THE LOTOS GROUP

DIRECTORS' REPORT
ON THE FINANCIAL PERFORMANCE OF THE LOTOS GROUP FOR Q4 2008

Gdańsk, March 2nd 2009

CONTENTS

1 INTRODUCTION

In Q4 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 Q4 2008 the Group produced crude oil and natural gas from the B3 and B8 deposits. Total crude oil production was 57.8 thousand tonnes, while natural gas output was 6,639 thousand m^3.

Petrobaltic conducted work relating in particular to the production from B8 and B3 deposits, maintenance and repair work, and seismic and geotechnical surveys.

In Q4 2008, LOTOS Exploration & Production Norge AS, following another transaction involving purchase of a 10% interest in the Yme field, came to hold a 20% interest in the field. Furthermore, on October 31st 2008 the company acquired from Norwegian Energy Company AS rights and obligations arising from the ownership of a 20% interest in an exploration licence covering an area located in the southern part of the Norwegian sector of the North Sea.

The volume of crude oil processed in Q4 2008 was 1,545.3 thousand tonnes, which represented a 102.2% utilisation of the nameplate throughput capacity of the Gdańsk refinery. The volume of Ural crude processed was 1,372.2 thousand tonnes (88.8% of total crude oil processed). The volume of Rozewie oil processed was 94.9 thousand tonnes (6.1% of total crude oil processed).

In Q4 2008, the LOTOS Group sold 330 thousand tonnes of motor gasolines, 901 thousand tonnes of diesel oil, 111 thousand tonnes of light fuel oil, 152 thousand tonnes of heavy fuel oil, 127 thousand tonnes of jet fuel, 210 thousand tonnes of bitumens, and 181 thousand tonnes of other products.

In Q4 2008, the activities related to the implementation of the 10+ Programme focused on performing the execution contracts.

In the retail segment, the Group continued to develop a modern, countrywide network of LOTOS service stations by expanding the network. As at December 31st 2008, the number of COCO/CODO stations increased to 139, the number of DOFO stations rose to 79, and the number of DODO stations was 137. The Company was a party to a total of 92 franchise agreements.

In Q4 2008, the average price of Brent oil (Dated Brent FOB) was USD 55.47 per barrel, i.e. less than in Q3 2008 (by USD 59.62 per barrel, or 51.8%) and less than in Q4 2007 (by USD 32.98 per barrel, or 37.3%).
The average price of Ural CIF Rotterdam oil was USD 54.58 per barrel, and was lower than in Q3 2008 (by USD 48.16 per barrel, or 51.8%) and lower than in Q4 2007 (by USD 30.83 per barrel, or 36.1%).

Considerably lower oil prices in Q4 2008 as compared with Q3 2008 were accompanied by a 49.4% decline in the Brent/Ural differential – from USD 1.76 per barrel in Q3 2008 to USD 0.89 per barrel in Q4 2008. In relation to Q4 2007, the Brent/Ural differential fell by USD 2.15 per barrel (70.7%).

In Q4 2008, the average refining margin dropped to USD 7.39 per barrel and was 19.2% lower than in Q3 2008, and 42.1% higher (by USD 2.19 per barrel) year on year.

The LOTOS Group's performance in Q4 2008 was driven by a number of factors, including in particular: falling prices of crude oil and crude oil products on global markets – which reduced the financial result by PLN 893.3m (impact of using the LIFO valuation method), volatility of the PLN/USD exchange rate – which necessitated the revaluation of foreign currency loans and dragged the financial result down by PLN 348.7m, a decline in the Brent/Ural differential, a lower refining margin, costs of creating regulatory stocks of fuels, and the concluded hedging transactions.

In Q4 2008, the LOTOS Group posted consolidated sales revenue of PLN 3,773m, operating loss of PLN 661m, net loss on continued operations of PLN 899m, and net loss attributable to equity holders of the parent of PLN 903m.

