

Brief assessment of the standing of KGHM Polska Miedź S.A. for financial year 2011, including an evaluation of the internal control system and the Company's significant risk management system

(approved by resolution No. 33/VIII/12 of the Supervisory Board of KGHM Polska Miedź S.A. dated 17 April 2012)

In accordance with chapter III point 1 sub-point 1) of the „Code of Best Practice for WSE Listed Companies” the Supervisory Board of KGHM Polska Miedź S.A. hereby presents a brief assessment of the Company's standing, including an evaluation of the risk management system and the internal control system for the Company. This assessment has been prepared based on documents submitted by the Management Board, discussions held with the participation of the Management Board and other individuals invited to attend meetings of the Supervisory Board, and also takes into account the financial statements and the reports of the Management Board on the Company's activities, and based on the conclusions from the audit of the Company's account books by a Certified Auditor.

1. Realisation of the Company strategy and mission

The Company is realising the Strategy of KGHM Polska Miedź S.A. for the years 2009-2018 approved by the Supervisory Board on 23 February 2009. In accordance with the assumptions of the Strategy, KGHM Polska Miedź S.A. intends to become a major, global copper producer and to increase mined copper production in the Group to approx. 700 thousand tonnes annually.

Due to sale of the telecom assets in 2011 (Telefonia DIALOG S.A., Polkomtel S.A.) the Supervisory Board of the Company, on 10 October 2011, approved the updated Company Strategy, removing the strategic goal „Continued investment in the telecoms sector”.

The Strategy for the years 2009-2018 is based on five pillars, under which in 2011 the following activities were realised:

1.1. Pillar I – Improving productivity

Of fundamental importance to building Company value in the long term is the continuation of activities in the copper sector as the basic source of Company revenues. As a result, work on strategic tasks was continued, of which, apart from investment projects for total amount of PLN 1 519 million, of particular importance are the following:

- the „Effectiveness” program, of which, since 2009, 38 programs have been implemented: 22 with respect to TOP cost reduction programs and 16 process transformation programs (based on Lean Management) aimed at improving production efficiency,
- the project to centralise procurement in the KGHM Group – the Central Procurement Office opened in 2009 continued to follow a common procurement policy for the Division and the KGHM Group, thanks to which the Company gained substantial added value and savings in the area of procurement, mainly investments.

1.2. Pillar II – Developing the resource base

In execution of its strategic efforts to increase production to 700 thousand tonnes of mined copper and to achieve diversification in terms of production costs, KGHM Polska Miedź S.A., with respect to global resource projects:

- acquired in 2010 the Afton-Ajax copper/gold project located in British Columbia, Canada. In 2011 work was completed on the Bankable Feasibility Study for the Afton-Ajax project, which confirmed the main geological-mining parameters of the Ajax project, which until then had been estimated in an initial report from 2009.
- began the process of the friendly acquisition of the mining company Quadra FNX Mining Ltd listed on the Toronto Stock Exchange in Canada through the signing on 6 December 2011 of a binding conditional agreement between KGHM Polska Miedź S.A. and Quadra FNX Mining Ltd. In March 2012 the transaction was completed – the company 0929260 B.C. Unlimited Liability Company with its registered head office in Vancouver, as an indirect subsidiary of KGHM, purchased from the former shareholders 100% of the shares of Quadra FNX Mining Ltd.

To secure the production of electrolytic copper from its own concentrate at a stable level over the long term, in 2011 the Company continued work on developing its resource base in south-western Poland and in the region of Lusatia (Germany, Saxony) in local projects:

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- work was continued on the project commenced in 2006 of accessing the region „Głogów Głęboki Przemysłowy” (Deep Głogów),
- a program of geological work was carried out in the licensed mine region „Gaworzyce-Radwanice”,
- a project was commenced to explore the mine region „Synklina Grodziecka”, located in the vicinity of the so-called Old Copper Belt near the city of Bolesławiec,
- assumptions were prepared for the project of geological exploration of the copper ore deposit „Nowiny” located near the German border in the south-eastern part of the Żar pericline,
- work was continued on the copper ore exploration project „Weisswasser” in Germany,
- geological documentation work was carried out in the licensed region of the nickel ore deposit „Szkлары”, north of Zabkowice Śląskie,
- technological and organisational requirements for realisation of a project to increase salt production from 425 thousand tonnes to 1 million tonnes/year.

