**DIRECTORS' REPORT ON OPERATIONS**

**OF THE LUBELSKI WĘGIEL BOGDANKA GROUP**

**for the third quarter of 2010**
**ended on 30 September 2010**

BOGDANKA, NOVEMBER 2010

**LIST OF CONTENTS**

# 1. BASIC INFORMATION ON THE LUBELSKI WĘGIEL BOGDANKA GROUP

## 1.1 Structure of the Lubelski Węgiel BOGDANKA Group

As at 30 September 2010, the Lubelski Węgiel BOGDANKA Group (hereinafter referred to as the "Group", "LW BOGDANKA Group") consists of Lubelski Węgiel BOGDANKA S.A. as the Parent Undertaking and ŁĘCZYŃSKA ENERGETYKA Sp. z o.o. as the subsidiary undertaking.

The affiliated undertaking is EKSPERT Sp. z o.o. held in 50% by Łęczyńska Energetyka Sp. z o.o.

As at the date of submitting this Report (8 November 2010), LW BOGDANKA S.A. also held 24.41% of the shares of the bankrupt company Kolejowe Zakłady Maszyn KOLZAM S.A., with a total par value of PLN 168,050.00. The ownership title to the shares was transferred to LW BOGDANKA S.A. as security for settlements for performing transportation services. That company has not been included in the consolidation.

## 1.2 Information on the undertakings of the Lubelski Węgiel BOGDANKA Group subject to consolidation

The subsidiary ŁĘCZYŃSKA ENERGETYKA Sp. z o.o. was included in the abridged consolidated quarterly financial statements of the LW BOGDANKA Group for the third quarter of 2010 (the "consolidated quarterly financial statements") by the full consolidation method.

The affiliated company – EKSPERT Sp. z o.o. was included in the quarterly consolidated financial statements of the LW BOGDANKA Group by the equity method.

### 1.2.1 Information on the Parent Undertaking of the Lubelski Węgiel BOGDANKA Group

**Parent Undertaking of the LW BOGDANKA Group:**

Lubelski Węgiel BOGDANKA Spółka Akcyjna (hereinafter referred to as "LW BOGDANKA S.A.", the "Company", "Lubelski Węgiel BOGDANKA S.A.", "LW BOGDANKA" or "the Parent Undertaking").

Address: Bogdanka, 21-013 Puchaczów, Lublin Province
Tel.: (81) 462 51 00, (81) 462 51 01
Fax: (81) 462 51 91
Website: www.lw.com.pl
e-mail address bogdanka@lw.com.pl
Industry identification number (REGON): 430309210
Tax registration number (NIP): 713-000-57-84

**Business activities**

The scope of the Company's main business activity includes mining activities related to economic mining of hard coal and enriching excavated raw coal, sale of coal to consumers, and the protection and reclamation of mining areas.

According to the Company's Articles of Association, the business activities of Lubelski Węgiel BOGDANKA S.A. are:

a) agriculture, forestry, hunting and fishery (Section A),

b) mining and production (Section B),
c) industrial processing (Section C),
d) production and supply of electricity, gas, steam, hot water and air for air-conditioning installations (Section D),
e) water supply; liquid and solid waste management; activities related to reclamation (Section E),
f) construction (Section F),
g) wholesale, retail sale and repair of motor vehicles, including motorcycles (Section G),
h) transport and warehouse management (Section H),
i) activities related to lodging and catering (Section I),
j) information and communications (Section J),
k) finance and insurance (Section K),
l) real estate activities (Section L),
m) professional, scientific and technical activities (Section M),
n) administration and support activities (Section N),
o) education (Section P).

**Supplementary activities**

The Company's additional production is building materials, mainly in the form of ceramic façade bricks that are manufactured within the frameworks of utilising Carboniferous rock waste stone in the EkoKLINKIER Building Ceramics Plant. In September 2007, its building materials production business was discontinued as a result of a fire at ZCB EkoKLINKIER. From 2008 until September 2009, intensive works were continued in connection with reconstruction of the manufacturing buildings and process line. Production was re-commenced in the fourth quarter of 2009.

### 1.2.2 Information on the subsidiary and affiliated companies

**<u>Direct subsidiary undertaking:</u>**

**Łęczyńska Energetyka sp. z o.o.**

Address: Bogdanka, 21-013 Puchaczów, Lublin Province
Tel.: (81) 443 11 02, (81) 462 55 53
Fax: (81) 443 11 01
Website: www.lebog.com.pl
e-mail address biuro@lebog.com.pl
Industry identification number (REGON): 004164490
Tax registration number (NIP): 713-020-71-92

Share capital (as at 30 September 2010): PLN 82,677,000.00, divided into 82,677 shares of PLN 1,000.
Shareholding structure:
- 88.697% LW BOGDANKA S.A.
- 11.297% Łęczna Municipality
- 0.006% Puchaczów Municipality.

The business activities of Łęczyńska Energetyka Sp. z o.o. are: producing heat energy, refurbishing, maintaining and assembling of power production equipment, producing drinking and industrial water. The company also conducts activities involving the construction and refurbishment of heat-generating, water supply and sewage disposal installations.

Łęczyńska Energetyka Sp. z o.o. provides services to LW BOGDANKA S.A. involving supplying heat energy and conducts water/wastewater management.

**Affiliated undertaking:**

**EKSPERT Sp. z o.o.**

Address: Bogdanka, 21-013 Puchaczów, Lublin Province
Tel.: (81) 462 20 62
Fax: (81) 462 20 62
Website: -
e-mail address wkekspert@wp.pl
Industry identification number (REGON): 432693862
Tax registration number (NIP): 505-000-15-99

Share capital (as at 30 September 2010): PLN 50,000.00, divided into 100 shares of PLN 500.

The share of Łęczyńska Energetyka Sp. z o.o. in the share capital and votes at the Shareholders Meeting is 50.00%.

EKSPERT Sp. z o.o.'s business activities involve manufacturing metal constructions and activities involving preparing technical and structural/technological documentation.

## 1.3 Changes in the structure of the Lubelski Węgiel BOGDANKA Group and in organisational and capital affiliations of the Parent Undertaking with other entities, and the effects of changes in the structure of LW BOGDANKA S.A.

In the third quarter of 2010 there were no changes in the structure of LW BOGDANKA Group or in the Group's organisational and capital affiliations with other entities. In that period there were also no changes in the structure of the LW BOGDANKA Group due to the merger of business units, the take over or sale of units of the Group, long-term investments or the division, restructuring or discontinuation of activities.

As at the date of submitting this Report, no changes have occurred in the LW BOGDANKA Group.

## 2. OWNERSHIP CHANGES IN LW BOGDANKA S.A. IN THE THIRD QUARTER OF 2010

### 2.1 Shareholders holding at least 5% of the total number of votes at the General Shareholders Meeting (the "GSM"), either directly or indirectly through subsidiaries, as at the date of submitting the quarterly report, and changes in the ownership structure of substantial shareholdings in the period from the publication of the semi-annual report

On 9 March 2010 the State Treasury sold in block transactions 15,882,000 shares of the Company on the Warsaw Stock Exchange. Thus it ceased to hold the majority stake in the Company's share capital. As a result of the concluded transaction and commencing the process of signing agreements on free of charge acquisition of shares by the eligible employees, the State Treasury held 4.97% of the share capital of LW BOGDANKA S.A. as at 8 June 2010.

Table 1 The shareholding structure of LW BOGDANKA S.A. as at 31 August 2010 and 8 November 2010

| Shareholder | 31 August 2010 | | 8 November 2010 | |
|---|---|---|---|---|
| | Number of shares/ Number of votes at the GSM | Share in the share capital (%) | Number of shares/ Number of votes at the GSM | Share in the share capital (%) |
| Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK* | 5,014,644 | 14.74% | 5,014,644 | 14.74% |
| Otwarty Fundusz Emerytalny PZU „Złota Jesień" ** | 3,320,377 | 9.76% | 3,320,377 | 9.76% |
| ING Otwarty Fundusz Emerytalny*** | 3,275,953 | 9.63% | 3,275,953 | 9.63% |
| AMPLICO Otwarty Fundusz Emerytalny**** | 1,734,194 | 5.10% | 1,734,194 | 5.10% |
| State Treasury***** | 1,691,900 | 4.97 % | 1,691,900 | 4.97 % |
| Other | 18,976,522 | 55.80 % | 18,976,522 | 55.80 % |
| **Total** | **34,013,590** | **100.00%** | **34,013,590** | **100.00%** |

*According to the Notification received on 25 March 2010, described in Current Report of LW BOGDANKA S.A. No. 11/2010 of 25 March 2010;

**According to the Notification received on 18 March 2010, described in Current Report of LW BOGDANKA S.A. No. 10/2010 of 18 March 2010;

*** According to the Notification received on 11 August 2010, described in Current Report of LW BOGDANKA S.A. No. 35/2010 of 11 August 2010, until 21 July 2010 ING Otwarty Fundusz Emerytalny held 3,767,249 (three million seven hundred sixty–seven thousand two hundred and forty-nine) shares in the Company, representing 11.08% of the Company's share capital; as a result of the transactions as at 27 July 2010 3,623,549 (three million six hundred twenty-three thousand five hundred and forty-nine) shares were held on the Fund's securities account, representing 10.65% of the Company's share capital – this transaction was described in Current Report of LW. BOGDANKA S.A. No. 34/2010 of 28 July 2010.

****According to the Notification received on 12 May 2010, described in Current Report of LW BOGDANKA S.A. No. 17/2010 of 12 May 2010;

*****According to the Notification received on 8 June 2010, described in Current Report of LW BOGDANKA S.A. No. 22/2010 of 8 June 2010;

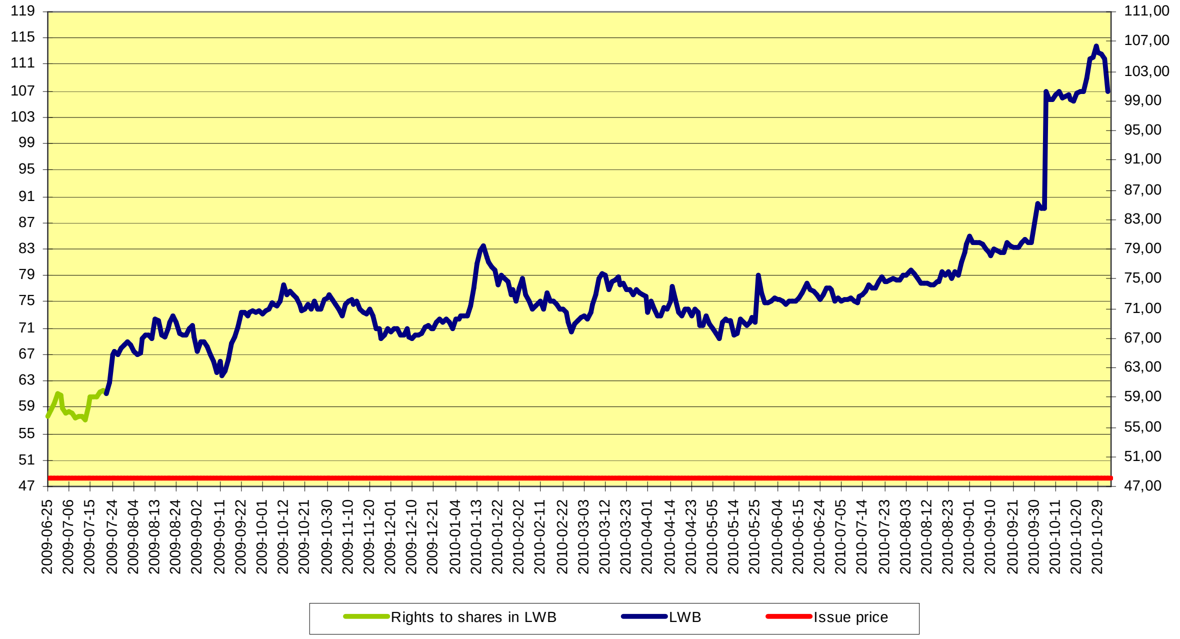
## 2.2 Table of holdings of shares of LW BOGDANKA S.A. or entitlements to them (options) by the management and supervisory personnel of LW BOGDANKA S.A., as at the date of submitting the quarterly report, and changes in shareholdings in the period from the publication of the semi-annual report, separately for each person