2 PETROBALTIC AND THE PRODUCTION SEGMENT

With respect to the upstream operations, in Q4 2008 Petrobaltic continued to produce oil and gas from the B3 and B8 deposits. The total crude oil and natural gas outputs were, respectively, 57.8 thousand tonnes and 6,639 thousand m^3. The entire crude oil output was shipped to the Gdańsk refinery, and the natural gas output, apart from the portion used by the Offshore Oil Rig (B3 deposit) and the gas flares of the Petrobaltic platform (B8 deposit), was sent via a pipeline to Energobaltic's CHP in Władysławowo. Petrobaltic's crude sales to Grupa LOTOS amounted to 40.7 thousand tonnes and the volume of Rozewie oil processed in Q4 2008 was 94.9 thousand tonnes (6.1% of total crude oil processed by the Gdańsk refinery).

In Q4 2008, the key tasks carried out by Petrobaltic included:

- Production from the B8 deposit at the Petrobaltic rig,
- Production from the B3 deposit, including water pumping to the deposit of the Offshore Oil Rig located at the Baltic Beta rig,
- Maintenance and repair work on PG-1.
- 2D seismic surveys over the B22 and B101 potential deposits,
- 3D seismic surveys over the B28 potential deposit,
- Sea bed geotechnical surveys performed to assess the possibility of rig anchoring.

In Q4 2008, following the second purchase of a 10% interest in 2008, LOTOS Exploration & Production Norge AS (LOTOS E&P Norge) came to hold a 20% interest in the Yme field, which corresponds to 13.6 million barrels (ca. 1,800 thousand tonnes) of recoverable crude oil reserves (figures according to estimates by Talisman, the field operator).

On October 22nd 2008, LOTOS E&P Norge signed an agreement with Norwegian company Det Norske Oljeselskap ASA concerning purchase of a 10% interest in the North Sea production licences No. 316, 316B, 316CS and 316DS. Upon the fulfilment of conditions precedent, on December 30th 2008 LOTOS E&P Norge acquired rights and obligations connected with the ownership of the 10% interest in the licences. The licences purchased from Det Norske Oljeselskap ASA cover the Yme field development plan and exploration areas.

In connection with the transaction, on January 20th 2009, LOTOS E&P Norge paid NOK 547,156,703, which comprised the acquisition price, capital expenditure connected with the development of the Yme field and costs of exploration work in the licence areas incurred between the economic date of the transaction and the date of its settlement, plus interest accrued for the period. The transaction was financed using a loan (USD 55m) extended by Petrobaltic S.A. and proceeds from the increase of LOTOS E&P Norge's share capital by Petrobaltic S.A (NOK 240m).

On October 31st 2008, upon fulfilment of conditions precedent, LOTOS E&P Norge acquired from Norwegian Energy Company AS rights and obligations arising from the ownership of a 20% interest in exploration licence PL455, covering an area of 1,365km^2 located in the southern part of the Norwegian sector of the North Sea. In exchange, the company undertook to cover in 2009 a portion of the expenditure incurred by the seller on the seismic surveys, up to NOK 37.6m.

On December 18th 2008, in the pre-qualification round APA 2008, LOTOS Exploration and Production Norge AS was granted interests in the following exploration licences in the southern area of the North Sea and in the Norwegian Sea:

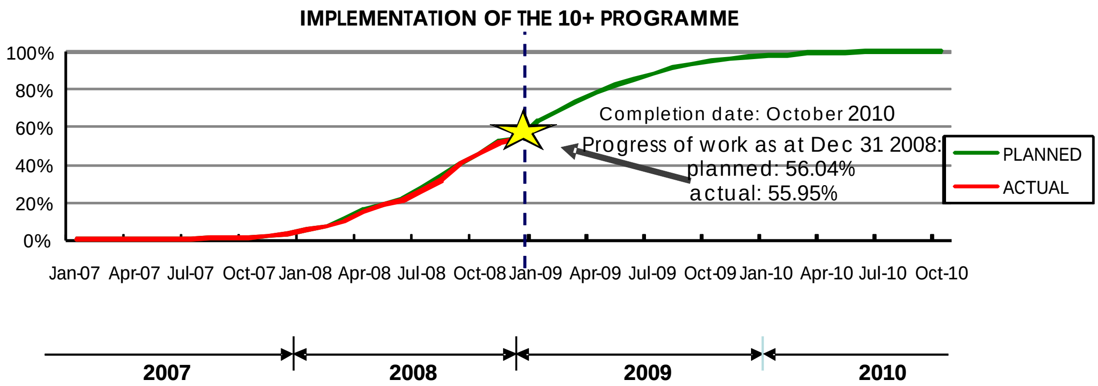
1. Exploration licence PL 497: LOTOS E&P Norge – 10% interest (other partners: Det Norske Oljeselskap ASA (acting as the operator) – 35% interest, Bridge Energy AS – 30% interest, Dana Petroleum Norway – 25% interest).
2. Exploration license PL 498: LOTOS E&P Norge (acting as the operator) – 25% interest (other partners: Skagen 44 AS – 25% interest, 4 Sea Energy AS – 25% interest, Edison International Spa Norway branch – 25% interest).
3. Exploration license PL 503: LOTOS E&P Norge (acting as the operator) – 25% interest (other partners: Skagen 44 AS – 25% interest, 4 Sea Energy AS – 25% interest, Edison International Spa Norway branch – 25% interest).