1.3. Pillar III – Diversifying sources of revenues and gaining independence from energy prices

In 2011, KGHM continued to realise its investments in the energy sector. From the point of view of KGHM, power generation is one of the most attractive sectors, as it is not correlated with conditions on the metals markets and represents a stable source of revenues. The most important projects for the Company in this regard are the following projects:

- „Construction of gas-steam blocks at the Głogów and Polkowice power plants”,
- „Construction of a power generation source with a sector partner based on the utilisation of natural gas as the raw material for its generation, on the grounds of the existing Blachownia Power Plant”,
- „Production of synthetic gas through the underground gasification of brown coal in the Copper Belt (LGOM)”

Additionally, an important investment in terms of diversification are the shares of TAURON Polska Energia S.A. In 2011, KGHM Polska Miedź S.A. acquired 71 292 212 shares of TAURON Polska Energia S.A. for the total amount of PLN 438 million, mainly from the State Treasury in an accelerated bookbuilding transaction. Following realisation of this transaction, KGHM Polska Miedź S.A. owned a total of 182 110 566 shares of TAURON Polska Energia S.A., representing 10.39% of the share capital (pursuant to a current report dated 23 March 2011). The carrying amount of the shares of TAURON Polska Energia S.A. at the end of financial year was PLN 974 million.

1.4. Pillar IV – Regional support

A significant element of the Company's business operations and increasing its value is corporate social responsibility. In 2011 work was performed on the preparation of a Strategy of Corporate Social Responsibility (CSR) for KGHM Polska Miedź S.A., which will enable the creation of a comprehensive system for looking at questions involving the corporate social responsibility of the Company and integration of actions undertaken up to now in this regard. Thanks to combining CSR strategy with the business pillars of the Strategy, it will be possible to properly manage relations with the Company's stakeholders, and in this way to achieve the Company's strategic goals.

1.5. Pillar V – Developing organisational know-how and capabilities

In human resource management solutions in KGHM Polska Miedź S.A., work continued on implementation of a Social Potential Management System, realising projects aimed at:

- development of the education and improvement system,
- career planning and skills management and the management of knowledge,
- optimising the process of recruitment and adaptation,
- the employee evaluation system, internal communication system and shaping the organisational culture,
- ensuring appropriate employee motivation.

Among activities related to improving and developing organisational and management potential in the Company, the following should be noted:

- completion of the accounting and financial services reorganisation project, based on the creation of a modern, centralised accounting and finance organisation to ensure the high quality and functionality of the financial and accounting services,

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- the introduction of a new management model for the KGHM Polska Miedź S.A. Group based on a separate business supervisory unit to facilitate the management and supervision of Group companies,
- the commencement of a project to develop and implement methodological standards for the management of projects, programs and portfolios in KGHM Polska Miedź S.A.,
- equity investments in health and curative spas, renewable energy and new technology realised under the auspices of the Closed-End Investment Funds managed by KGHM TFI S.A.

2. Macroeconomic conditions in 2011

In 2011 the highest prices in history were recorded, for both industrial as well as precious metals. The maximum official copper price on the London Metal Exchange was recorded on 14 February and amounted to 10 148 USD/t. The highest official silver price in history on the London Bullion Market Association was recorded on 28 April, when the price of this metal reached 48.7 USD/troz.

The average annual electrolytic copper price in 2011 on the London Metal Exchange (LME) amounted to 8 811 USD/t and was 17% higher than in 2010, when it reached 7 539 USD/t.

