



**RAFAKO S.A.  
in Racibórz  
BUSINESS REPORT**

**2010**

**March 21<sup>st</sup> 2011**

## Table of contents

	Page no.
I. General information.....	1
II. Economic and financial situation.....	4
1. External and internal factors affecting the current financial results and development prospects of RAFAKO S.A.	4
2. Principal risks and dangers	4
3. Analysis of main economic and financial indicators	5
3.1. Sales income structure	5
3.2. Procurement of deliveries, services and materials.	8
3.3. Transactions with related entities	8
3.4. Operational costs, structure of operational costs and gross sales result	8
3.5. Remaining revenues and operational costs, financial operations results	9
3.6. Revenues and their structure	9
3.7. Profitability and return on capital	10
3.8. Financial fluidity	10
3.9. Debt status	11
3.10. Assets financing structure	11
3.11. Fixed assets	12
3.12. Changes in RAFAKO S.A. capital relations with other entities	13
3.13. Status and structure of shareholders' equity	13
III. Major events related with Company's activity in 2010 and after till the issuance of financial report .....	14
1. Within the field of major contracts	14
2. Within the field of other major events (agreements)	15
3. Research & development and quality-related events	16
4. Major tasks within the field of management and IT technologies	16
5. Disputes , court and arbitration proceedings, administrative proceedings	17
6. Remaining information	17
IV. Company's development prospects for 2011.....	17

### Attachments:

- No. 1 Specification of indicators for 2010 and 2009.
- No. 2 Financial statement as per December 31<sup>st</sup> 2010 and December 31<sup>st</sup> 2009 - structure, changes and dynamics.
- No. 3 Total income statement for 2010 and 2009.
- No. 4 Gross result structure and dynamics for 2010 and 2009.
- No. 5 Specification of insurance agreements valid as per December 31<sup>st</sup> 2010.
- No. 6 Structure of RAFAKO S.A. portfolio of shares as December 31<sup>st</sup> 2010.
- No. 7 RAFAKO S.A. Corporate Order Statement for 2010.

## **I. General information**

RAFAKO S.A. (hereinafter referred to as "Company" or „RAFAKO S.A.”) is among the largest Polish companies dealing with design, manufacturing, construction and servicing of power-generating equipment. On December 31<sup>st</sup> 1949, the Ministry of Heavy Industry approved a decision to establish the state-run enterprise named „Technical Equipment Factory” located in Racibórz. It was agreed that the newly established company shall deal with manufacture steam boilers. This is where it all commenced, both history of the Company and history of Polish power generation sector.

From the very beginning of its history, RAFAKO S.A. was the main supplier of boilers for Polish power generation sector and industrial applications. Joint capacity of the boilers manufactured by RAFAKO S.A. accounts for a major part of the capacity installed in Polish utilities and industrial power generation sector. Major plants, which operate power generation boilers manufactured by the Company include: Warsaw Group of CHP Plants, Wrocław Cogeneration Group, Łódź Group of CHP Plants, Wybrzeże Group of CHP Plants, Zielona Góra CHP Plant as well as: Opole, Bełchatów, Kozienice, Dolna Odra, Rybnik, Pątnów – Adamów - Konin, Turów power plants and Southern Power Generation Company. Company has installed circulating fluidised bed boilers in Żerań and Bielsko-Biała II CHP Plants, in Siersza Power Plant and in Polpharma Pharmaceutical Plant in Starogard Gdański.

During the first half of 2008, a 460 MW power-generating unit installed in Pątnów II Power Plant was put into operation. Within the framework of this project, RAFAKO S.A., in co-operation with SNC Lavalin, has delivered a boiler and flue gas desulphurisation plant. The construction of Pątnów II supercritical parameters unit is the first investment of that kind in Poland both in terms of financial expenditure and in terms of power-generating capacity. Said high power-generating capacity results in considerably lower emissions of pollutants, mainly carbon dioxide, to the atmosphere.

The execution of a contract for delivery of a new 858 MW power-generating unit for Bełchatów Power Plant is nearing the end. For this Unit, the Company shall also deliver the flue gas desulphurisation plant. The unit shall be operated with the first Polish pilot CCS plant (CO<sub>2</sub> capture and storage).

The execution of an agreement for delivery of oil & gas-fired boiler complete with catalytic NO<sub>x</sub> emission reduction plant for PKN ORLEN S.A is under way. It is the first investment of that type in Poland.

RAFAKO S.A. is a leader within the field of large Polish flue gas desulphurisation plants. The Company has delivered the FGD plants to the following utilities: Jaworzno III Power Plant, Bełchatów Power Plant, Pątnów Power Plant and Ostrołęka „B” Power Plant. Recently, the contracts were signed for construction of FGD plants for Siewerki and Dolna Odra Power Plants. The contract for construction of wet FGD plant in Siewerki Power Plant - valued at MPLN 489 - commenced in 2009 is the largest environment protection investment in Poland and one of the largest contracts carried out by RAFAKO S.A.

Within the two-years period 2007 – 2008 the Company has put into operation the highly efficient semi-dry method flue gas desulphurisation plants installed in Łódź CHP Plant and Skawina Power Plant. This method, less costly than the wet one, is an original solution developed and engineered by RAFAKO S.A.

Export sales share in the overall sales volume of RAFAKO S.A. is becoming increasingly important (27,1 % in 2010). The largest boilers manufactured by the Company are operated in power plants located in the territory of former Yugoslavia. Numerous large units were delivered to China, Turkey and India. Bubbling fluidised bed boilers installed in Komořany Power Plant in Czech Republic are among our major reference units.

RAFAKO S.A. is also a well-known European market supplier of boiler elements. Company's traditional customers include the partners from Germany, Finland, Serbia and Czech Republic.

RAFAKO S.A. is also gaining and maintaining the strong position on Western European market of boilers for municipal waste incineration plants. In 2009, the Company has completed the construction of two waste incineration boilers for Visser & Smit. Currently, RAFAKO S.A. performs two important contracts for a French company CNIM (Constructions Industrielles de la Méditerranée). The first one entered into force in July 2009 and includes the delivery of two waste heat boilers for municipal waste incineration plant in Baku (Azerbaijan). This contract was signed with CNIM ENGINEERS FZC, a subsidiary of CNIM. The scope of the second one consists of manufacture and delivery of three waste heat boilers for municipal waste incineration plant in Torino (Italy).

In February 2009, Kielce Combined Heat and Power Plant has commissioned a new, biomass-fired cogeneration unit delivered by the Company in co-operation with ZRE Katowice. It is one of the first units of that type in Poland and, at the same time, the largest in terms of biomass-fired boiler parameters and capacity.

In 2010, RAFAKO S.A. signed two new contracts within the field of a so called “green energy”. These installations are located in Jaworzno and Stalowa Wola Power Plants belonging to Tauron Group. These innovative projects confirm the strong position of a Company perceived as a supplier of technologies for generation of energy on the basis of renewable sources. Jaworzno and Stalowa Wola Projects are also compatible with both, the “pro-ecological strategy” of RAFAKO S.A. and the strategy adopted by Polish government aiming at increasing the share of renewable energy sources in power generation sector by 2012.

Starting from 2009, the Company offers the dust removal equipment such as electrostatic precipitators and bag filters. During the year of 2009, RAFAKO S.A. signed the agreement, valued at MEUR 60, for delivery, erection and start-up of two (2) electrostatic precipitators for Westfalen Power Plant in Germany and two (2) other electrostatic precipitators for Eemshaven Power Plant in Netherlands. Within the same period, RAFAKO S.A. signed another agreement, valued at c.a. MPLN 79, for modernisation of electrostatic precipitators of BB-1150 boiler; units no. 5 and 6 in Belchatów Power Plant. In 2010, the Company signed a contract with „Kozienice” S.A. Power Plant for replacement of Unit no. 10 electrostatic precipitator, for the overall value of MPLN 48. In the first quarter of 2011, another agreement for replacement of Unit no. 4 electrostatic precipitator was signed.

The Company has implemented an intensive programme of preparation for execution of important investments, which are planned in Polish power generation sector in the coming years. In June 2010, RAFAKO S.A. and Siemens signed a letter of intent concerning the co-operation within the field of construction of new power-generating units for supercritical parameters. The co-operation with Siemens began two years before with the acquisition of a license enabling the Company to perform design, production, start-up and sales of BENSON-type boilers without any restrictions, all over the world, notwithstanding the design, size and fuel.

Currently, the Company offers:

- conventional power generation and district heating boilers with grate-type, fluidised and pulverised fuel furnaces for both sub- and supercritical steam parameters;
- heat recovery steam generators;
- boilers for waste incineration plants;
- dry method flue gas desulphurisation plants;
- semi-dry method flue gas desulphurisation plants;
- wet method flue gas desulphurisation plants;
- dust removal equipment (electrostatic precipitators, bag filters);
- boiler plants diagnostics, repairs and modernisation;
- manufacture of boiler and electrostatic precipitator elements;
- manufacture of steel structures and other non-pressure parts for power generation sector;
- manufacture of heat exchangers.

