PGNiG

Polskie Górnictwo Naftowe i Gazownictwo SA

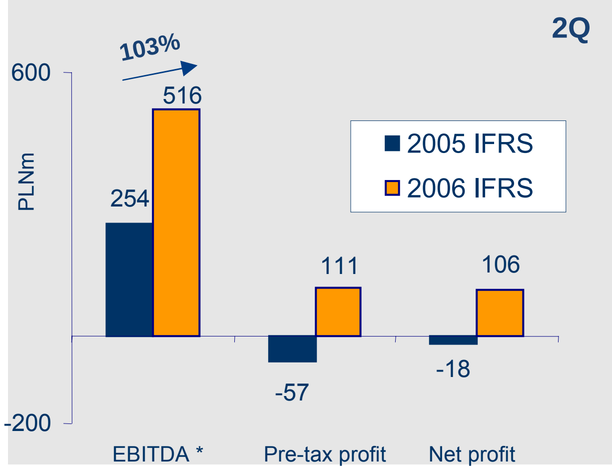
PGNiG S.A.
Financial Results for the Second Quarter of 2006

Financial Highlights

PGNiG Group – IFRS (PLNm)	Q2 2005	Q2 2006	change
Sales revenue	2,394	3,085	29%
Pre-tax profit	-57	111	-
Net profit	-18	106	-
EBITDA (leasing) *	254	516	103%

	Q1-Q2 2005	Q1-Q2 2006	change
Sales revenue	6,178	8,184	32%
Pre-tax profit	781	919	18%
Net profit	526	727	38%
EBITDA (leasing) *	1,692	1,687	0%

PGNiG Group Results



Comments

- The consolidated net profit **grew** by 38% on H1 2005, reaching **PLN 727m**.
- The net profit increase was driven by two factors: an increase in sales revenue (by 29%) coupled with high profitability in the non-regulated upstream segment.
- The upstream segment benefited from considerably higher prices of raw materials on global markets (in H1 2005 crude prices were in the range of USD 40-52/bbl and increased over the following year by more than 37%).
- Due to organisational changes (the spin-off of the transmission segment in July 2005), in order to ensure comparability of the financial results, EBITDA (leasing) was calculated to account for lease payments.

• EBITDA (leasing) = EBITDA + proceeds from a principal payment by OGP Gaz System Sp. z o.o. (recognised as payment of receivables in the balance sheet /interest payments are recognised under ”Other operating expenses (net)”).

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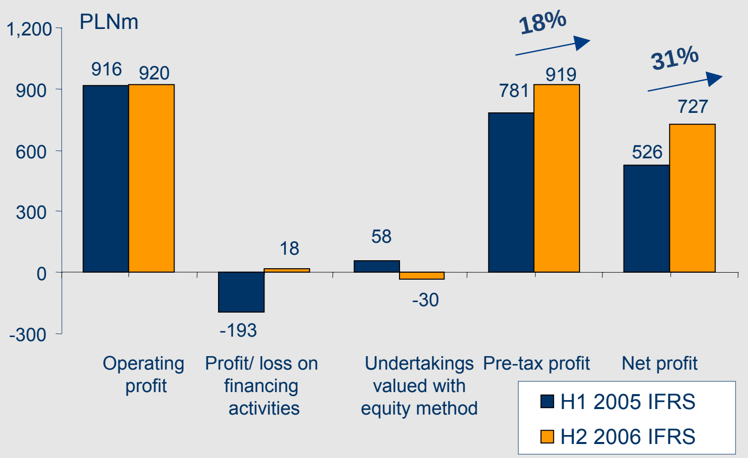
Performance Analysis

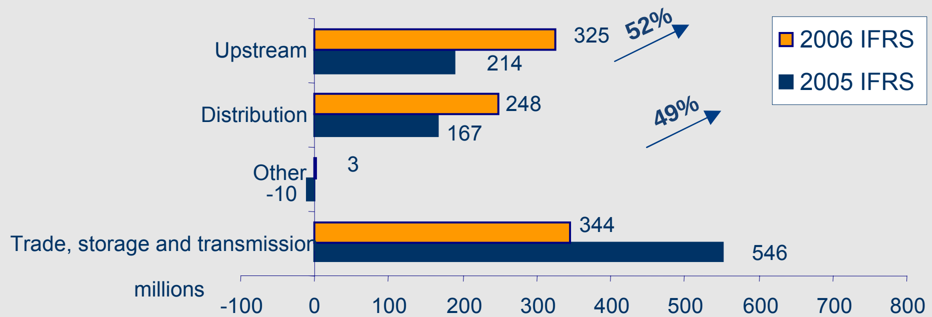
Structure of PGNiG Group results



- The operating result improved despite the transfer of the transmission margin to the transmission system operator.
- A significant improvement of the result on financing activities is attributable to the debt restructuring programme (repurchase of eurobonds) carried out in the first half of 2005.

Segment analysis

- A segment analysis of the operating profit shows a significant improvement in the performance of the **upstream** segment (better market conditions) and the **distribution** segment (higher sales and new tariffs).



