# DIRECTORS' REPORT

**on the Operations of Pfleiderer Grajewo S.A. in the period January 1st – December 31st 2011**

# FINANCIAL HIGHLIGHTS

| | Jan 1 2011-Dec 31 2011 | Jan 1 2010-Dec 31 2010 | Jan 1 2011-Dec 31 2011 | Jan 1 2010-Dec 31 2010 |
|---|---|---|---|---|
| | PLN '000 | | EUR '000 | |
| Revenue from sales of products, merchandise and materials | 730,081 | 616,183 | 176,344 | 153,878 |
| Operating profit | 40,004 | 23,939 | 9,663 | 5,978 |
| Profit before tax | 49,503 | 429 | 11,957 | 107 |
| Net profit | 40,801 | 1,294 | 9,855 | 323 |
| Net cash from (used in) operating activities | 51,741 | 62,805 | 12,498 | 15,684 |
| Net cash from (used in) investing activities | 58,754 | (23,201) | 14,191 | (5,794) |
| Net cash from (used in) financing activities | (109,954) | (43,629) | (26,558) | (10,895) |
| Total net cash flow | 541 | (4,025) | 131 | (1,005) |
| Basic earnings per share (PLN / EUR) | 0.82 | 0.03 | 0.2 | 0.01 |
| Diluted earnings per share (PLN / EUR) | 0.82 | 0.03 | 0.2 | 0.01 |
| **PLN/EUR average exchange rate** | | | 4.1401 | 4.0044 |

| | 31.12.2011 | 31.12.2010 | 31.12.2011 | 31.12.2010 |
|---|---|---|---|---|
| | PLN '000 | | EUR '000 | |
| Total assets | 1,507,764 | 1,480,137 | 341,370 | 373,744 |
| Liabilities | 982,741 | 995,326 | 222,501 | 251,326 |
| Non-current liabilities | 488,421 | 567,840 | 110,583 | 143,383 |
| Current liabilities | 494,320 | 427,486 | 111,918 | 107,943 |
| Equity | 525,023 | 484,811 | 118,870 | 122,418 |
| Share capital | 16,376 | 16,376 | 3,708 | 4,135 |
| Number of shares | 49,624,000 | 49,624,000 | 49,624,000 | 49,624,000 |
| Book value per share (PLN / EUR) | 10.58 | 9.77 | 2.40 | 2.47 |
| Share price as at the reporting date PLN / EUR | | | 4.4168 | 3.9603 |

# GENERAL INFORMATION

Pfleiderer Grajewo S.A. conducts its business in Grajewo, a town in north-eastern Poland.

Initially, the Company operated under the name of Zakłady Płyt Wiórowych S.A. of Grajewo and was originally registered on July 1st 1994 by the District Court, Commercial Court of Łomża, in Section B of the Commercial Register under entry No. 270. Subsequently, on May 9th2001, it was registered by the District Court of Białystok, XII Commercial Division of the National Court Register, under entry No. KRS 0000011422. On September 18th 2002, the Pfleiderer Grajewo Management Board received the decision of the District Court of Białystok to enter the Company's new name in the National Court Register. Accordingly, on September 18th 2002, the Company name was changed to Pfleiderer Grajewo S.A. The registered office of Pfleiderer Grajewo S.A. is situated at ul. Wiórowa 1, Grajewo, Poland. The Company shares are publicly traded. In accordance with the Polish Classification of Business Activities, Pfleiderer Grajewo S.A. is registered under No. 1621 Z.

Pfleiderer Grajewo S.A.'s business consists in the manufacturing of wood products, manufacturing and veneering of chipboard, impregnation of paper, trading activities in Poland and abroad, provision of industrial services related to the Company's core business as well as other services based on the Company's resources.

As at the end of the reporting period, the composition of the Pfleiderer Grajewo Management Board was as follows:

| | |
|---|---|
| 1. Wojciech Gątkiewicz | President of the Management Board |
| 2. Rafał Karcz | Member |
| 3. Dariusz Tomaszewski | Member |
| 4. Radosław Wierzbicki | Member |

With effect as of February 8th 2011, Johann Bitzi, Vice-President of the Management Board, was removed from office as member of the Pfleiderer Grajewo Management Board.

As at December 31st 2011, the composition of the Company's Supervisory Board was as follows:

| | |
|---|---|
| 1. Michael Wolff | Chairman |
| 2. Hans H. Overdiek | Member |
| 3. Jan Woźniak | Member |
| 4. Hans-Joachim Ziems | Member |
| 5. Hans-Kurt von Werder | Member |

On October 17th, Mr Heiko Graeve tendered his resignation from the position of a member of the Pfleiderer Grajewo Supervisory Board.

At the Extraordinary General Meeting held on November 24th 2011 Mr Paweł Wyrzykowski was removed from the post of Chairman of the Supervisory Board.
Mr Hans-Joachim Ziems and Mr Hans-Kurt von Werder were appointed as Members of the Supervisory Board.

At a meeting of the Pfleiderer Grajewo Supervisory Board held on December 21st 2011, Members of the Supervisory Board appointed Mr Michael Wolff to the post of Supervisory Board Chairman.

On March 7th 2012, Mr Hans-Joachim Ziems tendered his resignation from the position of a member of the Pfleiderer Grajewo Supervisory Board, with effect as of April 10th 2012.

At the Extraordinary General Meeting held on April 10th 2012 Mr Jochen Schapka was appointed as Member of the Supervisory Board.

**Large holdings of Pfleiderer Grajewo shares:**

| Shareholder structure as at Apr 16 2012 | Number of shares | Ownership interest (%) | Number of votes at GM | % of votes at GM |
|---|---|---|---|---|
| **Pfleiderer Service GmbH** | 32,308,176 | 65.11% | 32,308,176 | 65.11% |
| **Aviva OFE Aviva BZ WBK** | 4,928,816 | 9.93% | 4,928,816 | 9.93% |
| **ING OFE** | 2,639,144 | 5.32% | 2,639,144 | 5.32% |
| **Other shareholders** | 9,747,864 | 19.64% | 9,747,864 | 19.64% |
| **TOTAL** | 49,624,000 | 100.00% | 49,624,000 | 100.00% |

The information on the number of shares in Pfleiderer Grajewo S.A. held by Aviva OFE (former Commercial Union Otwarty Fundusz Emerytalny BPH CU WBK) is based on the most recent notification of change in the number of shares held, received by the Company on July 10th 2007.

Information on the number of shares in Pfleiderer Grajewo S.A. held by ING OFE is based on the most recent notification of change in the number of shares held, received by the Company on June 5th 2009.

The number of the Company shares held by its main shareholder, Pfleiderer Service GmbH, did not change during the period under review.

**External factors with a bearing on the Company's business:**

- Dependence on customers – cooperation with customers is based on long-term framework agreements, ensuring stable cooperation and long-term development.
- Customer insolvency risk – the Company monitors the financial liquidity of its customers on an ongoing basis, mitigating the customer insolvency risk by using trade credit insurance.
- Dependence on suppliers – key raw materials purchased by the Company include wood and wood waste, decorative paper, chemical substances, and machine parts. The Company mitigates the related risk by using diversified sources of supplies. Increases in the prices of the raw materials affect the Company as well as its competitors and for this reason do not have an adverse effect on the Company's competitive position.
- Currency risk – the Company is not exposed to any significant currency risk. It monitors its exposure to exchange-rate fluctuations on an ongoing basis and relies on natural hedging and forward transactions to hedge the risk.
- Seasonality – sales fall in the second quarter of the year. Seasonal changes do not give rise to a significant risk for the Company as lower sales in the period are accompanied by lower purchases of raw materials. The Company's liquidity remains relatively stable over the second quarter.