The equipment delivered by RAFAKO S.A. is covered with an extensive care programme including servicing, repairs, modernisation works focused on improvement of operational parameters and mitigating the environmental impact.

In our efforts to meet the customers’ requirements and to maintain the good image of the company RAFAKO S.A. continuously obtains and updates the certificates in accordance with PN-EN ISO 9001:2001, PN-EN ISO 14001:2005 standards and in accordance with the European Directive 97/23/EC within the field of compliance assessment module H/H1. Strict observance of the stipulations of relevant Quality Assurance Systems guarantees the meeting of technical safety requirements applicable on a domestic, European and United States markets. Implementation of EMAS requirements proves and documents the reliability of RAFAKO S.A. environmental awareness.

## Milestones in Company's history and ownership transformations:

**December 31<sup>st</sup>, 1949:** Ministry of Heavy Industry decides to establish in Racibórz a state-run company named "Technical Equipment Factory" and focused on manufacture of steam boilers;

**January 12<sup>th</sup>, 1993:** Ministry of Ownership Transformation decides to transform a state-run company named "Racibórz Boiler Factory RAFAKO" into an individual State's Treasury Company.

After aforementioned transformation:

- RAFAKO Sp. z o.o. (limited liability company, which later changed its legal form and name into "ENERGO-INVESTMENT S.A.") has acquired 50% of Company's shares,
- State's Treasury has retained 25% of Company's shares to be later sold within a public offer to minor investors,
- In accordance with the stipulations of Privatisation Act, employees have bought 20% of Company's shares,
- Company's management personnel acquired 5% of Company's shares.

On February 12<sup>th</sup>, 1993, the Company was registered in a Trade Register maintained by Katowice District Court under the name of "RAFAKO S.A. Boiler Engineering Company"<sup>1</sup>;

**March 7<sup>th</sup>, 1994:** "RAFAKO S.A." shares debut on Warsaw Stock Exchange;

**December 10<sup>th</sup>, 1997:** ELEKTRIM S.A. enters as a strategic investor of the Company becoming the owner - as a result of a new issuance of shares (H series) - of 46,38% of Company's initial capital (Shareholding structure valid as per December 31<sup>st</sup>;

**May 24<sup>th</sup> 2007:** Registration of Company's increased share capital as a result of emission of 52 200 000 I series shares (shareholding structure as per December 31<sup>st</sup> 2010 is shown in attachment no. 7).

---

<sup>1</sup> On August 24th, 2001 the Company was registered in National Legal Register of Companies under the number 34143.

## **II. Economic and financial situation**

### **1. External and internal factors affecting the current financial results and development prospects of RAFAKO S.A.**

#### **1.1. External factors:**

- power generation policy of European Union;
- investment and fuel diversification policy in power generation sector;
- existing electric energy market regulations;
- ongoing process of privatisation of power generation sector;
- increasing competition on European market related with the activity of competitors from Far East;
- financial situation and market standing of RAFAKO S.A. customers and consortium partners;
- Company's employers' payment records;
- price tendencies of raw material (mainly steel products), subcontracted products and services;
- currency exchange rate fluctuations (especially EUR);
- involvement of banks in financing and granting of bank guarantees within the framework of contracts executed by the Company;
- changes in market level of salaries in professions of key importance for the Company;
- technical development.

#### **1.2. Internal factors:**

- ability to use the effects of completed investment tasks in order to increase Company's operational effectiveness, especially within the field of manufacturing, management, increase of number of orders acquired and increase of execution capacities;
- optimisation of Company's management processes including long-term contracts management process and Company's operating costs („fixed” costs);
- maintaining of Company's financial fluidity;
- maintaining of existing and acquiring of new highly qualified manufacturing and design personnel.

### **2. Principal risks and dangers**

RAFAKO S.A. identifies the following risks and dangers for Company's activities within the nearest future:

- risk of downsizing or postponement of investment by Company's Customers;
- macroeconomic risk related with such factors as: fluctuations of currency exchange (preventing the correct assessment of a profitability of long-term contracts), changes in tax legislation and reactions of financial markets to the deficit in public finances;
- risk related with use of the existing reserve for possible liquidated damage for delay in execution of contracts signed with foreign customers;
- risk related with compatibility of amounts estimated for the costs of claims concerning several foreign contracts;
- process risk resulting from implementation of complex, innovative processes and quality-related procedures in manufacturing of elements on the basis of difficult, high grade materials and resulting risk of application of liquidated damages as a result of process errors;
- risk related with compatibility of amounts estimated for contract execution costs related with postponement of erection commencement dates (not attributable to the Company) within the framework of two export contracts;
- risk related with compatibility of amounts estimated for elimination of failure that occurred within the framework of on contract executed for the Polish investor;
- risk related with possible non-payment of receivables both subject and not subject to updating corrections;
- risk related with statutory qualification of allowable contents of nitrates in FGD plant post-process waste. At the present moment, there is no technology offering the efficient and cost-effective solution to this issue.

Description of purposes and principles of financial risk management with special emphasis on the most important risk types is included in item 40 of additional information supplementing the Company's financial statement.

Risks and opportunities related with ongoing „construction agreements” are specified in item 8 of additional information supplementing the Company's financial statement.

### 3. Analysis of main economic and financial indicators

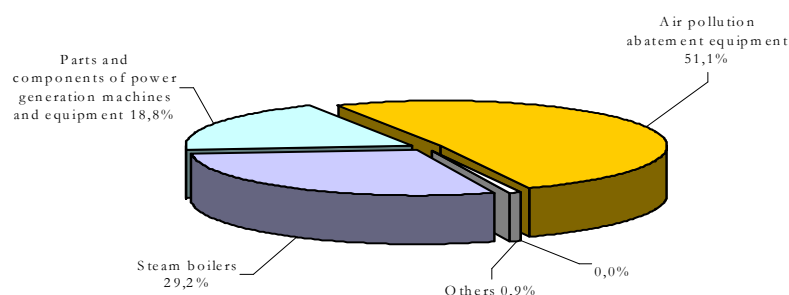
#### 3.1. Sales income structure

In 2010, the income generated by sales of products, goods and materials reached the record level of TPLN 1 110 307 and were by TPLN 205 127 (22,7%) higher than in the previous year. Sales of products and services generated the income of TPLN 1 105 686, while the income originating from the sales of materials amounted to TPLN 3 173. The income achieved as a result of fluctuations of currency exchange rates in sales contracts and related financial instruments (securing the currency exchange rate changes) amounted to TPLN 1 448.

The increase of sales value observed in 2010 is mainly due to the increase of sales volume within the field of air protection equipment including the flue gas desulphurisation plants. It is generally a result of contracts signed within the period 2008 - 2009: FGD plants for Siekierki CHP Plants Group, Dolna Odra Power Plants Group and electrostatic precipitators for Belchatów and Koźienice Power Plants.

The share of export sales in overall sales volume amounted to 27,1%, i.e. 11,2 percent decrease when compared with the previous year. In 2010, the value of export sales has reached the level of TPLN 300 564 and was 13,2% lower than the value of export sales achieved in 2009, when it amounted to TPLN 346 427.

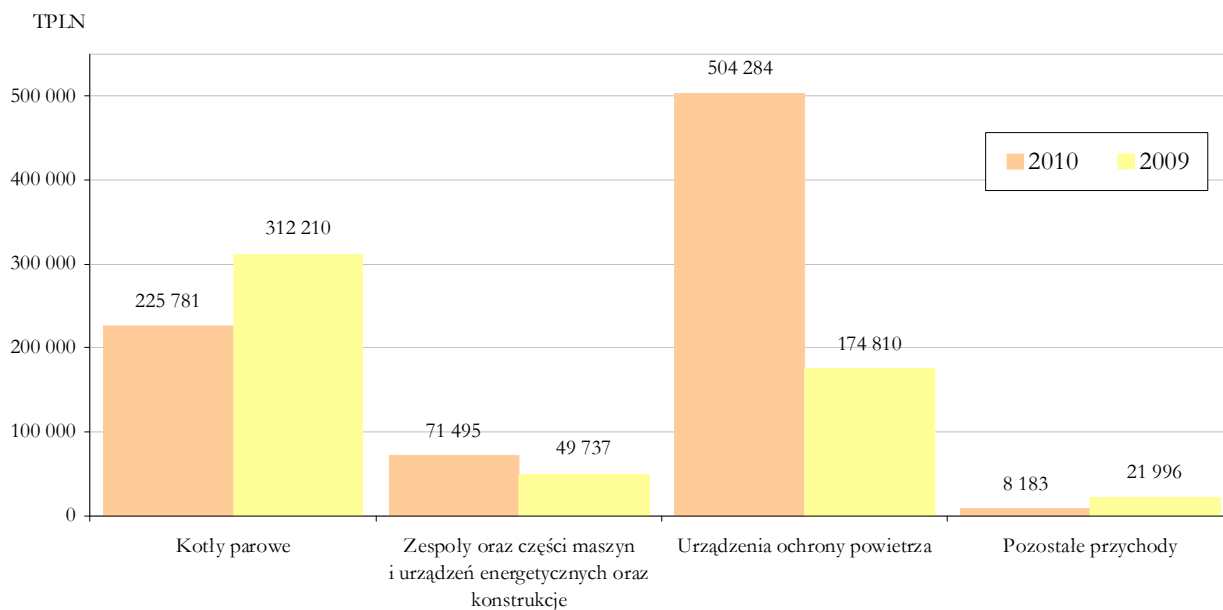
Sales assortment structure in 2009 may be visualised as follows:



