



## **THE LOTOS GROUP**

**DIRECTORS' REPORT ON THE OPERATIONS OF THE LOTOS GROUP  
IN THE SIX MONTHS ENDED JUNE 30TH 2010**

*This is a translation of the document originally issued in Polish*

Gdańsk, August 26th 2010

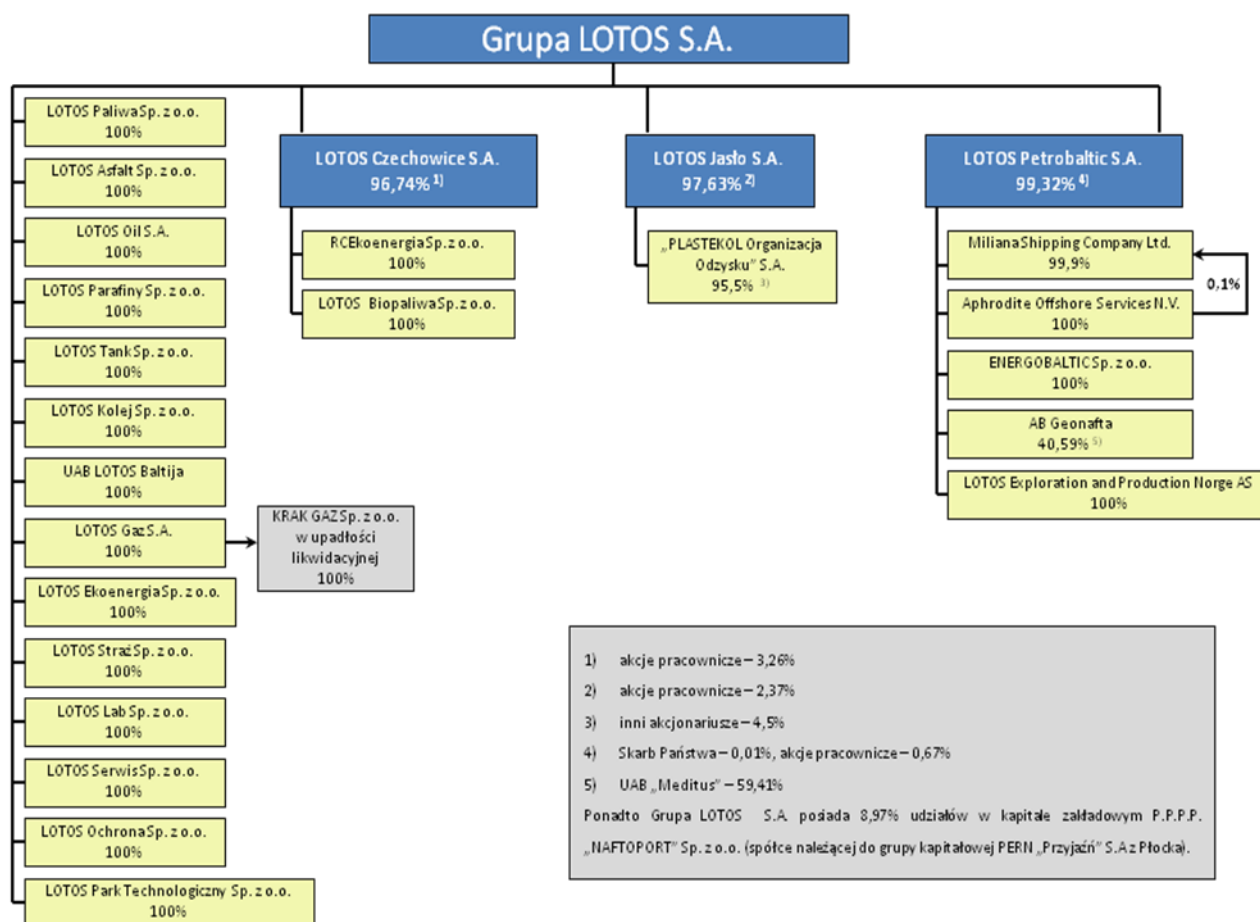
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# 1. BASIC INFORMATION ON THE LOTOS GROUP

## 1.1 ORGANISATION OF THE LOTOS GROUP AND CHANGES IN THE GROUP'S STRUCTURE

STAN NA DZIEŃ: 30.06.2010



Stan na dzień: 30.06.2010	As at June 30th 2010
KRAK GAZ Sp. z o.o. w upadłości likwidacyjnej	KRAK GAZ Sp. z o.o. in bankruptcy by liquidation
1) akcje pracownicze – 3,26%	1) employee shares – 3.26%
2) akcje pracownicze – 2,37%	2) employee shares – 2.37%
3) inni akcjonariusze – 4,5%	3) other shareholders – 4.5%
4) Skarb Państwa – 0,01%, akcje pracownicze – 0,67%	4) State Treasury – 0.01%, employee shares – 0.67%
5) UAB Meditus – 59,41%	5) UAB Meditus – 59.41%
Ponadto Grupa LOTOS S.A. posiada 8.97% udziałów w kapitale zakładowym P.P.P.P. „NAFTOPORT” Sp. z o.o. (spółce należącej do grupy kapitałowej PERN „Przyjaźń” S.A. z Płocka).	In addition, Grupa LOTOS S.A. holds 8.97% of the share capital of P.P.P.P. „NAFTOPORT” Sp. z o.o. (a member of the group whose parent undertaking is PERN „Przyjaźń” S.A. of Płock).