**Internal factors with a bearing on the Company's business:**

- Technological process – the technologies employed by the Company involve exposure to fire hazard. To mitigate that risk, the Company uses a number of technical and organisational safeguards. There is no risk of unscheduled process stoppages at the Company, as its plant and equipment is relatively new.
- Debt risk – the Company is the parent of the other Group companies. Therefore, it bears all the burdens related to the financing of investment projects within the Group. The debt is monitored on an ongoing basis. To mitigate the liquidity risk, the Company uses a full spectrum of available financial instruments.

## Plans and development prospects for 2012

- Focus on the furniture sector and strengthening of the Company's position as a leading full-range supplier for the sector.
- Geographical and product range expansion.
- Implementation of new technical systems and restructuring of the Company through further optimisation of the production processes and cost savings programme.
- Modernisation of the production plant and equipment in order to ensure the highest quality of products and enhancement of production efficiency.
- Promotion of the brand and mission of Pfleiderer as a modern and continuously expanding company, which implements state-of-the-art technologies and respects the natural environment.

### 1 In 2011, the efforts of Pfleiderer Grajewo S.A. were focused on the following tasks:

1. Optimisation of production and costs.
2. Analysis of production and sales volumes and adjusting them to current market demand.
3. Enhancing security of trade.
4. Optimisation efforts designed to improve the Company's operating efficiency.
5. Securing of wood supplies.
6. Improving the quality of products and services.
7. Enhancing efficiency and production processes through tight cost control.
8. Securing stable sources of external financing for the Company in the long-term perspective.
9. Promoting the Company's image as a financially stable and reliable business partner.
10. Strengthening of Pfleiderer's market position by promoting the Company's brand and vision.

### 2 Financial standing of Pfleiderer Grajewo S.A.

The structure of financing of the Company's assets is as follows:

| | Dec 31 2011<br>PLN '000 | Dec 31 2010<br>PLN '000 |
|---|---|---|
| Equity | 525,023 | 484,811 |
| Non-current liabilities | 488,421 | 567,840 |
| Long-term capital (equity + non-current liabilities) | 1,013,444 | 1,052,651 |
| Current liabilities | 494,320 | 427,486 |

In 2011, Pfleiderer Grajewo S.A. financed its operations chiefly with bank borrowings and, to a certain extent, issues of notes acquired by Pfleiderer Prospan S.A and Silekol Sp. z o.o.

On March 16th 2010, Pfleiderer Grajewo S.A. (the "Company") and its subsidiaries Pfleiderer Prospan S.A. and Silekol Sp. z o.o. (the "Subsidiaries") executed a PLN 700,000,000 credit facility agreement with a bank syndicate. The syndicate comprised Bank PEKAO S.A. as the syndication agent (the "Agent"), Bank Zachodni WBK S.A., BRE Bank S.A., Fortis Bank Polska S.A. and Bank Gospodarki Żywnościowej S.A. (the "Banks").
The credit facility is split into two tranches:

- PLN 530,000,000 Tranche A, in the form of a non-revolving facility to be used to repay the outstanding debt owed by the Company and its subsidiaries to the Banks;
- PLN 170,000,000 Tranche B, in the form of a working capital revolving facility to be used to repay the outstanding debt owed by the Company and its subsidiaries to the Banks and to finance the Company's day-to-day operations.

The funds were disbursed on March 31st 2010, following execution of the relevant security documents and security agreements, as well as an agreement between the lenders, executed by the Banks and the European Bank for Reconstruction and Development.

The credit facility bears interest at WIBOR plus bank margin, whose level is variable and depends on the ratio of net financial debt to EBITDA.

## 3 Staff and remuneration at Pfleiderer Grajewo S.A.

As at December 31st 2011, the Company employed 583 staff, including the management personnel and staff working under managerial contracts or appointed by the Supervisory Board. The employment structure as at the last day of the reporting period and the corresponding period of the previous year was as follows:

| | Dec 31 2011 | Dec 31 2010 |
|---|---|---|
| Employees | | |
| - direct production employees | 282 | 277 |
| - indirect production employees | 121 | 118 |
| - administration, office and other employees | 177 | 170 |
| - management staff | 3 | 4 |
| **Total** | **583** | **569** |

The employment at the Company has remained unchanged for a long time.

Remuneration of the members of the Pfleiderer Grajewo Management Board, including bonuses paid for the period January 1st – December 31st 2011 was as follows:

| | | | |
|---|---|---|---|
| 1. | President of the Management Board | - Wojciech Gątkiewicz | PLN 735 thousand |
| 2. | Member | - Rafał Karcz | PLN 369 thousand |
| 3. | Member | - Dariusz Tomaszewski | PLN 456 thousand |
| 4. | Member | - Radosław Wierzbicki | PLN 460 thousand |

In addition, the Management Board members listed above received remuneration from other subordinated entities. See Note 29 to the 2011 consolidated financial statements.

The managerial contract with Mr Rafał Karcz, member of the Management Board, contains a provision entitling Mr Karcz to a one-off severance pay equal to one month's remuneration if the contract is terminated by notice.

The managerial contract between Pfleiderer Prospan S.A., the Company's related entity, and Mr Dariusz Tomaszewski, member of the Management Board, contains a provision entitling Mr Tomaszewski to a one-off severance pay equal to one month's remuneration if the contract is terminated by notice.

The managerial contract with Mr Wojciech Gątkiewicz, President of the Management Board, in effect as of January 1st 2012, provides for a six-month notice period.

The remuneration paid to the members of the Pfleiderer Grajewo Supervisory Board for the period January 1st – December 31st 2011 amounted to PLN 48 thousand and was paid only to Mr Jan Woźniak.

As at December 31st 2011, the members of the Management and Supervisory Boards of Pfleiderer Grajewo S.A. had no outstanding debt under any loan agreements with the Company.

Under the stock option scheme of Pfleiderer AG, the parent of the Pfleiderer Group, members of the Pfleiderer Grajewo Management Board were entitled to acquire options for the parent's shares directly from Pfleiderer AG. The options were valued using the Black-Scholes model and assuming a three-year vesting period. The value of options granted to the members of the Pfleiderer Grajewo Management Board in the financial year was as follows:

- Mr Wojciech Gątkiewicz, President of the Management Board – PLN 0
- Mr Rafał Karcz, Member of the Management Board – PLN 15.5 thousand
- Mr Dariusz Tomaszewski, Member of the Management Board – PLN 10.1 thousand
- Mr Radosław Wierzbicki, Member of the Management Board – PLN 7.8 thousand.

## 4 Number of Pfleiderer Grajewo S.A. shares held by the management staff of Pfleiderer Grajewo S.A.

As at the date of this report, the number of Pfleiderer Grajewo shares held by the Management Board members was as follows:

- Mr Wojciech Gątkiewicz, President of the Management Board – 5,400 shares
- Mr Rafał Karcz, Member of the Management Board – 3,472 shares
- Mr Dariusz Tomaszewski, Member of the Management Board – 4,108 shares
- Mr Radosław Wierzbicki, Member of the Management Board – 2,000 shares.

Jan Woźniak, Member of the Supervisory Board – 10,000 shares of Pfleiderer Grajewo S.A. The other members of the Supervisory Board held no Company shares.

As at December 31st 2010, Mr Paweł Wyrzykowski, held 4,080 Company shares.

