

**GRUPA LOTOS S.A.  
DIRECTORS' REPORT  
ON THE GRUPA LOTOS S.A. OPERATIONS IN 2007**

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**GRUPA LOTOS S.A.**

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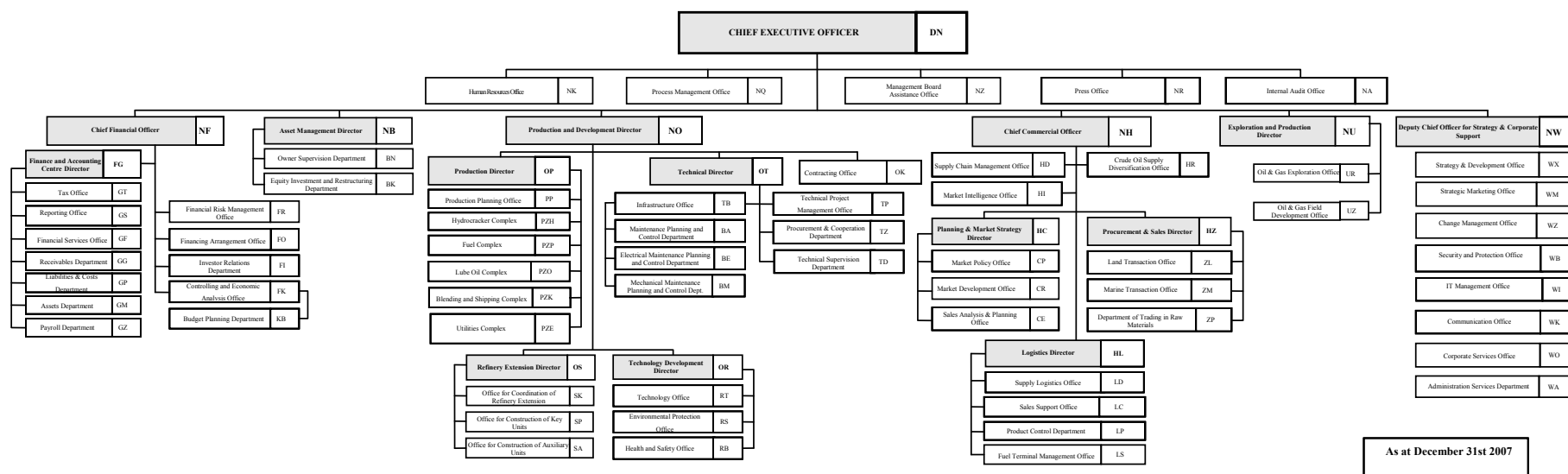
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**INTRODUCTION**

This Directors' Report on the operations of Grupa LOTOS S.A. in 2007 was prepared by the Management Board pursuant to the Polish Minister of Finance's Regulation on current and interim reports to be published by issuers of securities, dated October 19th 2005 (Dz.U. No. 209, item 1744).

**1. STRUCTURE OF GRUPA LOTOS S.A. AS AT DECEMBER 31ST 2007**



As at December 31st 2007, the organisational structure of Grupa LOTOS S.A. comprised the following units:

- 16 divisions, including 7 reporting directly to the Chief Executive Officer
- 40 offices
- 17 departments

The following document is a translation of 'Directors' Report on The Grupa LOTOS S.A. Operations in 2007', originally prepared in the Polish language, which is the only legally binding document.

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- 5 production plants

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## **2. CHANGES IN THE KEY MANAGEMENT RULES OF GRUPA LOTOS S.A.**

The key changes in the management rules followed from the Company's reorganisation aimed at ensuring effective implementation of "The LOTOS Group's Strategy until 2012" and reducing the cost of the Company's operations, which will result in improvement of the efficiency ratios and better communication between the organisational units. As a result of establishing new organisational units, the scope of responsibilities of the employees in charge of the newly-created units was changed.

In 2007, the key event with a bearing on the organisation and management of the LOTOS Group was the merger of Grupa LOTOS S.A. with its subsidiary LOTOS Partner Sp. z o.o. As a result of the merger, in mid-2007 Grupa LOTOS S.A. took over the activities performed by LOTOS Partner Sp. z o.o., including:

- sale of fuels to Polish institutional customers and retail fuel station networks of foreign operators
- organisation of primary logistics
- import and exchange of products in land transport
- provision of services related to national tenders
- sale of jet and bunker fuel

These changes triggered a reorganisation in the logistics division at Grupa LOTOS S.A. aimed at adjusting its structure to the new activities.

As of April 1st 2007, the subordination of the Security and Protection Office has been changed. The Office, which earlier reported directly to the Director of Security and Corporate Services, became subordinated to the Deputy Chief Officer for Strategy and Corporate Support.

The name of the organisational unit of Director of Security and Corporate Services was changed to Corporate and Administration Director.

The Restructuring Office and the Strategy and Development Office were merged to form a new organisational unit within the structures of Grupa LOTOS S.A., namely the Strategy and Restructuring Office, subordinated directly to the Deputy Chief Officer for Strategy and Corporate Support.

As of April 1st 2007, the following changes have been implemented in the organisational structure of the Division of the Chief Commercial Officer:

- the Sales Support Centre, which earlier reported directly to the Chief Commercial Officer, was subordinated to the Logistics Director,
- the Oil Procurement Department, which earlier reported to the Procurement and Sales Director, was liquidated and the Crude Oil Supply Diversification Office, subordinated directly to the Chief Commercial Officer, was created based on the liquidated department,
- the Tender Arrangement Department, which earlier reported directly to the Procurement and Sales Director, was liquidated and replaced with the newly-created Department of Product Swap Transactions.

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Organisational changes in the Division of the Chief Commercial Officer were introduced on July 2nd 2007:

- the Sales Support Centre was liquidated and replaced with the newly-created Sales Support Office,
- the Supply Logistics Department was liquidated and replaced with the newly-created Supply Logistics Office,
- the Product Logistics Department was liquidated and replaced with the newly-created Product Control Office,
- the following organisational units subordinated directly to the Procurement and Sales Director were liquidated:
  - Finished Products Trading Office,
  - Raw Materials Trading Department,
  - Department of Product Swap Transactions,

and replaced with the following newly-created organisational units:

- Land Transaction Office,
- Marine Transaction Office,
- Component Trading Department.

On September 3rd 2007, the scope of responsibilities of the Corporate Services Office and its superior unit, the Corporate and Administration Director, was changed. The Sponsoring Department was liquidated and its responsibilities were allocated between the Strategic Marketing Office and the Communications Office.

On November 19th 2007:

- Division of the Asset Management Director, subordinated directly to the Chief Executive Officer, was created, with two subordinate organisational units:
  - Ownership Supervision Department,
  - Equity Investment and Restructuring Department;
- the Change Management Office, subordinated directly to the Deputy Chief Officer for Strategy and Corporate Support, was created within the Division of the Deputy Chief Officer for Strategy and Corporate Support and the position of Corporate and Administration Director was liquidated;
  - Corporate Services Office,
  - Administration Services Department,
- in the Division of the Chief Commercial Officer, the Product Marketing Office and the Product Risk Management Department, subordinated directly to the Procurement and Sales Director, were liquidated,
- in the Division of the Chief Financial Officer, the Asset Management Office was liquidated and the name of the Risk Management Department was changed to Financial Risk Management Office,



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- in the Division of the Production and Development Director, the names of the following organisational units were changed as follows: Director of the Comprehensive Technical Upgrade Programme to Refinery Extension Director; Office for Coordination of the Comprehensive Technical Upgrade Programme to Office for Coordination of Refinery Extension; Key Unit Office to Office for Construction of Key Units; Auxiliary Unit Office to Office for Construction of Auxiliary Units.

**Integrated Risk Management System**

In 2007, a project to construct the Integrated Risk Management System was commenced at the LOTOS Group. The project's objective is to develop and implement an integrated risk management system (ERM) and establish effective mechanisms for risk identification, assessment, monitoring and counteracting.

**Internal Audit Rules**

In 2007, the Internal Audit Office of Grupa LOTOS S.A. developed the Internal Audit Rules for the LOTOS Group, which were issued after the balance-sheet date (on January 21st 2008). The Rules came into force on March 1st 2008.

The Rules define the objectives, powers, responsibilities and place of the Internal Audit Office within the organisational structure of the LOTOS Group. The mission of the Internal Audit Office is to contribute to increasing the Company's value by monitoring and revising the functioning of its business and providing advice with a view to improving the Company's operations. The document includes the Code of Ethics for the Internal Auditor within the LOTOS Group and indicates the Internal Audit Manual of the LOTOS Group as the set of rules and methodologies for planning, conducting and reporting audit tasks.

Besides the changes described above, which took place in 2007, no other material changes in the organisation and management of Grupa LOTOS S.A. occurred.

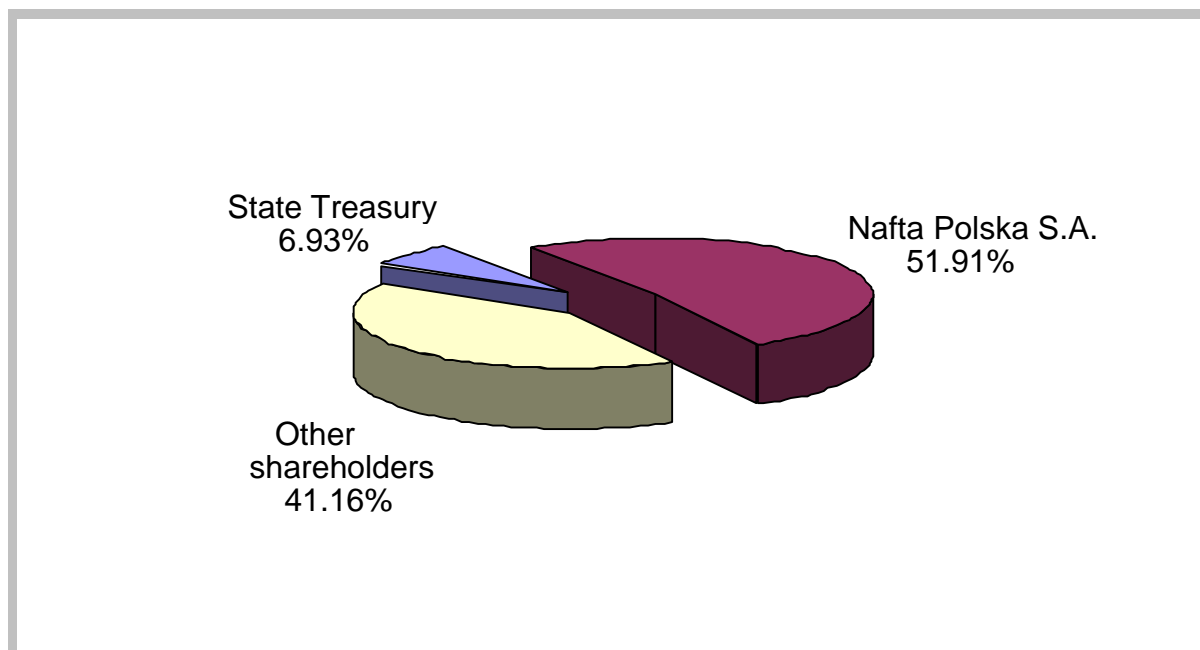
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### 3. OWNERSHIP CHANGES AT GRUPA LOTOS S.A. IN 2007

#### 3.1 STRUCTURE OF GRUPA LOTOS S.A.'S SHARE CAPITAL

**Chart 1** Structure of Grupa LOTOS S.A.'s share capital as at December 31st 2007



	Number of shares	Number of votes	Par value	% of share capital
State Treasury	7,878,030	7,878,030	7,878,030	6.93 %
Nafta Polska S.A.	59,025,000	59,025,000	59,025,000	51.91 %
Other shareholders	46,796,970	46,796,970	46,796,970	41.16 %
Total	113,700,000	113,700,000	113,700,000	100.00 %

#### 3.2 CHANGES IN THE SHAREHOLDER STRUCTURE OF GRUPA LOTOS S.A. IN 2007

##### **Increase of ING Nationale-Nederlanden Polska PTE S.A.'s stake above the 5% threshold**

On March 9th 2007, Grupa LOTOS S.A. was notified by ING Nationale-Nederlanden Polska Powszechnie Towarzystwo Emerytalne S.A. that on March 7th 2007, 5,876,589 Grupa LOTOS S.A. shares were registered in the securities account of ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny. The shares represented 5.17% of the Company's share capital and conferred the right to 5,876,589 votes at its General Shareholders Meeting (5.17% of the total vote).

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Prior to the change, ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny held 5,676,589 Grupa LOTOS S.A. shares, representing 4.99% of the Company's share capital and conferring the right to 5,676,589 votes at its General Shareholders Meeting (4.99% of the total vote).

**Decrease in ING Nationale-Nederlanden Polska PTE S.A.'s stake below the 5% threshold**

On October 22nd 2007, Grupa LOTOS S.A. was notified that as a result of disposal of the Company shares, settled on October 18th 2007, ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny reduced its share in the total vote at the General Shareholders Meeting of the Company to a level below 5%.

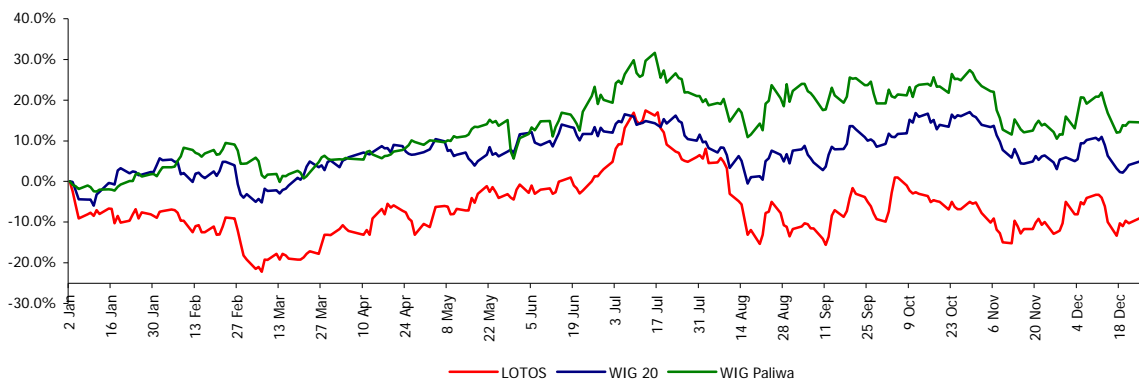
Prior to the disposal, ING Nationale-Nederlanden Polska held 5,701,348 (five million, seven hundred and one thousand, three hundred and forty-eight) Grupa LOTOS S.A. shares. The shares represented 5.01% of the Company's share capital and conferred the right to 5,701,348 votes at its General Shareholders Meeting (5.01% of the total vote). On October 19th 2007, 5,575,269 (five million, five hundred and seventy-five thousand, two hundred and sixty-nine) Grupa LOTOS S.A. shares were registered in the securities account of ING Nationale-Nederlanden Polska. The shares represented 4.90% of the Company's share capital and conferred the right to 5,575,269 votes at its General Shareholders Meeting (4.90% of the total vote).

**3.3 ACQUISITION OF 70% OF SHARES IN LOTOS TANK SP. Z O.O. FROM LOTOS JASŁO S.A.**

On April 11th 2007, Grupa LOTOS S.A. entered into an agreement with LOTOS Jasło S.A. (80.01% owned by Grupa LOTOS S.A.), whereby it purchased 700 shares in LOTOS Tank Sp. z o.o. (in which Grupa LOTOS S.A. previously held 30% of shares). Grupa LOTOS S.A. purchased the shares in LOTOS Tank Sp. z o.o. for PLN 642.5 thousand, using internally generated funds. As a result of the transaction, LOTOS Tank Sp. z o.o. became a 100% subsidiary of Grupa LOTOS S.A.

