Ladies and Gentlemen,

2006 was another excellent year for the LOTOS Group, both in terms of strong financial performance and the consistent execution of our strategy for building shareholder value. My intention in writing this letter is to present an overview of the 2006 milestones which had a material impact on our business and prospects of further rapid growth for many years to come.

The efforts undertaken by the Management Board of Grupa LOTOS S.A. have been rewarded with measurable economic benefits. The scale of operations, market share and financial results reported by the Group have been demonstrating a steady year-on-year growth. Following the launch by the Management Board of the development programmes back in 2002, last year shareholder value was created based on the development programme for the oil production area (Petrobaltic) and the supplies area (diversification of supplies), the Comprehensive Technical Upgrade Programme (PKRT), the PROSTA programme (expansion of the network of LOTOS service stations) and the Trading Structure Development and Optimisation Programme, in particular through intensification of commercial activities in Poland and in the Baltic Sea region. In addition, the Operational and Management Excellence Programme is currently underway (executed in cooperation with Shell).

One of the 2006 milestones took place on June 27th, when the Company’s Supervisory Board approved the Strategy for the LOTOS Group until 2012, which maps out the development directions for the next six years and provides for further growth of the Company value through making an optimum use of its potential in three major business areas – oil production and supplies, refining and marketing.

If the Strategy objectives are met, from 2011 onwards our annual oil throughput should rise to 10.5 million tonnes (up from the current level of 6 million tonnes), with a concomitant increase in the conversion ratio and a shift in the product mix towards the production of diesel oil, whose supply still falls short of the domestic demand. This will bolster the Company’s position in the Baltic Sea basin, and its share of the domestic retail and wholesale markets is expected to reach 10% and 30%, respectively. The total capital expenditure to be incurred by the LOTOS Group in connection with its Strategy until 2012 amounts to PLN 7.3bn, out of which PLN 5bn has been earmarked to execute PKRT, a programme of crucial importance from the point of view of the Group’s further development.

The LOTOS Group pioneers crude oil production from reserves discovered below the seabed of the Baltic shelf. Currently, the Group owns three reservoirs – the producing B3 reservoir, as well as the B8 and B23 reservoir. In 2006, the first trial wells were drilled on the B8 reservoir, confirming the quality of its reserves and the viability of its development, which is scheduled to be launched in the second half of 2007. On the other hand, the seismic images of the B23 reservoir revealed that its size is considerably larger compared to the B3 and B8 reserves, but it is located in much more challenging marine conditions (more than 100 metres below the sea level). The LOTOS Group is now carrying out preparatory work to begin the
exploitation of the B23 reserves. Trial wells will probably be drilled in the years 2011-2012, and the production is expected to begin after 2012.

In addition to implementing the plans for the development of the reserves currently held by the LOTOS Group, the Group is actively seeking to expand its portfolio of production projects both in the Baltic Sea region and abroad. However, given the Group’s financial resources and the estimated value of the necessary investment outlays, such projects will probably require cooperation with industry partners. The development initiatives in the upstream area are aimed at ensuring security of the Company’s operations and the energy security of Poland and, at the same time, at achieving incremental profit margins. As part of the strategy for diversification of oil supplies, by 2012 we intend to satisfy more than 40% of our total oil requirements with supplies from new sources, including a substantial portion (up to ca. 1 million tonnes) from own sources. The year 2006 saw the launch of our diversification strategy, when two tankerfuls of Arab oil, ordered as part of cooperative arrangements with Kuwait Petroleum Corporation, were processed on a trial basis. We are also holding negotiations with other oil suppliers in order to identify alternative sources of supplies and to optimise the quality and cost structure of the white product yield in future.

In 2006, the Gdańsk refinery processed 6.1 million tonnes of oil – the historical record which corresponded to 101.6% of our throughput capacity. This is positive proof of the superb work contributed by our technological staff with respect to maintenance and optimal utilisation of the processing lines. The LOTOS Group sold over 7.0 million tonnes of fuel products, up by 12.8% on the previous year’s figure. To note, the Group’s sales outstripped its total production capacity by 15.6%, which testifies to a mismatch between the domestic market’s production capacity and demand, while confirming that our decision to increase the production capacity was well-advised. Some of the credit for the high sales volume must go to our sales force, whose activities are already focused on potential future markets for our products.