## 5 Production volume and structure

In 2011 and 2010, the production volumes at Pfleiderer Grajewo S.A. by main product groups were as follows:

| | | 2011 | 2010 |
|---|---|---|---|
| Raw chipboards | $m^3$ | 575,906 | 554,515 |
| Melamine-faced chipboards | '000 $m^2$ | 17,733 | 17,379 |

In 2011, there was a slight change in the structure of the output as compared with 2010. Production of raw chipboard increased by 4% in 2011, while production of melamine-faced board rose by 2%.

## 6 Sales volume and structure

Revenue reported by the Company in 2011 was PLN 730,081 thousand, up 18.5% year on year.

| **Revenue structure** | **01.01.2011 - 31.12.2011** | **01.01.2010 - 31.12.2010** |
|---|---|---|
| **By geographical region** | | |
| Revenue from sales of products | **553,587** | **462,844** |
| *Domestic sales* | 359,652 | 297,539 |
| *Exports* | 193,935 | 165,305 |
| Revenue on sales of merchandise and materials | **143,173** | **119,072** |
| *Domestic sales* | 117,998 | 82,866 |
| *Exports* | 25,175 | 36,206 |
| Revenue from sales of products | **33,321** | **34,267** |
| *Domestic sales* | 31,077 | 26,706 |
| *Exports* | 2,244 | 7,561 |

| **By product group** | **01.01.2011 - 31.12.2011** | udział w % | **01.01.2010 - 31.12.2010** | udział w % |
|---|---|---|---|---|
| Revenue from sales of products | **553,587** | **75.83%** | **462,844** | **75,11%** |
| *Chipboard* | 425,134 | 58.23% | 350,080 | 56,81% |
| *Finish foil (foil, edge banding, edge foil)* | 110,954 | 15.20% | 70,440 | 11,43% |
| *Other* | 17,499 | 2.40% | 42,324 | 6,87% |
| Revenue on sales of merchandise and materials | **143,173** | **19.61%** | **119,072** | **19,32%** |
| *Revenue from sales of materials* | 116,598 | 15.97% | 77,336 | 12,55% |
| *Revenue from sales of merchandise* | 26,575 | 3.64% | 41,736 | 6,77% |
| *Revenues from services* | 33,321 | 4.6% | 34,267 | 5.56% |
| *Total Sales* | **730,081** | **100.00%** | **616,183** | **5.56%** |

Quantitative sale of the main products of the Pfleiderer Grajewo as follows

| **By product group '000 m$^3$** | **2011** | **2010** |
|---|---|---|
| Chipboard | 314.0 | 300.8 |
| MDF boards | 1.4 | 1.7 |
| Total quantitative sale | 315.4 | 302.5 |

The furniture industry continues to be the most important sector for Pfleiderer Grajewo S.A. as it accounts for 90% of total sales. The Company takes steps to more effectively place its products on the interior design market. On the other hand, it focuses its efforts on expanding its presence on the construction market, which is becoming increasingly more attractive for chipboard manufacturers in Poland.

The long-term sales strategy of Pfleiderer Grajewo S.A. in the furniture industry is based on three key distribution channels:

- Sales to industrial customers
- Sales to the Pfleiderer Partner dealership network (PP network)
- Export sales

Structure of the Company's sales in 2010-2011 by distribution channels:

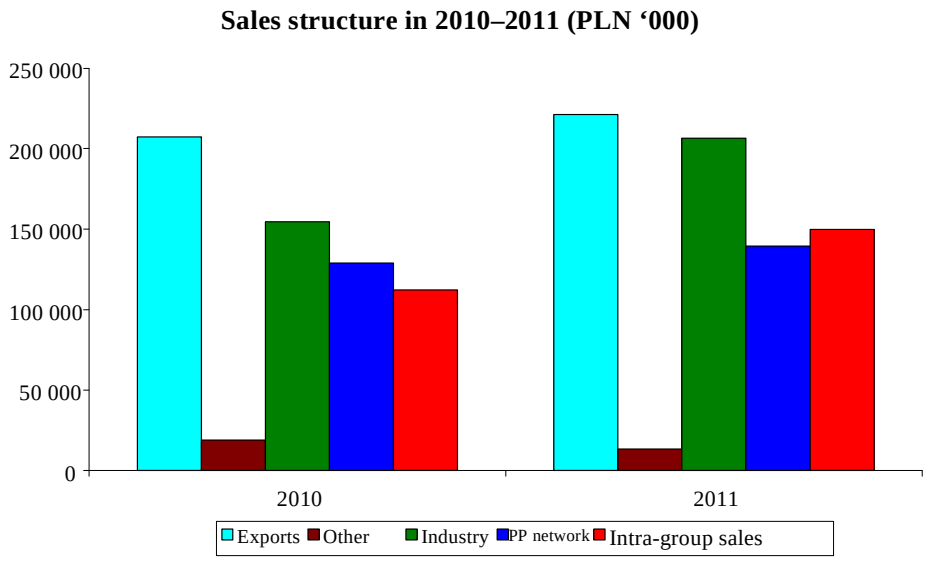


Fig. Sales structure in 2010–2011 (PLN '000)

Export, direct sales to large and medium-sized furniture producers and sales to the Pfleiderer Partner network remained the Company's key distribution channels on the Polish market. In 2011, export sales increased by 6% year on year. Similarly, a 34% year-on-year increase was reported for sales to large and medium-sized furniture producers. Sales to the Pfleiderer Partner network saw a 8% year-on-year increase. Intra-group sales to other subsidiaries of Pfleiderer Grajewo S.A. Group in Poland grew by 33%
Shares of individual distribution channels in Pfleiderer Grajewo S.A.'s total sales in 2010-2011:

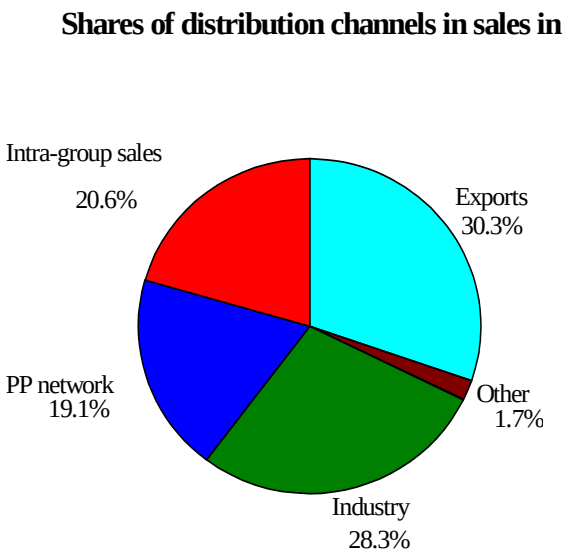


**Fig. Shares of distribution channels in sales in 2011:**

Relative to the previous year, the share of exports fell from 33% to 30.3%, whereas direct sales to large and medium-sized furniture producers rose from 26% to 28.3%, sales to the Pfleiderer Partner network fell from 21% to 19.1%, and intra-group sales advanced from 18% to 20.5%.

## 7 Procurement

In 2011, the Company purchased wood from traditional sources of raw material, located in close proximity to the plants.

The share of individual product groups in total supplies varied slightly between the plants due to their different production profiles, local markets, or the current pricing of various raw materials.

In Poland, forest wood represented 47.6% of all supplies, while by-products of the wood processing industry accounted for 50.8% of the total. In 2011, the share of recycled raw materials increased to 1.6%. Supplies of wood from Poland prevailed, and represented 72% of total purchases.

