Implementation plan of new cost reduction program in the PKN ORLEN Capital Group

Igor Chalupec, CEO

Jan Maciejewicz, SVP Cost Management and IT

July 7th, 2005

Implementation of new cost reduction program OPTIMA will allow PKN ORLEN to gain a leading regional position in terms of efficiency and internal management

PKN ORLEN S.A. mission statement

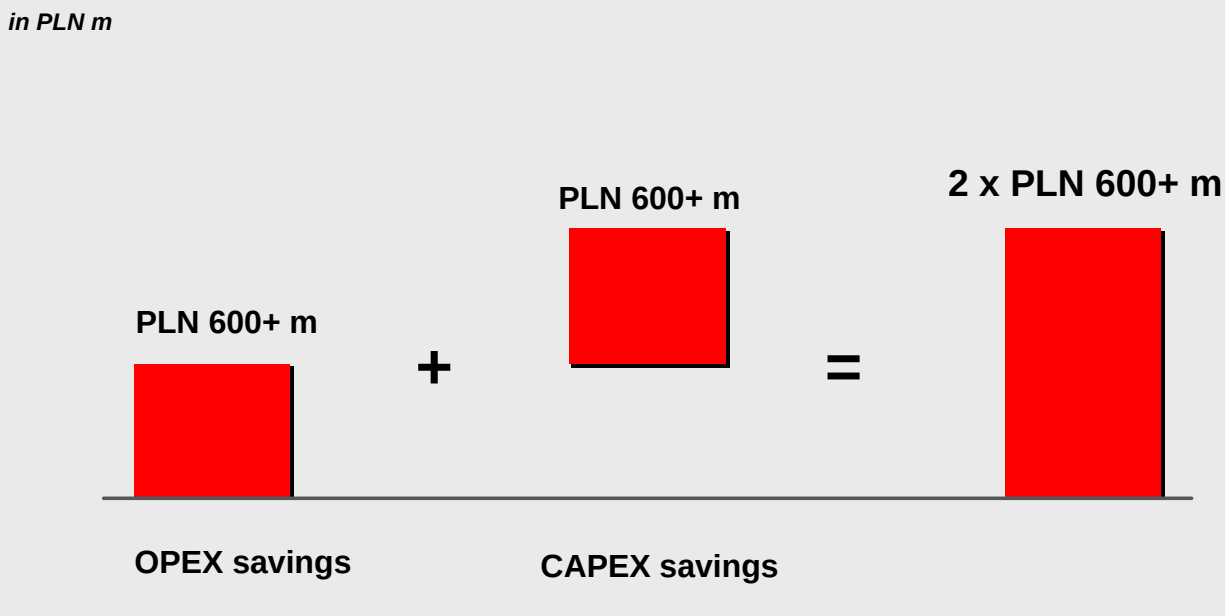
"In the pursuit of regional leadership we strive to deliver long-term growth in shareholder value" (…)

Cost reduction program

"Improvement of the company's cost and investment efficiency is the key element of PKN ORLEN strategy. Our ambition is to achieve best-in-class efficiency and performance."

Program OPTIMA is a long-term plan aimed at unlocking further OPEX and CAPEX savings at PKN ORLEN Capital Group

New compound Program OPTIMA → **„2 x PLN 600+ m of savings”[1]**



1) To be achieved by year 2009 r. within PKN ORLEN Capital Group

Further OPEX and CAPEX savings will be accomplished through extension of the efficiency improvements to the Capital Group as well as improvements to cost control and procurement processes

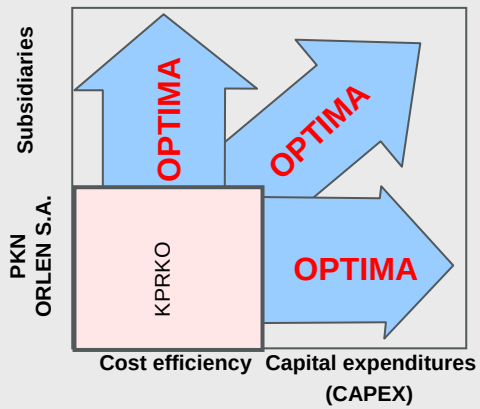
New program OPTIMA is an element of PKN ORLEN S.A. strategy

Continuation of cost cutting efforts along the entire value chain

- **Management's commitment to deliver by the end of 2005 a sustainable reduction in operating cost by PLN 800 m resulting from the current cost cutting program**
- **Preparation of the launch of the new cost cutting program, which is to address:**
  - Centralization of procurement
  - Efficiency improvement of production assets
  - Cost reduction in the retail network
  - Establishing shared services centres for companies of the PKN ORLEN Group.

