

## **THE LOTOS GROUP**

**DIRECTORS' REPORT  
ON THE FINANCIAL PERFORMANCE OF THE LOTOS GROUP IN Q4 2009**

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

**Gdańsk, February 23rd 2010**

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## 1 INTRODUCTION

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In Q4 2009, Grupa Kapitałowa Grupy LOTOS S.A. (the LOTOS Group, the Group) conducted operations in two basic operating segments:

- the upstream segment (exploration and production of crude oil),
- the downstream segment (oil refining, wholesale of refined petroleum products and retail sale of fuels).

In Q4 2009, Przedsiębiorstwo Poszukiwań i Eksploatacji Złóż Ropy i Gazu Petrobaltic S.A. (Petrobaltic) conducted work relating in particular to the production from the B3 field and the test production from the B8 field.

The Q4 2009 total crude oil output was 60.9 thousand tonnes. Crude sales to Grupa LOTOS S.A. in the reporting period amounted to 56.5 thousand tonnes, which represented a year-on-year increase of 15.8 thousand tonnes (+38.8%).

In Q4 2009, under its licences LOTOS Exploration & Production Norge AS conducted exploration activities, both as the operator (licences PL498 and PL503) and as an interest holder (licences PL316DS, PL316CS, PL455, PL497 and PL515). The Company also participated in the YME Production Project, under which production wells were drilled and a production rig was being constructed in Q4 2009. Launch of the production from the YME field is expected in late Q2 or early Q3 2010.

The volume of crude oil processed in Q4 2009 was 1,558.5 thousand tonnes, which represented a 103.1% utilisation of the nameplate throughput capacity of the Grupa LOTOS S.A.'s refinery in Gdańsk. In the reporting period, the Gdańsk refinery processed 1,305.6 thousand tonnes of Ural crude (83.78% of total crude oil processed), 122.1 thousand tonnes of Rozewie crude (7.84% of total crude oil processed), 65.8 thousand tonnes of SAHARA crude (4.22% of total crude oil processed) and 64.9 thousand tonnes of other types of crude.

In Q4 2009, the LOTOS Group sold 340.3 thousand tonnes of motor gasolines, 1,069.4 thousand tonnes of diesel oil, 106.3 thousand tonnes of light fuel oil, 127.1 thousand tonnes of heavy fuel oil, 61.4 thousand tonnes of jet fuel, 212.3 thousand tonnes of bitumens, and 154.6 thousand tonnes of other products. In Q4 2009, retail sales of fuels through CODO and DOFO petrol stations amounted to 157 thousand tonnes.

In Q4 2009, the activities related to the implementation of the 10+ Programme focused on performing the execution contracts.

In the reporting period, the Group continued to develop a modern, countrywide network of LOTOS petrol stations. As at the end of Q4 2009, the number of CODO stations was 144 (up by 2 stations relative to Q3 2009), the number of DOFO stations was 98 (up by 3 stations), and the number of DODO stations was 62 (down by 25 stations). The number of new concluded franchise agreements was 107.

In Q4 2009, the average price of Brent oil (Dated Brent FOB) was 74.53 USD/bbl, more than in Q3 2009 (by 6.45 USD/bbl, or 9.5%) and in Q4 2008 (by 19.06 USD/bbl, or 34.4%). The average price of Ural CIF Rotterdam oil was 74.21 USD/bbl, and was higher than in Q3 2009 (by 6.45 USD/bbl, or 9.5%) and in Q4 2008 (by 19.63 USD/bbl, or 36.0%).

However, despite the higher oil prices in Q4 2009 vs. Q3 2009, the Brent/Ural differential remained flat at 0.32 USD/bbl in Q3 and Q4 2009. In relation to Q4 2008, the Brent/Ural differential shrank by 0.57 USD/bbl (or 64.0%).

Q4 2009 saw a drop of the average refining margin from 2.87 USD/bbl to 0.93 USD/bbl. The margin was 67.6% lower than in Q3 2009, and 87.4% lower (by 6.46 USD/bbl) year on year.

The USD/PLN exchange rate fluctuated from 2.71 to 2.93, to reach 2.85 at the end of December 2009 (down by 1.4% from the end of Q3 2009). In Q4 2009, the average USD/PLN exchange rate was 2.82 and was by 4.1% lower than the average exchange rate in Q3 2009. The EUR/PLN exchange rate ranged from 4.07 to 4.29, to reach 4.11 at the end of Q4 2009 (down by 2.6% relative to the end of Q3 2009). The average EUR/PLN exchange rate was 4.17 in Q4 2009 (down by 0.7% on Q3 2009).

