THE LOTOS GROUP

DIRECTORS' REPORT ON THE FINANCIAL PERFORMANCE OF THE LOTOS GROUP FOR Q3 2008

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

Gdańsk, November 13th 2008

CONTENTS

1 INTRODUCTION

In Q3 2008, the Management Board of Grupa LOTOS S.A. pursued the LOTOS Group's Strategy until 2012 in the key areas of the Group's business, including:

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

In the E&P segment, in Q3 2008 the Group produced crude oil and natural gas from the B3 and B8 deposits. Total crude oil production was 61.1 thousand tonnes, while total natural gas output was 6.937 m m^3.

In Q3 2008, Petrobaltic conducted work relating in particular to the drilling of the B8-Z1 well, production from B8 and B3 deposits, as well as maintenance and repair work.

In August, a transaction concerning purchase by LOTOS E&P Norge of a 10% interest in production licences covering the Yme field in the North Sea from Revus Energy was completed as all conditions precedent to the purchase agreement were fulfilled.

The volume of crude oil processed in Q3 2008 was 1,577.4 thousand tonnes, which represented a 104.3% utilisation of the nameplate throughput capacity of the Gdańsk refinery. The volume of Ural crude processed in Q3 2008 was 1,379.4 thousand tonnes (87.4% of total volume of crude oil processed). The volume of Rozewie oil processed by the Gdańsk refinery in Q3 2008 was 20.4 thousand (1.3% of total volume of crude oil processed).

In Q3 2008, the LOTOS Group sold 371 thousand tonnes of motor gasolines, 860 thousand tonnes of diesel oil, 74 thousand tonnes of light fuel oil, 58 thousand tonnes of heavy fuel oil, 122 thousand tonnes of jet fuel, 307 thousand tonnes of bitumens and 238 thousand tonnes of other products.

In Q3 2008, the activities related to the implementation of the 10+ Programme focused on performing the execution contracts, signing further contracts, and arranging financing for the 10+ Programme.

In the retail segment, in Q3 2008, the Group continued to develop a modern countrywide LOTOS service station network by restructuring the stations network and launching new products. As at the end of Q3 2008, the number of CODO stations was 137, the number of DOFO stations stayed at 76, and the number of DODO stations was 138. The number of franchise agreements signed was 88.

In Q3 2008, the average price of Brent oil (Dated Brent FOB) was USD 115.09 per barrel, i.e. less than in Q2 2008 (by USD 6.12 per barrel, or 5.1%) and more than in Q3 2007 (by USD 40.35 per barrel, or 54.0%). The average price of Ural CIF Rotterdam oil was USD 113.32 per barrel, and was lower than in Q2 2008 (by USD 4.15 per barrel, or 3.5%) but higher than in Q3 2007 (by USD 41.34 per barrel, or 57.4%).

The lower oil prices in Q3 2008 as compared with Q2 2008 were accompanied by a 52.8% decline in the Brent/Ural differential – from USD 3.73 per barrel in Q2 2008 to USD 1.76 per barrel in Q3 2008. In relation to Q3 2007, the Brent/Ural differential fell by USD 1.00 per barrel (36.2%).

In Q3 2008, the average refining margin increased to USD 9.15 per barrel and was 16% higher than in Q2 2008, and 66.7% higher (up by USD 3.66 per barrel) year on year.

The LOTOS Group's performance in Q3 2008 was driven by a number of factors, including in particular high volatility of prices of crude oil and crude oil products on global markets, a decline in the Brent/Ural differential, a higher refining margin, costs of creating regulatory stocks of fuels, high volatility of the złoty/US dollar and the concluded hedging transactions.

In Q3 2008, the LOTOS Group posted consolidated sales revenue of PLN 4,764.2m, operating profit of PLN 39.2m, net profit on continued operations of -PLN 223.9m and net profit attributable to equity holders of the parent of -PLN 237.9m. Year on year, sales revenue increased by 35.0%, operating profit went up by 84.7%, net profit on continued operations declined to -PLN 223.9m, and net profit attributable to equity holders amounted to -PLN 237.9m.

2 PETROBALTIC AND THE PRODUCTION SEGMENT

In the E&P segment, in Q3 2008 oil and gas production continued from the B3 and B8 deposits. The total crude oil and natural gas outputs were, respectively, 61.1 thousand tonnes, and 6.937 m m3. The entire crude oil output was shipped to the Gdańsk refinery, and the natural gas output, after being partially used – by the B3 Offshore Oil Rig and the gas flares of the Petrobaltic platform (B8 deposit), was sent via a pipeline to Energobaltic's heat and power plant in Władysławowo. Petrobaltic's crude sales to Grupa LOTOS amounted to 53.2 thousand tonnes and the volume of processed Rozewie oil was 39.2 thousand tonnes in Q3 2008.

