POLISH ENERGY PARTNERS CAPITAL GROUP

POLISH ENERGY PARTNERS CAPITAL GROUP DIRECTORS' REPORT FOR 6 MONTHS PERIOD ENDED JUNE 30, 2005

Stephen Klein – President of the Management Board in charge from 10 June 2005

Zbigniew Prokopowicz – Supervisory Board Member designated to temporarily act as President of the Management Board of the parent company in charge from 21 November 2004 till 10 June 2005

Grzegorz Skarżyński – Vice - President of the Management Board of the Parent Company

Wojciech Cetnarski – Vice - President of the Management Board of the Parent Company in charge from 10 June 2005

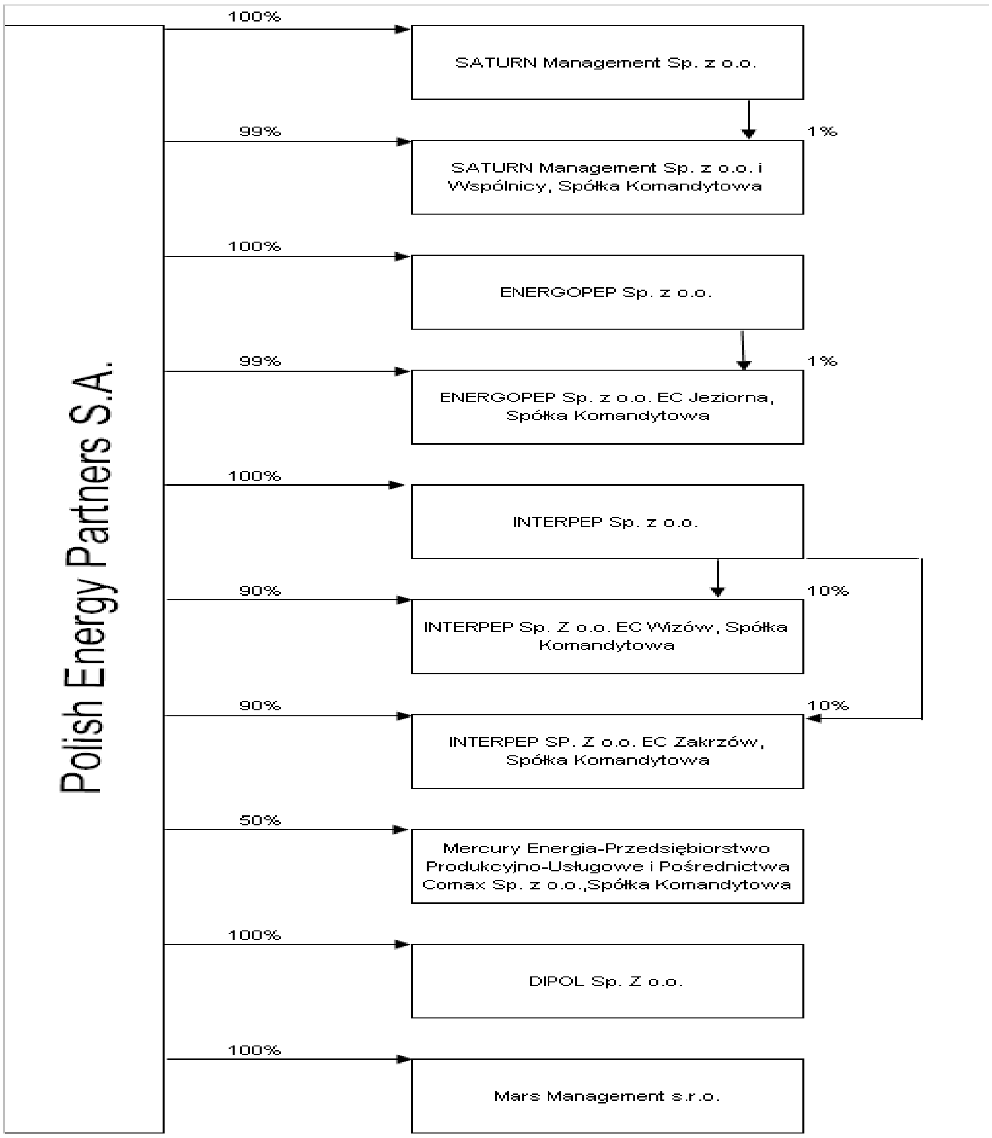
Anna Kwarcińska – Member of the Management Board of the Parent Company

Warsaw, August 12, 2005

BUSINESS ACTIVITIES OF POLISH ENERGY PARTNERS S.A. CAPITAL GROUP

The parent company of the Polish Energy Partners S.A. Group is Polish Energy Partners S.A., hereinafter referred to as "Parent Company" which was registered on July 17, 1997 in Entrepreneurs Register held by the city of Warsaw District Court, XX Economic Department of National Court Register, Entry no. KRS 26545. The half year ended June 30, 2005 started the fourth year of operations of the Group and the 8th year of operations of the Parent Company. The half year ended June 30, 2005 was a period in which the business activities of the Group commenced in 2004 were continued. This continuation gave grounds for the further development of the Group at the higher qualitative and quantitative level. Due to the fact the Parent Company is listed on Warsaw Stock Exchange the Group increased its credibility on the market which enables it to acquire additional capital and new investors.