**3.4 PRICE OF GRUPA LOTOS S.A. SHARES ON THE WARSAW STOCK EXCHANGE IN 2007**

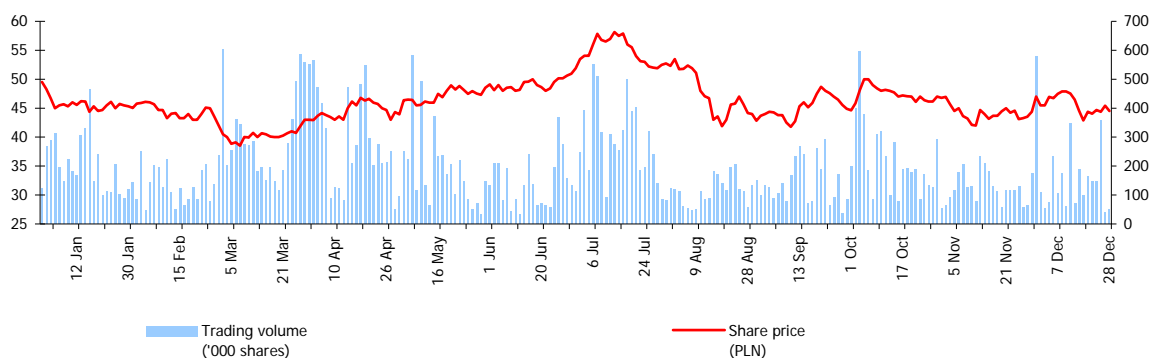
**Chart 1 Performance of Grupa LOTOS S.A. stock price and of WIG 20 and WIG Paliwa indices in 2007**



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**Chart 2 Grupa LOTOS S.A. - Share price and trading volume in 2007**



In January 2007, Grupa LOTOS S.A. shares started trading at PLN 49.50, with WIG 20 at 3,347.75 points. The Company stock price continued to decline in the first months of the year as a result of the strong downward trends which began in early September 2006 (a correction of the downward trend took place at the end of 2006). The first two months of the year were also marked by falling stock prices of other oil companies, due to low prices of oil and oil products prevailing on international markets. In that period, the WIG 20 index was rising and reached its all-time high on February 22nd 2007.

At the end of February and beginning of March, the Warsaw Stock Exchange suffered a correction caused by news of a slowdown in the US economy and a massive sale of shares at the Chinese stock exchange. On March 7th, the WIG 20 index and Grupa LOTOS S.A. share price hit their all-time lows (at 3,173.93 points and PLN 38.50, respectively). Then, both WIG 20 and Grupa LOTOS S.A. stock price recovered from these lows and followed a rising trend, moving to new historic maximums at the WSE in mid-July (a correction in the upward movement took place in the second half of April). WIG 20 reached its maximum of 3,899.59 points on July 6th, while the price of Grupa LOTOS S.A. shares hit its all-time high on July 13th, reaching PLN 58.15. The performance of WIG 20 was positively affected by the selection of Poland as the co-host of the European Football Championship finals (EURO 2012). In Q2 2007, the WIG-Paliwa index provided the highest rate of return among all the sector subindexes (13.9%), driven by a rise in oil prices on global markets.

Between mid-July and mid-August, Grupa LOTOS S.A. share price strongly depreciated (by almost 28%). Thereafter, the Company stock price followed a horizontal trend until the end of the year, driven by relatively strong fluctuations between PLN 41.8 and PLN 50.0. A rise seen in November was related to the publication of the Company's quarterly results, which exceeded market expectations. In the same period, the WIG 20 index was in a long-term downward trend caused by the US subprime mortgage crisis and its escalation. Declines in the WIG-Paliwa subindex were related to a drop in the refining margin on global markets and the US dollar weakening against the zloty.

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During the entire 2007, the Company stock price performed worse relative to the WIG-Paliwa sector subindex (which comprises the following stocks: PKN Orlen, PGNiG, Grupa LOTOS S.A., MOL, Petrolinvest and CP Energia). At the end of the year, the price of the Company shares was PLN 44.5, which represented an all-year decrease of 10.1%. As at the end of the year, the WIG-Paliwa index stood at 3,548.44 points, which represented a 13.3% increase relative to the beginning of January, taking into account a change in the value of the subindex due to a 1-to-10 subindex denomination of May 28th 2007 (the denomination of all sector subindexes was designed to enhance the transparency of information delivered through the indexes to investors and analysts). As at the end of 2007, the WIG 20 index stood at 3,456.05 points, which represented a growth of 3.2% for the entire year.

### **3.5 ASSIMILATION OF SHARES SUBSEQUENT TO THE BALANCE-SHEET DATE**

By virtue of Resolution No. 52/08 of January 29th 2008, on February 1st 2008 the National Depository for Securities (Polish NDS) assimilated 6,400 ordinary bearer shares of Grupa LOTOS S.A. (created through conversion, on February 1st 2008, of 6,400 ordinary registered shares bearing ISIN code PLOTOS00033) with 55,629,209 ordinary bearer shares of Grupa LOTOS S.A. bearing ISIN code PLOTOS00025.

Following the assimilation, the shares were marked with ISIN code PLOTOS00025.

Since February 1st 2008:

- 55,635,609 shares of Grupa LOTOS S.A. have been marked with ISIN code PLOTOS00025, and
- 58,064,391 shares of Grupa LOTOS S.A. have been marked with ISIN code PLOTOS00033.

By virtue of Resolution No. 71/2008 of January 24th 2008, the Management Board of the Warsaw Stock Exchange introduced, on February 1st 2008, by way of the ordinary procedure, 6,400 Series A ordinary bearer shares of Grupa LOTOS S.A., with a par value of PLN 1.00 per share and ISIN code PLOTOS00033, to trading on the main market.

In line with the aforementioned resolution, the shares were introduced to trading on February 1st 2008 on condition that on that day the Polish NDS would convert the registered shares in Grupa LOTOS S.A. into ordinary bearer shares and assimilate them, on February 1st 2008, with the shares of Grupa LOTOS S.A. already traded on the stock-exchange under ISIN code PLOTOS00025.

## **4. PAYMENT OF DIVIDEND FOR 2006**

On May 28th 2007, the Annual General Shareholders Meeting of Grupa LOTOS S.A. adopted a resolution on the distribution of Grupa LOTOS S.A.'s net profit for 2006. Pursuant to the resolution, the net profit of PLN 406,714 thousand for the year ended December 31st 2006 was allocated to:

- the statutory reserve funds – PLN 365,782 thousand,
- dividend payment – PLN 40,932 thousand.

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Pursuant to the abovementioned resolution of the Annual General Shareholders Meeting of May 28th 2007, on July 31st 2007 Grupa LOTOS S.A. paid out dividend for the financial year ended December 31st 2006 in the amount of PLN 0.36 per share.

**5. KEY PRODUCTS, GOODS AND SERVICES OF GRUPA LOTOS S.A.**

**Production volume structure (%) – GRUPA LOTOS S.A.**

	<b>2007</b>	<b>2006</b>
Diesel oils	41%	37%
Gasolines	21%	23%
Fuel oil, including:	13%	17%
Light fuel oil	5%	7%

**Sales by products, goods and services (PLN '000) – GRUPA LOTOS S.A.**

	<b>Jan 1 – Dec 31 2007</b>	<b>% share</b>	<b>Jan 1 – Dec 31 2006</b>	<b>% share</b>
Gasolines	5,379,716	30.6%	5,334,104	31.8%
Diesel oils	8,767,601	49.9%	7,680,183	45.9%
Light fuel oil	715,834	4.1%	955,390	5.7%
Heavy fuel oil	506,508	2.9%	614,245	3.7%
Jet-A1 aviation fuel	879,035	4.9%	919,873	5.5%
Base oils	359,471	2.1%	355,200	2.1%
Bitumens and components for their production	592,349	3.4%	515,192	3.1%
Liquid gases	109,227	0.6%	132,568	0.8%
Other refinery products	137,528	0.8%	148,250	0.9%
<b>Total crude oil products and goods, including:</b>	<b>17,447,269</b>	<b>99.3%</b>	<b>16,655,005</b>	<b>99.5%</b>
Other goods and materials	5,206	0.1%	5,334	0.0%
Services	101,065	0.6%	86,910	0.5%
<b>Total</b>	<b>17,553,540</b>	<b>100.0%</b>	<b>16,747,249</b>	<b>100.0%</b>
Elimination of excise tax and fuel charge	(5,686,946)		(5,117,428)	
<b>Total</b>	<b>11,866,594</b>		<b>11,629,821</b>	

**Sales by products, goods and services (thousands of tonnes) – GRUPA LOTOS S.A.**

	<b>Jan 1 – Dec 31 2007</b>	<b>% share</b>	<b>Jan 1 – Dec 31 2006</b>	<b>% share</b>
Gasolines	1,473	21%	1,581	23%
Diesel oils	2,810	41%	2,498	37%
Light fuel oil	334	5%	448	7%
Heavy fuel oil	596	9%	686	10%

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Jet-A1 aviation fuel	441	6%	450	7%
Base oils	187	3%	172	3%
Bitumen components	899	13%	780	11%
Liquid gases	55	1%	66	1%
Other refinery products	122	2%	142	2%
<b>Total crude oil products and goods</b>	<b>6,917</b>	<b>100%</b>	<b>6,823</b>	<b>100%</b>

In 2007, Grupa LOTOS S.A.'s sales volume was 1.5% higher than in 2006, and reached 6,917 thousand tonnes. Relative to 2006, the most substantial rise in sales volume was recorded in the bitumen component group (up by 119 thousand tonnes or 15%). Strong sales were also reported in base oils, which grew by 9%. The increase of 312 thousand tonnes in Grupa LOTOS S.A.'s sales volume was driven mainly by a 12% rise in sales of diesel oil. On the other hand, relative to 2006 sales of gasolines and light fuel oil dropped by 108 thousand tonnes and 114 thousand tonnes, respectively, while sales of heavy fuel oil were lower 90 thousand tonnes. Sales of jet fuel and other refinery products remained roughly unchanged relative to the 2006 figures.

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**6. CHANGES IN SALES MARKETS AND SOURCES OF SUPPLY OF  
MATERIALS, GOODS AND SERVICES**

Net sales revenue of Grupa LOTOS S.A. by markets (PLN '000)

	Jan 1 – Dec 31 2007	% share	Jan 1 – Dec 31 2006	% share
Domestic sales, including:	<b>15,154,057</b>	<b>86.3%</b>	<b>14,149,767</b>	<b>97.8%</b>
- <i>products</i>	14,710,349	83.8%	13,775,347	82.3%
- <i>goods and materials</i>	443,708	2.5%	374,420	15.5%
Export sales, including:	<b>2,399,483</b>	<b>13.7%</b>	<b>2,597,482</b>	<b>2.2%</b>
- <i>products</i>	2,390,845	13.6%	2,597,388	2.2%
- <i>goods and materials</i>	8,638	0.1%	94	0.0%
<b>Total</b>	<b>17,553,540</b>	<b>100.0%</b>	<b>16,747,249</b>	<b>100.0%</b>
Including excise tax and fuel charge	(5,686,946)		(5,117,428)	
<b>TOTAL</b>	<b>11,866,594</b>		<b>11,629,821</b>	

**Key customers of Grupa LOTOS S.A. in 2007**

In 2007, Grupa LOTOS S.A. had two customers whose shares in Grupa LOTOS S.A.'s revenue exceeded 10%. These were LOTOS Paliwa Sp. z o.o., a subsidiary of Grupa LOTOS S.A., with a 67.22% share, and STATOIL Poland with an 11.83% share.

In 2006, Grupa LOTOS S.A. had two customers whose shares in Grupa LOTOS S.A.'s revenue exceeded 10%. These were the subsidiaries: LOTOS Paliwa Sp. z o.o. and LOTOS Partner Sp. z. o.o., with respective shares of 38.2% and 33.3%.

**Grupa LOTOS S.A.'s purchases of raw materials and crude oil goods by region in 2007**

	Jan 1 – Dec 31 2007	% share	Jan 1 – Dec 31 2006	% share
Domestic purchases	1,018,387	9.3%	850,829	8.0%
Imports	9,983,820	90.7%	9,837,887	92.0%
<b>Total purchases</b>	<b>11,002,207</b>	<b>100.0%</b>	<b>10,688,716</b>	<b>100.0%</b>



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**Grupa LOTOS S.A.'s supply structure in 2007 (PLN '000)**

	<b>Jan 1 – Dec 31 2007</b>	<b>% share</b>	<b>Jan 1 – Dec 31 2006</b>	<b>% share</b>
Raw materials	10,583,334	83.5%	10,374,759	88.1%
Goods	417,989	3.3%	313,417	2.7%
Services	724,578	5.7%	600,998	5.1%
Other purchases	954,137	7.5%	482,406	4.1%
<b>Total</b>	<b>12,680,037</b>	<b>100.0%</b>	<b>11,771,580</b>	<b>100.0%</b>

**Grupa LOTOS S.A.'s crude oil goods supply structure**

	<b>Jan 1 – Dec 31 2007</b>	<b>% share</b>	<b>Jan 1 – Dec 31 2006</b>	<b>% share</b>
Diesel oils	104,986	25.12%	94,773	30.24%
Gasolines	307,205	73.49%	103,603	33.05%
Light fuel oil	-	-	112,792	35.99%
Heavy fuel oil	5,798	1.39%	2,249	0.72%
<b>Total</b>	<b>417,989</b>	<b>100.00%</b>	<b>313,417</b>	<b>100.00%</b>

**Grupa LOTOS S.A.'s raw materials, semi-finished products and chemicals supply structure (PLN '000)**

	<b>Jan 1 – Dec 31 2007</b>	<b>% share</b>	<b>Jan 1 – Dec 31 2006</b>	<b>% share</b>
Crude oil	8,609,679	81.4%	8,630,069	83.2%
Diesel oil	1,414,370	13.4%	1,105,293	10.7%
MTBE	201,046	1.9%	207,029	2.0%
Heavy fuel oil	130,720	1.2%	135,361	1.3%
Straight-run gasoline	11,511	0.1%	83,655	0.8%
Vacuum distillate	9,874	0.1%	73,976	0.7%
Ethyl alcohol	67,491	0.6%	60,479	0.6%
Additives	56,995	0.5%	25,519	0.2%
Light fuel oil	34,099	0.3%	-	0.0%
Other	47,549	0.7%	53,378	0.5%
<b>Total</b>	<b>10,583,334</b>	<b>100.0%</b>	<b>10,374,759</b>	<b>100 %</b>

**Grupa LOTOS S.A.'s major suppliers in 2007**

In 2007, there were two suppliers whose shares in Grupa LOTOS S.A.'s purchases exceeded 10% of its revenue: J&S Service Investment Ltd of Cyprus, whose share in Grupa LOTOS S.A.'s purchases amounted to 40.78%, and Petraco Oil Company Ltd of United Kingdom, with a share of 17.79%.

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In 2006, suppliers whose shares in Grupa LOTOS S.A.'s purchases exceeded 10% of its revenue included J&S Service Investment Ltd of Cyprus, with a 45.2% share in the Company's purchases, and Petraco Oil Company Ltd of United Kingdom, with a 21.7% share.

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**7. KEY FINANCIAL AND ECONOMIC DATA CONTAINED IN THE ANNUAL FINANCIAL STATEMENTS AND NON-RECURRING FACTORS AND EVENTS WITH A BEARING ON GRUPA LOTOS S.A.'s PERFORMANCE**

**7.1 INCOME STATEMENT**

**SALES REVENUE**

In 2007, Grupa LOTOS S.A.'s net revenue from sales of products, goods for resale and materials amounted to PLN 11,866.6m and were higher by 2.0% relative to the 2006 figure. Net revenue from sales of products accounted for 95.6% of total sales revenue. In 2007, net revenue from sales of goods for resale and materials amounted to PLN 452.3m and were up by 20.8% compared to 2006. Net domestic revenue from sales of products accounted for 78.9% of total net revenue from sales of products. In 2007, the total sales volume reached 6,917.2 thousand tonnes, including 108.4 thousand tonnes of fuel sales and 37.8 thousand tonnes of crude oil sales. Diesel oils were the largest item in the sales structure, accounting for 40.6% of total sales. The total sales volume increased by 1.5% compared to 2006. Sales of diesel oils, bitumen components, and base oils by grew 312.0 thousand tonnes, 119.0 thousand tonnes, and 15.0 thousand tonnes, respectively. On the other hand, sales of light fuel oils declined by 114.0 thousand tonnes, sales of gasolines – by 108.0 thousand tonnes, and sales of heavy fuel oils – by 90.0 thousand tonnes. Sales of liquefied gas fell by 11.0 thousand tonnes, and sales of Jet-A1 fuel by 9.0 thousand tonnes, while sales of other products and goods for resale dropped by 20.0 thousand tonnes. The volume of export sales of products decreased by 3.9%, while domestic sales of products grew by 3.2%. In 2007, the average net selling price of crude oil products and goods was PLN 1,700.2 per tonne and rose by 0.6% on 2006.