The average annual silver price on the London Bullion Market Association (LBMA) in 2011 amounted to 35.12 USD/troz (1 129 USD/kg), which means an increase by 74% versus the average price in 2010: 20.19 USD/troz (649 USD/kg).

From the start of the year until April 2011, the Polish zloty systematically strengthened versus the USD and EUR. However, at the start of May the situation on the financial market diametrically changed. The Polish currency began to lose its value versus the currencies of developed countries, with the pace of weakening increasing towards the end of the year. The average USD/PLN exchange rate (National Bank of Poland) in 2011 amounted to 2.96 USD/PLN and was lower versus the prior year by 2.0% (3.02 USD/PLN).

3. Basic Company results

3.1. Mine and smelter production

Ore extraction by dry weight in 2011 was higher by 0.4 million tonnes than in 2010, and amounted to 29.7 million tonnes. The increase in extraction in 2011 was due to an increase in daily extraction on working days and an intensification of work on days legally free from work.

The average copper content in extracted ore amounted to 1.61% and was lower than that achieved in 2010 (1.64%), due to work in regions with lower copper ore mineralisation.

Despite the increase in ore extraction, the decrease in its quality led to a decrease in copper content in extracted ore by 1.3 thousand tonnes. In 2011, the amount of ore processed increased by 0.6 million tonnes versus the prior year, which directly led to an increase in production of copper in concentrate by 1.2 thousand tonnes. The amount of silver in concentrate was lower than achieved in 2010 by 14 tonnes.

The production of electrolytic copper increased versus 2010 by 23.9 thousand tonnes, i.e. 4% and reached the highest level in the Company's history, i.e. 571.0 thousand tonnes. The increase in production was due to higher processing of own concentrate and use of purchased copper-bearing materials in the form of scrap, copper blister and imported concentrate. The augmentation of own concentrates with purchased copper-bearing materials enabled the effective utilisation of existing technological abilities.

The production of other smelter products (silver, wire rod, OFE and CuAg rod and round billets) depends on the level of electrolytic copper production, the type of raw materials used and on market demand.

In relation to 2010, the production of metallic gold decreased by 72 kg (9%), while the production of silver and lead increased respectively by 99 tonnes (9%) and 4.3 thousand tonnes (21%).

3.2. Revenues from sales

Total revenues from the sale of KGHM Polska Miedź S.A. products in 2011 amounted to PLN 19 977 million, and were higher by 26% than revenues achieved in 2010, mainly due to higher copper and silver prices and an increase in the amount of copper sold. Revenues from the sale of copper and

copper products were higher by 18%. Revenues from silver sales versus their level in 2010 were higher by 65%, while revenues from gold sales were higher by 10%.

In 2011, versus the prior year, the Company increased the volume of copper sales by 21.6 thousand tonnes (4%). The structure of sales changed, i.e. the volume of cathode sales increased by 11% (31.0 thousand tonnes) alongside slightly lower sales of copper wire rod by 6% (13.5 thousand tonnes).

The volume of sales of precious metals was lower versus the prior year - silver sales amounted to 1 179 tonnes and were lower by 6% (68 t), while gold sales decreased by 21% (180 kg) and amounted to 660 kg.

3.3. Operating costs

In 2011 total expenses by nature increased by PLN 1 660 million, i.e. by 18%, mainly due to:

- the higher value of purchased copper-bearing materials (PLN 881 million) due to an increase in purchase prices and in the volume of consumption by 10.7 thousand tonnes of copper (of which 4.6 thousand tonnes relates to electrolytic copper production),
- external services (PLN 227 million) – mainly due to an increase in the scope of mining preparation work (+9 km) (PLN 118 million),
- materials and fuel (PLN 215 million) – mainly due to an increase in prices,
- labour costs (PLN 194 million) – mainly due to higher provisions for future employee benefits by PLN 73 million,
- depreciation/amortisation (PLN 57 million) – due to an increase in realised investments in property, plant and equipment (+20%).