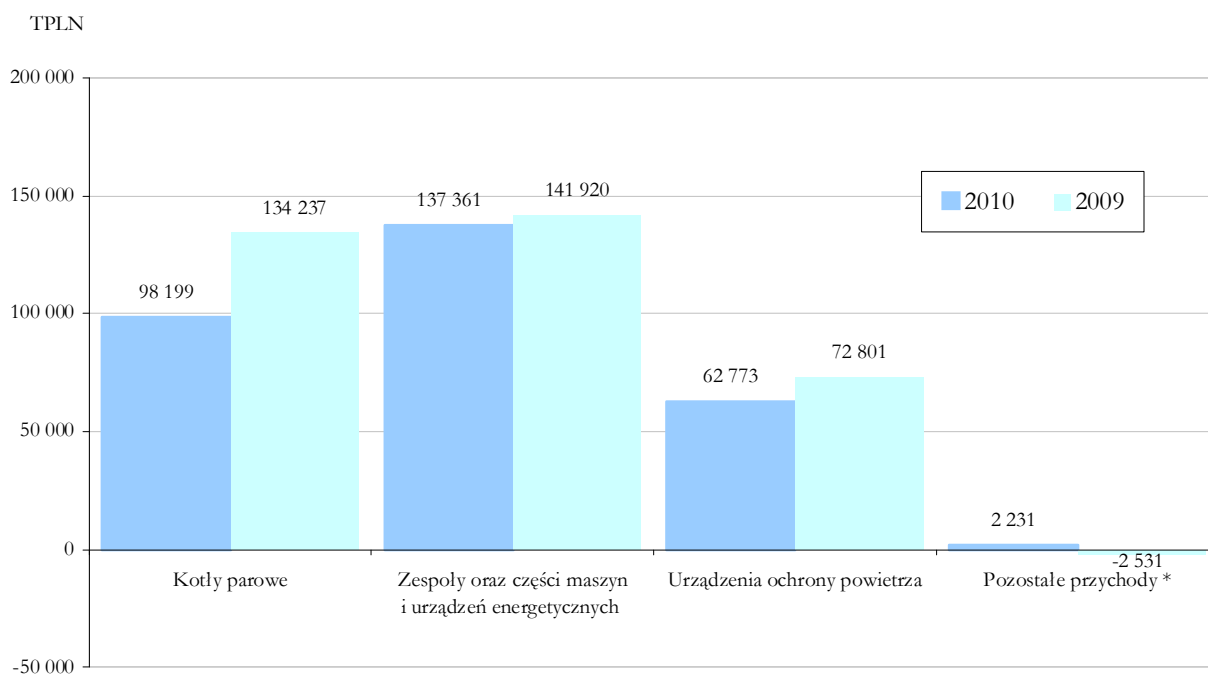
Domestic and foreign suppliers of power generation plants as well as domestic and foreign utilities and industrial power generation sector continue to be the main customers for RAFAKO S.A. products and services.

Sales assortment divided into sales markets is shown in the tables below:

**Domestic market: (2010: TPLN 809 743; 2009: TPLN 558 753):**



**Foreign markets: (2010: TPLN 300 564; 2009: TPLN 346 427):**

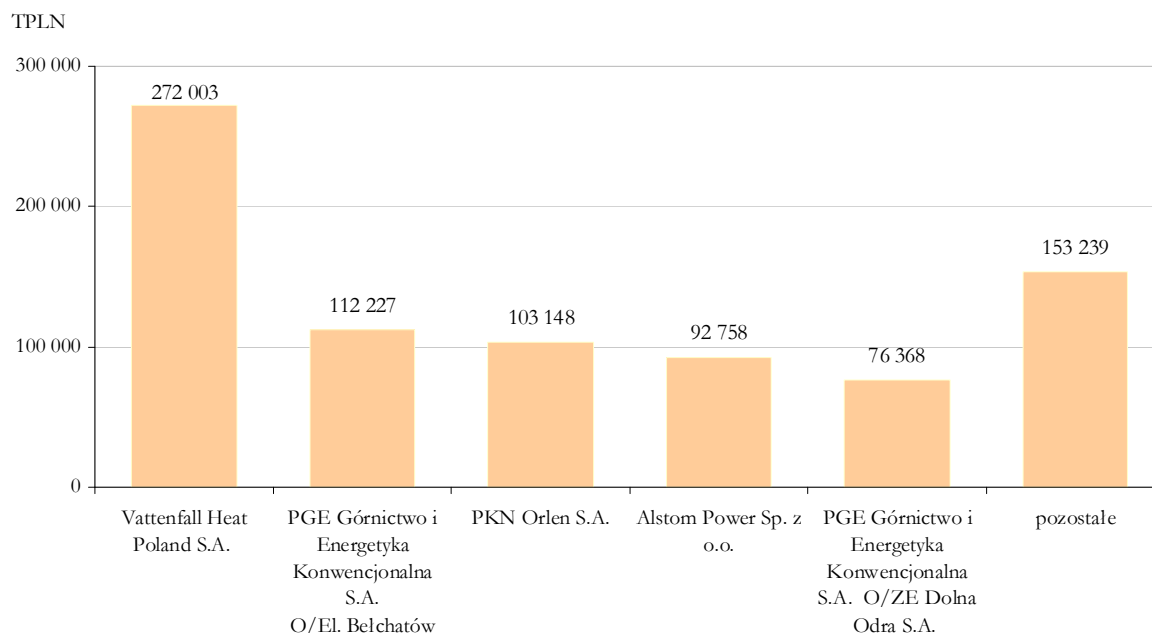


\* negative value of the remaining income for 2009 results from evaluation of the fluctuations of currency exchange and derivative instruments that had a negative balance in 2009.



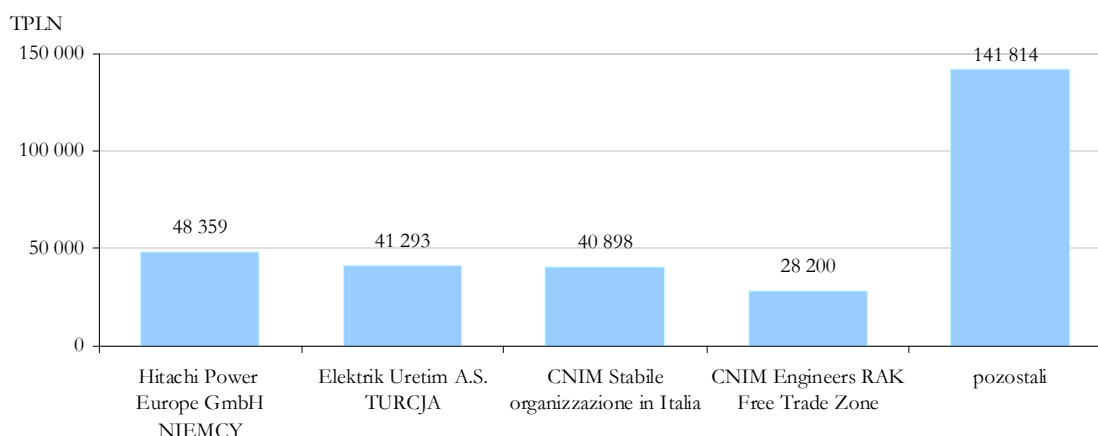
The main customers of RAFAKO S.A. in 2010 include:

**domestic market (in total TPLN 809 743):**



In 2010, Vattenfall Heat Poland S.A. with its official seat in Warsaw became the main customer of the Company. Its share in sales volume amounts to 24,5% (12,1% in 2009). Sales contract carried out for this customer consists in construction of wet-method flue gas desulphurisation plant located in Siekierki Combined Heat & Power Plant in Warsaw. Also the PGE Mining and Conventional Power Generation S.A. Bełchatów Power Plant Branch reached a considerable share in Company's sales volume (10,1% share in 2010 compared with 5,6% in 2009). This contract also consists in construction of wet-method flue gas desulphurisation plant and additionally in modernisation of electrostatic precipitators. PKN Orlen S.A. (9,3% share in sales volume for 2010) is another important customer of the Company. The projects carried out for this customer consist in deliveries of boilers and power-generation equipment including the most modern steam boiler in industrial power generation sector.