Table 2 Table of holdings of shares of LW BOGDANKA S.A.

| | **Number of shares as at the date of publishing the Consolidated Directors' Report on Operations for the first half of 2010 (31 August 2010)** | **Number of shares as at the date of submitting the report (8 November 2010)** |
|---|---|---|
| **The Management Board** | | |
| Mirosław Taras | 2,737 | 2,737 |
| Krystyna Borkowska | 1,299 | 1,299 |
| Zbigniew Stopa | 3,834 | 3,834 |
| Waldemar Bernaciak | 2,162 | 2,162 |
| **The Supervisory Board** | | |
| Eryk Karski | 0 | 0 |
| Andrzej Lulek | 0 | 0 |
| Ewa Pawluczuk | 0 | 0 |
| Stefan Kawalec | 0 | 0 |
| Jadwiga Kalinowska | 1,024 | 1,024 |
| Adam Partyka | 1,024 | 1,024 |
| **Total** | **12,080** | **12,080** |

## 2.3 Price of Rights to Shares/ Shares of the Company since its debut on the Warsaw Stock Exchange.

**Closing prices of the shares in LW BOGDANKA S.A. from the beginning of listings (i.e. 25 June 2009) until 5 November 2010**



## 3. PRINCIPLES OF DRAWING UP THE GROUP'S ABRIDGED QUARTERLY CONSOLIDATED FINANCIAL STATEMENTS

The Group's abridged quarterly consolidated financial statements were prepared in compliance with the International Accounting Standards and International Financial Reporting Standards as well as the Regulation of the Minister of Finance on current and periodic information published by issuers of securities and the conditions for deeming equally important the information required by provisions of law of a country which is not a Member State of 19 February 2009 (Dz.U. of 2009 No. 33, item 259).

Data for the consolidated quarterly abridged financial statements and the quarterly abridged financial statements of Lubelski Węgiel Bogdanka S.A. has been prepared in compliance with the same accounting principles and calculation methods as in the previous annual financial statements.

## 4. ANALYSIS OF AND INFORMATION ON THE BASIC ECONOMIC AND FINANCIAL VALUES DISCLOSED IN THE FINANCIAL STATEMENTS OF THE LW BOGDANKA GROUP FOR THE FIRST THREE QUARTERS OF 2010, I.E. FROM 1 JANUARY 2010 TO 30 SEPTEMBER 2010

This section presents selected ratios characterising the Group's financial position for the period from 1 January 2010 to 30 September 2010, calculated on the basis of the financial data included in the Group's financial statements, prepared in compliance with the International Financial Reporting Standards approved by the European Union for the periods ended on 30 September 2010.

### 4.1 Information on the Company or its subsidiary granting sureties for a credit facility or loan or granting guarantees

In the third quarter of 2010, neither Lubelski Węgiel BOGDANKA S.A. nor its subsidiary granted sureties for a credit facility or loan and they did not grant guarantees jointly to a single entity or a subsidiary company of that entity worth the equivalent of at least 10% of the Company's shareholders' equity.

### 4.2 Selected financial information

Table 3 Selected financial information of the Group

| item | 3 quarters 2010 | 3 quarters 2009 | Change (2010/2009) | for the third quarter of 2010 | for the third quarter of 2009 | Change (2010/2009) |
|---|---|---|---|---|---|---|
| Sales revenue | 934,224 | 850,672 | 9.82% | 356,125 | 329,877 | 7.96% |
| Pre-tax profit | 317,232 | 302,854 | 4.75% | 134,129 | 143,234 | -6.36% |
| EBIT (Operating profit) | 233,140 | 213,302 | 9.30% | 106,502 | 108,756 | -2.07% |
| EBITDA | 337,458 | 319,454 | 5.64% | 142,749 | 145,759 | -2.07% |
| Pre-tax profit | 241,865 | 217,440 | 11.23% | 109,046 | 113,207 | -3.68% |
| Net profit | 192,980 | 174,387 | 10.66% | 86,060 | 90,849 | -5.27% |
| Operating cash flow | 283,836 | 293,866 | -3.41% | 123,443 | 133,663 | -7.65% |
| Investing cash flow | -447,443 | -279,939 | 59.84% | -182,561 | -116,486 | 56.72% |
| Financing cash flow | | 583,439 | -100.00% | | 420,099 | -100.00% |

Table 4

| item | 30.09.2010 | 30.09.2009 | Change (2010/2009) |
|---|---|---|---|
| Total assets | 2,744,192 | 2,468,237 | 11.18% |
| Fixed assets | 2,009,463 | 1,561,883 | 28.66% |
| Current assets | 734,729 | 906,354 | -18.94% |
| Shareholders' equity | 1,931,877 | 1,722,354 | 12.16% |
| Provisions and liabilities | 812,315 | 745,883 | 8.91% |

The scope and structure of the work carried out significantly affect the results for the different reporting periods. Extraction of coal and revenue from the sale of coal are a consequence of the geological conditions and the technological capabilities, which are subject to change even over a short period of time. The scope of additional investment, upgrading and repair work is different in different reporting periods, therefore a comparison of the Group's quarterly results cannot serve as a reliable assessment of the Group's activity.

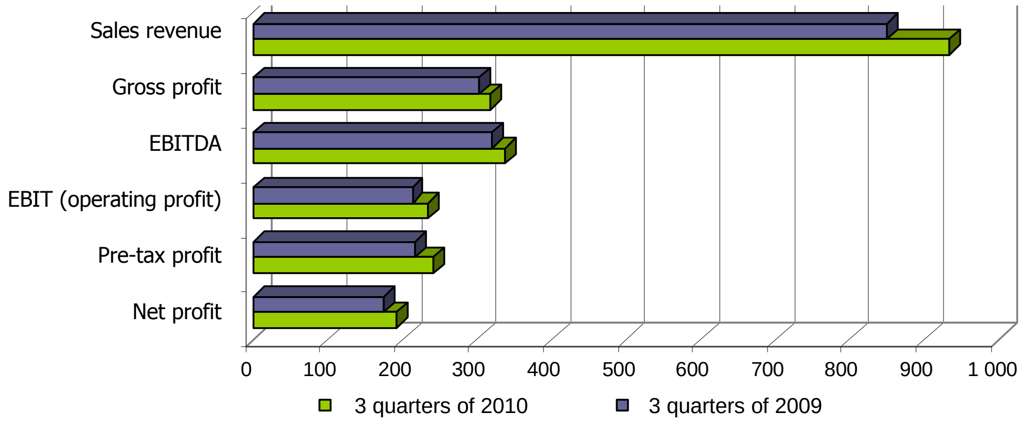
The financial statements prepared for the period from 1 January 2010 to 30 September 2010 show that the Lubelski Węgiel BOGDANKA Group's sales revenue was PLN 934,224,000, which is an increase of 9.82%, or by PLN 83,552,000, compared to the same period of the previous year. A comparison of the Group's quarterly results shows that the Group's sales revenue increased from PLN 329,877,000 in the third quarter of 2009 to PLN 356,125,000 in the third quarter of 2010.

The Group's gross profit for the first nine months of 2010 was PLN 317,232,000, compared to PLN 302,854,000 for the same period of 2009. The Group's third-quarter gross profit dropped from PLN 143,234,000 in 2009 to PLN 134,129,000 in 2010.

The drop in gross profit in the third quarter of 2010 as compared to the same period of 2009 was attributable to the costs of a rescue operation following a coal self-ignition event in the return airway of longwall 2/II in coal seam 382 and to higher provisions for employee benefits. The Parent Undertaking records employee benefits for a given year as measured by an actuary and based on data as of the end of the previous year. The input data for the calculation of employee benefits (e.g. the discount rate, pay levels, the official prices of coal given in kind as part of wages) are adjusted by an actuary as of the end of the year and recorded in the Mine's books of account in the fourth quarter. In line with the Company's growth strategy, the Mine's staff numbers in the reporting periods increased: from 3,804 people as of 30 September 2009 to 3,949 people as of 30 September 2010. In addition, in the fourth quarter of 2010 the Company plans to begin recruiting people to work in the Mechanical Coal Processing Plant now under construction, which is reflected in the higher provisions for employee benefits.

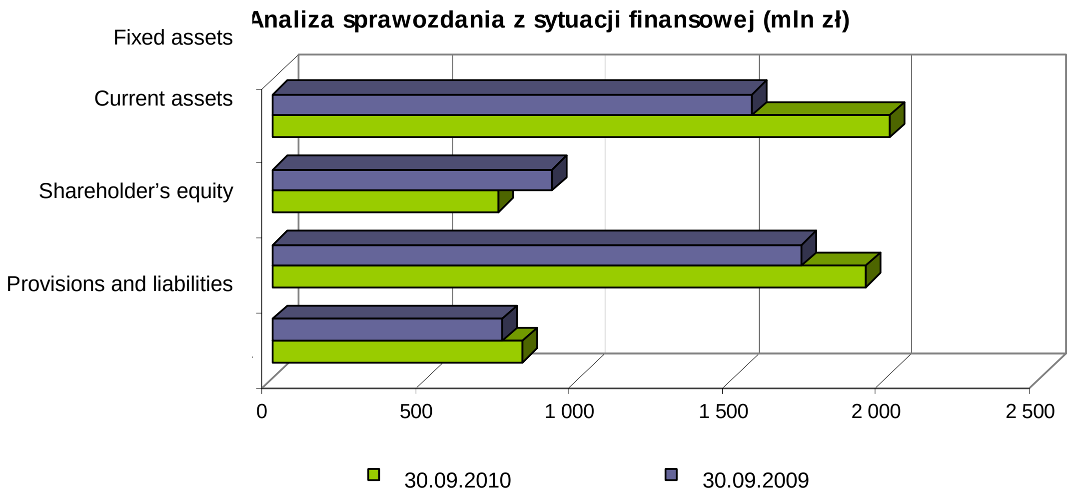
In the first three quarters of 2010, the Group's operating profit increased from PLN 213,302,000 to PLN 233,140,000 (+9.30% on a year-to-year basis). EBITDA (operating profit before depreciation/amortisation) was PLN 337,458,000 for the period from 1 January 2010 to 30 September 2010 and PLN 319,454,000 for the same period of 2009.

**Analysis of the consolidated statement of comprehensive income (PLN million)**




The Group's net profit for the third quarter of 2010 alone was PLN 86,060,000, compared to PLN 90,849,000 a year earlier. The Group's net profit for the first three quarters of 2010 was PLN 192,980,000, compared to PLN 174,387,000 for the same period of 2009, which means an increase of 10.66% or by PLN 18,593,000.

**Analysis of the statement of financial position (PLN million)**




The Group's statement of financial position prepared as of 30 September 2010 shows an increase in the balance sheet total from PLN 2,744,192,000, or by PLN 275,955,000, compared to the figure as of 30 September 2009. The value of fixed assets increased from PLN 1,561,883,000 (30 September 2009) to PLN 2,009,463,000 (30 September 2010). This increase (+28.66%) is the result of implementing an investment programme involving the development of the Stefanów Field (expected to double the Group's extraction of commercial coal) and purchasing a longwall coal ploughing system for low deposit mining. The value of the Group's current assets fell from PLN 906,354,000 to PLN 734,729,000 (PLN - 171,625,000 or -18.94%), mostly as a consequence of a decrease in cash (resulting from expenditure on the Group's investment programmes).