**OPERATING PROFIT**

In 2007, the cost of sales amounted to PLN 10,851.4m and was up by 1.3% on the 2006 figure. The unit cost of sales decreased to PLN 1,540.7 per tonne, or by 1.3%, compared to 2006. In 2007, Grupa LOTOS S.A.'s gross profit on sales reached PLN 1,015.2m and was up by 10.6% compared to the 2006 figure. The increase was attributable mainly to better business environment of the refining operations compared to 2006, and in particular to higher average refining margins. The average refining margin in 2007 was USD 5.80/bbl, up by 20.6% on the 2006 figure. The upward trend in the prices of crude oil and crude oil products prevailing in 2007 and the valuation of inventories at the average weighted purchase price also had a positive effect on the Company's gross profit on sales in 2007. On the other hand, the strengthening of the Polish zloty accompanied by a long position in the US dollar held by Grupa LOTOS S.A. offset the positive effect of the prices and price trends on the gross profit on sales. In 2007, the average USD/PLN exchange rate fell by PLN 0.34, or 10.8%, relative to the average USD/PLN exchange rate recorded in 2006.

Selling costs incurred by the Company in 2007 amounted to PLN 394.7m and were down by PLN 17.7m compared to 2006. The decrease was due mainly to the lower USD exchange rate and lower export sales volume. A 19.4% rise in general and administrative expenses was attributable to business scale expansion. In 2007, the

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net result on other operating activities was negative and stood at PLN -8.8m, due mainly to a valuation allowance for the risk that a part of the expenditure incurred on the heavy residue gasification project may remain unused due to the postponement of the project implementation. The aforementioned factors contributed to a 22.9% increase in the operating profit relative to 2006, to PLN 416.1m.

#### **FINANCING ACTIVITIES**

In 2007, the financial income of Grupa LOTOS S.A. amounted to PLN 472.1m and was up by PLN 308m compared to 2006, mainly due to an increase in dividends received, higher foreign exchange gains resulting from a significant appreciation of the Polish zloty as well as the concluded hedging transactions. In 2007, the result on financing activities stood at PLN 456.1m and was up by PLN 303.0m on the 2006 figure.

#### **PRE-TAX PROFIT AND NET PROFIT**

The 2007 pre-tax profit generated by Grupa LOTOS S.A. stood at PLN 872.1m, up by 77.4% on the 2006 figure. The 2007 net profit on continuing operations amounted to PLN 745.1m, up by PLN 338.4m, or 83.2%, year on year.

### **7.2 BALANCE SHEET**

As at December 31st 2007, Grupa LOTOS S.A.'s assets, equity and liabilities as disclosed in the balance sheet totalled PLN 7,680.5m following an increase of PLN 1,866.1m in 2007. A PLN 689.3m growth (25.6%) in non-current assets relative to the figure reported as at December 31st 2006 was mainly driven by a PLN 643.4m increase in prepayments for tangible assets under construction due to the implementation of the investment projects under the 10+ Programme.

In 2007, current assets increased by PLN 1,176.8m (37.8%) compared to 2006 and as at December 31st 2007 stood at PLN 4,293.5m. The increase was due mainly to a PLN 894.2m rise in inventories following largely from higher prices of raw materials and products and a higher level of mandatory stocks. In 2007, the Company also recorded a PLN 103.1m increase in cash and cash equivalents, a PLN 96.1m rise in current financial assets and a PLN 75.1m increase in trade receivables due to higher prices of products. Current financial assets include the value of transactions concluded to hedge the refining margin and exchange rates in 2008 of PLN 95.7m, which is connected with the efforts taken by the Company to mitigate the market risk related to the refining margin and exchange rates during the implementation of the 10+ Programme. The details of the transactions are presented below.

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**Refining Margin Hedging Transactions**

The Company hedges the strategic price risk by using full barrel swaps<sup>1</sup>.

The table below presents detailed information on the concluded forward transactions.

**Table 1 List of forward transactions as at December 31st 2007**

<b>Period</b>		<b>Q1</b>	<b>Q2</b>	<b>Q3</b>
		<b>2008</b>	<b>2008</b>	<b>2008</b>
<b>Volume (bbl)</b>		3,029,999	4,699,998	2,246,001
<b>Product/raw material</b>	<b>Index</b>	<b>Average weighted barrel structure</b>		
Gasoline	Gasoline 95r 10ppm NWE barge (Argus)	37.0%	29.0%	29.1%
Jet fuel	Jet Cargoes CIF NWE / ARA (Platts)	6.6%	7.7%	7.7%
Diesel oil	10 PPM Cargoes CIF NWE / ARA (Platts)	33.6%	39.0%	39.4%
Light fuel oil	Gasoil .1 Cargoes CIF NWE / ARA (Platts)	5.9%	5.2%	5.2%
Heavy fuel oil	3.5 PCT Barges FOB Rotterdam (Platts)	16.9%	19.1%	18.6%
Crude oil	Brent (Dtd) (Platts)	-100.0%	-100%	-100%
<b>Margin spread in transactions (USD/bbl)</b>		9.19-9.30	9.25-9.60	8.90-9.20

**Foreign Exchange Hedging Transactions**

The US dollar is the natural currency of the market on which Grupa LOTOS S.A. operates. The US dollar is used in quotations of market prices of crude oil and crude oil products and settlements between counterparties on the fuel market. Grupa LOTOS S.A. has a structural long position in the US dollar resulting from its operating activities. Therefore, it was deemed that the most appropriate currency to incur and repay long-term loans to finance the 10+ Programme is the US dollar (reduction of the structural long position and the resultant strategic limitation of the foreign exchange risk).

<sup>1</sup> In a full barrel swap, a fixed price for a crude oil index as well as for individual product indices, according to a pre-defined pattern, is determined in one transaction. Such transactions are used to hedge the strategic price risk of Grupa LOTOS S.A. because by selling such a swap the Company protects itself against significant fluctuations in refining margins.

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In view of the market standards as well as the situation on the EPC market (engineering, procurement and construction management services) at the time of signing the contracts for the implementation of the 10+ Programme, the remuneration of the EPC contractors under the EPC contracts was specified mainly in the euro.

In a situation discussed above, where the currency of capital expenditure differs from the currency of the loan financing the expenditure (and from the currency of own funds generated by the Company), there is a significant risk that the available funds will be insufficient to cover the capital expenditure in the event of any adverse changes in the EUR/USD exchange rate, i.e. strengthening of the euro against the US dollar.

The purpose of the foreign exchange transactions open as at the end of 2007 was to limit the investment risk (primarily the EUR/USD risk) and the operating risk (primarily the USD/PLN risk). Certain EUR/USD and all EUR/PLN transactions were concluded to finally produce USD/PLN transactions, which very often is a more efficient way to execute foreign exchange transactions due to the higher liquidity of the EUR/PLN market. The table below presents detailed information on the concluded foreign exchange transactions.

**Table 2 List of forward transactions**

<b>Currency pair</b>	<b>Instrument</b>	<b>Volume</b>	<b>Spread</b>	<b>Valuation Dec 31 2007 (PLNm)</b>
EUR/USD	Forward	EUR 670,000,000	1.43727 – 1.46951	42.922
EUR/PLN	Forward	-EUR 195,500,000	3.58224 – 3.624	6.556
USD/PLN	Forward	-EUR 499,000,000	2.481466 – 2.5324	35.455

The valuation of open transactions may change significantly and should not be considered separately from an assessment of the effect of risk factors on the cash flows generated on the items disclosed as underlying exposure.

The share of non-current assets in total asset of Grupa LOTOS S.A. fell slightly from 46.4% in 2006 to 44.1% in 2007, mainly due to a drop in the share of property, plant and equipment and financial assets. A moderate rise in the share of current assets in total assets was attributable to the fact that the increase in the share of inventories, current financial assets and cash and cash equivalents was larger than the drop in the share of trade and other receivables.

A PLN 722.8m increase in the equity of Grupa LOTOS S.A. resulted from higher retained earnings in 2007. The share of equity in total equity and liabilities decreased from 74.9% in 2006 to 66.1% in 2007.

In 2007, Grupa LOTOS S.A.'s non-current liabilities grew by PLN 479.2m, mainly due to higher long-term loans, which were up by PLN 486.4m. As at December 31st 2007, current liabilities stood at PLN 1,975.3m and

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were up by PLN 664.2m compared to December 31st 2006, mainly due to higher trade payables, which rose by PLN 395.6m as a result of higher prices of raw materials and a PLN 258.3m increase in short-term loans and borrowings.

### **7.3 CASH FLOWS**

As at the end of 2007, the balance of cash held by Grupa LOTOS S.A., including bank overdrafts, was negative, at - PLN 274.1m, having decreased by PLN 155.2m relative to the end of the previous year.

Grupa LOTOS S.A.'s net cash provided by operating activities in 2007 amounted to PLN 40.6m and rose by PLN 232.4m relative to the negative balance recorded in 2006. The factors which contributed to the positive balance included a net profit of PLN 745.1m, a PLN 203.3m decrease in receivables, amortisation and depreciation charges of PLN 180.4m and a PLN 92.4m increase in liabilities and accruals and deferred income. The main factors which reduced the balance of net cash provided by operating activities in 2007 included a PLN 893.2m increase in inventories, net interest and dividend paid in the amount of PLN 206.7m and a profit on investing activities of PLN 69.1m.

In 2007, net cash used in investing activities amounted to -PLN 644.0m, which represented a PLN 416.7m change from the balance of -PLN 227.3m recorded in 2006. The change was caused mainly by a PLN 519.8m increase in prepayments for tangible assets under construction and a PLN 120.7m decline in the proceeds from sales of financial assets. The negative balance of net cash from investing activities in 2007 was attributable mainly to the expenditure incurred on the prepayments on tangible assets under construction of PLN 655.2m and the expenditure of PLN 219.9m on the acquisition of property, plant and equipment and intangible assets. The negative balance was reduced by dividend received of PLN 205.2m.

Due to the proceeds from contracted loans and borrowings, Grupa LOTOS S.A. posted PLN 445.9m in net cash provided by financing activities in 2007, compared to a zero balance recorded in 2006.

### **7.4 NON-RECURRING EVENTS AFFECTING THE COMPANY'S OPERATING PERFORMANCE**

No non-recurring events which could have a material bearing on Grupa LOTOS S.A.'s performance occurred in 2007.

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**8. CONTRACTED LOANS (INCLUDING LOAN MATURITY DATES) AND  
SURETIES AND GUARANTEES GRANTED TO GRUPA LOTOS S.A.**

**8.1 LOANS AND BORROWINGS AS AT DECEMBER 31ST 2007**

**Loans and borrowings**

PLN '000	Dec 31 2007	Dec 31 2006
Bank loans and credit facilities	864,946	120,309
Borrowings	-	-
<b>Total</b>	<b>864,959</b>	<b>120,309</b>
Including:		
Non-current portion	486,379	-
Current portion	378,580	120,309

**Maturity of loans and borrowings by currency**

	EUR loans	USD loans	PLN loans	Total
<b>PLN '000</b>				
2008	15,258	62,584	300,725	378,580
2009	-	-	-	-
2010	-	-	-	-
2011	-	486,379	-	486,379
2012	-	-	-	-
after 2012	-	-	-	-
<b>Total</b>	<b>15,258</b>	<b>548,963</b>	<b>300,725</b>	<b>864,959</b>

As at December 31st 2007, the average effective interest rate on the loans is approx. 5.30%. (December 31st 2006: 4.80%). Banks' margins on the loans and borrowings fall in the range between 0.05% and 2%.



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**Loans and borrowings as at December 31st 2007**

Bank's name and form of incorporation	Registered office	Loan amount as per agreement		Outstanding loan amount (current portion)		Outstanding loan amount (non-current portion)		Maturity date		Financial terms and conditions (interest rate, interest payment schedule etc.)	Type of security
		PLN	Foreign currency	PLN	Foreign currency	PLN	Foreign currency	Current portion	Non-current portion		
Bank Millennium S.A.	Warsaw	120,000	-	72,341	-	-	-	overdraft facility	-	1M WIBOR + bank's margin	submission to enforcement
PKO BP S.A.	Warsaw	254,000	-	16,704	-	-	-	overdraft facility	-	1M WIBOR + bank's margin	submission to enforcement
ING Bank Śląski S.A.	Warsaw	-	USD 40,000 or equivalent	-	-	-	-	overdraft facility	-	1M WIBOR + bank's margin	submission to enforcement
ING Bank Śląski S.A.	Warsaw	-		1,741	USD 715	-	-	overdraft facility	-	1M LIBOR + bank's margin	submission to enforcement
ING Bank Śląski S.A.	Warsaw	-		14,647	EUR 4,089	-	-	overdraft facility	-	1M EURIBOR + bank's margin	submission to enforcement
Citibank Handlowy S.A.	Warsaw	-	USD 40,000 or equivalent	586	-	-	-	overdraft facility	-	T/N WIBOR + bank's margin	submission to enforcement
Citibank Handlowy S.A.	Warsaw	-		60,844	USD 24,987	-	-	overdraft facility	-	LIBOR SW + bank's margin	submission to enforcement
Citibank Handlowy S.A.	Warsaw	-		610	EUR 170	-	-	overdraft facility	-	EURIBOR SW + bank's margin	submission to enforcement
Bank BPH S.A.	Warsaw	20,000 or equivalent	-	20,044	-	-	-	overdraft facility	-	O/N WIBOR + bank's margin	submission to enforcement
Bank BPH S.A.	Warsaw		-	-	-	-	-	overdraft facility	-	1M LIBOR + bank's margin	submission to enforcement
BZ WBK S.A.	Warsaw	30,000	-	2,101	-	-	-	overdraft facility	-	1M WIBOR + bank's margin	submission to enforcement
Bank Pekao S.A.	Warsaw	300,000	-	188,962	-	-	-	overdraft facility	-	1M WIBOR + bank's margin	submission to enforcement

The following document is a translation of 'Directors' Report on The Grupa LOTOS S.A. Operations in 2007', originally prepared in the Polish language, which is the only legally binding document.

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Bank's name and form of incorporation	Registered office	Loan amount as per agreement		Outstanding loan amount (current portion)		Outstanding loan amount (non-current portion)		Maturity date		Financial terms and conditions (interest rate, interest payment schedule etc.)	Type of security
		PLN	Foreign currency	PLN	Foreign currency	PLN	Foreign currency	Current portion	Non-current portion		
Consortium of Bank Pekao S.A., PKO BP S.A., BRE Bank S.A. and Rabobank Polska S.A.	Warsaw		USD 400,000	-	-	486,37 9	USD 199,745	-	Dec 20 2011	1W LIBOR + bank's margin	registered pledge over inventories, financial and registered pledge over receivables under bank account agreements related to the Agreement, power of attorney to the bank accounts, power of attorney for each bank to establish pledges over new accounts related to the Agreement, assignment of rights under agreements for storage of the LOTOS Group's inventories by third parties, assignment of rights under insurance policies covering inventories, representation on submission to enforcement
<b>TOTAL</b>				<b>378,580</b>	<b>USD 25,702 EUR 4,259</b>	<b>486,37 9</b>	<b>USD 199,745</b>				

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**8.2 SURETIES AND GUARANTEES GRANTED TO GRUPA LOTOS S.A.**

- On January 3rd 2007, at the request of Grupa LOTOS S.A. Bank PKO BP S.A. issued a bank guarantee for the benefit of ABB Lummus Global GmbH in the form of a letter of credit for the amount of EUR 19,034 thousand. The guarantee expires on April 30th 2008. On May 8th 2007 and on October 16th 2007 the amounts of EUR 13,436 thousand and EUR 43 thousand, respectively, were drawn down under the letter of credit, while on October 25th another EUR 31 thousand was drawn thereunder. The balance as at the date of these interim financial statements was EUR 5,524 thousand.
- On January 27th 2007, at the request of Grupa LOTOS S.A. Bank Handlowy w Warszawie S.A. issued a bank guarantee in the form of a letter of credit for the amount of USD 42,600 thousand. The guarantee expired on April 10th 2007.
- On April 27th 2007, at the request of Grupa LOTOS S.A. Bank PKO BP S.A. issued a bank guarantee for the benefit of the Customs Chamber to secure liabilities under customs-duty debts, taxes and other customs-related charges for the amount of PLN 160,000 thousand. The guarantee expires on May 4th 2008, while the guarantor's liability continues until July 3rd 2008. On May 5th 2008, the amount of the guarantee was changed to PLN 200,000 thousand. The guarantee expires on May 5th 2009, while the guarantor's liability continues until July 3rd 2009..
- On July 10th 2007, at the request of Grupa LOTOS S.A. Bank PKO BP S.A. issued a bank guarantee in the form of a stand-by letter of credit for EUR 45,000 thousand for the benefit of Technip Italy S.p.a. The letter of credit was issued to secure the provision of services connected with the construction of an MHC unit and an amine complex. As of October 19th 2007, the validity term of the letter of credit was extended until June 30th 2008 and the amount of the letter of credit was raised to EUR 52,313 thousand in the period January 1st – March 31st 2008 (inclusive), and subsequently up to EUR 53,462 thousand in the period April 1st – June 30th 2008. The original validity term of the guarantee was to expire on December 31st 2007.
- On August 10th 2007, at the request of Grupa LOTOS S.A. Deutsche Bank PBC S.A. issued a bank guarantee for the benefit of the Customs Chamber to secure liabilities under customs duty, taxes and other customs charges for the amount of PLN 7,000 thousand. The contingent liability expired on January 31st 2008.