**foreign markets (in total TPLN 300 564):**



The German Company Hitachi Power Europe GmbH was the main foreign market customer of RAFAKO S.A. Its share in sales volume amounted to 4,4%. The contracts carried out for this customer include the deliveries of boiler pressure parts and electrostatic precipitators.

The nature of Company's products is such that, within the periods of execution of the largest contracts, the shares achieved by important customers exceeds the level of 10%.

Above-listed income figures include sales income generated on the basis of construction contracts priced using the cost advancement method.

### 3.2. Procurement of deliveries, services and materials.

In 2010, the main procurement sources for RAFAKO S.A. included:

<i>Procurement source</i>	<i>Purchase volume in TPLN</i>			
	<i>2010</i>		<i>2009</i>	
	<i>Value</i>	<i>Share in total purchase volume</i>	<i>Value</i>	<i>Share in total purchase volume</i>
Domestic suppliers	691 602	76,9%	564 526	83,1%
Foreign suppliers	207 755	23,1%	115 216	16,9%
<b>TOTAL</b>	<b>899 357</b>	<b>100,0 %</b>	<b>679 742</b>	<b>100,0 %</b>

In 2010, the structure of suppliers' pool demonstrated a considerable diversification and none of suppliers has achieved the share exceeding 10% of total volume of purchasing.

RAFAKO S.A. purchases the external supplies of tubes, plates, profiles, welding consumables, specialised equipment and various service including: engineering works, delivery and installation of machines and equipment, construction and erection services, transport services.

Assortment of purchased elements closely depends on the nature and needs related with orders being executed (one-off production). Availability of materials for manufacture as well as availability of deliveries and services is not considered as an important restriction in Company's business. Selection of suppliers depends on their ability to deliver materials and equipment meeting the specific technical and quality-related requirements within the specified deadline and in a most economic way. Purchasing is carried out on the basis of market analysis. The pool of suppliers is limited to the approved ones, both on the basis of good quality of their products and on the basis of their records of observance of safety, environment protection and other regulations specific for a given product.

In case of some contracts the list of potential manufacturers and service providers has to be accepted by RAFAKO S.A. Employers.

Part of production dedicated for foreign markets is carried out on the basis of materials free-issued by Employer (i.e. „customer's materials”) thus, on one hand, reducing the risk of increase of Company's operational costs due to fluctuations of material prices but, on the other hand, reducing the sales volume achieved by RAFAKO S.A.

### 3.3. Transactions with related entities

In 2010, the Company has not carried out any important transactions with its subsidiaries based on the conditions other than the market ones.

### 3.4. Operational costs, structure of operational costs and gross sales result

Costs of products, goods and materials sold in 2010 amounted to TPLN 938 142, thus, considering the level of revenues amounting to TPLN 1 110 307, resulting in Company's gross profit on sales at the level of TPLN 172 165 (70,5% higher than in 2009).

Such increased profit results from the increase of gross profitability of operational activities (4,3 percent higher than in the analogue period of a previous year), which, in turn, was due to lower than expected costs of execution of some projects achieved thanks to lower costs of deliveries and services purchased from sub-suppliers and subcontractors.

Improved result of one of the domestic contract (as a result of the increase of contract price and correction of project execution costs implemented upon successful hydrostatic testing of the boiler) also contributed to the increase of gross profitability of operational activities. Aforesaid price adjustment was caused by the extension of contractual scope and compensation for increase of operational costs pursuant to changes in regulations and related implementation of technical corrections in the elements of contractual deliveries.

Moreover, the increase of gross profitability of operational activities results from lower reserves and lower costs of guarantee repairs, reduction of a correction updating the balance value of the reserves, as well as higher result of evaluation and settlement of currency exchange hedging transactions.

Considerable adverse effect on gross profitability of operational activities was related with lower than expected results of two contracts carried out for a foreign customer due to the costs of guarantee claims and partial correction of contractual revenues.

Considerable effect on gross profitability of operational activities was related with the increase of costs of a project carried out for a foreign customer. It was mainly due to the higher than expected costs of material procurement, costs of manufacturing and costs of elaboration of technical documentation. In some part, said costs increase appeared as a consequence of material grade changes implemented in contractual design documentation by a customer (The Company conducts the negotiations concerning the reimbursement of such costs).

In 2010, the cumulated costs of sales and general management costs amounted to TPLN 22 552 and were TPLN 663 lower than in the analogue period of a previous year.

In 2010, the costs of sales reached the level of TPLN 47 118 and were TPLN 23 410 higher than in the analogue period of a previous year. The reason of such an increase lies in implementation of a correction updating the receivables due from a foreign customer (TPLN 23 593 increase).

After taking into account said cumulated costs of sales and overall management costs, the profit on sales amounted to TPLN 102 495 and was TPLN 48 469 (i.e. 89,7%) higher than the profit generated in 2009.

### 3.5. Remaining revenues and operational costs, financial operations results

#### 3.5.1. Result of remaining operational activities

In 2010, the Company observed a loss on remaining operating activity amounting to TPLN 46 695 (in 2009 the loss amounted to TPLN 6 750). This loss was caused by:

	<i>in TPLN</i>
1. change of balance of calculated and actually applied costs of liquidated damages (in minus)	(49 802)
2. donations and sponsoring	(338)
3. positive balance of contractual liquidated damages paid and received	2 933
4. compensations received	142
5. positive balance of remaining revenues and operational costs	370

#### 3.5.2. Result of financial activities

In 2010, the Company's financial activity has resulted in a loss equal to TPLN 4 276 (in 2009, the Company's financial activity has generated a profit equal to TPLN 862). This loss was caused by:

	<i>in TPLN</i>
1. costs of orders acquisition	(6 761)
2. creation of reserves for financial costs	(2 159)
3. negative balance of exchange rate fluctuations	(1 346)
4. costs related with shares release	(627)
5. interests related with: deposits, bank accounts, loans granted, overdue liabilities	4 830
6. evaluation of financial instruments	1 138
7. result of TFI shares sales and release	584
8. positive balance of remaining revenues and financial costs	65

### 3.6. Revenues and their structure

Net profit achieved in 2010 was higher than in the analogue period of a previous year and amounted to TPLN 40 184 (compared with TPLN 35 654 generated in 2009, i.e. 12,7 % increase). Achieved gross profit, bearing in mind the loss on financial activities (TPLN 4 276) and the loss on remaining operational activities (TPLN 46 695), was mainly affected by sales profit. i.e. profit achieved on Company's principal activities amounting to TPLN 102 495.

The events that have considerably affected the results achieved by RAFAKO S.A. in 2010 include:

- increased profitability of some projects, mainly as a result of successful procurement of a part deliveries and services;
- improved result of one of the domestic contract (as a result of the increase of contract price and correction of project execution costs implemented upon successful hydrostatic testing of the boiler) also contributed to the increase of gross profitability of operational activities. Aforesaid price adjustment was caused by the extension of contractual scope and compensation for increase of operational costs pursuant to changes in regulations and related implementation of technical corrections in the elements of contractual deliveries;
- positive result of evaluation and settlement of transaction securing the currency exchange fluctuations;
- positive balance of interests received and paid;
- increase of the amount of reserves for possible liquidated damages for non-meeting of penalised milestones on several contracts for both domestic and foreign markets;
- increase of the value of corrections updating the liabilities;
- impairment of profitability on four contracts carried out for two foreign customers as a result of evaluation of costs of claims and correction of a part of contractual revenues;
- changes in reserves and costs related with guarantee claims;
- negative balance of currency exchange fluctuations;
- costs of acquisition of orders;
- increase of costs within the framework of a project carried out for a foreign customer as a result of higher than expected costs of materials, costs of manufacture and elaboration of technical documentation. In some part, said costs increase appeared as a consequence of material grade changes implemented in contractual design documentation by a customer (The Company conducts the negotiations concerning the reimbursement of such costs);
- costs of technical progress (research and development works).

Financial results shown in a report for 2010 cannot be compared to the previously published result forecasts for the same period because the Company hasn't issued such forecasts.

*Structure and dynamics of gross result for 2010 and 2009 are shown in the Attachment no. 4.*

### **3.7. Profitability and return on capital**

The year of 2010, when compared with the same period of a previous year, saw the increase of Company's operational profitability. The indicator of gross sales operational profitability has reached the level of 5,0% (when compared with 5,2% in 2009).