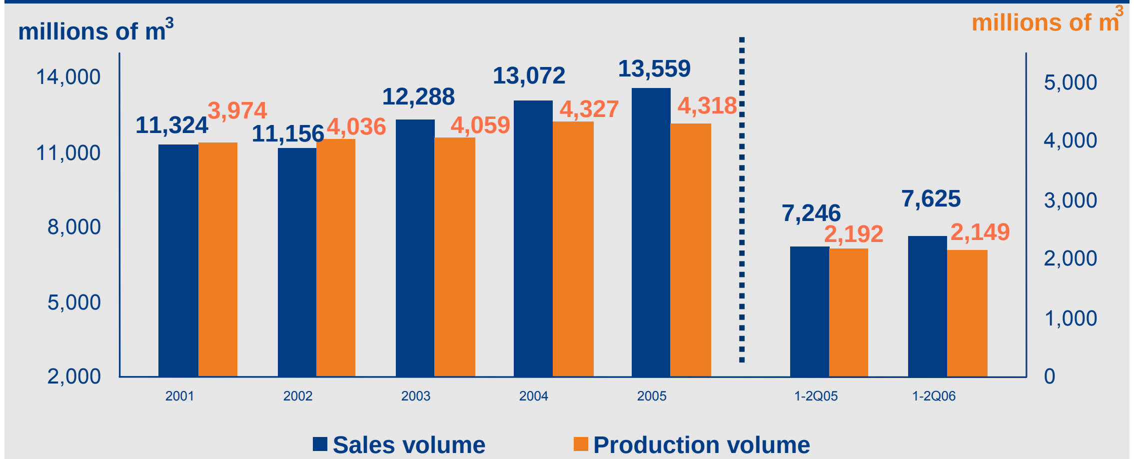
- The segments comprise:

Upstream	Crude oil, direct gas sales, sale of exploration services, other products (helium, LPG, LNG, etc.)
Trade	Interest income on lease agreement, tariff gas sales, storage operations, other services (e.g. rental services)
Distribution	Operations of six Distribution Companies within the PGNiG Group

PGNiG Sales Volume and Revenue

PGNiG Group – IFRS	Q1-Q2 2005	Q1-Q2 2006	change
Sales volume of natural gas (milions of m^3)	**7,246**	**7,625**	**5%**
Sales revenue (PLNm)	**6,178**	**8,184**	**32%**
- Methane-rich gas (E)	5,063	6,642	**31%**
- Nitrogen-rich gas (Ls, Lw)	474	621	**31%**
- Other	641	921	**44%**

Natural gas sales and production volumes [1]



Comments

- In H1 2006, gas sales volume grew by 5% compared with the previous year. However, the growth was posted only in Q1, when record low temperatures occurred.
- In Q2 2006, gas sales actually went down by 1% (i.e. approx. 18 million m^3) compared with the corresponding period of the previous year.
- The decline was due to the lower gas demand from industrial customers, resulting from scheduled technical shut-downs during summer.
- Higher revenue on other sales was recorded, which was attributable to the sales of crude oil and geological and exploration services.
- The PGNiG Group comprises six subsidiary companies with the equity of PLN 388,2m, which conduct global operations in the area of gas and crude oil exploration, geophysical prospecting, drilling and other areas.

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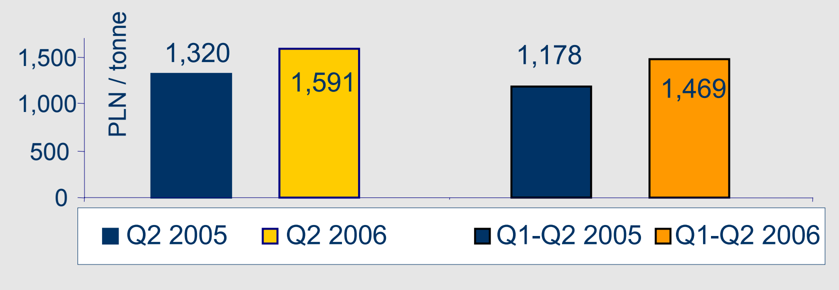
PGNiG, consolidated financial statement prepared in accordance with IFRS.
(1) Methane-rich gas equivalent (E).

Crude Oil

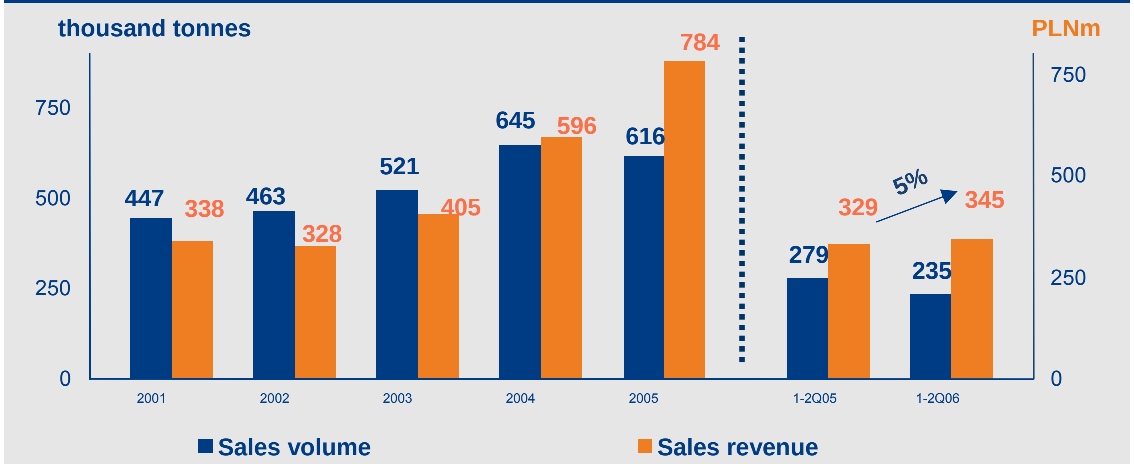
PGNiG Group – IFRS	Q1-Q2 2005	Q1-Q2 2006	change
Crude sales volume (thousand tonnes)	**279**	**235**	-15%
Revenue on crude sales (million)	329	345	5%
Unit price of crude oil (PLN/tonne)	1,177	1 469	25%
Unit price of crude oil (USD/bbl) *	**49,7**	**62,3**	25%