4. Exploration license PL 515: LOTOS E&P Norge – 20% interest (other partners: Rocksource ASA (acting as the operator) – 60% interest, Skagen 44 AS – 20% interest).

3 10+ PROGRAMME

In Q4 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.

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



Source: Grupa LOTOS S.A.

In Q4 2008, the work on the technical and outline design of the ROSE unit was continued in cooperation with the contractors, M.W. Kellogg and KBR.

As part of the HDS (diesel hydrodesulphurisation) project, in Q4 2008 the prefabrication and assembly of pipelines and apparatuses was continued and electric cables and equipment were fitted. Work also continued on the fitting of thermal insulation on apparatuses and pipelines. The fire protection system for trestle bridges and apparatuses was completed. The start-up procedures were fine-tuned.

As part of the CDU/VDU project (crude distillation unit), in Q4 2008 the laying of foundations was completed. The assembly of steelwork structures was continued and a stack for both furnaces of the CDU/VDU unit was erected on the foundations. Work on the start-up documentation was commenced and the design work for specific works is currently being finalised.

As part of the MHC (mild hydrocracking unit) project, in Q4 2008 the engineering design work, foundation laying and the work on the underground pipeline continued. Work was underway on the construction of cable conduits, slop channels and the underground system. Electrical works were also carried out.

As part of the HGU (hydrogen generating unit) project, assembly of the structure of the reformer furnace and assembly of apparatuses and equipment continued. Work on the HGU manual was in progress.

As part of the KAS project (amine sulphur unit), the mechanical assembly of overground tanks was completed, while the assembly of apparatuses was being finalised. In November 2008, the start-up team commenced its work.

In the area of auxiliary installations and infrastructure, work continued on construction of inter-unit connections and utilities, storage tanks and auxiliary facilities.

Moreover, in Q4 2008 the assembly of steel shells of four VR, VGO and pyrolyse gasoline storage tanks was completed. Work on the roofing of the four tanks was carried out. Foundation laying for the

LPG tank was completed. The assembly of the pipeline leading to the R7 terminal situated on the premises of Grupa LOTOS S.A. was in progress.

Financing of the 10+ Programme

In Q4 2008, another several drawdowns under the credit facility financing the 10+ Programme were made and their dates and amounts were set taking into account Grupa LOTOS S.A.'s payment position and the level of expenditure connected with the implementation of the 10+ Programme. The drawdowns were disbursed by the banks without any reservations, in accordance with the relevant requests filed by Grupa LOTOS S.A. and based on the information on the current financial standing of Grupa LOTOS S.A.

As at December 31st 2008, approx. 46% of the total value of the facilities available to finance the 10+ Programme were used.

In November 2008, Grupa LOTOS S.A. received a notification from the District Court of Gdańsk on entering into the Land and Mortgage Register, for the benefit of the security agent, a blanket security mortgage representing one of the main types of collateral used for the facilities advanced to finance the 10+ Programme.

4 THE *PROSTA* PROGRAMME

In Q4 2008, the Group was developing its retail service station network through subsidiary LOTOS Paliwa, focusing on continued expansion of the COCO and CODO station network and the development of the DOFO station network.

