THE LOTOS GROUP

DIRECTORS' REPORT ON THE FINANCIAL PERFORMANCE OF THE LOTOS GROUP FOR Q2 2008

Gdańsk, August 13th 2008

(This is a translation of a document originally issued in Polish)

CONTENTS

1 INTRODUCTION

In Q2 2008, the Management Board of Grupa LOTOS S.A. pursued the LOTOS Group's Strategy until 2012 in the key areas of the Group's business, including:

- exploration and production of crude oil,
- oil refining and wholesale of refined petroleum products,
- retail sale of fuels.

In the E&P area, in Q2 2008 the Group produced crude oil and natural gas from the B3 and B8 deposits. Total crude oil production amounted to 67.1 thousand tonnes, while total natural gas output was 7,579 thousand m^3.

In Q2 2008, Petrobaltic conducted work relating in particular to the drilling of the B8-Z1 well, production from B8 and B3 deposits, as well as maintenance and repair work.

Petrobaltic S.A., the leading company of the LOTOS Group in the field of exploration and production, acquired 100% of shares in LOTOS Exploration and Production Norge A.S. (LOTOS E&P Norge), whose core business consists in exploration for and production of crude oil on the Norwegian Continental Shelf.

On May 20 2008, LOTOS E&P Norge signed an agreement with Norwegian company Revus Energy concerning purchase of 10% of interests in North Sea production licences. The recoverable crude oil reserves of the YME field which correspond to the 10% interest held by LOTOS E&P Norge AS, amount to 6.8 million bbl.

The volume of crude oil processed in Q2 2008 was 1,538.7 thousand tonnes, which represented a 102.9% utilisation of the nameplate throughput capacity of the Gdańsk refinery. The volume of Ural crude processed in Q2 2008 was 1,421.9 thousand tonnes (92.4% of total volume of crude oil processed).

In Q2 2008, the LOTOS Group sold 374 thousand tonnes of motor gasolines, 720 thousand tonnes of diesel oil, 53 thousand tonnes of light heating oil, 104 thousand tonnes of heavy fuel oil, 121 thousand tonnes of jet fuel, 276 thousand tonnes of bitumens, and 126 thousand tonnes of other products.

In Q2 2008, the activities related to the implementation of the 10+ Programme focused on execution of contracts, singing further contracts, and arranging financing for the 10+ Programme.

In the retail area, in Q2 2008, the Group continued to develop a modern countrywide LOTOS service station network by restructuring the stations network and launching new products. As at the end of Q2 2008, the number of COCO/CODO stations was 134, the number of DOFO stations was 76, and the number of DODO stations fell to 138. The number of franchise agreements signed amounted to 88.

In Q2 2008, the average price of Brent oil (Dated Brent FOB) was USD 121.21 per barrel, and was higher than in Q1 2008 (by USD 24.50 per barrel, or 25.3%) and in Q2 2007 (by USD 52.46 per barrel, or 76.3%). The average price of Ural CIF Rotterdam oil was USD 117.47 per barrel, and was higher than in Q1 2008 (by USD 24.12 per barrel, or 25.8%) and in Q2 2007 (by USD 52.44 per barrel, or 80.6%).

The higher oil prices in Q2 2008 as compared with Q1 2008 were accompanied by a 10.7% increase in the Brent/Ural differential – from USD 3.37 per barrel in Q1 2008 to USD 3.73 per barrel in Q2 2008. In relation to Q2 2007, the Brent/Ural differential increased by 0.3% (from USD 3.72 per barrel).

In Q2 2008, the average refining margin increased to USD 7.89 per barrel and was 77.7% higher than in Q1 2008, and 2.9% higher (up by USD 0.22 per barrel) year on year.

The LOTOS Group's performance in Q2 2008 was driven by a number of factors, including in particular increased prices of crude oil and crude oil products on global markets, higher sales of petroleum products, costs of creating regulatory stocks of fuels, the złoty strengthening against the US dollar and the concluded hedging transactions.

In Q2 2008, the LOTOS Group posted consolidated sales revenue of PLN 4,217.9m, operating profit of PLN 381.8m, net profit on continued operations of PLN 422.2m and net profit attributable to equity holders of the parent in the amount of PLN 396.5m. Year on year, sales revenue increased by 37.4%, operating profit went up by 52.2%, net profit on continued operations increased by 74.4%, and net profit attributable to equity holders of the parent by 65.5%.