Net profit increase amounting to 12,7% (i.e. TPLN 4 530) combined with 5,4% (i.e. TPLN 19 031) increase of Company's own capital lie behind the increase of the rate of return on capital to the level of 10,7%.

Rate of return on assets has dropped from 4,7% in 2009 to 4,4% in 2010. This is mainly due to 19,3 % increase of the amount of assets (i.e. TPLN 146 791 increase).

*Profitability indices for 2010 and 2009 are shown in the Attachment no. 1.*

### **3.8. Financial fluidity**

In 2010, the value of indices measuring the Company's financial fluidity remained on the satisfactory level: both „current fluidity” index and „immediate fluidity” index equalled 1,3.

In 2010, the lengthening of liability rotation period to 77 days (i.e. 7 days longer) was combined with the lengthening of stock rotation period to 152 days (i.e. 56 days longer) and with lengthening of commercial liabilities rotation period to 70 days (i.e. 11 days longer). The acting capital rotation cycle (commercial liabilities rotation + stock rotation – commercial liabilities repayment period) was 52 days longer and amounted to 159 days (when compared to the end of 2009). The main reason of such lengthening of acting capital rotation cycle lies in the lengthening of stock rotation period resulting mainly from the increase of stock value on one of the projects concerning the construction of wet-method flue gas desulphurisation plant.

Company's ability to meet the liabilities has to be assessed as satisfactory. All liabilities towards ZUS (social Insurance Company, fiscal authorities and employees were timely executed. Such an outstanding fluidity results in elimination of delays in payments for suppliers.

Due to the fact that, as per December 31<sup>st</sup> 2010, the Company demonstrated no debt related with credits, the changes in interest rates and credit margins applied by banks did not affect the activity of RAFAKO S.A.

Taking all this into account, the risk of lack of cash resources and the risk of loss of financial fluidity by the Company has to be assessed as negligible.

Information concerning the financial instruments and information concerning purposes and principles of financial risk management is shown in items 28.1, 33 and 38 of additional information supplementing the Company's financial statement for 2010.

### **3.9. Debt status**

In 2010, the amount of Company's liabilities towards the creditors saw the increase by TLN 127 760. Cumulated amount of long- and short-term liabilities, as per the end of December 2010 amounted to TPLN 532 835. By the end of December 2009, this figure amounted to TPLN 405 075. The largest increase was observed within the field of liabilities related with deliveries and services (TPLN 62 616 increase). Increase of reserves related with liquidated damages (TPLN 49 801 increase) was also observed.

The value of Company's assets not charged with (both long- and short-term) liabilities as per the end of December 2010 amounted to TPLN 374 730 (as per the end of December 2009, this value was 5,4% lower and amounted to TPLN 355 699).

In 2010, the index of charging the Company's capital with (both long- and short-term) liabilities indicating the Company's ability to secure the debt repayment with the capital, saw the increase and, as per the end of December 2010, amounted to 58,7% (5,5% increase when compared with 2009).

The index of charging the assets with liabilities does not take into account Company's liabilities resulting from bank guarantees issued for and on behalf of RAFAKO S.A (mainly performance bonds and advance payment guarantees, which are typical securities for Company's field of activity and for power generation equipment market) as well as from letters of credit issued by RAFAKO S.A. (related with purchasing of imported goods). The amount of Company's liabilities resulting from aforementioned instruments amounts to, as per the end of December 2010, TPLN 680 790. In 2010, with regard to RAFAKO S.A. participation in calls for tender and as a result of contractual requirements, banks and insurance companies have issued, on behalf of RAFAKO S.A., the guarantees amounting to TPLN 235 163.

When compared with the status as per the end of 2009, the value of conditional liabilities saw the decrease by TPLN 43 636.

In 2010, the Company did not issue any warranties.

Due to the contracts being executed the Company possesses, apart from conditional liabilities (outside the balance), the conditional receivables amounting to, as per the end of December 2010, TPLN 238 683 (TPLN 235 123 as per the end of December 2009). Bank guarantees and insurance company guarantees amounting to TPLN 198 577 are the main components of these liabilities.

Due to relatively high financial fluidity as pre the end of December 2010, the Company was not indebted towards banks and other loaning institutions.

*Financial fluidity and debt indices for 2010 and 2009 are shown in attachment no. 1.*

### **3.10 Assets financing structure**

The sum of assets, as per the end of December 2010, amounted to TPLN 907 565 and was TPLN 146 791 higher than that sum of assets, as per the end of December 2009. The share of Company's own capital in total assets financing sources, when compared with the end of 2009 saw the 5,5 percent decrease and amounted to 41,3%.

Fixed capital, consisting of own capital and long-term reserves liabilities totally covered the value of fixed assets. The value of current assets was covered in 25,1%.

As per December 31<sup>st</sup>, 2010, assets financing structure may be summarised as follows:

1. fixed assets and long-term assets for sale amounting to TPLN 223 087 were totally financed with fixed capital,
2. current assets amounting to TPLN 684 478 were financed with:
  - fixed capital 25,1%,
  - deferred income 33,4%,
  - commercial liabilities 25,6%,
  - remaining short-term liabilities 15,9%.

### 3.11 Fixed assets

#### 3.11.1. Structure of fixed assets

The structure of fixed assets was subject to change as a result of investment tasks, sales of property, liquidation of expendable fixed assets, updating of assets value or change of long-term accruals and deferred income. By the end of December 2010 and the end of December 2009 this structure may be summarised as follows:

	<i>December 31<sup>st</sup> 2010</i>	<i>December 31<sup>st</sup> 2009</i>
1. Tangible fixed assets, including:	57,6%	61,2%
- land and buildings	34,8%	37,0%
- technical equipment and machines	19,9%	21,1%
- transport means	1,4%	1,1%
- fixed assets under construction	1,5%	2,0%
2. Investment real estate	—	—
3. Intangible values	3,8%	3,1%
4. Financial assets	19,3%	21,0%
5. Deferred income taxes	19,3%	14,7%

In 2010, the Company did not perform the issuance of shares.

#### 3.11.2. Description of major investment tasks within the field of fixed assets

In 2010, the Company's investment expenditure for non-financial fixed assets amounted to TPLN 11 365, including:

- for material fixed assets TPLN 10 317,
- for intangible values TPLN 1 048.

The subject of investment expenditure performed during the analysed period consisted mainly in purchasing of machines and equipment for manufacturing needs and building infrastructure. The subject of investment expenditure within the field of intangible values consisted mainly in purchasing of engineering software. All investment tasks were financed with Company's own resources.

Moreover, available financial resources of the Company were put to use as short-term investments. As per December 31<sup>st</sup> 2010, the value of short-term deposits amounted to TPLN 27 304. Short-term investment consisted in purchasing of shares of investment fund:

- TFI Allianz Pieniężny Open Investment Fund: TPLN 22 009;
- KBC Gamma Specialised Open Investment Fund: TPLN 5 295.

In 2007, on the basis of a decision taken by Extraordinary Meeting of Shareholders of RAFAKO S.A. on January 23<sup>rd</sup>, 2007, RAFAKO S.A. has carried out the emission of new shares with drawing rights. As a result of the emission of 52 200 000 ordinary I series shares with nominal value amounting to PLN 2,00 each, the initial capital of the Company saw the increase by MPLN 104,4.

Till the end of 2010, the revenues from the issuance of shares were used for the following purposes:

1. Purchase of the components of financial fixed capital for the amount of MPLN 42,7, including:
  - a) purchase of 82,19% of shares of FPM S.A. Mikołów for the total amount of MPLN 35,2 (including the increase of initial capital and purchase of 630.830 shares for MPLN 5,0);
  - b) increase of initial capital and purchase of 5 048 shares of „ELWO” S.A. Pszczyna for the amount of MPLN 6,4;
  - c) other transactions for the amount of MPLN 1,1;
2. financing of expenditure within the field of non-financial fixed capital for the amount of MPLN 32,5;
3. increase of the components of current assets for the amount of MPLN 20,0;
4. covering of shares issuance costs amounting to MPLN 1,9.

In total, till 31.12.2010, MPLN 97,1 originating from the issuance of I series shares was used.

Remaining resources amounting to c.a. MPLN 7,3 shall be used for financing of capital acquisitions.