## 8 Economic and financial data

The cost of materials and energy continues to be the most significant component in the cost structure, accounting for (62%) of the technical production cost. Other significant cost components include depreciation/amortisation (2%), salaries and overheads (6%) and services (7%). The high share of services in the overall cost structure is attributable to the fact that certain auxiliary functions have been outsourced and certain types of services are contracted from external providers; another cause is a gradual rise of transport costs related to sales of products and supplies of raw materials. Finance expenses are an important component of the income statement.
In 2011, the Company recorded a year-on-year decline in margins:

| | **Jan 1 2011 -Dec 31 2011** | **Jan 1 2010 -Dec 31 2010** |
|---|---|---|
| $\frac{\text{Gross profit}}{\text{Revenue}}$ | 6,78% | 0.07% |
| | **Jan 1 2011 -Dec 31 2011** | **Jan 1 2010 -Dec 31 2010** |
| $\frac{\text{Net profit}}{\text{Revenue}}$ | 5.59% | 0.21% |

## 9 Use of bank borrowings

As at December 31st 2011, Pfleiderer Grajewo S.A and its subsidiaries Pfleiderer Prospan S.A. and Silekol Sp. z o.o. had a PLN 499m credit facility, used to refinance the Company's debt. The companies executed the credit facility agreement with a bank syndicate comprising the same institutions which had previously provided funding to the Company, i.e. Bank PEKAO S.A. (syndication agent), Bank Zachodni WBK S.A. BRE Bank S.A. Fortis Bank Polska S.A. and Bank Gospodarki Żywnościowej S.A.

The new facility, provided under an agreement of March 16th 2010, is split into two tranches:

- PLN 530,000,000 Tranche A, in the form of a non-revolving facility to be used to repay the outstanding debt owed by the Company and its subsidiaries to the Banks;
- PLN 170,000,000 Tranche B, in the form of a working capital revolving facility to be used to repay

the outstanding debt owed by the Company and its subsidiaries to the Banks and to finance the Company's day-to-day operations.

The repayment deadline for Tranche A is December 30th 2013, while Tranche B is to be repaid two years after execution of the credit facility agreement. Furthermore, under Tranche B bank guarantees and letters of credit may be issued.

As at December 31st 2011, the debt outstanding under the bank borrowings was as follows:
- Tranche A: PLN 490m
- Tranche B: PLN 9m

Also, Pfleiderer Grajewo S.A. has a commitment towards the European Bank for Reconstruction and Development ("EBRD") under the put/call option agreement of December 28th 2005. In performance of the agreement, Pfleiderer OOO issued, and the EBRD acquired, new shares worth EUR 7m. The agreement provides for the Bank to maintain its equity involvement for a period of five years. Following the lapse of the period, the shares will be sold to Pfleiderer Grajewo S.A. The transaction's annual funding costs, resulting from the difference between the purchase price and the selling price of the shares, will be equal to the interest expense on the facility advanced by the EBRD to Pfleiderer OOO.

Pfleiderer Grajewo S.A. has a call option enabling it to repurchase the shares held by the Bank at any time before the lapse of the five-year period. The EBRD holds a put option to sell the shares if the financing agreements executed by the Company and Pfleiderer OOO with the EBRD are breached and if there is a risk that the shares will not be repurchased by the agreed deadline. As at December 31st 2011, the Company's liabilities under the agreement were PLN 39,301 thousand.

As at December 31st 2011, the total debt outstanding under the bank borrowings was PLN 539m.

For more information on interest rates applicable to the credit agreements, see Note 17 to the Company's separate financial statements.

## 10 Investments and overhauls

To ensure proper operation on the market and its ability to satisfy the customers' growing expectations, the Company must maintain its plant and equipment in the best technical and technological condition. In 2011, the Company spent PLN 9.0m on overhauls and maintenance of the plant and equipment. The Company's efforts in this respect result in gradual improvement of the quality of products and help increase the production capacity.
To maintain the necessary production volumes and to consistently enhance the quality of products, the Company's 2011 capex was allocated chiefly to increasing the productivity. The largest project was a PLN 3.8m upgrade of the Holzma panel saw. In total, the Company's capex in 2011 was PLN 6.0m.

## 11 Feasibility of Pfleiderer Grajewo S.A.'s investment plans for 2012

Pfleiderer Grajewo S.A.'s plans for 2012 assume capex at PLN 21.0m. The largest portion of the amount (PLN 16.0m) will be spent on a new short cycle lamination press for large-sized boards (PLN 14.7m will be spent in 2012, the project is scheduled for completion in 2013). The rest of the amount will be spent on smaller projects related to production, infrastructure and the plant's IT systems development.

## 12 Marketing activities in 2011

**Promotion of the Pfleiderer brand and mission**

- OUR MISSION STATEMENT: Through partnership in development and building common value, we strive to ensure functional and sustainable wood-based solutions for your home.
-

The Pfleiderer brand
- Creation of a positive image of the Pfleiderer brand among all stakeholders;
- Pfleiderer – a reliable business partner offering attractive prospects for growth;
- Professionalism, responsibility and credibility of the management staff;
- Consistent internal and external communication.

Corporate objectives
- Positive financial result at all levels of the P&L in 2011;
- 10% margin on new products;
- Improved customer service – customer segmentation;
- Increased focus on products generating higher margins;
- Sector diversification.
-

Marketing objectives
- Development of the Premium brands and products;
- Finding new applications for the existing product mix;
- Using all possible opportunities for strong entry onto local markets;
- Creating new quality of dealership network;
- Developing new communication channels at Pfleiderer;
- Implementing trade and marketing standards for serving new markets and customers.

**Product policy**

First of all, Pfleiderer Grajewo S.A. took steps to optimise its product portfolio and continued search for new markets. The Company put a lot of effort into further development of its product mix.

**Pricing**

The continued efforts to withdraw from the commodity segment of the furniture industry require the Company to take broader look at its offering. Apart from items exposed to significant price pressures, the group also includes many products with a potential for better margins.

In interior design, the Company entered the market with high-end products. The customers expect good quality and they are also ready to bear higher costs connected.

**Distribution strategy**
Over the years, the duality of services rendered for the furniture industry has proven to be an efficient system and may now be considered optimal.
The Company needs to put yet more effort into improving the distribution system in the interior design sector.

New communication/distribution channels/; increasing the Company's presence on the interior design market through cooperation with the following partner groups:

- design and architecture studios,
- kitchen studios,
- entities offering interior design products and accessories,
- innovative and non-mainstream furniture manufacturers,
- Pani Kowalska (communications).

**Communications policy**
Our extensive communications efforts effectively conveyed information about the Company, its products and values to all target groups. Depending on the form of interaction between Grajewo Pfleiderer and the target groups (e.g. type of application of our products or of business relations), the communications process is based on different criteria and promotes relevant values.
From the point of view of the target groups, such messages may be broken down into those addressed to end users and business partners, although these areas of communication may often overlap.

The customer dimension - “Pfleiderer as a partner providing functional and sustainable wood-based solutions for your home”

- Differentiation of Pfleiderer's products from those offered by our competitors;
- Building strong product distinctiveness and characteristics;
- Communications policy based on products' strengths and possible applications.

The business dimension - “Pfleiderer as a partner in development and building common value”

- Building Pfleiderer's position as an industry leader;
- Promoting the Company's image as an innovative and experienced partner introducing new solutions to the market;
- Promoting the Company’s image as a financially stable partner focused on business growth.

