

## 17. Business combinations

PLN '000	Dec 31 2008 (audited)	Dec 31 2007 (audited)
Carrying value of consolidation goodwill:		
LOTOS Partner Sp. z o.o.,	1,862	1,862
LOTOS Gaz S.A. <sup>(1)</sup>	10,009	10,009
KRAK-GAZ Sp. z o.o. <sup>(2)</sup>	-	12,645
<b>Total</b>	<b>11,871</b>	<b>24,516</b>
Carrying value of acquisition goodwill <sup>(3)</sup> , including:		
- purchase of ESSO service stations network	31,759	31,759
- purchase of Slovnaft Polska S.A. service stations network	1,932	1,932
<b>Total</b>	<b>33,691</b>	<b>33,691</b>
<b>Total goodwill</b>	<b>45,562</b>	<b>58,207</b>

<sup>(1)</sup> formerly LOTOS Mazowsze S.A. The goodwill relates to an organized part of LOTOS Gaz S.A.'s business (wholesale of fuels) acquired by LOTOS Paliwa Sp. z o.o.

<sup>(2)</sup> Acquisition of KRAK-GAZ Sp. z o.o. shares by LOTOS Gaz S.A.

Upon obtaining the Competition and Consumer Protection Office's approval of the business concentration involving the acquisition by LOTOS Gaz S.A. (formerly LOTOS Mazowsze S.A.) of control over KRAK-GAZ Sp. z o.o. by purchasing its shares, on July 9th 2007 LOTOS Gaz S.A. entered into the final agreement on the purchase of 34,500 shares in KRAK-GAZ Sp. z o.o. Prior to obtaining approval from the Competition and Consumer Protection Office, on March 26th 2007 LOTOS Gaz S.A. concluded a conditional preliminary agreement on the purchase of 34,500 shares in KRAK-GAZ Sp. z o.o. from natural persons.

The shares, with a total par value of PLN 3,450 thousand, are equal and indivisible, and represent 100% of the share capital of KRAK-GAZ Sp. z o.o. The acquisition is deemed a long-term investment by LOTOS Gaz S.A.

The shares were acquired for PLN 16,368 thousand, and the transaction was financed with LOTOS Gaz S.A.'s own financial resources. The acquisition cost (the cost of merger) was affected by additional expenses incurred by LOTOS Gaz S.A. in connection with tax and financial consulting services.

The core business of KRAK-GAZ Sp. z o.o. consists in wholesale and retail distribution of LPG.

Pursuant to IFRS 3, as at the date an entity is taken over, i.e. as at the acquisition date, the acquirer is obliged to allocate the cost of the business combination by recognising the acquiree's identifiable assets, liabilities and contingent liabilities at their fair values at that date. Any difference between the acquisition cost and the acquirer's interest in the value of the assets, liabilities and contingent liabilities so measured constitutes the goodwill.

The allocation is made exclusively with respect to those assets and liabilities that exist on the acquisition date. In addition, IFRS 3 prohibits, in relation to the acquired net assets, the creation of provisions for operating losses of future periods as they are an item arising after the acquisition.

As at the date of these consolidated financial statements, LOTOS Gaz S.A., in accordance with the above policies, recognised the difference between the acquisition cost of businesses and the interest in the net fair value of the identifiable assets, liabilities and contingent liabilities as goodwill.

As a result of acquisition of KRAK-GAZ Sp. z o.o. goodwill was recognised which as at December 31st 2007 represents the difference between the acquisition cost and the value of acquired assets, in the amount of PLN 12,645 thousand.

**PLN '000**

<b>Merger cost (acquisition cost)</b>	<b>17,329</b>
Interest in the equity of acquired undertakings	100,00%
Current assets, including:	42,987
Cash and cash equivalents	91
Non-current assets	20,210
<b>Total assets</b>	<b>63,197</b>
Provisions and other	792
Current liabilities and accruals and deferred income	57,721
<b>Total liabilities</b>	<b>58,513</b>
<b>Net assets</b>	<b>4,684</b>
<b>The Company's share in net assets</b>	<b>4,684</b>
<b>Excess of the share in net assets over acquisition cost</b>	<b>12,645</b>

By December 31st 2008, LOTOS Gaz S.A. had discharged the liabilities related to the acquisition of the shares in the amount of PLN 15,711 thousand. The value of acquired shares in KRAK-GAZ Sp. z o.o., less the acquired cash in the amount of PLN 91 thousand, is PLN 15,738 thousand.