* bbl – 158.99 litres; average crude oil density = 0.844

Unit prices (PLN/tonne)



Crude sales



Comments

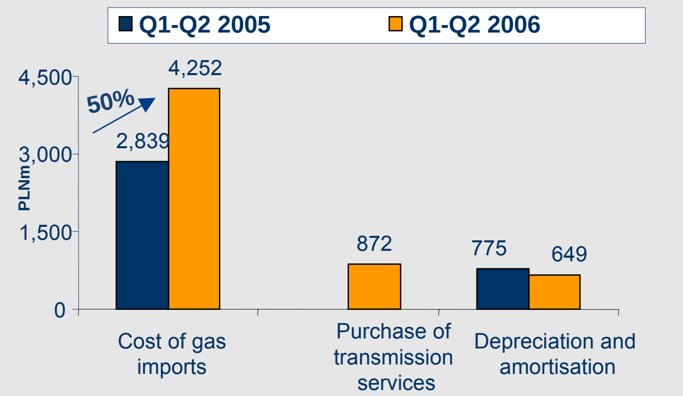
- PGNiG sells crude oil on market terms (non-regulated sales). In Q2 2006, the average price of crude oil sold by PGNiG was **USD 68/bbl.**
- Despite a drop in the crude oil sales volume, the sales revenue for H1 2006 grew by 5%;
- The decrease in the sales volume does not result from lower production, but is related to the increase in the balance of crude oil stocks in Q2 2006.

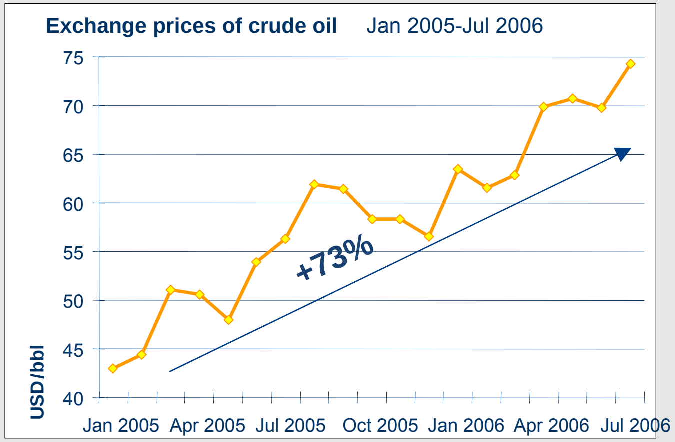
PGNiG, consolidated financial statement prepared in accordance with IFRS.

Operating Expenses

PGNiG Group – IFRS (PLNm)	Q2 2005	Q2 2006	change
Total operating expenses	**5,261**	**7,264**	**38%**
- purchase of natural gas	**2,839**	**4,252**	50%
- raw materials and energy used	**215**	**239**	11%
- employee benefits	**813**	**811**	-
- depreciation and amortisation	**775**	**649**	(16%)
- OGP Gaz System transmission services	**0**	**872**	-
- other contracted services	**480**	**458**	(5%)
- other operating expenses (net)	**423**	**392**	(7%)
- change in inventories	**(91)**	**(176)**	94%
- cost of products and services for own needs	**(193)**	**(233)**	20%

Key cost items





Comments

- Expenses rose primarily due to increased cost of imports (up by 50%).
- Global gas prices are influenced by the conditions prevailing on the crude oil and oil products markets. Gas prices are strongly correlated with the current exchange quotations of crude prices (an increase of 73%).
- Higher crude oil prices drive an increase (although somewhat deferred) in gas prices under import contracts. Gas prices in Europe are at a level similar to the import prices paid by PGNiG.

