

Brief assessment of the standing of KGHM Polska Miedź S.A. for year 2009 including an evaluation of the internal control system and the Company's significant risk management system.

(approved by the Supervisory Board of KGHM Polska Miedź S.A. on 16 April 2010)

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 SA 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 accounts by a Certified Auditor.

1. Realisation of the Company strategy and mission

In February 2009 the Supervisory Board of KGHM Polska Miedź SA approved the Strategy of KGHM Polska Miedź SA for the years 2009-2018, which assumes an improvement in the cost competitiveness of KGHM Polska Miedź SA. In the Strategy, strategic goals were identified in five areas for Company development, such as:

- **improving productivity of the core business**, aimed at reversing the trend of increases in the unit cost of production, despite the long-term trend of decreases in copper content in ore and mining at increasing depth. Key actions to improve productivity assume investments in new technology, modernisation of the machine park and optimisation of production processes and organisation.

In this area in 2009 realisation of a project was completed related to the centralisation of procurement and the „Effectiveness” project was begun, which should result in cost savings.

- **developing the resource base** in order to increase the production of copper (to over 700 thousand tonnes annually). Due to the limited opportunities to increase extraction in the current operating region, realisation of these goals will require the acquisition of foreign mining assets. Additionally, to ensure increase of the resource base, KGHM plans to concentrate on further development of deep mining technology, exploring for new deposits in the region and intensifying the processing of scrap.

Realising the goals thus worded, in 2009 a company was founded, among others, together with a German partner, called KGHM HMS Bergbau AG, which is involved in the exploration of deposits of copper and other metals throughout Europe.

In addition, boundary criteria were developed for assessing foreign mining assets which have the potential to be acquired, based on which a short list was prepared of projects for further analysis.

- **decreasing dependence from energy prices and diversifying sources of revenues.** KGHM plans to decrease the dependence from copper price volatility, mainly through gradual entrance into the power sector and by realisation of projects from other sectors which have a minimal degree of correlation with the core business of KGHM.

Among the actions taken by the Company regarding diversifying sources of revenue in 2009 were the following:

- the purchase by „Energetyka” sp. z o.o. of 85% of the shares of WPEC Legnica S.A. through privatisation, and
- the signing of a letter of understanding between KGHM Polska Miedź SA and Tauron Polska Energia SA on cooperation in the construction of a coal-fired power plant on the grounds of Elektrownia Blachownia in Kędzierzyn – Koźle.

The above-mentioned equity investments may result in restricting dependence on external suppliers of energy.

- **actions on behalf of the regional community.** As a significant regional employer, KGHM will undertake actions on behalf of the regional community enabling the creation of new jobs, conducting programs for managing production waste, protecting the health of employees, and supporting regional sport, culture and education.

Realising the goals thus put forth, in 2009, KGHM augmented the capital of Miedziove Centrum Zdrowia SA by PLN 1.5 million for the purpose of purchasing medical equipment, including the purchase of an operating microscope for the larynx and ears, and the purchase of a tomograph console with software. In addition, KGHM actively supported cultural and educational events in the region.

- **developing organisational know-how and capabilities,** aimed at creating the basis for long-term development. Key improvements include the introduction of a mechanism for management through goals, KGHM staff development programs, creating a transparent Group structure and transparent information.

In realising the above-mentioned goal, on 27 April 2009 the Supervisory Board of KGHM Polska Miedź SA agreed to the foundation of the company KGHM Towarzystwo Funduszy Inwestycyjnych SA. The activities of KGHM TFI SA create the possibility for the independent and rapid assessment of projects, obtaining external investment capital as well as the diversification of investment risk for KGHM Polska Miedź SA.

The Budget of the Company as adopted by the Supervisory Board of KGHM Polska Miedź SA assumes the continuation in 2010 of initiated strategic tasks and intensification of the investment program. In realisation of the annual Company investment plan, particular emphasis will be placed on initiatives with respect to replacing production assets, purchasing a foreign mining entity and the acquisition of investment certificates of KGHM TFI SA.

2. Macroeconomic conditions in 2009

Since 2008, the global economic crisis has impacted the operations of KGHM in terms of macroeconomic conditions. After a significant decrease, the price of copper in 2009 began to gradually increase. However, despite a rising trend, the average copper price on the London Metal Exchange was 26% lower than in the prior year, and amounted to 5 164 USD/t. The lowest average three-month price was recorded in the first quarter (3 435 USD/t) and the highest in the fourth quarter (6 643 USD/t).

