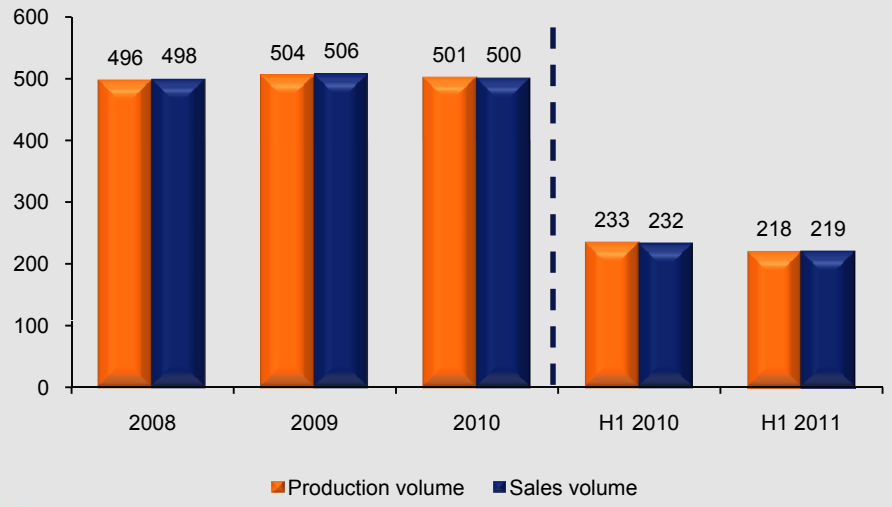
* Measured ad as high-methane gas equivalent (E).

Crude oil

PGNiG Group*	H1 2010	H1 2011	*change*	Q2 2010	Q2 2011	*change*
Production volume (ths. t)	233	218	*(6%)*	96	84	*(12%)*
Sales volume (ths. t)	232	219	*(6%)*	97	89	*(8%)*
Sales revenue (PLN m)	376	474	*26%*	168	203	*21%*
Oil unit price (PLN/t)	1,620	2,168	*34%*	1,728	2,263	*31%*
Average price of Brent Dated oil for the period (USD/bbl)	78	111	*43%*	79	117	*49%*

Oil production and sales volume (ths. t)*



- Crude oil output in the second quarter of each year is traditionally lower than in the other quarters due to the annual four-week long overhaul and measurement stoppage at the Dębno production facility. This year, like a year before, the stoppage started in May.
- The year-on-year decease in the volumes of crude oil production and sales in the quarter under review was caused by the fact that one of the customers was not able to offtake natural gas, which is produced in correlation with crude oil, and that it was impossible to pump crude oil into the pipeline due to a failure at one of the storage tanks at the Dębno facility.
- Despite the lower volume of crude oil sold, the Company recorded a rise in revenue from sales of crude oil both in the second quarter and in the entire first half of 2011, driven by the growing oil prices on global markets.

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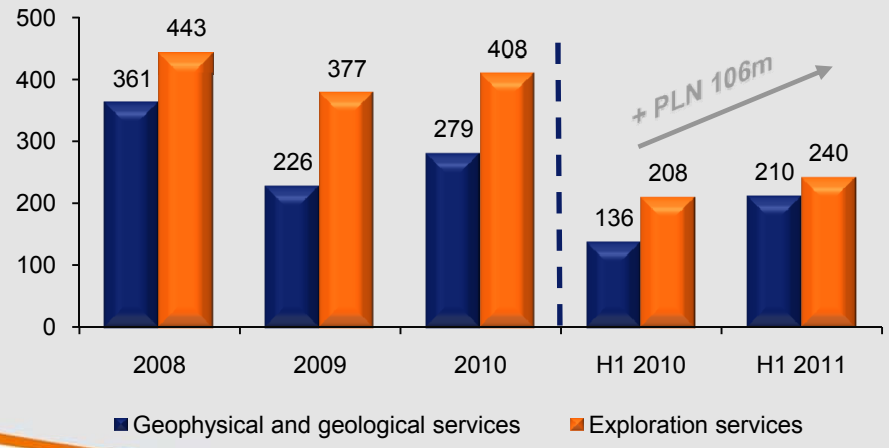
* For crude and condensate (together with tests from production).