The pre-precious metals credit unit cost of copper production (unit cost prior to decrease by the value of anode slimes containing among others silver and gold) in 2011 increased versus 2010 by 1 994 PLN/t, i.e. by 13%, mainly due to an increase in the value of purchased copper-bearing materials (+1 010 PLN/t) due to a higher volume of consumption by 4% (4.6 thousand tonnes of copper) and of purchase prices by 22%.

3.4. Financial results

The Company realised a profit for 2011 in the amount of PLN 11 335 million, the highest in the history of KGHM Polska Miedź S.A. In relation to 2010, profit for the period increased by 2.5-times, i.e. by PLN 6 766 million. Basic factors impacting the change in the financial result:

- copper prices higher by 17% and silver by 74% (+PLN 3 752 million),
- profit realised on Polkomtel S.A. sales, before taxation (PLN 2 512 million) and DIALOG S.A. (PLN 144 million),
- the change in the result due to measurement and realisation of derivatives (+PLN 1 493 million) and the change in adjustment of revenue due to hedging (+PLN 99 million),
- an increase in operating costs (PLN (1 446) million),
- an increase in the value of income tax (PLN (1 282) million),
- a change in the value of exchange differences (+ PLN 926 million),
- an increase in the volume of copper sales by 21.6 thousand t alongside lower silver sales by 68 t (+ PLN 369 million),
- a change in the exchange rate from 3.02 USD/PLN to 2.96 USD/PLN (PLN (281) million).

3.5. Selected financial ratios

The highest profit for the period in the Company's history led directly to achievement of the high level of profitability ratios, which in relation to 2010 increased respectively: ROA from 23% to 29% and ROE from 32% to 49%.

The profit earned also increased the Company's equity, which at the end of 2011 amounted to PLN 23 136 million and represented the main source of financing of assets – the Company did not make use of borrowing. The debt ratio decreased from 27% to 21%.

Due to the profit earned in 2011, cash and cash equivalents at the end of 2011, despite payment of a dividend in the amount of PLN 2 980 million, reached the level of PLN 12 836 million, which were invested mainly in short-term bank deposits in expectation of the Company's financing of investment projects (Quadra FNX Mining Ltd. and AJAX MINING INC.).

As a result, the level of liquidity ratios at the end of 2011 significantly increased: quick liquidity changed from 1.9 to 3.9, and current liquidity from 2.6 to 4.5.

The high level of the aforementioned liquidity ratios should be treated as a temporary situation related to the accumulation of resources for the purpose of purchasing Quadra FNX Mining Ltd. This transaction, amounting in total to CAD 2 900 million (the equivalent of PLN 9 147 million) was concluded on 5 March 2012.

4. Assessment of market risk management system in the Company in 2011

The main types of market risk to which the Company is exposed are:

- the risk of changes in metals prices,
- the risk of changes in exchange rates,
- the risk of changes in interest rates,
- liquidity risk, and
- credit risk.

The Management Board is responsible for the **management of market risk** in the Company and for adhering to the approved policy in this regard. The main body responsible for overseeing market risk management is the Market Risk Committee, which recommends actions to the Management Board in this regard. The primary technique for market risk management is the use of hedging strategies involving derivative instruments. Apart from this, natural hedging is also used.

The Company continuously monitors the commodity and currency markets, and these monitoring activities are the basis for taking decisions on implementing hedging strategies. The management of market risk is also determined by the internal situation of the Company. KGHM Polska Miedź SA applies future cash flow hedge accounting. Monitoring of the amount of market risk in the Company is based on analysis of the impact of market risk factors on the activities of the Company (profit, statement of financial position, statement of cash flows) among others using the market risk measure Earnings-at-Risk, based on Corporate Metrics methodology.

The Management Board is responsible for the **management of financial liquidity** in the Company and for adhering to the approved policy in this regard. The Company actively manages financial liquidity, understood as the capacity to punctually regulate its liabilities and to obtain funds to finance its current activities and investment needs. Financial liquidity is analysed across several time horizons, beginning from immediate liquidity to long-term liquidity.