Table1. Members of the LOTOS Group

Name	Registered office	Business profile	Method of consolidation/ valuation of shares	Percentage of share capital held by the Group		
				Jun 30 2010	Dec 31 2009	Jun 30 2009
<b>Parent Undertaking</b>						
<b>Grupa LOTOS S.A.</b>	Gdańsk	Production and processing of refined petroleum products (mainly fuels) and their wholesale	Not applicable	Not applicable	Not applicable	Not applicable
<b>Direct Subsidiary Undertakings</b>						
<b>LOTOS Paliwa Sp. z o.o.</b>	Gdańsk	Wholesale and retail sale of fuels, light fuel oil, management of the LOTOS service station network	full	100,00%	100,00%	100,00%
<b>LOTOS Gaz S.A.<sup>(1)</sup></b>	Mława	Production, wholesale and retail sale of LPG, the company does not conduct operations at the moment	full	100,00%	100,00%	100,00%
<b>LOTOS Oil S.A.</b>	Gdańsk	Production and sale of lubricating oils and lubricants, and domestic sale of base oils	full	100,00%	100,00%	100,00%
<b>LOTOS Asphalt Sp. z o.o.</b>	Gdańsk	Production and sale of bitumens	full	100,00%	100,00%	100,00%
<b>LOTOS Ekoenergia Sp. z o.o.<sup>(2)</sup></b>	Gdańsk	The company has not commenced operations	full	100,00%	100,00%	100,00%
<b>LOTOS Kolej Sp. z o.o.</b>	Gdańsk	Railway transport	full	100,00%	100,00%	100,00%
<b>LOTOS Serwis Sp. z o.o.</b>	Gdańsk	Maintenance of mechanical and electric operations and controlling devices, repairs	full	100,00%	100,00%	100,00%
<b>LOTOS Lab Sp. z o.o.</b>	Gdańsk	Laboratory testing	full	100,00%	100,00%	100,00%
<b>LOTOS Straż Sp. z o.o.</b>	Gdańsk	Fire protection	full	100,00%	100,00%	100,00%
<b>LOTOS Ochrona Sp. z o.o.</b>	Gdańsk	Personal and property protection	full	100,00%	100,00%	100,00%
<b>LOTOS Parafiny Sp. z o.o.</b>	Jasło	Production and sale of paraffin	full	100,00%	100,00%	100,00%
<b>LOTOS Tank Sp. z o.o.</b>	Gdańsk <sup>(3)</sup>	Wholesale of petroleum products	full	100,00%	100,00%	100,00%
<b>LOTOS Czechowice S.A.</b> (parent undertaking of another group)	Czechowice-Dziedzice	Storage and distribution of fuels	full	96.74% <sup>(5)</sup>	85.04% <sup>(4)</sup>	80.04%
<b>LOTOS Jasło S.A.</b> (parent undertaking of another group)	Jasło	Services related to distribution of petroleum products, storage of fuels, building and maintenance of fuel stocks; production and processing of refined petroleum products and their wholesale and retail sale	full	97.63% <sup>(5)</sup>	85.01% <sup>(4)</sup>	80.01%
<b>LOTOS Petrobaltic S.A.<sup>(6)</sup></b> (parent undertaking of another group)	Gdańsk	Acquisition of crude oil and natural gas reserves and their exploitation	full	99.32%	99.32% <sup>(4)</sup>	69.00%

Name	Registered office	Business profile	Method of consolidation/ valuation of shares	Percentage of share capital held by the Group		
				Jun 30 2010	Dec 31 2009	Jun 30 2009
<b>UAB LOTOS Baltija</b>	Lithuania	Wholesale and retail sale of lubricating oils in Lithuania, Belarus, Ukraine and Latvia; from January 2009 – business and legal advisory services	full	100.00%	100.00%	100.00%
<b>LOTOS Park Technologiczny Sp. z o.o.</b>	Jasło	Business and management consultancy services/the company does not conduct operations at the moment	full	100.00% <sup>(7)</sup>	0.29% <sup>(7)</sup>	86.91%
<b>Indirect Subsidiary Undertakings</b>						
<b>RCEkoenergia Sp. z o.o.</b>	Czechowice-Dziedzice	Provision of services	full	96.74% <sup>(9)</sup>	85.04% <sup>(8)</sup>	80.04%
<b>LOTOS Biopaliwa Sp. z o.o.</b>	Czechowice-Dziedzice	Production of fatty acid methyl esters (FAME) <sup>(10)</sup>	full	96.74% <sup>(9)</sup>	85.04% <sup>(8)</sup>	80.04%
<b>RC Serwis Sp. z o.o.</b>	Czechowice-Dziedzice	Provision of services	_(11)	-	_(12)	86.91%
<b>„PLASTEKOL Organizacja Odzysku” S.A.</b>	Jasło	Provision of services	full	93.24% <sup>(9)</sup>	81.18% <sup>(8,13)</sup>	75.21% <sup>(13)</sup>
<b>KRAK - GAZ Sp. z o.o.</b> in bankruptcy by liquidation	Kraków		_(1)			100.00%
<b>Miliana Shipping Company Ltd.</b>	Cyprus	Provision of services	full	99.32%	99.32% <sup>(8)</sup>	68.93%
<b>LOTOS Exploration and Production Norge AS</b>	Stavanger Norway	Oil exploration and production at the Norwegian continental shelf, provision of services related to oil exploration and production; the company commenced operations in November 2007	full	99.32%	99.32% <sup>(8)</sup>	69.00%
<b>Aphrodite Offshore Services Ltd.</b>	Netherlands Antilles	Provision of services	full	99.32%	99.32% <sup>(8)</sup>	69.00%
<b>Energobaltic Sp. z o.o.</b>	Władysławowo <sup>(15)</sup>	Production activities	full <sup>(14)</sup>	99.32%	99.32%	32.16%

<sup>(1)</sup> Until July 23rd 2009 LOTOS Gaz S.A. controlled KRAK-GAZ Sp. z o.o., a subsidiary. On April 30th 2009, KRAK-GAZ Sp. z o.o. filed a bankruptcy petition with the District Court for Kraków Śródmieście, VIII Commercial Division for Bankruptcy and Recovery. On July 23rd 2009, the District Court for Kraków Śródmieście, VIII Commercial Division for Bankruptcy and Recovery resolved to declare KRAK-GAZ Sp. z o.o.'s bankruptcy by liquidation of the company's assets.

<sup>(2)</sup> On May 6th 2010, a change in the company's legal form (from a joint stock company to a limited liability company) was registered. Currently the company operates under the name LOTOS Ekoenergia Sp. z o.o.

<sup>(3)</sup> On August 12th 2009, the registered office of LOTOS Tank Sp. z o.o. was relocated from Jasło to Gdańsk.

<sup>(4)</sup> On July 9th 2009, an agreement was signed providing for the acquisition by the State Treasury of Grupa LOTOS S.A. shares. In exchange, the State Treasury made non-cash contributions to Grupa LOTOS S.A. in the form of 30.32% of shares in LOTOS Petrobaltic S.A., 5% of shares in LOTOS Czechowice S.A. and 5% of shares in LOTOS Jasło S.A.

<sup>(5)</sup> By June 30th 2010, Grupa LOTOS S.A. acquired from non-controlling interests an additional 11.70% of shares in LOTOS Czechowice S.A. and 12.62% of shares in LOTOS Jasło S.A. (see Note 15 to the interim condensed consolidated financial statements).

<sup>(6)</sup> On March 31st 2010, change in the name of Przedsiębiorstwo Poszukiwań i Eksploatacji Złóż Ropy i Gazu Petrobaltic Spółka Akcyjna to LOTOS Petrobaltic Spółka Akcyjna (abbreviated name: LOTOS Petrobaltic S.A.) was entered in the National Court Register.