2 PETROBALTIC AND THE PRODUCTION AREA

In the E&P area, in Q2 2008 oil and gas production continued at the B3 and B8 deposits. The crude oil and natural gas outputs were, respectively, 67.1 thousand tonnes and 7,579 thousand m^3. The entire crude oil output was shipped to the Gdańsk refinery, and the natural gas was sent via a pipeline to Energobaltic's power plant in Władysławowo. Petrobaltic's crude sales to the LOTOS Group amounted to 82.4 thousand tonnes.

In Q2 2008, the key tasks carried out by Petrobaltic included:

- drilling of the B8-Z1 well and the B8-Z1 bis branch from the Petrobaltic platform,
- production from the B8 deposit from the Petrobaltic platform,
- production from the B3 deposit, including water pumping to the deposit on the Baltic Beta platform,
- maintenance and repair work on PG-1.

Petrobaltic S.A., the leading company of the LOTOS Group in the field of exploration and production, became a shareholder of LOTOS Exploration and Production Norge AS, whose core business consists in exploration for and production of crude oil on the Norwegian Continental Shelf. In connection with the planned further expansion of LOTOS E&P Norge's business, the company's share capital was increased to NOK 40m by way of issue of new shares. Petrobaltic S.A., having acquired all shares in the increased capital and then purchased the remaining shares from Grupa LOTOS S.A., became the sole shareholder of LOTOS E&P Norge. On May 27th 2008, the Norwegian companies registrar registered the share capital increase at LOTOS E&P Norge AS.

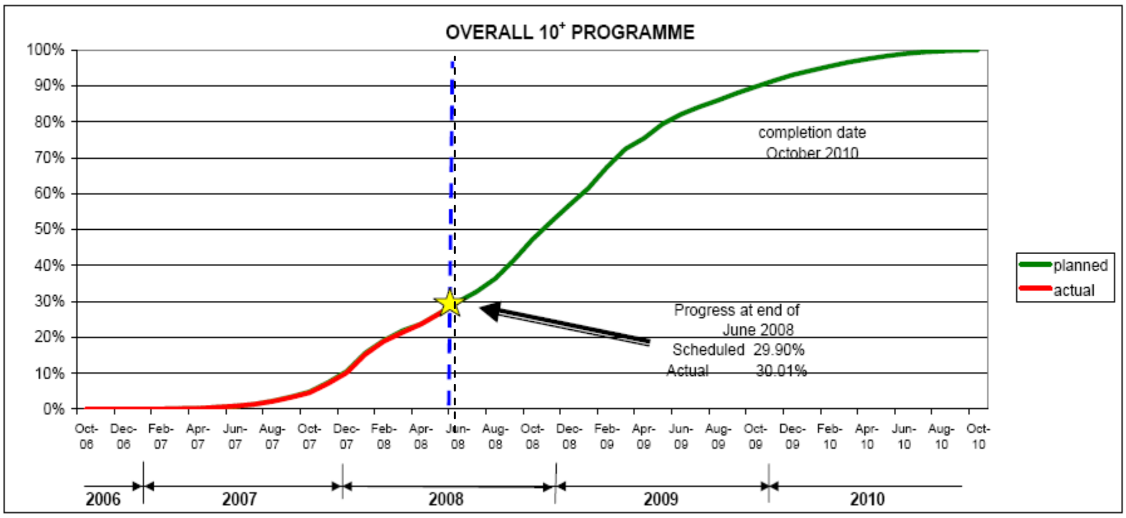
In order to expand its activities on the Norwegian Shelf, LOTOS E&P Norge applied to the Norwegian Ministry of Energy and Crude Oil for a permit for conducting the production of crude oil and took steps designed to acquire assets necessary for launching operations. On May 20th 2008, the company signed an agreement with Norwegian company Revus Energy concerning purchase of 10% of interests in the North Sea production licences No. 316, 316B, 316CS and 316DS. The purchased licences cover the YME field and an additional exploration area. The YME field is located 110 km off the coast in the southern part of the Norwegian sector of the North Sea.

The recoverable crude oil reserves of the YME field which correspond to the 10% interest held by LOTOS E&P Norge AS, are estimated by the operator (Talisman) at 6.8 million bbl (about 900 thousand tonnes). Production from the field is expected to start in the second half of 2009.

3 10+ PROGRAMME

In Q2 2008, the implementation of the 10+ Programme, the largest investment project of the LOTOS Group of key importance for the future growth of the Group's value, focused on execution of contracts, signing further contracts and arranging financing for the 10+ Programme.

The current progress of work under the 10+ Programme is presented in the chart below.



Source: Grupa LOTOS S.A.

As part of the SDA/ROSE project, following the tender and contractor selection, the Early Work Agreement ("EWA") was signed with Technip Italy SpA, for design and delivery of materials and equipment necessary for the unit construction, as well as for technological advisory and designer supervision during the construction work.