**Events Subsequent to the Balance-Sheet Date**

- On January 2nd 2008, at the request of Grupa LOTOS S.A., Bank Pekao S.A. opened a stand-by letter of credit for EUR 39,085 thousand (the equivalent of PLN 140,608 thousand at the mid-exchange rate quoted by the National Bank of Poland as at January 2nd 2008) for the benefit of Technip KTI S.p.a, valid through June 30th 2008. The letter of credit was issued to secure the performance of a construction contract related to the amine complex. On April 23rd 2008, the validity period of the letter of credit was extended to December 31st 2008. The amount of the stand-by letter of credit in the period

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July 1st–September 30th 2008 will be EUR 38,668 thousand, and in the period October 1st–December 31st 2008 – EUR 37,561 thousand.

- On January 16th 2008, at the request of Grupa LOTOS S.A. Deutsche Bank PBC S.A. issued a payment guarantee of USD 10,800 thousand (PLN 26,214 thousand translated at the mid exchange rate quoted by the National Bank of Poland for January 16th 2008) for the benefit of Total Deutschland GmbH in connection with the supply of gasoline. The guarantee expires on May 31st 2008.

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## 9. ASSESSMENT OF FINANCIAL RESOURCES MANAGEMENT

During the period covered by the financial statements, Grupa LOTOS S.A. was able to meet all of its liabilities towards third parties. In the period from January 1st to December 31st 2007 the Company used investment and working capital overdraft facilities. As at December 31st 2007, the Company had available funds under the overdraft facilities. For a detailed specification of debt under loans see Note 24 to the financial statements.

Grupa LOTOS S.A.'s overall economic and financial situation was assessed by analysing the profitability, liquidity and debt ratios.

<b>Item</b>	<b>2007</b>	<b>2006</b>
Operating profit (PLN '000)	416,054	338,477
Operating margin (1)	3.51%	2.91%
Pre-tax profit (PLN'000)	872,137	491,511
Gross margin (2)	7.35%	4.23%
Net profit (PLN '000)	745,084	406,714
Net margin (3)	6.28%	3.50%
Return on equity (ROE) (4)	14.68%	9.34%
Return on assets (ROA) (5)	9.70%	7.00%
Current ratio (6)	2.17	2.38
Quick ratio (7)	0.92	1.17
Average collection period (in days) (8)	47.49	40.05
Average payment period (in days) (9)	28.62	24.23
Capital employed (10)	2,317,772	1,805,118
Capital employed to total assets (11)	30.18%	31.05%
Debt ratio (12)	33.92%	25.14%
Debt to equity ratio (13)	51.32%	33.58%

(1) *operating profit/ net sales revenue*

(2) *pre-tax profit/ net sales revenue*

(3) *net profit/ net sales revenue*

(4) *net profit/ equity at end of period*

(5) *net profit/ assets at end of period*

(6) *current assets / current liabilities*

(7) *(current assets - inventories) /current liabilities*

(8) *(average trade receivables/ net sales revenue)\*365*

(9) *(average trade payables/ cost of sales)\*365*

(10) *current assets - current liabilities*

(11) *capital employed /assets*

(12) *total liabilities/ assets*

(13) *total liabilities/ equity*

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## **10. KEY RISKS AND THREATS**

### **10.1 EXTERNAL RISKS AND THREATS RELATED TO THE COMPANY'S MARKET ENVIRONMENT**

- **Risk related to the overall macroeconomic situation** – the financial situation of the Company is dependent on the domestic and global economic situation. The financial performance of Grupa LOTOS S.A. depends on: the GDP growth rate, the inflation rate, interest rates, population's private incomes, the unemployment rate, development of the road infrastructure, and the development of the services and retail sector. Any material changes in the aforementioned factors may adversely affect the pace at which Grupa LOTOS S.A.'s financial performance develops and improves. This risk affects all companies in the sector to a similar degree.
- **Risk related to future legal regulations** – the business and financial performance of Grupa LOTOS S.A. is affected by legal regulations (both internal – Polish regulations, and external – EU regulations), on such issues as taxes, mandatory stocks, product quality standards, protection of the natural environment, fuel storage, service stations and pipelines, and competition.

Consequently, the introduction of any new, more restrictive regulation in any of the above areas, may lead to higher costs of operations and necessitate greater capital expenditure at the Company. Grupa LOTOS S.A. analyses information on any potential future legislation, in terms of how it may impact the Company's business. This risk affects all companies in the sector to a similar degree.

- **Risk related to changes in the fiscal regulations and their interpretation** – In Poland, fiscal regulations are subject to frequent changes which quite often result in interpretational ambiguity of tax legislation and differences in opinions between entrepreneurs and tax authorities. In its operations, Grupa LOTOS S.A. seeks to minimise tax-related risk. Nevertheless, it is not possible to define to what degree the Company is exposed to this risk.
- **Risk related to CO<sub>2</sub> emission allowances** – Grupa LOTOS S.A. refinery can be potentially granted CO<sub>2</sub> emission allowances for 2008–2012 that will not be sufficient to cover the CO<sub>2</sub> emissions level anticipated after the completion of the 10+ Programme. In such a case, Grupa LOTOS S.A. may need to purchase emission allowances on the market, which will increase its operating expenses.

### **10.2 INTERNAL RISKS AND THREATS RELATED TO THE COMPANY'S BUSINESS**

- **Financial risks** – the Company is primarily exposed to market risk (prices of raw materials and oil products, CO<sub>2</sub> emission allowances as well as the currency and interest rate risks) and the liquidity and credit risks. Grupa LOTOS S.A. has established procedures for managing each of those risk types, as described in detail in the Notes to the 2007 Financial Statements of Grupa LOTOS S.A.

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- **Risk related to the execution of the 10+ Programme** – key risks related to the execution of the 10+ Programme include the risk of high costs of investments, the risk of delays in project execution, and technological risks. Other risks related to the execution of the Programme are being gradually reduced, as the work on preparing and executing the project advances.

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**11 SIGNIFICANT AGREEMENTS CONNECTED WITH THE OPERATIONS OF GRUPA LOTOS S.A., INCLUDING AGREEMENTS BETWEEN SHAREHOLDERS, INSURANCE AGREEMENTS, AND COOPERATION AGREEMENTS**

**11.1 SIGNIFICANT AGREEMENTS EXECUTED BY GRUPA LOTOS S.A. IN 2007**

- On January 2nd 2007, Grupa LOTOS S.A. and LOTOS Kolej Sp. z o.o. (wholly owned by Grupa LOTOS S.A.) signed an agreement whereby LOTOS Kolej Sp. z o.o. will provide comprehensive railway services to Grupa LOTOS S.A.

The services include:

- dispatch and receipt of railway shipments sent by or addressed to Grupa LOTOS S.A.,
- procurement of the required number of tank cars of appropriate type for Grupa LOTOS S.A.'s shipments,
- technical servicing and maintenance of proper technical condition of railway assets owned by Grupa LOTOS S.A.

The agreement was concluded for five years. It provides for standard contractual penalties, whose amount will depend on the extent of LOTOS Kolej's delay in the performance of or failure to perform the services. The value of the agreement is estimated at approximately PLN 1,000,000 over the agreement term. The agreement is deemed significant as its estimated value represents more than 10% of the equity of Grupa LOTOS S.A.

- On January 23rd 2007 Grupa LOTOS S.A., LOTOS Partner Sp. z o.o. (wholly-owned subsidiary of Grupa LOTOS S.A.) and BP Polska Sp. z o.o. signed a significant agreement concerning sale and delivery of liquid fuels to BP Polska Sp. z o.o.

The agreement was concluded for a definite term (until December 31st 2007) and its value is estimated at PLN 1,000,000 thousand. The agreement provides for contractual penalties of up to PLN 22,000 thousand but does not contain any provisions excluding the right to seek additional compensation on general terms.

The agreement is deemed significant as its value exceeds 10% of Grupa LOTOS S.A.'s equity.

- On June 21st 2007, as part of the 10+ Programme, Grupa LOTOS S.A. and Technip Italy S.p.A., as the general contractor, along with Technip KTI S.p.A., Technip Polska Sp. z o.o and KTI Poland S.A., signed the EPC LSTK (Lump Sum Turn Key) contract for engineering, procurement and construction of the mild hydrocracking unit (MHC) and the amine sulphur recovery complex, i.e. acid recovery unit (ARU), sour water stripper (SWS) and sulphur recovery unit/tail gas treatment unit (SRU/TGTU) for Grupa LOTOS S.A.

The scope of the construction of MHC, ARU, SWS and SRU/TGTU is adjusted to the planned annual oil processing volume of 10.5 million tonnes. The contract is to be performed within 42 months.



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The value of the contract amounts to PLN 2,208,050,600 (translated at the mid exchange rate quoted by the National Bank of Poland for June 20th 2007). The agreement is deemed significant as its value exceeds 10% of Grupa LOTOS S.A.'s equity.

The contract provides for payment of contractual penalties to Grupa LOTOS S.A. in the event of a delay in the performance or failure to comply with the parameters agreed for the constructed units. The overall contractor's liability towards Grupa LOTOS S.A. is limited to 8% of the contract's value.

The contract will become effective upon fulfilment of the following conditions precedent: receipt of the required performance bonds by Grupa LOTOS S.A., issue of a letter of credit by the bank of Grupa LOTOS S.A. and transfer to Technip Italy S.p.A. of the rights and obligations under the prior agreements for delivery of relevant equipment concluded by Grupa LOTOS S.A.

The contract was executed as part of the development strategy of the LOTOS Group, which provides for the construction of utilities under the 10+ Programme. The Programme's objective is to increase the annual throughput capacity of the Gdańsk refinery by approximately 75%, to 10.5 million tonnes of crude oil, with a higher conversion ratio.

- On August 1st 2007, Grupa LOTOS S.A. and Lurgi S.A. of Kraków executed an annex to the contract of July 19th 2007 for engineering, procurement and construction management services to build the oil distillation unit (Current Report No. 37/2007). In accordance with the annex, Lurgi S.A. of Kraków is to deliver components for the construction of the oil distillation unit. The construction of the unit is to be completed in the second half of 2009.

Following the execution of the annex, the aggregate value of agreements concluded between Grupa LOTOS S.A. and Lurgi S.A. in the 12 months immediately preceding the execution of the annex amounts to EUR 183m (PLN 697.7m at the mid exchange rate quoted by the National Bank of Poland for August 1st 2007). Taking into account the annex, the contract for engineering, procurement and construction management services to build the oil distillation unit is the largest transaction concluded between Grupa LOTOS S.A. and Lurgi S.A. and its value stands at approx. EUR 101m (approx. PLN 385m at the mid exchange rate quoted by the National Bank of Poland as at August 1st 2007).

The contract provides for contractual penalties. Lurgi S.A.'s liability in the event of failure to properly perform the contract is limited to 8% of the contract's value.

The contract is deemed significant as the total value of agreements concluded between Grupa LOTOS S.A. and Lurgi S.A. in the last 12 months exceeds 10% of Grupa LOTOS S.A.'s equity.

- On October 8th 2007, Grupa LOTOS S.A. and PKN Orlen S.A. executed two agreements on sale and purchase of liquid fuels between Grupa LOTOS S.A. and PKN Orlen S.A.

Following the execution of the two agreements the estimated aggregate value of all contracts concluded between Grupa LOTOS S.A. and PKN Orlen S.A. over the 12 months preceding the execution of the contracts is PLN 732m. From among those agreements the agreement with the largest value in the preceding 12 months is that of October 8th 2007, providing for the sale of liquid fuels by Grupa LOTOS

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S.A. to PKN Orlen S.A. The agreement was concluded for a definite term, until January 20th 2008. Its value is estimated at PLN 173m.

The agreement provides for contractual penalties of up to approx. PLN 1m and does not contain provisions permitting either party to seek additional compensation in excess of the penalties.

The agreement is considered significant as the total value of the contracts concluded between Grupa LOTOS S.A. and PKN Orlen S.A. over the preceding 12 months exceeds 10% of the equity of Grupa LOTOS S.A.

- On December 4th 2007, the Management Board of Grupa LOTOS S.A. reported that the aggregate value of the contracts concluded between Grupa LOTOS S.A. and J&S Service & Investment Ltd. over the preceding 12 months amounted to PLN 637,392 thousand, and thus exceeded 10% of Grupa LOTOS S.A.'s equity.

The largest of the contracts in terms of value is the SPOT contract for the delivery of Rebco crude concluded on June 14th 2007; its value is PLN 197,771 thousand. The contract contains no provisions on contractual penalties and its terms do not differ from the terms commonly applied in contracts of this type.

- On December 20th 2007, Grupa LOTOS S.A. and a consortium of four banks, comprising BANK POLSKA KASA OPIEKI S.A. of Warsaw, PKO BP S.A. of Warsaw, BRE BANK S.A. of Warsaw, and RABOBANK POLSKA S.A. of Warsaw executed a loan agreement.

The agreement provides for a four-year revolving loan for a total amount of USD 400,000 thousand (PLN 1,004,600 thousand, translated at the mid exchange rate quoted by the National Bank of Poland for December 19th 2007), for refinancing and financing the inventories of Grupa LOTOS S.A. The agreement is the first element of the financing strategy for the operations of Grupa LOTOS S.A. in the coming years, related to the execution of the 10+ Programme. The lending term under the agreement may be extended by the parties by one year. The main security for the loan is an agreement on registered pledge over the inventories of Grupa LOTOS S.A. (along with related assignments of rights under agreements on storage of inventories and insurance agreements) and an agreement on pledge over cash receivables under an agreement on keeping the bank accounts of Grupa LOTOS S.A. related to the loan agreement (along with a power of attorney to the accounts). The other provisions of the loan agreement, including those pertaining to contractual penalties, do not differ from provisions commonly applied in agreements of such type

The agreement is deemed significant as its estimated value exceeds 10% of the equity of Grupa LOTOS S.A.

The Management Board of Grupa LOTOS S.A. also reported that in connection with the above loan agreement, Grupa LOTOS S.A. entered into two registered pledge agreements in order to secure the liabilities incurred by Grupa LOTOS S.A. Pursuant to the agreements, the registered pledge created for the lenders covers the inventories of Grupa LOTOS S.A. with the estimated value (as at November 30th

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2007) of ca. USD 900,000 thousand (PLN 2,260,350 thousand, translated at the mid exchange rate quoted by the National Bank of Poland for December 19th 2007) and cash receivables under an agreement for keeping the bank accounts of Grupa LOTOS S.A. related to the loan agreement.

There are no links between Grupa LOTOS S.A. or its management staff and the banks for which the pledges were created or their management staff.

The assets covered by the pledge agreements are deemed assets of significant value as their value exceeds 10% of the equity of Grupa LOTOS S.A.

- On December 27th 2007, Grupa LOTOS S.A. and Shell Polska Sp. z o.o. executed an agreement on sale of fuels. The agreement, in effect from January 1st 2008 to December 31st 2008, provides for supplies of liquid fuels to Shell Polska Sp. z o.o.

The estimated value of the agreement, which is the largest among all agreements executed with Shell Polska Sp. z o.o. over the past 12 months, is approximately PLN 380,000 thousand.

Pursuant to the provisions of the agreement, the maximum estimated value of contractual penalties may reach PLN 6,000 thousand. Except as stated above, the agreement does not contain any provisions which would enable the parties to seek satisfaction of their claims for non-performance of the contractual obligations pursuant to the laws of general application.