<sup>(7)</sup> On November 20th 2009, the then-shareholders of LOTOS Park Technologiczny Sp. z o.o. sold their shares to LOTOS Park Technologiczny Sp. z o.o.:

- Grupa LOTOS S.A. – 9,400 shares out of the total of 9,500 shares held,
- LOTOS Czechowice S.A. – the entire stake of 12,314 shares,
- LOTOS Jasło S.A. – the entire stake of 9,866 shares,
- LOTOS Serwis Sp. z o.o. – the entire stake of 2,834 shares,
- Partner Holding Management Sp. z o.o. - the entire stake of 100 shares.

LOTOS Park Technologiczny Sp. z o.o. acquired its own shares with a view to their voluntary retirement by way of reduction of the share capital. Following the transaction, the shareholder structure of LOTOS Park Technologiczny Sp. z o.o. was as follows:

- LOTOS Park Technologiczny Sp. z o.o. – 99.71%,
- Grupa LOTOS S.A. – 0.29%.

Grupa LOTOS S.A. retained control over LOTOS Park Technologiczny Sp. z o.o. given the GM powers vested in Grupa LOTOS S.A. as the only shareholder. On March 31st 2010, reduction in the share capital of LOTOS Park Technologiczny Sp. z o.o. to PLN 50 thousand was registered. The share capital of LOTOS Park Technologiczny Sp. z o.o. is divided into 100 shares. Following registration of the changes in the National Court Register, Grupa LOTOS S.A. holds a 100% stake in LOTOS Park Technologiczny Sp. z o.o.

<sup>(8)</sup> The shareholding changes described in item (4) above led to changes in the Group's indirect interests in the share capitals of the subsidiaries of Petrobaltic S.A. (currently LOTOS Petrobaltic S.A.), LOTOS Czechowice S.A. and LOTOS Jaslo S.A.

<sup>(9)</sup> The shareholding changes described in item (5) above led to changes in the Group's indirect interests in the share capitals of the subsidiaries of LOTOS Czechowice S.A. and LOTOS Jaslo S.A.

<sup>(10)</sup> On March 1st 2009, LOTOS Biopaliwa Sp. z o.o. commenced operations.

<sup>(11)</sup> Shares contributed to LOTOS Park Technologiczny Sp. z o.o. by the LOTOS Czechowice Group on January 2nd 2006.

<sup>(12)</sup> On November 6th 2009, LOTOS Park Technologiczny Sp. z o.o. sold 100% of shares in RC Serwis Sp. z o.o. to a third party for PLN 1,800 thousand. As a result of this transaction, the Group realised a gain of PLN 688 thousand.

<sup>(13)</sup> In May – June 2008 and January – December 2009, LOTOS Jaslo S.A. acquired shares in PLASTEKOL Organizacja Odzysku S.A. As a result of the executed transactions, LOTOS Jaslo S.A.'s share in the share capital of PLASTEKOL Organizacja Odzysku S.A. increased to 95.5%.

<sup>(14)</sup> On November 27th 2009, Petrobaltic S.A. acquired control over Energobaltic Sp. z o.o..

<sup>(15)</sup> The relocation of Energobaltic Sp. z o.o.'s registered office from Gdańsk to Władysławowo was registered on January 25th 2010.

Other than the changes listed below and discussed at greater length in Note 15 to the interim condensed consolidated financial statements for the six months ended June 30th 2010, in the reporting period there were no material changes in the structure of the LOTOS Group.

### **Change in the Number of Grupa LOTOS S.A. Shares Held by the State Treasury**

On January 22nd 2010, the State Treasury sold in block transactions an aggregate of 14,000,000 ordinary bearer shares in Grupa LOTOS S.A., representing 10.78% of Grupa LOTOS S.A.'s share capital. Following this transaction, the State Treasury holds in aggregate 69,076,392 ordinary bearer shares in Grupa LOTOS S.A., representing in aggregate 53.19% of the share capital of Grupa LOTOS S.A.

### **Introduction to Stock-Exchange Trading of Grupa LOTOS S.A. Series A Shares; Assimilation of Grupa LOTOS S.A. Shares by the Polish NDS**

On January 19th 2010, the National Depository for Securities decided to assimilate 57,987,030 ordinary bearer shares in Grupa LOTOS S.A., created through a conversion of 57,987,030 ordinary registered shares (code No. PLLOTOS00033) with 55,635,609 ordinary bearer shares in Grupa LOTOS S.A. (code No. PLLOTOS00025).

On April 12th 2010, the National Depository for Securities decided to assimilate 8,250 ordinary bearer shares in Grupa LOTOS S.A., created through a conversion of 8,250 ordinary registered shares (code No. PLLOTOS00033), with 113,622,639 ordinary bearer shares in Grupa LOTOS S.A. (code No. PLLOTOS00025).

Since April 12th 2010, shares in Grupa LOTOS S.A. have been marked as follows:

- 113,630,889 shares have been marked with code No. PLLOTOS00025, and
- 69,111 shares have been marked with code No. PLLOTOS00033.

### **Registration of Reduction in the Share Capital of LOTOS Park Technologiczny Sp. z o.o.**

On March 31st 2010, reduction in the share capital of LOTOS Park Technologiczny Sp. z o.o. to PLN 50 thousand was registered. The share capital of LOTOS Park Technologiczny Sp. z o.o. is divided into 100 shares. Following registration of the changes in the National Court Register, Grupa LOTOS S.A. holds a 100% stake in LOTOS Park Technologiczny Sp. z o.o.

### **Acquisition of LOTOS Jasło S.A. Shares**

On February 4th 2010, Grupa LOTOS S.A. made an offer to purchase LOTOS Jasło S.A. shares. The offer was addressed only to the following persons: employees and former employees of LOTOS Jasło S.A. who acquired the shares free of charge under the Act on Commercialisation and Privatisation of State-Owned Enterprises, dated August 30th 1996, as well as their heirs and members of their immediate family who acquired the shares through donation directly from such persons. The offer was valid until March 22nd 2010. The purchase price offered for the shares was PLN 4.90 per share in the period from February 8th 2010 to March 8th 2010, and PLN 4.23 per share in the period from March 9th 2010 to March 22nd 2010. As at the date of approval of this Directors' Report, the purchase procedure, which commenced on March 9th 2010, has not been completed.