As part of the HDS project (diesel hydrodesulphurisation), in Q2 2008, the final phase of the construction work on cable conduits and trays was underway and delivered apparatuses was assembled.

As part of the CDU/VDU project (crude distillation unit), in Q2 2008, the selection of contractors was completed and major agreements were signed for furnace assembly, the installation of fire-proof shielding and the DCS and ESD systems. The assembly of steelwork and pipeline prefabrication also commenced.

As part of the MHC project (mild hydrocracking), principally, the engineering design work was continued. In Q2 2008, the majority of apparatuses and equipment was ordered, first deliveries were made to the construction site and foundation laying started.

As part of the HGU (hydrogen generating unit) project, by the end of Q2 2008, 61% of construction work and 90% of underground piping were executed. The external structure of the reformer furnace was assembled, as was the basic internal pipeline trestle bridge. All catalyst pipes for the reformer furnace and materials for pipeline prefabrication were delivered to the construction site.

As part of the KAS project (amine sulphur unit), the foundations laying on the ARU/SWS/SRU/TGTU installations was completed, and underground infrastructure development is currently in progress, as is the assembly of the main trestle bridge of the ARU and SWS installations. In Q2 2008, the deliveries and assembly of apparatuses commenced. Pipeline components and materials are being delivered to the site.

In the area of auxiliary installations and infrastructure, work continued on construction of inter-unit connections and utilities, storage tanks and auxiliary facilities. Materials were ordered for pipeline systems for most of the inter-unit connections, an agreement was signed for the assembly of pipelines and pipe bearers, as well as for construction of a new nitrogen unit, providing for deadlines harmonised with the requirements of the construction process. Currently, the construction work on new power-supply facilities is in progress.

In the case of storage tanks (pipeline to the sea terminal), the foundations laying for the VR, VGO and pyrolytic gasoline storage tanks is in the final stage. Piling work under the foundations of the diesel oil storage tanks is completed and foundations laying has commenced. Currently, a construction design is being prepared for the pipeline to the terminal. Preparations are being made for the commencement of work on the LPG tank.

With respect to auxiliary facilities, the work is continued on extension of the waste water treatment plant, final commissioning and pressure testing of underground network systems are being performed, foundations laying for new inter-unit trestle bridges is ongoing. Designs are also being prepared for new fan coolers, while internal roads and the wharf are being reconstructed in order to adapt them to the handling and transport of heavy cargo from the wharf.

In April 2008, Grupa LOTOS S.A. and a group of banks signed a commitment letter which forms the banks' binding obligation to advance a credit facility on the agreed terms, together with the term sheet including basic formal and legal terms of the transaction. Subsequently, detailed provisions of the loan facility agreement and the accompanying financial documentation (including security agreements) were drafted and then negotiated.

On June 27th 2008, Grupa LOTOS S.A. and a bank syndicate executed a credit facility agreement to finance the implementation of the 10+ Programme and the working capital of Grupa LOTOS S.A. Bank Calyon of Paris acts as the Senior Facility Agent, while Société Générale of Paris performs the role of the Senior Security Agent. Concurrently, under the credit facility agreement, Grupa LOTOS S.A. executed a subagreement concerning the credit facility tranche guaranteed by SACE, an Italian export credit agency

Moreover, in Q2 2008, the process of fulfilling conditions precedent to the origination of these facilities started.

4 *PROSTA* PROGRAMME

In Q2 2008, the Group was developing its retail service station network through subsidiary LOTOS Paliwa, focusing on continued expansion of the COCO and CODO station network and the development of the DOFO station network.

In the period, the Group continued the following activities commenced in the previous quarters:

- a COCO/CODO service station at ul. Arkuszowa in Warsaw was placed in service on June 19th 2008,
- new stations (in Bartoszyce, Dębica, Cieszyn, Włodawa, Zwoleń, Kórnik and Gronów Górny near Elbląg) were included into the LOTOS Family Commercial Partnership Programme.

As at June 30th 2008, the LOTOS service station network comprised 348 locations, including 134 CODO stations, 76 DOFO stations and 138 DODO stations.

A total of 88 franchise agreements were signed. In line with the assumptions of the PROSTA Programme regarding transfer of the DODO stations to another operational platform, since Q1 2007 the total number of high-margin COCO/CODO and DOFO service stations has been larger than the number of DODO stations.

5 SOUTHERN REFINERIES (LOTOS CZECHOWICE AND LOTOS JASŁO)

In Q2 2008, LOTOS Czechowice and LOTOS Jasło were pursuing the objectives set out in the LOTOS Group's strategy for the Southern Refineries.