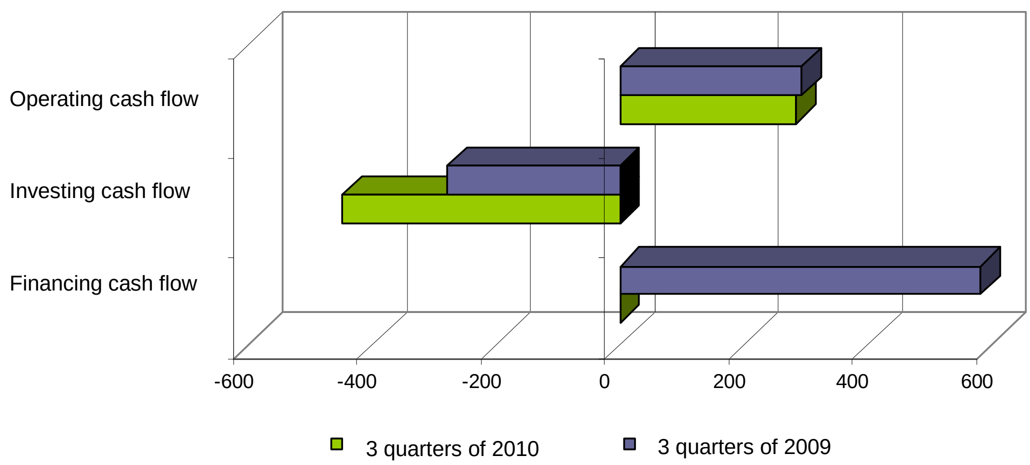
On the liabilities side, equity increased by 12.16% to PLN 1,931,877,000, while provisions and liabilities by 8.91% to PLN 812,315,000. The rise in 'other capital' was attributable to carrying the Group's retained earnings for 2009 over to other capital (as shown in the Consolidated Statement of

Changes in Equity). The rise in provisions and liabilities, on the other hand, was attributable to an increase in the following balance sheet items:

- short-term trade creditors and other liabilities (+PLN 26,639,000)
- short-term provisions for other liabilities and charges (+PLN 19,392,000)
- long-term employee benefits liabilities (+PLN 12,339,000)

Equity accounted for 70.40% and 69.78% of the Group's liabilities and equity as of 30 September 2010 and 30 September 2009, respectively.

**Analysis of the consolidated cash flow statement (PLN million)**




In the first three quarters of 2010, the Group financed its activities with net cash flows from operating activities. Net cash flows from operating activities in the reporting period were PLN 283,836,000, down by PLN 10,030,000 compared to the same period of the previous year (as a result of a higher income tax payment and higher financial expenses).

Net cash flows from investing activities for the first three quarters of 2010 were PLN 447,443,000, up by PLN 167,504,000 compared to the same period of 2009. This rise was attributable to expenditure on tangible fixed assets (e.g. purchasing a longwall coal ploughing system for low deposit mining, developing the Stefanów Field) and on intangible assets.

In January – September 2010, the Group had no net cash flows from financing activities, while a year earlier the Group's net cash flows from financing activities were PLN 583,439,000 (attributable to an increase in the share capital by issuing shares; taking out and repaying a loan; and paying dividend).

## 4.3 Information on the current financial position of the Group/ the Company

### 4.3.1 Coal extraction and sales

In the three quarters of 2010 (as in the previous years), the revenue on sales generated by the LW BOGDANKA Group were primarily determined by the Company's production (extraction) capacity, as presented in the table below.

Table 5 Production capacity of LW BOGDANKA for 3 quarters of 2010 and 3 quarters of 2009 ('000 tonnes)

| 3 quarters of 2010 | 3 quarters of 2009 | Change |
|---|---|---|
| 4,388.09 | 3,945.23 | 11.23% |

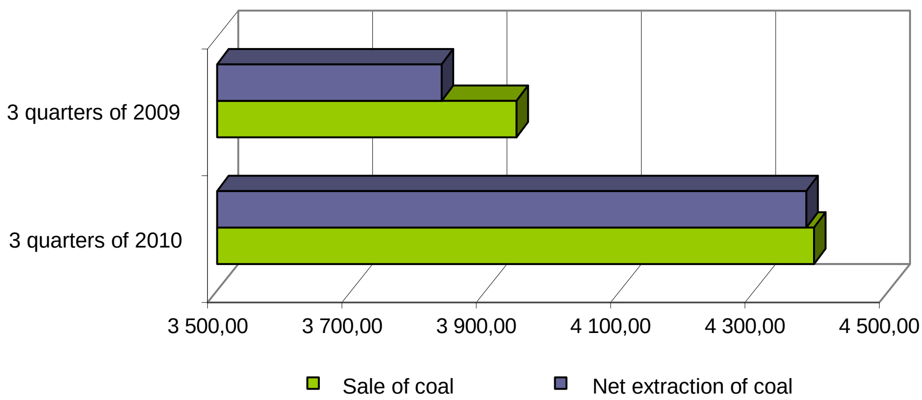
Production of commercial coal in the first three quarters of 2010 increased by over 11%, to PLN 4,388,090 tonnes, compared to the same period of 2009, when production was 3,945,230 tonnes.The 11.23% rise in production of commercial coal was achieved with gross production lower by 1.89%. This proves that the mining technology solutions implemented by the Group (e.g. purchasing a longwall coal ploughing system for low deposit mining, as well as improving the process of initial separation of waste rock from the material underground) are effective and efficient. The commercial coal production/gross production ratio for the first three quarters of 2010 was 74.44%, compared to 65.66% for the same period of 2009.

Table 6 Sale of coal of LW BOGDANKA for 3 Qs 2010 and 3 Qs 2009 ('000 tonnes)

| 9 months of 2010 | 9 months of 2010 | Change |
|---|---|---|
| 4,376.83 | 3,834.24 | 14.15% |

Due to effectively implemented projects, production of commercial coal in the first nine months of 2010 was 440,000 tonnes higher than in the same period of 2009, which translated into higher sales (4,376,830 tonnes for the first nine months of 2010 – up by 14.15%, or 542,590 tonnes). The graph below shows the figures for production and sales of commercial coal for the periods covered by this report.

**Analysis of the extraction and sale of coal ('000 tonnes)**



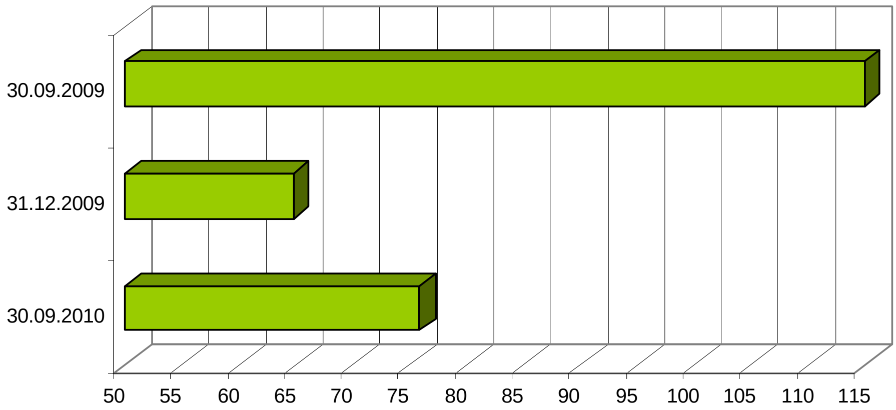

### 4.3.2 Stocks

The level of stocks of coal held by the Company as at 30 September 2010 amounted to 75,849.31 tonnes (which constituted an increase by 11,064.67 tonnes relative to the level as of 31 December 2009 [+17.08%] and a decrease by 39,074.34 tonnes relative to 30 September 2009 [-34.00%]). It should be noted that this is a standard stock level, allowing the current sales to be secured and is an operational technological stock with the current daily extraction of approx. 19,200 tonnes/day.

Table 7 Stock of coal (tonnes)

| item | 30.09.2010 | 31.12.2009 | 30.09.2009 | Change 30.09.2010/ 31.12.2009 | Change 30.09.2010/ 30.09.2009 |
|---|---|---|---|---|---|
| Stock of coal | 75,849.31 | 64,784.64 | 114,923.55 | 17.08% | -34.00% |

**Stock of coal ('000 tonnes)**




### 4.3.3 Sales revenue

In the first three quarters of 2010, the LW BOGDANKA Group's sales revenue was PLN 934,224,000, up by PLN 83,552,000 compared to the sales revenue figure for the first three quarters of 2009. The rise in revenue was the result of higher sales volumes of commercial coal, with the average price of the coal sold being slightly lower than in 2009.

Of the Group's four revenue categories, growth was recorded in the case of coal sales (+10.46%). In the other categories (sales of ceramics, other activities, sales of goods and materials), quarter-to-quarter revenue was down by between 6.28% and 10.23%.

The main source of sales revenue for the LW BOGDANKA Group in the first three quarters of 2010 (as well as in the first three quarters of 2009) was production and sale of power coal. From 1 January to 30 September 2010, sales of power coal accounted for 97.05% of the LW BOGDANKA Group's sales revenue (96.48% in the same period of the previous year). Most (approx. 90%) coal sales realised in the analysed period of 2010 (as well as in the same period of the previous year) were carried out on the basis of long-term commercial agreements with regular key customers of the Parent Undertaking (primarily Elektrownia Kozienice S.A., GDF Suez Energia S.A., Zakłady Azotowe Puławy S.A. and Elektrownia Ostrołęka S.A.).

The Group's revenue from other activities (including the revenue generated by the subsidiary Łęczyńska Energetyka Sp. z o.o. in Bogdanka) accounted for 1.59% of the Group's total revenue for the period from 1 January 2010 to 30 September 2010, compared to 1.89% a year earlier. Revenue from the sale of ceramics accounted for less than 1% of the Group's total sales revenue in both the periods covered by this report.

Table 1 Dynamics of changes in product range with respect to revenue on sales of the LW BOGDANKA Group (PLN '000)

| item | 9 months of 2010 | 9 months of 2009 | Change 2010/2009 |
|---|---|---|---|
| Sales of coal | 906,651 | 820,764 | 10.46% |
| Sales of ceramics | 6,699 | 7,148 | -6.28% |
| Other activities | 14,869 | 16,071 | -7.48% |
| Sales of goods and materials | 6,005 | 6,689 | -10.23% |
| **Total revenue on sales** | **934,224** | **850,672** | **9.82%** |

Table 9 Structure by product range with respect to revenue on sales of the LW BOGDANKA Group (in PLN '000)

| item | 9 months of 2010 | Share | 9 months of 2009 | Share |
|---|---|---|---|---|
| Sales of coal | 906,651 | 97.05% | 820,764 | 96.48% |
| Sales of ceramics | 6,699 | 0.72% | 7,148 | 0.84% |
| Other activities | 14,869 | 1.59% | 16,071 | 1.89% |
| Sales of goods and materials | 6,005 | 0.64% | 6,689 | 0.79% |
| **Total revenue on sales** | **934,224** | **100.00%** | **850,672** | **100.00%** |

The LW BOGDANKA Group operates primarily in Poland. During the analysed periods (of both 2010 and 2009), export sales constituted a fraction of revenues generated and concerned sales of ceramics. The share of export sales in total revenue on sales did not exceed 0.1%.