### **Acquisition of LOTOS Czechowice S.A. Shares**

On February 4th 2010, Grupa LOTOS S.A. made an offer to purchase LOTOS Czechowice S.A. shares. The offer was addressed only to the following persons: employees and former employees of LOTOS Czechowice S.A. who acquired the shares free of charge under the Act on Commercialisation and Privatisation of State-Owned Enterprises, dated August 30th 1996, as well as their heirs and members of their immediate family who acquired the shares through donation directly from such persons. The offer was valid until March 22nd 2010. The purchase price offered for the shares was PLN 7.98 per share in the period from February 8th 2010 to March 8th 2010, and PLN 6.89 per share in the period from March 9th 2010 to March 22nd 2010. As at the date of approval of this Directors' Report, the purchase procedure, which commenced on March 9th 2010, has not been completed.

### **Share Capital Increase at LOTOS Gaz S.A.**

On December 14th 2009, an Extraordinary General Shareholders Meeting of LOTOS Gaz S.A. was held, during which the share capital of LOTOS Gaz S.A. was increased from PLN 3,680 thousand to PLN 10,080 thousand, i.e. by PLN 6,400 thousand, by way of raising the par value of the existing 160,000 shares from PLN 23 to PLN 63 per share. The share capital increase at LOTOS Gaz S.A.'s was not registered, and the payment in the amount of PLN 6,400 thousand made by the Company in connection with the increase was returned.

### **Change in the Legal Form of LOTOS Ekoenergia Sp. z o.o.**

On May 6th 2010, a change in the company's legal form from a joint stock company to a limited liability company was registered. Currently the company operates under the name LOTOS Ekoenergia Sp. z o.o.

## 1.2 SHAREHOLDERS HOLDING OVER 5% OF THE TOTAL VOTE AT THE GENERAL SHAREHOLDERS MEETING OF GRUPA LOTOS S.A. AS AT JUNE 30TH 2010

Table 2. Shareholder structure of Grupa LOTOS S.A.

Shareholder	Number of shares	Number of votes	Par value of shares	% of the share capital
State Treasury	69,076,392	69,076,392	69,076,392	53.19%
ING OFE	6,524,479	6,524,479	6,524,479	5.02%
Other shareholders	54,272,491	54,272,491	54,272,491	41.79%
<b>Total</b>	<b>129,873,362</b>	<b>129,873,362</b>	<b>129,873,362</b>	<b>100.00%</b>

To the best of the Company's knowledge, the entities listed above held shares in Grupa LOTOS S.A. as at June 30th 2010 and as at the date of publication of this Directors' Report.

## 1.3 GRUPA LOTOS S.A. SHARES HELD BY THE MANAGEMENT AND SUPERVISORY PERSONNEL

Table 3. Grupa LOTOS S.A. shares

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

To the best of the Company's knowledge, the persons listed above held shares in Grupa LOTOS S.A. as at June 30th 2010 and as at the date of publication of this Directors' Report.

## 1.4 HUMAN RESOURCES

### Changes in the Composition of the Management and Supervisory Boards

In the period from January 1st 2010 until the date of approval of this Directors' Report, the composition of the Management Board of Grupa LOTOS S.A. was as follows:

Paweł Olechnowicz – President of the Management Board, Chief Executive Officer,

Mariusz Machajewski – Vice-President of the Management Board, Chief Financial Officer,

Marek Sokółowski – Vice-President of the Management Board, Chief Operation Officer,

Maciej Szozda – Vice-President of the Management Board, Chief Commercial Officer.



As at January 1st 2010, the composition of the Supervisory Board of Grupa LOTOS S.A. was as follows:

Wiesław Skwarko – Chairman of the Supervisory Board,  
Leszek Starosta – Deputy Chairman of the Supervisory Board,  
Mariusz Obszyński – Secretary of the Supervisory Board,  
Radosław Barszcz – Member of the Supervisory Board,  
Małgorzata Hirszel – Member of the Supervisory Board,  
Jan Stefanowicz – Member of the Supervisory Board,  
Ireneusz Fąfara – Member of the Supervisory Board.

On February 11th 2010, the Extraordinary General Shareholders Meeting of Grupa LOTOS S.A. adopted a resolution to remove Messrs Mariusz Obszyński, Radosław Barszcz and Jan Stefanowicz from their positions on the Supervisory Board of Grupa LOTOS S.A.

Next, Messrs Oskar Pawłowski, Michał Rumiński and Rafał Wardziński were appointed as members of the Supervisory Board of the seventh term of office.

On March 29th 2010, the Company received a resignation by Mr Ireneusz Fąfara, Member of the Supervisory Board of Grupa LOTOS S.A., from his position as Member of the Company's Supervisory Board.

On June 28th 2010, the following persons were appointed to the Supervisory Board of Grupa LOTOS S.A. of the seventh term of office: Ms Ewa Sibrecht-Ośka and Mr Rafał Lorek – as Independent Member of the Supervisory Board.

As at June 30th 2010 and as at the date of approval of this Directors' Report, the composition of the Supervisory Board of Grupa LOTOS S.A. was as follows:

Wiesław Skwarko – Chairman of the Supervisory Board,  
Leszek Starosta – Deputy Chairman of the Supervisory Board,  
Oskar Pawłowski – Secretary of the Supervisory Board,  
Małgorzata Hirszel – Member of the Supervisory Board,  
Michał Rumiński – Member of the Supervisory Board,  
Rafał Wardziński – Member of the Supervisory Board,  
Ewa Sibrecht-Ośka – Member of the Supervisory Board,  
Rafał Lorek – Independent Member of the Supervisory Board.

## Staffing levels at the LOTOS Group as at June 30th 2010

Table 4. Employment structure by job category – Grupa LOTOS S.A.