During the period of first half ended June 30, 2005 the company Dipol Sp. z o.o., dedicated to complete the wind farm project started to be consolidated with full method.



PRINCIPLES OF CONSOLIDATED FINANCIAL STATEMENTS PREPARATION

The principles of consolidated financial statements preparation were described in the introduction to the consolidated financial statements and comparable consolidated financial data.

SHORT DESCRIPTION OF SIGNIFICANT ACHIEVEMENTS OR FAILURES OF THE COMPANY IN THE PERIOD COVERED BY THIS REPORT INCLUDING LIST OF THE MOST IMPORTANT EVENTS RELATING TO THESE ACHIEVEMENTS OR FAILURES

During the half year ended June 30, 2005 the Capital Group continued works to complete two new projects. The milestones were achieved in line with the assumed deadlines and the expenses for development of new projects were not overrun. In the first half year of 2005 the implementation of industrial energy outsourcing project in Konstancin Jeziorna was started which was described in the prospectus as project C.

DESCRIPTION OF FACTORS AND EVENTS ESPECIALLY UNUSUAL IN NATURE WHICH HAVE SIGNIFICANT IMPACT ON THE REPORTED FINANCIAL RESULTS

In the first half year of 2005 revenues resulting from share of benefits between the Group and one of its clients had significant impact on the reported financial result. The above mentioned benefits result from sale of electricity at preferred prices ("renewable energy", "green energy").

EXPLANATION OF SEASONALITY AND CYCLICALITY OF COMPANY'S ACTIVITY IN THE REPORTED PERIOD

The Capital Group PEP operates in the industrial energy outsourcing market. Key accounts consume heat and electricity in its production plants for the production purposes. The demand for heat and electricity for production purposes indicates no seasonality. However some of the heat delivered is consumed to heat the buildings. The above refers both to industrial and municipal offtakers. Demand for building heating indicates seasonality which is higher in 1st and 4th quarter of the financial year. The seasonality of this demand does not have significant impact on the reported financial result.

DESCRIPTION OF MAIN RISKS AND THREATS

Risk Related to Competition

The Issuer is active on the market of industrial energy outsourcing. At present, the PEP Group enjoys a dominant position in this segment of the power market, with an approximately 77% share in heat generation, computed as percentage share of total heat supplied under outsourcing projects functioning on the Polish market and known to the Issuer. Given the market's attractiveness for investors, the Company anticipates that competition will intensify, also on part of financially-strong foreign operators, which may affect the PEP Group's ability to attract new outsourcing contracts and to negotiate good terms and conditions of project execution. PEP SA has gathered unique experience on the Polish market in the area of both the development and implementation of optimally-customised technological solutions as well as construction of the right legal, fiscal and financial structures – which secures PEP SA a significant competitive edge. Furthermore, the PEP Group believes it crucial that the provided services are of top quality and that its qualifications are regularly enhanced by know-how relating to cutting-edge technologies and more effective management methods.
Given the steady growth in demand for energy generated from renewable sources (required under regulations currently in force), its small supply, and, as a consequence, the anticipated rise in its prices, investments in green energy generation are becoming increasingly more attractive. Thus, this market segment is likely to also see the tightening of competition. The Issuer plans to launch wind farm operations. Given the weather and environmental constraints in Poland, this is the energy source which in addition to biomass combustion, is viewed as one offering the greatest potential as a source

of green energy. This segment of the Polish power market is likely to attract Western European and American companies with relevant experience gathered on other markets. From the project profitability's perspective, the factor of utmost importance is the location of wind farms. The Issuer has concluded an exclusive agreement for development of wind farm projects with Przedsiębiorstwo Projektowo-Serwisowe Elektroniki, Pomiarów i Automatyki EPA Sp. z o.o., a leading developer of wind energy projects in Poland. Under the agreement, PEP SA has access to information on best sites for wind farms, results of wind measurements, and hands-on experience in execution of wind farms in Poland. Thus, the Issuer is provided with an edge over any potential competition, as the gathering of such data is time-consuming and costly.