Table 10 Geographical structure of revenue on sales of the LW BOGDANKA Group (in PLN '000)

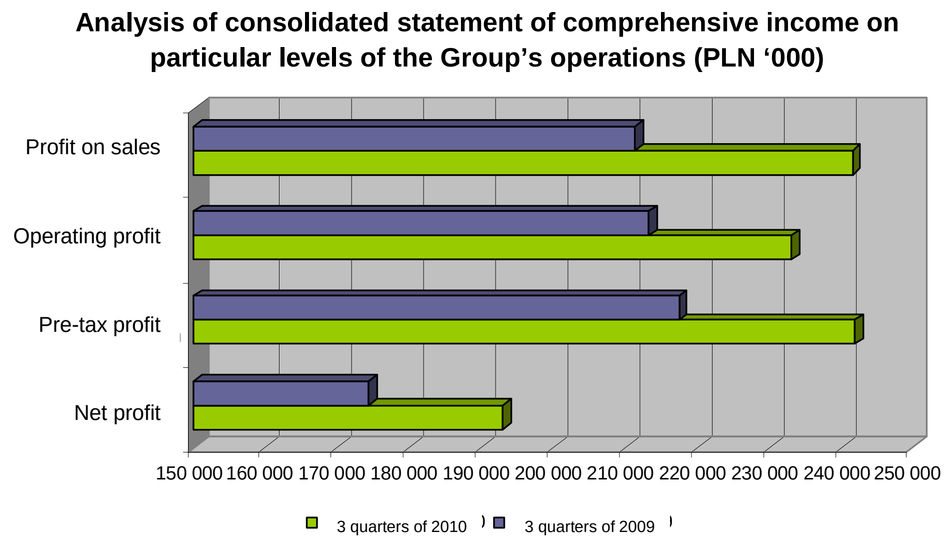
| item | 9 months of 2010 | Share | 9 months of 2010 | Share |
|---|---|---|---|---|
| Domestic sales | 933,568 | 99.93% | 850,212 | 99.95% |
| Foreign sales | 656 | 0.07% | 460 | 0.05% |
| **Total revenue on sales** | **934,224** | **100.00%** | **850,672** | **100.00%** |

### 4.3.4 Consolidated Statement of Comprehensive Income

In the first three quarters of 2010, revenue on sales of the LW BOGDANKA Group, as compared to the same period of the previous year, increased by 9.82% up to the level of PLN 934,224,000. In the same period the Group's costs (total costs of products, goods and materials sold, cost of sales, administrative expenses) increased by 8.36% up to the level of PLN 692,677,000. Such dynamics in costs and revenue led to the profit on sales increasing by 14.24%, i.e. PLN 241,547,000 for nine months of 2010 as compared to PLN 211,430,000 for the same period of 2009.

Table 11 Selected items of the consolidated statement of comprehensive income of the LW BOGDANKA Group (in PLN '000)

| item | 3 quarters 2010 | 3 quarters 2009 | Change (2010/2009) |
|---|---|---|---|
| Sales revenue | 934,224 | 850,672 | 9.82% |
| Cost of products, goods and materials sold, cost of sales, administrative expenses | 692,677 | 639,242 | 8.36% |
| **Profit on sales** | **241,547** | **211,430** | **14.24%** |
| Other income | 4,458 | 5,380 | -17.14% |
| Other expenses | 1,998 | 2,754 | -27.45% |
| Other net profit/loss | -10,867 | -754 | 1341.25% |
| **Operating profit** | **233,140** | **213,302** | **9.30%** |
| Financial income | 18,239 | 12,359 | 47.58% |
| Financial expenses | 9,466 | 8,417 | 12.46% |
| -share in (losses)/profits of affiliated undertakings | -48 | 196 | -124.49% |
| **Pre-tax profit** | **241,865** | **217,440** | **11.23%** |
| Income tax | 48,885 | 43,053 | 13.55% |
| **Net profit** | **192,980** | **174,387** | **10.66%** |
| - attributable to shareholders of the Company | 191,683 | 174,381 | 9.92% |




Other income

For the first nine months of 2010, other operating revenues amounted to PLN 4,458,000 compared to PLN 5,380,000 for the same period of the previous year – this means a decrease in their value by 17.14%. The Group recognised PLN 5,380,000 in revenue from extraordinary non-recurring events (penalties imposed on the Group, compensation received by the Group, and provisions).

Other expenses and other net profit/loss

Other expenses for the first nine months of 2010 were PLN 1,998,000, compared to PLN 2,754,000 for the same period of 2009, which means an increase of 27.45%. Other net profit/loss was PLN

10,867,000 and PLN 754,000, respectively. Other operating expenses for the first three quarters of 2010 amounted to PLN 8,869,000, compared to PLN 2,000,000 a year earlier, which means an increase of 343.45% on a year-to-year basis. In 2010, the Group recorded higher provisions and an increase in negative exchange differences resulting from the purchase by the Parent Undertaking of foreign currency to pay for the longwall coal ploughing system.

Adjusted for profit on sales, other revenue, other expenses and other net profit/loss, the Group's net operating profit for the first three quarters of 2010 is PLN 233,140,000, up by 9.30% compared to the same period of 2009.

Financial income

Financial income for the first nine months of 2010 was PLN 18,239,000, compared to PLN 12,359,000 a year earlier. The rise in financial income is attributable to an increase in the average annual levels of cash within the Group, particularly within the Parent Undertaking (in mid-2009, the Group received cash from the increase in the share capital and kept the cash in bank deposits until the end of the third quarter of 2009).

Financial expenses

The Group's financial expenses in the first three quarters of 2010 amounted to PLN 9,466,000, compared to PLN 8,417,000 a year earlier (+12.46%). The rise in financial expenses is the result of an increase, in 2010, in the Group's average annual level of loans compared to a year earlier (in the first half of 2009, the Group received PLN 180,000,000 in new payments of a long-term loan).

The increase in financial income by 47.58% and in financial expenses by 12.46% compared to 2009 resulted in the Group's pre-tax profit for the first three quarters of 2010 being 11.23% higher than a year earlier (PLN 241,865,000 for the first three quarters of 2010, compared to PLN 217,440,000 for the same period of 2009).

Adjusted for corporate tax paid by the Group, net profit for the period from 1 January 2010 to 30 September 2010 was PLN 192,980,000, compared to PLN 174,387,000 for the same period of 2009 - up by 10.66% on a year-to-year basis.

### 4.3.5 Profitability of the Group

Table 12 Profitability ratios of the LW BOGDANKA Group

| item | 9 months of 2010 | 9 months of 2009 |
|---|---|---|
| Gross margin on sales | 33.96% | 35.60% |
| EBITDA | 36.12% | 37.55% |
| EBIT | 24.96% | 25.07% |
| Gross margin | 25.89% | 25.56% |
| Net margin | 20.66% | 20.50% |
| Return on Assets | 7.40% | 8.45% |
| Return on Equity | 10.51% | 12.29% |

*Principles for calculating the ratios:*

Gross margin on sales = gross profit for the period/revenue on sales for the period
EBITDA = EBITDA for the period/revenue on sales for the period
EBIT = EBIT (operating profit ) for the period/revenue on sales for the period
Gross margin = pre-tax profit/revenue on sales for the period
Net margin = net profit/revenue on sales for the period
Return on assets = net profit/average assets based on the value from the beginning and end of the period
Return on equity = net profit/average shareholders' equity based on the value from the beginning and end of the period

During the first three quarters of 2010, the profitability ratios regarding the conducted operations achieved higher values than in the same period of the previous year.

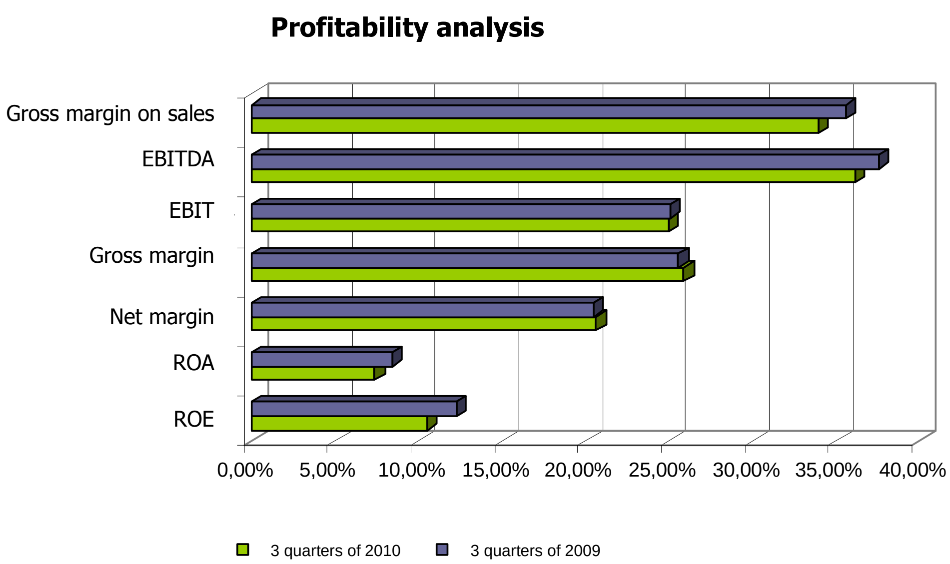
Gross margin on sales of the LW BOGDANKA Group decreased from 35.60% (Q3 2009) to 33.96% (Q3 2010) The decrease in that ratio resulted from a higher dynamics of products, goods and materials sold relative to the dynamics of revenues.

In the analysed period the profitability of EBIT amounted to 24.96%, which means a decrease by 0.11 p.p. in comparison to the same period in the previous year. The small change in EBIT indicates that in the first three quarters of 2010, the value of the Group's revenue in relation to the costs of products, goods and materials sold (including costs of sales and administrative costs) was almost identical to the same period of 2010.

The Group's gross profit and net profit for the first three quarters of 2010 were 25.89% and 20.66%, respectively. The quarter-to-quarter rise is the result of an increase in financial income, received by the Parent Undertaking from keeping cash in bank deposits.

The drop in the Group's ROA does not mean that the Group's financial situation deteriorated, but rather it is the result of a considerable investment process (e.g. the development of the Stefanów Field) – the Group is now producing assets that will generate benefits in the future. The Group's ROA should be expected to fall until all the assets under construction are put into operation.

As was the case with ROA, the drop in the Group's ROE is not indicative of the Group's financial standing deteriorating, but rather the result of the Group obtaining new capital (by issuing shares in 2009), which the Group should benefit from in the years to come. The Group's ROE should be expected to fall until all the assets under construction are put into operation.




### 4.3.6 The debt ratios and financing structure of the LW BOGDANKA Group

Table 13 Debt ratios of the LW BOGDANKA Group

| item | 30.09.2010 | 30.09.2009 |
|---|---|---|
| Overall debt ratio | 29.60% | 30.22% |
| Debt to equity ratio | 42.05% | 43.31% |
| Fixed capital to fixed assets ratio | 117.03% | 121.64% |

| item | 30.09.2010 | 30.09.2009 |
|---|---|---|
| Short-term debt ratio | 11.93% | 20.65% |
| Long-term debt ratio | 17.67% | 9.57% |

*Principles for calculating the ratios:*

overall debt ratio = total liabilities / total shareholders' equity and liabilities

debt to equity ratio = total liabilities / shareholders' equity

fixed capital to fixed assets ratio = (shareholders' equity + long-term liabilities excluding provisions) / fixed assets

short-term debt ratio = short-term liabilities / total liabilities

long-term debt ratio = long-term liabilities / total liabilities

As at 30 September 2010, the share of liabilities in the financing of the operations of the LW BOGDANKA Group, measured by the overall debt ratio, amounted to 29.60% and, respectively, 30.22% as at 30 September 2009. The LW BOGDANKA Group's debts did not constitute a threat to its operations or ability to punctually pay its liabilities in the period covered by the consolidated financial statements for the three quarters. In the analysed period, the debt to equity ratio decreased from 43.31% to 42.05% (as at 30 September 2010) – which indirectly is a result of an increase by PLN 209,523,000 in equity.

The Company's asset financing structure is correct – the long-term liabilities to fixed assets ratio, although down by 4.61 percentage points, is still over 100%.