OPTIMA goes beyond the scope of the previous program (KPRKO[1]):

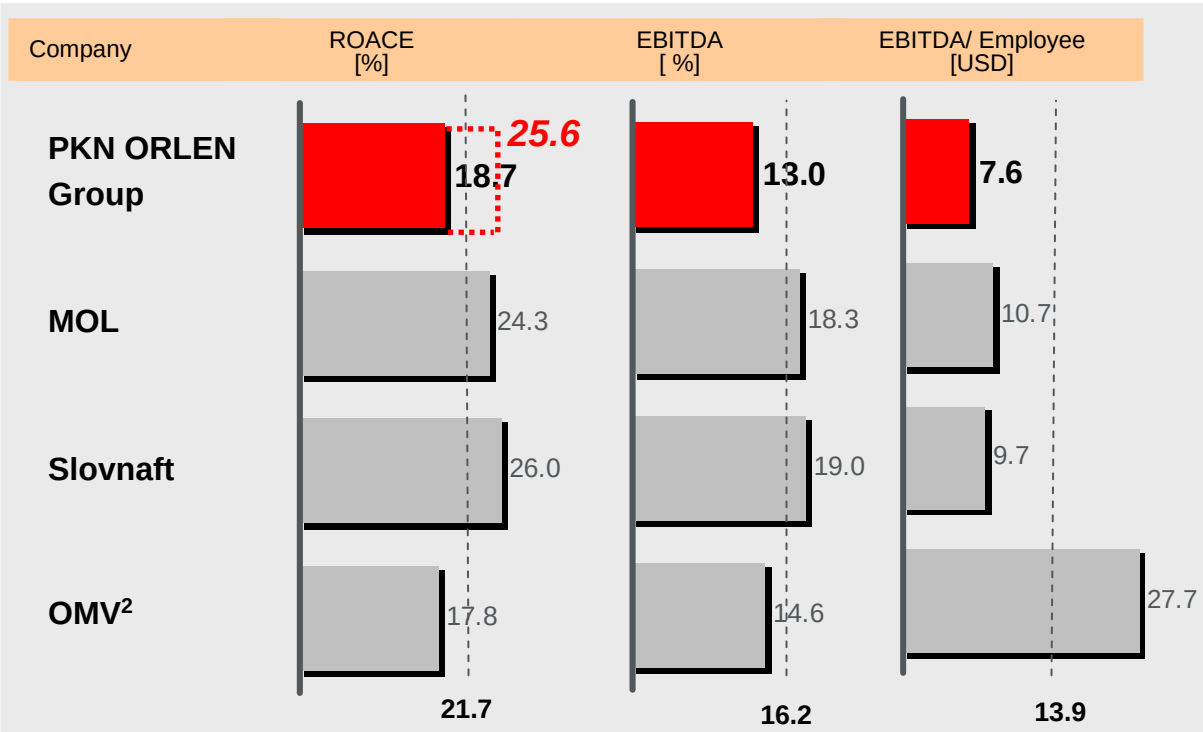
- **Objective "2 x PLN 600+ m by 2009" is a driver for reaching the target ROACE[2] >17.5%.**
- **Broad range of activities in entirely new areas[3]:**
  - Cost savings in subsidiaries of PKN ORLEN
  - Optimisation of capital expenditures



1) KPRKO Program – launched in 2003, full year effect of the program is 800 m PLN of sustainable cost savings form 2005 on.
2) ROACE = NOPAT / average (equity + net debt)
3) Unipetrol shall be encompassed by OPTIMA Program, although is not included in calculation of the target „2 x 600+ m PLN". OPTIMA Program does not cover the Margins Optimisation project.

Implementation of new cost savings program OPTIMA will ensure PKN Orlen's leadership in efficiency.

By 2004 PKN ORLEN reached lower levels of efficiency versus its oil&gas Central European peers



Conclusions

- **New cost reduction Program by PLN 600+ m will substantially enhance PKN ORLEN's efficiency, as compared to its peers[1]**

1) Assuming the 2004 level of capital employed and unchanged performance of the „best-in-class" companies
2) Excluding Petrom