## 13 Material related-party transactions as at December 31st 2011

The table below presents related-party transactions executed by the Company in the reporting period.
In 2011, the Company did not execute any related-party transactions other than on an arms' length basis.

PLN '000

| Entity | Sales | Finance income | Other operating income | Dividend income | Finance expenses | Purchase of merchandise, services and materials | Receivables under loans granted | Liabilities under borrowings and bonds | Trade and other receivables | Trade payables |
|---|---|---|---|---|---|---|---|---|---|---|
| Pfleiderer MDF OOO | 382 | 12,497 | 0 | 0 | 0 | 0 | 166,174 | 0 | 3,610 | 0 |
| Pfleiderer Unifloor Sp .z o.o. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Pfleiderer MDF Sp. z o.o. | 126,650 | 264 | 0 | 0 | 0 | 48,061 | 390 | 0 | 4,905 | 10,302 |
| Silekol Sp. z o.o. | 647 | 2,098 | 0 | 0 | 1 | 68,022 | 16,300 | 0 | 110 | 8,148 |
| OOO Pfleiderer Russia | 63,926 | 16,141 | 0 | 0 | 0 | 0 | 201,051 | 0 | 6,298 | 0 |
| Pfleiderer Prospan S.A. | 22,428 | 0 | 0 | 16,392 | 11,777 | 11,339 | 0 | 293,515 | 3,969 | 0 |
| Jura Polska Sp. z o.o. | 725 | 0 | 15 | 0 | 0 | 22,603 | 0 | 0 | 164 | 2,472 |
| Pfleiderer Services GmbH | 327 | 0 | 0 | 0 | 1,554 | 4,134 | 0 | 24,904 | 1,344 | 1,100 |
| Pfleiderer Aktiengesellschaft | 0 | 0 | 0 | 0 | 0 | 3,256 | 0 | 0 | 75,147 | 601 |
| Wodego GmbH | 50 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Duropal GmbH | 0 | 0 | 0 | 0 | 0 | 232 | 0 | 0 | 0 | 0 |
| Pergo Inc. | 19 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Pergo (Europe) AB | 7 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total** | **215,161** | **31,000** | **15** | **16,392** | **13,331** | **157,647** | **383,915** | **318,419** | **95,547** | **22,623** |

Receivables from Pfleiderer AG are exclusively receivables under a deposit placed with Blitz.

## 14 Management of Pfleiderer Grajewo S.A.'s financial resources in 2011

In 2011, Pfleiderer Grajewo S.A. financed its operations chiefly with bank borrowings and, to a certain extent, issues of notes acquired by Pfleiderer Prospan S.A and Silekol Sp. z o.o.

As at December 31st 2011, the nominal value of the Company's debt under notes in issue totalled PLN 294m, and the debt under bank borrowings was PLN 539m.

## 15 Financial instruments

**Overview of the financial instruments**

### a) Forward transactions

Forward transactions included purchase of foreign currency at a predetermined rate. In 2011, the Company used forward transactions to hedge its currency risk related to business transactions (product exports).

As at December 31st 2011, the Company had no unsettled forward contracts.

Since January 1st 2009, the Company has applied hedge accounting. As a result, the effective portion of gains or losses on fair value measurement of forward hedging instruments is recognised under other comprehensive income as other capital reserves – cash flow hedges, and transferred to current period's profit or loss when the transaction is closed.

### b) Notes, use by the issuer incomes of the issue to date report on the operations

The commercial paper programme consists in issues of short-term notes in compliance with the Law on Bonds dated 29 June 1995 in Polish zlotys, as bearer, dematerialized, unsecured, and zero-coupon securities.
The notes issued by Pfleiderer Grajewo S.A. mature in up to one year, and are held by Pfleiderer Prospan S.A. and Silekol Sp. z o.o. through the agency of Bank PEKAO S.A. Thus, Pfleiderer Grajewo S.A. does not use bank borrowings bearing higher interest, and Pfleiderer Prospan S.A. has placements which bear higher interest than such instruments as treasury bills. The cost borne by the notes issuer is the Bank's commission fee. The notes are discount instruments – their issue price reflects the discount interest and they are redeemed at par.
As at December 31st 2011, Pfleiderer Grajewo S.A.'s debt under notes in issue towards Pfleiderer Prospan S.A. was PLN 294m (including interest). After December 31st 2011, Pfleiderer Grajewo S.A. carried out 16 issues of debt securities in the form of short-term notes, to optimise the management of the Group's financial liquidity, to decrease Company's external debts and to finance it's current business activities

The programme's objective is to optimise cash management within the Group, to decrease Company's external debts and to finance it's current business activities

### c) Loans, sureties and guarantees

Pfleiderer Grajewo S.A. executes new projects through new companies in which it holds equity interests. The projects are financed partly with loans advanced directly to special-purpose vehicles and partly with loans granted by Pfleiderer Grajewo S.A.
In 2011, Pfleiderer Grajewo granted loans to four companies in which it held equity interests:

- Pfleiderer OOO
- Pfleiderer MDF OOO
- Pfleiderer MDF Sp. z o.o.
- Silekol Sp. z o.o.

In the case of Pfleiderer OOO, as at December 31st 2011, the debt outstanding under the loan was PLN 201,051 thousand. The projects were financed with RUB-denominated long-term loans granted by Pfleiderer Grajewo S.A. to Pfleiderer OOO. Interest on the loans accrues on a monthly basis and is recognised as finance income. In 2011, Pfleiderer OOO repaid a portion of its debt: PLN 36,278 thousand in principal and PLN 5,107 thousand in interest payments.

As at December 31st 2011, the outstanding amount of loans granted by Pfleiderer Grajewo S.A. to Pfleiderer MDF OOO (through which Pfleiderer Grajewo S.A. is constructing an MDF/HDF board production plant in Russia) was PLN 166,174 thousand.
In 2011, Pfleiderer Grajewo SA granted two loans to Pfleiderer MDF OOO of the total amount of RUR 82,182 thousand. Interest of loans is MOSPRIME + margin. All these loans are the subordinated debts to credit granted by banks to the Pfleiderer Grajewo S.A.

As at December 31st 2011, Pfleiderer MDF Sp. z o.o. and Silekol Sp. z o.o., subsidiaries, had two outstanding loans advanced by Pfleiderer Grajewo S.A.
On February 8th 2011, the share capital of Pfleiderer MDF Sp. z o.o. was increased by PLN 35,278 thousand. The new shares were acquired by Pfleiderer Grajewo S.A. (PLN 17,639 thousand) and Pfleiderer Service GmbH (PLN 17,639 thousand). As agreed upon on February 25th 2011, the share capital increase was effected through debt set-off by converting debt under loans advanced by Pfleiderer Grajewo S.A. and Pfleiderer Service GmbH into equity. Therefore, as at December 31st 2011, Pfleiderer MDF Sp. z o.o.'s debt outstanding under the loan was PLN 390 thousand.
As at December 31st 2011, Silekol Sp. z o.o.'s debt outstanding under the loan was PLN 16,300 thousand. Silekol Sp. z o.o. repaid a portion of its debt: PLN 8,700 thousand in principal and PLN 3,131 thousand in interest payments.

Pfleiderer Grajewo has outstanding loan advanced by Pfleiderer Services GmbH in EUR for financing day-to-day operations. As at December 31st 2011 Pfleiderer Grajewo’s debt outstanding under the loan was PLN 24.9 m. Full amount of loan falls due on June 30th 2014.