Average silver prices decreased by 2% during the year, i.e. from 14.99 USD/troz (482 USD/kg) in 2008 to 14.67 USD/troz (472 USD/kg) in 2009. Similarly as in the

case of copper, the lowest quarterly average was recorded after the first three months (12.60 USD/troz), and the highest in the fourth quarter of 2009 (17.57 USD/troz).

In 2009, as a result of the global crisis, the price of the Polish zloty experienced significant volatility. At first the zloty was seen to depreciate, but then began to significantly strengthen. Volatility of the exchange rate in 2009 was within a range of 3.45 USD/PLN in the first quarter to 2.82 USD/PLN in the final quarter. The average USD/PLN exchange rate (per the NBP) for 2009 was 3.12 USD/PLN, which means a favourable for KGHM weakening of the Polish zloty versus 2008, when the exchange rate was at the level of 2.41 USD/PLN.

The exchange rate did not differ from the level assumed by the Company in the adjusted Budget approved by the Supervisory Board in August 2009. Meanwhile the forecast for copper and silver prices was exceeded respectively by 15% and 13%.

3. Basic Company results

Mine and smelter production

In 2009, 499.5 thousand tonnes of copper in ore was extracted, and 439.0 thousand tonnes of copper in concentrate was produced. This means an annual increase respectively by 17.9 thousand tonnes (4%) and 9.6 thousand tonnes (2%).

The increase in mine production was possible due to an increase in extraction to 29.7 million tonnes of ore, dry weight, i.e. by 0.3 million tonnes (1%). Of significance was the quality of the ore, reflected in a higher ratio of copper content in extracted ore from 1.64% in 2008 to 1.68% in 2009.

The favourable production results in mining did not affect the level of electrolytic copper production, which decreased by 24.3 thousand tonnes (5%), i.e. from 526.8 thousand tonnes in 2008 to 502.5 thousand tonnes in 2009. The decrease in production was mainly due to the three-month maintenance of the flash furnace complex at the Głogów smelter.

There was a change in the product structure, especially with respect to wire rod and billets. As a result of decreased market demand, production in this regard was decreased respectively by 14% and 26%.

It should be pointed out that the production results were in line with the levels assumed in the Company Budget, which took into account a decrease in production due to furnace maintenance.

The global position of KGHM in terms of production did not change. Similarly as in 2008, production by KGHM represented respectively 3% of global refined copper production and 7% of silver mine production.

Revenues from sales

Revenues from sales amounted to PLN 11 061 million, of which PLN 433 million represented the result on derivative instruments. In comparison to 2008, revenues decreased by PLN 242 million (2%), mainly due to:

- lower metals prices – the decrease in prices described in point 2 caused a decrease in revenues by around PLN 2 553 million,
- a lower volume of copper sales – annual sales of copper products decreased by 27 thousand tonnes, which was also due to the maintenance stop at the Głogów smelter (lower production). As a result, revenues from sales decreased by PLN 453 million,
- a lower result on hedging – in comparison to 2008, the result on derivative instruments (hedging of prices and the exchange rate) accounted for under sales was lower by PLN 147 million.

The level of sales was positively impacted by the depreciation of the Polish zloty, which increased revenues by approx. PLN 2 912 million.

The planned level of revenues from sales was exceeded by 15%, mainly due to metals prices, which were above projected amounts.

Basic operating costs

Basic operating costs in 2009 amounted to PLN 7 864 million and were lower than those realised in 2008 by PLN 47 million, which was impacted by:

- the negative change in the value of inventories by PLN 489 million, due among others to the maintenance stop, and consequently to an increase in internal copper concentrate inventories by 31 thousand tonnes of Cu, and
- higher costs by type by PLN 435 million.

