

BRIEF ASSESSMENT OF THE STANDING OF KGHM POLSKA MIEDŹ S.A. FOR 2007

(approved by the Supervisory Board of KGHM Polska Miedź S.A. on 16 May 2008)

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 internal control system and the significant risk management 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 reflects the financial statements and the reports of the Management Board on the Company’s activities, from the audit of the Company’s accounts by a certified auditor.

Realisation of the Company strategy and mission

The strategy, developed and approved by the Management Board in the second half of 2006, did not bring about significant changes as expressed in the effects of the accepted new directions of functioning of the Company. The effectiveness of operations conducted is decreasing mainly due to the increase of costs, especially labour costs, and the significant fall in copper content in excavated ore. There has as yet been no consideration of multi-year plans to expand the core business activities internationally, while the multi-year mining commitment in Africa has not yet concluded with concrete decisions respecting the processing of accumulated ore. There was also no significant improvement in the financial position of companies of the KGHM Polska Miedź S.A. Group. However, intensive feasibility and preparatory studies have been initiated, which are to be implemented in subsequent years, on maintaining the rapidly-depleting copper ore resources in areas under current exploitation. For the first time, significant budgetary funds have been allocated for this purpose.

Macroeconomic conditions in 2007.

In 2007 copper prices were not much higher than in the prior year. The average electrolytic copper price on the London Metal Exchange in 2007 increased to 7 126 USD/t and was 6% higher than in 2006, when it amounted to 6 731 USD/t.

The average silver price on the London Bullion Market reached 13.38 USD/troz in 2007, and was 16% higher than in 2006, when it amounted to 11.55 USD/troz.

In 2007 the Polish zloty remained in a rising trend. During this period the average USD/PLN exchange rate per NBP amounted to 2.77 and was lower in comparison to the prior year by 11% (USD/PLN 3.10).

Basic information and important events.

Management Board of the Company

During the reported period described, the composition of the Management Board of KGHM Polska Miedź S.A. was as follows:

Krzysztof Skóra	President of the Management Board
Maksymilian Bylicki	Vice President of the Management Board (Development)
Ireneusz Reszczyński	Vice President of the Management Board (Sales)
Marek Fusiński	Vice President of the Management Board (Finance)
Stanisław Kot	Vice President of the Management Board (Production)

On 6 November 2007 the Supervisory Board of KGHM Polska Miedź S.A. dismissed Maksymilian Bylicki as I Vice President of the Management Board, and appointed Dariusz Kaśków to the Management Board, and simultaneously the Supervisory Board appointed Ireneusz Reszczyński to the function of I Vice President of the Management Board. Following these changes the composition of the Management Board was as follows:

Krzysztof Skóra	President of the Management Board
Ireneusz Reszczyński	I Vice President of the Management Board (Sales)
Marek Fusiński	Vice President of the Management Board (Finance)
Stanisław Kot	Vice President of the Management Board (Production)
Dariusz Kaśków	Vice President of the Management Board (Development)

Mine production:

The amount of excavated ore (dry weight) decreased in 2007 by approx. 1 million t, i.e. from 31.28 million t in 2006 to 30.26 million t in 2007. This decrease in extraction in 2007 was caused by the curtailment, at the request of the National Labour Inspectorate, of extraction in the mines on days legally free from work, which work was reflected in the Company's production budgets.

As a result of work progressing to areas with a lower mineralisation of copper ore, the average copper content also decreased, from 1.79% in 2006 to 1.67% in 2007.

In 2007 451.9 thousand tonnes of Cu in concentrate was produced, meaning a decrease versus the prior year (497.2 thousand tonnes) by 9%. There was also a decrease in copper content in concentrate from 25.6% in 2006 to 24.1% in 2007.

The amount of Ag in concentrate was lower than that achieved in 2006 by 5% (a decrease from 1 265 tonnes to 1 199 tonnes).

Metallurgical production:

Electrolytic copper production was lower than that achieved in 2006 by 23.6 thousand tonnes (i.e. by 4%) and amounted to 533.0 thousand tonnes. Despite the decrease in production from internal charges by 3% versus 2006, the final level of production was achieved thanks to an increase in share of external charges in the form of imported concentrate, copper blister and scrap.

At the end of 2007 production of metallic silver amounted to 1 215 tonnes, and decreased by 2.2% versus the prior year. Metallic gold production was lower (883 kg, i.e. 48.1% less than in 2006).