Agenda

PKN ORLEN today – current cost savings program

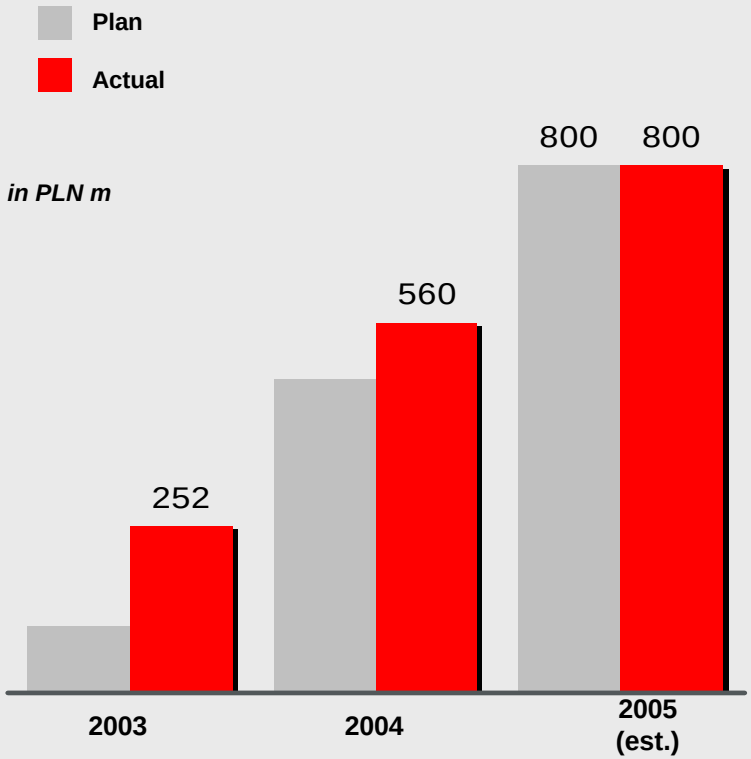
New cost savings program OPTIMA

- **Further improvements of cost efficiency**
- **CAPEX savings**

Summary

The on-going cost-cutting program (KPRKO) yields tangible and sustainable results

Cost reduction effects of the KPRKO program (net)



Key facts about the current cost-cutting program

- Cost savings objectives defined in a top-down manner
- Spontaneous generation of 340 initiatives to deliver required cost savings effects
- Planned net effect of PLN 800 m shall be delivered despite increase in other costs (not included in the Program) by PLN 130 m (incl. PLN 100 m in employment costs)
- 2004: last year of implementation of cost cutting initiatives
- 2005: full year effects of initiatives shall yield the planned cost reduction by PLN 800 m

- 2005: cost saving initiatives implemented shall be part of new Program OPTIMA
- 2006-2009: expected reduction effects of the new Program

Agenda

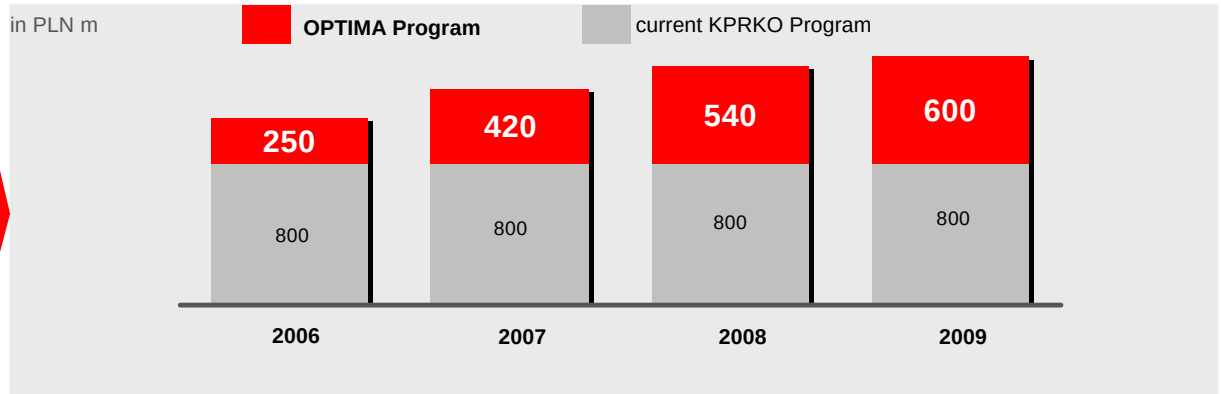
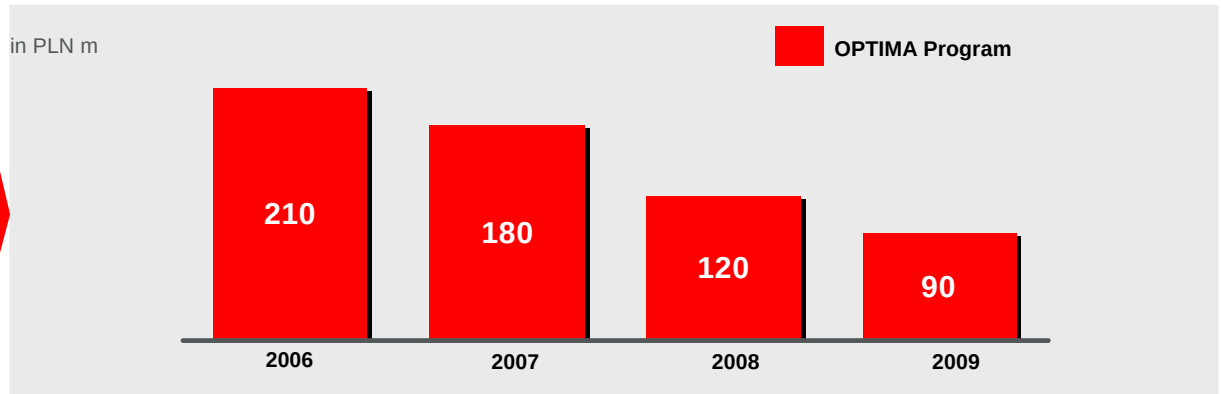
PKN ORLEN today – current cost savings program