In the period, the Group continued the initiatives taken up in the previous quarters:

- COCO/CODO service stations in Strzeszowice, Radzymin i Zegrze were placed in service in December 2008; in October 2008 a service station in Lipno (Bydgoszcz Province) was excluded from the network and sold.
- Three new stations – in Ruściec, Żabno and Ostrowiec Świętokrzyski – joined the LOTOS Family Commercial Partnership Programme;
- PREMIUM fuels were offered at 54 DOFO stations as at December 31st 2008.

As at December 31st 2008, the LOTOS service station network comprised 355 locations, including 139 CODO stations, 79 DOFO stations and 137 DODO stations. A total of 92 franchise agreements were signed. In line with the assumptions of the Company's strategy for 2008–2012 regarding transfer of the DODO stations to another operational platform, since Q1 2007 the total number of COCO/CODO and DOFO service stations has been larger than the number of DODO stations.

5 SOUTHERN REFINERIES (LOTOS CZECHOWICE AND LOTOS JASŁO)

In Q4 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 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, 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 Q4 2008, the average price of Brent crude (Dated Brent FOB) was USD 55.47 per barrel and was lower by USD 59.62 per barrel (51.8%) quarter on quarter, and by USD 32.98 per barrel (37.3%) year on year.

The average price of Ural CIF Rotterdam was USD 54.58 per barrel and was lower by USD 48.16 per barrel (51.8%) quarter on quarter, and by USD 30.83 per barrel (36.1%) year on year.

The substantially lower crude prices were accompanied by a fall in the Brent/Ural differential, from USD 1.76 per barrel in Q3 2008 to USD 0.89 per barrel in Q4 2008 (49.4%). The differential fell by USD 2.15 per barrel relative to Q4 2007 (70.7%).

In Q4 2008, the average refining margin fell by 19.2% quarter on quarter, to USD 7.39 per barrel. Relative to Q4 2007, the refining margin increased by USD 2.19 per barrel (42.1%).

The average crack margin on gasoline shrank by 54.8% on Q3 2008, to USD 62.93 per tonne, while the average crack margin on diesel oil dropped by 13.4%, to USD 195.47 per tonne. Compared with Q4 2007, the average crack margin on gasoline declined by 51.8%, whereas the average crack margin on diesel oil rose by 24.2%.

6.2 Operational Review

In Q4 2008, the Gdańsk refinery processed 1,545.3 thousand tonnes of crude, which represented a 102.2% utilisation of the nameplate throughput capacity.

The Gdańsk refinery processed 1,372.2 thousand tonnes of Ural crude, which accounted for 88.8% of the total processing volume. The balance comprised the Rozewie oil extracted by Petrobaltic – 94.9 thousand tonnes (6.1% of the processing volume), the Volve oil – 45.8 thousand tonnes (3.0% of the processing volume), and the Aasgard oil – 32.4 thousand tonnes (2.1% of the processing volume).

In Q4 2008, the LOTOS Group sold 330 thousand tonnes of motor gasolines, 901 thousand tonnes of diesel oil, 111 thousand tonnes of light fuel oil, 152 thousand tonnes of heavy fuel oil, 127 thousand tonnes of jet fuel, 210 thousand tonnes of bitumens, and 181 thousand tonnes of other products (including 30 thousand tonnes of LPG, 16 thousand tonnes of engine oils, 26 thousand tonnes of base oils, 36 thousand tonnes of reformate, 47 thousand tonnes of bunker fuel, and 26 thousand tonnes of other petroleum products).

Compared with Q3 2008, the headcount at the LOTOS Group in Q4 2008 increased to 4,878 employees (14 new employees hired).

7 DISCUSSION OF CONSOLIDATED RESULTS OF THE LOTOS GROUP

7.1 Income Statement

In Q4 2008, sales revenue of the LOTOS Group was PLN 3,772.7m, i.e. less by PLN 207.7m than in Q4 2007, mainly due to decrease in the prices of crude oil and petroleum products on the global markets as compared with the relevant prices in Q4 2007. In Q4 2008, the average price of Brent crude (Dated Brent) was USD 55.48 per barrel, which represented a year-on-year fall of 37.3%. The average net selling price dropped by 8.8%, from PLN 2,057 per tonne in Q4 2007 to PLN 1,875 per tonne in Q4 2008.

