

## **REPORT OF THE SUPERVISORY BOARD OF IZOSTAL S.A.**

**on the results of the assessment of the following documents submitted by the Management Board:**

- **financial statement of Izostal S.A. for 2010**
- **Management Board's report on the Company's activity in 2010**
- **Management Board's motion on appropriation of net profit for 2010, including the assessment of the Company's situation in 2010**

Supervisory Board examined the financial statement of IZOSTAL S.A. for 2010 and analyzed the report and opinion of the chartered auditor - Kancelaria Porad Finansowo-Księgowych dr Piotr Rojek Sp. z o.o. seated in Katowice which examined the Company's financial statement for that period.

Based on the above, the Supervisory Board states that the financial statement of Izostal S.A. for 2010, which includes:

- Introduction to financial statement,
- Statement of financial position prepared as on December 31, 2010 with the amount of PLN 203,466 thou. (say: two hundred three million four hundred and sixty-six thousand zlotys) under assets and liabilities,
- Statement of comprehensive income for the financial year from January 1, 2010 to December 31, 2010, with total income of PLN 7,438 thou. (say: seven million four hundred and thirty-eight thousand zlotys),
- Statement of changes in equity for the financial year from January 1, 2010 to December 31, 2010 showing increase of equity by PLN 69.817 thou. (say: sixty-nine million eight hundred and seventeen thousand zlotys),
- Cash flow statement for the financial year from January 1, 2010 to December 31, 2010, showing an increase in net cash by PLN 39.229 thou. (say: thirty-nine million two hundred and twenty-nine thousand zlotys),
- notes,

was prepared in line with effective accounting regulations, and is compatible with books and documents. The Supervisory Board also states that in view of the above, the business activity, results and the property and financial situation of the Company are shown correctly and reliably.

The Supervisory Board also analyzed in detail the Management Board's report on the Company's activity in 2010 and declared that the presented facts supported with relevant figures reflect the reality, and reliably show the Company's situation in financial year 2010.

Having taken into account the results of the aforementioned analyses, the Supervisory Board passed a resolution requesting the Annual General Meeting to approve the following documents submitted by the Management Board: the financial statement of Izostal S.A. for 2010 and the Management Board's report on the Company's activity in financial year 2010.

Supervisory Board also acquainted itself with a proposal concerning the distribution of net profit for 2010 which, based on a motion filed with the Supervisory Board, the Management Board plans to submit for approval of the Annual General Meeting.

Supervisory Board accepts the Management Board's proposal concerning the appropriation of profit for 2010 in the amount of PLN 7,437,765.11 (say: seven million four hundred and

thirty-seven thousand seven hundred and sixty-five zlotys and 11/100), and allocate it to the Company's spare capital.

Relevant motion of the Management Board and a Supervisory Board resolution will be submitted for approval of the Annual General Meeting.

### **Brief assessment of the Company's situation.**

Supervisory Board is of the opinion that year 2010 may be seen again as a year of development and increase of sales level with implementation of investments being one of key elements of the strategy adopted by Izostal S.A. thanks to which the Company has production and logistic infrastructure necessary for further expansion.

In the reporting period the Company completed the construction of the Anticorrosion Coating Center in Kolonowskie. A production plant with logistic infrastructure was built and is equipped with modern production lines for the production of internal insulation LAYTEC® and coating pipes of diameter of 219mm to 1220mm with external insulation. Thanks to a successful marketing campaign of the new product i.e. internal insulation LAYTEC®, the Company recorded a 145.9% increase of sales volume in case of this assortment as compared to 2009. The Company also obtained a subsidy in the amount of PLN 7.263 thou. from the Ministry of Economy for the construction of the Research and Development Center for steel technologies and projects under the Operational Program Innovative Economy, action 4.5, sub-action 4.5.2.

The issue of 12 million shares of series K also had a considerable impact on the financial results recorded by the Company. The issue price was set at PLN 5.50 per share. In 2010 the Company obtained PLN 62.379 thou. from the issue of shares. Funds credited to the Company's account led to:

- an increase of equity from PLN 51.529 thou. to PLN 121.346 thou.,
- repayment of the overdraft facility of PLN 14.000 thou. and working capital credit in the amount of PLN 8.000 thou.

Supervisory Board declares that the Company consistently follows the strategy adopted and achieves the planned financial income:

- income from sales in the amount of PLN 138.329 thou. i.e. by 53.3% more than in 2009. The increase resulted mostly from the increase in the sales volume of internal insulation LAYTEC® - 124 thou. m<sup>2</sup> of insulation were sold in 2010 against 50 thou. m<sup>2</sup> sold in 2009. The sales of external insulation in 2010 reached the level of 306 thou. m<sup>2</sup> i.e. 11% more than in 2009. Income increase was also the result of export sales (100.7% increase). Share of costs of products, goods and materials sold against income from sales increased slightly from 81.1% in 2009 to 85.2% in 2010, mainly due to the bigger share of goods sold in 2010. The increase of sales costs by 16.2% was related to the value of sales realized. Increase of overheads resulted mainly from costs (depreciation, utilities) related to the warehouse infrastructure handed over for use at the beginning of 2010 in the Anticorrosion Coating Center.