### **3.12 Changes in RAFAKO S.A. capital relations with other entities**

In 2010, the following changes within the field of RAFAKO S.A. relations with other entities took place:

1. On June 1<sup>st</sup> 2010, on the grounds of an agreement concerning the transfer of shares without compensation, the Company has taken over from DEKOTRA Inzenjering d.o.o., 2% of shares in RAFAKO Engineering Solution doo. As per the date of this report, the Company owns 77% in RAFAKO Engineering Solution doo.
2. On November 30<sup>th</sup> 2010, the District Court in Gliwice, Economic Department X of National Register has registered the decrease of initial capital of a subsidiary named PGL-DOM Sp. z o.o. with the amount of PLN 6.630.000. After such reduction of capital in a way of release of 663 shares, the initial capital of PGL-DOM Sp. z o.o. amounts to PLN 6.070.000 and is subdivided into 607 shares valued at PLN 10.000 each.
3. In 2010, the Company has purchased 9 337 common shares of FPM S.A. for the amount of PLN 180 714,55. These shares represent 0,89% share in initial capital and the same number of votes at General Meeting of Shareholders of this company. Thus the Company share in FPM S.A. was increased to the level of 71,39%.
4. On December 7<sup>th</sup> 2010, RAFAKO S.A., on the grounds of sales agreement, has sold to Polimex-Mostostal S.A., 88 shares of the company Centralne Biuro Konstrukcji Kotłów S.A. with its official seat in Tarnowskie Góry for the amount of TPLN 242.
5. On October 20<sup>th</sup> 2010, the subsidiary FPM S.A. performed the increase of its equity with the amount of PLN 1 999 731,10, i.e. to the level of PLN 5 308 799,00, as a result of issuance of 630 830 B series shares having the nominal value of PLN 3,17 each and the issuance price set at the level of PLN 8,00. On October 26<sup>th</sup> 2010, RAFAKO S.A. has acquired, on the basis of a relevant agreement, 630 830 shares of FPM S.A. for the amount of PLN 5 046 640,00.
6. On July 16<sup>th</sup> 2010, RAFAKO S.A. has exchanged 14 781 shares of Południowy Koncern Energetyczny S.A. with its official seat in Katowice for 73 219 shares of TAURON Polska Energia S.A.

### **3.13 Status and structure of shareholders' equity**

As per December 31<sup>st</sup> 2010, the shareholders' equity of RAFAKO S.A. amounted to TPLN 374 730 including:

1. share capital amounting to TPLN 139 200 subdivided into 69 600 000 ordinary shares of A, B, C, D, E, F, G, H, and I series. This capital was not subject to any changes during the 12 months of 2010;
2. revenue originating from sales of shares above their nominal value amounted to TPLN 36 778. This component was not subject to any changes during the 12 months of 2010;
3. reserve capital amounting to TPLN 158 142 (TPLN 14 774 increase observed during 2010 results from the transfer of a part of total net profit generated in 2009 into reserve capital);
4. profits withheld (from the current period) amounting to TPLN 40 184;
5. currency exchange fluctuations originating from recalculation amounting to TPLN 426.

In 2010, the Company did not acquire its own shares.

### **III. Major events related with Company's activity in 2010 and after till the issuance of financial report**

Among major events related with RAFAKO S.A. activity we shall mention the following:

#### **1. Within the field of major contracts**

- a. Signing of the agreement valued at MPLN 48 with „Kozienice” S.A. Power Plant for replacement of an electrostatic precipitator of a Unit no. 10 in Kozienice Power Plant;
- b. Signing of several agreements valued in total at MEUR 17,5 with CNIM Constructions Industrielles de la Méditerranée. The subject of the largest of these agreements consists in delivery of 3 waste heat boilers for municipal waste incineration plant in Torino (Italy);
- c. Signing of an amendment increasing the value, extending the scope and the execution time period of an agreement carried out within the framework of a consortium of Alstom companies for PGE Belchatów Power Plant consisting in construction of 858 MW power-generating unit for supercritical parameters. RAFAKO S.A. (member of internal consortium of the companies Alstom Power Systems GmbH and Alstom Power sp. z o.o.) share in such increased value of aforementioned agreement amounts to c.a. MPLN 67. The new completion deadline is set for April 30<sup>th</sup> 2011;
- d. Signing, by a consortium of companies led by RAFAKO S.A., of an agreement with PKE S.A. Jaworzno III Power Plant - Power Plant II for design, delivery, erection and start-up of a biomass-fired OFz-201 boiler to be installed in PKE S.A. Jaworzno III Power Plant - Power Plant II. The value of this agreement amounts to c.a. MPLN 230 including the share of RAFAKO S.A. valued at c.a. MPLN 163;
- e. Signing of an agreement with Stalowa Wola Power Plant (TAURON Group) for extension of OP-150, K10 boiler for firing of biomass complete with biomass storage, preparation and transport system to be installed in Stalowa Wola S.A. Power Plant. The value of this agreement amounts to MPLN 130;
- f. Signing of an agreement with PGE Mining and Conventional Power Generation S.A. – Belchatów Power Plant Branch for modernisation and overhaul of flue gas reheat system for units no. 8, 10, 11 and 12 in Belchatów Power Plant. The value of this agreement amounts to MPLN 186,6;
- g. Signing of several agreements with Metso Power OY for the total amount of c.a. MEUR 11,1. The subject of the largest of these agreements, valued at MEUR 3,1, consists in delivery of boiler pressure parts for the needs of Eldorado Project (Brazil);
- h. Signing of an agreement with PGE Mining and Conventional Power Generation S.A. – Belchatów Power Plant Branch for modernisation and overhaul of rotary air preheaters complete with auxiliary systems for units no. 7 - 12 in Belchatów Power Plant. The value of this agreement amounts to MPLN 120. The agreement was signed in January 2011;
- i. Signing of the agreement valued at MPLN 23,9 with „Kozienice” S.A. Power Plant for replacement of an electrostatic precipitator of a Unit no. 4 in Kozienice Power Plant. The agreement was signed in March 2011;
- j. Signing of an agreement with MARTIN GmbH (with its official seat in Munich) for the amount of c.a. MEUR 18,5. The subject of the agreement consists in manufacture of boiler pressure elements for municipal waste incineration boiler complete with auxiliary equipment, manufacture and delivery of steel structures, erection and start-up of a plant located in Roskilde (Denmark). The agreement was signed in March 2011;
- k. Receipt of a notification from EUAS – Ankara (Turkey) of a selection of the offer submitted by a Consortium RAFAKO S.A. - EFOR Makina, for modernisation of electrostatic precipitators of Units no. 3 and 4 in SOMA Combined Heat and Power Plant (Turkey), as the best one. The value of said offer amounts to c.a. MPLN 53,2 including the RAFAKO S.A. share amounting to c.a. MPLN 18,8. The notification was received in March 2011.



## **2. Within the field of other major events (agreements)**

- a. Ruling of a Supreme Court of Ukraine, which, upon the analysis of an appeal claim submitted by the Company on March 2<sup>nd</sup> 2010, decided to maintain the validity of a ruling issued by Donetsk Economic Appeal Court dated December 23<sup>rd</sup>, 2008 assigning to RAFAKO S.A. - as liquidated damages, interests for delay, judicial costs and legal representation costs - the total amount of 56,74 million of Hryvna equivalent to (as per the date of submittal of a relevant suit) c.a. MUSD 11,5. Due to the uncertainties concerning the enforcement of said amount, RAFAKO S.A. did not take this amount into account in the revenues;
- b. Decision taken by a General Meeting of Shareholders of RAFAKO S.A. on July 15<sup>th</sup> 2010 concerning the payment of a dividend from profit generated in 2009 amounting to TPLN 20 880, i.e. PLN 0,30 per one share;
- c. State's Treasury decided to discontinue the negotiations conducted with RAFAKO S.A. and to close - without finalising - the process of privatisation of the companies: Lignite Mine Adamów S.A.; Lignite Mine Konin S.A. and Pątnów-Adamów-Konin S.A. Group of Power Plants;
- d. Conclusion of several agreements with Energomontaż-Północ Belchatów Sp. z o.o. (Contractor) for the total amount of c.a. MPLN 66,4. The largest of these agreements valued at c.a. MPLN 28,7 was signed on September 3<sup>rd</sup>. 2010. Its subject consists in delivery and erection of absorber and flue gas fan complete with support structures for flue gas desulphurisation plant in PGE Mining and Conventional Power Generation S.A., Belchatów Power Plant Branch;
- e. Conclusion (within the period of 12 months - from March 2010 till March 2011) of several agreements with Elektrobudowa S.A. (Contractor) for the total amount of c.a. MPLN 41,6. The largest of these agreements valued at c.a. MPLN 27,5 was signed on March 15<sup>th</sup> 2011. Its subject consists in delivery, erection and start-up, on a turnkey basis, of the electrical part for FGD plants of Units no. 1 and 2 in PGE GiEK S.A. Belchatów S.A. Power Plant Branch;
- f. Establishment and registration, on March 2<sup>nd</sup> 2011, of a subsidiary named RAFAKO Hungary Kft. with its official seat in Budapest. The initial capital of this subsidiary amounts to MHUF 40 and was totally acquired by RAFAKO S.A. The company shall conduct its business activities within the field of erection of equipment for power generation sector and for chemical industry;
- g. On March 7<sup>th</sup> 2011, the Supervisory Board of RAFAKO S.A. decided to increase the number of Members of Company's Management Board to four (4) persons and to assign, beginning with March 7<sup>th</sup> 2011, Mr. Maciej Kaczorowski as a Vice-President of Company's Management Board.