The other terms of the agreement do not differ from those customarily applied in agreements of this type.

The agreement is deemed significant as the total estimated value of the agreements executed between Grupa LOTOS S.A. and Shell Polska Sp. z o.o. over the preceding 12 months amounted to PLN 660,000 thousand, thus exceeding 10% of the equity of Grupa LOTOS S.A.

- On December 31st 2007, Grupa LOTOS S.A. and Lukoil Warsaw Sp. z o.o. of Warsaw (formerly ConocoPhillips Poland Sp. z o.o.) executed an agreement on sale of fuels. The agreement provides for the sale of liquid fuels to Lukoil Warsaw Sp. z o.o. and will be in force between January 1st 2008 and December 31st 2008.

The agreement, whose estimated value is PLN 480,000 thousand, is the largest of all agreements concluded between Grupa LOTOS S.A. and Lukoil Warsaw Sp. z o.o. over the 12 months immediately preceding its execution, whose value totalled PLN 840,000 thousand.

Pursuant to the provisions of the agreement, the maximum estimated amount of contractual penalties may reach PLN 7,500 thousand. Receipt of contractual penalties precludes the parties from seeking additional compensation for damages in excess of the contractual penalties pursuant to the laws of general application. The other terms of the agreement do not differ from those customarily applied in agreements of such type.

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The agreement is deemed significant as the total estimated value of the agreements executed between Grupa LOTOS S.A. and Lukoil Warsaw Sp. z o.o. over the past 12 months exceeded 10% of the equity of Grupa LOTOS S.A.

**11.2 SIGNIFICANT AGREEMENTS CONCLUDED BY GRUPA LOTOS S.A. SUBSEQUENT TO THE BALANCE-SHEET DATE**

- On January 14th 2008, Grupa LOTOS S.A. and BP Polska Sp. z o.o. of Kraków entered into an agreement on sale and purchase of liquid fuels between Grupa LOTOS S.A. and BP Polska Sp. z o.o.

The agreement, whose estimated value amounts to PLN 1.300m, will remain in force until December 31st 2008.

The estimated maximum amount of contractual penalties is PLN 21,000 thousand. The agreement does not contain any provisions permitting either party to seek compensation in excess of the contractual penalties. The other terms and conditions of the agreement do not differ from the terms and conditions commonly applied in agreements of such type.

The agreement is considered significant as its estimated value exceeds 10% of Grupa LOTOS S.A.'s equity.

In 2007, Grupa LOTOS S.A. did not enter into any significant insurance or cooperation agreements.

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**12. ORGANISATIONAL OR CAPITAL LINKS BETWEEN GRUPA LOTOS S.A. AND OTHER ENTITIES, SPECIFICATION OF KEY DOMESTIC AND FOREIGN INVESTMENTS**

**12.1 ORGANISATIONAL OR CAPITAL LINKS AS AT DECEMBER 31ST 2007**

**Undertakings in which the Company Holds Shares or Votes at the General Shareholders Meeting.**

As at December 31st 2007 and December 31st 2006, the Company's share in the total vote at the General Shareholders Meetings of its subsidiary undertakings equalled the Company's share in the share capital of these undertakings.

Entity	Registered office	Business profile	Percentage of share capital held by Grupa LOTOS S.A.	
			Dec 31 2007	Dec 31 2006
LOTOS Paliwa Sp. z o.o.	Gdańsk	Wholesale and retail sale of fuels, light fuel oil, management of the LOTOS service station network	100.00%	100.00%
LOTOS Partner Sp. z o.o.	Gdańsk	Sale of fuels and provision of services for retail networks of international concerns; logistic services	(1)	100.00%
LOTOS Gaz S.A. (2) (formerly LOTOS Mazowsze S.A.; parent undertaking of another group)	Mława	Sale of LPG and sulphur	100.00%	100.00%
LOTOS Oil S.A.	Gdańsk	Production and sale of lubricating oils and lubricants, and domestic sales of base oils and plasticizers	100.00%	100.00%
LOTOS Asfalt Sp. z o.o.	Gdańsk	Production and sale of bitumens and sale of heavy fuel oil	100.00%	100.00%
LOTOS Ekoenergia S.A.	Gdańsk	The company has not commenced operations	100.00%	100.00%
LOTOS Kolej Sp. z o.o.	Gdańsk	Railway transport	100.00%	100.00%
LOTOS Serwis Sp. z o.o.	Gdańsk	Maintenance of mechanical and electric operations and controlling devices; repairs	100.00%	100.00%
LOTOS Lab Sp. z o.o.	Gdańsk	Laboratory testing	100.00%	100.00%
LOTOS Straż Sp. z o.o.	Gdańsk	Fire protection	100.00%	100.00%
LOTOS Ochrona Sp. z o.o.	Gdańsk	Personal and property protection	100.00%	100.00%
LOTOS Parafiny Sp. z o.o.	Jasło	Production and sale of paraffin, and production and sale of grave candles	100.00%	100.00%
LOTOS Czechowice S.A. (parent undertaking of another group)	Czechowice	Storage and distribution of fuel	80.04%	80.04%
LOTOS Jasło S.A. (parent undertaking of another group)	Jasło	Production and processing of refined petroleum products and their wholesale and retail sale	80.01%	80.01%
Petrobaltic S.A. (parent undertaking of another group)	Gdańsk	Acquisition of reserves, crude oil and natural gas production	69.00%	69.00%
UAB LOTOS Baltija	Lithuania	Wholesale and retail sale of lubricating oils in Lithuania and Belarus	100.00%	100.00%
BiproRaf Sp. z o.o.	Gdańsk	Design services for oil industry	(3)	50.00%

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Entity	Registered office	Business profile	Percentage of share capital held by Grupa LOTOS S.A.	
			Dec 31 2007	Dec 31 2006
Rafineria Nafty Glimar S.A. in liquidation	Gorlice	Refining (currently discontinued due to the company's bankruptcy)	91.54%	91.54%
LOTOS Hydrokompleks Sp. z o.o. in liquidation <sup>(4)</sup>	Gorlice	the company has not commenced operations	100.00%	100.00%
LOTOS Park Technologiczny Sp. z o.o.	Gorlice	Restructuring of the Southern Refineries' assets (LOTOS Czechowice S.A. and LOTOS Jasło S.A.)	27.45%	27.45%
LOTOS Tank Sp. z o.o.	Jasło	Wholesale of liquid and gaseous fuels and derivative products	100.00% <sup>(5)</sup>	30.00%
LOTOS Exploration and Production Norge AS	Norway	Exploration and production of crude oil on the Norwegian continental shelf	100.00% <sup>(6)</sup>	-
<b>Other undertakings</b>				
Naftoport Sp. z o.o.	Gdańsk	Operation of reloading terminals for crude oil and petroleum products	6.41% <sup>(7)</sup>	8.97%
Daltrade PLC	UK	Import and distribution of chemical products	1.99%	1.99%

<sup>(1)</sup> On June 29th 2007, the merger of Grupa LOTOS S.A. and LOTOS Partner Sp. z o.o. was registered. The merger was effected pursuant to Art. 492.1.1 of the Commercial Companies Code by way of a transfer of all assets in LOTOS Partner Sp. z o.o. (the acquiree) to Grupa LOTOS S.A. (the acquirer).

<sup>(2)</sup> On July 5th 2007, change of the company's name from LOTOS Mazowsze S.A. to LOTOS Gaz S.A. was registered.

<sup>(3)</sup> On January 15th 2007, Grupa LOTOS S.A. sold 35 shares in Przedsiębiorstwo Projektowo-Usługowe BiproRaf Sp. z o.o. (PPU BiproRaf Sp. z o.o.) to KTI Poland S.A. of Warsaw. As a result of the transaction, Grupa LOTOS S.A. is no longer a shareholder of BiproRaf Sp. z o.o.

<sup>(4)</sup> On November 26th 2007, by virtue of Resolution of the Extraordinary General Shareholders Meeting, LOTOS Hydrokompleks Sp. z o.o., a wholly-owned subsidiary of Grupa LOTOS S.A., was placed in liquidation.

<sup>(5)</sup> On April 11th 2007, Grupa LOTOS S.A. concluded an agreement with LOTOS Jasło S.A. (in which Grupa LOTOS S.A. holds 80.01% of shares) for the purchase of 700 shares in LOTOS Tank Sp. z o.o. (before that date, Grupa LOTOS S.A. held 30% of shares in the company).

<sup>(6)</sup> On September 22nd 2007, the Central Registrar of Businesses in Brønnøysund registered LOTOS Exploration and Production Norge AS, with registered office in Norway. Grupa LOTOS S.A. acquired 100% of shares in the new entity.

<sup>(7)</sup> On April 17th 2007, by virtue of the ruling of the Court of Appeals of Szczecin, dated December 28th 2006, concerning an action brought by the Minister of State Treasury against Polska Żegluga Morska Przedsiębiorstwo Państwowe and Grupa LOTOS S.A. (Docket No. I ACa 675/06), the number of shares held by Grupa LOTOS S.A. in Naftoport Sp. z o.o. as entered in the share register of Naftoport Sp. z o.o. was changed from seven to five.

## 12.2 CHANGES IN ORGANISATIONAL OR CAPITAL LNKS

### LOTOS Hydrokompleks Sp. z o.o. w likwidacji (in liquidation)

On November 26th 2007, by virtue of Resolution of the Extraordinary General Shareholders Meeting, LOTOS Hydrokompleks Sp. z o.o., a wholly-owned subsidiary of Grupa LOTOS S.A., was placed in liquidation.

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**LOTOS Exploration and Production Norge AS**

On September 22nd 2007, the Central Registrar of Businesses in Brønnøysund registered LOTOS Exploration and Production Norge AS, with registered office in Norway. Grupa LOTOS S.A. acquired 100% of shares in the new company and paid up the entire share capital of NOK 8,000,000 (i.e. PLN 3,871,200, translated at the mid-exchange rate quoted by the National Bank of Poland on September 17th 2007).

**LOTOS Gaz S.A. (former LOTOS Mazowsze S.A.)**

On July 5th 2007, change of the company's name from LOTOS Mazowsze S.A. to LOTOS Gaz S.A. was registered. On July 9th 2007, the company acquired 100% of shares in Krak-Gaz Sp. z o.o.

**LOTOS Partner Sp. z o.o.**

On June 29th 2007, the merger of Grupa LOTOS S.A. and LOTOS Partner Sp. z o.o. was registered. The merger was effected pursuant to Art. 492.1.1 of the Commercial Companies Code by way of a transfer of all assets in LOTOS Partner Sp. z o.o. (the acquiree) to Grupa LOTOS S.A. (the acquirer).

**Przedsiębiorstwo Przeladunku Paliw Płynnych Naftoport Sp. z o.o.**

On April 17th 2007, by virtue of the ruling of the Court of Appeals of Szczecin, dated December 28th 2006, concerning an action brought by the Minister of State Treasury against Polska Żegluga Morska Przedsiębiorstwo Państwowe and Grupa LOTOS S.A. (Docket No. I ACa 675/06), the number of shares held by Grupa LOTOS S.A. in Naftoport Sp. z o.o. as entered in the share register of Naftoport Sp. z o.o. was changed from seven to five. As a result of the change, Grupa LOTOS S.A.'s share in the share capital of Naftoport Sp. z o.o. fell from 8.97% to 6.41%.

**LOTOS Tank Sp. z o.o.**

On April 11th 2007, Grupa LOTOS S.A. concluded an agreement with LOTOS Jasło S.A. (in which Grupa LOTOS S.A. holds 80.01% of shares) for the purchase of 700 shares in LOTOS Tank Sp. z o.o. (before that date, Grupa LOTOS S.A. held 30% of shares in that company). Grupa LOTOS S.A. purchased the shares in LOTOS Tank Sp. z o.o. for PLN 642.5 thousand using internally generated funds.

**BiproRaf Sp. z o.o.**

On January 15th 2007, Grupa LOTOS S.A. sold 35 shares in Przedsiębiorstwo Projektowo-Usługowe BiproRaf Sp. z o.o. (PPU BiproRaf Sp. z o.o.) to KTI Poland S.A. of Warsaw. As a result of the transaction, Grupa LOTOS S.A. is no longer a shareholder of BiproRaf Sp. z o.o.

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### 12.3 KEY DOMESTIC AND FOREIGN INVESTMENTS OF THE COMPANY

#### INVESTMENTS IN TANGIBLE AND INTANGIBLE ASSETS

Grupa LOTOS S.A.'s major investments in tangible and intangible assets made in 2007 (PLN '000)

<b>Tangible assets under construction and purchases of property, plant and equipment and intangible assets, including:</b>	<b>Capital expenditure Jan 1 – Dec 31 2007</b>
Construction and assembly work	62,325
Procurement from external suppliers – purchases	15,595
Acquisition of intangible assets	16,094
Other capital expenditure	167,110
Prepayments for tangible assets under construction	655,193
Settled prepayments	(12,157)
<b>Total</b>	<b>904,160</b>

#### EQUITY INVESTMENTS

##### Acquisition of 100% of shares in LOTOS Exploration and Production Norge AS

On September 22nd 2007, the Central Registrar of Businesses in Brønnøysund registered LOTOS Exploration and Production Norge AS, with registered office in Stavanger, Norway. The share capital of the company is divided into 8,000,000 shares with a par value of NOK 1 per share, conferring the right to 8,000,000 votes. Grupa LOTOS S.A. acquired 100% of shares in the new company by contributing the entire share capital of NOK 8,000,000 (i.e. PLN 3,871,200, translated at the mid-exchange rate quoted by the National Bank of Poland on September 17th 2007). The Company was established for the purpose of exploration and production of oil on the Norwegian Continental Shelf.

##### LOTOS Tank Sp. z o.o.

On April 11th 2007, Grupa LOTOS S.A. concluded an agreement with LOTOS Jasło S.A. (in which Grupa LOTOS S.A. holds 80.01% of shares) for the purchase of 700 shares in LOTOS Tank Sp. z o.o. (before that date, Grupa LOTOS S.A. held 30% of shares in that company). Grupa LOTOS S.A. purchased the shares in LOTOS Tank Sp. z o.o. for PLN 642.5 thousand using internally generated funds. As a result of the transaction, LOTOS Tank Sp. z o.o. became a wholly-owned subsidiary of Grupa LOTOS S.A.



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### 13. TRANSACTIONS WITH RELATED UNDERTAKINGS

Transactions in excess of EUR 500,000 executed by the Parent Undertaking with its related undertakings, (PLN '000)

No.	Party to the transaction	Sale (PLN '000)	Purchase (PLN '000)
1	LOTOS Paliwa Sp. z o.o.	7,977,174	-
2	LOTOS Partner Sp. z o.o.	2,380,777	47,297
3	LOTOS Oil S.A.	215,470	-
4	LOTOS Parafiny Sp. z o.o.	69,633	-
5	LOTOS Kolej Sp. z o.o.	7,243	213,228
6	LOTOS Serwis Sp. z o.o.	49,219	4,797
7	LOTOS GAZ S.A. Group	111,946	-
8	LOTOS Lab Sp. z o.o.	-	12,615
9	LOTOS Ochrona Sp. z o.o.	-	6,828
10	LOTOS Straż Sp. z o.o.	-	10,287
11	LOTOS Asphalt Sp. z o.o.	696,631	-
12	Grupa Kapitałowa LOTOS Jasło S.A.	74,172	82,783
13	Grupa Kapitałowa LOTOS Czechowice S.A.	-	18,316
14	Grupa Kapitałowa Petrobaltic S.A.	5,479	286,803

\* The equivalent of EUR 500,000 is PLN 1,888 thousand (EUR/PLN = 3,7768 – arithmetic mean of the exchange rates quoted by the National Bank of Poland on the last day of each month in the period January 1st – December 31st 2007).

Except for the transactions described below, in the period from January 1st to December 31st 2007 Grupa LOTOS S.A. did not enter into any non-typical transactions with any of its related parties whose value would exceed EUR 500 thousand.

- On January 2nd 2007, Grupa LOTOS S.A. and LOTOS Kolej Sp. z o.o. (wholly owned by Grupa LOTOS S.A.) signed an agreement whereby LOTOS Kolej Sp. z o.o. will provide comprehensive railway services to Grupa LOTOS S.A. The services include:
  - dispatch and receipt of railway shipments sent by or addressed to Grupa LOTOS S.A.,
  - procurement of the required number of tank cars of appropriate type for Grupa LOTOS S.A.'s shipments,
  - technical servicing and maintenance of proper technical condition of railway assets owned by Grupa LOTOS S.A.