	Men	Women	Total
blue-collar jobs	511	5	516
white-collar jobs	404	396	800
<b>Total:</b>	<b>915</b>	<b>401</b>	<b>1,316</b>

**Table 5. Employment structure by job category – the LOTOS Group**

	Men	Women	Total
blue-collar jobs	2,452	239	2,691
white-collar jobs	1,398	925	2,323
<b>Total:</b>	<b>3,850</b>	<b>1,164</b>	<b>5,014</b>

**Table 6. Employment structure – the LOTOS Group companies**

Company	Employment as at Jun 30 2010	
	blue-collar jobs	white-collar jobs
Grupa LOTOS S.A	516	800
LOTOS Paliwa Sp. z o.o.	0	264
LOTOS Kolej Sp. z o.o.	397	137
LOTOS Oil S.A.	139	201
LOTOS Lab Sp. z o.o.	109	40
LOTOS Serwis Sp. z o.o.	543	178
LOTOS Straż Sp. z o.o.	74	13
LOTOS Asfalt Sp. z o.o.	146	147
LOTOS Gaz S.A.	1	7
LOTOS Ochrona Sp. z o.o.	148	25
UAB LOTOS Baltija	0	7
LOTOS Park Technologiczny Sp. z o.o.	0	1
LOTOS Parafiny Sp. z o.o.	185	87
LOTOS Tank Sp. z o.o.	6	10
LOTOS Jasło S.A.	60	50
PLASTEKOL Organizacja Odzysku S.A.	1	3
LOTOS Czechowice S.A.	83	56
RC Ekoenergia Sp. z o.o.	44	26
LOTOS Biopaliwa Sp. z o.o.	21	13
LOTOS Petrobaltic S.A.	197	231
Energobaltic Sp. z o.o.	21	13
LOTOS E&P Norge AS	0	14
<b>Total</b>	<b>2,691</b>	<b>2,323</b>
		<b>5,014</b>

## 2. FINANCIAL PERFORMANCE OF THE LOTOS GROUP

### 2.1 FACTORS WITH A BEARING ON THE RESULTS ACHIEVED IN THE FIRST HALF OF 2010

Table 7. Macroeconomic conditions

		H1 2010	H1 2009	H1 2010 vs. H1 2009
DATED Brent FOB prices	USD/bbl	77.29	51.68	49.6%
Ural CIF Rotterdam prices	USD/bbl	76.10	50.94	49.4%
Brent/Ural differential	USD/bbl	1.18	0.74	59.5%
Refining margin	USD/bbl	3.31	3.97	-16.6%
Crack margin: Gasoline	USD/t	152.25	117.46	29.6%
Crack margin: Diesel oil (10 ppm)	USD/t	85.61	86.99	-1.6%
Crack margin: Light fuel oil	USD/t	69.29	65.17	6.3%
Crack margin: Aviation fuel	USD/t	116.45	103.57	12.4%
Crack margin: Heavy fuel oil	USD/t	-148.69	-118.00	-26.0%
Average quarterly PLN/USD exchange rate	PLN/USD	3.02	3.36	-10.1%

#### Upstream Segment

The upstream segment's higher revenue and results for H1 2010 compared with H1 2009 were attributable to 49.6% higher Brent dtd crude prices on the global markets and 43.8% higher volumes of Rozewie crude sold.

The upstream segment's operating result for the first six months of 2010 accounts for the effect of recognition of PLN 20.8m of impairment losses on the assets connected with the operations of LOTOS E&P Norge and the general and administrative expenses incurred by this company while no operating revenue was generated. In connection with the tax regulations effective in Norway, 78% of the impairment losses on the exploration assets (cost of drillings) decreased the company's loss at the net earnings level.

Table 8. Operating result of the upstream segment

		H1 2010	H1 2009	H1 2010 vs. H1 2009
Sales of Rozewie crude	000' t	138.6	96.4	43.8%
Sales of natural gas	m m <sup>3</sup>	6.0	3.1	93.5%
Sales revenue	PLN m	227.6	109.0	108.8%
Operating profit	PLN m	74.5	-5.3	-
Amortisation and depreciation	PLN m	31.0	22.9	35.4%
EBITDA	PLN m	105.5	17.6	499.4%

**Table 9. Operating data of the upstream segment**

		H1 2010	H1 2009	H1 2010 vs. H1 2009
<b>Crude oil output</b>	<b>000' t</b>	<b>114.9</b>	<b>71.1</b>	<b>61.6%</b>
from B3 field	000' t	83.9	68.1	23.2%
from B8 field	000' t	31.0	3.0	933.3%
<b>Natural gas output</b>	<b>m m<sup>3</sup></b>	<b>12.9</b>	<b>8.0</b>	<b>61.3%</b>

## Downstream Segment

The increase in the volume of processed crude oil in the current period is connected with the use of the CDU/VDU installation which has been constructed as part of the 10+ Programme. Additionally, crude processing in the corresponding period of 2009 was lower than on average, due the 33-day overhaul stoppage at Grupa LOTOS S.A.'s refinery in late Q1 and early Q2 2009.

**Table 10. Structure of crude oil refining**

		H1 2010	H1 2009	H1 2010 vs. H1 2009
Volume of crude processed by the Gdańsk refinery	000' t	3,675.6	2,388.7	53.9%
including:				
Ural crude	000' t	3,362.1	2,208.5	52.2%
Rozewie crude	000' t	127.0	35.9	253.8%
Other types of crude	000' t	186.5	144.3	29.2%

The 39.4% higher sales revenue generated by the downstream segment in H1 2010 relative to H1 2009 was mostly due to the year-on-year increase in prices of crude oil and petroleum products on the global markets and a 15.3% higher sales volume.

In H1 2010, the year-on-year increase in the operating result of the downstream segment was strongly driven by a 525.8 thousand tonnes higher volume of products and goods sold, among other factors connected with a 53.9% increase in the volume of crude processed by the Gdańsk refinery.

The changes in crack margins on the particular refined products, and especially the high increase of the margin on gasolines in Q1 2010 and the increase of the margin on the medium fractions in Q2 2010 relative to the corresponding periods of the previous year had a positive effect on the operating result for H1 2010 relative to the same period of 2009. Also the average Brent/Ural differential, which amounted to 1.18 USD/bbl in H1 2010 (up by 0.44 USD/bbl year-on-year) was a factor contributing to the improved operating result in H1 2010 relative to H1 2009.

As a result of significant movements in exchange rates, currency exchange differences had a negative effect on the operating result of the downstream segment. At the Parent Undertaking,

currency exchange differences from operating activities (connected mainly with the crude oil payments cycle) amounted to -PLN 238.6m for H1 2010. In H1 2009, foreign exchange losses from operating activities stood at -PLN 105.0m.

**Table 11. Operating result of the downstream segment**

		H1 2010	H1 2009	H1 2010 vs. H1 2009
Sales revenue	PLN m	8,666.6	6,215.2	39.4%
Operating profit	PLN m	242.8	164.4	47.7%
Depreciation/Amortisation	PLN m	135.7	107.3	26.5%
EBITDA	PLN m	378.5	271.7	39.3%

**Table 12. Structure of sales generated by the LOTOS Group**

		H1 2010	H1 2009	H1 2010 vs. H1 2009
Consolidated sales of products and goods for resale, including:	000' t	3,973.7	3,445.7	15.3%
Gasoline	000' t	702.8	620.5	13.3%
Diesel oil	000' t	1,852.7	1,646.2	12.5%
JET aviation fuel	000' t	136.1	187.3	-27.3%
Light fuel oil	000' t	156.6	163.4	-4.2%
Heavy fuel oil	000' t	547.7	273.6	100.2%
Bitumen	000' t	280.3	271.1	3.4%
Other petroleum products	000' t	297.5	283.6	4.9%
Consolidated sales of products and goods for resale, including:				
Downstream segment	000' t	3,971.5	3,445.7	15.3%
Other business	000' t	2.2	0.0	-

Higher share of the *Dynamic* fuels in the total sales structure contributed to an improvement in the average unit retail margin on fuel sales, however costs of lease of land which is to accommodate service stations located along motorways and other costs connected with the new service stations which were launched during H1 2010 weighted heavily on the operating results of the retail business.