LOTOS Jasło focused on changing its operating profile in connection with the discontinuation of oil processing, scheduled for the end of 2008. The company is developing a number of projects which involve recycling of plastics. For instance, it has begun reprocessing of plastics into reusable granules and pellets.

In May 2008, LOTOS Czechowice launched a methyl ester (FAME) production unit. Methyl esters are a component used by Grupa LOTOS S.A. in biodiesel production (project executed by LOTOS Biopaliwa Sp. z o.o. on LOTOS Czechowice's site).

Q2 2008 saw the start-up of the FAME production unit at full capacity (100 thousand tonnes of FAME per year in the continuous production process). In the near future, methyl esters will be produced from rapeseed oil (about 90% of feedstock) and methanol (about 10% of feedstock). The LOTOS Group has entered into agreements for the feedstock supplies with Komagra Sp. z o.o., Zakłady Tłuszczowe Kruszwica S.A. and Zakłady Tłuszczowe of Bodaczów.

In accordance with the contract terms, production tests were being carried out and production of the biocomponent was launched at LOTOS Czechowice. The construction work for a tank with the capacity of 32 thousand m^3 was continued. Once completed, the tank will increase the LOTOS Group's available storage capacities in southern Poland. The tank is scheduled to be placed in service in mid-November 2008.

At LOTOS Jasło, negotiations were being held with the aim to upgrade and expand the used oil recycling process. Having reviewed their respective proposals and technologies, the company began negotiations with prospective investors, aimed at reaching agreements in the form of letters of intent that would define the terms and conditions of proposed cooperation.

Efforts undertaken by LOTOS Czechowice led to an agreement for the use of the ABT and furfurol units (which are currently out of operation) as part of a project executed jointly with a foreign investor.

At LOTOS Park Technologiczny, the restructuring of the company's human resources and assets is progressing according to schedule and is now nearing completion.

6 MARKET ENVIRONMENT AND OPERATIONS

6.1 Oil and Fuel Markets

In Q2 2008, the average price of Brent crude (Dated Brent FOB) was USD 121.21 per barrel and was higher by USD 24.50 per barrel, i.e. 25.3%, quarter on quarter, and by USD 52.46 per barrel, i.e. 76.3%, year on year.

The average price of Ural CIF Rotterdam was USD 117.47 per barrel and was higher by USD 24.12 per barrel, i.e. 25.8%, quarter on quarter, and by USD 52.44 per barrel, i.e. 80.6%, year on year.

The higher crude prices were accompanied by a rise in the Brent/Ural differential, from USD 3.37 per barrel in Q1 2008 to USD 3.73 per barrel in Q2 2008 (up 10.7%). The differential increased from USD 3.72 per barrel in Q2 2007 (up 0.3%).

In Q2 2008, the average refining margin rose by 77.7% quarter on quarter, to USD 7.89 per barrel (USD 4.44 per barrel in Q1 2008). Relative to Q2 2007, the refining margin increased by USD 0.22 per barrel (2.9%).

The average crack margin on gasoline improved by 19.07% on Q1 2008, to USD 145.54 per tonne, while the average crack margin on diesel oil went up by 64.71%, to USD 270.32 per tonne. Compared with Q2 2007, the average crack margin on gasoline declined by 37.96%, whereas the average crack margin on diesel oil rose by 139.22%.

6.2 Operational Review

In Q2 2008, the Gdańsk refinery processed 1,538.7 thousand tonnes of crude, which represented a 102.9% utilisation of the nameplate throughput capacity.

The Gdańsk refinery processed 1,421.9 thousand tonnes of Ural crude in the reporting period, which accounted for 92.4% of the total processing volume. The balance comprised the Rozewie oil extracted by Petrobaltic – 38.1 thousand tonnes (2.5% of the processing volume), the Volve oil – 65.3 thousand tonnes (4.2% of the processing volume), and the Sleipner oil condensate – 13.4 thousand tonnes (0.9% of the processing volume).

In Q2 2008, the LOTOS Group sold 374 thousand tonnes of motor gasolines, 720 thousand tonnes of diesel oil, 53 thousand tonnes of light heating oil, 104 thousand tonnes of heavy fuel oil, 121 thousand tonnes of jet fuel, 276 thousand tonnes of bitumens, and 126 thousand tonnes of other products (including 50 thousand tonnes of LPG, 12 thousand tonnes of engine oils, 26 thousand tonnes of base oils, 12 thousand tonnes of other oils, 12 thousand tonnes of paraffins, 9 thousand tonnes of sulphur, 4 thousand tonnes of plasticizers, and 1 thousand tonnes of other oil products).