The implementation of the PKRT Project – the largest technical upgrade scheme ever to have been undertaken by the LOTOS Group – is running smoothly and according to plan. The year 2006 was a time of intensive work aimed at developing the Front End Engineering Design for the PKRT Project. At the end of December 2006, we received two bids for the Project execution, from Fluor, an engineering company, and from the Uhde/Technip consortium. The LOTOS Group is currently conducting negotiations with the bidders to optimise the scope of work to be performed by the prospective contractors and the terms and conditions of the submitted bids. In June 2006, we placed the first orders for four reactors to be used in the new Mild Hydrocracking Unit, which represent the critical element of the project, while also being the most time-consuming one.

In 2006, as part of the strategy update, we made a decision to complement the programme of the Company’s technical upgrade with two key units – the atmospheric distillation unit and the hydrodesulphurisation unit (HDS). The first of these facilities will boost our basic processing capacity by 4.5 million tonnes, up to the total of 10.5 million tonnes, while the additional HDS unit used to hydrodesulphurise diesel oils will accommodate larger production volumes and will make the entire production output compliant with the strictest EU-imposed quality requirements. To achieve the same end, the existing hydrocracking unit will be modernised – thanks to the new facilities, the Company will no longer have to depend on imports of additional feedstock for the PKRT units and will realise full margins on processing crude oil into high-margin products. Both production units (HDS and
hydrocracker) will be constructed under a licence from Chevron Lummus Global. In November, the first contract for execution of the HDS project was concluded with ABB Lummus Global.

In 2006, the Company was developing its retail service station network through its subsidiary LOTOS Paliwa under the PROSTA project, which focused on the continued expansion of the COCO and CODO station network, in particular by incorporating the ESSO and Slovnaft stations acquired near the end of 2005 into the LOTOS network, and the development of the DOFO station network. As at December 31st 2006, the LOTOS service station network comprised 401 outlets, including 132 COCO and CODO stations, 57 DOFO stations and 212 DODO stations. Additionally, all ESSO and Slovnaft stations had been incorporated into the LOTOS fuel station network and re-branded as LOTOS.

Since their acquisition in February 2005, the Southern Refineries have been undergoing an operational turnaround. As part of the programme, the Group’s capital structure was streamlined, for instance through transformations and mergers of companies with overlapping business scopes. In parallel to the restructuring efforts, the LOTOS Group is implementing new investment projects in various areas of the oil market and related sectors. The Czechowice Refinery already operates a fuel terminal, and another one is soon to be launched at the Jasło Refinery. Additionally, a production centre of LOTOS Parafiny was opened in Czechowice. Also in Czechowice a biofuel production plant, with an annual production capacity of 100 thousand tonnes, is being constructed.

It needs to be noted that thanks to its “amicable” restructuring, as well as the investment programmes implemented by the LOTOS Group and its business expansion, it is possible to raise the total headcount across the Group, to preserve a majority of jobs at the Southern Refineries and to replace the jobs made redundant for market-driven reasons with new posts created within the Group, at the same time ensuring efficient human resources management. As at the end of 2006, the LOTOS Group’s total headcount was 5,624 employees, up by 3.5% relative to the end of 2005.

Looking at the years ahead, I am deeply convinced that we are creating a strong LOTOS Group, whose ambitious development plans – once implemented – will allow it to maintain its competitive edge for many subsequent years, laying a solid foundation for the establishment and future operations of Bałtycki Koncern Naftowy LOTOS. Our overarching objective, successfully pursued since 2002, is to create shareholder value. In the coming years, we intend to continue our efforts aimed at translating the vision of the LOTOS Group presented in our strategy into tangible reality.

Pawel Olechnowicz
President of the Management Board
Chief Executive Officer