The agreement was concluded for five years. It provides for standard contractual penalties, whose amount will depend on the extent of LOTOS Kolej's delay in the performance of or failure to perform the services. The value of the agreement is estimated at approximately PLN 1,000,000 over the agreement term. The agreement is deemed significant as its estimated value represents more than 10% of the equity of Grupa LOTOS S.A.

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- On January 23rd 2007, Grupa LOTOS S.A., LOTOS Partner Sp. z o.o. (a wholly-owned subsidiary of Grupa LOTOS S.A.) and BP Polska Sp. z o.o. concluded a significant agreement for the sale and supply of liquid fuels to BP Polska Sp. z o.o.

The agreement was concluded for a definite term (until December 31st 2007) and its value is estimated at PLN 1,000,000 thousand. The agreement provides for contractual penalties of up to PLN 22,000 thousand but does not contain any provisions excluding the right to seek additional compensation on general terms.

The agreement is deemed significant as its value exceeds 10% of Grupa LOTOS S.A.'s equity.

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**14. LOANS ADVANCED, INCLUDING LOANS, SURETIES AND GUARANTEES  
GRANTED TO THE RELATED UNDERTAKINGS OF GRUPA LOTOS S.A.**

**14.1 LOANS ADVANCED**

**Loan Advanced by Grupa LOTOS S.A. to Rafineria Nafty Glimar S.A.**

On September 23rd 2003 and on April 8th 2004, Grupa LOTOS S.A. and Rafineria Nafty Glimar S.A. entered into loan agreements for the financing of operating and investing activities, including, in particular, the Glimar Hydrocomplex investment project, for an aggregate amount of PLN 90m. By December 31st 2004, Grupa LOTOS S.A. had advanced PLN 48m to Rafineria Nafty Glimar S.A. under these agreements. Additionally, in connection with the Letter of Comfort signed by Grupa LOTOS S.A. on February 12th 2004 for Bank Przemysłowo-Handlowy S.A., the Company undertook commitments relating to the co-financing of the Glimar Hydrocomplex investment project and maintaining of an appropriate financial standing of Rafineria Nafty Glimar S.A. In the opinion of the Company's Management Board, the commitments under the Letter of Comfort do not represent financial liabilities as at the balance-sheet date.

As at December 31st 2007, assets under the loans were fully covered by a valuation allowance, and as at December 31st 2007 the Company maintained a provision of PLN 15m for the potential liabilities relating to these agreements.

On January 19th 2005, the District Court of Nowy Sącz declared Rafineria Nafty Glimar S.A. of Gorlice bankrupt. On March 11th 2008, the District Court of Nowy Sącz issued a decision to discontinue the bankruptcy proceedings with respect to Rafineria Nafty Glimar S.A. As at the date of this report, the decision was not final.

**Loans Advanced by Grupa LOTOS S.A. to LOTOS Parafiny Sp. z o.o.**

On September 8th 2005, Grupa LOTOS S.A. and LOTOS Parafiny Sp. z o.o. concluded a loan agreement under which LOTOS Parafiny Sp. z o.o. was lent PLN 2,500 thousand. Next, on March 10th 2006, Grupa LOTOS S.A. executed an agreement under which it granted to LOTOS Parafiny Sp. z o.o. a loan of PLN 4,500 thousand. Both loans were allocated to finance the investment in a candle production plant in Czechowice.

Both loans were repaid by LOTOS Parafiny Sp. z o.o. in December 2007, i.e. before the final repayment date specified in the agreements.

**Loans Advanced by Grupa LOTOS S.A. to LOTOS Park Technologiczny Sp. z o.o.**

On August 24th 2005, Grupa LOTOS S.A. and LOTOS Park Technologiczny Sp. z o.o. concluded a loan agreement under which LOTOS Park Technologiczny Sp. z o.o. was lent PLN 1,900 thousand, to be repaid in full by the end of August 2008.

On February 27th 2007, Grupa LOTOS S.A. executed an agreement on a loan of PLN 1,200 thousand to LOTOS Park Technologiczny Sp. z o.o. Two annexes to the agreement were subsequently signed: Annex No. 1 of February 27th 2007, under which the deadline for creating security with respect to the loan was postponed, and Annex No. 2 of January 30th 2008, effective from December 31st 2007, under which the final loan repayment date was changed to June 30th 2008.

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On June 26th 2007, Grupa LOTOS S.A. executed an agreement on granting a loan of PLN 600 thousand to LOTOS Park Technologiczny Sp. z o.o. Subsequently, Annex No. 1 to the agreement was signed on January 30th 2008, effective from December 31st 2007, under which the loan repayment date was changed to June 30th 2008.

#### **14.2 SURETIES, GUARANTEES AND SECURITY INTERESTS**

##### **Surety Agreement of February 9th 2004 Concluded with the National Fund for Environmental Protection and Water Management**

Under the agreement, the Company issued an irrevocable surety for repayment of the loan contracted by Rafineria Jasło S.A. from the National Fund for Environmental Protection and Water Management under a loan agreement of December 10th 2003. The surety covers the loan amount of up to PLN 15,000 thousand. In connection with the surety agreement, on February 6th 2004 Rafineria Jasło S.A. (currently LOTOS Jasło S.A.) and the Company signed an agreement on securing the Company's interest with respect to the surety.

As at the date of these financial statements, subject to the annex of October 20th 2005, the loan is secured with a registered pledge on the plastics processing unit owned by LOTOS Jasło S.A.. The pledge was created under a registered pledge agreement of February 18th 2004.

Irrespective of the above, the agreement states that LOTOS Jasło S.A. will seek to obtain a bank guarantee or surety to replace the surety issued by the Company.

If LOTOS Jasło S.A. is in breach of the agreement, it will pay the Company a contractual penalty of 10% of the surety value, subject to the reservation that if the value of the damage is higher than the contractual penalty, the Company may seek compensation equal to the full value of the damage.

##### **Security Granted to Customs Office**

- The validity of the promissory note of March 16th 2006 for PLN 200,000 thousand, issued to secure the Company's tax liability connected with the suspended excise tax collection procedure, was extended until June 16th 2008. The original validity term of the promissory note expired on March 16th 2007.
- The validity of the blank promissory note of July 7th 2005 for PLN 200,000 thousand, issued to secure the Company's tax liability connected with the suspended excise tax collection procedure, was extended until July 7th 2007. The original validity term of the blank promissory note expired on July 7th 2006.

##### **Other Contingent Liabilities**

- On January 3rd 2007, Grupa LOTOS S.A. issued a blank promissory note and a promissory note declaration as financial security for a contract with ABB Lummus Global GmbH.

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As at December 31st 2007, the Company's liabilities under material agreements concerning capital expenditure on property, plant and equipment (the 10+ Programme) amounted to PLN 2,735m (compared with PLN 699m as at December 31st 2006).

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## **15. USE OF ISSUE PROCEEDS TO IMPLEMENT THE ISSUE OBJECTIVES**

In line with the issue objectives presented in the Prospectus of Grupa LOTOS S.A., by December 31st 2007 the net issue proceeds were used to finance:

- acquisition of the Southern Refineries and Petrobaltic S.A.: PLN 257.3m,
- the 10+ Programme (formerly the Comprehensive Technical Upgrade Programme): PLN 495.8m,
- PROSTA service stations network development programme: PLN 65m,
- modernisation projects at the Gdańsk Refinery: PLN 188m.

**16. EXPLANATION OF DIFFERENCES BETWEEN ACTUAL FINANCIAL RESULTS AND PREVIOUSLY PUBLISHED FORECASTS OF FINANCIAL RESULTS**

Grupa LOTOS S.A. did not publish forecasts of its non-consolidated results for 2007.

## **17. MAJOR RESEARCH AND TECHNICAL DEVELOPMENT ACHIEVEMENTS OF GRUPA LOTOS S.A.**

In 2007, the Company completed R&D work on the following technologies:

- production technology of the Premium fuels (Lotos Dynamic Diesel and Lotos Dynamic 98),
- production technology of paraffins with low oil content,
- production technology of a new generation, non-toxic plasticizer for the rubber industry.

Grupa LOTOS S.A. acquired the technology for the production of paraffin emulsions used as anticaking agents in synthetic fertilizers.

Furthermore, Grupa LOTOS S.A. launched the production of hydrofined paraffin, a new product complying with the RAL quality requirements.

Technical approvals for turbine oils were obtained from turbine producers.



## **18. ASSESSMENT OF FEASIBILITY OF PLANNED INVESTMENTS, INCLUDING EQUITY INVESTMENTS, IN VIEW OF AVAILABLE FUNDS**

In 2007, Grupa LOTOS S.A. financed investments using its own resources and was in the process of raising debt financing for the 10+ Programme.

On December 20th 2007, Grupa LOTOS S.A. and a consortium of four banks, comprising BANK POLSKA KASA OPIEKI S.A. of Warsaw, PKO BP S.A. of Warsaw, BRE BANK S.A. of Warsaw and RABOBANK POLSKA S.A. of Warsaw, executed an agreement concerning a four-year revolving loan for a total amount of USD 400,000 thousand (PLN 1,004,600 thousand, translated at the mid exchange rate quoted by the National Bank of Poland for December 19th 2007), for refinancing and financing the inventories of Grupa LOTOS S.A.

The agreement is the first element of the financing strategy for the operations of Grupa LOTOS S.A. in the coming years, related to the execution of the 10+ Programme. In the opinions issued to date, the financial advisors engaged by the Company to lend support in the process of raising financing for the investments stated that the attractiveness of the 10+ Programme will allow the Company to obtain debt financing, which will cover Grupa LOTOS S.A.'s needs related to the ongoing and planned investment projects.

## **19. MATERIAL EVENTS WHICH OCCURRED DURING THE FINANCIAL YEAR AND AFTER ITS END, PRIOR TO THE RELEASE OF ANNUAL REPORT**

### **10+ Programme (Comprehensive Technical Upgrade Programme)**

With respect to the execution of the 10+ Programme, the Company's largest investment project of key importance for the growth of its value, the Company's efforts in 2007 focused on reviewing the received bids, preparing the contractor selection process and launching the implementation phase of the project, commencing the performance of concluded execution contracts, further selection of contractors and efforts relating to the organisation of financing: technological, market, legal and insurance analyses of the 10+ Programme, as well as work on a financing concept for the Programme, negotiations and cooperation with financial institutions.

In 2007, the Company continued the efforts to commence the construction of a new distillation unit (CDU/VDU). A tender procedure for execution of the unit was conducted on the basis of bids submitted by six international engineering companies. A preliminary contract was signed with Lurgi S.A., under which a detailed engineering design of the unit was prepared to serve as the basis for ordering the main unit components and obtaining the construction permit. The contract with Lurgi S.A. was finally executed on July 19th 2007 and then amended on August 1st 2007 by including equipment delivery at an agreed lump price. The contract value amounted to EUR 101.5m.

Negotiations concerning the construction of the unit were also finalised (as a continuation of the preliminary agreement). A tender procedure was conducted and the contractor for the construction work (piling and foundation construction) was selected. Following the obtainment of the construction permit for the unit, the work started in mid-December 2007. Following the construction of the new CDU/VDU unit, the annual oil throughput in the Gdańsk refinery of Grupa LOTOS S.A. will increase to 10.5m tonnes in 2010 up from the current level of 6m tonnes.

The work was also continued on optimising the concept for the utilisation of the ROSE unit, based on the Kellogg Brown & Root technology, as part of the implemented configuration of the 10+ Programme. On July 25th 2007, a meeting with the licensor was held in London, in August samples of vacuum residue were sent to Houston, USA, and an agreement on technological analyses was executed. In September, a reference visit to a refinery in the United States was held and tests were performed on a comparable unit. These efforts were designed to prepare assumptions for the verification of the base design of the unit. On October 19th 2007, an agreement was executed with the licensor (KBR) for a review of the base design of the unit.

Under an EPC contract with ABB Lummus Global, the contractor constructed the diesel hydrodesulphurisation unit (HDS). The main modules and apparatus (columns, reactor, compressors, separators, heat exchangers and pumps) were ordered. ABB selected the contractor to perform the construction work. The subsequent stages of the engineering design were completed. The Company transferred to the contractor land purchased as a backup. On July 23rd 2007, the final construction permit for the unit was obtained. The construction of the HDS unit will

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enable the Group to increase its production of diesel oils and meet the quality requirements which are to apply as of 2009 (maximum sulphur content of 10 ppm).

On August 20th, a decision permitting the construction of a new access way Grupa LOTOS S.A.'s premises became final.

As far as the other units to be constructed as part of the 10+ Programme are concerned, the execution concept consisting in constructing and launching, in the first place, the hydrocracking unit and the auxiliary units and making the necessary extensions to the utilities and offsite facilities was approved.

The time of execution of the heavy residue gasification unit will depend on the market situation with respect to the sale of heavy products, in particular bitumens, whose sale is an alternative for heavy residue gasification.

In June 2007, a number of EPC contracts were signed for the execution of the key installations of the 10+ Programme, including a contract for the engineering design, delivery and construction of the hydrocracking unit (MHC) and the amine sulphur recovery (ASR) unit (a contract with Technip Italy and KTI) and the auxiliary installations, i.e. the hydrogen generating unit (HGU) (with Lurgi). An EPC contract for the design, organisation of deliveries and construction management was also signed with Fluor S.A., concerning the extension of the utilities and offsite facilities (U&O). All those contracts were preceded by preliminary contracts, thanks to which work related to the engineering design could begin as early as April and May 2007. On October 8th 2007, decision on environmental requirements to be complied with by the units planned to be executed took effect. On November 8th 2007, a construction permit for the ASR unit was obtained and the construction work commenced immediately after the permit became final. On November 20th 2007, a construction permit for the HGU unit was obtained.

With respect to the other units, work connected with the engineering design and ordering key equipment was continued. All investment tasks were executed in line with their budgets and timetables.

As regards utilities and offsite facilities, the preparation of a concept for the modernisation of the sewage treatment plant has been ordered, and assumptions concerning fan cooling towers have been agreed upon. A tender for the execution of works designed to ensure an additional access way to the construction site was underway. Terms of reference for the purposes of a tender for the construction of new tanks have been prepared and the design assumptions for the pipeline connecting the refinery and Naftoport were developed in more detail.

As part of the work aimed at arranging financing for the 10+ Programme, the transaction structure and an information package for banks were being prepared.

Wood MacKenzie was engaged to perform a market analysis for the purposes of the 10+ Programme. The analysis confirmed the possibility of selling additional quantities of products to be produced by Grupa LOTOS S.A. on the European market without entering into long-term contracts. Wood MacKenzie (WMK) presented its assessment of the European product market from the perspective of the production structure to be introduced by Grupa LOTOS S.A. in the future, as well as an analysis of the bitumen market. The volume of domestic sales as projected by Grupa LOTOS S.A. was also confirmed as achievable. A comparative analysis of Grupa LOTOS S.A.'s competitiveness before and after the implementation of the 10+ Programme was performed. The comparison included 107 European refineries. The final report on the analysis confirmed the correctness of

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Grupa LOTOS S.A.'s market assumptions justifying the execution of the 10+ Programme, including in particular: demand forecasts for individual products and possibility of marketing these products in Poland and other European countries, price forecasts, and the favourable effect of the 10+ Programme on the Company's competitive position.

Stone & Webster performed a technological analysis of the 10+ Programme for the financing institutions. In the analysis, Stone & Webster considered the current configuration of the Programme and the concluded EPC contracts. Also the final due diligence report included a positive assessment of the 10+ Programme and identified no material risks in any of the Programme's aspects covered by the due diligence examination (including the budget, timetable, contractor selection strategy, management strategy, environmental issues, permits, and technology).

Additionally, a legal adviser to the financial institutions was selected and engaged. Based on the bids submitted, the Linklaters law firm was selected as the legal adviser to the institutions and engaged to perform a legal due diligence of the 10+ Programme and Grupa LOTOS S.A. The legal due diligence report, containing a positive assessment of Grupa LOTOS S.A., was prepared towards the end of December 2007. Linklaters was also involved in the preparation of the term sheet proposed to prospective participants in financing.

The legal adviser to financial institutions will participate in adopting decisions concerning the final wording of financial documents connected with the financing of the Programme, such as credit facility agreements or the package of legal security instruments.