The LOTOS Group's performance in the reporting period was driven by a number of factors, including in particular:

- lower refining margin,
- decline in the Brent/Ural differential (y-o-y),
- trends in the crude oil prices,
- decline of the USD/PLN exchange rate,
- revaluation of foreign-currency loans,
- concluded hedging transactions,
- non-recurring events.

In Q4 2009, the LOTOS Group posted consolidated sales revenue of PLN 4,024.0m, operating profit of PLN 86.2m, net profit from continuing operations of PLN 225.3m, and net profit attributable to owners of the parent of PLN 223.6m. Compared with Q4 2008, the sales revenue grew by PLN 272.9m (or 7.3%) whereas operating profit rose by 751.6m.

## **2 THE UPSTREAM SEGMENT**

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### **The Baltic Sea Area**

With respect to the upstream operations, in Q4 2009 production of oil and gas from the B3 field and test production from the B8 field continued. The Q4 2009 total crude oil output was 60.9 thousand tonnes. Crude sales to Grupa LOTOS S.A. in the reporting period amounted to 56.5 thousand tonnes, which represented a year-on-year increase of 15.8 thousand tonnes (+38.8%). In the reporting period, output of natural gas was 6.8 million cubic metres, having increased by 2.0% year on year. In Q4 2009, Petrobaltic's key operations included:

- production from the B3 field, including water injection to the well at the Baltic Beta rig,
- launch of test production from the existing wells in the B8 field in November 2009,
- continuation of work on the base engineering design comprising the production centre and the related infrastructure for the B8 field.

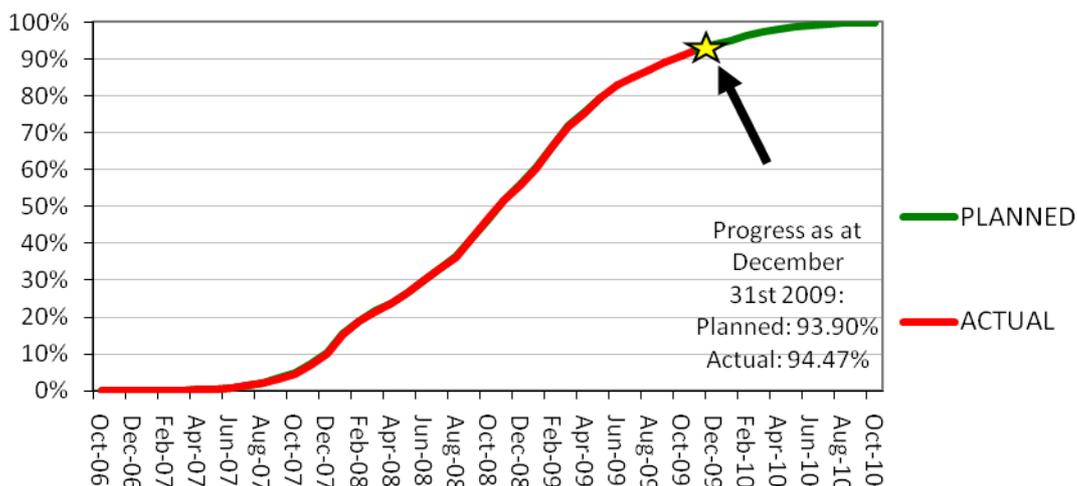
### **The Norwegian Continental Shelf Area**

In Q4 2009, LOTOS Exploration & Production Norge AS conducted exploration activities, both as the operator (licences PL498 and PL503) and as an interest holder (licences PL316DS, PL316CS, PL455, PL497 and PL515). The work included preparations for drilling an exploration well in the licence PL316DS area; additionally, a decision was made to move to the stage of seismic surveys in the PL503 and PL 515 licence areas. Moreover, in Q4 2009 LOTOS Exploration & Production Norge AS's operations carried out as part of the YME Production Project included drilling of production wells and work on the construction of a production rig. Drilling of six wells, including four production wells, was completed. The start of production from the YME field is expected in late Q2 or early Q3 2010.

### 3 10+ PROGRAMME

In Q4 2009, the implementation of the 10+ Programme, Grupa LOTOS S.A.'s largest project which is of key importance for future growth of the Company's value, was focused on performing the concluded execution contracts.

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

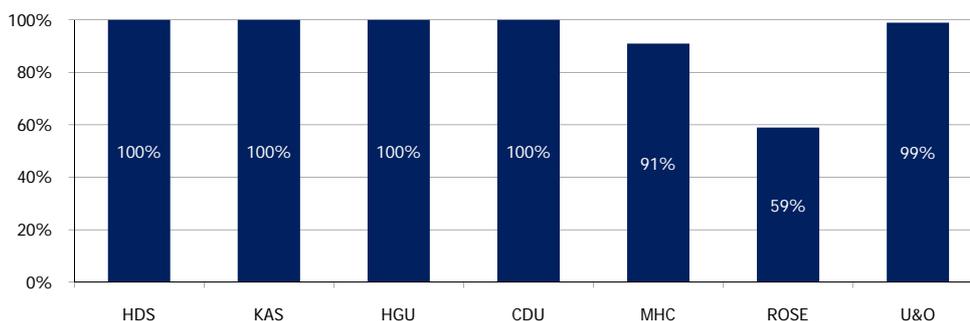


Source: Grupa LOTOS S.A.