Table 14 Liquidity ratios of the LW BOGDANKA Group (in days)

| item | 30.09.2010 | 30.09.2009 |
|---|---|---|
| Current liquidity ratio | 2.91 | 2.00 |
| Quick liquidity ratio | 2.72 | 1.88 |

*Principles for calculating the ratios:*

current liquidity ratio = current assets/short-term liabilities excluding provisions

quick liquidity ratio = (current assets – stocks)/short-term liabilities excluding provisions

In the period covered by the consolidated quarterly financial statements, the liquidity ratios of the LW BOGDANKA Group remained at a very high, safe level, and the LW BOGDANKA Group is not having any difficulties in settling its liabilities. A high level of the liquidity ratios (both as at 30 September 2010 and 31 December 2009) results from the value of cash injected to the Parent Undertaking as a result of the share capital increase (debut at the Warsaw Stock Exchange). The increase in the ratios is also attributable to a presentation change. As of 30 September 2009, the Group's long-term liabilities included PLN 250,000,000 in loans and borrowings. Following an extension of the repayment period, part of the loan (PLN 241,000,000) was reclassified as a long-term loan, which required the amount to be transferred to long-term liabilities in the balance sheet. Due to the Group's investment programme, the above ratios should be expected to fall to levels considered in the literature as optimum levels.

Table 15 Turnover rates of the LW BOGDANKA Group (in days)

| item | 30.09.2010 | 30.09.2009 |
|---|---|---|
| Stock turnover | 22.0 | 22.3 |
| Trade debtors collection rate | 41.7 | 46.6 |
| Trade creditors payment rate | 83.8 | 84.0 |
| Operating cycle | 63.6 | 68.9 |
| Cash conversion cycle | -20.2 | -15.1 |

*Principles for calculating the ratios:*

stock turnover = (average stocks based on the level at the beginning and end of the financial year/cost of products, goods and materials sold) x the number of days in the period

trade debtors collection rate = (average trade debtors based on the level at the beginning and end of the financial year/revenue on sales) x the number of days in the period

trade creditors payment rate = (average trade creditors based on the level at the beginning and end of the financial year/cost of products, goods and materials sold) x the number of days in the period
Operating cycle = stock turnover + trade debtors collection rate
Cash conversion cycle = operating cycle - trade creditors payment rate

In the reporting period, the stock turnover rate was slightly lower compared to its level as of 30 September 2009, i.e. 22.3 days against 22.0 days (with a year-to-year increase in the average stock level and in the cost of products, goods and materials sold).

The trade creditors payment rate was 46.6 days (30 September 2009) and 41.7 days (30 September 2010). The drop in the rate is attributable to a year-to-year increase in sales revenue (by PLN 83,552,000), with a slight drop in the average level of trade creditors (by PLN 2,696,000).

The operating cycle for current assets (a sum of stock turnover and trade debtors collection rate) in the analysed period was at 63.6 days, as compared to 68.9 days as at 30 September 2009.

The trade creditors payment rate decreased slightly in the period covered by financial information from 84 days as at 30 September 2009 to 83.8 days as at 30 September 2010.

As a result of the trends described above, a cash conversion cycle of -20.2 days was achieved as at 30 September 2010 compared to -15.1 as at 30 September 2009, and the Group's using non-interest-bearing borrowed capital to a larger extent.

## 4.4 Costs by type of the Parent Undertaking, LW BOGDANKA S.A.

This section presents costs of LW BOGDANKA S.A. by type and function.

### 4.4.1 Costs by type

In the first three quarters of 2010, LW BOGDANKA S.A.'s costs amounted to PLN 884,094,000 compared to PLN 823,151,000 in the same period of the previous year, which means that the costs increased by 7.40%. The above nominal increase in costs was largely the result of higher costs of outsourced services as well as costs of materials and energy consumption, and to a smaller degree, an increase in costs of representation, advertising as well as taxes and charges. The result of an adjustment of costs by type by change in stocks and the cost of own work capitalised yields the costs of products sold, which in the three quarters of 2010 increased by 8.71% as compared to the same period in 2009.

Table 16 Costs by type of LW BOGDANKA S.A. (in PLN '000)

| item | III quarter of 2010 | III quarter of 2009 | Change [%] | Change [PLN '000] |
|---|---|---|---|---|
| Amortisation | 103,630 | 103,850 | -0.21% | -220 |
| Materials and energy consumption | 266,960 | 241,193 | 10.68% | 25,767 |
| Outsourced services | 198,670 | 139,097 | 42.83% | 59,574 |
| Employee benefits | 275,042 | 292,532 | -5.98% | -17,490 |
| Taxes and charges | 15,790 | 14,512 | 8.81% | 1,278 |
| Entertainment and advertising expenses | 8,899 | 8,338 | 6.73% | 561 |
| Other expenses | 15,102 | 23,629 | -36.09% | -8,527 |
| **TOTAL COSTS BY TYPE** | 884,094 | 823,151 | 7.40% | 60,943 |
| Change in products | 5,959 | -4,096 | -245.47% | 10,055 |

| | | | | |
|---|---|---|---|---|
| **Cost of sales** | 890,053 | 819,054 | 8.67% | 70,998 |
| Activities for the Company's own needs | 207,138 | 191,761 | 8.02% | 15,377 |
| Cost of goods and materials sold | 5,763 | 6,207 | -7.15% | -444 |
| **Cost of products sold** | 688,678 | 633,501 | 8.71% | 55,177 |

Analysing the increase in costs of outsourced services (from PLN 139,097,000 to PLN 198,670,000, i.e. by 42.83%) it must be indicated that this change was the result of more preparatory and deposit-opening work connected with the Company's development strategy compared to last year, within the scope of which over 3,100 running metres of galleries were completed (up by approx. 21.1%). Part of preparatory works within the scope of extension of the Mine by adding the Stefanów Field, including Saturday/Sunday work was subcontracted to external specialist companies. Additionally, this year, as in the previous years, the Company resumed post-production waste (carbonaceous shale) recovery and utilisation by carrying it away and rehabilitating the land, not – as was the case in the first five months of 2009 – by dumping the waste on the dumping site in Bogdanka.

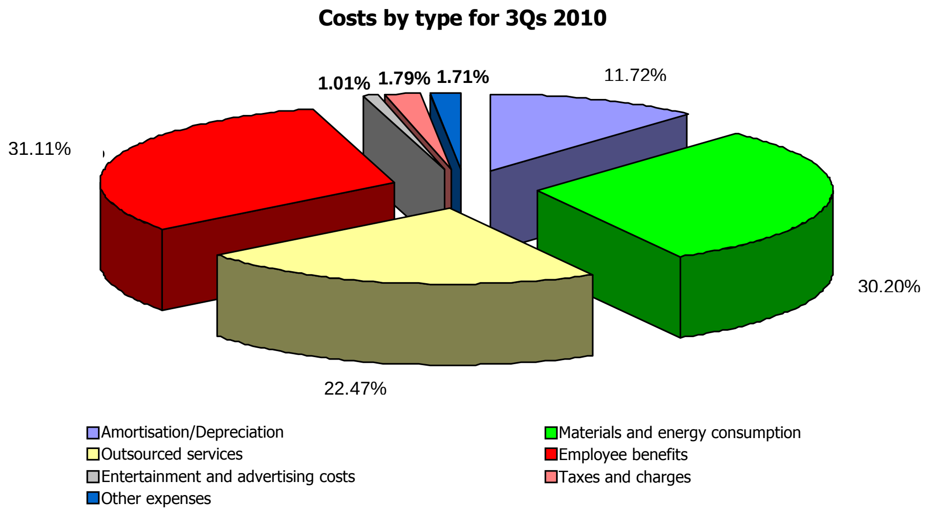
An analysis of the increase in the costs of materials and energy consumption shows that the increase is mostly the result of:

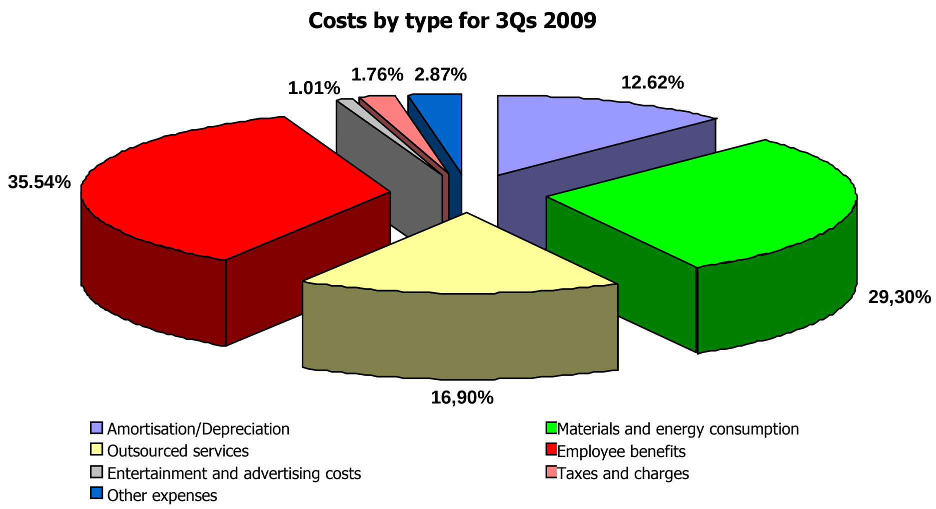
- an increase in the costs of materials used (by 11.31%, attributable mostly to higher demand for steel, conveyor belts, fuel and power engineering products used in the construction of underground workings);

an increase in the costs of energy (by 8.33%, attributable to higher costs of electricity and thermal energy).The presented changes in costs by type were reflected in a change of the structure of costs by type. In the first nine months of 2010, the most significant position, as was the case in the same period of the previous year, was the employee benefits costs, even though their share decreased by 4.43 p.p. to the level of 31.11%. The share of material and energy consumption costs increased and it currently accounts for 30.20% of the total costs by type. As a result of a significant increase in the costs of outsourced services, their growth was the highest, i.e. from 16.90% in the first three quarters of 2009 to 22.47% at present (three quarters of 2010). It should be noted that the above cost items (materials and energy, employee benefits, outsourced services) account for over 83.75% of the total costs incurred by the Company.

Table 17 Structure of costs by type at LW BOGDANKA S.A.

| item | III quarter of 2010 | III quarter of 2009 | Change |
|---|---|---|---|
| Amortisation | 11.72% | 12.62% | -7.09% |
| Materials and energy consumption | 30.20% | 29.30% | 3.05% |
| Outsourced services | 22.47% | 16.90% | 32.98% |
| Employee benefits | 31.11% | 35.54% | -12.46% |
| Taxes and charges | 1.79% | 1.76% | 1.31% |
| Entertainment and advertising expenses | 1.01% | 1.01% | -0.62% |
| Other expenses | 1.71% | 2.87% | -40.49% |
| **TOTAL** | **100.00%** | **100.00%** | |




### 4.4.2 Costs by function

For the first nine months of 2010, Lubelski Węgiel Bogdanka S.A.'s cost of products sold was PLN 688,678,000, which means an increase by PLN 55,177,000, or 8.71%, compared to the same period of the previous year. An analysis of the different components of the cost of products sold shows that the increase is attributable to an increase in the cost of products, goods and materials sold (by 13.00%), with administrative costs and the costs of sales down by 1.86% and 35.37%, respectively.

A decrease in selling costs is, among other things, a result of lower costs of maintenance and repair in respect of the rail transport department's assets.

Table 18 Costs by function

| item | III quarter of 2010 | III quarter of 2009 | Change [%] | Change [PLN '000] |
|---|---|---|---|---|
| Cost of products, goods and materials sold | 614,652 | 543,957 | 13.00% | 70,694 |
| Selling costs | 26,720 | 41,343 | -35.37% | -14,623 |
| Administrative costs | 47,306 | 48,201 | -1.86% | -895 |
| **Cost of sales** | **688,678** | **633,501** | **8.71%** | **55,177** |

Due to a significant increase in the costs of products, goods and materials sold, the structure of the Group's cost of products sold changed. The predominant item in the structure is still the cost of products, goods and materials sold (up from 85.87% in 2009 to 89.25% in 2010), while the other costs in this group of costs were lower: now the cost of sales account for 3.88% and administrative costs for 6.87% of the cost of products sold.