Miller was selected as the insurance adviser to the financial institutions. Based on a due diligence examination concerning the insurance programme connected with the execution of the 10+ Programme, Miller accepted and positively assessed Grupa LOTOS S.A.'s insurance assumptions for the coming years.

Insurance policies covering construction and assembly risks connected with the commencement of the 10+ Programme (in line with the assumptions of Grupa LOTOS S.A.'s Insurance Programme for 2008–2010) were arranged. Work was completed on extended operating insurance for the existing assets of Grupa LOTOS S.A.'s Gdańsk refinery. The policy for 2008–2010 was signed on November 30th 2007.

The process of developing a concept of and organising the financing for the 10+ Programme and other needs of the Company had several phases.

The final version of the Information Memorandum comprising the financial model for the 10+ Programme was prepared. The memorandum was included in the documentation package intended for banks interested in submitting financing proposals concerning the Programme. Following the preparation of the financing concept, a brief presentation of the concept ("Project Brief") was prepared in September 2007 and sent to selected financial institutions. Q3 2007 saw a round of meetings with the financial institutions interested in financing the Programme, during which the proposed financing structure was presented and discussed. Following the meetings, Grupa LOTOS S.A. received declarations of interests from all their participants containing preliminary

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proposals of financing terms and conditions, as well as – in certain cases – comments on the concept. Generally, the financing structure presented to the financial institutions met with their approval.

In December 2007, the Company signed a credit facility agreement with a syndicate of four banks (Bank PEKAO S.A., PKO BP S.A, BRE BANK S.A. and RABOBANK Polska S.A.). The agreement provided for USD 400m for refinancing/financing the inventories maintained by Grupa LOTOS S.A. This was the first step in the process of raising financing for Grupa LOTOS S.A.'s needs connected with the execution of the 10+ Programme. The facility will enable the existing inventories to be refinanced and the funds frozen in the inventories to be released.

On December 21st 2007, Grupa LOTOS S.A. sent to the interested financial institutions an invitation to submit bids for financing the 10+ Programme and the Company's working capital in the amount of USD 1,550m and USD 200m, respectively. The invitation was accompanied by an extensive information package including the Information Memorandum, reports from technological, market, insurance and legal due diligence of the 10+ Programme and Grupa LOTOS S.A., the financial model, annual reports and environmental impact studies, the proposed term sheet together with an opinion issued by the banks' legal adviser, and a signed credit facility agreement for the financing of inventories. The invitation documentation was saved on a dedicated server and made available to banks and other financial institutions. The deadline for submitting bids was set for January 2008.

Towards the end of January 2008, Grupa LOTOS S.A. started receiving firm bids from banks. A preliminary bid was also submitted by the Italian export credit agency SACE.

In February 2008, the submitted bids underwent careful evaluation. Throughout March 2008, work was underway to determine the final composition of the consortium of financial institutions which would cover all the Company's financing needs, as well as to agree on common commercial (commissions, margins) and legal (commitment letter, term sheet) terms of the financing. As a result, on April 11th and April 14th, a Commitment Letter was signed with a selected group of approximately a dozen banks which:

- formally established the bank consortium which made a commitment to advance the credit facility in the agreed amount on the agreed commercial terms,
- provided the basis for taking further steps and entering the final stage of negotiations addressing the legal issues related to the financing,
- allowed the banks to allocate appropriate resources to the 10+ Programme.

Furthermore, on February 20th 2008 the Extraordinary General Shareholders Meeting adopted a resolution to approve the provision of security for the loans required to finance the 10+ Programme.

In Q1 2008, work on the arrangement of a CARGO insurance policy covering deliveries for the purposes of the 10+ Programme was being completed. The policy, which will remain valid throughout the life of the 10+

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Programme (in line with the assumptions of Grupa LOTOS S.A.'s Insurance Programme for 2008-2010), was signed at the end of March 2008.

In 2007 Grupa LOTOS S.A. also implemented a programme of recruitment of employees who – after receiving appropriate training and gaining experience at the refinery – will operate units constructed as part of the 10+ Programme.

As at December 31st 2007, the aggregate expenditure (including prepayments) on the execution of the 10+ Programme amounted to PLN 1,130m.

The construction and launch of the units under the 10+ Programme will increase the oil conversion ratio and the volume of the produced fuels, especially diesel oil.

**Petrobaltic and the production segment**

In 2007, in the exploration and production segment the company continued oil and gas production at the B3 reservoir, where 3,006,774 tonnes of crude oil have been produced since the launch of production.

The total 2007 crude oil and natural gas outputs amounted to 186,571 tonnes and 20,543,598 cubic metres, respectively. The entire 2007 crude oil output from the B3 reservoir was shipped by an oil tanker to the Gdańsk refinery and the natural gas (16,021,261 cubic metres) was transmitted via a pipeline to Energobaltic Sp. z o.o.'s CHP plant in Władysławowo.

Petrobaltic S.A. also continued the preparations to commence the exploration of new offshore crude oil reserves outside the Polish economic zone of the Baltic Sea. An analysis of potential geologic deposits of carbohydrates in the Polish economic zone of the Baltic Sea was conducted, thus delineating a considerably larger exploration area for Petrobaltic S.A.

In May 2007, Petrobaltic S.A. obtained a 25-year licence for the production of gasoline gas from the B4 reservoir.

Petrobaltic S.A. evaluated the reserves and economic feasibility of production with respect to its four sea exploration licences:

1. Wolin
2. Gaz Południe
3. Sambia Wschód
4. Sambia Zachód

The most important projects executed in 2007 in the exploration and production segment included:

- preparation of liquidation of the B3-16 well.
- reconstruction of the B3-7 well and resumption of production with the use of a deep-well pump,
- commencement of drilling of the B8-Z1 bore and preparation of production from the B8 field,
- implementation of new IT programs supporting bore modelling and economic analyses of crude oil projects,

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- preparation of the launch of operations of Exploration and Production Norge AS, Grupa LOTOS S.A.'s subsidiary in Norway,
- completion of the reconstruction of the B3-9 and B3-15 wells at the B3 field and launch of production from those wells.
- drilling of the B3-21 well.

***PROSTA Programme***

In 2007, the Company was developing its retail service station network through subsidiary LOTOS Paliwa under the *PROSTA* programme, which focused on continued expansion of the COCO and CODO station network and the development of the DOFO station network.

In 2007, the Company continued the following activities commenced in previous quarters:

- a CODO service station in Katowice was placed in service on January 5th 2007;
- land with the permit for construction of a service station was purchased and the construction of the service station in Opole at ul. Sosnkowskiego/Szarych Szeregów was commenced; the station was launched on July 24th 2007;
- two preliminary agreements were concluded, relating to the acquisition of land plots intended for the construction of service stations (in Warsaw and Strzeszowice (the Zielona Góra Province));
- the comprehensive LPG module installation programme was continued with regard to the service stations acquired from ExxonMobil and Slovnaft;
- fourteen new stations (in Tarnów, Opatówek near Kalisz, Serock, Szczecin, Koszalin, Nidzica, Koźnice, Wola Cicha, Baranów Sandomierski, Słupia, Budzyń, Sompolinek, Busko Zdrój and Jasionka) were included into the LOTOS Family Commercial Partnership Programme;
- two agreements for the running of DOFO stations (in Kowalewo and Piława) were terminated;
- a CODO service station in ul. Elbląska, Gdańsk, was launched on December 8th 2007.

As at December 31st 2007, the LOTOS service station network comprised 379 locations, including 133 COCO/CODO stations owned by LOTOS Paliwa, 71 DOFO stations and 175 DODO stations. A total of 90 franchise agreements were signed. In line with the assumptions of the *PROSTA* programme concerning the transfer of the DODO stations to another operating platform, the total number of high-margin COCO/CODO/DOFO stations has exceeded the number of DODO stations as of Q1 2007.

***Southern Refineries***

In 2007, the Company continued the restructuring efforts aimed at adapting LOTOS Jasło S.A. and LOTOS Czechowice S.A. to operate within the LOTOS Group.

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LOTOS Czechowice S.A. executed the FAME investment project (unit for the production of diesel oil biocomponents) through its subsidiary LOTOS Biopaliwa Sp. z o.o. The phase of the project consisting in the construction of ancillary infrastructure (storage tanks, electricity service lines, etc.) and the construction work on the principal part of the plant were completed. Installation of technological equipment entered its final stage. The start-up of the plant is scheduled to take place in spring 2008 and its commissioning – at the end of April 2008.

Moreover, LOTOS Czechowice S.A. prepared new investment projects (approved at the level of Grupa LOTOS S.A.) aimed at expanding the capacity of fuel storage on a service basis (construction of a new storage tank and upgrade of the existing tanks to comply with applicable legal requirements) and enhancing the product mix of distributed fuels (construction of an LPG terminal). The projects are scheduled to be completed in Q3–Q4 2008. They will lead to a gradual increase in the company's revenue from fuel storage and distribution services provided to Grupa LOTOS S.A.

LOTOS Jasło S.A. undertook efforts aimed at improving its financial performance. The company started to restructure its headcount through voluntary severance schemes and voluntary redeployment schemes.

The work at the DRW unit is limited to the production of feedstock used by LOTOS Asphalt, as it is no longer possible to conduct economically effective production of fuels after the abolition of the relief encouraging the use of a plastics component in the production of gasolines and diesel oils and after the discontinuation of plastics pyrolysis.

A development plan for a production unit processing waste plastics was prepared. The first phase of the project – waste sorting – had already been launched and completed. During the second phase, LOTOS Jasło installed a plastics regranulation line, which will further extend the Company's recycling operation. Furthermore, negotiations were held with potential investors interested in cooperating with LOTOS Jasło in the area of treatment of used oils at Jasło.

Drawing upon the knowledge of specialised foreign research centres, the company searched for technical and technological possibilities of using the plastics processing unit to produce alternative fuels. An option which was considered provides, among other things, for the expansion of the existing unit and launch of processing of oils with the use of highly advanced technologies to finally obtain products that may be used to produce oils.

LOTOS Jasło also undertook activities aimed at including a part of the refinery's site in the Tarnobrzeg Special Economic Zone, with the intention of using it for new investment projects to be executed in Jasło by the marketing companies of the LOTOS Group. LOTOS Asphalt Sp. z o.o. plans to develop a tar board production plant there, while LOTOS Parafiny – a candle plant. In November 2007, LOTOS Jasło received a decision on the creation of a Special Economic Zone on the site owned by the company. Part of the area located within the zone has already been allocated to a greenfield investment to be executed by LOTOS Asphalt (a tar board production plant). The remaining area will be gradually used in new investment projects undertaken by the LOTOS Group.

In addition, both southern Refineries undertook activities aimed at disposing of the real estate owned by them to interested parties: companies of the LOTOS Group and third parties. LOTOS Czechowice and LOTOS Jasło



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have already performed stock takes and valuations of disposable assets (real estate), and presented a proposal for their utilisation.

Moreover, in line with the approved strategy for closing down the operations of LOTOS Park Technologiczny by the end of 2008, a process of selling the company's assets to the LOTOS Group members operating in Czechowice and Jasło as well as to external investors was continued.

**Merger of Grupa LOTOS S.A. and LOTOS Partner Sp. z o.o.**

On February 27th 2007, the Management Board of Grupa LOTOS S.A. signed the plan of merger of Grupa LOTOS S.A. and LOTOS Partner Sp. z o.o., prepared in accordance with Art. 499.1 of the Commercial Companies Code. On June 29th 2007, the merger was registered. The merger was effected pursuant to Art. 492.1.1 of the Commercial Companies Code by way of transfer of all LOTOS Partner Sp. z o.o.'s assets (the acquiree) to Grupa LOTOS S.A. (the acquirer).

As the acquirer held 100% of shares in the acquired company, the merger was executed pursuant to Art. 515.1 of the Commercial Companies Code, i.e. without increasing the share capital of Grupa LOTOS S.A.

The merger was executed as part of the restructuring of the LOTOS Group, aimed at streamlining its organisational structure. The objective of the restructuring programme is to provide the LOTOS Group with more operating flexibility and facilitate quicker response to changes in the market environment. The merger of Grupa LOTOS S.A. and LOTOS Partner Sp. z o.o. is an element of the restructuring of the sales division within the entire LOTOS Group and did not have a material effect on the consolidated financial results of the LOTOS Group.

## **20. EXTERNAL AND INTERNAL FACTORS MATERIAL FOR THE DEVELOPMENT OF GRUPA LOTOS S.A.; DEVELOPMENT PROSPECTS OF GRUPA LOTOS S.A.**

### **20.1 EXTERNAL AND INTERNAL FACTORS MATERIAL FOR THE DEVELOPMENT OF GRUPA LOTOS S.A.**

**The key external factors material for the development of Grupa LOTOS S.A. include:**

- **Quotation prices of crude oil and petroleum products** – changes of market prices of crude oil and petroleum products have a material impact on the Company's financial performance. In 2007 the prices of crude oil were higher than in 2006.
- **PLN/USD exchange rate** – the performance of the Company and its Group is also, to a material/large extent, affected by foreign exchange rates, particularly the PLN/USD exchange rate, due to the fact that the prices of the raw material and of some products are quoted in the American dollar.
- **Petroleum products demand and supply levels** – the demand for diesel oil is expected to rise in the long run, while the demand for engine fuels is expected to stabilise. These trends are reflected in the investment plans for the Company and its Group.

**The key internal factors material for the development of Grupa LOTOS S.A. include:**

- **Further expansion of the fuel retail sales network** – implementation of the PROSTA programme is the key factor in strengthening the Company's position on the fuel retail market. In particular, restructuring activities aimed at improving the efficiency of service stations will play a crucial role.
- **Execution of the 10+ Programme** – a material factor with a bearing on the development and financial performance of Grupa LOTOS S.A. and the LOTOS Group in the long run is timely execution of the 10+ Programme. Construction and start-up of the installations provided for in the Programme will allow the Gdańsk refinery to increase its processing capacity (to 10.5 million tonnes per annum) and oil conversion ratio, which will have a positive effect on the product slate.
- **Development of upstream business** – the planned development of the upstream business is expected to strengthen the Group's independence from external sources of raw materials, further improve its financial performance and enhance the Company's value.

### **20.2 DEVELOPMENT PROSPECTS OF GRUPA LOTOS S.A.**

The restructuring and investment activities undertaken by the Management Board of Grupa LOTOS S.A. (appointed in 2002), which were crowned with the public offering, floatation of the Company shares on the Warsaw Stock Exchange and obtaining additional funds, constitute a springboard for the LOTOS Group's further development and building shareholder value.

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The execution of the investment programmes and plans set forth in the 2006-2012 strategy will enhance the domestic market position of the Company and the LOTOS Group and should consequently improve its financial performance and share price.

The key objective of Grupa LOTOS S.A.'s development policy is to maintain the competitiveness of the Company among oil companies operating in the Baltic Sea basin and the Central and Eastern Europe. Grupa LOTOS S.A. intends to pursue this goal through various operational and market activities.

The operating activities include the implementation of the 10+ Programme. Completion of the Programme will enable the Company to improve the economies of scale in refining volumes and depth of conversion, which in turn should lead to an improvement of the general economic efficiency of oil processing at Grupa LOTOS S.A.'s refinery in Gdańsk.

Another important direction in the development of the Group's operating activities is creation of an upstream segment, which will enable the Group to reduce its exposure to fluctuations in crude oil prices.

As far as marketing activities are concerned, Grupa LOTOS S.A. intends to pursue the goal of maintaining its competitive position in the region by increasing its market shares and then keeping them at a stable level, by expanding its the CODO and DOFO service station network, and by drawing on the competitive edge resulting from the seaside location of the Gdańsk refinery.

The Company's policy also envisages development of the Southern Refineries by their expansion into new areas, i.e. logistics and distribution, biofuel production and plastic recycling.

The Company's policy assumes that expansion in the abovementioned areas will be pursued with due regard to environmental protection and reduction of the company's environmental impact.

## **21. CHANGES IN THE COMPOSITION OF THE MANAGEMENT AND SUPERVISORY BOARDS OF GRUPA LOTOS S.A.**

### **21.1 CHANGES IN THE COMPOSITION OF THE MANAGEMENT BOARD OF GRUPA LOTOS S.A.**

#### **MANAGEMENT BOARD – sixth term of office**

From January 1st until November 13th 2007, the composition of the Management Board was as follows:

1. Paweł Olechnowicz – President
2. Marek Sokołowski – Vice-President
3. Mariusz Machajewski – Vice-President
4. Jarosław Kryński – Vice-President

On November 13th 2007, the Supervisory Board of Grupa LOTOS S.A. removed Mr Jarosław Kryński from the position of Vice-President of the Management Board, Chief Commercial Officer.