In Q3 2008, the key tasks carried out by Petrobaltic included:

- drilling of B8-Z1 and the B8-Z1 bis branch from the Petrobaltic platform,
- geochemical surveys conducted on the B22, B101 and K1 structures,
- production from the B8 deposit from the Petrobaltic platform,
- production from the B3 deposit, including water pumping to the deposit of the Offshore Oil Rig located at the Baltic Beta platform,
- maintenance and repair work on PG-1.

On August 29th 2008, upon fulfilment of the conditions precedent, LOTOS Exploration and Production Norge A.S. (LOTOS E&P Norge) purchased from Revus Energy a 10% interest in the production licences No. PL316, 316B, 316CS and 316DS, covering the Yme field in the North Sea. The value of assets acquired under the transaction amounted to NOK 368.2m.

The transaction was financed with proceeds from a capital increase at LOTOS E&P Norge and a loan advanced by Petrobaltic S.A., obtained as a result of the following actions:

- on August 26th 2008, Petrobaltic S.A. acquired 150,000,000 new LOTOS E&P Norge shares for a price of NOK 1 per share (same as par value), i.e. for a total price of NOK 150m; and
- on August 26th 2008, a loan agreement was signed, under which Petrobaltic advanced a USD 50m loan to Lotos E&P Norge, to be repaid by 2012.

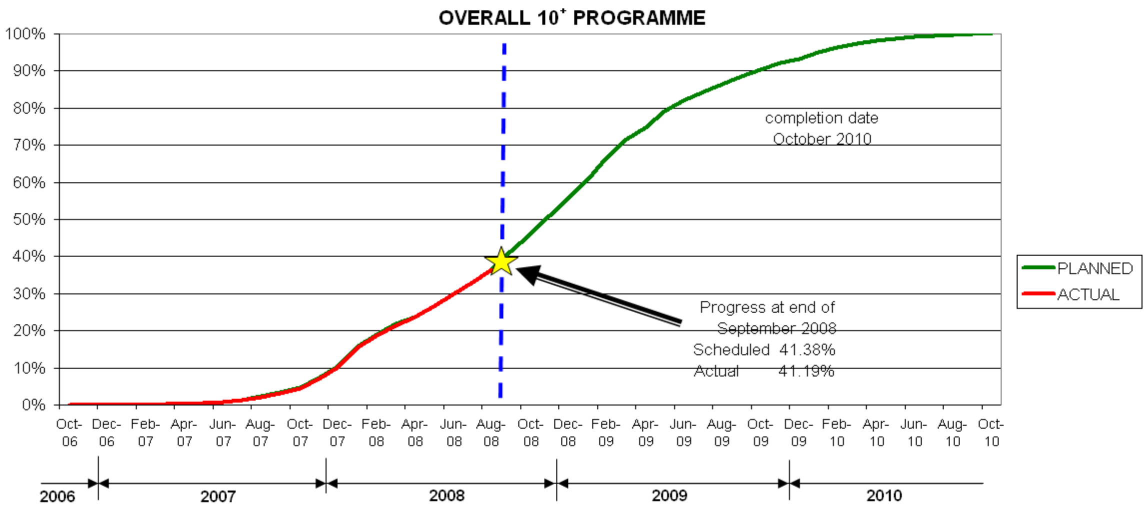
The recoverable crude oil reserves of the Yme field which correspond to the 10% interest held by LOTOS E&P Norge AS, are estimated by the operator (Talisman) at 6.8m bbl (about 900 thousand tonnes). Production from the field is expected to start in the second half of 2009.

In addition, on August 26th 2008, LOTOS E&P Norge signed an agreement on purchase of a 20% interest in the PL455 exploration licence covering an area of 1,365 square kilometres, located in the southern part of the Norwegian section of the North Sea. Lotos E&P Norge acquired a 20% interest in the said licence in exchange for covering 40% of the estimated expenditure to be incurred by Noreco on performance of seismic surveys under the PL455 licence, i.e. approx. NOK 38m (PLN 15.9m, translated at the mid exchange rate for NOK quoted by the National Bank of Poland for August 26th 2008).

3 10+ PROGRAMME

In Q3 2008, the implementation of the 10+ Programme, the largest investment project of the LOTOS Group of key importance for the future growth of the Group's value, focused on performing the execution contracts, signing further contracts and arranging financing for the 10+ Programme.