Risk Related to the General Economic Situation in Poland

Implementation of the strategic goals assumed by the Issuer and the projected financial results are influenced, among others, by macroeconomic factors, which are independent of the Company's activities. These factors include GDP growth, the inflation rate, general situation in Polish economy and changes in the legislation. Unfavourable changes of the macroeconomic indicators may adversely affect the Issuer's projected revenue or increase its operating costs.

Currency Risk

Part of the PEP Group's agreements with its customers provide for payments in foreign currency. Therefore, exchange rate fluctuations can affect the Group's revenue as translated into the Polish currency. The Issuer's Group mitigates the effect of the currency risk on the projects' profitability by using natural hedging – in projects which involve currency conversions into the złoty, the majority of expenses incurred in connection with the construction, upgrading and operation of the CHP plants are borne in the same currency. This also refers to loans incurred to finance the projects.

Interest Rate Risk

The share of debt in the structure of the Group's financing is high. According to the PEP Group's strategy, which assumes maximisation of return on equity, 80% of the financing of the projects under development comes in the form of debt. Under loan agreements concluded by the Group companies, interest on the contracted loans accrues at variable rates. A considerable increase in market interest rates above the values projected by the Issuer and assumed in project budgets may adversely affect the PEP Group's financial performance. The Issuer is aware of such risks and in order to prevent their possible adverse effects it continuously monitors the money market situation, efficiently manages its financial resources, and includes in its agreements with customers clauses which provide for the customers' participation in the interest rate risk.

Risk of Fluctuations of Coal and Natural Gas Prices and Risk Related to the Availability of These Resources

The Issuer and its Group companies use natural gas, hard coal and biomass to generate electricity and heat.

In Poland, the PGNiG Group is the main supplier of gas, which comes mainly from Russia. If PGNiG encounters any difficulties in importing the gas in quantities required to satisfy the existing needs, gas supplies to customers may be limited. In a case like this, market prices of natural gas would probably rise, and it could also happen that the Issuer and its Group would not be able to purchase required amounts of the fuel gas. This could limit the business activities of the Issuer and the members of its Group.

The Issuer and its Group have implemented mechanisms intended to protect them against adverse effects of fluctuations of the natural resource prices. As a rule, prices of electricity and heat are linked to prices of hard coal and natural gas. However, there can be no assurance that the financial results of the Issuer and its Group will not be adversely affected in spite of implementing mechanisms protecting against price fluctuations.

Risk Related to Polish Energy Market

The energy market in Poland is regulated. The President of the Energy Regulatory Authority (URE) is the body appointed under the Energy Law to perform tasks related to the regulation of the fuel and energy management and promotion of competition in the power sector. The President of URE's powers and responsibilities include: granting, amending and revoking licences; approval of draft development plans for power companies; settling disputes between power companies and between power companies and their customers; approval and control of tariffs in the energy sector in terms of their compliance with the regulations, especially with the principle of customer protection against unjustified pricing. The President of URE has the power to impose penalties on licensed operators.

In its present form, the Energy Law substantially ensures covering justified operating expenses of power companies. The producers' right to include their profit in the heat tariffs is limited, particularly by the overriding principles provided for in the energy law, such as the principles of protecting customer interests. Thus, profit earning potential depends, to a large extent, on the company's ability to reduce operating costs.

As the process of implementing competitive market mechanisms in the power sector is well advanced, licensed power producers are exempt from the obligation to file electricity tariffs for approval (subject to certain exceptions). PEP SA's electricity tariffs are not subject to approval by the URE. However, the tariffs must be prepared according to the principles provided for in the Energy Law and secondary legislation thereto. On the other hand, PEP SA is required to draw up heat tariffs and obtain their approval by the URE.

Draft amendments to the Energy Law are currently being considered by the Polish Parliament. It is proposed that the amendments open way for including profits in tariffs to a larger extent than currently. Draft amendments to the Energy Law have been approved by the Sejm (the lower chamber of Polish Parliament). The approved draft amendments are favourable to heat producers, as they provide for the possibility of including the cost of capital invested in energy-related activities in the tariffs. The secondary legislation to the Energy Law is also to be amended. The final wording of the new regulations has not been determined yet; however, the draft amendments approved by the Sejm will most probably not be changed materially. Detailed rules for the inclusion of the cost of capital invested by heat producers in their activities will be stipulated in the secondary legislation. In addition, the government may also change its policy and strategy for the power sector in the future.

At present, the Energy Law does not provide for a situation where a power company applies for the approval of a tariff and uses previous tariff rates in its settlements with customers while the approval is pending. Currently, the Issuer is awaiting approval of the tariffs for the Wizów CHP Plant and the Zakrzów CHP Plant, while applying the tariff effective in the previous period. There is a small risk that the prices in the new tariff will be lower than those in the previous one, but in the Issuer's opinion, the possible difference will be immaterial.