The largest increase in costs was recorded in the following items:

- energy costs (PLN 175 million) – their increase was due to higher purchase prices of electricity by 31% (together with delivery) and exceeded the impact of decreased energy consumption by 1.7%,
- labour costs (PLN 134 million) – this increase was mainly due to the impact of the annual employee bonus of PLN 113 million, together with charges,
- the value of external copper-bearing materials (PLN 244 million) – which was impacted by the higher purchase price of copper-bearing materials alongside a quantitative decrease (PLN 119 million) and an increase in costs due to the purchase of other materials for the production of silver, wire rod and lead (PLN 125 million),
- depreciation/amortisation (PLN 66 million) due to increased investment expenditures,

Costs were also decreased among others in respect of:

- materials and fuels (PLN (76) million) – a decrease in the purchase price of smelter fuels (coke) and diesel fuel,
- taxation and fees (PLN (35) million) – a decrease in costs due to elimination of the statutory requirement for the Company to calculate and pay fees related to the storage of mine tailings,

The pre-precious metals credit unit cost of copper production (prior to decreasing by the value of silver and gold) increased by 510 PLN/t (4%), from 13 434 PLN/t in

2008 to 13 944 PLN/t, mainly due to the above-mentioned increase in costs by type, the decrease in copper production and the increase in concentrate inventories.

The total unit cost of copper production, decreased by the value of silver and gold in anode slimes, amounted to 11 170 PLN/t, and decreased by 566 PLN/t (5%). This was due to depreciation of the PLN, as well as to higher silver and gold prices expressed in PLN.

Likewise, basic operating costs, as well as the total pre-precious metals credit unit cost, were higher than assumed in the Company Budget. Exceeding of the planned amounts, respectively by 5% in the case of basic operating costs and by 3% with respect to the unit cost, is mainly the result of the increase in prices above the forecast, which in turn had a significant impact on the valuation of external copper-bearing materials used in the production of electrolytic copper. It should however be pointed out that the pre-precious metals credit unit cost of electrolytic copper production from internal concentrates was in line with the level assumed in the Budget.

Financial results

Profit before income tax in 2009 amounted to PLN 3 067 million, composed of: gross profit decreased by the cost of sales, marketing and administrative expenses (profit on sales) in the amount of PLN 3 197 million, a loss on other operating activities of PLN (99) million and loss on financing activities of PLN (31) million.

The result on other operating activities was mainly impacted by the following (million PLN):

– income from dividends	455
– loss on measurement and realisation of derivative instruments	(539)
– foreign exchange losses	(62)
– impairment of shares in a subsidiary	(50)
(including mainly an impairment loss on the shares of Zagłębie Lubin S.A.)	

Profit before income tax was charged by income tax in the amount of PLN 526 million, composed of current income tax of PLN 621 million, PLN (107) million due to temporary differences, as well as adjustment to income tax from prior periods (PLN 12 million). As a result, profit for 2009 amounted to PLN 2 540 million, meaning a decrease versus 2008 by 13%. This decrease was mainly due to other activities, including mainly the loss on measurement and realisation of derivative instruments, which was higher than that of the prior year by PLN 327 million, and to exchange differences, which caused a decrease in the result by PLN 184 million.

The deterioration in the result on other operating activities also had a significant impact on the decrease in EBITDA by 11%, from PLN 4 078 million in 2008 to PLN 3 646 million in 2009.

Selected financial ratios

The decrease in the financial result had the largest impact on the level of profitability of assets and equity, which decreased in respect of 2008 as follows:

- ROA from 21.0% to 18.2%,
- ROE from 27.6% to 24.4%.

The changes in the structure of assets and equity and liabilities – an increase in the share of liabilities and a decrease in current assets – were not without impact on the debt ratio and on liquidity. In comparison to 2008 these ratios changed as follows:

- debt ratio – an increase from 23.8% to 25.4%,
- current liquidity – a decrease from 3.1 to 2.4
- quick liquidity – a decrease from 2.2 to 1.4.

With respect to liabilities, there was mainly an increase in the amount of employee benefits and derivative instruments, respectively by PLN 143 million and PLN 331 million. With respect to current assets there was a significant decrease in cash and cash equivalents by PLN 818 million, mainly due to a lower profit for the period of PLN 380 million and dividends paid, which exceeded the level of dividend paid in 2008 by PLN 536 million.

4. Assessment of market risk management system in the Company in 2009

The main types of 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 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 (financial result, balance sheet, cash flow statement) 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 acquire 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.

Due to the lack of necessity to finance current activities and investments from external loans, the Company did not hold interest rate risk hedging instruments.