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



Source: Grupa LOTOS S.A.

In line with the Early Work Agreement (EWA) concerning the ROSE unit construction signed on June 27th 2008 with Technip Italy SpA, the terms and conditions of the contract had been negotiated by the end of July 2008 and, subsequently, placed under analysis of the bank syndicate responsible for co-financing of the 10+ Programme. Upon obtaining approval of the financing institutions, the EP contract for the design services and deliveries necessary for the ROSE unit construction was signed on September 10th 2008.

As part of the HDS project (diesel hydrodesulphurisation), Q3 2008 saw completion of the construction work on cable conduits and trays. Delivered apparatuses were assembled, including the 713-tonne reactor shipped from Italy. Prefabrication and assembly of pipelines was also carried out, and work on the fire protection system for trestle bridges was under way.

As part of the CDU/VDU project (crude distillation unit), in Q3 2008 the construction work and work on the underground infrastructure was under way. The assembly of steelwork for internal trestle bridges and racks was continued. Also, further deliveries of materials for pipeline prefabrication were received, and deliveries of apparatuses and equipment commenced.

As part of the MHC project (mild hydrocracking), principally, the engineering design work was continued. In Q3 2008, the majority of apparatuses and equipment was ordered and commissioning inspections were initiated with respect to the reactors which will be delivered and assembled in H1 2009. Further deliveries were made to the construction site and foundation laying continued. The construction of the underground pipeline system started.

As at the end of Q3 2008, the progress of work under the HGU (hydrogen generating unit) project was as follows: construction work – 95%, steelwork – 74%, pipeline system – 7%, and the assembly of apparatuses and equipment – 38%. In Q3 2008, electrical and automation works were initiated. Furthermore, work on assembling the structure of the reformer furnace was continued, and the general assembly of internal trestle bridges and racks was completed.

As part of the KAS project (amine sulphur unit), work on the fire protection system for the trestle bridge of the ARU/SWS/SRU/TGTU complex was completed. The assembly of the main trestle bridge of the ARU and SWS installations is currently in progress, as is the prefabrication of pipelines whose assembly has already commenced. In Q3 2008, the deliveries and assembly of apparatuses continued. Pipeline components and materials are being delivered to the site.

In the area of auxiliary installations and infrastructure, work continued on construction of inter-unit connections and utilities, storage tanks and auxiliary facilities. Deliveries of materials for pipeline systems forming the inter-unit connections were continued, as was the construction work on new power-supply facilities. Work related to the high voltage cable routes was carried on. In addition, a contract for the construction of a unit forming part of the process water preparation complex was executed, as was a contract for upgrading the interconnection control systems and water systems.

In the case of storage tanks and the pipeline to the sea terminal, the foundations laying for the VR, VGO and pyrolyse gasoline storage tanks was completed. The assembly of steel tank shells commenced. Foundation laying for the LPG tank was in progress, and pipe deliveries commenced. Also, anticorrosion work began on the pipeline leading to the R7 terminal.

With respect to auxiliary facilities, the work is continued on extension of the wastewater treatment plant, final commissioning and pressure testing of underground network systems were performed, foundations laying for new inter-unit trestle bridges was ongoing, as was the construction of new trestle bridges and expansion of the existing ones. Concrete and reinforcement works are in progress in the complex of new cooling water towers (CWT), and construction of a pipeline used in transporting decarbonised water from the CWT complex to the water treatment plant commenced. Furthermore, construction work began at the Water Department site, deliveries were launched for the purposes of expanding the CHP building, and preparations for construction of the discharge system commenced.

Financing of the 10+ Programme

In August 2008, the Company satisfied the conditions precedent permitting the drawdowns of a non-current credit facility for the financing of the 10+ Programme and the working capital of Grupa LOTOS S.A., for which a credit facility agreement was signed on June 27th 2008.

On August 19th 2008, the Company effected the first drawdown of the working capital facility tranche, and on August 26th 2008 – the first drawdown of the investment credit facility tranche. Subsequently, a series of drawdowns in the investment tranche was executed. The amounts and dates of drawdowns depended on Grupa LOTOS S.A.'s payment position and the level of expenditure connected with the implementation of the 10+ Programme. The drawdowns were made available when requested.

In September 2008, the Company obtained a final confirmation from the Agent responsible for the credit facility tranche guaranteed by SACE, to the effect that the conditions precedent for the drawdown of that investment credit facility tranche were satisfied. As a result, the first drawdown of this credit facility tranche was effected in October 2008.