The Q4 2008 sales volume of the LOTOS Group was 2,011.6 thousand tonnes, which represented a year-on-year increase of 76.9 thousand tonnes (4.0%). In the analysed quarter, the sales volume of diesel oils, bunker oil and heavy fuel oils increased, whereas sales of gasolines, liquefied gases, bitumens and bitumen components, light fuel oils, JET A-1 fuel, base oils and lubricants declined.

Year on year, in Q4 2008 cost of sales went up by 17.0% and amounted to PLN 4,077.7m. Cost of sales in Q4 2008 was significantly affected by the necessity to adjust the value of stocks of raw materials and products held at the end of the year, amounting to PLN 200.9m, to reflect their real value at current prices, connected with the continuing fall of crude oil prices in December 2008. As at December 31st 2008, the average price of Brent crude was USD 36.55 per barrel and was lower by USD 57.16 per barrel (61.0%) from the average price of Brent crude as at September 30th 2008.

The Q4 2008 unit cost of sales was PLN 2,027 per tonne, i.e. 12.5% more than in Q4 2007.

The growth of unit cost of sales and the concurrent decline of the average net selling price resulted in a year-on-year drop of gross profit on sales in Q4 2008, by PLN 799.0m. In Q4 2008, the LOTOS Group reported a gross loss on sales of PLN 305.0m.

In Q4 2008, crack margins on intermediate fractions of oil exceeded the figures for Q4 2007. In Q4 2008, the average quarterly crack margins on Diesel 10, on Gasoil 0.1% and on JET Fuel were seen up year on year by 20.3%, 36.8% and 11.8%, respectively. In Q4 2008, the average refining margin reached USD 7.39 per barrel, and was higher than the Q4 2007 margin which stood at USD 5.20 per barrel.

The average USD/PLN exchange rate was 13.1% higher than in Q4 2007 (up by USD/PLN 0.33). Since the LOTOS Group has a long USD position, the depreciation of the złoty against the US dollar positively contributed to the Group's operating result in Q4 2008.

Selling costs incurred by the LOTOS Group in Q4 2008 amounted to PLN 203.5m, and were up by 9.1% 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 Q4 2007 and amounted to PLN 110.7m.

Costs of other operating activities incurred by the LOTOS Group in Q4 2008 amounted to PLN 49.8m. Loss on other operating activities in Q4 2008 was PLN 42.0m and was PLN 3.1m lower year on year.

Due to the highly unfavourable macroeconomic conditions driven by the unmatched weakening of the Polish złoty in Q4 2008, a rapid decrease in the crude oil prices during Q3 and Q4 2008, and the fall of the Brent/Ural differential – from USD 3.04 per barrel in Q4 2007 to USD 0.9 per barrel in Q4 2008 – the LOTOS Group reported a loss on operating activities in Q4 2008 of PLN 661.1m. The drop of the average Brent crude prices from USD 115.09 per barrel in Q3 2008 to USD 55.48 per barrel in Q4 2008 and significant downward trend in the prices of petroleum products had a negative bearing on the Q4 2008 results, contrary to the upward trend in prices in Q4 2007 having a positive influence on the results in that quarter. A quarter-on-quarter decline in prices in Q4 2008 had a strong bearing on the difference between the LIFO valuation of raw materials and the operating profit on the one hand, and the valuation with the use of weighted average, as applied by the LOTOS Group, on the other. In Q4 2008, the operating result computed using the LIFO method was higher by PLN 893.3m relative to the reported figure and reached PLN 232.1m against the PLN 4.9m loss in Q4 2007 computed using the same method.

In Q4 2008, loss on financing activities was -PLN 451.5m as compared with a profit of PLN 164.0m in Q4 2007. This loss in Q4 2008 results chiefly from foreign exchange loss on revaluation of loans, amounting to -PLN 348.7m and from the valuation and settlement of market risk hedging transactions of -PLN 135.5m. Since the revaluation affects long-term loans whose repayment is spread over a long period, the dynamic increase in the exchange rate which occurred in Q4 2008 had no bearing on the Company's liquidity in the short or medium term.