As at the end of June 2010, the number of CODO stations was 153 (up by 11 stations relative to the end of June 2009), the number of DOFO stations was 103 (up by 16 stations) and the number of DODO stations was 62 (down by 27 stations). The aggregate number of executed franchise agreements was 107.

Relative to H1 2009, in H1 2010 retail sales grew by 21.1 thousand tonnes, or 7.5% (+11.9 thousand tonnes CODO and 9,2 thousand tonnes DOFO).

## Other Business

**Table 13. Operating results of other business**

		H1 2010*	H1 2009**	H1 2010 vs. H1 2009
Sales revenue	PLN m	11.4	0.1	11,300%
Operating profit (loss)	PLN m	-0.8	-0.1	-
Depreciation/amortisation	PLN m	5.1	0.0	-
EBITDA	PLN m	4.3	-0.1	-

\* Includes LOTOS Ekoenergia Sp. z o. o., LOTOS Park Technologiczny Sp. z o.o., LOTOS Gaz S.A. and Energobaltic Sp. z o.o. (from the date of acquiring control by LOTOS Petrobaltic S.A.).

\*\* In connection with the purchase of an organised part of business in the form of the LPG Trading Division of LOTOS Gaz S.A. by LOTOS Paliwa Sp. z o.o. from LOTOS Gaz S.A. in December 2009, in order to ensure data comparability, the sales revenue, operating profit (EBIT), amortisation and depreciation, and operating profit before amortisation and depreciation (EBITDA) related to the LPG trading business of the LOTOS Gaz Group have been presented in the downstream segment.

## Statement of Comprehensive Income

In H1 2010, the LOTOS Group posted PLN 296.7m in operating profit, which represented a year-on-year improvement of PLN 126.0m.

The Group's high net loss on financing activities of -PLN 1,118.5m reported in H1 2010 was chiefly attributable to foreign exchange losses on revaluation of loans and borrowings and to negative valuation and settlement of market risk hedging transactions. In H1 2009 the Group reported net loss on financing activities of -PLN 28.6m.

In H1 2010, the Group recorded net foreign exchange loss on revaluation of loans and borrowings of -PLN 970.9m, which related mainly to loans and borrowings at the Parent Undertaking.

The overall excess of the negative settlement of derivatives for the first six months of 2010 charged to finance expenses was -PLN 107.0m and included: settlement of interest rate risk hedging IRSs of -PLN 79.6m, settlement of foreign exchange risk hedging transactions (forwards) of -PLN 27.1m, and settlement of other hedging transactions of -PLN 0.3m.

In H1 2010, the effect of valuation of open (not settled) forward and futures contracts was -PLN 215.0m, which included: valuation of foreign exchange risk hedging forwards of -PLN 143.0m, valuation of interest rate risk hedging IRSs of -PLN 35.8m, valuation of currency swaps of -PLN 19.5m, valuation of transactions executed to hedge the risk of changes in prices of petroleum products of -PLN 16.0m, and valuation of other hedging transactions of -PLN 0.7m.

**Table 14. Transactions executed to hedge the risk of changes in prices of petroleum products, as at June 30th 2010**

Period	Product/Commodity	Light fuel oil	Heavy fuel oil
		Gasoil .1 Cargoes CIF NWE / ARA (Platts)	3.5 PCT Barges FOB Rotterdam (Platts)
Q3 2010	Volume (mt)	-6,684	30,384
	Price range (USD/mt)	676.70 - 756.00	460.75 - 496.00
Q4 2010	Volume (mt)	-7,306	33,206
	Price range USD/mt	660.50 - 756.00	422.00-496.00
Q2 2011	Volume (mt)	-2,848	12,948
	Price range (USD/mt)	715.00 - 716.00	473.00 - 476.25
Q3 2011	Volume (mt)	-4,794	21,794
	Price range (USD/mt)	715.00 - 796.00	473.00 - 517.00
Q4 2011	Volume (mt)	-4,034	18,334
	Price range (USD/mt)	715.00 - 796.25	473.00 - 517.75

**Table 15. Foreign exchange risk hedging transactions as at June 30 2010**

Currency pair	Instrument	Volume	Currency	FX rate range
EUR/USD	Forward	204,350,000	EUR	1.2185 - 1.4520
EUR/PLN	Forward	-9,750,000	EUR	4.0473 - 4.1682
USD/PLN	Forward	31,500,000	USD	2.8929 - 3.5000

**Table 16. Interest rate risk hedging transactions as at June 30 2010**

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

In connection with the net loss on financing activities, in the six months ended on June 30th 2010 the LOTOS Group recorded net loss from continuing operations of -PLN 621.4m, compared with net profit from continuing operations of PLN 103.3m reported in H1 2009. Net loss attributable to owners of the parent reached -PLN 623.1m.

## Consolidated Statement of Financial Position

As at June 30th 2010, the LOTOS Group had total assets of PLN 17,102.0m, which means a PLN 1,876.0m increase in H1 2010. In H1 2010, non-current assets grew by PLN 760.8m, chiefly due to a PLN 611.5m increase in property, plant and equipment (including tangible assets under construction and prepayments for tangible assets under construction) following mainly from implementation of the 10+ Programme at the Parent Undertaking and investment expenditure in the upstream segment. Moreover, deferred tax assets rose by PLN 178.4m, mainly at the Parent Undertaking and the LOTOS Petrobaltic Group.

As at June 30th 2010, inventories amounted to PLN 3,806.8m, having increased over H1 2010 by PLN 783.6m, mainly due to higher volumes of mandatory stocks (171.1 thousand m<sup>3</sup> more of fuels and heavy fuel oil and 36.7 thousand tonnes more of crude oil) and higher prices of crude oil and petroleum products as at the end of H1 2010 relative to the prices at the end of 2009. Higher prices of products also led to a PLN 300.5m rise in trade receivables. In H1 2010, cash increased by PLN 93.9m, mainly at subsidiary undertaking LOTOS Paliwa. As at the end of H1 2010, current assets totalled PLN 6,242.5m, and were by PLN 1,116.1m higher relative to the end of 2009.