In Q3 2008, the Company continued and completed work leading to the establishment of security for the benefit of the financing institutions (e.g. notices on assignment of rights under new sales agreements, hedging agreements, EPC contracts, etc.). In September 2008, the Company received a decision of the District Court of Gdańsk-Północ, concerning registration of a pledge over the assets and interests constituting the Gdańsk refinery, which is one of the forms of security created for the benefit of the financing institutions.

4 *PROSTA* PROGRAMME

In Q3 2008, the Group was developing its retail service station network through subsidiary LOTOS Paliwa, focusing on continued expansion of the CODO station network and the development of the DOFO station network.

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

- The following CODO service stations were placed in service: at ul. Batalionów Chłopskich in Szczecin in August 2008, at ul. Żwirki i Wigury in Bydgoszcz and at ul. Kapelanka in Kraków in September 2008;
- A new station in Lublin was included into the LOTOS Family Commercial Partnership Programme, whereas a DOFO station in Bielsk Podlaski was excluded from the Programme;
- Premium fuels were launched at 33 DOFO stations.

As at September 30th 2008, the LOTOS service station network comprised 351 locations, including 137 CODO stations, 76 DOFO stations and 138 DODO stations. A total of 88 franchise agreements were signed. In line with the assumptions of the PROSTA Programme regarding transfer of the DODO stations to another operational platform, since Q1 2007 the total number of high-margin COCO/CODO and DOFO service stations has been larger than the number of DODO stations.

5 SOUTHERN REFINERIES (LOTOS CZECHOWICE AND LOTOS JASŁO)

In Q3 2008, LOTOS Czechowice and LOTOS Jasło continued the restructuring of their human resources, operations, internal organisation and technologies, and pursued other activities with a view to developing their production capacities and implementing new projects with the use of to-date idle assets.

In addition, work was undertaken to incorporate the Southern Refineries' assets (terminals and storage facilities) in the integrated fuel logistics system of the LOTOS Group.

In order to discontinue its operating activities by the end of 2008, LOTOS Park Technologiczny conducted an allocation of the company's human resources and assets, as scheduled.

6 MARKET ENVIRONMENT AND OPERATIONS

6.1 Oil and Fuel Markets

In Q3 2008, the average price of Brent crude (Dated Brent FOB) was USD 115.09 per barrel and was lower by USD 6.12 per barrel, i.e. 5.1%, quarter on quarter, and higher by USD 40.35 per barrel, i.e. 54.0%, year on year.

The average price of Ural CIF Rotterdam was USD 113.32 per barrel and was lower by USD 4.15 per barrel, i.e. 3.5%, quarter on quarter, but rose by USD 41.34 per barrel, i.e. 57.4%, year on year.

The lower crude prices were accompanied by a fall in the Brent/Ural differential, from USD 3.73 per barrel in Q2 2008 to USD 1.76 per barrel in Q3 2008 (52.8%). The differential fell by USD 1.00 per barrel relative to Q3 2007 (36.2%).

In Q3 2008, the average refining margin rose by 16.0% quarter on quarter, to USD 9.15 per barrel. Relative to Q3 2007, the refining margin increased by USD 3.66 per barrel (66.7%).

The average crack margin on gasoline decreased by 4.28% on Q2 2008, to USD 139.31 per tonne, while the average crack margin on diesel oil dropped by 16.53%, to USD 225.64 per tonne. Compared with Q3 2007, the average crack margin on gasoline declined by 10.07%, whereas the average crack margin on diesel oil rose by 88.51%.

6.2 Operational Review

In Q3 2008, the Gdańsk refinery processed 1,577.4 thousand tonnes of crude, which represented a 104.3% utilisation of the nameplate throughput capacity.

The Gdańsk refinery processed 1,379.4 thousand tonnes of Ural crude in the reporting period, which accounted for 87.4% of the total processing volume. The balance comprised the Rozewie oil extracted by Petrobaltic – 20.4 thousand tonnes (1.3% of the processing volume), the Volve oil – 175.1 thousand tonnes (11.1% of the processing volume), and the Sleipner oil condensate – 2.5 thousand tonnes (0.2% of the processing volume).

In Q3 2008, the LOTOS Group sold 371 thousand tonnes of motor gasolines, 860 thousand tonnes of diesel oil, 74 thousand tonnes of light fuel oil, 58 thousand tonnes of heavy fuel oil, 122 thousand tonnes of jet fuel, 307 thousand tonnes of bitumens, and 238 thousand tonnes of other products (including 101 thousand tonnes of bunker fuel, 66 thousand tonnes of LPG, 21 thousand tonnes of lubricants, 22 thousand tonnes of base oils, and 28 thousand tonnes of other oil products).