Compared with Q1 2008, the employment at the LOTOS Group in Q2 2008 increased to 4,843 personnel (62 new employees hired). The headcount increase was due to hiring new employees to operate production units as part of the "Staff 2009 – 10+ Programme" and intensified activity in the area of licensed transportation services at LOTOS Kolej.

7 DISCUSSION OF CONSOLIDATED RESULTS OF THE LOTOS GROUP

7.1 Income Statement

In Q2 2008, the sales revenue of the LOTOS Group amounted to PLN 4,217.9m and was up by 37.4% year on year, mainly due to substantial increase in the prices of crude oil and petroleum products on the global markets and larger volumes of sales of petroleum products and oil derivatives. The average net selling price rose by 29.1%, from PLN 1,842 per tonne in Q2 2007 to PLN 2,378 per tonne in Q2 2008. The Q2 2008 sales volume of the LOTOS Group was 1,773.8 thousand tonnes, which represented a year-on-year increase of 106.4 thousand tonnes (6.4%). In the analysed quarter, the sales volume of diesel oils, bitumens and bitumen components, JET A-1 fuel, gasolines, liquefied gases, heavy fuel oils and base oils increased, whereas the sales of light heating oils and lubricants declined.

Compared with the corresponding period of the previous year, in Q2 2008 cost of sales went up by 37.3% and amounted to PLN 3,544.5m. The Q2 2008 unit cost of sales was PLN 1.998 per tonne, i.e. 29.0% more than in Q2 2007.

In Q2 2008, gross profit on sales posted by the LOTOS Group increased by PLN 184.6m (37.8%) relative to Q2 2007, to PLN 673.5m. The Q2 2008 increase was driven mainly by a considerable rise in crack margins on middle distillates. In Q2 2008, the average quarterly crack margins on Diesel 10 and JET Fuel were seen up year on year by 146.3%, and 120.2%, respectively. In the analysed period, the sales structure changed favourably in terms of the margin (the changes included rises in sales of diesel oils and the JET A-1 fuel by 47.5 thousand tonnes and 13.1 thousand tonnes, respectively). Growing prices of petroleum products on global markets, in particular soaring prices of middle distillates, also positively affected the Group's performance in Q2 2008. Compared with Q2 2007, in Q2 2008, the LOTOS Group obtained better terms of purchase of the Ural oil, which is the basic raw material. However, the Group's performance in Q2 2008 was negatively affected by the strengthening of the Polish złoty. The average PLN/USD exchange rate was 22.7% lower than in Q2 2007 (down by PLN/USD 0.64).

Selling costs incurred by the LOTOS Group in Q2 2008 amounted to PLN 185.3m, and were up by 11.4% year on year, principally due to the higher volume of sales and the changed structure of sales. In the analysed period, general and administrative expenses rose by 17.2% year on year, to PLN 88.2m. The growth was mainly driven by the increasing scale of operations.

In Q2 2008, the Group disclosed operating profit of PLN 381.8m, up by PLN 130.9m year on year.

In Q2 2008, profit on financing activities was PLN 139.3m and was PLN 86.6m higher year on year, mainly due to charging foreign exchange differences relating to financing activities, including restatement of foreign-currency long-term loans of PLN 36.8m, to financial income and charging the valuation of hedging transactions executed to mitigate the market risk related to changes in the refining margin and foreign exchange rates related to the implementation the 10+ Programme to financial expenses.

The margin, FX and interest rate hedging transactions follow from the steps taken to manage the market risk related to the implementation of the 10+ Programme and to satisfy the requirements set forth in the agreement for financing the 10+ Programme.

The total excess of the positive settlement of derivatives recognised as financial income for the first six months of 2008 was PLN 253.5m and was lower by PLN 7.3m quarter on quarter. The relevant figure includes the effect of negative settlement of refining margin hedging transactions (full barrel swaps), amounting to -PLN 67.8m, the settlement of foreign exchange risk hedging transactions (forwards) of PLN 59.1m and the valuation of futures contracts executed to hedge the prices of CO_2 emission rights of PLN 1.4m.

As at the end of June 2008, open (not settled) futures contracts charged to financial expenses totalled PLN 78.5m. The valuation of financial instruments charged to financial expenses for Q2 2008 reduced financial expenses by PLN 53.7m and included refining margin hedging transactions (full barrel swaps) with a value of PLN 28.1m, foreign exchange risk hedging transactions (forwards) with a value of PLN 11.6m, futures contracts executed to hedge the prices of CO_2 emission rights with a value of PLN 7.4m, and SWAP and FRA transactions executed to hedge the interest rates risk, amounting to PLN 5.6m and PLN 0.9m, respectively.