## 5. INFORMATION ON KEY INVESTMENTS IN FIXED ASSETS AND EQUITY INVESTMENTS OF THE LW BOGDANKA GROUP

### 5.1 LW BOGDANKA GROUP's investments in fixed assets in the third quarter of 2010

A list of LW BOGDANKA GROUP's key investments in fixed assets in three quarters of 2010 is presented in the table below.

Table 2 LW BOGDANKA GROUP's key investments in fixed assets over the period of the first 3 quarters of 2010 (PLN '000)

| Key investments in fixed assets | Expenditure incurred over the period 01.01.2010 - 30.09.2010 | Expenditure incurred over the period 01.07.2010 – 30.09.2010 |
|---|---|---|
| Building and assembly works | 271,889 | 113,676 |
| Completion of deliveries and purchases of finished products | 223,937 | 31,819 |
| Other issues | 2,854 | 1,750 |
| Advance payments for fixed assets under construction | 96 | 57 |
| **Total** | **498,776** | **147,302** |

In September 2010, the Company's Investment Expenditure Plan was reviewed. In line with its new Plan, the total investment expenditure will amount to PLN 856,969,800 in 2010.

**Works completion stage as of 30 September 2010**

**<u>Building the Excavation and Ventilation Shaft 2.1 in the Stefanów Field</u>**

1. Shaft 2.1: The I-Beam deck is being dismantled, works are carried out to adapt the Head to build the Hoist Tower's guiding system.
2. Hoist Tower: Steel support construction is being erected with the degree of its completion being 30%. Foundations for the Tower's angle braces, emergency hoist, and friction winch have been completed in full. Foundations for the Shaft tower' passageway have been built. The shaft top

building for Shaft 2.1: some of the trench works have been completed, the building's steel support construction is being slowly built with completion percentage of approx. 10%

3. The Ventilation Channel that connects the Shaft with the Main Fan Station is under construction at the moment. Channel mouth into the Shaft is under construction too.
4. Storage Reservoirs are being drilled in the Stefanów Field: 34 m long 2fS Storage Reservoir - (24m left to completion, and the loading chamber is being torcreted); 1fS Storage Reservoir: the upper part of the crossing of the 4fS Belt Heading with the 1/385 Southern Heading has been rebuilt, and works have been commenced to rebuild the loading chamber.

**Development of the Mechanical Coal Processing Plant**

1. Mechanical Coal Processing Plant is to be developed up to the processing capacity of 2,400 t/h. In 2010, the tendering procedure was completed, and the Contractor for these building works has been selected, i.e. the Consortium of Mostostal Warszawa S.A. and Acciona Infraestrukturas S.A. On 29 June 2010, a Contract was signed to complete the Project within the period of 18 months from the day of executing the Contract. At the moment, we are at the stage of compiling working designs.
2. Transport of the excavated material from Shaft 2.1 in Stefanów: in 2009, the tendering procedure was conducted and the Contractor was selected, i.e. Polimex – Mostostal S.A., with which, on 30 November 2009, the Building Works Contract was signed with its completion time of 12 months from the day of Contract signature. As of 30 September 2010, these works were completed in approx. 35%.
3. Development of the coal dump facility: procedures are underway in relation to the drawing up the Site Improvement Plan as well as construction and detailed documentation.

**Other investments in the Stefanów Field's technical infrastructure**

1. The hoisting machine building has been prepared for both the machine and the switching station to be installed in it. Mechanical works have been already completed in the hoisting machine. Electric works are underway.
2. The Main Fans Station: this facility has been completed in approx. 70%; main fans have started to be installed in their mechanical part.
3. Other investments: the OHS complex is being extended (at the third and fourth floor) and a car park for passenger cars is being built.
4. The air-conditioning station has been completed as far as the building discipline is concerned, electrical control installation is being mounted, and pipelines are being built downstairs and at the bottom of the pit.

**Development of the Bogdanka station's track system**

1. In 2010, the tendering procedure was completed, and a construction works contract was signed on 25 June 2010 with the Consortium of VolkerRail Polska Sp. z o.o. and Schweerbau GmbH & Co. KG Bauunternehmen, with the completion time being 6.5 months from the day of executing the Contract. The progress of works to completion is about 40%.

**Making coal deposits available**

1. Workings at level 990 in the Stefanów Field: drilling processes of all workings at level 990 have been completed; W detour rebuilding works are just about to be finished.
2. Ventilation and transport workings: in October, the drilling of the ventilation heading 1/VIII/385 will be completed (its current length is 763.7 m).
3. Workings in deposit 385/2 aimed at starting up the first 7/VII panel in the Stefanów Field: The drilling of the 7/VII upper road and the 7/VII cross-cut has been completed; the 7/VII bottom road has achieved the length of 5 182.6 m.
4. Workings in deposit 385/2, Field VII: The 5/VII – 988.1 m long bottom road is currently being drilled; the 6/VII bottom road is 145.0 m long.

**Purchases of finished goods**

1. Reinforcement of panel 1/VI in deposit 385: Providing a coal-ploughing system that includes: powered roof support sections, panel scraper conveyor, mining plough, 3.3 kV supply and control devices, bottom road scraper conveyor. In 2009, costs were incurred of the advance payment to the amount of 10% of the coal-ploughing system's total value, as well as costs of assembly of the scraper conveyor and partial assembly of the panel lining. Panel reinforcement works were completed in the first quarter of 2010, and the panel was commissioned on 1 April 2010, achieving very good progress parameters and the design efficiencies. In October 2010, the coal-ploughing system is supposed to be withdrawn from the 1/VI/385 panel, and it will be relocated into the 7/VII panel as soon as it is made longer up to the length of 305 m. The coal-ploughing system will be re-started in June 2011. The advance payment for making the 7/VII panel set longer, in the amount 10% of the total value thereof, has already been made.

2. The main items to be purchased are as follows:

   - Coal-ploughing system,
   - Belt conveyors,
   - Means of transport at the bottom of the pit (suspended locomotives, transport sets, mobile winches, people carrying car strings, containers, trolleys, timber carriers)
   - Transformer stations and switch-off facilities,
   - Hydraulic pumps and power packs,
   - Coal cars,
   - Roof bolter,
   - Wall cooling facilities,
   - Road-heading machines,
   - Establishing the right of perpetual use of land

The total amount for the above-mentioned items is PLN 84,023.100 in the 2010 Plan.

**Replacement investments**

1. Erecting buildings in the Bogdanka and Nadrybie Fields
2. Development of the existing buildings
3. Switching station buildings for hoisting machines and other electrical and power systems
4. Power supply and control systems for LV facilities and workshops
5. Telecommunications systems and devices
6. Alarm and monitoring systems
7. Modernising some mining machines

8. Machinery repairs
9. Power and telecommunications cable networks
10. Replacement investments in the Mechanical Coal Processing Plant

**Environmental protection**

1. Extending the mining waste dump
2. Storage reservoir Szczecin.

### 5.2 Planned capital expenditure for development purposes in 2010-2014

In pursuance of its investment programme, LW BOGDANKA concluded agreements for the performance of all key investment tasks planned for the Stefanów Field project (construction and equipment for shaft 2.1, development of the Mechanical Coal Processing Plant, and construction of conveyor system for transporting yield from the Stefanów Field to the Mechanical Coal Processing Plant). The abovementioned agreements are performed as per the adopted timetable.

The highest capital expenditure for development purposes will be incurred in 2010 and 2011, and will amount to PLN 618 million and PLN 455 million, respectively.

In the period of 2010-2014, the Company intends to allocate the total of approx. PLN 1.8 billion for development purposes, allowing for outlays for mining works related to preparation and providing access.

### 5.3 LW BOGDANKA Group's equity investments in the third quarter of 2010

The LW BOGDANKA Group did not carry out any equity investments in the third quarter of 2010.

## 6. LW BOGDANKA S.A. MANAGEMENT BOARD'S POSITION ON THE POSSIBILITY TO ACHIEVE PREVIOUSLY PUBLISHED FORECAST RESULTS FOR A GIVEN YEAR, IN THE LIGHT OF RESULTS PRESENTED IN THE QUARTERLY REPORT COMPARED TO THE FORECAST RESULTS

On 30 September 2010, the Company published its current report no. 38/2010 containing forecasts of the LW BOGDANKA Group's financial results for 2010.

An analysis of the Company's technical, economic and financial results achieved during the first nine months of 2010 and of the prospects for the remaining months of the year shows that the Company's profit from extraction of commercial coal in 2010 will be the highest in the Company's history.

The forecast increase in extraction and sales of coal will affect the Company's revenue (although the average sale price for all of 2010 is expected to be slightly lower than that for all of 2009), the unit cost of production of coal and, therefore, the Company's financial results.

The table below contains the forecast and actually achieved values of selected items presented in the LW BOGDANKA Group's statement of comprehensive income in the first nine months of 2010.

Table 20. Forecast and achieved values (PLN '000) of selected items presented in the LW BOGDANKA Group's statement of comprehensive income in the first nine months of 2010 and forecast achievement percentages (%)

| Description | Forecast for 2010 (PLN '000) | Achieved in the first 3 quarters of 2010 (PLN '000) | Percentage achieved in the first 3 quarters of 2010 [%] |
|---|---|---|---|
| Net sales revenue | 1,228,000 | 934,224 | 76.08% |
| Operating profit | 242,000 | 233,140 | 96.34% |
| EBIDTA | 391,000 | 337,458 | 86.31% |
| Net profit | 201,000 | 192,980 | 96.01% |

The Group's net sales revenue for the first nine months of 2010 was PLN 934,224,000, which accounts for 76.08% of the forecast for all of 2010. In the first three quarters of 2010, the Group achieved its operating profit forecast for 2010 in 96.34% and its EBIDTA (operating profit before amortisation) in 86.31%. The Group's net profit for the first nine months of 2010 was PLN 192,980,000, accounting for 96.01% of the net profit forecast for all of 2010.

As of the date of submission of this Report, the Management Board of Lubelski Węgiel Bogdanka S.A. does not see any threats to the Group's operations that might result in the Group's failure to achieve its forecasts for 2010, including the forecasts for its sales revenue, EBITDA and net profit.

The Company continuously monitors its technical and financial performance as well as its capacity to achieve its published financial forecasts. Any changes of its financial results equal or exceeding 10% in relation to the forecasts will be communicated to the public in current reports.

## 7. DEVELOPMENT STRATEGY OF THE LW BOGDANKA GROUP

The strategic objective of the development of the LW BOGDANKA Group is to build and increase its value for the shareholders by:

- gaining access to new reserves and increasing the level of coal extraction based on the enlargement of the Stefanów Field;
- maintaining a stable position as the main supplier of coal in eastern Poland, particularly for the commercial power industry;
- strengthening its competitive position by cutting the units costs of extractions and production.

The main strategic objectives of development defined by the LW BOGDANKA Group are:

- doubling the level of extraction of raw materials and thereby doubling the share in the market for hard coal producers in Poland,
- improving the efficiency of hard coal extraction and production,
- ensuring that LW BOGDANKA S.A. is self-sufficient regarding the supply of electricity by developing electricity production activities,
- environmental protection measures.

In the near future, measures aimed at implementing the planned development strategy of the LW BOGDANKA Group will primarily focus on the implementation of the Company's investment tasks, including the development of the Mechanical Coal Processing Plant.

Enlarging the Stefanów Field will enable the production capacity of LW BOGDANKA S.A. to be doubled, as well as the annual quantity of hard coal extraction, starting from 2011 (from the present 5.7 million tonnes through the extraction estimated for 2011 at 6.8 million tonnes, in 2012 at 8.3 million tonnes, in 2013 at 10.3 million tonnes to the target level of 11.5 million tonnes per annum in 2014).