As at December 31st 2011, Pfleiderer Grajewo S.A. had two outstanding sureties:

- up to the amount of EUR 35,000 thousand valid for indefinite term, for the benefit of the European Bank for Reconstruction and Development for the liabilities under the bank borrowing granted to its subsidiary, Pfleiderer OOO, to finance the construction of a new plant in Russia. As at December 31st 2011, the debt outstanding under the facility was EUR 7,692 thousand (PLN 33,975 thousand). The surety expires upon Pfleiderer OOO’s achieving the agreed levels of financial ratios and establishing security on its assets for the benefit of the Bank.
- surety of up to EUR 1.1m (PLN 4.9m) for Pfleiderer MDF Sp. z o.o. This surety secures the partial repayment of a PLN 227m credit facility advanced to Pfleiderer MDF Sp. z o.o. by PKO BP S.A.

In order to secure the Banks’ claims under the credit facility agreement, on March 25th 2010 the Company executed documents and agreements concerning in particular:

- establishing contractual security mortgages over the Company’s and the Subsidiaries’ real estate, up to the maximum amount of PLN 1,400m;
- establishing registered pledges over assets owned by the Company and the Subsidiaries (pledge over a business), up to the maximum amount of PLN 1,050m);
- creation of registered and financial pledges over amounts credited to bank accounts;
- assignment of rights under insurance agreements by way of security;
- establishing financial and registered pledges over the Company’s shares in the Subsidiaries; the

pledge covers 100% of the shares in Pfleiderer Prospan S.A. and 50% of the shares in Silekol Sp. z o.o.

Furthermore, on March 25th 2010 the Company and the Banks executed a creditors agreement with the European Bank for Reconstruction and Development ("EBRD"), which provides financing to Pfleiderer OOO of Russia (a subsidiary of the Company) under the credit facility agreement of December 27th 2005. Under the creditors agreement, the parties agreed upon the scope of the security to be created over the Company's and the Subsidiaries' assets.
In order to secure the EBRD's claims under the guarantee agreement and the put/call option agreement, on March 25th 2010 the Company executed agreements and documents whereby:

- contractual blanket security mortgages were established over the Company's and the Subsidiaries' real estate, up to the maximum amount of PLN 70.5m;
- registered pledges were created over assets owned by the Company and the Subsidiaries (pledge over a business), up to the maximum amount of PLN 79.5m.

In addition, in H1 2010, the Company signed an agreement whereby a pledge was created over the Company's equity interest in Pfleiderer OOO for the benefit of the EBRD, to secure repayment of a credit facility advanced to Pfleiderer OOO under the credit facility agreement of December 27th 2005. The pledge was established over one share in Pfleiderer OOO's share capital, representing 84.1913% of the company's share capital and conferring the right to 84.1913% of the total vote at Pfleiderer OOO's General Meeting.

| Security | Company | Bank | Maximum amount of security | Currency | Claim |
|---|---|---|---|---|---|
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | PEKAO S.A. | 247,918,868 | PLN | Tranche A |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | PEKAO S.A. | 79,521,178 | PLN | Tranche B |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BZ WBK S.A. | 260,282,382 | PLN | Tranche A |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BZ WBK S.A. | 83,486,802 | PLN | Tranche B |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BRE Bank S.A. | 206,924,494 | PLN | Tranche A |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BRE Bank S.A. | 66,372,008 | PLN | Tranche B |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BGŻ S.A. | 149,662,370 | PLN | Tranche A |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | BGŻ S.A. | 48,004,910 | PLN | Tranche B |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | Fortis Bank Polska S.A. | 195,221,786 | PLN | Tranche A |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | Fortis Bank Polska S.A. | 62,615,102 | PLN | Tranche B |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | EBRD | 52,500,000 | EUR | Guarantee |
| Mortgage over real estate | PFLEIDERER GRAJEWO S.A. | EBRD | 18,000,000 | EUR | Put option |
| Pledge over assets | PFLEIDERER GRAJEWO S.A. | PEKAO S.A. | 795,000,000 | PLN | Tranche A |
| Pledge over assets | PFLEIDERER GRAJEWO S.A. | PEKAO S.A. | 255,000,000 | PLN | Tranche B |
| Pledge over assets | PFLEIDERER GRAJEWO S.A. | EBRD | 79,500,000 | EUR | Guarantee and put option |

### d) Shareholdings

For details concerning holdings of shares see "Investments in subsidiaries" in Notes to the annual separate financial statements.

## Financial risks related to the Company's operations

## Objectives and methods of financial risk management adopted by the Company

The Company manages all types of risk described above which may have a significant effect on its operations in the future. In its risk control measures, the Company focuses on the following risk types:

- credit risk
- currency risk
- liquidity risk
- interest rate risk

The objective behind credit risk management is to reduce the Company's losses which may follow from customers' insolvency. This risk is mitigated through insurance of receivables and non-recourse factoring.

The objective of currency risk management is to minimise losses arising out of unfavourable changes in foreign exchange rates. Pfleiderer Grajewo S.A. monitors its currency position from the point of view of cash flows rather than profit or loss. To manage the currency risk, it first relies on natural hedging and where necessary uses forward contracts. The time horizon adopted for position monitoring and hedging transactions is up to 12 months.

The objective of financial liquidity management is to protect the Company against insolvency. This objective is pursued through regular projection of debt levels in a five-year horizon, and arrangement of appropriate financing sources.

### a) Credit risk

Transactions which expose Pfleiderer Grajewo S.A. to credit risk involve trade receivables. The credit risk related to trade receivables is limited, as the customer base is highly dispersed and the risk is diversified. Therefore, the credit risk concentration is insignificant. Moreover, the Group operates a strict receivables management policy, whereby the customer credit risk mitigated through the use of trade credit insurance and factoring. In 2011, approx. 90% of the Company's trade receivables were secured in this way. In the event of insolvency of customers who have insurance coverage, the compensation is paid by the insurer. Each customer has a trade credit limit (usually covered by an insurance limit).

### b) Interest rate risk

The Company has liabilities under bank borrowings. The interest rate risk is related to interest payments under borrowings with floating interest rates. The Company does not hedge the interest rate risk.

### c) Currency risk

As at December 31st 2011, Pfleiderer Grajewo S.A. was not exposed to currency risk under foreign-currency loans, except for a loan with a nominal value of EUR 5m received from Pfleiderer Service GmbH and liabilities due to the EBRD under the put/call option.

Foreign currency transactions relate both to purchases of raw materials and sale of products. Therefore, in the event of any exchange rate fluctuations the resulting foreign exchange gains and losses are offset to a certain extent. The Company monitors its foreign currency positions on an ongoing basis and hedges open positions – first, through natural hedging (i.e., by carefully selecting currencies for new contracts), and second, with forward transactions. Pfleiderer Grajewo S.A. monitors its currency exposure in terms of cash flows.

In 2011, Pfleiderer Grajewo S.A. entered into a number of EUR/PLN forward contracts to hedge against currency risk related to planned trade transactions. The Company had no unsettled forward contracts as at December 31st 2011.

Furthermore, Pfleiderer Grajewo S.A. is exposed to currency risk resulting from RUB-denominated loans extended to Pfleiderer OOO and Pfleiderer MDF OOO.

### d) Price risk associated with financial instruments

Pfleiderer Grajewo S.A. is not exposed to any material price risk associated with financial instruments.

### e) Risk of material cash-flow disruptions

Pfleiderer Grajewo S.A. is protected against any material cash-flow disruptions by using significant credit facilities available at any time. Material cash-flow disruptions are also unlikely due to high customer diversification. Extraordinary expenditure is always planned well ahead and accounted for in the liquidity management process.