New cost savings program OPTIMA

- Further improvements in cost efficiency
- CAPEX savings

Summary

OPTIMA Program is a long-term initiative with a direct positive impact on investment as well as operating cash flows, in addition to the effects of the current cost savings program

Strategic objective	Effects in years 2006-2009 – „2 x PLN 600+ m”
OPEX savings (over the current KPRKO Program)[1]	
CAPEX savings[2]	

1) Completion of the initiatives to be implemented according to schedule
2) Recurring CAPEX savings: 20-25% in 2006-2009. Non-recurring CAPEX savings: 10% in 2006, 15-20% in 2007-2009

OPTIMA shall contribute to significant improvement in performance vs. 2004 and enhance the financial standing as compared to the regional competition

Summary of OPTIMA objectives

- **Significant improvement of operating performance in PKN ORLEN Group owing to:**
  - **Optimisation of cost efficiency of key processes**
  - **CAPEX savings owing to improvements to investment processes**

+

Areas of improvement

- **Operating costs in PKN ORLEN**
- **Operating costs in the subsidiaries of PKN ORLEN**
- **Improvement of supporting activity**
- **Major overhaul of procurement processes**
- **Capital expenditures in PKN ORLEN and subsidiaries**

Tangible effects

- **Delivery of strategic target of ROACE over 17.5% in 2009[1]**
- **Improvement in operational performance:**
  - PLN 600+ m cost savings (2006-2009) on top of the current program (KPRKO)
  - PLN 600+ m CAPEX savings, assuming performance of all the investment projects planned in PKN ORLEN strategy

1) ROACE = NOPAT / average (equity + net debt)