The Management Board is responsible for the **management of credit risk** in the Company and for adhering to the approved policy in this regard. The main body responsible for overseeing actions in this area is the Credit Risk Committee. KGHM Polska Miedź SA continuously evaluates creditworthiness: of its customers with whom physical sales transactions are undertaken; of the financial institutions (banks/brokers) with whom hedging transactions are undertaken; and of the entities in which direct investments or equity investments are made.

In 2011 copper price hedging strategies represented approx. 35% (in 2010 33%) of the sales of this metal realised by the Company. With respect to silver sales this figure amounted to approx. 9% (in 2010 18%). In the case of the currency market, hedged revenues from sales represented approx. 19% (in 2010 16%) of total revenues from sales realised by the Company.

In 2011 the Company implemented copper price hedging strategies with a total volume of 151 thousand tonnes and a time horizon falling from September 2011 to December 2013. The Company made use of options (Asian options), including: option strategies (collars and producer's puts). In addition, the Company performed a restructure, implemented in the first and third quarters of 2010, of seagull options for 2012 with a total volume of 97.5 thousand tonnes through the buyback of sold puts. Restructure enables the full use of put options purchased within this structure in the case of any decrease in the price of copper in 2012.

In 2011 the Company implemented silver price hedging strategies with a total volume of 14.4 million troz and a time horizon falling in 2012 and 2013. The Company made use of options (Asian options) including puts, seagulls and collars. Additionally, the Company performed a restructure, implemented in the analysed period, of a collar strategy for 2012, through the buyback of sold calls for 3.6 million troz, and simultaneous sale of puts of the same nominal amount and with an execution price below the price of the put options held (from the collar structure). A put spread structure was thereby gained. Restructure guarantees greater flexibility in the selection of derivatives implemented for 2012 and enables full participation in any eventual increases in the price of silver in this period for the hedged

nominal amount of 3.6 million troz. In addition – in case of a deep fall in prices in this period – it restricts benefits from the put options held to the level of execution of put options sold.

In the case of the forward currency market, in 2011 the Company implemented transactions hedging revenues from sales with a total nominal amount of USD 1 920 million and a time horizon falling in years 2012-2014. The Company made use of options (European options), and option strategies (collars and seagulls).

The Company remains hedged for a portion of copper sales planned in the period from January to December 2012 (205.5 thousand tonnes), in 2013 (61.5 thousand tonnes), and also for a portion of silver sales planned in the period from January to December 2012 (10.8 million troz) and in 2013 (3.6 million troz). With respect to revenues from sales (currency market) the Company holds a hedging position in 2012 (USD 960 million), in 2013 (USD 960 million) and 2014 (USD 360 million).

5. Evaluation of the internal control system and internal audit

5.1. Internal audit

The Company systematically examines and monitors the control mechanisms and identifies potential risks in individual processes occurring in the Company. This function is performed by the internal audit, which is independent in its activities.

Audit activities focus on estimating risk and examining the functioning of control systems in a process based on the collection of data (information and communications) of a given control environment in order to improve process functioning.

As a result of control audits performed in 2011, the Management Board ordered the realisation of recommendations and corrective measures to eliminate ineffective control mechanisms and to minimise potential risks in the following processes: information communication and management; product sales; corporate governance; management of property, plant and equipment; human resources management; management of financial resources (transferred by KGHM Polska Miedź S.A. to companies of the KGHM Polska Miedź S.A. Group); and ensuring the legal conformity of operations.

The implementation of these recommendations is continuously monitored by the Management Board and evaluated by the Supervisory Board Audit Committee of KGHM Polska Miedź S.A.

5.2. Internal control

Internal (institutional) control is performed by a separate department in the organisational structure of KGHM Polska Miedź S.A. – the Internal Control Department.

The internal control system in KGHM Polska Miedź S.A. is based on the principle of independence, and encompasses all Company processes, including those areas having direct or indirect impact on its proper functioning.