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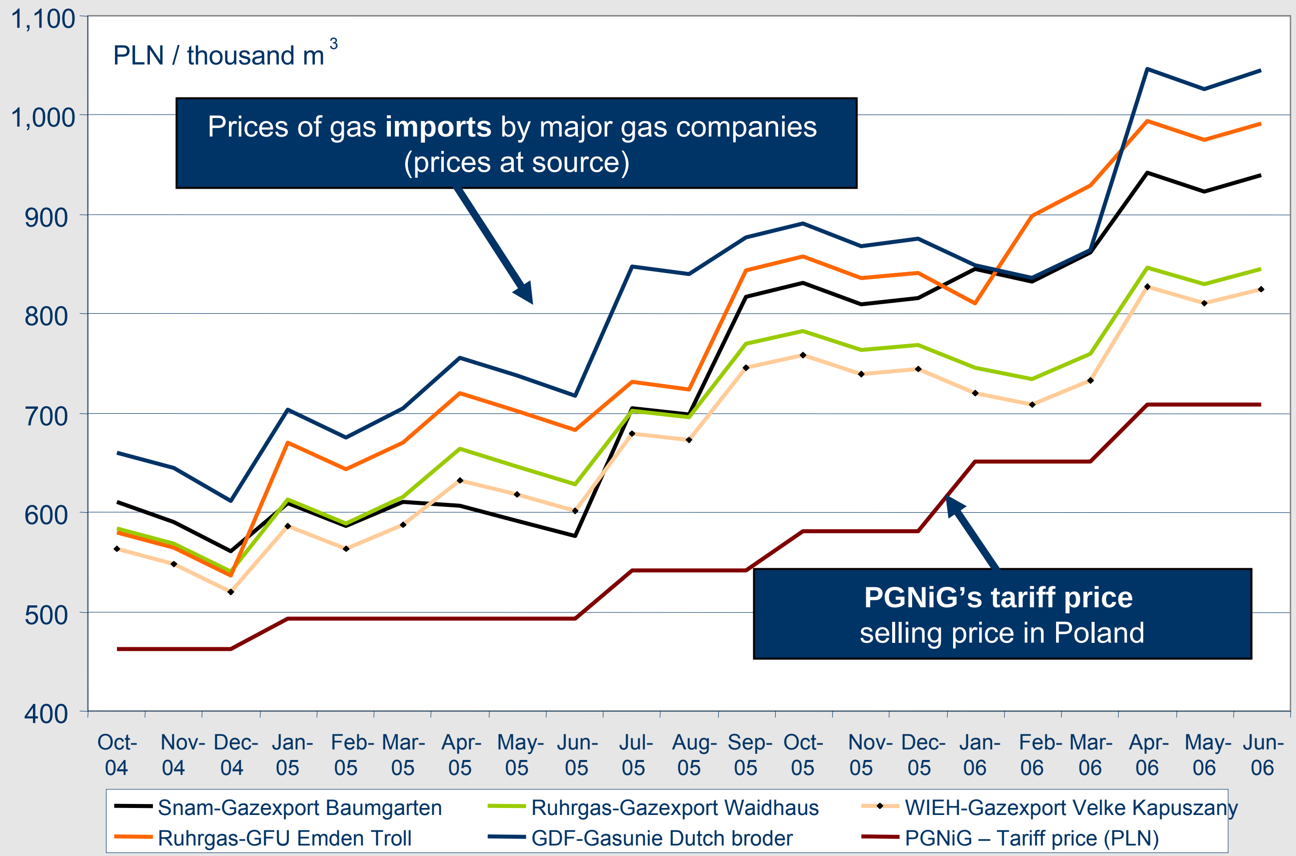
PGNiG, consolidated financial statement prepared in accordance with IFRS.

Financial performance was driven by rising gas import prices...

Comments

- A significant increase in the cost of gas imports (by PLN 1.4bn) was the key factor in the H1 results.
- The increase reflected the situation on the European gas market. According to European Gas Markets, the prices of imported gas under major import contracts in Europe increased from USD 204 per 1,000 m³ (Q1 2005) to USD 294 per 1,000 m³ (Q2 2006), i.e. 44%.
- In June 2006, the average import price in Europe was approx. PLN **950** (USD 299) per 1,000 m³. At the same time, PGNiG's gas wholesale price amounted to PLN **708.6** per 1,000 m³.
- The chart shows gas purchase prices from different sources compared with the wholesale prices charged by PGNiG S.A.

Gas import prices in Europe (according to EGM)* and PGNiG's tariff price



* The prices under major import contracts are quoted after European Gas Markets.
The prices were translated into the złoty at average exchange rates quoted by the National Bank of Poland for each period.

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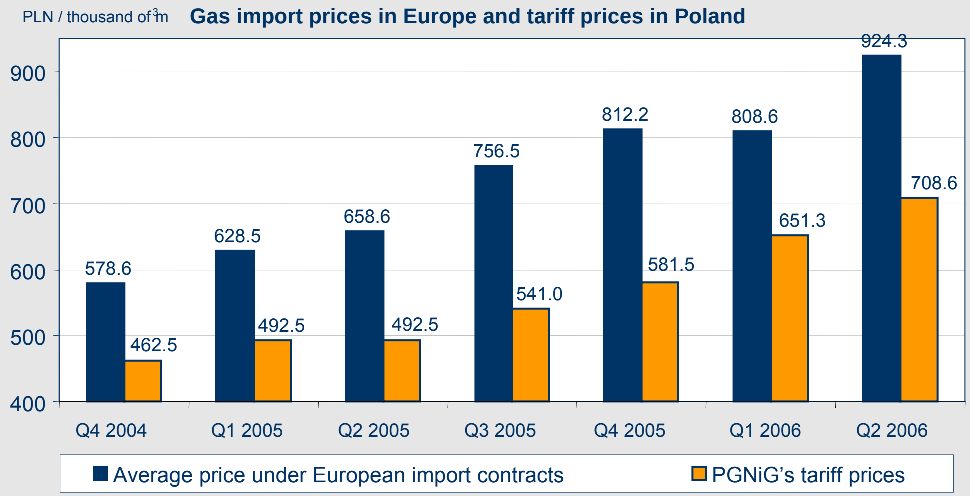
The increases in gas purchase prices have not been fully reflected in the PGNiG tariff …