Agenda

PKN ORLEN today – current cost savings program

New cost savings program OPTIMA

- Further improvements in cost efficiency
- CAPEX savings

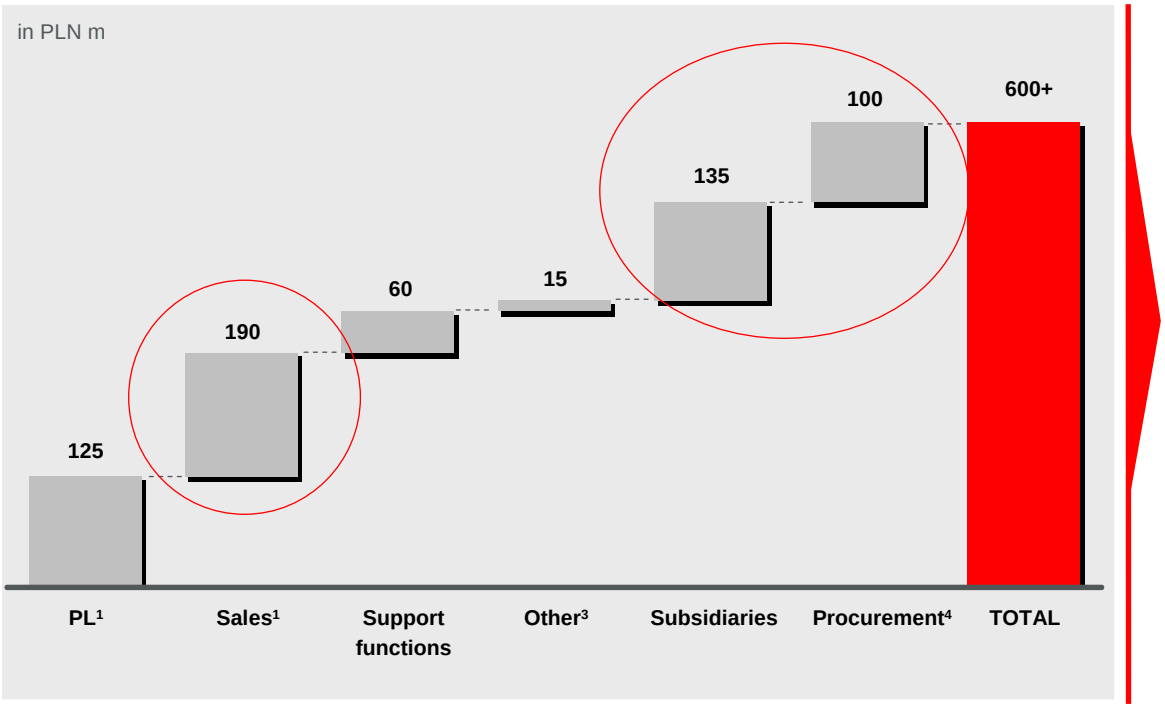
Summary

The is substantial room for further improvement of efficiency at PKN ORLEN

4 key areas of further improvement were identified	Cost saving potential was estimated for each area by an in-depth analysis.
Operating costs in PKN ORLEN	***Refining & Petchems*** • Improvement of energy utilization in production processes • Increased utilization of key production facilities and optimisation of the processes ***Logistics*** • Optimisation of logistics processes and inventories • Optimisation of the network structure ***Retail network*** • Reduction of unit costs as the result of restructuring of the retail network
Operating costs in Subsidiaries of PKN ORLEN	• Launch of cost-saving programs in key subsidiaries • Establishment of centralized shared services functions for key subsidiaries
Employment efficiency	• Organizational improvement and employment optimisation in: ➢ Production ➢ Logistics support functions ➢ Support functions of PKN ORLEN ➢ Selected support functions in subsidiaries
Procurement processes	• Optimisation of the procurement processes in Capital Group ➢ Economies of scales in the improvement of the purchasing position

Estimated potential for cost reduction exceeds PLN 600 m by 2009 and covers the entire Capital Group

OPTIMA addresses new areas of improvement in the business units, subsidiaries, as well as within the framework of the procurement improvement program.



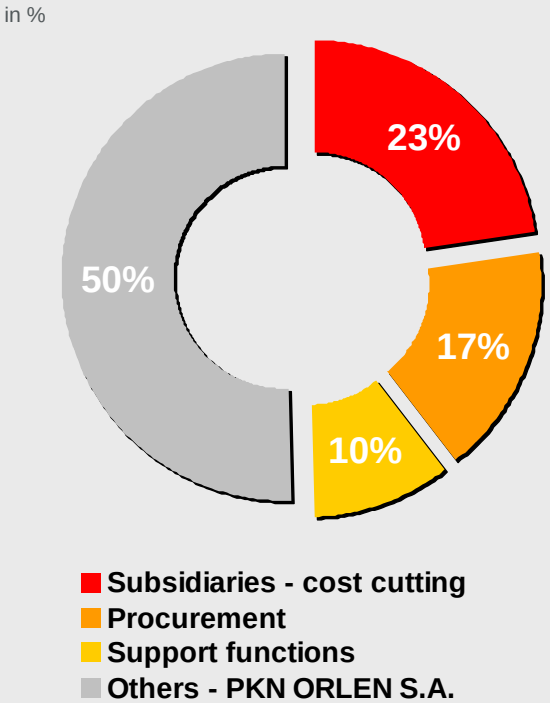
- **Cost saving potential of each area are to be further revised**
- **New Cost Management Department will have a defining role in the realization of the new initiatives. It will also support operational activity of other departments.**

1) PL – Production & Logistics
2) Planned restructuring of the retail network to reduce fixed cost per station and variable unit costs per 1l
3) E.g. marketing, PR, administration etc.
4) Estimated cost savings due to the procurement improvement program „BONUS”

OPTIMA shall address new areas of improvement such as: subsidiaries, procurement processes and support functions in the PKN ORLEN Group

These new areas of improvement within the PKN ORLEN Capital Group shall constitute over 50% of cost savings in Capital Group identified within the OPTIMA framework

Savings by area



Cost savings in key PKN ORLEN subsidiaries

PLN 135 mln cost savings

- Cost improvements in key subsidiaries
- OPEX savings in production and distribution subsidiaries (e.g. Anwil, southern refineries, ORLEN Oil, and Asfalt, IKS SOLINO)
- Scope of activities to broaden gradually e.g. by encompassing Unipetrol

Centralization and optimisation of procurement processes

PLN 100 mln cost savings

- **A major overhaul of the existing procurement process in PKN ORLEN Capital Group**
- **Enhancement of cooperation with business partners**
- **Improvements in demand management and renegotiation of the business agreements**

Efficiencies in the support functions

PLN 60 mln cost savings

- **Introduction and centralization of the support functions for the companies of the group (Accounting, Admin, HR, IT etc.)**