The oil distillation unit (CDU/VDU) reached the RFSU (Ready For Start Up) status on December 11th 2009.

The Staff 2009 Project, which envisages hiring of 120 operational personnel to operate the units delivered as part of the 10+ Programme, was fully implemented and training of the operators continued.

Progress of work on each unit as at December 31st 2009 is presented in the chart below.



#### Financing of the 10+ Programme

In Q4 2009, further drawdowns under the credit facilities used to finance the 10+ Programme were made on such dates and in such amounts as were required given the Grupa LOTOS's current payment position and the level of current expenditure connected with the implementation of the 10+ Programme. The drawdowns were

disbursed by the banks on the dates and in the amounts requested by Grupa LOTOS S.A.

As at December 31st 2009, approx. 81.8% of the total value of the facilities available to finance the 10+ Programme had been drawn.

In addition to the debt financing, the Grupa LOTOS also used internally generated cash from operating activities to finance the 10+ Programme, to the extent provided for in the credit facility agreement.

#### **4 THE PETROL STATION EXPANSION PROGRAMME**

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In Q4 2009, the Group was developing its retail petrol station network through its subsidiary LOTOS Paliwa, focusing on continued expansion of the CODO and DOFO station network:

- CODO petrol station in Wieliczka was placed in service in October 2009; in November 2009, a CODO petrol station was launched in Rzepin;
- Four new stations – in Lipa, Pikutkowo, Lubraniec and Stara Łubianka – joined the LOTOS Family Commercial Partnership Programme, at the same time a petrol station in Bydgoszcz was excluded from the network;
- As at December 31st 2009, Premium fuels were offered at 139 CODO stations and 82 DOFO stations.

On December 31st 2009, 23 agreements for the operation of DODO stations expired. A total of 107 franchise agreements were signed. As at January 1st 2010, the LOTOS petrol station network comprised 304 locations, including 144 CODO stations, 98 DOFO stations and 62 DODO stations.

#### **5 ENERGOBALTIC, LOTOS CZECHOWICE AND LOTOS JASŁO**

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##### **5.1 Restructuring of Energobaltic**

In Q4 2009, the restructuring of Energobaltic Sp. z o.o. (a wholly-owned subsidiary of Pertobaltic S.A.) was completed. The restructuring process involved an arrangement with the creditors as part of recovery proceedings and an agreement with the other shareholders of the company, as a result of which Petrobaltic acquired the rest of the shares in Energobaltic and assumed control over the company.

Thanks to the implementation of the above measures, it was possible amongst other things to release a provision for business risk and to reverse an impairment charge for shares and a loan. The combined positive effect of the release and the reversal on the Group's Q4 2009 financial result was PLN 55m.

##### **5.2 LOTOS Czechowice and LOTOS Jasło**

In Q4 2009, LOTOS Czechowice S.A. and LOTOS Jasło S.A. 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 involving the use of idle assets.

Since H1 2009, the two companies' terminals and storage tanks have been operated as part of the integrated fuel logistics system of the LOTOS Group.

## **6 MARKET ENVIRONMENT AND OPERATIONS**

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### **6.1 Oil and Fuel Markets**

In Q4 2009, the average price of Brent crude (Dated Brent FOB) was 74.53 USD/bbl, up by USD 6.45 (9.5%) quarter on quarter, and up by 19.06 USD/bbl (34.4%) year on year. The average price of Ural CIF Rotterdam was 74.21 USD/bbl and was higher by 6.45 USD/bbl (9.5%) quarter on quarter and higher by 19.63 USD/bbl (36.0%) year on year.

Despite the higher crude prices, the Brent/Ural differential remained flat at 0.32 USD/bbl in Q3 and Q4 2009. The differential shrank by 0.57 USD/bbl (64.0%) relative to Q4 2008.

In the reporting period, the average refining margin fell by 67.6% quarter on quarter, from 2.87 USD/bbl to 0.93 USD/bbl. Relative to Q3 2008, the refining margin lost 6.46 USD/bbl (87.4%).

The average crack margin on gasoline dropped by 10.7% on Q3 2009, to USD 121.31 per tonne, while the average crack margin on diesel oil grew by 10.3%, to USD 67.00 per tonne. Compared with Q4 2008, the average crack margin on gasoline increased by 92.8%, whereas the average crack margin on diesel oil fell by 66.9%.