In January 2007 the production of refined lead began in the Legnica smelter, which at the end of 2007 reached the level of 15.29 thousand tonnes.

Revenues

In 2007 526.8 thousand tonnes of copper and copper products were sold, i.e. 5% less than in 2006, alongside an increase in sales of copper wire rod by 10% (21.8 thousand tonnes). There was a decrease in silver sales versus 2006 by 5%, to 1 177 t. Gold sales also decreased by 54% and amounted to 738 kg.

The large increase in copper and silver prices, alongside a lower volume of sales, caused an increase in revenues from the sales of these products in 2007 by, respectively, 7.5% (PLN 716.58 million) and 41% (PLN 132.04 million).

Altogether, revenues from sales amounted to PLN 12 183.11 million, i.e. 7.0% more than in the prior year. Revenues from sales in 2007 reflect the negative result from the settlement of commodity hedging instruments in the amount of PLN (632.73) million (in 2006 PLN (2 453.73) million) and profit from the realisation of currency hedging instruments in the amount of PLN 146.23 million (in 2006 PLN 83.17 million). Revenues from sales were also adjusted for the foreign exchange gains which arose from the hedging of foreign currency loan and were recognised under revenues from cathode exports in the amount of PLN 50.99 million (in 2006 PLN 39.53 million).

Costs

The total unit cost of electrolytic copper production increased from 10 497 PLN/t in 2006 to 11 160 PLN/t in 2007.

The increase in the unit cost of copper production versus 2006 by 6.3%, i.e. by 663 PLN/tonne of Cu, was mainly due to the following: the increase in labour costs, in connection with a higher additional annual bonus (an increase from 14% in 2006 to 24% in 2007), the decrease in copper production from internal concentrate, and the use of relatively more expensive internal semi-products from storage, alongside a lower price and amount of external copper-bearing materials used in production.

The cost of copper production from internal charges increased by 1 128 PLN/t, i.e. by 14%, which was mainly due to the increase in labour costs and the decrease in copper production from internal concentrates.

The cost of copper production represented 94% of total costs by type. In 2007 costs by type decreased by PLN 587.69 million, i.e. by 7%, due to the lower value of copper-bearing materials which was due to lower volume (by 29 thousand tonnes) and a lower purchase price (by 2 373 PLN/t).

Costs by type excluding purchased copper-bearing materials increased in 2007 by PLN 234.56 million, i.e. by 4%, mainly due to an increase in labour costs due to a higher additional annual bonus by PLN 164.05 million and an increase in depreciation costs by PLN 37.12 million.

Financial results

Profit before tax in 2007 amounted to PLN 4 655.53 million and was 6% higher versus the prior year. Profit before tax was affected by the following financial categories: profit from sales (PLN 4 879.75 million), the loss on other operating activities (PLN (197.71) million), and the loss on financing activities (PLN (26.50) million).

The loss on other operating activities in the amount of PLN 197 714 thousand (in 2006 a gain of PLN 264 068 thousand) is mainly due to:

- income from dividends – a decrease from PLN 469 598 thousand to PLN 270 363 thousand,
- the loss on the measurement and realisation of derivative instruments – an increase in costs from PLN 150 471 thousand to PLN 313 147 thousand (costs mainly due to changes in the time value of options which are settled in future periods), and
- foreign exchange losses – an increase from PLN 63 778 thousand to PLN 165 451 thousand.

Profit for 2007 increased by 5.4% to PLN 3 798.83 million, while EBITDA increased by 6.6% to PLN 5 100.59 million.

Selected financial ratios

The value of the following ratios increased:

- current liquidity to 2.53 (2007) from 1.86 (2006);
- quick liquidity to 1.72 (2007) from 1.28 (2006);
- return on assets (ROA) to 30.7% (2007) from 29.4% (2006);
- earnings per share (EPS) to PLN 18.99 (2007) from PLN 18.02 (2006);
- price per share / earnings per share (P/E) to 5.6 (2007) from 4.9 (2006);
- market capitalisation / book value (P/BV) to 2.4 (2007) from 2.2 (2006);

The value of two ratios decreased:

- return on equity (ROE) to 42.4% (2007) from 44.4% (2006) due to an increase in equity by 10% in 2007;
- the debt ratio to 27.6% (2007) from 33.8% (2006), due to a decrease in the level of liabilities (by 17%).