Regulatory mechanism and PGNiG's gas prices

- H1 2006 saw a decline in the profitability of **gas trading operations.** The decrease was caused by a significant growth of the **cost of gas imports**, which was not fully reflected in the tariffs.
- Due to the regulatory mechanism, the regulated tariff prices do not cover the cost of gas imports (the price is calculated as the average weighted of the cost of gas imports and the relatively lower cost of gas from domestic production).



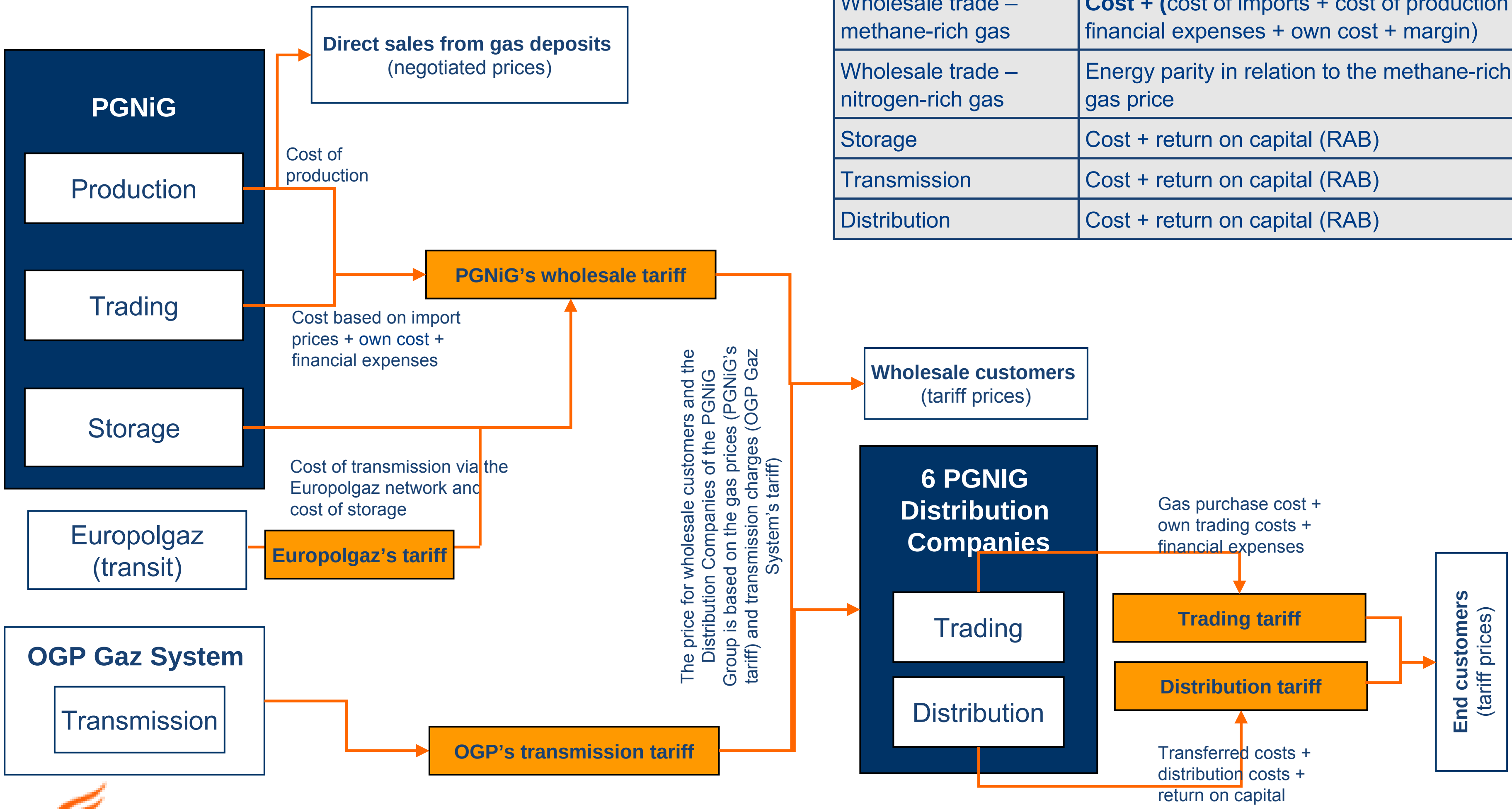
Comments

- 2005 saw the widening of the gap between the average prices under import contracts in Europe and PGNiG's tariff price.
- In June 2006, import price paid by PGNiG increased **by 58%** compared with January 2005. At the same time, the President of the ERO approved only a **43.8%** increase in the gas fuel charges.
- The lower profitability of trading in methane-rich gas was offset by an improvement in the results of the upstream segment.
- Improved profitability was also recorded in **trading in nitrogen-rich gas,** which is sourced only from domestic production and its price is determined in relation to the price of methane-rich gas (energy parity). Nitrogen-rich gas prices grew by 43.8% relative to January 2005.