Compared with Q2 2008, the employment at the LOTOS Group in Q3 2008 increased to 4,864 personnel (21 new employees hired). The headcount increase was due to hiring new employees in connection with intensified activity in the area of licensed transportation services at LOTOS Kolej.

7 DISCUSSION OF CONSOLIDATED RESULTS OF THE LOTOS GROUP

7.1 Income Statement

In Q3 2008, the sales revenue of the LOTOS Group amounted to PLN 4,764.2m and was up by 35.0% year on year, mainly due to substantial increase in the prices of crude oil and petroleum products on the global markets and larger volumes of sales of petroleum products and oil derivatives. The average net selling price rose by 25.4%, from PLN 1,872 per tonne in Q3 2007 to PLN 2,347 per tonne in Q3 2008. The Q3 2008 sales volume of the LOTOS Group was 2,029.9 thousand tonnes, which represented a year-on-year increase of 143.9 thousand tonnes (7.6%). In the analysed quarter, the sales volume of diesel oils, gasolines, reforming products, heavy fuel oils and liquefied gases increased, whereas the sales of bitumens and bitumen components, light fuel oils, JET A-1 fuel, base oils and lubricants declined.

Year on year, in Q3 2008 cost of sales went up by 47.8% and amounted to PLN 4,451.5m. The Q3 2008 unit cost of sales was PLN 2,193 per tonne, i.e. 37.3% more than in Q3 2007.

The growth of unit cost of sales was higher than that of net prices (exclusive of VAT) of products sold, which resulted in a 39.7% year-on-year drop of gross profit on sales in Q3 2008, to PLN 312.8m.

In Q3 2008, crack margins on intermediate fractions of oil considerably exceeded the figures for Q3 2007. In Q3 2008, the average quarterly crack margins on Diesel 10 and on JET Fuel were seen up year on year by 87.9%, and 104.5%, respectively. In Q3 2008, the average refining margin reached USD 9.15 per barrel and was higher than the Q3 2007 margin which stood at USD 5.49 per barrel. Concurrently, the falling prices of crude oil and petroleum products in Q3 2008 had an adverse effect on the quarter's results.

In Q3 2008, there was a sudden weakening of the Polish złoty, from USD/PLN 2.1194 as at June 30th 2008 to USD/PLN 2.3895 as at October 1st 2008.

The Group's performance in Q3 2008 was negatively affected by the strengthening of the Polish złoty relative to the corresponding period of the previous year. The average USD/PLN exchange rate was 20.2% lower than in Q3 2007 (down by USD/PLN 0.56).

Selling costs incurred by the LOTOS Group in Q3 2008 amounted to PLN 187.1m, and were up by 6.1% year on year, principally due to the higher volume of sales and the changed structure of sales. General and administrative expenses remained at a level close to that seen in Q3 2007 and amounted to PLN 78.0m.

Despite the highly unfavourable macroeconomic conditions driven by the unmatched weakening of the Polish złoty in Q3 2008, the Group disclosed operating profit of PLN 39.2m.

In Q3 2008, loss on financing activities was -PLN 319.1m and was connected with hedging transactions executed to mitigate the market risk related to changes in the refining margin and foreign exchange rates related to the implementation of the 10+ Programme, as well as with recognition in Q3 2008 of -PLN 83.4m of foreign exchange losses on revaluation of loans.

The total excess of the positive settlement of derivatives recognised as financial income for the first six months of 2008 was in Q3 2008 reduced by the effect of negative settlement of hedging transactions, amounting to -PLN 175.4m, charged to financial income and including: settlement of foreign exchange risk hedging transactions (forwards) of -PLN 93.5m and settlement of refining margin hedging transactions (full barrel swaps) of -PLN 84.3m. As at the end of September 2008, the excess of the positive settlement of derivatives recognised as financial income was PLN 78.1m.

As at the end of September 2008, open (not settled) futures contracts charged to financial expenses totalled PLN 184.2m. The valuation of financial instruments charged to financial expenses for Q3 2008 increased financial expenses by PLN 105.7m and included foreign exchange risk hedging transactions (forwards) with a value of PLN 70.0m, refining margin hedging transactions (full barrel swaps) with a value of PLN 27.4m, futures contracts executed to hedge the prices of CO_2 emission rights with a value of PLN 9.3m, and SWAP and FRA transactions executed to hedge the interest rate risk, amounting to PLN 2.7m.