As the coal extraction and processing develops, the Company sustains its intention to increase employment to the target figure being as much as 4,400 employees. In 2014, the unproportionate increase in extraction over the increase in labour costs will allow the Company to improve the operating costs structure, reduction of unit costs and an improvement of efficiency per employee from the current 1,460 tonnes per annum to approx. 2,660 tonnes per annum in 2014.

# 8. DESCRIPTION OF RISK FACTORS, THREATS AND FACTORS WHICH, IN THE ASSESSMENT OF LW BOGDANKA S.A., WILL AFFECT THE RESULTS ACHIEVED BY THE COMPANY WITHIN AT LEAST THE FOLLOWING QUARTER

## 8.1 Risk associated with the Company's market environment

### 8.1.1 Risk of a hostile takeover of the Company

Following its flotation on the Warsaw Stock Market on 25 June 2009 and the start of trading in shares issued following an increase in the Group's share capital, the Lubelski Węgiel Bogdanka S.A. Group has become part of the capital market in the broad sense. On 9 March 2010, the Polish State Treasury sold, in block trades, 15,882,000 shares held in the Company. As a result, the majority of the Company's shares are held by private shareholders and 90.5% of its shares can be traded in on the Warsaw Stock Exchange. Under these circumstances, the Company is exposed to the risk of a hostile takeover.

Given the investment projects being implemented and planned (the Stefanów Field), which are expected to increase the mine's annual coal output to 11.5 million tonnes (by 2014), its growing market share, its very good results and continuously growing technical, economic and financial performance, the Company may be the object of a hostile takeover.

A hostile takeover attempt may be made by an investor operating in the fuel and energy industry and being the owner of or planning to acquire mining plants or planning to build, within the geographical area of the Group's operations, new power-generating facilities based on coal with characteristics similar to those of the coal produced by the Company. The above risk of a hostile takeover puts the Group at risk of failure to implement its development programme and to carry out its operating strategy.

The level of this risk is the highest in the period of implementing the Group's investment activities, when such activities are not producing any economic benefits resulting in an increase in the Company's results and capitalisation.

### 8.1.2 Risk associated with the social and economic situation in Poland and the world

LW BOGDANKA Group's financial position depends on the economic situation in Poland and the world. The financial results generated by the Company are affected by the rate of increase in domestic and global GDP, particularly the rate of increase in industrial production, changes in exchange rates, the level of inflation, the rate of unemployment, national fiscal policy, and the demand for electricity and heat energy, etc.

In the event of a significant deterioration of the economic situation of the customers for the power coal or in connection with a deterioration of economic situation in Poland, which will result in a decrease in demand for electricity and heat energy, the Group's financial results may decline. However, due to long-term agreements, which oblige the customers to specified level of power coal purchase, the risk of significant decline is scarce. This thesis finds its confirmation in the fact that regardless of the macroeconomic situation in Poland and the world, since 1994 the LW BOGDANKA Group has regularly achieved positive financial results.

### 8.1.3 Factors associated with the economic policy of the State in relation to the hard coal mining sector

The plans of the Ministry of Economy and the Ministry of State Treasury concerning the enterprises operating in the hard coal mining and power sector are an important factor influencing the LW BOGDANKA Group's market position. Those plans are set forth in particular in the following documents:

- "Strategy for hard coal mining sector in Poland for 2007-2015" adopted by the Council of Ministers in July 2007,
- "Poland's energy policy until 2025" adopted by the Council of Ministers in December 2004, which includes the consolidation plans for the fuel-energy sector, updated by the "Poland's energy policy until 2030" adopted by the Council of Ministers on 10 November 2009.
- "The privatisation plan for 2008-2011" adopted by the Council of Ministers on 22 April 2008, updated on 10 February 2009.

Implementation or amendment of the adopted assumptions may have a significant impact on the future competitive position and financial results of the LW BOGDANKA Group. The Group's competitiveness may be threatened by government aid for restructured Silesian mines involving subsidies, debt redemption and entity-specific grants.

### 8.1.4 Risk associated with the levels of prices for raw materials for power production in Poland and the world

The levels of prices of raw materials for power production, including the prices of power coal and raw materials which constitute an alternative to power coal (crude oil, natural gas, renewable sources) on global markets and therefore on the domestic market, have key significance for the activities conducted by the LW BOGDANKA Group.

LW BOGDANKA S.A. mitigates the risk associated with prices of raw materials for energy production by signing long-term commercial contracts with key customers for power coal. Information on the material trade agreements signed by the Group in the period of three quarters of 2010 is presented in section 11 of the Report.

### 8.1.5 Risk associated with the specific nature of mining sector operations and the possibility of unforeseen events

The operating activities of the LW BOGDANKA Group are exposed to risks and dangers beyond its control resulting from the specific nature of conducting activities in the mining industry. These include events associated with the environment (e.g. industrial and technological malfunctions) and extraordinary events (e.g. geotechnical phenomena, mining disasters, fires or flooding of excavations with mine waters). Such events or phenomena could cause a temporary suspension of the LW

BOGDANKA Group's operating activities or losses relating to property, financial assets and employees or could result in the LW BOGDANKA Group being held legally liable.

The most important natural threats occurring in the mine include:

- coal dust explosion threat – class "b";
- fire threat - IV self-combustion group (on a five-grade scale);
- water threat – category I and II (on a three-grade scale).

Another key risk associated with the specific nature of mining operations is mining damage. The relevant legislation, including the Environmental Protection Law and the Act on the Protection of Agricultural and Forest Land, impose an obligation on mining companies to reclaim post–industrial land, which means they have to incur related costs, which could have an adverse effect on the financial results achieved by the Group in the future.

The safety level of the operating conditions in LW BOGDANKA S.A.'s mine is relatively high, which is reflected in the low accident indicators compared to other companies in the industry. This is due to, in particular, the Company's strict compliance with the principles of health and safety in the workplace, ongoing monitoring of threats at individual workstations, appropriate preventative measures, the absence of the risk of mine collapses, gas breakouts and rock outbursts and the low risk of a methane explosion (category 1 methane threat on a four-grade scale).

Other factors which reduce the effect of the risk associated with the specific nature of the mining industry on LW BOGDANKA S.A.'s operations include:

- the Company's use of advanced mining machines and equipment, which reduces the risk of industrial malfunctions occurring;
- no geological disruptions occurring and the fact that the mining deposits are relatively regularly laid out;
- the relatively low costs of repairing mining damage resulting from the low urbanisation of the area in which LW BOGDANKA S.A. extracts hard coal.

### 8.1.6 Currency risk

An analysis of the Group's historical data shows that between 0.03% and 0.07% of the Group's total sales revenue was generated by exports. This means that the main market for the Group is the Polish market and, therefore, the majority of the Group's transactions are settled in the Polish currency. As of the date of submission of the financial statements, the Group's operations are not exposed to currency risk.

The situation is different in the case of investing activities, where certain transactions (e.g. the purchase of a longwall coal ploughing system for low deposit mining) were denominated in the Euro currency. For the purposes of such transactions, the Group purchased foreign currency and kept it in a bank account until the payment of the invoice. Following changes in world markets, the PLN/EUR exchange rate fluctuated, which resulted in the Group's gain/loss on foreign exchange differences. As the Group plans to purchase other fixed assets in the future, including another longwall coal ploughing system, it may be exposed to currency risk in the future.

### 8.1.7 Liquidity risk

In mid-2009, the Lubelski Węgiel Bogdanka Group raised PLN 528 million gross by issuing 11 million shares. The Issue Prospectus said that the money raised from increasing the share capital would be used as financing for the Group's investment plan (e.g. the development of the Stefanów Field).

A major factor in evaluating a company's insolvency risk is the level of the company's operating cash flows, cash and liquidity ratios. As of 30 September 2010, the Group's cash is PLN 518,052,000, current ratio is 2.91 and quick ratio is 2.72. In the period from 1 January 2010 to 30 September 2010, cash flows from operating activities continued at more or less the same level in relation to the figure for the same period of 2009 and amounted to PLN 283,836,000. As of the date of submission of the financial statements, the Group is not threatened with insolvency. In order to avoid potential threats to the Group's solvency in the future and to minimise liquidity risk, the Group prepares long- and short-term analyses and forecasts as the basis for identifying the Group's cash requirements. This enables the Group to plan its inflows and outflows and to determine the optimum level of cash and the optimum method of financing for the future, taking into account the principles of economic calculation.

### 8.1.8 Credit risk

As of 30 September 2010, the Group's debt (long- and term-liabilities) is PLN 250,000,000. As the Group plans to develop the Mine further in the future (launching coal extraction in the Stefanów Field, purchasing new mining machinery and equipment, etc.) and as levels of cash flows from operating activities and money raised by issuing shares are limited, the Group may have to use additional sources of external financing, e.g. a bank loan.

Under the current economic circumstances in Poland, it is increasingly likely that the Polish Monetary Policy Council will raise interest rates (this is expected to happen at one of the Council's meetings in the near future). A rise in interest rates will translate into higher WIBOR rates, which are the reference rates for calculating the Group's cost of capital. This, in turn, will result in an increase in the Group's financial expenses and lower gross and net profit/loss figures.

Given its present debt of PLN 250 million, the Group is exposed to the risk of failure to repay the loan in full or in part. However, the Group prepares and reviews long-term analyses on an ongoing basis.

## 8.2 Risk directly associated with the Group's operations

### 8.2.1 Technical and technological risk

Extracting coal from underground seams is a complex process which is subject to strict technical and technological requirements. During such operations, various kinds of stoppages can occur due to planned and unplanned technical interruptions (e.g. malfunctions). There is a potential risk associated with the effect of unplanned stoppages caused by serious malfunctions on the volume of extraction and sales and the possibility of punctually making deliveries to the customers of the LW BOGDANKA Group, and therefore on the financial results achieved by the Group in future.

The Company stresses that the risk of stoppages occurring in hard coal extraction operations is minimised by the fact that LW BOGDANKA S.A. extracts coal by the longwall system and its target production capacity is obtained from two mining faces, while due to technical and technological mining conditions the planned level of extraction can be maintained if a stoppage occurs at one of the faces by intensifying work on the other. The enlargement of the Stefanów Field planned by the Company and the associated start-up of a second mining shaft will further reduce the risk of a technological stoppage by ensuring the continuity of hard coal extraction if one of the shafts breaks down.

The Company would also like to point out that it uses advanced mining equipment and machines in its mining operations and conducts intensive research and development work aimed at increasing the productivity of its operations, introducing solutions with a high degree of technical and technological reliability (underground coal storage silos with a capacity of 11,500 tonnes) and increasing the safety of the work environment. These measures will significantly reduce the Company's technical and technological risk.

### 8.2.2 Risk of IT systems malfunctioning

A partial or complete loss of data due to a malfunction of the Company's computer systems could adversely affect ongoing operations of the LW BOGDANKA Group and therefore affect its future financial results.

However, the Company stresses that LW BOGDANKA is systematically taking action aimed at minimising the risk associated with the possibility of IT systems malfunctioning. Our main database servers are in cluster arrangement, and we have the central data backup.

The Company implemented a "Policy for Safety of Information in the IT Systems of Lubelski Węgiel BOGDANKA S.A." regulating organisational and technical measures for data protection and maintaining the continuity of systems' operation. This refers to the organisation of access to data, making safety copies and their storage, using firewalls, anti-virus systems on servers and employees' PCs. The servers supporting the systems are a high-class equipment with double power and data storage systems. In order to increase the level of infallibility of the IT systems by means of virtualization technology, works are continuously carried out.

IT systems used at the LW BOGDANKA Group have no effect on operating activities associated with extracting hard coal and therefore if they malfunction the continuity of hard coal extraction would not be threatened.

### 8.2.3 Key customer risk

Vast majority of the power coal produced by the Company is sold to a relatively small group of large contracting parties operating on the domestic market. There is therefore a risk that the reduction or termination of cooperation with a key customer or the deterioration of the financial/economic situation of any of the main customers of the Company could have an adverse effect on the financial results achieved by the LW BOGDANKA Group.