Other sales

Sales revenue PGNiG Group (PLN m)	H1 2010	H1 2011	*change*	Q2 2010	Q2 2011	*change*
Helium	21.5	**26.4**	*23%*	11.3	**12.9**	*14%*
Porpane-butane gas (LPG)	22.3	**24.2**	*9%*	8.7	**8.6**	*(1%)*
LNG	13.8	**15.1**	*9%*	5.9	**6.4**	*9%*
Geophysical and geological services	136.3	**209.8**	*54%*	72.5	**109.3**	*51%*
Exploration services	208.1	**239.9**	*15%*	111.2	**134.4**	*21%*
Other products, services and materials	239.5	**235.9**	*(2%)*	126.8	**122.3**	*(4%)*

Revenues from geophysical, geological and exploration services (PLN m)



- The year-on-year rise in revenue from sales of helium reported in H1 2011 was attributable to a **4%** rise in helium production capacity coupled with a **20%** increase in its unit sales price.
- The **growth in revenue** from sales of geophysical, geological and exploration services follows from the stronger demand for these services, especially in Poland where it has been driven by **interest in shale gas**.

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Operating expenses

PGNiG Group (PLN m)	H1 2010	H1 2011	*change*	Q2 2010	Q2 2011	*change*
Total operating expenses	**9,560**	**10,451**	***9%***	**4,154**	**4,585**	***10%***
Cost of gas sold	5,669	6,562	*16%*	2,153	2,407	*12%*
Other raw materials and consumables used	272	328	*21%*	141	170	*21%*
Employee benefits	1,283	1,380	*8%*	713	783	*10%*
Depreciation and amortisation	745	777	*4%*	379	387	*2%*
OGP GAZ-SYSTEM transmission services	788	765	*(3%)*	333	350	*5%*
Cost of written-off dry wells	90	140	*55%*	54	53	*(1%)*
Other contracted services	640	663	*4%*	343	346	*1%*
Other operating expenses net	435	317	*(27%)*	234	305	*30%*
Cost of products and services for own needs	(361)	(481)	*33%*	(195)	(217)	*11%*

- The largest item of operating expenses was the cost of gas sold. In H1 and Q2 2011, the operating expenses went up by respectively **16% and 12%**, relative to the corresponding periods of 2010, on the back of increased volume of gas imports (**7% and 12%**, respectively) as well as the nine-month average price of petroleum products being higher by over 20%. The adverse effect of the increase in operating expenses was partially offset by a nearly 7% year-on-year appreciation of the zloty against the dollar.
- The growth in value of dry wells written off, reported in H1 2011, resulted from the high costs of wells written off in Q1 2011. Year on year, the cost of wells written off in Q2 2011 remained **flat**.
- A rise in cost of products and services for own needs follows from the higher expenditure on exploration for hydrocarbons, reflecting the expanded scope of exploration activities and the need to make deeper, and consequently more expensive, drillings.

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Summary

INCREASING COST OF GAS

The continued growth of oil prices over the last two years, strengthened in 2011 by the unstable situation in North Africa, has had an adverse effect on the costs of gas purchased by the Company; in H1 2011 the costs rose by **16%**, which translated into the negative margin on gas sales and the concurrent decline in the operating result. In Q3 2011, due to persistently high (above 100 USD/boe) prices of crude oil, the nine-month moving average price of petroleum products will grow by a **further 15%**.

EXPLORATION SERVICES SALES GROWTH

Intensification of hydrocarbons exploration on the Polish territory has contributed to a significant growth of interest in geophysical, geological, drilling and other services from external clients. Revenues from sales of these services in the first half and the second quarter of 2011 increased by over **30%** y-o-y.

PROFIT ON THE SALE OF SHARES

The considerably improved result on financing activities, recorded both in H1 and Q2 2011, was chiefly attributable to a **PLN 70m** gain on sales of the shares in Zakłady Azotowe of Tarnów-Mościce.

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PGNiG to acquire 99.8% stake in Vattenfall Heat Poland SA

August 31st, 2011

Why Vattenfall Heat Poland?