* The prices under major import contracts are quoted after European Gas Markets.
The prices were translated into the złoty at average exchange rates quoted by the National Bank of Poland for each period.

Tariff Model in Poland

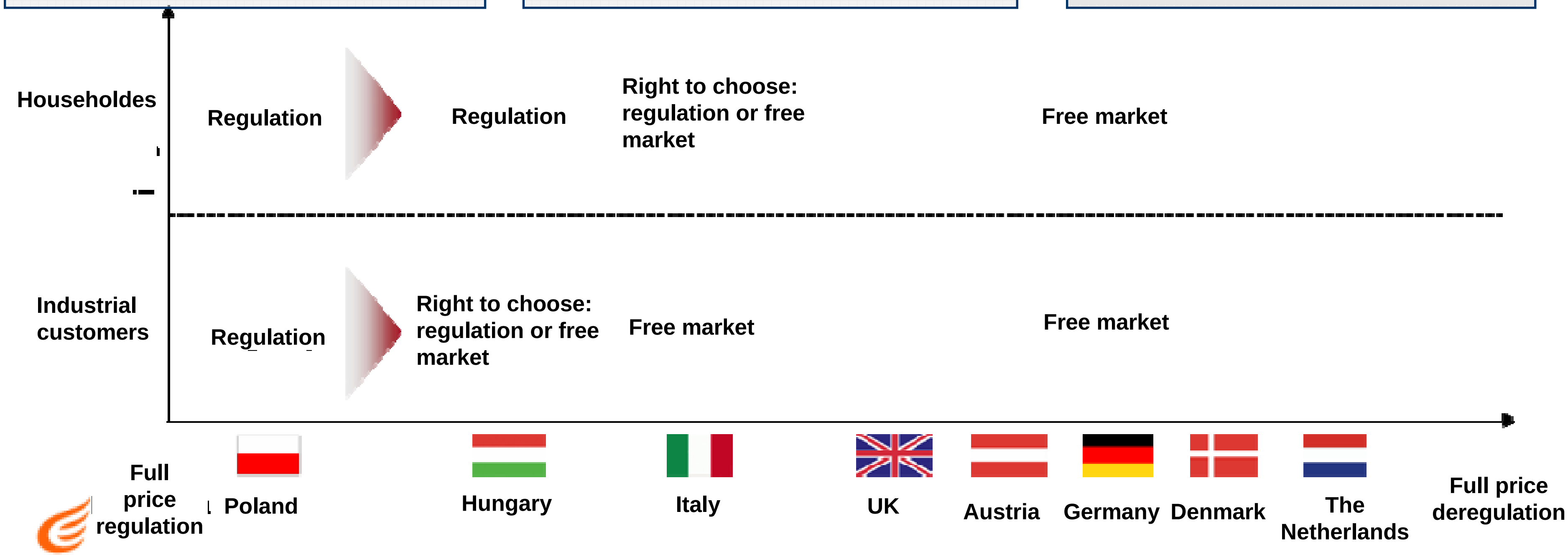
Type of activity	Regulatory mechanism
Direct sales	None
Wholesale trade – methane-rich gas	**Cost + (**cost of imports + cost of production + financial expenses + own cost + margin)
Wholesale trade – nitrogen-rich gas	Energy parity in relation to the methane-rich gas price
Storage	Cost + return on capital (RAB)
Transmission	Cost + return on capital (RAB)
Distribution	Cost + return on capital (RAB)



Regulatory Models in Gas Trading Activities

In the EU countries, there are three basic models of the gas trading market: full liberalisation of gas prices, partial liberalisation of gas prices, and full regulation of prices. The latter is used only in Poland and Lithuania.

FULL REGULATION OF GAS PRICES	HYBRID MODELS	FULL LIBERALISATION OF PRICES
All customers – both households and industrial customers – **are required to purche gas on the regulated market.**	**Maintenance of price regulation for small customers,** mainly for households and small businesses, and deregulation of gas sales to large customers.	**Complete deregulation of prices in gas trading.**



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Regulated Operations – PGNiG's Tariff

Gas fuel tariff

- The main reason behind the rise in gas fuel prices is the continued upward trend in prices of gas imports. It was the reason for the most recent price increase which took effect as of April 1st 2006.

PGNiG S.A.' tariff	2004	2005			2006	
Gas price (PLN/m³)	**Jan-Dec**	**Jan-Jun**	**Jul-Sep**	**Oct-Dec**	**Jan-Mar**	**Apr-**
E	0.4625	0.4925	0.5410	0.5815	0.6513	0.7086
Increase (%)		6.5%	9.8%	7.5%	12.0%	8.8%

- PGNiG's tariff applies to large customers, such as nitrogen plants, steelworks or the Distribution Companies. The Distribution Companies of the PGNiG Group, which sell natural gas to smaller customers, calculate their own tariffs on the basis of the PGNiG's tariff.
- Since April 1st 2006, the Distribution Companies have also changed their tariffs. The changes reflected an increase in gas purchase prices paid by the Companies (trading operations) and an increase in distribution rates (below). One of the reasons for the rise in distribution rates was the fact that the return on capital was for the first time included in the tariff calculations.