### f) Risk of liquidity loss

The Company monitors its liquidity position on an on-going basis, both with respect to short-term liquidity (a few days forward) and long-term liquidity (a few years forward).

| | Current ratio | Quick ratio | Average collection period | Average payment period | Inventory turnover ratio |
|---|---|---|---|---|---|
| | Current assets / Current liabilities | Current assets + inventories / Current liabilities | Average trade and other receivables / Net sales revenue:360 | Average trade and other liabilities / Net sales revenue: 360 | Average inventory / Net sales revenue:360 |
| 31.12.2011 | 0.74 | 0.58 | 63 days | 49 days | 32 days |
| 31.12.2010 | 0.43 | 0.31 | 78 days | 48 days | 27 days |

On March 16th 2010, the Company executed a PLN 700,000 thousand credit facility agreement ("Credit Facility Agreement") with a bank syndicate.

The Credit Facility Agreement contains financial covenants concerning the required level of certain financial ratios, which are based on consolidated financial data of the Pfleiderer Grajewo Group. The ratios are:

- financial debt to EBITDA
- total equity to total assets,
- current assets to current liabilities,
- debt-service coverage ratio,

In connection with a series of events relating to legal and economic situation PAG, in 2010, there was a breach of Pfleiderer AG of its loan agreements. Pfleiderer Grajewo Group obtained waivers from its financing banks, whereby the banks waived their rights to terminate the credit facility agreement with the Group due to the breach of credit agreements by Pfleiderer AG.

On May 12th 2011, Pfleiderer AG reported that it had reached an agreement with its financing banks regarding key elements of the financial restructuring and debt refinancing plan. The terms of the agreement required an approval of the agreement by Pfleiderer AG's share- and stakeholders. Some non-controlling shareholders and holders of hybrid bonds have appealed against the resolutions granting the approvals to competent courts. As a result of negative verdict of Higher Regional Court, Frankfurt/Main from March 27th 2012 the debt relief and recapitalization of the company that had been planned within the scope of the restructuring plan is now no longer possible by this means. On 28 March 2012 Pfleiderer AG in Neumarkt filed an application for insolvency. According to the information provided by Pfleiderer AG, the Management Board of Pfleiderer AG filed a request to open insolvency proceedings and has requested to act as debtor in possession. The Management Board, supervised by a judicial administrator, will continue managing and restructuring the company.

According to the best knowledge of the Board of Pfleiderer Grajewo agreements concluded between the PAG and its banks were not uttered in connection with PAG application for insolvency. Moreover, according to the best knowledge of the Board of Pfleiderer Grajewo PAG application for insolvency is not a breach of Pfleiderer Grajewo credit agreement.

Pfleiderer AG still runs the risk of breaching credit agreements, which would put the Company in default on some of its borrowings. However, the Company believes that, especially given its current financial performance, the likelihood of failing to obtain relevant waivers from its creditors is low.

Pfleiderer Grajewo S.A. monitors the ratios on an ongoing basis and, based on its short-term financial plans, reviews the risk of failure to meet the ratios.

The exposure to currency, credit and interest rate risks has not materially changed since the release of the Company's previous annual report for 2010.

## 16 2012 performance forecast

Given the current economic climate, the Company will refrain from publishing its forecast for 2012 until the market volatility subsides and the Polish furniture market stabilises.

## 17 Court proceedings

There are no court, arbitration or administrative proceedings pending with respect to any liabilities or claims of the Company, whose value would represent 10% or more of the Company’s equity.

## 18 Corporate governance

**Appointment and removal of the management staff**

Pursuant to the Company’s Articles of Association, the Management Board members are appointed by the Company’s Supervisory Board. The Articles of Association and resolutions of the Company’s General

Meeting do not provide for any special powers for the Management Board members with respect to making decisions on the issue or repurchase of shares.

**Description of operation governing bodies**
The Management Board complies at least 2 members. The term of office lasts five years, members of the Management Board are appointed for the common term of office. The Supervisory board appoints the President of the Management Board and on the President motion, other Board Members. In the scope of Company management, the Management Board exercises all its powers, except for the rights reserved by the law or by the Company Statue to the other Company's governing bodies. The Management Board's procedure of conducting and all the cases that can be mandated to its members are precisely described in the Management Board regulations, adopted by the Management Board and approved by the Supervisory Board.

The Supervisory Board is appointed by Shareholders. The Supervisory Board complies 5, 7 or 9 members. The term of office lasts five years, members of the Supervisory Board are appointed for the common term of office. The Supervisory board supervises the Company's activities. The rights and duties of Supervisory Board are described in the Company Statue and law, including Code of Commercial Companies. The Supervisory Board adopts its regulations, describing detail procedure of supervisory Board conducting.

**Amendments to the Articles of Association of the Company**
The Articles of Association of the Company are amended in line with the procedure specified in the Commercial Companies Code. No special provisions with respect to this practice are set forth in the Articles of Association of the Company.

**Proceedings of the General Meeting of the Company**
The General Meetings of the Company has the powers specified in the Commercial Companies Code and the Articles of Association. The proceedings of the General Meeting are governed by the Articles of Association and the Rules of Procedure of the General Meeting, available on the Company's web site.

**Company shares**
The Company did not issue any shares granting special control powers. In addition, there are no limitations on the exercise of voting rights attached to the shares issued by the Company. Also, there exist no rights related to the securities issued by the Company which would be separate from the ownership of the securities.
Neither the Company's Articles of Association nor any other of its internal regulations provide for any limitations on transfer of the Company shares. Therefore, transfer of ownership of the Company shares is subject only to the limitations imposed by the applicable laws and the stock-exchange regulations.

**The Company's financial statements**
The Company's financial statements are prepared by a separate organisational unit. All financial statements are reviewed, verified and approved at several levels of management, eliminating the risk related to financial reporting.

**Statement of compliance with corporate governance principles at the Parent**
The Pfleiderer Grajewo Management Board declares that the Company complies with the corporate governance rules contained in "Best Practices of WSE-Listed Companies" as appended to the WSE Supervisory Board resolution No. 20/1287/2011, dated October 19th 2011, save for the following rule:

Rule III.6

At least two members of the Supervisory Board should meet the criteria of being independent from the company and entities with significant connections with the company. The independence criteria should be

applied under Annex II to the Commission Recommendation of February 15th 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Irrespective of the provisions of point (b) of the Annex, a person who is an employee of the company, its subsidiary or an associated company cannot be deemed to meet the independence criteria described in the Annex. In addition, a relationship with a shareholder precluding the independence of a member of the Supervisory Board as understood in this rule is an actual and significant relationship with any shareholder who has the right to exercise at least 5% of all votes at the General Meeting.

The Company does not comply with the rule. Instead, it ensures that an independent member serves on the Supervisory Board as specified below:

In accordance with the Company's Articles of Association, at least one member of the Supervisory Board comprising five persons, two members of the Supervisory Board comprising seven persons and three members of the Supervisory Board comprising nine persons are independent members who satisfy the following criteria:

- they are not members of the governing bodies of Pfleiderer Grajewo S.A.'s parent or of such parent's subsidiaries,
- they are not employed by Pfleiderer Grajewo S.A.'s parent or by such parent's subsidiaries,
- they are not relatives (a spouse, direct descendant or direct ascendant) of a member of the governing bodies of Pfleiderer Grajewo S.A. or Pfleiderer Grajewo S.A.'s parent.