In addition, the obligation fully remains for each employee to control their own performance, and for every level of management staff to perform their control – within supervisory-related duties.

In 2011, the Internal Control Department realised 13 planned control audits and 9 ad hoc audits. A total of 22 control audits were realised in 2011. Control audits were performed in the Divisions of KGHM Polska Miedź S.A. and, in one instance, in a company of the KGHM Polska Miedź S.A. Group.

The control audits involved the following issues:

- the method of managing liquid fuel based on selected Divisions of KGHM Polska Miedź S.A.,
- the application of/adherence to existing legal standards related to the conduct of business by KGHM Polska Miedź S.A.,
- with respect to personal and property protection services, realised in the form of technical security measures,
- adherence to art. 64 section 1 of the Act dated 7 July 1994 – Construction law, in the context of facilities,
- the utilisation in underground production of selected groups of mining-related vehicles,
- the scrapping of mining-related vehicles,
- adherence to existing standards related to entering into contracts/agreements,

- the management of precious metals,
- the management of S-49 rails,
- the realisation of shaft transport and management of the social fund,
- the production, distribution and supply of anode slime,
- the providing of servicing for a Mining Division by employees of an external entity,
- the construction of maintenance-storage units for the ventilation section of a Mining Division,
- the construction of switching stations for a Mining Division with respect to the holding of a tender and signing of a contract.

The control audits identified irregularities and transgressions most often of an organisational-legal nature. The post-audit recommendations (which have been or are being implemented) addressed to the parties audited were aimed at eliminating the irregularities identified and implementing corrective measures to conform to existing legal standards, as well as improving supervisory effectiveness by responsible persons in individual areas.

6. Selected areas requiring attention

6.1. Procedure for the purchase of Quadra FNX Mining Ltd.

Of importance for evaluation of the Company's standing is the transaction completed in March 2012 involving purchase of the company Quadra FNX Mining Ltd., commenced on 6 December 2011 by a binding conditional agreement between KGHM Polska Miedź S.A. and Quadra FNX Mining Ltd. (hereafter Quadra FNX).

Following the fulfilment of conditions precedent, consisting of:

- gaining shareholder approval as expressed by a majority 2/3 of the votes at the General Meeting of Quadra FNX,
- approval of the Supreme Court of British Columbia in Canada for the transaction, and
- regulatory approvals by appropriate monopoly-control bodies, and by the Canadian Minister of Industry,

on 5 March 2012 the transaction was completed – the company 0929260 B.C. Unlimited Liability Company with its registered head office in Vancouver, an indirect subsidiary of KGHM, purchased from the former shareholders 100% of the shares of Quadra FNX, for the price of CAD 15.00 per share, i.e. the total price of CAD 2 900 million (the equivalent of PLN 9 147 million at the average exchange rate of the National Bank of Poland of 5 March 2012).

The purchase of Quadra FNX will enable an increase in production in the KGHM Polska Miedź S.A. Group by 100 thousand tonnes of copper annually, starting from 2012, and by 2018 by over 180 thousand tonnes. Furthermore, commencement of the Sierra Gorda project in Chile (2014) and Victoria in Canada will lead to a substantial reduction in the unit cost of copper production in the KGHM Polska Miedź S.A. Group.

The main assumptions of the process of integrating KGHM and the new company KGHM International are assurance of business continuity, an appropriate control and building value from the acquisition. In Poland and Canada, 18 working groups were established as part of the integration process, which are closely cooperating on all important areas, such as production, sales and risk management, finance, exploration projects, procurement and taxation. KGHM will hold a majority of seats on the Board of Directors of KGHM International. Remaining as the head of the company is President Paul Blythe, while two persons from KGHM will join the Management (the equivalent of the Management Board).

6.2. Mineral extraction tax

In evaluating the financial standing of KGHM Polska Miedź S.A., the impact of the Act on the mineral extraction tax, in effect from 18 April 2012, should be taken into consideration. The mineral extraction tax will be calculated from the amount of copper and silver contained in produced concentrate.