Average distribution rates (gas E) since Apr 1 2006 (PLN/m³)	DSG	GSG	KSG	MSG	PSG	WSG	Total
	0.3707	0.3946	0.3596	0.4087	0.3977	0.3253	0.3735
Increase (%)	7.0%	7.2%	7.0%	6.9%	7.0%	7.0%	7.0%

Refusal to approve amended tariff

- PGNiG has the right to request a change in the tariff prices in the event of a material unforeseen change of the business environment.
- On May 10th 2006, PGNiG requested the President of the ERO to amend Tariff No. 4 for gas fuels for the period **July 1st – December 31st 2006** (by 12%).
- On June 20th 2006, the President of the ERO **refused** to approve the amended Tariff proposed by PGNiG.
- On July 4th 2006, PGNiG **appealed** against the decision of the President of the ERO.
- To mitigate the negative effects of the refusal, PGNiG filed a request to amend the Tariff for the period **September 1st - December 31st 2006** (by 8%).

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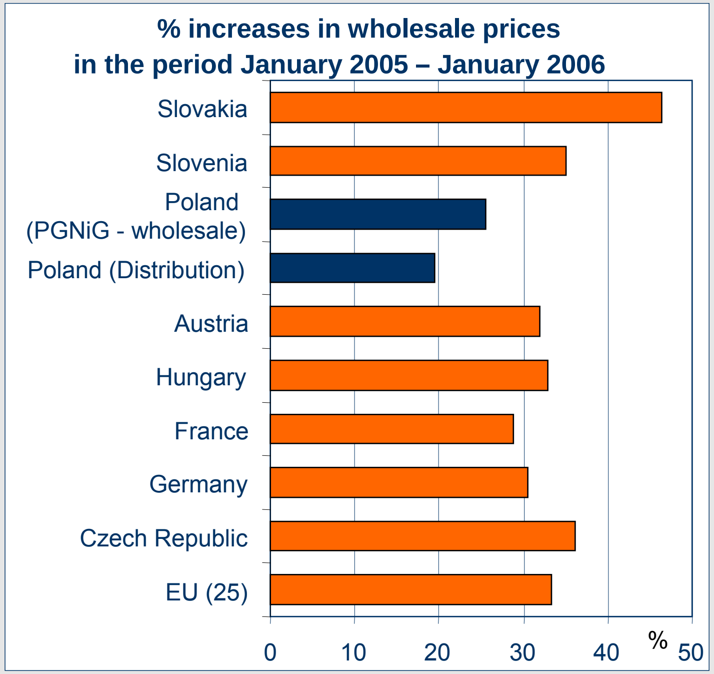
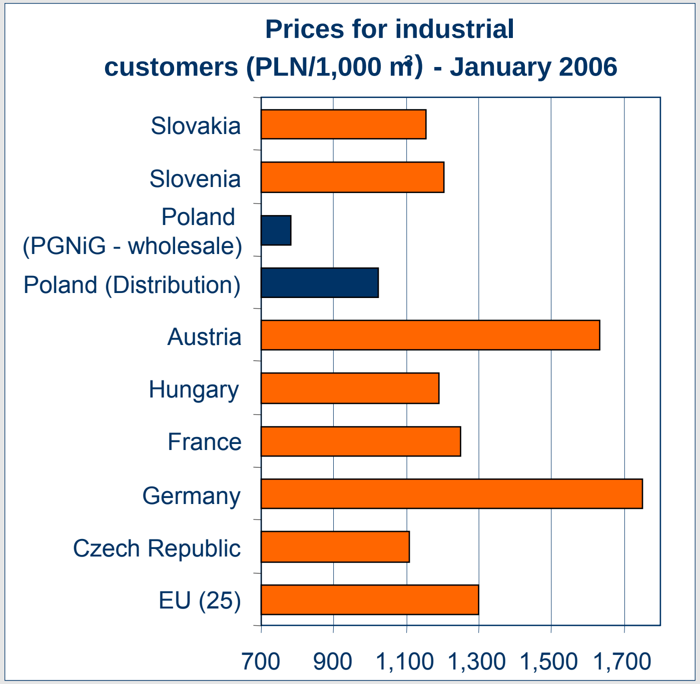
Gas Prices for Industrial Customers * in the EU

Poland versus other EU countries

- Gas prices in Poland remain one of the lowest in the EU. Their dynamics is also the lowest.
- The costs of gas procurement by the countries listed below are similar (all import gas mainly from Russia).