As at December 31st 2008, following the events which are discussed below, the Group recognised an impairment loss in the total amount of PLN 12,645 thousand on the goodwill arising on the acquisition of KRAK-GAZ Sp. z o.o. by LOTOS Gaz S.A.

On June 20th 2008, the Tax Supervision Authority in Kraków issued a post-inspection report as part of the proceedings instituted on November 21st 2006 (i.e. prior to the purchase of shares in KRAK-GAZ Sp. z o.o. by LOTOS Gaz S.A.) in order to review the correctness of settlement of excise tax for the years 2003–2004 by KRAK-GAZ Sp. z o.o. In the course of the proceedings, it was established that KRAK-GAZ Sp. z o.o. failed to pay the excise tax due in the total amount of PLN 7,545 thousand plus interest (the figure as at June 30th 2008).

On October 31st 2008, the Director of Tax Supervision Authority in Kraków issued a decision whereby the excise tax liability for the years 2003–2004 was established at PLN 16,408 thousand. On November 25th 2008, KRAK-GAZ Sp. z o.o. appealed against that administrative decision. The appeal has not yet been considered by the appellate body. With the letter of February 6th 2009, the Director of the Customs Chamber in Kraków notified KRAK-GAZ Sp. z o.o. that there was a delay in processing the appeal, and set March 31st 2009 as the new deadline for considering it.

On November 26th 2008, the Director of the Customs Chamber initiated enforcement proceedings against KRAK-GAZ Sp. z o.o. by issuing enforcement orders covering the amount specified in the decision issued by the Director of Tax Supervision Authority.

On December 8th 2008, KRAK-GAZ Sp. z o.o. appealed against the decision to initiate enforcement proceedings. In accordance with the letter of December 17th 2008, the Director of the Customs Chamber decided to allow the appeal concerning errors in calculating the amount of excise tax arrears and to discontinue the proceedings.

On December 19th 2008, the company received another final decision and enforcement orders from the Customs Chamber, for the revised amounts of excise tax arrears and interest. The excise tax due for 2003-2004 was established at PLN 8,309 thousand, including interest and costs of enforcement proceedings.

On December 29th 2008, KRAK-GAZ Sp. z o.o. submitted objections against the aforementioned enforcement orders, citing, inter alia, incorrect identification of the creditor. By virtue of a decision of January 19th 2009, the Director of the Customs Chamber in Kraków dismissed the objections as groundless. On January 27th 2009, KRAK-GAZ Sp. z o.o. filed a complaint against the decision of January 19th 2009 directly with the Head of the Kraków Tax Chamber, who by virtue of his decision of March 9th 2009 upheld the Customs Chamber Director's decision of January 19th 2009. Through the Director of the Customs Chamber, KRAK-GAZ Sp. z o.o. lodged an appeal against the decision, in a letter dated April 6th 2009, with the Provincial Administrative Court of Kraków.

Furthermore, KRAK-GAZ Sp. z o.o. submitted with the Director of Tax Supervision Authority in Kraków a request to stay execution of the decisions and, if this request were not to be granted, a request to allow payment of the tax arrears in instalments.

By virtue of a decision of February 24th 2009, the Director of the Customs Chamber in Kraków dismissed the request to stay the execution of the decisions. KRAK-GAZ Sp. z o.o. lodged a complaint against the dismissal on March 9th 2009, seeking reversal of the decision of February 24th 2009 and stay of execution of the decision issued by the Director of Tax Supervision Authority on October 31st 2008. On March 30th 2009, KRAK-GAZ Sp. z o.o. received a notification from the Customs Office in Kraków, responsible for considering the company's request to allow payment of tax arrears in instalments, setting April 30th 2009 as a new deadline for considering the request.

As at the date of approval of these consolidated financial statements, the tax proceedings concerning KRAK-GAZ Sp. z o.o.'s tax liabilities for 2003–2004 were pending, and the requests to stay execution of the enforcement decisions and to allow payment of tax arrears in instalments had not yet been considered.

Given KRAK-GAZ Sp. z o.o.'s potential excise tax liabilities for 2003–2004, as at December 31st 2008 the Group had set up a provision for the principal amount of and interest on those liabilities.