Agenda

PKN ORLEN today – current cost savings program

New cost savings program OPTIMA

- Further improvements in cost efficiency
- **CAPEX savings**

Summary

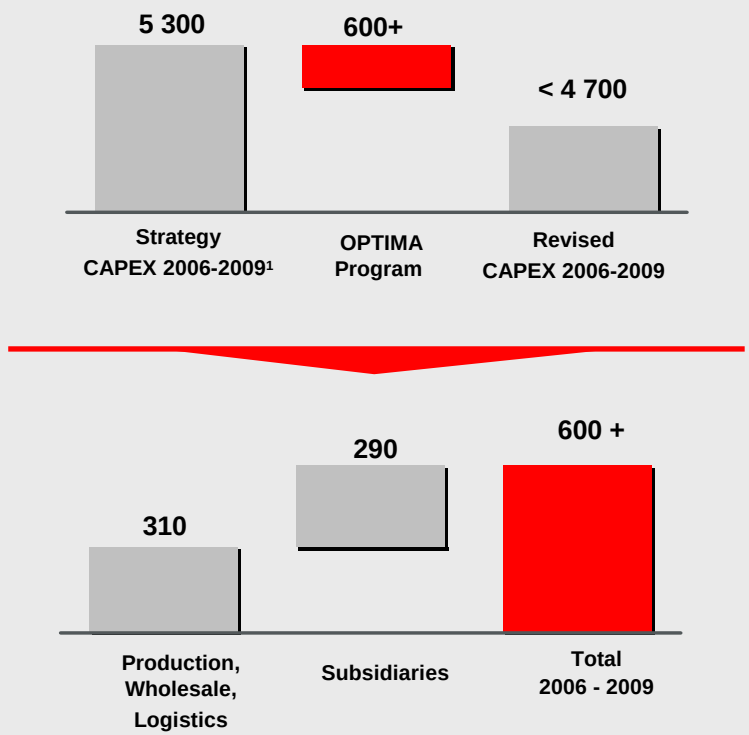
Optimisation potential in CAPEX to amount PLN 600+ m is in line with full investment program for PKN ORLEN Capital Group

Introduction of an improved CAPEX control process

- **CAPEX optimisation in production and logistics facilities**
- **Centralized procurement of investment goods and services**
- **Improvements in investment processes (planning, execution, monitoring)**
  - Differentiation of requirements for various types of investment projects.
  - Intensification usage of the sensitivity analyses and scenarios to optimize the investment assumptions.
  - Stricter approval criteria for investment projects
  - Introduction of various techniques for market-risk assessment.
  - Monitoring of quality of market forecasts and of performance of realised investment projects.

Expected effect of OPTIMA – CAPEX savings vs. planned investment program 2006-2009.