The total excess of the negative settlement of derivatives in Q4 2008 was charged to financial expenses and amounted to -PLN 313.1m, including: settlement of foreign exchange risk hedging transactions (forwards) of -PLN 285.1m, settlement of refining margin hedging transactions (full barrel swaps) of -PLN 30.1m, settlement of futures contracts executed to hedge the prices of CO_2 emission rights of -PLN 1.2m, and settlement of FRA transactions executed to hedge the interest rate risk, amounting to PLN 3.3m. As at the end of 2008, the excess of the negative settlement of derivatives charged to financial expenses was -PLN 235.0m.

As at the end of December 2008, open (not settled) futures contracts charged to financial expenses totalled -PLN 6.6m. The valuation of financial instruments charged to financial expenses for Q4 2008 reduced financial expenses by PLN 177.6m and included foreign exchange risk hedging transactions (forwards) with a value of PLN 169.8m, refining margin hedging transactions (full barrel swaps) with a value of PLN 169.1m, futures contracts executed to hedge the prices of CO_2 emission rights with a value of PLN 0.5m, SWAP transactions executed to hedge the interest rate risk, amounting to -PLN 152.2m, and other transactions (FRAs and options), amounting to -PLN 9.6m.

The tables below present detailed information on open hedging transactions.

Table 1 Refining margin hedging transactions (full barrel swap) as at December 31st 2008

	Period	Q1 2009	Q2 2009	Q3 2009
	Volume (bbl)	3,000,999	2,501,004	3,000,999
Product/Raw material	**Index**	**Weighted average barrel structure**		
Gasoline	Gasoline 95r 10ppm NWE barge (Argus)	36.00%	24.86%	25.67%
Jet fuel	Jet Cargoes CIF NWE / ARA (Platts)	8.00%	13.02%	10.95%
Diesel oil	10 PPM Cargoes CIF NWE / ARA (Platts)	30.00%	32.70%	43.57%
Light fuel oil	Gasoil .1 Cargoes CIF NWE / ARA (Platts)	8.00%	6.22%	1.22%
Heavy fuel oil	1 PCT Cargoes FOB NEW (Platts)	0%	0.36%	0.08%
Heavy fuel oil	3.5 PCT Barges FOB Rotterdam (Platts)	18.00%	22.84%	18.52%
Crude oil	Brent (Dtd) (Platts)	-100.00%	-100.00%	-100%
Margin ranges in transactions (USD/bbl)		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 December 31st 2008

Currency pair	Instrument	Value	FX rate range
EUR/USD	Forward	EUR 364,650,000	1.2463–1.4269
EUR/PLN	Forward	EUR 7,900,000	3.5046–4.1850
USD/PLN	Forward	-USD 134,300,000	2.5736–3.1115
EUR/USD	Option	EUR 0	1.5900–1.5900

Source: Grupa LOTOS S.A.

Table 3 Interest rate risk hedging transactions as at December 31st 2008

Instrument	Start date	Expiry date	Principal	Interest rate range	Reference rate
FRA	Jan 15 2009	Jul 15 2009	USD 100,000,000	2.5%–2.5%	6M LIBOR
IRS	Oct 15 2008–Jul 15 2009	Jun 30 2011–Jan 15 2013	USD 1,080,000,000	3.442%–4.33%	6M LIBOR

Source: Grupa LOTOS S.A.

Net loss on continued operations for the period January-December 2008 was PLN 422.0m whereas net loss on continued operations in Q4 2008 was PLN 899.9m.

7.2 Balance Sheet

As at December 30th 2008, the balance-sheet total of the LOTOS Group was PLN 12,117.1m, up by PLN 2,396.7m during 2008. The growth was primarily caused by a 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 2,052.8m) and prepayments for tangible assets under construction (up by PLN 418.9m). Over 2008, current assets decreased by PLN 111.6m. Inventories decreased by PLN 134.5m and cash and cash equivalents by PLN 212.6m, while, over the same period, current financial assets increased by PLN 209.4m and income tax receivable by PLN 195.8m. As at the end of December 2008, current financial assets amounted to PLN 328.8m, including PLN 302.3m relating to the measurement of transactions hedging refining margin and foreign exchange rates.

As at December 31st 2008, the Group's equity was PLN 5,350.8m, which means a PLN 465.4m drop in 2008, principally as a result of lower retained earnings (down by PLN 475.7m).