The tables below present detailed information on open hedging transactions.

Table 1 Refining margin hedging transactions (full barrel swap) as at June 30th 2008

Period		Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009
Volume (bbl)		6,300,000	7,247,700	3,000,999	1,001,001	2,500,998
Product/Raw material	**Index**	**Weighted average barrel structure**				
Gasoline	Gasoline 95r 10ppm NWE barge (Argus)	27.11%	27.00%	36.00%	26.00%	26.00%
Jet fuel	Jet Cargoes CIF NWE / ARA (Platts)	8.54%	10.00%	8.00%	9.00%	11.00%
Diesel oil	10 PPM Cargoes CIF NWE / ARA (Platts)	36.57%	33.00%	30.00%	39.00%	45.00%
Light fuel oil	Gasoil .1 Cargoes CIF NWE / ARA (Platts)	7.65%	11.00%	8.00%	4.00%	0.00%
Heavy fuel oil	3.5 PCT Barges FOB Rotterdam (Platts)	20.14%	19.00%	18.00%	22.00%	18.00%
Crude oil	Brent (Dtd) (Platts)	-100.00%	-100.00%	-100.00%	-100.00%	-100%
Margin ranges in transactions (USD/bbl)		8.45–9.2	8.6–13.2	7.6–10.3	10.0–11.6	13.0–14.3

Table 2 Foreign exchange risk hedging transactions as at June 30th 2008

Currency pair	Instrument	Value	FX rate range
EUR/USD	Forward	EUR 329,950,000	1.5453–1.5784
EUR/PLN	Forward	-EUR 3,080,000	3.3645–3.3882
USD/PLN	Forward	-USD 410,420,000	2.1215–2.2247

Table 3 Interest rate risk hedging transactions as at June 30th 2008

Instrument	Start date	Expiry date	Principal	Interest rate range	Reference rate
FRA	Sep 15 2008	Jan 15 2009	USD 200,000,000	2.2%–2.245%	3M LIBOR
IRS	Sep 15 2008–Jul 15 2009	Jun 30 2011	USD 780,000,000	3.442%–4.33%	6M LIBOR

Source: the LOTOS Group.

The Q2 2008 pre-tax profit was PLN 521.2m, up by PLN 217.6m year on year.

The Q2 2008 net profit on continued operations was PLN 422.2m, which represented a year-on-year increase of 74.4%. The Q2 2008 profit attributable to equity holders of the parent was PLN 396.5m.

During H1 2008, the LOTOS Group's sales revenue was PLN 7,779.4m, with operating profit at PLN 476.5m, net profit on continued operations at PLN 700.9m and profit attributable to equity holders of the parent at PLN 664.4m. Compared with H1 2007, sales revenue rose by 38.6%; operating profit by 56.8%; net profit on continued operations by 129.8%;
and profit attributable to equity holders of the parent by 124.8%.

7.2 Balance Sheet

As at June 30th 2008, the balance-sheet total of the LOTOS Group was PLN 10,933.2m, up by PLN 1,212.8m during H1 2008. The growth was primarily caused by a rise in non-current assets of PLN 730.5m, mainly driven by an increase in prepayments for tangible assets under construction connected with the implementation of the 10+ Programme (up by PLN 437.8m), and by an increase in property, plant and equipment (up by PLN 311.0m). In the period under review, inventories increased by PLN 477.3m on account of the higher requirement concerning the volume of regulatory stocks and by higher prices of crude oil and petroleum products at the end of Q2 2008 compared with the prices reported at the end of 2007. An increase by PLN 233.4m in trade and other receivables is attributable to the significant increase in prices of products in H1 2008. A decline by PLN 203.1m in cash and cash equivalents is connected with the implementation of the 10+ Programme.

As at June 30th 2008, the Group's equity amounted to PLN 6,842.8m, which means a PLN 691.9m rise during H1 2008, as a result of higher retained earnings (up by PLN 664.4m) and a PLN 33.7m increase in equity attributable to minority shareholders.

In H1 2008, non-current liabilities went up by PLN 268.8m, primarily due to an increase in the level of non-current loans and borrowings (up by PLN 281.9m). As at the end of June 2008, non-current liabilities amounted to PLN 1,484.4m, of which PLN 1,124.8m is attributable to interest-bearing loans and borrowings.