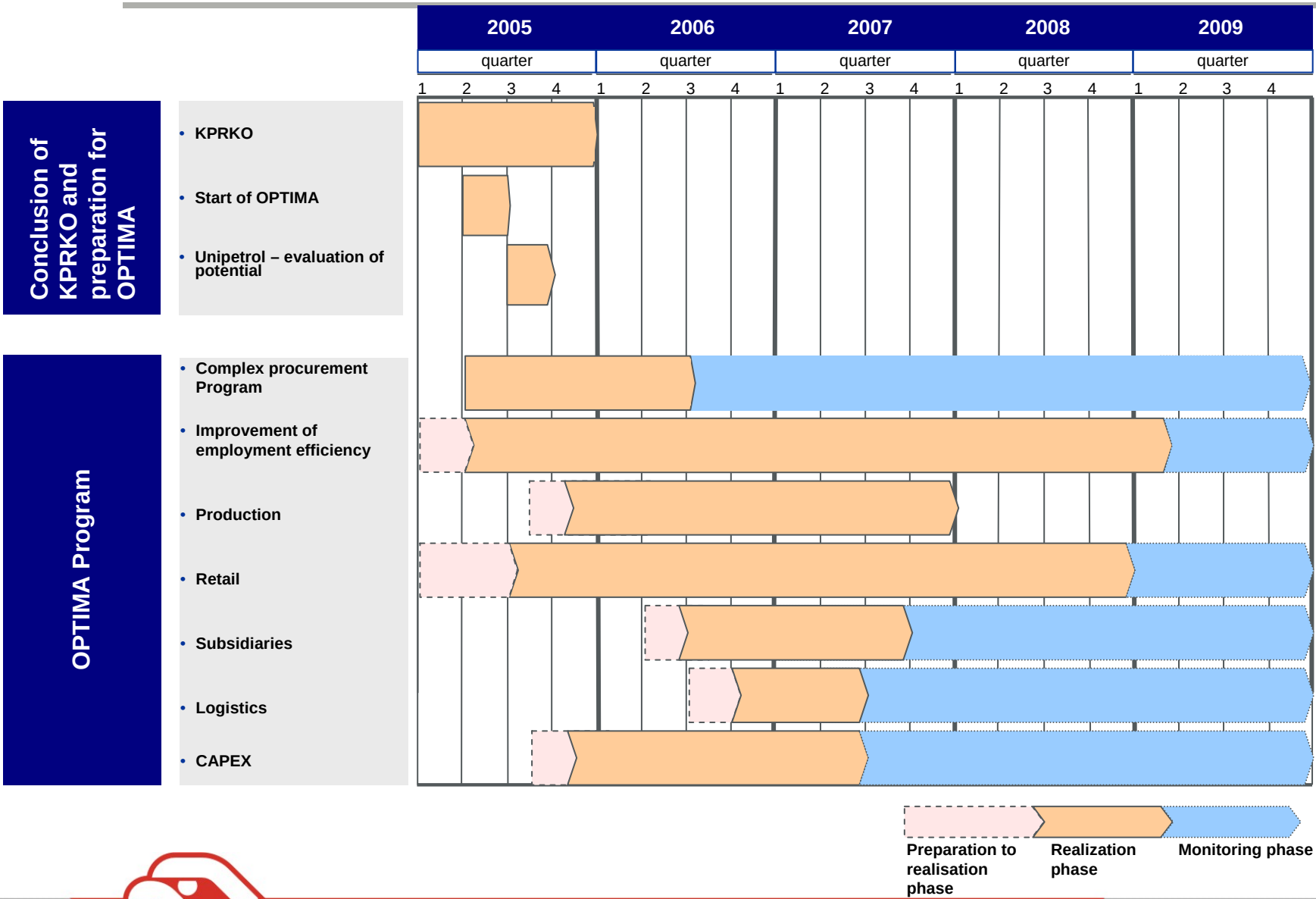
in PLN m



- **Savings assume implementation of all investment projects assumed in the PKN ORLEN Strategy.**

1) The investment plan for years 2006-2009 is in line with the PKN Group strategy
Planned CAPEX methodology for years 2006-2009: PLN 8 700 m (2005-2009 strategy) – PLN 2 400 m (CAPEX in 2005) – PLN 1 000 m (Unipetrol)

Most of OPTIMA activities to be completed by 2007, whereas full effects to be delivered in 2009 will allow PKN ORLEN to get closer to the best-managed companies in the region



Agenda

PKN ORLEN today – current cost savings program

New cost savings program OPTIMA

- Further improvements in cost efficiency
- CAPEX savings

Summary

Objectives of OPTIMA program - 2 x PLN 600 m savings to achieve regional leadership in terms of efficiency and profitability

Strategic objectives	Financial objectives (2006-2009 r.)	Areas of activity	Key initiatives and projects
OPEX savings	**Over PLN 600 m** (over the effects of the current program)	• **Operating costs in PKN ORLEN S.A.**[1]	• **Efficiency of production processes** • **Optimisation of logistics**
		• **Operating costs in subsidiaries**	• **Centralization of support functions for key subsidiaries** • **Complex reduction of expenses**
		• **Supply chain management**	• **Optimisation of organizational structure and best-in-class procurement processes** • **Centralization of procurement in the PKN Group**
		• **Employment efficiency**	• **Headcount optimisation in all areas of operations and in support functions in PKN ORLEN S.A.**
CAPEX savings	**Over PLN 600 m** (relative to CAPEX plan 2006-2009)	• **Investment planning and implementation**	• **Implementation of separate investment requirements criteria for regulatory and expansion investments**[2] • **Centralization of procurement of investment goods and services.** • **Stricter acceptance criteria for new projects through restrictive evaluation of the risks involved**

1) Refers to production, logistics, retail and support functions of PKN ORLEN S.A.
2) Regulatory investments refer to legal requirements, such as environmental restrictions, etc. Expansion investments aimed at maximum value enhancing to shareholders.

Disclaimer

This strategy presentation (the "**Presentation**") has been prepared by PKN ORLEN (the "**Company**"). Neither this Presentation nor any copy of it may be reproduced, redistributed or passed on, directly or indirectly, to any person for any purpose. The distribution of this Presentation in other jurisdictions may be restricted by law and persons into whose possession this Presentation comes should inform themselves about, and observe, any such restrictions. Any failure to comply with these restrictions may constitute a violation of applicable laws.

It is not the purpose of this Presentation to provide, and you may not rely on this document as providing, a complete or comprehensive analysis of the Company's financial or commercial position or prospects. A detailed description of the business and financial condition of the Company is set forth in the current and periodic reports to which you are invited to refer. Copies of the current and periodic reports may be obtained at the website of the Company.

This Presentation and the associated slides and discussion contain financial forecasts and other kinds of forward-looking statements. These forward-looking statements may include, but are not limited to, those regarding capital employed, capital expenditure, cash flows, costs, savings, debt, demand, depreciation, disposals, dividends, earnings, efficiency, gearing, growth, improvements, investments, margins, performance, prices, productivity, profits, returns, sales, special and exceptional items, strategy, synergies, tax rates, trends, value, volumes, and the effects of PKN ORLEN merger and acquisition activities.

Such forward-looking statements are not guarantees of future performance. These statements are based on management's current expectations or beliefs and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. These risks, uncertainties, and other factors include, but are not limited to developments in government regulations, foreign exchange rates, crude oil prices, crack spreads, political stability, economic growth, the completion of ongoing transactions. Many of these factors are beyond the Company's ability to control or predict.

Given these and other uncertainties, you are cautioned not to place undue reliance on any of the forward-looking statements contained herein or otherwise. The Company does not undertake, nor does it have, any obligation to provide updates and/or to release publicly any revisions to these forward-looking statements (which speak only as of the date hereof) to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except as may be required under applicable securities laws.