Co-operation agreements concluded in 2010 and having the major importance for Company's activities also include, apart from those listed in Chapter III, item 1 and 2, the insurance agreements.

*The list of insurance agreements valid as per December 31<sup>st</sup> 2010 is shown in attachment no. 5.*

Information concerning the agreement concluded with the entity entitled to perform the auditing of financial statements is shown in item 39 of additional information to Company's financial statement.

### **3. Research & development and quality-related events**

Major research and development programmes and quality-related events completed in 2010 include:

- a. execution of examinations and elaborations aimed at gaining the independence within the field of designing of wet lime method FGD plants;
- b. examinations of the effect of high-frequency generator manufactured by Sames on the efficiency of dust removal process;
- c. determination of the quantitative effect of the increase of electrodes pitch on the efficiency of dust removal process;
- d. analysis and optimisation of stress concentration areas in pressure vessels subject to changeable mechanical loads;
- e. elaboration of software for balancing of flue gas desulphurisation plants;
- f. examination of operational parameters of FGD Skawina in view of updating of calculation model for semi-dry flue gas desulphurisation technology and the application thereof in TPO plants;
- g. examinations and evaluation of a biomass-derived fuel for Ohz 201 boiler;
- h. examination of the effect of the extent of plastic forming of a flat bar and type of filler metal on the properties of membrane wall elements made of 7CrMoVTiB10-10 material grade;
- i. examination of the effect of welding heat on the properties of a flat bar made of 7CrMoVTiB10-10 material grade;
- j. anti-corrosion analysis of butt weld joints of tubes and membrane walls made of 7CrMoVTiB10-10 material grade;
- k. extension of the possibilities of welding with TIP-TIG method (new equipment - process testing);
- l. anti-corrosion protection of elements of internal equipment of electrostatic precipitators.

RAFAKO S.A. maintains a close and continuous co-operation with scientific sector and especially with Wrocław Technical University, Silesian Technical University, Cracow Technical University, Institute of Ferrous Metallurgy, Welding Institute.

The year of 2010 saw the commencement of a strategic research project named „Advanced energy generation technologies” including the activities carried out by RAFAKO S.A. and by leading scientific institutes in Poland. The programme was initiated at the order of National Research and Development Centre in order to elaborate the technology for highly-efficient, „zero-emission” coal-fired power-generating units combined with CO<sub>2</sub> capture from flue gas.

### **4. Major tasks within the field of management and IT technologies**

RAFAKO S.A. has implemented ERP class (BAAN) system, communication system (Lotus Notes) and CAD (Microstation) integrated at the level of basic business items (customer, project, supplier). Said systems enable us to perform the whole series of thorough analyses and creation of reliable databases supporting the decision-making process.

In 2010, the ERP business model was modified as a result of establishment of a new Division of Electrostatic Precipitators. Integration of separate logistics was implemented in RAFAKO finance model.

In 2010, RAFAKO S.A. didn't implement any major changes within the principles of Company Management.

The Company did not initiate the employees' shareholding programmes.

In conjunction with the contract signed in November 2007 with Elektrik Uretim A.S. from Turkey for „turnkey” modernisation of two (2) boilers in Yenikoy Power Plant as well as for the needs related with future contracts on this market, the Company has established the Branch Office in Turkey, in 2008.

## **5. Disputes , court and arbitration proceedings, administrative proceedings**

The Company does not participate in court proceedings, arbitration or administrative proceedings with the value exceeding 10% of Company's capital. Important disputes and court proceedings are described in item 36.3. of additional information to Company's financial statement.

## **6. Remaining information**

Declaration of corporate order policy applied by RAFAKO S.A. in 2010 is included in the attachment no. 7.

Information concerning the salaries, awards and other benefits for management and supervisory personnel is given in explanatory note no. 38.6 to Company's financial statement.

The company has signed an agreement with each member of management staff. These individual agreements govern the issues related with compensation for termination of employment contract or resigning of a given person from the function and title.

The quantity of RAFAKO S.A. shares owned by management and supervisory personnel as well as the number of shares in entities related with RAFAKO S.A. owned by management and supervisory personnel is indicated in item 38.5 of additional information to Company's financial statement.

The Company is not aware of the agreements that may result, in future, in changing of proportions of shares owned by the existing shareholders.

## **IV. Company's development prospects for 2011**

The year of 2010 brought the improvement of global economic tendencies. It may also be observed in electric energy generation and consumption. Electric energy generated in the first half of 2010 in OECD countries has reached the level of 5 003,3 TWh. When compared with the first half of 2009, energy generation saw the increase of 3,2%. The highest growth (15,7%) is related with the sector of energy generated on the basis of renewable energy resources.

The factors that shaped the economic situation in Polish power generation sector in 2010 and shall continue to affect the investment decision-making in 2011 and in subsequent years include:

- increased electric energy generation and consumption as a result of economic revival;
- changes in power generation structure concerning especially the extent of use of hard coal as a fuel;
- increase in import of hard coal;
- visible decrease of electric energy wholesale prices;
- increase in prices of energy distribution services;
- lower financial results (when compared with the previous year) achieved by electric energy generating companies.

Economic revival in the environment of Poland resulted in increasing of fuel and power consumption. In the context of Polish commitments concerning the generation of electric power on the basis of renewable energy resources we may observe a highly dynamic increase of power generation share generated by wind turbines and as a result of co-firing of biomass in utilities.

Polish and foreign operators active in Poland are currently facing the necessity to restore and develop the power-generating infrastructure and to take the strategic decision concerning the selection of technologies for further investment. These choices have to be made on the grounds climatic & power-generation package (also known as "3 x 20") that entered into force in December 2008. We are witnessing the implementation of increasingly stringent emission standards and gradual reduction of a share of coal in power generation. It is a dominant and continuing tendency in Europe. Changing European regulations may be seen as a considerable risk factor in power-generating companies' development strategies.

### **Emission regulations resulting from European Union legislation**

In accordance with the legislation of European Union including a so called „climatic & power-generation package” investment decisions shall be taken bearing in mind the increasingly severe environmental requirements. The most important regulations are set forth in the following documents:

- IED Directive (Industrial Emissions Directive) concerning the industrial emissions;
- Polish Energy Policy till 2030;
- European Directive 2009/28/EC concerning the activities promoting the use of renewable resources in power generation;
- European Directive 2009/29/EC governing the principles of greenhouse gases emission trading system in European Union;
- European Directive 2009/31/EC concerning the geological storage of carbon dioxide;
- Decision 2009/406/EC aimed at reduction of emission of gases from the sources, which are not subject to emission trading system.

Works on a new industrial emissions directive (IED) meant to replace the IPPC Directive are completed. Proposed regulations practically exclude the combustion of coal in boilers, which are not equipped with desulphurisation, nitric oxides removal and highly efficient dust removal systems. Proposed implementation thereof already in 2016 creates a perspective of extensive modernisation or replacement of virtually every coal-fired boiler. In Poland, the emission limits set forth for sulphur oxides, nitric oxides and particulate matter result from international commitments being the basis for local emission standards for fuel combustion plants and local limits for individual pollutants. Forecasts elaborated for the needs of Polish Energy Policy didn't take into account the restrictions originating from Industrial Emissions Directive adopted by EU, which shall enter into force in 2016. The provisions of said directive stipulate that the sources having the output higher than 50 MW shall not be able to use coal as a fuel without highly efficient desulphurisation, nitric oxides and dust removal systems. This shall create the necessity to install, in all coal-fired heating plants, combined heat and power plants and power plants, of highly efficient wet-method flue gas desulphurisation plants, secondary NOx removal systems and bag filters or electrostatic precipitators.

Polish Energy Policy till 2030 assumes that „coal shall be used as the main fuel in electric power generation in order to assure the appropriate energy supply safety for the country”. The question remains whether it is feasible taking into account the current restrictions resulting from the energy policy adopted by European Union setting the considerable reduction of carbon dioxide emissions as a priority. Reduction of coal share in electric energy generation shall take place as a result of intensification of use of renewable energy resources, natural gas (to a certain extent) and, after 2020, the nuclear power plants appearing within the system. In terms of renewable energy resources the priorities are set as follows: biomass (more than six times increase in 2030 when compared with 2006), wind energy (70 times increase) and biogas (33 times increase). It is also necessary to take the actions leading to considerable increase of share of co-generation of electric power and heat. The development of co-generation and low-emissions power generation technologies is one of the priorities of aforementioned Polish Energy Policy.