The tables below present detailed information on open hedging transactions.

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

Period		Q4 2008	Q1 2009	Q2 2009	Q3 2009
	Volume (bbl)	7,247,700	3,000,999	1,001,001	3,000,999
Product/Raw material	**Index**	**Weighted average barrel structure**			
Gasoline	Gasoline 95r 10ppm NWE barge (Argus)	27.00%	36.00%	26.00%	25.67%
Jet fuel	Jet Cargoes CIF NWE / ARA (Platts)	10.00%	8.00%	9.00%	10.95%
Diesel oil	10 PPM Cargoes CIF NWE / ARA (Platts)	33.00%	30.00%	39.00%	43.57%
Light fuel oil	Gasoil .1 Cargoes CIF NWE / ARA (Platts)	11.00%	8.00%	4.00%	1.22%
Heavy fuel oil	1 PCT Cargoes FOB NEW (Platts)	0%	0%	0%	0.08%
Heavy fuel oil	3.5 PCT Barges FOB Rotterdam (Platts)	19.00%	18.00%	22.00%	18.52%
Crude oil	Brent (Dtd) (Platts)	-100.00%	-100.00%	-100.00%	-100%
Margin ranges in transactions (USD/bbl)		8.6–13.2	7.6–10.3	10.0–11.6	12.4–14.3

Source: Grupa LOTOS S.A.

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

Currency pair	Instrument	Value	FX rate range
EUR/USD	Forward	EUR 270,190,000	1.3877–1.5715
EUR/PLN	Forward	- EUR 38,000,000	3.4214–3.4214
USD/PLN	Forward	-USD 202,450,000	2.0465–2.4817
EUR/USD	Option	EUR 210,000,000	1.5900–1.5900

Source: Grupa LOTOS S.A.

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

Instrument	Start date	Expiry date	Notional Amount	Interest rate range	Reference rate
FRA	Sep 15 2008	Jan 15 2009	USD 200,000,000	2.2%–2.245%	3M LIBOR
IRS	Sep 15 2008– Jul 15 2009	Jun 30 2011– Jan 15 2013	USD 880,000,000	3.442%–4.33%	6M LIBOR

Source: Grupa LOTOS S.A.

Net profit on continued operations for the period January-September 2008 was PLN 477.9m, 13.5% down year on year, despite highly unfavourable macroeconomic conditions, which contributed to net loss of –PLN 223.9m in Q3 2008.

7.2 Balance Sheet

As at September 30th 2008, the balance-sheet total of the LOTOS Group was PLN 12,894.5m, up by PLN 3,174.1m during Q1–Q3 2008. The growth was primarily caused by a PLN 1,830.5m rise in non-current assets in connection with the implementation of the 10+Programme and purchase of interests in production licences covering the Yme field on the North Sea, including mainly increases in property, plant and equipment (up by PLN 1,366.3m) and prepayments for tangible assets under construction (up by PLN 474.2m). In the period under review, inventories increased by PLN 787.4m on account of the higher requirement concerning the volume of mandatory stocks and by higher prices of crude oil and petroleum products at the end of Q3 2008 compared with the prices reported at the end of 2007. An increase by PLN 410.1m in trade and other receivables is attributable to the increase in prices of products in Q1–Q3 2008. In the period under review, cash and cash equivalents increased by PLN 144.1m, to PLN 1,069.1m.

As at September 30th 2008, the Group's equity was PLN 6,623.5m, which means a PLN 472.6m rise in Q1–Q3 2008, as a result of higher retained earnings (up by PLN 428.1m) and a PLN 47.1m increase in equity attributable to minority shareholders.

In Q1–Q3 2008, non-current liabilities went up by PLN 961.6m, due to an increase in the level of non-current loans and borrowings primarily connected with the 10+ Programme. As at the end of September 2008, non-current liabilities amounted to PLN 2,177.2m, of which PLN 1,822.0m is attributable to interest-bearing loans and borrowings. As at September 30th 2008, Grupa LOTOS S.A. had used USD 245m under the investment loan (on the date of publication of the Q3 2008 report – USD 433m).

As at the end of Q3 2008, current liabilities amounted to PLN 4,093.7m, which means a PLN 1,739.9m (73.9%) rise in Q1–Q3 2008, primarily caused by higher levels of current loans and borrowings connected with the 10+ Programme, and liabilities reflecting higher prices of raw materials. In Q1–Q3 2008, the LOTOS Group's current loans and borrowings increased by PLN 893.2m, and as at September 30th 2008 amounted to PLN 1,410.4m. A working capital loan was granted to Grupa LOTOS S.A. in the form of overdraft facilities and is used by the Company in line with its needs for working capital.