### **6.2 Foreign Exchange Market**

In Q4 2009, the USD/PLN exchange rate moved within the range of 2.71–2.93, to end the quarter at 2.85 (down by 1.4% on Q3 2009). In Q4 2009, the average USD/PLN exchange rate was 2.82, and was 4.1% lower on Q3 2009 and 1.4% down on Q4 2008.

In Q3 2009, the EUR/PLN exchange rate moved within the range of 4.07–4.29, to end the quarter at 4.11 (down by 2.6% on Q3 2009). The average EUR/PLN exchange rate during the period was 4.17 (0.7% lower on Q3 2009 and 10.6% higher on Q4 2008).

### **6.3 Operational Review**

In Q4 2009, the Gdańsk refinery processed 1,558.5 thousand tonnes of crude, which represented a 103.1% utilisation of the nameplate throughput capacity.

In the reporting period, the Gdańsk refinery processed 1,305.6 thousand tonnes of Ural crude (83.8% of total crude oil processed), 122.1 thousand tonnes of Rozewie crude (7.84% of total crude oil processed), 65.8 thousand tonnes of SAHARA crude (4.22% of total crude oil processed), and 64.9 thousand tonnes of other types of crude.

In Q4 2009, the LOTOS Group sold 340.3 thousand tonnes of motor gasolines, 1,069.4 thousand tonnes of diesel oil, 106.3 thousand tonnes of light fuel oil, 127.1 thousand tonnes of heavy fuel oil, 61.4 thousand tonnes of jet fuel, 212.3 thousand tonnes of bitumens and 154.6 thousand tonnes of other products (including 48.9 thousand tonnes of reformat, 19.4 thousand tonnes of LPG, 16.7 thousand tonnes of lubricants, 26 thousand tonnes of base oils, 11.8 thousand tonnes of bunker fuel and 31.8 thousand tonnes of other petroleum products).

In Q4 2009, total retail sales volume in CODO and DOFO stations reached 157 thousand tonnes, up by 18.2% on Q4 2008 and down by 5.0% on Q3 2009.

Compared with the end of Q3 2009, the headcount at the LOTOS Group in Q4 2009 increased by 39 employees, to 4,949.

## **7 DISCUSSION OF CONSOLIDATED RESULTS OF THE LOTOS GROUP**

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### **7.1 Consolidated Statement of Comprehensive Income**

In Q4 2009, sales revenue of the LOTOS Group was PLN 4,024.0m, i.e. PLN 272.9m up on Q4 2008, mainly due to the rising prices of crude oil and petroleum products on the global markets as compared with the prices in Q4 2008. In Q4 2009, the average price of Brent crude (Dated Brent) was 74.53 USD/bbl, which represented a year-on-year increase of 34.4%. The average net selling price grew by 4.2%, from PLN 1,865 per tonne in Q4 2008 to PLN 1,943 per tonne in Q4 2009.

The Q4 2009 sales volume of the LOTOS Group was 2,071.4 thousand tonnes, which represented a year-on-year increase of 59.8 thousand tonnes (3.0%). Relative to the Q4 2008 sales volume of 2,011.6 thousand tonnes, the analysed quarter saw an improvement in the sales volumes in the following products: diesel oil (up by 168.4 thousand tonnes), reformat (up by 12.4 thousand tonnes), gasolines (up by 10.8 thousand tonnes), bitumens (up by 2.6 thousand tonnes), lubricants (up by 0.8 thousand tonnes) and other oil products (up by 5.3 thousand tonnes), which was accompanied by falling sales volumes of: JET A-1 fuel (down by 65.2 thousand), bunker oil (down by 35.0 thousand tonnes), heavy fuel oils (down by 24.9 thousand tonnes), liquefied gases (down by 10.4 thousand tonnes), light fuel oils (down by 4.4 thousand tonnes) and base oils (down by 0.6 thousand tonnes).

Year on year, in Q4 2009 consolidated cost of sales went down by PLN 466.2m (or 11.5%) and amounted to PLN 3,604.8m. In the reporting period, unit cost of sales was PLN 1,740 per tonne, i.e. 14.0% less than in Q4 2008.

In Q4 2009 the LOTOS Group generated a gross profit of PLN 419.2m, as compared with a loss of PLN 739.1m in the corresponding period of 2008.

The weighted average method used by the LOTOS Group to measure decrease in inventories improved its operating profit in Q4 2009 by PLN 81.8m. In Q4 2008, the weighted average method used to measure decrease in inventories reduced the gross result figure by PLN 893.3m.