In the Issuer's case, as well as in the case of all the other companies in the power sector, there is a risk that the URE will refuse to recognise particular expenses borne by the Issuer as justified ones, which may lead to a lack of possibility to recover the expenses through heat charges paid by customers. Similarly, there exists a risk that the URE will not permit, in the future, to increase the prices of the heat energy in proportion to the rise in expenses, or that it will impose penalties on licensed operators. Based on its to-date experience, the Issuer is seeking ways to reduce the risk. Thanks to the use of efficient technological solutions and the Issuer's ability to deliver energy outside the transmission network (without incurring transmission costs), the prices offered by the PEP Group are competitive in comparison to market prices.

Risk Related to Customers' Financial Standing

The PEP Group derives revenues from developed and implemented industrial energy outsourcing projects under long-term agreements for electricity and heat supplies. Therefore, customers' financial standing and their ability to pay liabilities towards PEP SA constitute a key factor for the success of the projects as well as the PEP Group's financial performance and standing. A sudden fall in energy consumption by a customer may also affect the efficiency of energy generation. Prior to concluding outsourcing agreements and commencing investment projects, the Issuer conducts a thorough analysis of the potential customers, sometimes using the services of external consultants, with a view to assessing the customers' creditworthiness and prospects for their respective sectors. The PEP Group is very careful in selecting its customers from sectors with good market potential. The Issuer analyses in great detail the customer's technological process and the project launch is preceded by several-month cooperation of the two parties.

Risk of Dependence on Key Customers

Every industrial energy outsourcing project, developed and implemented by the Issuer, is in reality prepared for one customer – a production company. To-date, the PEP Group has implemented four projects in this area. The share of each of the Group's customers in the revenue structure exceeded 10%, which means dependence on the customers. With the development of the Group's activity, execution of new outsourcing projects and the Group's expansion on the renewable energy market, particular customers' shares in the revenue structure will be diminishing.

Risk of Loss of Key Personnel

The activities of the Issuer and the Group are based primarily on the knowledge and experience of their highly qualified personnel. Due to the limited availability of experts in industrial energy outsourcing, and the possible attempts by the existing and future competitors to take over the experts by offering them attractive terms of employment and remuneration, there is a risk of losing the employees who are of key importance for the development of the Issuer and its Group. This could adversely affect the Issuer's financial performance and strategy.
The risk is mitigated through:

- High corporate culture of the Issuer, which helps the employees identify themselves with the Company;
- Attractive of remuneration schemes focusing on incentives and promoting loyalty;
- Knowledge management and extensive training programme.

Risk of CHP Plant Operations

CHP plant operations involve the risk of failure to achieve the projected efficiency and availability of the plant, and failure to meet the contractual terms of energy supplies. The Issuer's experience shows that the risk of unexpected breakdowns leading to the plants' operational budget overruns, is limited. To mitigate this risk, PEP SA enhances operational procedures and concludes insurance agreements, or applies contractual clauses whereby any potential additional costs are transferred onto subcontractors.

REMUNERATION OF MANAGING PERSONS

In the first half year ended June 30, 2005 remuneration of the Management Board amounted to:

In thousands zlotys	30.06.2005
Stephen Klein	194
Grzegorz Skarżyński	198
Wojciech Cetnarski	-
Anna Kwarcińska	158
Total Management Board	**550**

In the first half year ended June 30, 2005 the Management Board Members and Supervisory Board Members of the parent company did not receive any remuneration resulting from being in the management boards of related companies.

Till June 30, 2005 Members of the Supervisory Bodies received remuneration in the amount of 172 thousand zlotys, including Mr. Zbigniew Prokopowicz in the amount of 172 thousand zlotys. Other Supervisory Board Members did not receive any remuneration.

MANAGEMENT REPRESENTATION

Management of Polish Energy Partners S.A. confirms that these consolidated financial statements and comparable data were prepared in accordance with accounting principles and that reflect truly and fairly the financial and material situation of the Group Polish Energy Partners S.A. and the financial result and informs that the Director's report includes the true description of development and achievements and the situation of the Group including description of basic risks and threats.

MANAGEMENT REPRESENTATION ABOUT THE ENTITY TO AUDIT THE FINANCIAL STATEMENTS

Management of Polish Energy Partners S.A. confirms that the entity engaged in the review of half year consolidated financial statements was chosen in compliance with applicable laws and that the entity and the auditors reviewing the consolidated financial statements meet the requirements to issue and independent review report in compliance with applicable domestic law.