As at June 30th 2010, equity stood at PLN 6,234.0m, having decreased by PLN 612.1m in H1 2010, primarily due to a decrease in retained earnings and non-controlling interests following the acquisition by Grupa LOTOS S.A. of the remaining minority interests in LOTOS Jasło S.A. and LOTOS Czechowice S.A.

In H1 2010, non-current liabilities increased by PLN 1,152.3m, mainly due to a PLN 1,302.8m rise in non-current loans and borrowings connected primarily with the implementation of the 10+ Programme. Foreign currency debt under non-current loans at the Parent Undertaking grew in H1 2010 by USD 114.7m. Such a high increase in non-current debt was mainly caused by foreign exchange losses on revaluation of loans and borrowings. As at June 30th 2010, non-current liabilities in the LOTOS Group totalled PLN 6,813.0m, including interest-bearing loans and borrowings of PLN 6,245.4m and negative valuation of financial instruments of PLN 110.0m.

As at the end of June 2010, current liabilities totalled PLN 4,054.9m, having increased in H1 2010 by PLN 1,335.9m, primarily due to a PLN 896.8m increase in trade payables. This increase was primarily attributable to a 77.4% rise in the volume and a 111.6% rise in the value of crude oil purchased in June 2010 as compared with the crude oil purchased in December 2009. In the discussed period, other current financial liabilities increased by PLN 281.9m to reach PLN 301.0m at the end of June 2010, of which PLN 297.9m related to negative valuation of financial instruments. In H1 2010, the LOTOS Group's current debt grew by PLN 146.6m, chiefly in connection with expenditure on investments in the upstream segment.

As at June 30th 2010, the financial debt of the LOTOS Group amounted to PLN 7,150.5m, up by PLN 1,449.4m on the 2009 figure. The ratio of financial debt (adjusted by free cash) to equity was 107.4%, i.e. by 29.4 percentage points more than at December 31st 2009.



**Table 17. Consolidated statement of financial position**

		Jun 30 2010	Dec 31 2009	Change	%
<b>Assets</b>	<b>PLN m</b>	<b>17,102.0</b>	<b>15,226.0</b>	<b>1,876.0</b>	<b>12.3%</b>
Non-current assets	PLN m	10,855.1	10,094.4	760.7	7.5%
Property, plant and equipment	PLN m	4,976.5	3,438.6	1,537.9	44.7%
Tangible assets under construction (including prepayments for tangible assets under construction)	PLN m	5,313.9	6,240.3	-926.4	-14.8%
Current assets	PLN m	6,242.5	5,126.4	1,116.1	21.8%
Inventories	PLN m	3,806.8	3,023.1	783.7	25.9%
Trade and other receivables	PLN m	1,837.4	1,536.9	300.5	19.6%
Current financial assets	PLN m	28.3	47.0	-18.7	-39.8%
Cash and cash equivalents	PLN m	455.9	362.1	93.8	25.9%
<b>Equity and liabilities</b>	<b>PLN m</b>	<b>17,102.0</b>	<b>15,226.0</b>	<b>1,876.0</b>	<b>12.3%</b>
Equity	PLN m	6,234.0	6,846.2	-612.2	-8.9%
Non-current liabilities	PLN m	6,813.1	5,660.8	1,152.3	20.4%
Current liabilities	PLN m	4,054.9	2,719.0	1,335.9	49.1%

### Consolidated Statement of Cash Flows

As at the end of June 2010, the LOTOS Group's cash balance (including debt under overdraft facilities) was -PLN 61.8m, and was by PLN 277.9m lower than as at June 30th 2009.

In H1 2010, net cash provided by operating activities, of PLN 466.0m, was by PLN 40.6m lower than the net operating cash flow recorded in the comparable period, mainly due to a PLN 926.0m rise in current liabilities.

In the discussed period, PLN 1,332.3m higher negative cash flows from investing activities were mainly attributable to lower (by PLN 1,204.1m) expenses incurred in connection with the acquisition of property, plant and equipment and intangible assets as well as lower (by PLN 125.0m) prepayments for tangible assets under construction.

The cash flows from financing activities for H1 2010 were by PLN 1,042.8m lower than in the corresponding period of 2009. The difference was mainly attributable to lower (by PLN 909.4m) cash inflows under contracted loans and borrowings less repayments of loans and borrowings and interest paid.

**Table 18. Consolidated statement of cash flows**

		H1 2010	H1 2009	Change
Cash flows from operating activities	PLN m	466.0	506.6	-40.6
Cash flows from investing activities	PLN m	-637.6	-1,969.9	1,332.3

Cash flows from financing activities	PLN m	259.2	1,302.0	-1,042.8
Change in net cash	PLN m	86.8	-122.3	209.1
Cash and cash equivalents at beginning of period	PLN m	-148.6	338.4	-487.0
Cash and cash equivalents at end of period	PLN m	-61.8	216.1	-277.9

### Assessment of the Group's Ability to Meet its Liabilities

In the first half of 2010, the LOTOS Group was fully able to meet all of its liabilities towards third parties.

### Information which is Material for Assessing the Group's Assets, Financial Standing and Financial Performance, or Changes in Any of the Foregoing

A synthetic assessment of the LOTOS Group's overall economic and financial standing was prepared in the form of a ratio analysis covering margins, liquidity and debt levels.

**Table 19. Margins, and liquidity and debt ratios**

Ratio	H1 2010	H1 2009
Operating profit/loss (PLN '000)	296,714	170,692
Operating margin (1)	3.43%	2.77%
Pre-tax profit/loss (PLN '000)	-821,762	142,100
Pre-tax margin (2)	-9.49%	2.31%
Net profit/loss from continuing operations (PLN '000)	-621,450	103,266
Net margin (3)	-7.18%	1.68%
Return on equity (ROE) (4)	-9.97%	1.75%
Return on assets (ROA) (5)	-3.63%	0.72%
Current ratio (6)	1.54	1.69
Quick ratio (7)	0.60	0.80
Average collection period (days) (8)	33.60	41.10
Average payment period (days) (9)	30.90	34.92
Capital employed (10)	2,187,557	2,273,987
Capital employed to total assets (11)	12.79%	15.82%
Debt ratio (12)	63.55%	58.87%
Debt to equity ratio (13)	174.33%	143.11%