Selling costs incurred by the LOTOS Group in Q4 2009 amounted to PLN 204.2m, and were comparable to selling costs in Q4 2008. In Q4 2009, the average selling cost per tonne of products sold was PLN 99, down by 2.4% year on year, primarily due to the decrease in the USD/PLN exchange rate. General and administrative expenses reached PLN 108.3m, i.e. up by 4.4% year on year, chiefly as a result of scaling up of the Group's operations, mainly in the production area.

In Q4 2009, the LOTOS Group reported a PLN 20.5m loss on other operating activities, mainly due to PLN 24.6m impairment charges for exploration and evaluation assets in the upstream segment.

Despite the unfavourable macroeconomic developments related to the low refining margin and Brent/Ural differential, in Q4 2009 the LOTOS Group reported an operating profit of PLN 86.2m.

In Q4 2009, the Group reported a profit of PLN 151.4m on financing activities, an improvement of PLN 609.2m on the loss on financing activities recorded in Q4 2008. The profit in Q4 2009 resulted chiefly from foreign exchange gains on revaluation of loans and borrowings, amounting to PLN 52.6m, other foreign exchange gains of PLN 89.6m, as well as release of the provision for Energobaltic Sp. z o.o. and reversal of the impairment charge for financial assets in Energobaltic Sp. z o.o. by the Petrobaltic Group, in the total amount of PLN 55.4m. Furthermore, in connection with the acquisition by Petrobaltic S.A. of shares in Energobaltic Sp. z o.o., the fair-value of the Energobaltic Sp. z o.o. equity interest previously held by the acquirer of PLN 6.7m was posted to finance income.

The balance of finance income and expenses in Q4 2009 related to the valuation and settlement of market risk hedging transactions was negative at -PLN 21.8m.

The total net gain on settlement of hedging instruments in Q4 2009 posted under finance income was PLN 86.3m, and included settlement of foreign exchange risk hedging transactions (forwards) of PLN 87.1m, settlement of refining margin hedging transactions (full barrel swaps) of PLN 4.5m, settlement of futures contracts executed to hedge the prices of CO<sub>2</sub> emission allowances of -PLN 1.2m and settlement of FRA transactions executed to hedge the interest rate risk of -PLN 4.1m.

In Q4 2009, open (not settled) forward and futures contracts totalled -PLN 108.1m, including foreign exchange risk hedging transactions (forwards) with a value of -PLN 90.5m, transactions executed to hedge the interest rate risk (FRA, IRS) amounting to -PLN 22.7m, refining margin hedging transactions (full barrel swaps) with a value of -PLN 2.6m, and futures contracts executed to hedge the prices of CO<sub>2</sub> emission allowances with a value of PLN 2.5m.

The tables below present detailed information on open hedging transactions.

Table 1. Foreign exchange risk hedging transactions as at December 31st 2009

Currency pair	Instrument	Volume	Currency	FX rate range
EUR/USD	Forward	156,300,000	EUR	1.4250 - 1.4420
EUR/PLN	Forward	45,900,000	EUR	4.1546 - 4.2052
USD/PLN	Forward	-59,000,000	USD	2.7610 - 3.2566

Table 2. Interest rate risk hedging transactions as at December 31st 2009

Instrument	Start date	Expiry date	Nominal value	Currency	Interest rate range	Reference rate
IRS	from Oct 15 2008 to Jul 15 2011	from Jun 30 2011 to Jan 15 2018	1,280,000,000	USD	3.33% -4.33%	6M LIBOR

In Q4 2009, net profit from continuing operations amounted to PLN 225.3m, compared with a net loss from continuing operations of PLN 867.8m reported in Q4 2008. Net profit attributable to owners of the parent reached PLN 223.6m.

## 7.2 Consolidated Statement of Financial Position

As at December 31st 2009, the LOTOS Group's total assets stood at PLN 15,034.7m, which means a PLN 2,832.7m increase in 2009. In 2009, non-current assets increased by PLN 2,801.2m while current assets rose by PLN 35.1m. In the twelve months of 2009, property, plant and equipment increased by PLN 3,786.0m, chiefly due to higher tangible assets under construction in connection with the implementation of the 10+ Programme at the Parent Undertaking, the expenditure and evaluation assets related to the development of the YME field in the North Sea and the first-time consolidation of Energobaltic Sp. z o.o. Non-current financial assets also increased by PLN 75.1m (following from, among other things, recognition of the non-current portion of gain on revaluation of financial instruments and changes in the shareholder structure of AB Geonafta), intangible assets by PLN 34.8m, goodwill by PLN 9.3m (due to initial recognition of the acquisition by Petrobaltic S.A. of the remaining 49.08% share in