As at the end of Q2 2008, current liabilities amounted to PLN 2,605.9m, which means a PLN 252.1m (10.7%) rise during H1 2008, primarily caused by a higher level of liabilities reflecting higher prices of raw materials. In H1 2008, the LOTOS Group's current loans and borrowings decreased by PLN 28.0m, and as at June 30th 2008 amounted to PLN 489.2m.

7.3 Cash Flow

As at the end of Q2 2008, the cash balance recorded by the LOTOS Group was PLN 320.2m, having decreased by PLN 157.3m relative to the end of Q2 2007.

In Q2 2008, net cash used in operating activities was -PLN 88.6m, which – given the positive cash flow of PLN 47.2m recorded in the corresponding period of 2007 – means a decrease by PLN 135.8m. The Q2 2008 increase in net cash provided by operating activities was driven primarily by net profit of PLN 422.2m, amortisation and depreciation of PLN 79.8m, a positive difference of PLN 11.2m between the current corporate income tax and the corporate income tax paid, a PLN 10.1m decrease in prepayments and deferred income, and an increase in provisions by PLN 9.2m.

In the analysed period, the key factors with a negative impact on the operating cash flows included a PLN 310.4m growth in receivables, an increase in inventories by PLN 185.4m, a fall in current liabilities by PLN 46.2m, gains on investing activities of PLN 38.8m, foreign exchange losses of PLN 32.0m and interest and dividend paid (PLN 8.3m).

In Q2 2008, cash used in investing activities amounted to PLN -351.3m, and declined by PLN 163.2m relative to the figure recorded in Q2 2007. The negative value of cash flows in Q2 2008 is mainly attributable to expenses incurred on acquisition of tangible assets and intangible assets (PLN 199.4m) and prepayments for tangible assets under construction (PLN 175.7m).

In Q2 2008, the balance of cash from financing activities at the Group reached PLN 155.0m (up by PLN 172.0m), which is a significant improvement taking into account the negative balance of -PLN 16.9m recorded in Q2 2007. The improvement followed from a rise in cash provided by loans and borrowings, up by PLN 172.8m from the Q2 2007 level.

8 OPERATING RESULTS BY BUSINESS AREAS

The operating activities of the LOTOS Group are divided into four business areas: exploration and production, refining and wholesale, retail, and other business. A detailed description of the business areas is provided in the Directors' Report on the Financial Results of the LOTOS Group for Q1 2006.

The sales revenue and operating expenses of the individual business areas are presented before eliminations of transactions between business areas.

The adjustments related to the results on intra-group transactions were appropriately allocated to the business area which acts as the seller in a given transaction.

Table 4 **H1 2008 operating result by business areas**

PLNm	Areas							
	Exploration & production		Refining and wholesale		Retail		Other business	
	H1 2008	H1 2007	H1 2008	H1 2007	H1 2008	H1 2007	H1 2008	H1 2007
Sales revenue	229	133	7,023	5,543	755	537	232	210
Intra-group sales	226	121	26	488	-	1	208	198
External sales	3	12	6,997	5,055	755	536	24	12
Operating expenses	-104	-80	-6,625	-5,297	-771	-555	-226	-196
Consolidation adjustments	-34	9	-	-1	-	3	-2	-2
Operating profit	91	62	398	245	-16	-15	4	12
Amortisation and depreciation	25	24	107	107	19	15	6	4
EBITDA	116	86	505	352	3	0	10	16

Source: Grupa LOTOS S.A.

Table 5 **Q2 2008 operating result by business areas**

PLNm	Areas							
	Exploration & production		Refining and wholesale		Retail		Other business	
	Q2 2008	Q2 2007	Q2 2008	Q2 2007	Q2 2008	Q2 2007	Q2 2008	Q2 2007
Sales revenue	148	56	3,509	3,039	416	302	131	112
Intra-group sales	145	51	-275	281	-	1	116	105
External sales	3	5	3,784	2,758	416	301	15	7
Operating expenses	-58	-35	-3,171	-2,799	-423	-306	-126	-104
Consolidation adjustments	-41	-3	-2	-14	-	2	-1	1
Operating profit	49	18	336	226	-7	-2	4	9
Amortisation and depreciation	12	12	52	54	10	7	3	2
EBITDA	61	30	388	280	3	5	7	11

Source: Grupa LOTOS S.A.

8.1 Crude Oil Production

The Q2 2008 revenue from crude oil production was PLN 148m. Net of the operating expenses of PLN 58m and after adjustments, the operating profit amounted to PLN 49m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) reached PLN 61m. In the corresponding period of 2007, the operating profit and EBIDTA were PLN 18m and PLN 30m, respectively.