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 continuously evaluates creditworthiness: of its customers with whom physical sale 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 2009 copper price hedging strategies represented approx. 34% (in 2008 35%) of sales of this metal realised by the Company. In the case of silver sales they amounted to approx. 25% (in 2008 32%).

In the case of the currency market, hedged revenues from sales represented approx. 34% (in 2008 11%) of total revenues from sales realised by the Company.

In 2009 the result on derivative instruments was at the level of PLN (105 450) thousand (in 2008 PLN 367 990 thousand).

In 2009, the Company implemented copper price hedging strategies of a total volume of 264 thousand tonnes and a time horizon falling in the second half of 2009, 2010 and in the first half of 2011. The Company made use of options (Asian options) including puts, corridors, seagulls and producer puts. Additionally, the Company performed a restructurisation, implemented during the analysed period, of its seagull options strategy for 2010 of a total volume of 58.5 thousand tonnes through the buyback of sold puts. During the analysed period the Company did not implement adjustment hedge transactions.

In the case of the silver market, during the analysed period strategies for hedging the price of this metal were implemented of a total volume of 7.2 million troz and a time horizon falling in 2010. The Company made use of puts (Asian options). Likewise, in 2009, no adjustment hedge transactions were implemented on the silver market.

In the case of the forward currency market, in 2009 the Company implemented strategies hedging the USD/PLN rate for an amount of USD 1 410 million and a time horizon falling in the second half of 2009 and the entire year 2010. The Company made use of options (European options) including puts, corridors and producer puts. Additionally, the Company performed a restructurisation, implemented in prior periods as well as in the analysed period, of its option strategies for 2009 and 2010 of a total nominal amount of USD 630 million through the sale of purchased puts and the sale of corridors. These operations were recognised in accumulated other comprehensive income in the amount of PLN 147 912 thousand, which will adjust in plus revenues from sales in 2010. During the analysed period there were no adjustment hedge transactions implemented on the currency market.

5. Evaluation of the internal control system and internal auditing

Internal control is performed by the Internal Control Department of KGHM Polska Miedź SA, while internal auditing is performed by the Auditing Department.

The system of internal control in KGHM 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 accordance with the control plan for 2009 approved by the President of the Management Board of KGHM Polska Miedź SA, the Internal Control Department was required to perform 16 controls of which 15 were realised.

Comparative analysis of the controls performed in the years 2008 – 2009 showed that their amounts are identical – at 15 controls performed per reporting year.

As part of the control tasks performed, the following issues were examined:

- evaluation of the procedures for selecting suppliers of services and goods,
- evaluation of the proper disposing of the Social Fund resources,
- transport under ground of employees in the Mining Divisions of KGHM Polska Miedź SA,
- the process of maintenance, repair and servicing of self-propelled underground machines in the Mining Divisions of KGHM Polska Miedź SA,
- the manner in which laws are adhered to with regard to the issuance and approval of documents respecting material turnover,
- the manner in which laws are adhered to with regard to the management of copper scrap,
- adherence to Building Law,
- the manner of realisation of an investment project,
- the manner of realisation of the „IT Strategy of KGHM Polska Miedź SA”.

The Company systematically examines the functioning of the system of internal control and its control mechanisms, and indicates 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.

The Supervisory Board, through the Audit Committee, maintains constant supervision over the Company's activities, also in terms of evaluating the system of internal control and risk management and takes decisions which increase the probability of operating the Company in an effective and efficient manner in order to achieve strategic goals.

6. Selected areas requiring attention

The following subjects require particular attention:

- the need to realise the Strategy approved in 2009, in particular the diversification of activities and the purchase of foreign mining assets;
- the need to intensify realisation of profitable Company investments in subsequent years (taking into account new technological solutions);
- implementation by the Company of the program to reduce the unit cost of copper production in order to improve the competitive position of KGHM Polska Miedź SA;
- the need to secure Company access to domestic copper ore resources through investments;
- the need to improve the operational effectiveness of Group companies;
- the need to constantly review transactions carried out by the Company with related companies (development of a price transfer policy);
- the need to constantly monitor the strategies of hedging against commodity and currency risks;
- the need to create an integrated Internal Audit function in the Group;
- the need to monitor IT risk in the Company and Group.

Warsaw 16 April 2010