The most radical changes in European Greenhouse Gases Emission Permit Trading System implemented with a Directive include: elimination of national permit assignment plans and introduction of one emission ceiling, at the community level, valid for all member countries. This limit shall be subject to linear decrease in subsequent years (annual reduction of 1,74%) starting from 2013, thus assuring the 21% reduction in 2020 when compared with the emissions declared in 2005. The level achieved in mid-period from 2008 to 2012 shall be adopted as a starting basis. Starting from 2013, European Commission intends to implement a system, in which the emission permits needed for electric power generation shall only be sold on auctions. In case of „electric power generation sector and CO<sub>2</sub> capture and storage sector” 100% auctioning of emission permits is foreseen already in 2013 (due to the easy transfer of costs to the final customer and lack of foreign competition). Other sectors, including the heat generation, shall see the departure from free-of-charge distribution of 80% emission permits (considered as a basis) and transfer to elimination of free-of-charge permits, in 2020. In case of power-generating plants co-generating the heat, the system stipulating the free-of-charge emission permits for heat-related part of emissions shall be maintained (within the framework of highly efficient co-generation plants compatible with the provisions of a Directive no. 2004/8/EC).

Electric power generation in Poland is based on combustion of coal thus making the country especially vulnerable to the effect of universal auctioning system. Estimated emission potential related with Polish power generation sector amounts to, in terms of CO<sub>2</sub>, c.a. 1 000 kg/MWh. For comparison - in France - the same indicator oscillates around 70 kg/MWh and in Germany, it ranges from 300 to 400 kg/MWh. The auctioning system shall thus strongly affect the costs of electric power generation in Poland. Its effect shall be more than ten times bigger than in France and more than two times stronger than in Germany. This danger, perceived not only in Poland, triggered the commencement of negotiations initiated by the "coal block" countries in order to mitigate the restrictions set forth in the auctioning system with regard to the starting level. As a result of said talks, the European Council decided to apply a derogation for power generation sector concerning the obligation of purchasing the emission permits within the auctioning system. Originally, in 2013, 30% of permits were to be sold within the auctioning system with the annual increase of 10%, i.e. to 100% in 2020. Derogations are only valid for the plants functioning before December 31<sup>st</sup> 2008 and the new plants with investment process "physically commenced" before this date.

### **Investment plans of power generation sector**

In 2010, the power generation market saw a visible revival. The data collected by PSE Operator demonstrate that 48 big and small power generation companies applied for connection to National Transmission Grid for a total power output nearing 25 000 MW. Investment plans are being developed by both, giant international players and smaller companies.

CCS plant (CO<sub>2</sub> capture and storage system) in Belchatów Power Plant is due to commence the operation in 2015. PGE announces subsequent large investments in power-generating units in Opole and Turów as well as in combined-cycle unit in Dolna Odra. Opole Power Plant prepares a project consisting in construction of 800 - 900 MW power-generating units with planned takeover to operation in 2015. Turów Power Plant plans to commence the operation of Unit no. 11 (460 MW) in 2016. The strategy adopted by PGE also includes the initiation of nuclear plants construction programme in Poland.

On January 13<sup>th</sup>, 2009, Polish Government has enacted a package of activities supporting the development of nuclear power generation and has assigned a Governmental Plenipotentiary for Polish Nuclear Power Generation Program thus triggering the commencement of related works. PGE Group was appointed by the government as a main contractor of this investment. PGE has performed the analysis of a possibility of construction of two nuclear power plants with preliminarily set output of 3 000 MW each. It is estimated that the first power-generating unit shall be put into operation till the end of 2020 - 2022 and the subsequent ones after two - three more years. PGE intends to introduce to the national power generation system, till 2030, 6 000 MW originating from nuclear power plants. PGE (Polska Grupa Energetyczna) shall also act as a main shareholder of a nuclear power plant (51 percent of shares in related investment).

Another strategic goal set forth by PGE Group consists in development of capacities based on renewable energy resources. PGE Group foresees that in 2012 c.a. 3,5 TWh shall be generated annually on the basis of „green" sources. In 2025, this value shall reach the level of 11,9 TWh. Moreover, the investment program prepared by PGE includes a number of modernisation & capacity restoration investments within the field of both conventional and renewable power. PGE Group generating capacities require a number of modernisation works aimed at optimisation of the existing plants.

Other local power generation companies also prepare the investments in new power-generating units. Tauron shall continue to invest in coal-fired units but shall also diversify its capacities with biomass-fired plants and wind turbines. Gdańsk-based Energa intends to invest in both coal-fired (Ostrolęka 1000 MW meant as its last coal-fired power plant) and gas-fired (Grudziądz, location of the largest Polish gas-fired power plant) capacities. Energa intends to construct the new capacities in co-operation with the Irish company ESB International. The decisions concerning the individual investments shall only be taken after the privatisation of the company. Both current management board and the ESBI representatives hope that the new owner would not abandon the construction of a gas-fired power plant in Grudziądz.

Within the coming years, a considerable part of existing coal-based electric power and heat-generating capacities - obsolete and high-emission ones - shall have to be decommissioned or subject to extensive modernisation. Power generation infrastructure is becoming old and incompatible with currently applicable environment protection standards. Therefore, numerous investment plans are related with decommissioning of the units unable to meet the emission standards. Bearing all this in mind, Polish power generation sector shall be prepared for construction of numerous new units.

Nuclear power generation offers RAFAKO S.A. a chance to become involved in construction of nuclear power plant in Poland. Implementation of nuclear power programme is compatible with long-term Company development strategy and intensification of new activities. It is worth mentioning that the Company has already manufactured the elements of nuclear power plants such as: pressure stabilisers, piping systems and fittings.

As a reply to the problems of missing generating capacities, environmental constraints and insufficient availability of energy carriers, the strategy developed by RAFAKO S.A. offers highly-efficient power generation and environment protection equipment.

The year of 2010 shall see the continuing activities of RAFAKO S.A. promoting the supercritical boilers, circulating fluidised bed boilers, heat recovery steam generators (including those operated in conjunction with gas turbines), boiler and boiler equipment diagnostics, modernisation and repairs.

The necessity to adapt increasingly stringent European environment protection norms and standards makes RAFAKO S.A. continuously active on environment protection equipment market with its technologies of flue gas desulphurisation plants, municipal and industrial waste incineration plants, biomass-fired boilers, boiler modernisation aimed at reduction of nitric oxides emission and dust removal equipment.

In 2011, the factors of utmost importance for Company's development and prospects shall include: participation in call for tenders for construction of power-generating units for supercritical steam parameters, execution of a large number of important contracts on both domestic and European markets including the construction of state-of-the-art boilers, flue gas desulphurisation plants, nitric oxides removal systems, biomass-fired boilers, industrial and municipal waste incineration plants as well as boiler pressure parts. The development of our Company and the future portfolio of orders shall also be supported by such factors as: license for designing and manufacture of Benson-type boilers for supercritical steam parameters acquired in 2008, license for catalytic nitric oxides removal system acquired in 2009 and the letter of intent concerning the construction of power-generating units for supercritical steam parameters signed with Siemens. All aforementioned factors affect the overall offer of the Company in terms of offering of turnkey plants.

The investment expenditure planned for 2011 shall be mainly focused on acquisition of manufacturing machines and equipment, computer software and hardware as well as further modernisation of buildings and structures.

Planned investment shall generally be financed from Company's own sources including the ones originating from the issuance of I series shares carried out in 2007. Use of specific investment credits is not foreseen. Part of investment expenditure may be used in form of leasing.

RAFAKO S.A. activity forecast for 2011 predicts the achievement of a positive net financial result. These plans are based on planned execution of already signed contracts, which account for a considerable part of forecasted sales volume and on purchase orders, which have to be secured by the Company till the end of 2011 in order to fully meet the planned values.

## Declaration of Management Board

RAFAKO S.A. Management Board declares that:

- 1) to our best knowledge, the financial statement for the year ended on December 31<sup>st</sup> 2009 as well as comparable financial data for the year ended on December 31<sup>st</sup> 2008 are elaborated in accordance with applicable accounting principles and fairly, clearly and truly reflect the Company's capital and financial standing as well as the Company's result; RAFAKO S.A. business report contains a true description of Company's standing, achievements and status including the description of principal risks and dangers;
- 2) the entity authorised to perform the auditing of financial statements, dealing with this annual financial report, was selected in accordance with applicable legal regulations; this entity as well as expert auditors carrying out the audit have met the conditions required for issuance of independent and impartial opinion concerning the audited annual financial report in accordance with applicable professional norms and regulations.

Signatures of members of Management Board

March 21 <sup>st</sup> 2011	Wiesław Różacki	President of Management Board	.....
March 21 <sup>st</sup> 2011	Krzysztof Burek	Vice-president of Management Board	.....
March 21 <sup>st</sup> 2011	Maciej Kaczorowski	Vice-president of Management Board	.....
March 21 <sup>st</sup> 2011	Piotr Wawrzynowicz	Member of Supervisory Board temporarily appointed to perform the functions of a Member of Management Board	.....