In line with the Company's Articles of Association, as at the date of the corporate governance statement, the Supervisory Board is composed of five persons, including one member meeting the independence criteria specified above.

## 19 The Auditor

The separate and consolidated financial statements are audited and reviewed on the basis of the decision made by the General Meeting on June 23rd 2010 on selection of an entity qualified to audit financial statements. Pursuant to the resolution, the following auditor was appointed:

KPMG Audyt Spółka z o.o. spółka komandytowa
ul. Chłodna 51
00-867 Warszawa, Poland

The financial statements were audited pursuant to an agreement of October 11th 2010, which provided for the audit of the annual separate financial statements of Pfleiderer Grajewo S.A. and the audit of the annual consolidated financial statements of the Pfleiderer Grajewo Group for the financial year ended December 31st 2011, prepared in accordance with the IFRS. The agreement also provided for an audit of the Group's annual report prepared for the majority shareholder. The fee for the audits specified above was PLN 236 thousand (PLN 236 thousand for the previous financial year).

## 20 Audit Committee

All duties of an audit committee were assigned to the Pfleiderer Grajewo Supervisory Board.

## 21 Non-recurring events affecting the Pfleiderer Grajewo Group's financial performance

No non-recurring events which might affect the Group's financial performance occurred in the reporting period.

## 22 Changes in the composition of the Company's Management Board during the financial year

with effect as of February 8th 2011, Johann Bitzi, Vice-President of the Management Board, was removed from office as member of the Pfleiderer Grajewo Management Board.

## 23 Changes in the composition of the Company's Management Board after the balance-sheet date

After December 31st 2011, the composition of the Company's Management Board did not change.

## 24 Changes in the composition of the Supervisory Board

On October 17th, Mr Heiko Graeve resigned from the Pfleiderer Grajewo Supervisory Board.

At the Extraordinary General Meeting held on November 24th 2011 Mr Paweł Wyrzykowski was removed from the post of Chairman of the Supervisory Board.
Mr Hans-Joachim Ziems and Mr Hans-Kurt von Werder were appointed as Members of the Supervisory Board.

At a meeting of the Pfleiderer Grajewo Supervisory Board held on December 21st 2011, Members of the Supervisory Board appointed Mr Michael Wolff to the post of Supervisory Board Chairman.

On March 7th 2012, Mr Hans-Joachim Ziems tendered his resignation from the position of a member of Pfleiderer Grajewo S.A.'s Supervisory Board, with effect as of April 10th 2012.

At the Extraordinary General Meeting held on April 10th 2012 Mr Jochen Schapka was appointed as Member of the Supervisory Board.

## 25 Events subsequent to the end of the reporting period

After December 31st 2011, Pfleiderer Grajewo S.A. carried out 16 issues of debt securities in the form of short-term notes, to optimise the management of the Group's financial liquidity. The notes were issued pursuant to a commercial paper programme agreement executed with Bank PEKAO S.A. on July 22nd 2003 and in accordance with the Polish Bonds Act of June 29th 1995 as złoty-denominated, unsecured, zero-coupon bearer securities in book-entry form. The notes are redeemed at their par value. The notes were acquired by subsidiary Pfleiderer Prospan S.A.

On January 31st 2012, Pfleiderer Grajewo S.A. received a notification dated January 27th 2012 from Wojciech Gątkiewicz, President of the Management Board. In the notification, Mr Gątkiewicz, acting pursuant to Art. 160 of the Act on Trading in Financial Instruments of July 29th 2005, notified the Company that in 2011 he acquired Company shares with a total value of up to EUR 5,000. 2,400 ordinary bearer shares were acquired at prices ranging from PLN 8.10 to PLN 8.78 per share in ordinary session transactions concluded on the Warsaw Stock Exchange on August 29th and September 6th 2011.

On March 7th 2012, Mr Hans-Joachim Ziems tendered his resignation from the position of a member of Pfleiderer Grajewo S.A.'s Supervisory Board, with effect as of April 10th 2012.

On March 15th 2012, an annex was signed to the Credit Facility Agreement of March 16th 2010 executed by Pfleiderer Grajewo S.A. as the lender, Pfleiderer Prospan S.A. and Silekol Sp. z o.o. as other obligors under the agreement and a syndicate of financing banks comprising: Bank Polska Kasa Opieki S.A., Bank

Zachodni WBK S.A., BRE Bank S.A., Bank Gospodarki Żywnościowej S.A. and BNP Paribas Bank Polska S.A. (formerly Fortis Bank Polska S.A.). Under the annex, the repayment date for Tranche B, previously scheduled for March 16th 2012, was extended. Consequently, the full amount of Tranche B (PLN 170m) falls due on March 16th 2013.
On 28 March 2012 Pfleiderer AG in Neumarkt filed an application for insolvency.

According to the information provided by Pfleiderer AG, the Management Board of Pfleiderer AG filed a request to open insolvency proceedings and has requested to act as debtor in possession. The Management Board, supervised by a judicial administrator, will continue managing and restructuring the company.

Pfleiderer AG is the parent of the Pfleiderer Group. It is a holding company, which does not conduct any operating activities. Pfleiderer AG employs 10 staff. The bankruptcy petition was filed exclusively with respect to Pfleiderer AG and does not involve the Pfleiderer AG Group's subsidiaries which continue their day-to-day operations unaffected.

The Pfleiderer Grajewo Group companies have not issued any sureties for Pfleiderer AG's liabilities.

The Company's direct shareholder is Pfleiderer Service GmbH in Neumarkt, however, the bankruptcy petition does not cover Pfleiderer Service GmbH. Pfleiderer AG is not a direct shareholder in any of the Pfleiderer Grajewo Group companies.

In the opinion of the Pfleiderer Grajewo Management Board, the potential declaration of Pfleiderer AG's bankruptcy will not adversely affect the Pfleiderer Grajewo Group's day-to-day operations. The Group companies are fully independent in terms of operations, have their own procurement systems and sales channels. The Pfleiderer Grajewo Group holds separate loan agreements securing funding of its day-to-day operations.

On April 2nd 2012 Company and its subsidiary undertaking Pfleiderer Prospan S.A. received a notification of initiation of anti-trust proceedings by the President of the Office of Competition and Consumer Protection ("UOKiK") dated March 30th 2012 on the conclusion by Kronospan Szczecinek Sp. z o.o., Kronospan Mielec Sp. z o.o., Kronopol Sp. z o.o., Pfleiderer Grajewo S.A. and Pfleiderer Prospan S.A. an agreement restricting competition on the domestic chipboard and fibreboard market.
The information obtained indicates that the case files are just currently created from the material gathered during the investigation. Pfleiderer Grajewo SA and a subsidiary of Pfleiderer S.A. are currently waiting for an opportunity to review case files. Units were given 14 days' notice for explanations. At this stage, the Board of Pfleiderer Grajewo and Pfleiderer basis of the available information is not able to quantify the risk.

At the Extraordinary General Meeting held on April 10th 2012 Mr Jochen Schapka was appointed as Member of the Supervisory Board.
Extraordinary General Meeting held on April 10th 2012 adopted resolution on a consent for extension of a duration of the debt bearing securities issue programme in a form of bonds by June 30th, 2017.

***Economic forecast for the nearest future***

Given the current economic climate, the Company will refrain from publishing its forecast for 2012 until the market volatility subsides and the Polish furniture market stabilises.

**Pfleiderer Grajewo Management Board** **Grajewo, April 16th 2012**

Wojciech Gątkiewicz

Rafał Karcz

Dariusz Tomaszewski

Radosław Wierzbicki