Operating profit generated by the production area has been affected by the volumes of Rozewie oil processed by the Gdansk refinery and LOTOS Jasło, which reached 38.1 thousand tonnes and 16.3 thousand tonnes, respectively, in Q2 2008, relative to the sales of Rozewie crude oil to Grupa LOTOS S.A. by Petrobaltic, which amounted to PLN 82.4 thousand tonnes.

8.2 Refining and Wholesale

In Q2 2008, the refining area generated sales revenue of PLN 3,509m, operating profit of PLN 336m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) of PLN 388m. In the corresponding period of 2007, the operating profit and EBIDTA were PLN 226m and PLN 280m, respectively.

The EBITDA margin of the refining area in Q2 2008 stood at 11.1%, and the operating margin reached 9.6%.

The operating profit of the refining area was considerably affected by the market conditions prevailing in Q2 2008. Compared with Q1 2008, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil rose by 25.3% and 25.8%, respectively; concurrently, the refining margin grew by 77.7% and the Brent/Ural differential increased by 10.7% quarter on quarter. Compared with Q2 2007, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil went up by 76.3% and 80.6%, respectively; the refining margin expanded by 2.9%, to USD 7.89 per barrel, and the Brent/Ural differential rose by 0.3%, to USD 3.73 per barrel. Another material contributing factor was the strengthening of the Polish złoty against the US dollar.

8.3 Retail Operations (Service Stations Network)

In Q2 2008, sales revenue in the retail area amounted to PLN 416m. The area reported operating loss of -PLN 7m, and EBITDA of PLN 3m. In the corresponding period of 2007, the area reported an operating loss of -PLN 2m, and an EBIDTA of PLN 5m.

In Q2 2008, retail margins went up by 8.5% relative to Q1 2008, and by 12.1% on the Q2 2007 figure.

In Q2 2008, the Group’s performance in the retail area was mainly affected by the process of restructuring and developing an optimum structure of the service stations network.

As at the end of Q2 2008, the number of COCO/CODO stations was 134 (one station more on Q1 2008), the number of DOFO stations was 76 (five stations more), and the number of DODO stations fell to 138 (3 stations fewer). The number of the franchise agreements was 88.

8.4 Other Business

In Q2 2008, sales revenue from other business was PLN 131m, the area’s operating profit was PLN 4m, and EBITDA amounted to PLN 7m. In the corresponding period of 2007, the operating profit and EBIDTA were PLN 9m and PLN 11m, respectively.

9 IMPACT OF THE LIFO INVENTORY VALUATION

Below we present information on the impact of the LIFO (last in, first out) inventory valuation method on the consolidated performance of the LOTOS Group for Q2 2008.

In line with its inventory valuation policies, the LOTOS Group uses the weighted average of the acquisition cost to measure decreases in inventories. This method of inventory valuation defers the impact of changes in oil prices on the prices of finished products. Thus, an increase in oil prices on the global market has a positive effect on the financial performance, while a decrease drives it down. The operating profit accounting for the impact of this valuation method is presented as item 1 in the table below.

The impact of the LIFO inventory valuation method is presented as item 2, and consolidated operating profit of the LOTOS Group for Q2 2008 accounting for the estimated impact of using the LIFO method for inventory valuation (along with the comparable data for Q2 2007) is presented as item 3.

Table 6 **Impact of inventory valuation on operating profit**

No.	*(PLNm)*	*Q2 2008*	*Q2 2007*	*Change*	*H1 2008*	*H1 2007*	*Change*
1.	Operating profit	381.8	250.9	55.2%	476.5	303.8	56.8%
2.	Effect of LIFO inventory valuation	-211.8	-129.4	63.6%	-257.0	-127.5	101.5%
3.	Operating profit – LIFO method	170.0	121.5	39.9%	219.5	176.3	24.5%

Source: Grupa LOTOS S.A.

In Q2 2008, the impact of inventory valuation increased operating profit by PLN 211.8m, compared with an increase of PLN 129.4m in Q2 2007. Should the LIFO method be applied for inventory valuation, operating profit would have amounted to PLN 170.0m in Q2 2008 and PLN 121.5m in Q2 2007.

In H1 2008 (cumulatively), the impact of inventory valuation increased operating profit by PLN 257.0m, compared with an increase of PLN 127.5m in H1 2007. Should the LIFO method be applied for inventory valuation, operating profit would have amounted to PLN 219.5m in H1 2008 and PLN 176.3m in H1 2007.

The assumptions made in calculating the Q2 2008 operating profit of the LOTOS Group accounting for the estimated impact of using the LIFO method for inventory valuation (along with the comparable data for Q2 2007) are described in Current Report No. 29/2006.