In 2008, non-current liabilities went up by PLN 2,502.7m, mainly due to an increase in the level of non-current loans and borrowings primarily connected with the 10+ Programme. As at the end of 2008, non-current liabilities amounted to PLN 3,718.3m, of which PLN 3,439.2m is attributable to interest-bearing loans and borrowings.

As at the end of 2008, current liabilities amounted to PLN 2,662.2m, which means a PLN 308.4m (13.1%) rise in 2008, primarily caused by higher levels of liabilities connected with the execution of the investment programme at Grupa LOTOS S.A. In 2008, the LOTOS Group's current loans and borrowings decreased by PLN 37.9m, and as at December 31st 2008 amounted to PLN 479.3m. As at the end of 2008, other current financial liabilities amounted to PLN 220.8m, with PLN 218.5m of that figure attributable to negative measurement of financial instruments.

7.3 Cash Flow

As at the end of 2008, the cash balance recorded by the LOTOS Group was PLN 342.0m, having decreased by PLN 135.1m relative to the end of 2007.
In Q4 2008, net cash provided by operating activities was PLN 297.5m and was up by PLN 255.5m year on year. The increase in cash flows from operating activities in Q4 2008 was driven primarily by a PLN 921.6m decrease in inventories, PLN 500.9m decrease in receivables, adjustments resulting from settlement of financial instruments of PLN 359.5m, foreign exchange loss of PLN 342.9m, and amortisation and depreciation of PLN 79.5m. In the analysed period, the key factors with a negative impact on the operating cash flows included a net loss of PLN 899.9m, a PLN 543.5m decrease in liabilities, a negative difference of PLN 264.7m between the corporate income tax disclosed in the income statement and the corporate income tax paid and gain on investing activities of PLN 194.8m.

In Q4 2008, cash used in investing activities amounted to -PLN 958.4m, and declined by PLN 562.5m year on year. The negative value of cash flows in Q4 2008 is mainly attributable to expenses incurred on acquisition of tangible and intangible assets (PLN 830.6m) and prepayments for tangible assets under construction (PLN 138.9m).

In Q4 2008, the balance of cash from financing activities at the Group reached PLN 865.8m (up by PLN 321.0m year on year). The improvement primarily followed from a rise in cash provided by loans and borrowings, which amounted to PLN 1,267.5m and were reduced by adjustments resulting from settlement of financial instruments of PLN 359.5m.

8 OPERATING RESULTS BY BUSINESS SEGMENTS

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-Q4 2008 operating result cumulatively, by business segments

PLNm	Crude oil production		Refining and marketing		Retail		Other business	
	Q1-Q4 2008	Q1- Q4 2007	Q1-Q4 2008	Q1- Q4 2007	Q1-Q4 2008	Q1- Q4 2007	Q1-Q4 2008	Q1- Q4 2007
Sales revenue	381	310	16,114	12,942	1,598	1,259	507	467
Intra-group sales	375	287	1,446	1,130	3	2	460	434
External sales	6	23	14,668	11,812	1,595	1,257	47	33
Operating expenses	-213	-196	-16,454	-12,325	-1,615	-1,309	-481	-447
Consolidation adjustments	26	20	1	-	-	-	-6	-7
Operating profit	194	134	-339	617	-17	-50	20	13
Amortisation and depreciation	49,	54	215	219	40	29	12	9
EBITDA	243	188	-124	836	23	-21	32	22

Segments

Source: Grupa LOTOS S.A.

Table 5 Q4 2008 operating result by business segments

PLNm	Crude oil production		Refining and marketing		Retail		Other business	
	Q4 2008	Q4 2007	Q4 2008	Q4 2007	Q4 2008	Q4 2007	Q4 2008	Q4 2007
Sales revenue	57	87	3,713	3,942	391	361	146	135
Intra-group sales	56	86	345	336	1	1	133	122
External sales	1	1	3,368	3,606	390	360	13	13
Operating expenses	-54	-56	-4,449	-3,785	-397	-388	-142	-136
Consolidation adjustments	76	-4	-	-	-	1	-2	-3
Operating profit	79	27	-736	157	-6	-26	2	-4
Amortisation and depreciation	12	18	54	57	10	6	3	3
EBITDA	91	45	-682	214	4	-20	5	-1

Segments

Source: Grupa LOTOS S.A.