- profit recorded on other operating activity reached PLN 1.356 thou., and resulted mostly from the subsidy obtained (under Operational Program Innovative Economy 4.4) for the construction of Anticorrosion Coating Center, and released revaluation write-offs of receivables;

- as for financial activity, a loss of (-) PLN 2.593 thou. was recorded, it was connected mostly with interest on an investment credit taken out for the construction of the Anticorrosion Coating Center.

While assessing the system of managing risk significant for the Company, the Supervisory Board underlines the indirect dependence of Izostal S.A. from PGNiG S.A. (exploration, utilization, trade and distribution of gas), and company OGP Gaz-System S.A. (operator of the transmission system), as well as from the investments planned and implemented by the above-mentioned companies due to the structure of the Polish market. To minimize risk, Izostal S.A. looks for new sales markets, both in Poland (private gas companies), and abroad. The petrochemical market and co-operation with Euroflow Zrt seated in Erd (Hungary) and Comtech Co S.R.L. seated in Slatina/Olt (Romania) may be used as an example.

Moreover, the Supervisory Board is of the opinion that the Company's financial situation is correlated with macroeconomic situation in Poland. Financial results recorded by the Company are also shaped by general factors such as the pace of GDP growth, pace of investment growth, changes in inflation level, exchange rates, unemployment rate and personal income, as well as fiscal and monetarist policy of the state. There is a threat that if the rate of economic growth slows down in Poland and globally, or if instruments shaping the state's economic policy, that could have a negative impact on the Company's functioning, are used, the financial results recorded may change. Reduction in capital expenditure on economy, slower GDP growth, uncontrolled increase of inflation, more restrictive fiscal and monetary policy of the state may have a particularly negative impact on the activity of IZOSTAL S.A. This risk however is minimized by the strategy of diversifying gas supply sources adopted by Poland, and restrictive regulations in scope of environmental protection and CO2 emission imposed by the European Union. Those factors enforce large investments in the gas and petrochemical sectors in Poland which are an opportunity for the Company to increase the sales of its products. Furthermore, the risk is mitigated by the necessity to utilize aid funds from multiple sources within the deadline prescribed, including among others European Energy Program for Recovery (EEPR, the so-called Recovery Plan), Operational Program Infrastructure and Environment 2007-2013, Trans-European Networks – Energy (TEN-E) Program and Operational Program Innovative Economy.

Profitability of anticorrosion coating services depends on changes in prices of production components required for production, in particular prices of chemical components, mainly polyethylene and polypropylene. The share of those components in the cost structure is around 20%. Prices of chemical raw materials are to a large extent correlated with global oil prices which may change dynamically due to the current political and economic situation.

Cost factors presented above may lead to periodic deterioration of the Company's financial results and the profitability level obtained. To minimize the risk connected with changing price of production components, the Company follows diversification strategy based on co-operation with several entities at each production stage.

The Supervisory Board also assessed the risk connected with changes in the price of pipes with the price of a steel pipe in a product "insulated steel pipe" may, depending on circumstances, constitute even 70% of the value.

High volatility of prices on the steel pipes market has a bearing on the income and margins obtained by the Company. To avoid the risk arising from the volatility of steel pipes prices, the Issuer optimizes stock levels by adjusting them to the scope of activity run.

In special cases steel pipes are purchased for stock at current prices to supplement assortment in volumes making it possible to sell goods and make profit.

As for purchases of pipes for major projects, the Company negotiates prices with suppliers and concludes contracts which make it possible to maintain the price negotiated regardless of the situation on the steel market.

Changes in the prices of pipes may have impact on the income and profitability of the Company, both in the main segment i.e. insulation, and trade in goods. The Company

secures itself against changes of prices under individual contracts, and thus in the short run changes in the price of pipes have a limited impact on the profitability of particular contracts. Nevertheless, in the long run the Company benefits from high prices of pipes (at the level of income and margins), and a drop in the price of pipes may result in a drop of income and profit from the sale of pipes.

The risk of exchange rate changes assessed by the Supervisory Board also has a considerable impact on the profitability of sales. Since the Company conducts both export and import activity, it is threatened by the risk of exchange rates fluctuations.

Both export and import is settled in Euro. The share of income obtained in Euro against total income was 12.9% in 2010. Funds in foreign currency obtained by the Company balance its needs connected with import purchases, thus exchange rate exposure for the Company is minimized. Taking into account very good financial results recorded by the Company in 2010, large involvement of the Management Board in current management, and in particular in processes aimed at strengthening the Company's position of an entity which effectively competes on the gas equipment market, and development processes aimed at enabling the Company to emerge on the market of transmission networks infrastructure, the Supervisory Board regards the motion to the General Meeting on granting the vote of approval to the Management Board members of Izostal S.A. for the fulfillment of duties in 2010 as justified.

Zawadzkie, April 2011

**Signatures of Supervisory Board Members**

Jerzy Bernhard, SB President

Zdzisław Mendelak, SB Vice-President

Jan Chebda, SB Secretary

Jan Kruczak, SB Member

Lech Majchrzak, SB Member

Adam Matkowski, SB Member