VHP's experienced management and employees will be PGNiG's key asset to expand further into the power sector

Diversification of PGNiG's core business by generation and sales of heat and electricity

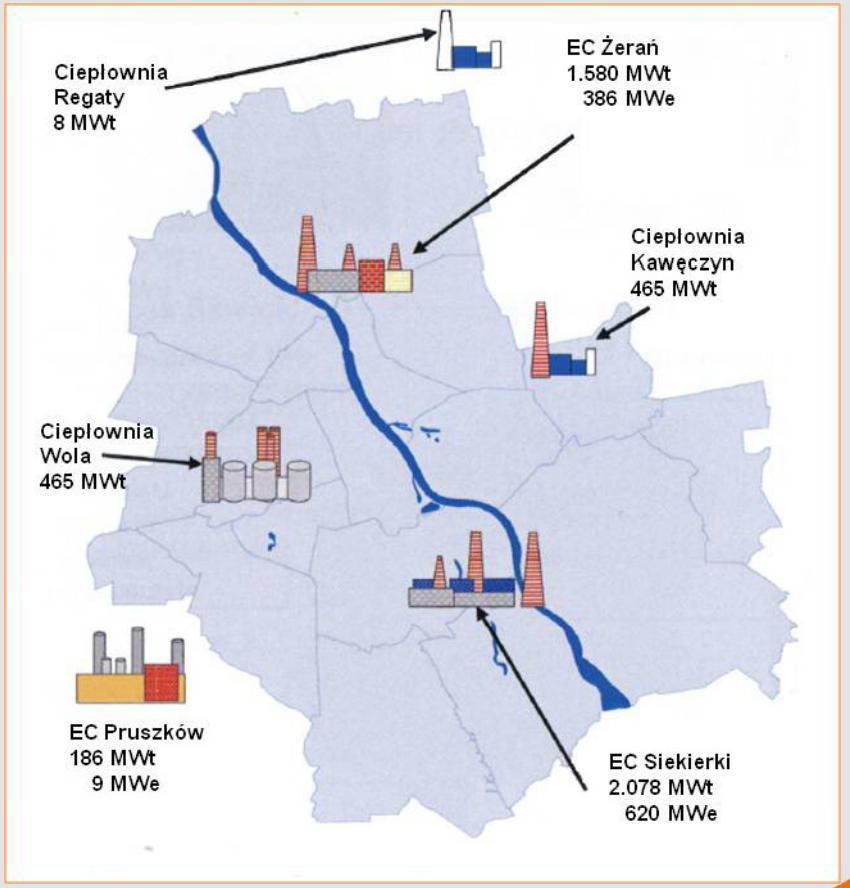
In terms of business effectiveness VHP is one of the leading companies in the Polish power sector

Attractive locations to develop new large gas-fired units – the planned increase in gas uptake is estimated above 1 bcm p.a.

The benchmarking tariff scheme brings significant EBITDA growth potential in upcoming years

Vattenfall Heat Poland operates the largest portfolio of heat generation assets in Poland

- VHP's heat generation assets represent over 23% of the total heat capacities installed in Poland.
- VHP covers approx. 75% of the total heat demand in Warsaw as well as 98% of the heat delivered to the network of SPEC.
- VHP's heat price is one of the lowest in Poland making the Warsaw heat market least interesting for any competitor considering the development of new heat sources.
- The new benchmarking scheme governing the tariff regulations in Poland creates significant upside for the Company's profitability.
- Most of the electricity generated in VHP is produced in cogeneration mode.
- VHP controls attractive locations with high potential to develop new gas-fired units and, in the long term, allowing for sizeable replacement of the hard coal with gas in the fuel mix.
- VHP's management and employees demonstrate proven expertise in the power sector.