Financial risk management system

Financial risk management includes the processes of identification and measurement, and the determination of appropriate methods to deal with those risks. The main financial risks to which the Company is exposed are:

- market risk: the risk of changes in commodity prices, foreign exchange rates and interest rates;
- liquidity risk;
- credit risk.

In the opinion of the Company, the main risk to which the Company is exposed is market risk. The Management Board is responsible for the management of market risk in the Company and for adhering to the *Policy* approved in this regard, while the main body responsible for its realisation is the Market Risk Committee, which recommends actions to be taken in this regard by the Management Board. The primary technique for market risk management is the use of hedging strategies involving derivative instruments. Natural hedging is also used.

The Company continuously monitors metal and currency markets, which are the basis for decisions on implementing hedging strategies. The Company applies hedge accounting to hedge the risk of changes of cash flows due to currency and commodity risk. Monitoring of the scale of market risk in the Company is based on analysis of the impact of risk factors on the Company's operations (financial result, balance sheet, cash flow).

In accordance with best world practice in this regard, appropriate units have been separated in the Company involved in entering into hedging transactions from others responsible for their authorisation and settlement, and for preparing measurements of these transactions. Such an organisational structure permits both control over the process of market risk management and minimises the risk of entering into unauthorised transactions on the derivative instruments market (the oversight principle). The above-described system of market risk management which is followed in the Company is based on best world standards, as confirmed by the positive opinion of the auditors and consulting firms auditing this process, as well as by the highly-rated transparency of the financial statements in this regard.

Internal control system

An important element of operational risk management is the auditing of procedures carried out by the Department of Auditing and internal control (institutional) carried out by the Department of Internal Control.

During the conduct of each audit the functioning of the internal control system is assessed, as well as the major types of risk which could adversely affect the achievement of Company goals. As a result of this analysis, the leadership staff gains insight into the actual functioning of a particular procedure, along with proposed corrective measures and recommendations vital for decision making.

In 2007 internal auditing was carried out in 8 functional areas of KGHM Polska Miedź S.A. As a result of this auditing, the following were exposed: areas in which there had arisen risks, the causes of arising of such risks, proposals for their elimination, and areas in which the internal control system doesn't work correctly.

Corrective measures (recommendations) were implemented with respect to:

- Corporate governance (The process of delegation of rights in the Company),
- Strategy („The process of delegation of rights in the Company”),
- Operating activities (setting prices, sales of copper and other products, distribution, transportation services, IT system),
- Infrastructure (property insurance),
- Internal factors (environmental protection – waste).

Internal Control (institutional) operates based on the „Regulations of internal control” as approved by the Management Board of the Company. The system of internal control, based on the principles of independence and objectivity, comprises all of the areas and organisational units of the Company. Simultaneously, the responsibility is fully maintained of employee self-control and of functional control by all levels of management as part of their coordination-supervisory responsibilities.

Previous activities of internal control units set up within the organisational structure of the Company's divisions failed to bring the expected effects, and therefore in the second half of

2007 the Department of Internal Control was established within the Head Office, under the direct control of the Members of the Management Board.

The controlling actions thus far of the Department of Internal Control have indicated among others the need to limit risk related with:

- 1) the selection of service contractors/suppliers, and
- 2) the method of managing complex projects.

As a result, far-reaching procedural changes have been proposed (not yet implemented) along with defining and executing the responsibilities of employees for the actions they take or for the failure to act as respects not only their own position, but also for the realisation of tasks with respect to the Committees and Teams to which they are appointed.

Selected areas requiring attention.

The Company should pay particular attention in the near future to the following:

- increasing the cost flexibility of the Company, starting with restricting cost increases and working towards their reduction,
- developing (verifying) the long-term development and operating strategy of the Company with a program for its consistent implementation and monitoring,
- intensifying the development of feasibility, conceptual and, in effect, investment programs, respecting access to domestic copper ore resources,
- reviewing and verifying the functional missions of Group companies,
- monitoring and improving strategies hedging mineral prices (using options) and the exchange rate – strong dependence of Company revenues on mineral prices and the exchange rate,
- the low share of assets and revenues from sales (i.e. by approx. 5%) of subsidiaries in the consolidated results of the KGHM Polska Miedź S.A. Group.

(Translation from the original Polish version. In the event of differences resulting from the translation, reference should be made to the official Polish version.)