(1) operating profit (loss)/net sales revenue

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

- (3) net profit (loss)/net sales revenue
- (4) net profit (loss)/equity at end of period
- (5) net profit (loss)/assets at end of period
- (6) current assets/current liabilities
- (7) (current assets – inventories)/current liabilities
- (8) (average trade receivables/net sales revenue)\*181
- (9) (average trade payables/cost of sales)\*181
- (10) current assets – current liabilities
- (11) capital employed/assets
- (12) total liabilities/assets
- (13) total liabilities/equity

An analysis of the above figures and ratios allows to identify the following changes in H1 2010 relative to H1 2009:

- an improvement of operating margin, and a deterioration of pre-tax and net margins, and of ROE and ROA;
- a deterioration of the current ratio (down by 9.1%) in connection with the fact that current liabilities were growing faster than current assets (up by 23.6% and 12.4%, respectively), a significant deterioration of the quick ratio (down by 25.2%), in connection with a 30.4% increase in inventories due to higher prices of crude oil and petroleum products at the end of H1 2010 relative to June 2009, and higher volumes of mandatory fuel stocks;
- with respect to efficiency ratios: collection period shortened by 7.5 days due to a 14.8% increase in average trade receivables accompanied by a significantly higher increase (up by 40.5%) in sales revenue; payment period shortened by 4.0 days due to average trade payables growing slower than cost of sales (up by 24.8% and 41.0%, respectively);
- a 3.8% decrease in capital employed, in connection with the fact that current liabilities were growing faster than current assets (up by PLN 775.5m and PLN 689.1m, respectively), and a decline of the share of capital employed in the total assets;
- higher debt ratios: debt ratio rose by 4.7 percentage points and debt to equity ratio – by 31.2 percentage points, mainly in connection with the fact that the Group's debt under bank loans increased by 34.1%.

As at June 30th 2010, the balance of overdraft facilities amounted to PLN 517.8m. For detailed information on the structure of debt under bank loans, see Note 17.2 to the interim condensed consolidated financial statements for the six months ended June 30th 2010.

## **2.2 FACTORS WHICH IN THE COMPANY'S OPINION MAY AFFECT THE LOTOS GROUP'S RESULTS IN Q3 AND Q4 2010**

Key factors which in the Company's opinion may affect the results in H2 2010 include:

- demand for petroleum products in Poland and Europe,
- changes in the macroeconomic environment, particularly with respect to prices of crude oil, refining margins and the USD/PLN exchange rate,

- further implementation of the 10+ Programme, which directly translates into an increase of the processing capacity of Grupa LOTOS S.A.'s refinery in Gdańsk,
- further implementation of projects which are under way in the upstream segment, in particular the YME production project.

### **2.3 THREATS AND RISKS IN THE SUBSEQUENT MONTHS OF 2010**

The LOTOS Group conducts its operations in such environment and conditions which carry numerous risks. Compared with the previous reporting period, the operating, financial and market risks have not changed materially; they are still present to a large extent and are monitored on an ongoing basis:

- risks related to the government's strategy for the oil and gas sector,
- risks related to changes in tax laws and to tax law interpretations,
- risks related to operating activities,
- risks related to the upstream business,
- risks related to the supply of raw materials,
- risks related to implementation of the 10+ Programme,
- marketing risks.

Key risks associated with the LOTOS Group's marketing activities in 2010 include:

- reduced demand for fuels and other petroleum products as a result of a global recession, which may lead to lower than planned sales growth,
- emergence of new importers importing petroleum products from various geographical directions, seeking new sales opportunities in Poland and using aggressive pricing policies,
- competitors' aggressive pricing policies,
- a decline in transit of goods through Poland,
- a global decline in air connections,
- lower number of road construction contracts being performed, and lengthy tendering procedures concerning new road construction projects,
- smaller vessel traffic in Polish ports, in connection with weakening exports/imports,
- smaller industrial production leading to lower demand for lubricants, fuels and petroleum products.

### **3. OTHER INFORMATION**

#### **3.1 MANAGEMENT BOARD'S POSITION ON THE FEASIBILITY OF MEETING PREVIOUSLY PUBLISHED FORECASTS FOR 2010**

The LOTOS Group has not published any consolidated performance forecasts for 2010.

#### **3.2 COURT, ARBITRATION OR ADMINISTRATIVE PROCEEDINGS**

In H1 2010 no court, arbitration or administrative proceedings were pending concerning liabilities or debt claims with a value in excess of 10% of Grupa LOTOS S.A.'s equity, to which Grupa LOTOS S.A. or any of its subsidiaries would be party. For information on other material proceedings, see Note 16.2 to the interim condensed consolidated financial statements for the six months ended June 30th 2010.

#### **3.3 MATERIAL RELATED PARTY TRANSACTIONS**

In H1 2010, transactions with related parties of Grupa LOTOS S.A. were executed on standard market terms. They have been described in Note 17.13 to the interim condensed consolidated financial statements for the six months ended June 30th 2010.

#### **3.4 SURETIES FOR THE REPAYMENT OF LOANS AND BORROWINGS, AND GUARANTEES ISSUED**

##### **Petrobaltic S.A.'s Undertaking towards the Government of Norway**

On June 17th 2008, Petrobaltic S.A. issued an unconditional and irrevocable guarantee for the benefit of the government of Norway covering all the activities undertaken by LOTOS Exploration and Production Norge AS as part of its exploration and production operations on the Norwegian Continental Shelf. In the guarantee, Petrobaltic S.A. confirmed that it undertakes to assume full financial liability which may arise in connection with LOTOS Exploration and Production Norge AS' activities consisting in exploration for and extraction of the natural resources from the sea bottom, including storage and transport on the Norwegian Continental Shelf using means of transport other than ships.

Other than the contingent liability described above, in the reporting period the LOTOS Group companies were not parties to any guarantees or sureties with a value in excess of 10% of Grupa LOTOS S.A.'s equity. Changes which occurred with respect to the contingent liabilities during H1 2010 have been described in Note 16 to the interim condensed consolidated financial statements for the six months ended June 30th 2010.

**4. SIGNATURES OF THE MANAGEMENT BOARD MEMBERS AND THE PERSON RESPONSIBLE FOR KEEPING THE ACCOUNTING BOOKS OF GRUPA LOTOS S.A.**

President of the Management Board, Chief Executive Officer	
	Paweł Olechnowicz
Vice-President of the Management Board, Chief Financial Officer	
	Mariusz Machajewski
Vice-President of the Management Board, Chief Operation Officer	
	Marek Sokołowski
Vice-President of the Management Board, Chief Commercial Officer	
	Maciej Szozda