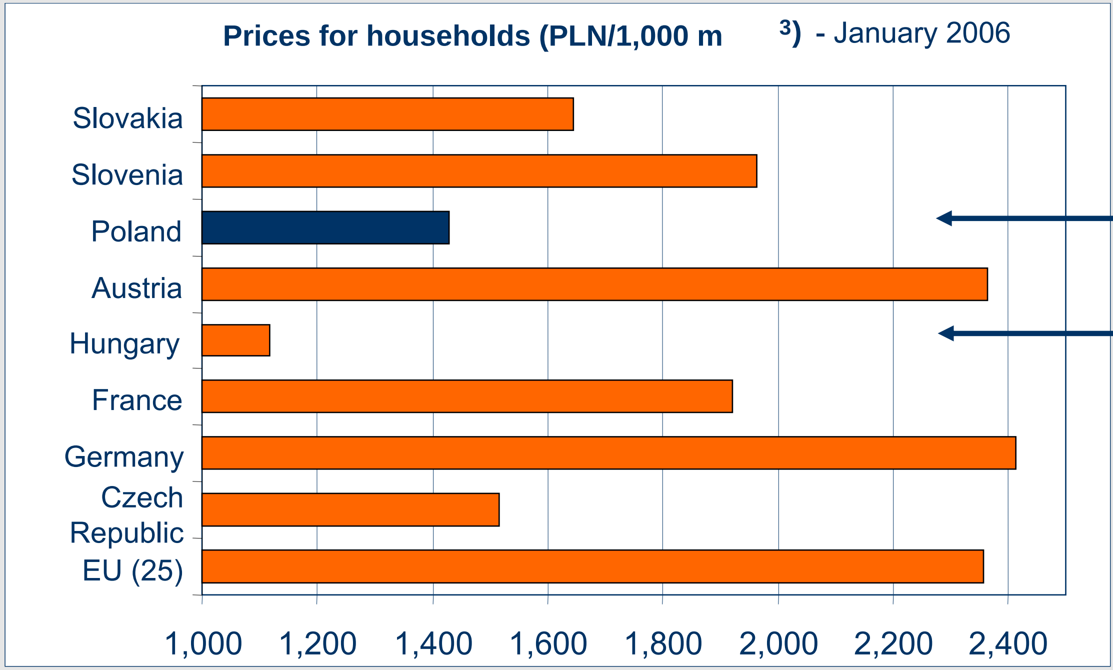
*) Annual consumption at 41,860 GJ (1.6m m^3)

Source: Eurostat, http://ec.europa.eu/eurostat.

Gas Prices for Households * in the EU

Poland versus other EU countries

- The prices for households in Poland are also one of the lowest in the European Union.
- In 2005, sharp increases were recorded in most of the EU countries (excluding Hungary, where the state controlled gas prices).



The proposed gas price increase in Poland would cause the price for households to go up by approx. 4.5% – 6.2%.

As of August, the retail gas prices for households in Hungary will grow by 30%. The Hungarian Government decided that it must cut the escalating gas subsidies for households (USD 700m annually)

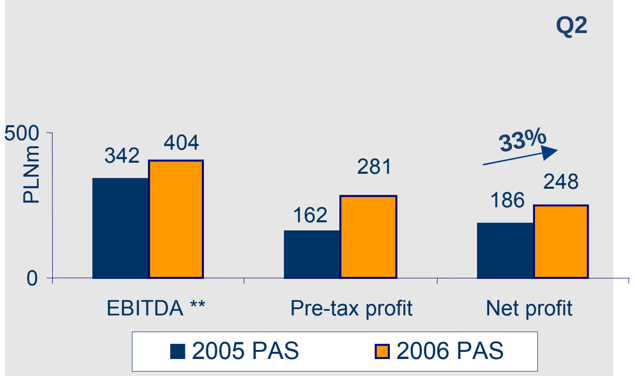
*) Annual consumption at 3.3 thousand m^3

Source: Eurostat, http://ec.europa.eu/eurostat.

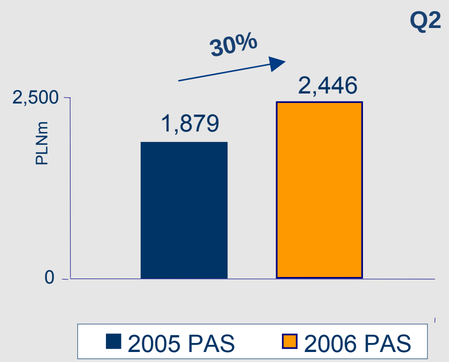
Financial Highlights (PAS)

PGNiG S.A. – PAS (PLNm)*	Q2 2005	Q2 2006	change
Sales revenue	**1,879**	**2,446**	**30%**
Pre-tax profit	**162**	**281**	**73%**
Net profit	**186**	**248**	**33%**
EBITDA (leasing) **	342	404	18%

PGNiG S.A.'s results



Sales revenue



Comments

- Positive trends in PGNiG's financial performance are confirmed by the PAS non-consolidated financial statements, according to which the net profit increased by 33%.

Changes due to spin-off of TSO

- No changes in sales revenue.
- The costs related to the transmission operations (such as own consumption of gas, salaries and wages, taxes, contracted services) were excluded from the operating expenses.
- In H1 2006, the cost of transmission services purchased by PGNiG from OGP Gaz-System was PLN 872m.
- In H1 2006, PGNiG's revenue under the lease agreement amounted to PLN 265m, of which :
  - PLN 146m was an interest payment (recognised under financial income),
  - PLN 119m was a principal payment (recognised as payment of receivables).

* The figures are based on non-consolidated financial statements of PGNiG S.A., which are the basis for payment of dividend to shareholders.
** EBITDA (leasing) = EBITDA + proceeds from lease payments by OGP Gaz System Sp. z o.o.

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