Energobaltic Sp. z o.o.) and non-current receivables by PLN 11.6m. Over the same period, prepayments for tangible assets under construction decreased by PLN 1,047.2m (mainly in connection with the progress of work related to the 10+ Programme), deferred tax assets dropped by PLN 58.8m, prepayments and accrued income fell by PLN 8.5m, while investment property shrank by PLN 1.1m. In the discussed period, inventories also increased by PLN 576.9m, reflecting higher prices of crude oil and petroleum products as at the end of Q4 2009 relative to the prices as at the end of 2008, as well as the increase in mandatory stocks that the Company is required to maintain under relevant laws. Following the rise in product prices in the twelve months of 2009, trade and other receivables increased by PLN 175.3m. Over the same period, current financial assets fell by PLN 272.3m, while income tax receivable decreased by PLN 73.4m, mainly at the Parent Undertaking. PLN 350.6m decrease in cash and cash equivalents is principally attributable to the capital expenditure incurred. As at the end of 2009, current financial assets amounted to PLN 56.5m, and mostly included hedging transactions.

The share of non-current assets in total assets increased from 58.1% in 2008 to 65.8% as at the end of 2009.

As at December 31st 2009, equity stood at PLN 6,713.5m, having increased by PLN 913.4m in 2009. This higher value was the effect of a PLN 906.3m increase in retained earnings, a PLN 340.4m increase in statutory reserve funds and a PLN 16.2m increase in share capital, following from a share capital increase at Grupa LOTOS S.A., and a PLN 9.6m increase in translation of foreign operations. Over the same period, non-controlling interests decreased by PLN 359.1m as a result of accounting for the acquisition of 30.32% of shares in Petrobaltic S.A., 5% of shares in LOTOS Czechowice S.A. and 5% of shares in LOTOS Jasło S.A. from non-controlling interests.

In 2009, non-current liabilities increased by PLN 1,795.8m, mainly owing to a PLN 1,518.1m increase in non-current loans and borrowings, primarily in connection with the 10+ Programme, and a PLN 262.0m increase in other financing liabilities, predominantly in connection with the recognition of the non-current portion of loss on revaluation of financial instruments. As at the end of 2009, non-current liabilities totalled PLN 5,496.4m, including interest-bearing loans and borrowings of PLN 4,930.4m.

As at the end of December 2009, current liabilities totalled PLN 2,824.9m, having increased by PLN 123.5m in the twelve months of 2009, primarily due to a PLN 259.3m increase in current loans and borrowings, mainly at the Parent Undertaking and at the Petrobaltic Group. As at December 31st 2009, the LOTOS Group's current interest-bearing loans and borrowings stood at PLN 766.6m. As at the end of 2009, other current financial liabilities amounted to PLN 102.6m and related to, among other things, negative valuation of financial instruments.

The share of equity in total equity and liabilities decreased from 47.5% as at the end of 2008 to 44.7% as at the end of 2009. The share of non-current liabilities increased by 6.2 percentage points.

### **7.3 Consolidated Statement of Cash Flows**

As at the end of 2009, the cash balance recorded by the LOTOS Group was -PLN 148.5m, having decreased by PLN 486.8m relative to the end of 2008.

In Q4 2009, net cash from operating activities was PLN 43.0m, having decreased by PLN 246.2m relative to Q4 2008. The items which increased cash from operating activities in Q4 2009 included mainly net profit of PLN 225.3m, a PLN 170.2m decrease in receivables, a PLN 112.6m adjustment relating to a loss on investment activities, depreciation and amortisation charges of PLN 80.5m, and interest and profit distributions of PLN 32.3m. The key factors which eroded operating cash flows in Q4

2009 included: a PLN 120.5m decrease in liabilities and accruals and deferred income, a PLN 115.7m increase in inventories, a negative balance of current tax for the period and the tax paid of -PLN 108.7m, adjustment relating to foreign exchange gains of PLN 108.7m, adjustments resulting from settlement of financial instruments of PLN 86.9m, a PLN 33.2m decrease in provisions, and a PLN 4.2m increase in prepayments and accrued income.

In Q4 2009, net cash from investing activities amounted to -PLN 543.7m and was PLN 407.8m higher than in Q4 2008 (-PLN 951.5m). The negative cash flows in Q4 2009 were mainly related to the excess of outflows over inflows relating to property, plant and equipment and intangible assets, and to outflows on prepayments for tangible assets under construction in a total amount of PLN 542.9m.

In Q4 2009, the LOTOS Group disclosed net cash from financing activities of PLN 333.7m, which was lower by PLN 529.7m relative to Q4 2008. The difference in Q4 2009 was mainly attributable to lower (by PLN 922.7m) cash inflows under contracted loans and borrowings, and higher (by PLN 446.4m) adjustments resulting from settlement of financial instruments relative to Q4 2008. In Q4 2009, cash inflows under contracted loans and borrowings amounted to PLN 343.3m. In Q4 2009, outflow related to payment of interest and repayment of loans totalled PLN 93.8m, having risen by PLN 50.8m from the corresponding period of 2008.