No representation or warranty can be given with respect to the completeness or accuracy of the information in the Presentation. Neither the Company nor its shareholders, subsidiaries, advisors or representatives of such persons shall have any liability whatsoever (in negligence or otherwise) for whatever reason arising from any use of this Presentation or its contents or otherwise arising in connection with this Presentation and nothing in this Presentation shall constitute an undertaking or representation made by the Company, its shareholders, subsidiaries, advisors or representatives of such persons.

This Presentation has been prepared solely for information and discussion purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or instrument or to participate in any trading strategy. This Presentation does not constitute an offer or invitation to purchase or subscribe for any securities in any jurisdiction and no part of it shall form the basis of, or be relied upon in connection with, any contract, commitment or investment decision in relation thereto.

Contact

For more information please contact our

IR Office:

phone: **+ 48 24 365 33 90**
fax: **+ 48 24 365 56 88**
e-mail: **ir@ORLEN.pl**

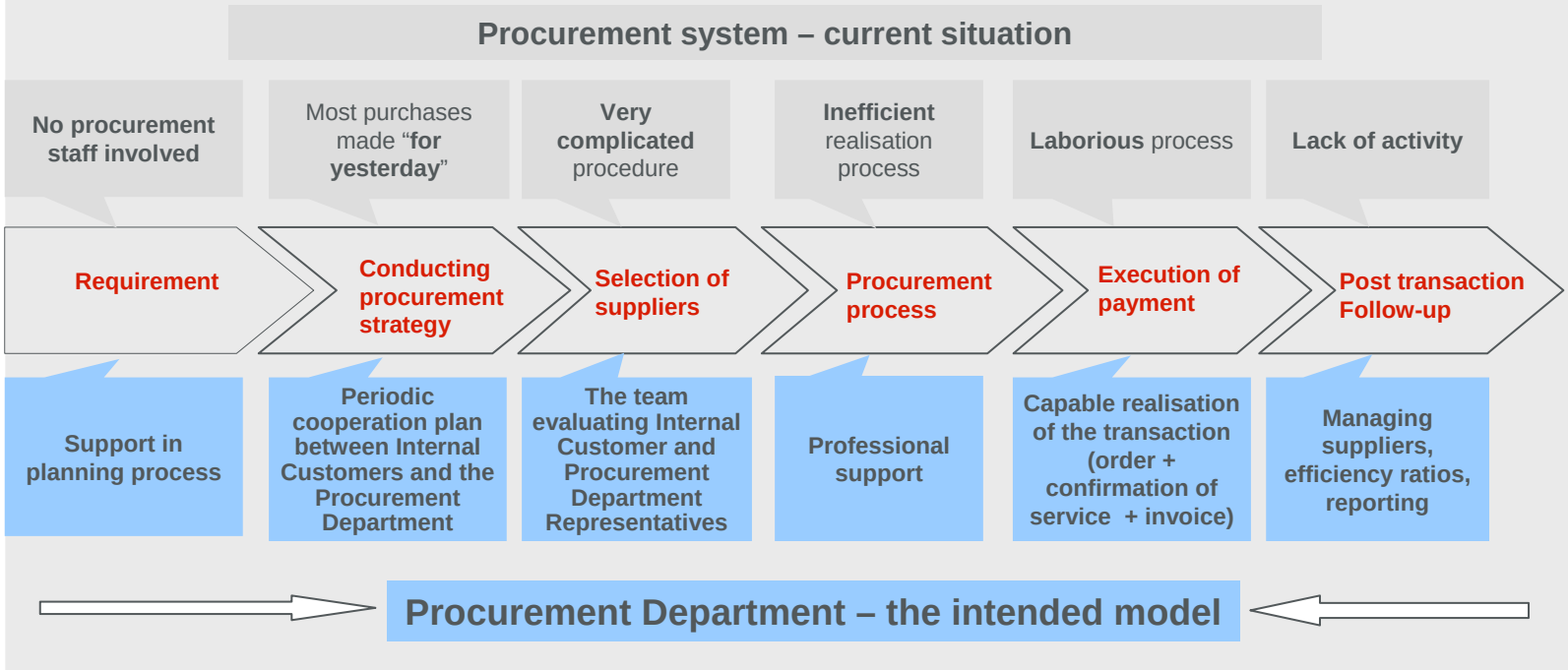
Press Office:

phone: **+ 48 24 365 41 50**
+ 48 22 695 34 57
fax: **+ 48 22 695 35 27**
e-mail: **media@ORLEN.pl**

www.ORLEN.pl

Supporting slides

Strategy update: Efficiency Improvement

Efficiency improvement in the Capital Group – new procurement program

- Cost reduction through purchase process centralization
- New procurement structure supports the preparation of the new cost-cutting program
- New Procurement Office in control of Program objectives