8.1 Crude Oil Production

The Q4 2008 revenue from crude oil production was PLN 57m. Net of operating expenses of PLN 54m and after adjustments, operating profit amounted to PLN 79m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) reached PLN 91m. In the corresponding period of 2007, operating profit and EBIDTA were PLN 27m and PLN 45m, respectively.

Operating profit generated by the production segment was affected by the volume of the Rozewie oil processed at the Gdańsk refinery, which reached 94.9 thousand tonnes in Q4 2008 vs. sales of the Rozewie crude to Grupa LOTOS S.A. by Petrobaltic of 40.7 thousand tonnes and the volume of Petrobaltic's oil output of 57.8 thousand tonnes, a lack of external revenue of the segment and an operating loss posted by Lotos E&P Norge.

8.2 Refining – Production and Wholesale

In Q4 2008, the refining segment generated sales revenue of PLN 3,713m, operating loss of -PLN 736m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) of -PLN 682m. In the corresponding period of 2007, operating profit and EBIDTA were 157m and PLN 214m, respectively.

The performance of the refining segment was determined to a large extent by the fact that, compared with Q3 2008, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil fell by 51.8% and 51.8% (impact of the LIFO valuation method), respectively; concurrently, the refining margin dropped by 19.2% and the Brent/Ural differential decreased by 49.4%, quarter on quarter. Compared with Q4 2007, the average prices of the Brent Dated (FOB) oil and the URAL CIF Rotterdam oil declined by 37.3% and 36.1%, respectively; the refining margin expanded by 42.1%, to USD 7.39 per barrel, and the Brent/Ural differential fell by 70.7%, to USD 0.89 per barrel.

8.3 Retail (Service Stations Network)

In Q4 2008, sales revenue in the retail segment was PLN 391m, operating loss stood at -PLN 6m, and EBITDA amounted to PLN 4m. In the corresponding period of 2007, the segment reported operating loss of -PLN 26m, and negative EBITDA of -PLN 20m.

As at December 31st 2008, the number of COCO/CODO stations was 139 (up by two stations on Q3 2008), the number of DOFO stations was 79 (up by three stations), and the number of DODO stations stood at 137 (down by one station). The number of the franchise agreements was 92.

8.4 Other Business

In Q4 2008, sales revenue from other business was PLN 146m, the segment's operating profit was PLN 2m, and EBITDA amounted to PLN 5m. In the corresponding period of 2007, operating loss and negative EBITDA were -PLN 4m and -PLN 1m, respectively.

9 IMPACT OF THE LIFO INVENTORY VALUATION

Below we present information on the impact of the LIFO (last in, first out) inventory valuation method on the consolidated performance of the LOTOS Group for Q4 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 Q4 2008 accounting for the estimated impact of using the LIFO method (along with the comparable data for Q4 2007) is presented as item 3.

Table 6 Impact of inventory valuation on operating result

No.	(PLNm)	Q4 2008	Q4 2007	Change	Q1–Q4 2008	Q1–Q4 2007	Change
1.	Operating profit	-661.1	153.3	-531.2%	-141.6	713.7	-119.8%
2.	Effect of LIFO valuation	893.3	-158.2	664.7%	612.1	-393.3	255.6%
3.	Operating profit – LIFO method	232.2	-4.9	4,838.8%	470.5	320.4	46.8%

Source: Grupa LOTOS S.A

In Q4 2008, inventory valuation had a negative effect on the operating result and eroded it by PLN 893.3m, compared with an increase of PLN 158.2m in Q4 2007. If the LIFO method had been applied to inventory valuation, operating profit/loss would have amounted to PLN 232.2m in Q4 2008 and -PLN 4.9m in Q4 2007.

In Q1–Q4 2008 (cumulative), the impact of inventory valuation reduced operating profit by PLN 612.1m, compared with an increase of PLN 393.3m in Q1–Q4 2007. If the LIFO method had been applied to inventory valuation, operating profit would have amounted to PLN 470.5m in Q1–Q4 2008 and PLN 320.4m in Q1–Q4 2007.

The assumptions made in calculating the Q4 2008 operating profit of the LOTOS Group accounting for the estimated impact of the LIFO method (along with the comparable data for Q4 2007) are described in Current Report No. 29/2006.