## **8 Operating Result by Business Segments**

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The Group's operating activity comprises two main reportable operating segments:

- Upstream segment – comprising activities related to the acquisition of crude oil and natural gas reserves, and crude oil and natural gas production,
- Downstream segment – comprising the production and processing of refined petroleum products and their wholesale and retail sale, as well as auxiliary, transport and service activities.

For a detailed description of the business segments, please see to the Directors' Report on the LOTOS Group's performance in Q1 2009.

The segment performance is computed and presented before the intersegment adjustments.

**Table 3. Q4 2009 operating result by business segments**

PLNm	Upstream		Downstream		Other		Consolidation adjustments		Consolidated	
	Q4 2009	Q4 2008	Q4 2009 (1)	Q4 2008	Q4 2009 (2)	Q4 2008 (3)	Q4 2009	Q4 2008	Q4 2009	Q4 2008
<b>Sales revenue</b>	83	57	4,019	3,698	35	103	-113	-107	4,024	3,751
<i>Intersegment sales</i>	82	56	24	22	7	29	-113	-107	0	0
<i>External sales</i>	1	1	3,995	3,676	28	74	0	0	4,024	3,751
<b>Operating profit</b>	-3	0	100	-726	11	-15	-22	76	86	-665
<i>Amortisation and depreciation</i>	18	11	62	66	1	1	0	0	81	78
<b>EBITDA</b>	15	11	162	-660	12	-14	-22	76	167	-587
<b>Total assets</b>	1,839	1,708	13,645	10,492	128	67	-577	-65	15,035	12,202

(1) Including an organised part of business in the form of LPG Trading Division of LOTOS Gaz, acquired by LOTOS Paliwa Sp. z o.o. from LOTOS Gaz S.A. (see Note 15 to the interim condensed consolidated financial statements).

(2) Includes: LOTOS Ekoenergia S.A., LOTOS Park Technologiczny Sp. z o.o., LOTOS Gaz S.A., Energobaltic Sp. z o.o. (from the date of acquiring control by Petrobaltic S.A., see Note 15 to the interim condensed consolidated financial statements).

(3) Includes: LOTOS Ekoenergia S.A., LOTOS Park Technologiczny Sp. z o.o. and the LOTOS Gaz Group.

Source: Grupa LOTOS S.A.

**Table 4. Q1–Q4 2009 operating result by business segments**

PLNm	Upstream		Downstream		Other		Consolidation adjustments		Consolidated	
	Q1-Q4 2009	Q1-Q4 2008	Q1-Q4 2009 (1)	Q1-Q4 2008	Q1-Q4 2009 (2)	Q1-Q4 2008 (3)	Q1-Q4 2009	Q1-Q4 2008	Q1-Q4 2009	Q1-Q4 2008
<b>Sales revenue</b>	235	382	14,231	16,086	256	470	-401	-643	14,321	16,295
<i>Intersegment sales</i>	229	376	120	162	52	105	-401	-643	0	0
<i>External sales</i>	6	6	14,111	15,924	204	365	0	0	14,321	16,295
<b>Operating profit</b>	-4	165	482	-312	-32	-22	-22	23	424	-146
<i>Amortisation and depreciation</i>	53	49	245	264	2	2	-0	0	300	315
<b>EBITDA</b>	49	214	727	-48	-30	-20	-22	23	724	169
<b>Total assets</b>	1,839	1,708	13,645	10,492	128	67	-577	-65	15,035	12,202

(1) Including an organised part of business in the form of LPG Trading Division of LOTOS Gaz, acquired by LOTOS Paliwa Sp. z o.o. from LOTOS Gaz S.A. (see Note 15 to the interim condensed consolidated financial statements).

(2) Includes: LOTOS Ekoenergia S.A., LOTOS Park Technologiczny Sp. z o.o., the LOTOS Gaz Group (until the date of the loss of control over subsidiary KRAK-GAZ Sp. z o.o., see Note 15 to the interim condensed consolidated financial statements), Energobaltic Sp. z o.o. (from the date of acquiring control by Petrobaltic S.A., see Note 15 to the interim condensed consolidated financial statements).

(3) Includes: LOTOS Ekoenergia S.A., LOTOS Park Technologiczny Sp. z o.o. and the LOTOS Gaz Group.

Source: Grupa LOTOS S.A.

## 8.1 Upstream Segment

The Q4 2009 revenue of the upstream segment was PLN 83m (up by 46% year on year). The operating profit amounted to -PLN 3m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) were PLN 15m. In the corresponding period of 2008, EBITDA was PLN 11m.