Taking into consideration the decision issued by the Director of Tax Supervision Authority in Kraków and the contents of the post-inspection report prepared by the Tax Supervision Authority in Kraków on June 20th 2008, the Management Board of LOTOS Gaz S.A. made two representations (on July 11th 2008 and December 9th 2008) towards the sellers of shares in KRAK-Gaz Sp. z o.o. regarding the reduction of the purchase price of shares in KRAK-GAZ Sp. z o.o. by a total amount of PLN 16,368 thousand. Accordingly, the sellers' claim for the last payment of the Purchase Price in the amount of PLN 1,500 thousand expired.

On July 28th 2008, the Management Board of LOTOS Gaz S.A. called upon the former owners of shares in KRAK-GAZ Sp. z o.o. to enter into mandatory negotiations, in line with the provisions of the share purchase agreement.

On December 15th 2008, the Management Board of LOTOS Gaz S.A. opened arbitration proceedings by serving a notice of arbitration hearing upon the sellers of shares in KRAK-Gaz Sp. z o.o. At present, the arbitration panel is being selected for the arbitration proceedings. Subsequently, at a date determined by the panel of arbitrators, a relevant statement of claim will be served. As at the date of approval of these consolidated financial statements, the case was pending.

LOTOS Gaz S.A. additionally obtained a decision from the Regional Court in Kraków, dated November 17th 2008, establishing a claim bond to secure LOTOS Gaz S.A.'s claims against the sellers of the shares up to the amount of PLN 5,975 thousand, with an enforcement clause setting the enforcement date at January 20th 2009. On February 2nd 2009, the sellers moved for the cancellation of the claim bond, as a result of which the proceedings continue, and any further steps aimed at seizing the sellers' assets are contingent upon whether the sellers' motion is granted.

On December 10th 2008, a notification of suspected offence against KRAK-GAZ Sp. z o.o. was submitted with the Regional Prosecutor's Office of Kraków Podgórze in Kraków, alleging an offence consisting in failure to fulfil professional duties by former members of the company's Management Board.

On January 29th 2009, two former members of KRAK-GAZ Sp. z o.o.'s Management Board received calls for payment of PLN 801 thousand as remedy for the damage done to the company.

As at the date of approval of these consolidated financial statements, the cases concerning the former members of KRAK-GAZ Sp. z o.o.'s Management Board were pending.

**(3) Goodwill arising on acquisition of ExxonMobil Poland and Slovnaft Polska**

As at December 31st 2008 and December 31st 2007, the Group disclosed goodwill arising upon the acquisition of an organised part of business from ExxonMobil Poland and Slovnaft Polska, with a net value of PLN 31,759 thousand and PLN 1,932 thousand, respectively. Based on IAS 36, as at December 31st 2007, the Group performed a test of goodwill acquired upon the purchases from ExxonMobile i Slovnaft for impairment. In accordance with IAS 36, the Group tests goodwill for impairment annually.

In order to determine the value in use, discounted cash flows (DCFs) were analysed for the purchased 39 service stations of the ESSO network and 12 service stations of the SLOVNAFT network, organised as separated cash generating centres, with use of WACC = 10.2%. The analysis was based on forecasts of future cash flows (EBITDA net of financial expenses) prepared based on the 2008 budget approved by the Management Board of LOTOS Paliwa Sp. z o.o. and on the planned cash inflows and outflows, as specified in the approved development strategy until 2012 for LOTOS Paliwa Sp. z o.o. The DCF residual value was computed based on the formula for perpetuity with growth.

As part of the goodwill test performed by the Group, the value in use as at December 31st 2007 was determined at:

- PLN 272,733 thousand for the ESSO service stations,
- PLN 49,783 thousand for the Slovnaft service stations.

The balance-sheet value of assets purchased from ExxonMobile and Slovnaft Polska as at December 31st 2007 amounts to:

- PLN 278,463 thousand for the ESSO service stations,
- PLN 57,717 thousand for the Slovnaft service stations.

As the test showed an excess of the carrying amount of the assets purchased from ExxonMobile and Slovnaft Polska over their value in use determined in the course of the goodwill test performed by the Group, in 2007 the Group recognised a goodwill impairment loss in a total amount of PLN 21,496 thousand.

As at December 31st 2008, the Group tested its assets for impairment. As at December 31st 2008, no additional impairment loss on goodwill was recognised.