7.3 Cash Flow

As at the end of Q3 2008, the cash balance recorded by the LOTOS Group was PLN 130.7m, having decreased by PLN 156.4m relative to the end of Q3 2007.

In Q3 2008, net cash provided by operating activities was PLN 23.3m and was up by PLN 14.1m year on year. The increase in cash flows from operating activities in Q3 2008 was driven primarily by a PLN 334.2m increase in the balance of liabilities, adjustments resulting from settlement of financial instruments of PLN 148.2m, net cash used in investing activities of

PLN 127.4, negative impact of foreign exchange differences of PLN 98.6m, and amortisation and depreciation of PLN 79.0m. In the analysed period, the key factors with a negative impact on the operating cash flows included a net loss of PLN 223.9m, an increase in inventories by PLN 304.2m, a negative difference of PLN 154.4m between the current corporate income tax and the corporate income tax paid, and a PLN 88.6m growth in receivables.

In Q3 2008, cash used in investing activities amounted to -PLN 673.2m, and declined by PLN 492.7m year on year. The negative value of cash flows in Q3 2008 is mainly attributable to expenses incurred on acquisition of tangible assets and intangible assets (PLN 538.5m) and prepayments for tangible assets under construction (PLN 154.7m).

In Q3 2008, the balance of cash from financing activities at the Group reached PLN 458.2m (up by PLN 478.0m), which is a significant improvement taking into account the negative balance of -PLN 19.8m in Q3 2007. The improvement followed from a rise in cash provided by loans and borrowings, which grew by PLN 650.9m relative to Q3 2007 and were reduced by adjustments resulting from settlement of financial instruments of PLN 148.2m.

8 OPERATING RESULTS BY BUSINESS SEGMENT

The operations of the LOTOS Group are divided into four business segments: crude oil production, refining and marketing, retail, and other business. A detailed description of the business segments is provided in the Directors' Report on the Financial Results of the LOTOS Group for Q1 2006.

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

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

Table 4 Q1-Q3 2008 operating result by business segments

PLNm	Segments							
	Crude oil production		Refining and marketing		Retail		Other business	
	Q1-Q3 2008	Q1-Q3 2007	Q1-Q3 2008	Q1-Q3 2007	Q1-Q3 2008	Q1-Q3 2007	Q1-Q3 2008	Q1-Q3 2007
Sales revenue	324	223	11,338	9,000	1,207	898	361	332
Intra-group sales	319	201	38	794	2	1	327	312
External sales	5	22	11,300	8,206	1,205	897	34	20
Operating expenses	-159	-140	-10,942	-8,540	-1,218	-921	-339	-311
Consolidation adjustments	-50	24	1	-	-	-1	-4	-4
Operating profit	115	107	397	460	-11	-24	18	17
Amortisation and depreciation	37	36	160	162	30	23	9	6
EBITDA	152	143	557	622	19	-1	27	23

Source: Grupa LOTOS S.A.

Table 5 Q3 2008 operating result by business segments

PLNm	Segments							
	Crude oil production		Refining and marketing		Retail		Other business	
	Q3 2008	Q3 2007	Q3 2008	Q3 2007	Q3 2008	Q3 2007	Q3 2008	Q3 2007
Sales revenue	95	90	4,315	3 457	452	361	129	122
Intra-group sales	93	80	12	306	2	-	119	114
External sales	2	10	4,303	3 151	450	361	10	8
Operating expenses	-54	-60	-4,321	-3 243	-447	-366	-113	-115
Consolidation adjustments	-16	15	1	1	-	-4	-2	-2
Operating profit	25	45	-5	215	5	-9	14	5
Amortisation and depreciation	12	12	53	55	11	8	3	2
EBITDA	37	57	48	270	16	-1	17	7

Source: Grupa LOTOS S.A.

8.1 Crude Oil Production

The Q3 2008 revenue from crude oil production was PLN 95m. Net of operating expenses of PLN 54m and after adjustments, operating profit amounted to PLN 25m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) reached PLN 37m. In the corresponding period of 2007, operating profit and EBIDTA were PLN 45m and PLN 57m, respectively.

Operating profit generated by the production segment was affected by the volume of the Rozewie oil processed in the capital group, which reached 39.2 thousand tonnes in Q3 2008 vs. sales of the Rozewie crude to Grupa LOTOS S.A. by Petrobaltic of 53.2 thousand tonnes and the volume of Petrobaltic's oil output of 61.1 thousand tonnes, lower external revenue of the segment and an operating loss posted by Lotos E&P Norge A.S.