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Benchmarking tariff scheme

- Based on the ruling of the Minister of Economy, the new heat tariff scheme based on the benchmarking mechanism came into force in 2011. The new tariff regime is optional for CHP plants.
- The benchmark (or the reference price) is calculated based on the country's average heat-only boiler prices from the previous year for respective fuel type and is announced by Energy Regulatory Office on annual basis and adjusted by the reference ratio currently set at the level of 1.0.
- The current benchmark based on 2010 data for hard coal fired units amounts to **34.52 PLN/GJ** and **60.46 PLN/GJ** for gas fired units.
- Heat producers with tariffs below the benchmark price are allowed to gradually increase tariffs towards the benchmark price, however the maximum annual heat price increase is capped at the level of increase of the corresponding benchmark plus 2 p.p.
- New generating units are eligible to receive the full benchmark price since commissioning.
- Heat generators adopting the new benchmarking tariffs regulations will remain highly independent from the fluctuations of the fuel prices, CO_2 allowances or any other typical cost item as any changes in cost base should also be reflected in the benchmark, however with 1 year lag (benchmark for each fuel type is calculated based on historical data from year n and can be applied by heat generator in year n+1). In case of significant change in the cost base heat producer applying the benchmark tariffs will recover its positive or negative change in margin in the following year, with the exception of year 2013 where significant increase of CO_2 costs is expected and following to the separate formula defined in the benchmarking decree, this additional costs should be recovered by the heat generators in the same year.
- VHP being the generator with the lowest heat tariffs in the country has at the same time the biggest potential to increase the tariffs while converging to the full benchmark price.
- For more details please refer to: *http://www.ure.gov.pl/portal/pl/492/3774/Rozporzadzenie_Ministra_Gospodarki_z_dnia_17_wrzesnia_2010_r_w_sprawie_szczegolo.html*

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Source: Vattenfall, Minister of Economy's ruling dated 17 September 2010 on detailed principles of setting the tariffs and settlements of the heat supply.

Benchmarking tariff scheme: simplified example

Exemplary impact of benchmarking tariff scheme on financial results of a heat generation company

	Unit	Year n	Item change	Year n+1
Revenues from heat sales	PLNm	**1,000**	**12%**	**1,120**
Benchmark growth	%		**10%**	
Convergence to benchmark	p.p.		**2 p.p.**	
Heat price	PLN/GJ	25.0	**12%**	28.0
Heat sales volume	TJ	40,000	-	40,000
Operating expenses	PLNm	**700**	**10%**	**770**
Fuel	PLNm	400	10%	440
CO2 allowances	PLNm	200	10%	220
Other costs	PLNm	100	10%	110
EBITDA	PLNm	**300**	**17%**	**350**
EBITDA margin	*%*	*30.0%*	*1.3 p.p.*	*31.3%*

1

Assumptions:
1. **10% costs increase, including fuel and CO_2 allowances.**
2. **corresponding growth of the benchmark price equal to 10% yoy**

2

Heat price increases by 12%, being the sum of benchmark growth and 2 p.p. (according to benchmarking tariff ordinance – convergence to benchmark)

3

As a result EBITDA rises by 17% and EBITDA margin grows by 1.3 p.p. as heat price increase is faster than the hike in operating expenses

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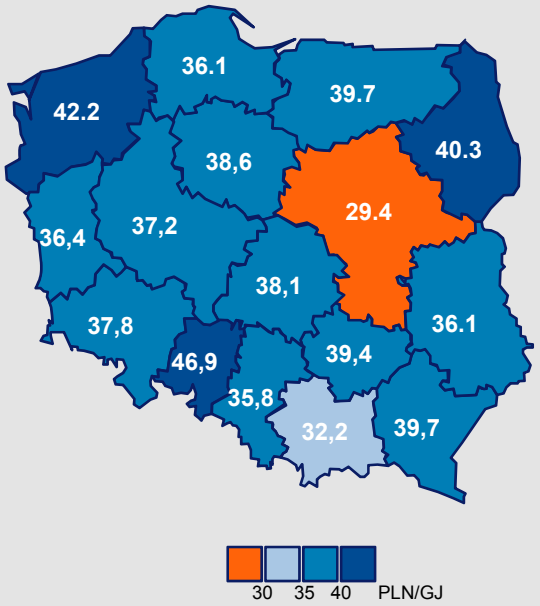
VHP is the most competitive heat generator in Poland with significant upside from the new tariff regulations

- Thanks to the optimisation of the generation process and the scale of the operations, VHP is the most competitive heat generator in Poland, thus will benefit from the new benchmarking tariff scheme to the highest extent.
- VHP's average heat tariff in year 2010 was approx. 38% lower than corresponding benchmark announced by the Energy Regulatory Office (URE).
- Implementation of the new tariff scheme brought VHP the increase in the average heat price of around 5% in the end of June 2011.