Higher revenue generated by the upstream segment in Q4 2009 was driven by the following factors: a 34% increase in Brent dtd prices for crude oil on the global markets and a 39% increase in the volume of crude oil sales. The Q4 2009 operating profit of the upstream segment was adversely affected by the recognition of PLN 25m impairment charges for exploration and evaluation assets (mainly in connection with the fact that the drilling of a well on the B22 deposit failed to confirm the presence of crude oil) and also by the fact that the operations of LOTOS E&P Norge focused on management matters and generated general and administrative expenses, while the company reported no operating income.

## 8.2 Downstream Segment

In Q4 2009, the downstream segment generated sales revenue of PLN 4,019m (up by 9% over the corresponding period of 2008), operating profit of PLN 100m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) of PLN 162m. In the corresponding period of 2008, the downstream segment recorded operating loss of -PLN 726m and its EBITDA amounted to -PLN 660m.

The use of the weighted average method to measure decrease in inventories at the LOTOS Group significantly contributed to the improved year-on-year performance of the downstream segment in Q4 2009. The upward trend in global prices for crude oil and petroleum products seen in the discussed quarter also contributed to the positive performance of the segment. In Q4 2008, the operating result was severely affected by the fall of crude oil and petroleum product prices. Factors adverse to the downstream segment included also an 87% fall in the refining margin relative to Q4 2008, and a 64% decline in the Brent/Ural differential.

The downstream segment includes the retail business (a network of CODO service stations as well as petrol stations located along motorways). As at the end of 2009, the number of CODO stations was 144 (up by 2 stations relative to the end of September 2009), the number of DOFO stations was 98 (up by 3 stations), and the number of DODO stations stood at 62 (down by 25 stations). The number of new concluded franchise agreements was 107.

In Q4 2009, in the downstream segment, the retail business recorded sales revenue of PLN 441m, an operating loss of -PLN 5m, and earnings before interest, depreciation, income tax and amortisation (EBITDA) of PLN 6m. In the corresponding period of 2008, the operating loss and EBITDA were -PLN 6m and PLN 3m, respectively. In Q3 2009, the retail business recorded operating profit of PLN 17m.

The operating loss of the retail business is attributable to a falling unit retail margin on fuel sales in the closing months of 2009, and a decreasing volume of fuel sales. The margin per one tonne of fuel sold in December 2009 was 31% lower than the average annual margin. In Q4 2009, the average margin on fuel sales shrank by 32% relative to Q3 2009, and by 9% relative to the corresponding period of 2008. In Q4 2009, CODO and DOFO stations sold 157 thousand tonnes of fuel. In addition, the performance of the retail business was adversely affected by the costs of land lease (approx. PLN 2m in Q4 2009), relating to petrol stations located along motorways which have not yet been launched.

### 8.3 Other Business

In Q4 2009, sales revenue from other business was PLN 35m, the segment's operating profit was PLN 11m, and EBITDA amounted to PLN 12m. In the corresponding period of 2008, the operating profit and EBITDA amounted to -PLN 15m and -PLN 14m, respectively.

### 8.4 Consolidation Adjustments

In Q4 2009, consolidation adjustments on the operating result level were -PLN 22m. The adjustment relating to unrealised margin on the processing of Rozewie crude purchased in intra-group transactions in Q4 2009 was -PLN 13.2m and was attributable to the fact that products of processing of 35 million tonnes of Rozewie oil crude were sold outside the Group, whereas the volume of the crude sold in Q4 2009 to Grupa LOTOS S.A. was 56.5 million tonnes.

## 9 Impact of the LIFO Inventory Valuation

In line with its inventory valuation policies, the LOTOS Group uses the weighted average of the acquisition cost to measure decrease 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 2009 accounting for the estimated impact of using the LIFO method (along with the comparable data for Q4 2008) is presented as item 3.

Table 5. Impact of inventory valuation on operating result

Item	PLNm	Q4 2009	Q4 2008
1. Operating profit		86.2	-665.4
2. Effect of LIFO valuation		-81.8	893.3
3. Operating profit – LIFO method		4.4	227.9

Source: Grupa LOTOS S.A.

In Q4 2009, the impact of inventory valuation drove up the operating result by PLN 81.8m, compared with the decrease of PLN 893.3m in Q4 2008. If the LIFO method had been applied to inventory valuation, the operating result would have been PLN 4.4m for Q4 2009 and PLN 227.9m for Q4 2008.

The assumptions made in calculating the Q4 2009 operating result of the LOTOS Group accounting for the estimated impact of the LIFO method (along with the comparable data for Q4 2008) are described in Current Report No. 29/2006, with a reservation that, starting from 2009, quantitative increases (a difference between the balance at the end of a period and the balance at the beginning of a given period) are measured at unit cost as at the end of the individual quarters of a given year.