8.2 Refining – Production and Wholesale

In Q3 2008, the refining segment generated sales revenue of PLN 4,315m, operating loss of PLN 5m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) of PLN 48m. In the corresponding period of 2007, operating profit and EBIDTA were PLN 215m and PLN 270m, respectively.

The EBITDA margin of the refining segment in Q3 2008 was 1.1%, and the operating margin reached 0.1%.

In Q3 2008, operating profit of the refining segment was significantly affected by the market conditions, in particular the high volatility of foreign exchange markets. The USD/PLN exchange rate moved in the range of 2.02 – 2.45, to end the quarter at 2.37. In Q3 2008 the average USD/PLN exchange rate was 2.20, and was by 0.9% higher than in Q2 2008. As a result of significant movements of the exchange rates, foreign exchange differences had a negative effect on the operating result of the segment, which was related to the settlement cycle of crude oil payments. Moreover, compared with Q2 2008, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil fell by 5.1% and 3.5%, respectively; concurrently, the refining margin grew by 16.0% and the Brent/Ural differential decreased by 52.8% quarter on quarter. Compared with Q3 2007, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil went up by 54.0% and 57.4%, respectively; the refining margin expanded by 66.7%, to USD 9.15 per barrel, and the Brent/Ural differential fell by 36.2%, to USD 1.76 per barrel.

8.3 Retail (Service Stations Network)

In Q3 2008, sales revenue in the retail segment amounted to PLN 452m, having increased by PLN 91m relative to the corresponding period of the previous year. The segment reported operating profit of PLN 5m, and EBITDA of PLN 16m. In the corresponding period of 2007, the segment reported operating loss of PLN 9m, and a negative EBIDTA of PLN 1m.

In Q3 2008, retail margins went up by 18.6% relative to Q2 2008, and by 23.5% on the Q3 2007 figure.

Apart from market factors, the Group's Q3 2008 performance in the retail segment benefited from the restructuring and streamlining of the service stations network, the launch of sales of branded fuels and the positive effects produced by operating service stations as part of an integrated network.

As at the end of Q3 2008, the number of COCO/CODO stations was 137 (up by three stations on Q2 2008), the number of DOFO stations was 76 (no change), and the number of DODO stations stood at 138 (no change). The number of the franchise agreements was 88.

8.4 Other Business

In Q3 2008, sales revenue from other business was PLN 129m, the segment's operating profit was PLN 14m, and EBITDA amounted to PLN 17m. In the corresponding period of 2007, operating profit and EBIDTA were PLN 5m and PLN 7m, respectively.

9 IMPACT OF LIFO INVENTORY VALUATION

Below we present information on the impact of the LIFO (last in, first out) inventory valuation method on the consolidated performance of the LOTOS Group for Q3 2008.

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

The impact of the LIFO valuation is presented as item 2, and consolidated operating profit of the LOTOS Group for Q3 2008 accounting for the estimated impact of using the LIFO method (along with the comparable data for Q3 2007) is presented as item 3.

Table 6 Impact of inventory valuation on operating profit

No.	*(PLNm)*	*Q3 2008*	*Q3 2007*	*Change*	*Q1-Q3 2008*	*Q1-Q3 2007*	*Change*
1.	Operating profit	39.2	256.5	-84.7%	519.6	560.3	-7.3%
2.	Effect of LIFO valuation	-24.1	-107.6	-77.6%	-281.2	-235.1	19.6%
3.	Operating profit – LIFO method	15.0	148.9	-89.9%	238.4	325.2	-26.7%

Source: Grupa LOTOS S.A.

In Q3 2008, inventory valuation added PLN 24.1m to operating profit, compared with an increase of PLN 107.6m in Q3 2007. If the LIFO method had been applied to inventory valuation, operating profit would have amounted to PLN 15.0m in Q3 2008 and PLN 148.9m in Q3 2007.

In Q1-Q3 2008 (cumulatively), the impact of inventory valuation increased operating profit by PLN 281.2m, compared with an increase of PLN 235.1m in Q1-Q3 2007. If the LIFO method had been applied to inventory valuation, operating profit would have amounted to PLN 238.4m in Q1-Q3 2008, and PLN 325.2m in Q1-Q3 2007.

The assumptions made in calculating the Q3 2008 operating profit of the LOTOS Group accounting for the estimated impact of the LIFO method (along with the comparable data for Q3 2007) are described in Current Report No. 29/2006.