Heat tariffs by regions (PLN/GJ)



2010 VHP's average heat price: 21.5 PLN / GJ

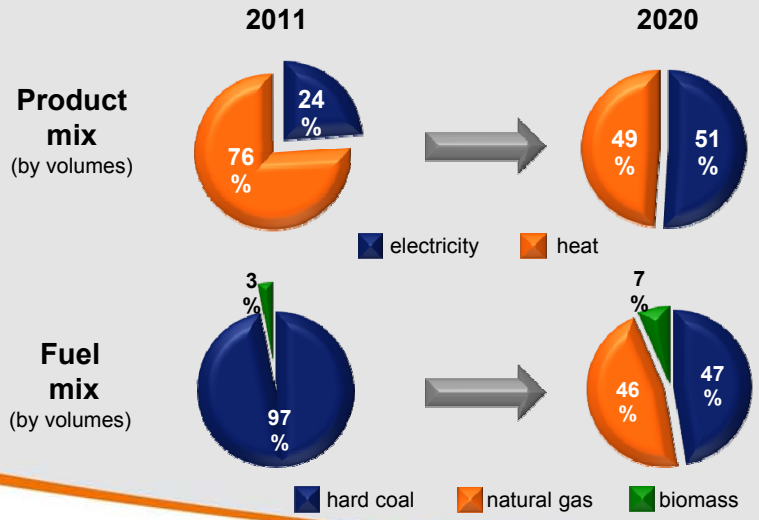
→ **60.5% heat tariffs increase potential** →

Benchmark for the coal-fired units: 34.5 PLN / GJ

Source: Vattenfall

Capex plan - stable convergence into gas fired generation

- PGNiG assumes commissioning of the 450MWe CCGT unit at the Żerań site in 2016 and investigates the feasibility to commission similar unit at the other location in Warsaw by the 2018. Additionally, VHP initiated the biomass conversion process of the 72MWt boiler at Siekierki that should be finalised in 2013.
- Total capex is expected to be financed from the operating cash flows and debt financing drawn at the level of VHP. Until 2020 ca. 2/3 of the total capex should be spent on the development of new units while the remaining part on the modernization of the existing assets base.



CCGT unit at Żerań site

Technology	CCGT
Fuel type	natural gas
Available electric/heat capacity	456 MWe/255 MWt
Expected annual power/heat output	3 TWh / 3.6 PJ
Annual gas consumption	> 550 mn m³
Capex	PLN 1.7 bn

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Key information about Vattenfall Heat Poland (2008-2010)

Financial* and operating data (2008-2010)

	Unit	2008	2009	2010
Revenues	PLNm	**1,583**	**1,691**	**1,808**
Revenue from heat sales	PLNm	824	838	923
Heat sales volume	TJ	38,183	38,955	42,980
Heat price (average)	PLN/GJ	21.6	21.5	21.5
Revenue from electricity	PLNm	643	745	722
Electricity sales volume	GWh	3,661	3,580	3,761
Electricity price (average)	PLN/MWh	175.7	208.2	191.9
Revenue from certificates	PLNm	93	85	140
Other revenues	PLNm	22	23	24
COGS, of which	PLNm	**(1,148)**	**(1,179)**	**(1,288)**
Coal cost	PLNm	677	799	828
Coal consumption	TJ	63,225	63,669	67,659
Gross profit	PLNm	**434**	**512**	**520**
Gross margin	*%*	*27.4%*	*30.3%*	*28.8%*
EBITDA	PLNm	**417**	**454**	**431**
EBITDA margin	*%*	*26.4%*	*26.9%*	*23.8%*
Net profit	PLNm	**323**	**319**	**278**
Fixed aseets (net book value, EOP)	PLNm	1,616	1,815	1,973
Capital expenditures	PLNm	**369**	**423**	**301**

- Increase in heat revenues in 2010 was driven by a higher volume of heat sold as a result of an exceptionally cold winter, with average heat tariffs remaining unchanged.
- Revenues from electricity decreased in 2010 after a sharp growth in 2009. That change was mainly driven by declining electricity prices in 2010, following a significant increase in 2009.
- Growth of COGS in 2010 was primarily caused by higher production volume and rising coal prices.
- Non-recurring items amounted to PLN 37m in 2010 and reflected *inter alia* costs of ash yard recultivation and recognition of environmental costs relating to prior years. Underlying EBITDA adjusted for one-offs amounted to PLN 468m in 2010.

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* according to IFRS Financial Data

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