From November 13th to December 31st 2007, the composition of the Management Board was as follows:

1. Paweł Olechnowicz – President
2. Marek Sokołowski – Vice-President
3. Mariusz Machajewski – Vice-President

Until May 8th 2008, no changes occurred in the composition of the Management Board of Grupa LOTOS S.A.

### **21.2 CHANGES IN THE COMPOSITION OF THE SUPERVISORY BOARD OF GRUPA LOTOS S.A.**

#### **SUPERVISORY BOARD – sixth term of office**

From January 1st to May 28th 2007, the composition of the Supervisory Board was as follows:

1. Jan Stefanowicz – Deputy Chairman
2. Beata Zawadzka – Member
3. Jacek Mościcki – Member
4. Henryk Siodmok – Member
5. Jacek Tarnowski – Member
6. Grzegorz Szczodrowski – Secretary

On May 28th 2007, the Annual General Shareholders Meeting of Grupa LOTOS S.A. removed Mr Jacek Tarnowski from the position of Member of the Supervisory Board of Grupa LOTOS S.A. and appointed:

- Jan Stefanowicz to the position of Chairman of the Supervisory Board of Grupa LOTOS S.A., who previously served as Deputy Chairman of the Supervisory Board of Grupa LOTOS S.A.,
- Marta Busz to the position of Member of the Supervisory Board of Grupa LOTOS S.A.,
- Izabela Emerling to the position of Member of the Supervisory Board of Grupa LOTOS S.A.

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On May 14th 2007, the Supervisory Board appointed Mr Henryk Siodmok to the position of Deputy Chairman of the Supervisory Board of Grupa LOTOS S.A.

From May 28th to December 31st 2007, the composition of the Supervisory Board was as follows:

1. Jan Stefanowicz – Chairman
2. Henryk Siodmok – Deputy Chairman
3. Beata Zawadzka – Member
4. Marta Busz – Member
5. Izabela Emerling – Member
6. Jacek Mościcki – Member
7. Grzegorz Szczodrowski – Secretary

Until May 8th 2008, no changes occurred in the composition of the Supervisory Board of Grupa LOTOS S.A.

### **21.3 RULES OF APPOINTMENT AND REMOVAL OF MANAGEMENT STAFF; SCOPE OF POWERS OF THE MANAGEMENT STAFF**

#### **Rules of Appointment and Removal of Management Staff; Scope of Powers of the Management Staff, in particular the Power to Decide on an Issue or Redemption of Shares**

1. The Management Board is appointed by the Supervisory Board. The Supervisory Board first appoints the President of the Management Board, and then, at the President's request, the Vice-Presidents and other Members of the Management Board..
2. The Management Board is appointed for a joint, three-year term of office. For important reasons, the President, the Vice-Presidents and other members of the Management Board, as well as the Management Board as a whole, may be removed from office or suspended by the Supervisory Board at any time.
3. Supervisory Board's resolutions concerning appointment or removal of the particular Members of the Management Board, or of the Management Board as a whole, are adopted in the presence of at least two thirds of the Supervisory Board Members.

The Management Board takes any decisions related to the management of the Company's business which are not reserved for the General Shareholders Meeting or the Supervisory Board pursuant to the Commercial Companies Code or the Company's Articles of Association.

1. Management Board resolutions are required with regard to the following matters:
  - 1) setting the organisational rules of the Company, including organisation of the Company's business,
  - 2) setting annual budget for the Company,
  - 3) adoption of strategy for the LOTOS Group,
  - 4) setting rules of procedure for the Company's business as required under the law,
  - 5) making the Company's equity investments and implementing all projects related to capital expenditure in property, plant and equipment (with the exception of replacement investment projects) with the value of up to PLN 100,000,

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- 6) exercising the Company's voting rights at the General Shareholders Meetings of the subsidiaries, with regard to:
  - appointing or removing members of the Management and Supervisory Boards,
  - coverage of loss,
  - increasing or reducing the share capital,
  - merging with another company or transforming the company,
  - selling or leasing the Company's business and/or encumbering it with usufruct rights,
- 7) appointing and removing members of the Management and Supervisory Boards who are appointed or removed directly by Grupa LOTOS S.A.,
- 8) establishing companies under commercial law,
- 9) acquiring and selling shares in limited-liability companies,
- 10) acquiring and selling shares, except where the shares are acquired or disposed of as part of public trading in securities, unless such acquisition or disposal results in gaining or losing the status of the parent,
- 11) acquiring and disposing of real property, perpetual usufruct rights or interest in real property,
- 12) establishing or joining partnerships, organisations or ventures which involve unlimited liability enforceable against the Company's assets.
- 13) preparing:
  - the Company's financial statements for the previous financial year, in accordance with the Polish Accountancy Act, along with the Directors' Report on the Company's operations for the previous financial year – no later than within three months from the balance-sheet date,
  - consolidated financial statements and a report on the LOTOS Group's operations for the previous financial year – no later than within five months from the balance-sheet date,
- 14) convening ordinary and Extraordinary General Shareholders Meetings in due time, on its own initiative, at a written motion of the Supervisory Board or at the request of a shareholder or shareholders representing at least one-tenth of the share capital, as well as in other cases as provided for in the Commercial Companies Code,
- 15) establishing the agenda for a General Shareholders Meeting,
- 16) matters going beyond the scope of the ordinary management of the enterprise,
- 17) matters which have been objected to by at least one of the members of the Management Board,
- 18) matters which must be resolved by virtue of Management Board resolutions if so required by the President of the Management Board or at least half of the members of the Management Board, and which fall within the scope of responsibilities of particular members of the Management Board.

**President of the Management Board, Chief Executive Officer** – manages and directs all aspects of the operations of the LOTOS Group and is responsible for the Group's operations in general.

**Vice-President of the Management Board, Production and Development Director** – manages, coordinates and directs all aspects of the operations of the production division, technology division and the division of implementation of the 10+ Programme of the Company and is responsible for these areas of activities.

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**Vice-President of the Management Board, Chief Financial Officer** – manages all financial and economic as well as accounting aspects of the Company's operations and is responsible for these areas of activities.

**Vice-President of the Management Board, Chief Commercial Officer** – effectively manages all aspects of the sales, procurement and distribution processes at the LOTOS Group in accordance with the marketing strategy adopted by the Management Board and is responsible for these areas of activities.

At the meeting of November 13th 2007, the Supervisory Board removed Mr Jarosław Kryński from the position of Vice-President of the Management Board, Chief Commercial Officer, and assigned his duties to the President of the Management Board until the appointment of a new member of the Management Board.

## **22. AGREEMENTS BETWEEN THE ISSUER AND THE MANAGEMENT STAFF**

### **Compensation Agreements**

Apart from standard employment contracts concluded by Grupa LOTOS S.A. with the management staff in 2007, no agreements were executed that provide for compensation to the management staff in the event they resign or are dismissed without a good reason or in the event they resign or are dismissed as a result of the Company's takeover by another entity.



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**23. REMUNERATION, AWARDS, OR BENEFITS PAYABLE OR POTENTIALLY PAYABLE TO THE MANAGEMENT AND SUPERVISORY STAFF OF GRUPA LOTOS S.A.**

**23.1 REMUNERATION PAID AND DUE TO MEMBERS OF THE MANAGEMENT BOARD OF GRUPA LOTOS S.A. IN 2007**

PLN '000	Year ended December 31st 2007
Paweł Olechnowicz	181
Marek Sokołowski	180
Mariusz Machajewski*	239
Jarosław Kryński	138
<b>Total</b>	<b>738</b>

\*Including remuneration due for the period preceding appointment to the Management Board of Grupa LOTOS S.A.

**23.2 REMUNERATION PAID AND DUE TO MEMBERS OF THE MANAGEMENT BOARD OF GRUPA LOTOS S.A. IN CONSIDERATION OF THEIR MEMBERSHIP IN THE SUPERVISORY BOARDS OF SUBSIDIARY UNDERTAKINGS IN 2007**

PLN '000	Year ended December 31st 2007
Paweł Olechnowicz	219
Marek Sokołowski	34
Jarosław Kryński	1
Mariusz Machajewski	20
<b>Total</b>	<b>274</b>

**23.3 REMUNERATION PAID AND DUE TO MEMBERS OF THE SUPERVISORY BOARD OF GRUPA LOTOS S.A. IN 2007**

PLN '000	Year ended December 31st 2007
Beata Zawadzka	36
Marta Busz	19
Emerling Izabela	19
Grzegorz Szczodrowski	36
Henryk Siodmok	36
Jacek Mościcki	36
Jacek Tarnowski	18
Jan Stefanowicz	38
<b>Total</b>	<b>239</b>

**23.4 LOANS AND SIMILAR BENEFITS PROVIDED TO MEMBERS OF THE MANAGEMENT AND SUPERVISORY BOARDS**

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No agreements on loans or similar benefits were concluded between Grupa LOTOS S.A. and members of the management and supervisory boards in 2007.

**24. AGGREGATE NUMBER AND PAR VALUE OF ALL SHARES IN GRUPA LOTOS S.A. AND SHARES IN RELATED UNDERTAKINGS OF GRUPA LOTOS S.A. HELD BY MANAGEMENT AND SUPERVISORY STAFF**

To the Company's knowledge, the following persons hold shares in Grupa LOTOS S.A.:

The management and supervisory staff of Grupa LOTOS S.A. holding shares in Grupa LOTOS S.A. as at December 31st 2007:

	<b>Number of shares</b>	<b>Par value (PLN)</b>
Management Board, including::	<b>8,636</b>	<b>8,636</b>
Marek Sokołowski	8,636	8,636
<b>Supervisory Board</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>8,636</b>	<b>8,636</b>

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**25. SHAREHOLDERS HOLDING, DIRECTLY OR INDIRECTLY THROUGH  
SUBSIDIARIES, 5% OR MORE OF THE TOTAL VOTE AT THE GENERAL  
SHAREHOLDERS MEETING OF GRUPA LOTOS S.A.**

To the Company's knowledge, as at December 31st 2007, the shareholders holding, directly or indirectly, through subsidiaries, 5% or more of the total vote at the General Shareholders Meeting of Grupa LOTOS S.A. were as follows:

Shareholders	Number of shares	Number of votes	% of total vote at GM	Par value of shares	% of share capital held
State Treasury	7,878,030	7,878,030	6.93%	7,878,030	6.93%
Nafta Polska S.A	59,025,000	59,025,000	51.91%	59,025,000	51.91%
Other	46,796,970	46,796,970	41.16%	46,796,970	41.16%
<b>Total</b>	<b>113,700,000</b>	<b>113,700,000</b>	<b>100.00%</b>	<b>113,700,000</b>	<b>100.00%</b>

**Material Changes to the Share Capital Structure in 2007**

On March 9th 2007, Grupa LOTOS S.A. was notified by ING Nationale-Nederlanden Polska Powszechnie Towarzystwo Emerytalne S.A. that on March 7th 2007, 5,876,589 Grupa LOTOS S.A. shares were registered in the securities account of ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny. The shares represented 5.17% of the Company's share capital and conferred the right to 5,876,589 votes at its General Shareholders Meeting (5.17% of the total vote).

Prior to the change, ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny held 5,676,589 Grupa LOTOS S.A. shares, representing 4.99% of the Company's share capital and conferring the right to 5,676,589 votes at its General Shareholders Meeting (4.99% of the total vote).

On October 22nd 2007, Grupa LOTOS S.A. was notified that as a result of disposal of the Company shares settled on October 18th 2007 ING Nationale-Nederlanden Polska Otwarty Fundusz Emerytalny reduced its share in the total vote at the General Shareholders Meeting of the Company to a level below 5%.

Prior to the disposal, ING Nationale-Nederlanden Polska held 5,701,348 (five million, seven hundred and one thousand, three hundred and forty-eight) Grupa LOTOS S.A. shares. The shares represented 5.01% of the Company's share capital and conferred the right to 5,701,348 votes at its General Shareholders Meeting (5.01% of the total vote).

On October 19th 2007, 5,575,269 (five million, five hundred and seventy-five thousand, two hundred and sixty-nine) Grupa LOTOS S.A. shares were registered in the securities account of ING Nationale-Nederlanden Polska. The shares represented 4.90% of the Company's share capital and conferred the right to 5,575,269 votes at its General Shareholders Meeting (4.90% of the total vote).

**26. INFORMATION ON AGREEMENTS WHICH MAY GIVE RISE TO FUTURE  
CHANGES IN THE NUMBER OF SHARES HELD BY THE EXISTING  
SHAREHOLDERS AND BONDHOLDERS**

The Management Board of Grupa LOTOS S.A. has no knowledge of any agreements which may give rise to future changes in the number of shares held by the existing shareholders and bondholders.

**27. INFORMATION ON HOLDERS OF SECURITIES WHICH CONFER SPECIAL CONTROL POWERS WITH RESPECT TO GRUPA LOTOS S.A.**

The Management Board of Grupa LOTOS S.A. has no knowledge of any holders of securities which confer special control powers with respect to Grupa LOTOS S.A.

## **28. INFORMATION ON CONTROL SYSTEMS FOR EMPLOYEE STOCK OPTION PLANS**

In 2007, no control system for employee stock option plans existed at Grupa LOTOS S.A.

**29. INFORMATION ON RESTRICTIONS ON TRANSFERABILITY OF THE  
SECURITIES OF GRUPA LOTOS S.A. AND ON VOTING RIGHTS ATTACHED  
TO THE SHARES OF GRUPA LOTOS S.A.**

One Grupa LOTOS S.A. share confers the right to one vote at the General Shareholders Meeting with a proviso that as long as Nafta Polska SA holds the Company shares conferring the right to at least one-fifth of the total number of votes at the Company, the rights of Grupa LOTOS S.A. shareholders are limited so that neither of them can exercise more than one-fifth of the total number of votes at the Company on the day a General Shareholders Meeting. This limitation of voting rights does not apply to Nafta Polska S.A. For the purposes of this paragraph, the exercise of voting rights by a subsidiary is deemed the exercise of voting rights by the parent undertaking within the meaning of the regulations on public trade in securities.

The limitation of the voting rights referred to in the first sentence of Par. 10.3 of the Articles of Association of Grupa LOTOS S.A. does not release the buyers and holders of the Company shares from the obligations provided for in the regulations on public trade in securities, in particular from the disclosure requirement related to the purchase and sale of shares in a public company, the obligation to obtain approval of a relevant authority for purchase of a specific number of shares in a public company, the obligation to announce tender offers for sale or exchange of shares in a public company and to announce and carry out tender offers for sale of the remaining shares in a public company.

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**30. INFORMATION ON THE AGREEMENT WITH A QUALIFIED AUDITOR OF  
FINANCIAL STATEMENTS**

On June 29th 2007, Grupa LOTOS S.A. and Deloitte Audyt Sp. z o.o. of Warsaw concluded an agreement on the review of the non-consolidated and consolidated financial statements for the first half of the years 2007, 2008, and 2009 and audit of the annual non-consolidated and consolidated financial statements for 2007, 2008, and 2009.

The total value of the agreement for 2007 was PLN 865 thousand, including PLN 856 thousand for the review of the non-consolidated and consolidated financial statements for the first half of 2007 and for the audit of the non-consolidated and consolidated financial statements for 2007.

The total value of the agreement for 2008–2009 amounted to PLN 1,678 thousand.

On July 7th 2006, Grupa LOTOS S.A. and Ernst and Young Audit Sp. z o.o. of Warsaw concluded an agreement on the review of the non-consolidated and consolidated financial statements for the first half of 2006 and audit of the non-consolidated and consolidated financial statements for 2006.

The total value of the agreement was PLN 855 thousand, including PLN 850 thousand for the review of the non-consolidated and consolidated financial statements for the first half of 2006 and for the audit of the non-consolidated and consolidated financial statements for 2006.



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**31. SIGNATURES OF THE MANAGEMENT BOARD MEMBERS**

President of the Management Board, CEO	
	Paweł Olechnowicz
Vice-President of the Management Board, Chief Financial Officer	
	Mariusz Machajewski
Vice-President of the Management Board, Production and Development Director	
	Marek Sokołowski