As at the date of submitting the Report, the Company has agreements signed with key customers ensuring sales of the coal and reasonable financial and technical planning, and is intensely negotiating new agreements ensuring sales of the coal until the end of 2020. Also, the Company monitors the consolidation, privatisation and capital and ownership change processes regarding the main customers for its coal if such processes may significantly affect the Company's sales structure and/or make the Company more dependent on certain key customers. The Company monitors and analyses, on an ongoing basis, the economic and financial standing of its key customers and their compliance with deadlines for contractual payments, which significantly reduces the risk of unfavourable relations resulting from the possible deterioration of the financial standing of any of the Company's main customers for its coal.

### 8.2.4 Key supplier risk

The specific nature of the Company's operations requires applying technologies which often involve the use of highly specialised machinery and equipment as well as specialised services. Therefore there is a risk of problems occurring in identifying proper suppliers, as well as a risk of suppliers failing to meet their obligations under agreements concluded with the Company.

The LW BOGDANKA Group, when signing agreements with suppliers, assesses possible threats for the contract performance and options for establishing cooperation with other suppliers. Furthermore, in order to secure the performance of "higher risk" contracts, the Company requires that a performance bond is made.

### 8.2.5 Risk associated with competition by other power coal producers and the relatively low quality of the coal produced by LW BOGDANKA S.A.

On both the domestic and export markets, the LW BOGDANKA Group is exposed to price competition from other producers of power coal in Poland (e.g. the mine companies Katowicki Holding Węglowy S.A., Kompania Węglowa S.A. and Jastrzębska Spółka Węglowa S.A.), as well as from eastern markets (including Russia, Ukraine and Kazachstan) and import of the coal by sea form ARA ports.

In the case of domestic coal companies, significant risk factors associated with competition are:

- consolidation processes in the mining industry (vertical and horizontal consolidation within large energy groups) leading to the creation of powerful entities in terms of capital which determine how the domestic power coal market will develop;
- government assistance for hard coal mines in the Silesia region covered by a restructuring programme, which includes providing additional funding, cancelling debts and company subsidies,

In the case of coal suppliers from eastern markets, LW BOGDANKA Group has a significant logistical advantage.

In comparison to Polish producers of hard coal, the Company's competitive strengths minimise the risk associated with price competition.

Another significant risk factor associated with competition are the less favourable quality parameters of the coal compared to the hard coal mined in the Silesia region (its lower calorific value and higher sulphur content), which limits the range of applications of the coal extracted in LW BOGDANKA S.A. to industry and power production and forces the Company's customers to invest in fume desulphurisation installations. However, because customers for power coal have technologies which are prepared for burning coal with a particular calorific value and because, as at the date of submitting this Report, all the key customers of the Company have fume desulphurisation installations, the risk associated with the less favourable quality parameters of the coal produced by LW BOGDANKA S.A. is limited.

### 8.2.6 Risk associated with the strong position of the trade unions in the Group

Trade unions hold a significant position in the hard coal mining sector and play an important role in determining staff and payroll policy, frequently forcing renegotiations of wage policy through protest actions. As at the day of submitting the Report, four trade union organisations were operating at the Company, whose membership constituted a total of 63% of the Company's employees, and a total of six trade union organisations operated in the LW BOGDANKA Group bringing together 62,5% of its employees.

The strong position of the trade unions creates a situation in which there is a risk of the costs of remuneration increasing under negotiated wage agreements in future, which could adversely affect the financial results of the LW BOGDANKA Group. Furthermore, any protests and/or strikes organised by the trade unions operating in the LW BOGDANKA Group could affect the operating activities conducted by the Group. It concerns also possible protests connected with a risk of the Company's hostile takeover.

In the Company's opinion, cooperation of the Management Board of LW Bogdanka with the trade unions operating in the Company has so far been successful. The Company's objectives include continuation of the cooperation between its Management Board and the trade unions in order to maintain good mutual relations and increase the unions' involvement in achieving the Company's objectives and strategy.

### 8.2.7 Risk of delays in planned investments due to the obligation to apply the Public Procurement Act

The granting of contracts by entities conducting business activities involving mining hard coal for the purpose of conducting those business activities is subject to the provisions of law on public utilities contracts. The way the Public Procurements Act has been applied in the past shows that, because of protests and cancellations and also the frequent invalidation of tenders, granting a contract can significantly delay the commencement of an investment. A delay in an investment can result in an increase in costs or a decrease in revenues for LW BOGDANKA and therefore adversely affect its financial results. The Company exercises due diligence to ensure that issues associated with granting public contracts do not cause delays in carrying out investments.

### 8.2.8 Risk of the employees of the Company being additionally employed at Korporacja Gwarecka S.A.

In 2002, former and present employees of LW BOGDANKA S.A. founded Korporacja Gwarecka S.A., which, as at the date of submitting the Report, cooperates with the Company. That cooperation involves Korporacja Gwarecka S.A. providing outsourcing services to the Company, whereby it provides workers to perform mining and maintenance/refurbishment work on Saturdays, Sundays and holidays. Because that work requires that people with appropriate qualifications and experience be employed, the people employed by Korporacja Gwarecka S.A. are mainly employees who work at the Company from Monday to Friday on the basis of an employment contract concluded directly with the Company.

If the performance of work by employees of LW BOGDANKA S.A. contracted from Korporacja Gwarecka S.A. or a different external entity for LW BOGDANKA S.A. could not be continued, the Company would be forced to employ additional employees or limit its production, which could adversely affect the financial results achieved by the LW BOGDANKA Group.

## 8.3 Risk factors associated with proceedings and legal environment

### 8.3.1 Risk of change to tax laws

The laws on the tax on goods on services, the corporate income tax, personal income tax, real property tax and social insurance contributions are frequently changed, which results in certain inconsistency and unpredictability in the conduct of tax authorities in relation to taxpayers. The regulations currently in force also include discrepancies and unclear issues which result in differences of opinions as to the legal interpretation of the tax laws both between state authorities and between state authorities and companies. Tax settlements may be the subject of control of tax authorities which, if irregularities are found, have the right to calculate the tax arrears with interest. Tax statements submitted by companies may be reviewed by fiscal authorities for the period of five years and some transactions carried out in that period, including transactions with affiliates, may be questioned for tax purposes by competent tax authorities. As a result, the amounts disclosed in the financial statements may be changed at a later date, when they are determined in a final way by fiscal authorities.

### 8.3.2 Risk of real estate tax on mining excavations

In line with its strategy, when the Company draws up its real estate tax returns, it does not take into account the value of building structures and equipment located in its pits for the purposes of calculating the tax. There is a risk of the tax authorities and courts taking a position in this matter according to which for the purpose of charging real estate tax, a mining excavation should be treated not as a unified structure but as a building structure consisting of individual structures (or devices) which are functionally connected to each other, i.e. shafts, side drifts, power lines etc. used to extract minerals. In this sense, the structures and devices in question would constitute a constituent part of a pit used for conducting business activities and real estate tax should be levied on those structures (devices). Such a risk is indicated by certain court judgements issued in the context of factual statuses which occurred after 1 January 2003, i.e. after the amendment of the Act on Local Taxes and Charges (consolidated text in Dz.U. of 2006, No. 121, item 844, as amended), by virtue of which a definition of building structures was introduced into the Act on Local Taxes and Charges by reference to the provisions of construction law (e.g. the judgements of the Provincial Administrative Court in Wrocław of 14 April 2008 and of 16 May 2007). The issue of charging real estate tax on mining excavations and the building structures and equipment located in them is controversial in the light of applicable tax laws.

For the purposes of calculating real estate tax on mining excavations, the value of fixed assets recorded in the fixed asset account in group 2 (land and water engineering structures), subgroup 20 (complex building structures in industrial areas), type 200 (building structures for mining) is taken into account, with the exception of selected fixed assets.

Please also note that in December 2008 a government draft amendment to the Mining and Geological Law was put before the Sejm (the lower chamber of Polish parliament). The draft provides that "underground mining excavations and the installations and equipment that they contain are not building structures or construction devices in the meaning of the provisions of construction law". If an amendment to the act is adopted in this form, it will settle the issue of whether mining excavations should be subject to real estate tax, though this would only be effective in the future. The ministerial justification for the amended provisions states that the proposed change results from the inconsistency of past judgements and practice relating to charging real estate tax on mining excavations and the building structures and devices located in them. However, it does not refer to the issue of taxation or its absence until the moment when the amended laws are introduced. As at the date of submitting the Report, there are still legislative works pending as regards the draft - the Mining and Geological Law.

### 8.3.3 Risk of a change in the law and its interpretation and application

The provisions of law in Poland are frequently changed. Interpretations of the law and the way in which it is applied are also changed. Laws can be changed to companies' advantage, but changes can also have adverse consequences. Changing laws and varying interpretations, particularly with regard to tax law, geological and mining law, the law governing business activity, labour and social security law and the law relating to securities, could have adverse consequences for the Group. Particularly frequent are interpretational changes in tax laws. There is no consistency in the practice of tax authorities or in case law relating to taxation. If tax authorities adopt an interpretation of tax law which differs from that adopted by the Group or if the Mining Law introduces new requirements to be imposed on the Company, it could lead to a deterioration of its financial situation and as a result negatively affect its results and development prospects.

In order to minimise this risk, the Company monitors changes and possible changes to legislation (during the legislative process) as well as legislative interpretations that may directly or indirectly affect the Group's activities, its financial situation and results, and responds appropriately in such cases.

### 8.3.4 Risk of a decrease in demand for hard coal from the Polish power industry

There is a limited risk that the Polish power industry may be able to switch to a raw material other than hard coal within the next 10 years. However, it is expected that the probability of a decrease in demand for coal will increase in subsequent years.

The Company currently has long-term contracts which secure it from the risk of a change during the next few years. Poland's long-term power production policy up to 2030 assumes that power production based on hard coal will be maintained.

The Company is taking measures aimed at further long-term securing of its provision of coal for commercial power production, relating to existing and prospective power units within the area of its operations. The Company with other entities is also taking action to explore the possibilities to increase the use of hard coal in Poland, which involves the future introduction of a coal gasification installation

### 8.3.5 Risk of unfavourable/inappropriate contractual terms being concluded

Due to the high degree of complexity of the agreements signed by the Company (particularly those relating to the purchase of specialist equipment and technology), it is exposed to a risk of an agreement being concluded on unfavourable terms.

This risk also occurs where a business partner has a very strong negotiating position (e.g. in the case of a contract for deliveries from the only manufacturer of a particular product).

Sales agreements do not currently refer to any market indices, but there is an increasing tendency to adapt contracts with customers in line with market conditions. It is expected that within a few years there will be no more agreements which do not contain a reference to the market.

The Company is taking the following measures to minimise the probability of this risk occurring and its impact:

- rigorous legal and substantive supervision of the process of concluding agreements resulting from tender procedures according to the procedures of public tenders and others;
- securing commercial contracts relating to the sale of its products with an option to renegotiate the prices depending on market changes that may occur;
- training in the logistics of concluding contracts and market analysis and training in negotiations and trading, particularly at the international level.

## 9. PROCEEDINGS PENDING BEFORE A COURT, THE RELEVANT AUTHORITY FOR ARBITRATION PROCEEDINGS OR A PUBLIC ADMINISTRATION AUTHORITY

As at the day of preparing the Directors' Report on Operations of the LW BOGDANKA Group for the third quarter of 2010, neither LW BOGDANKA S.A. nor its subsidiary were parties to proceedings pending before court, arbitration body or administrative body, regarding:

- liabilities or claims of LW BOGDANKA S.A. or its subsidiary worth at least 10% of LW BOGDANKA S.A.'s shareholders' equity,
- two or more proceedings concerning liabilities or claims worth a total of at least 10% of LW BOGDANKA S.A.'s shareholders' equity.

## 10. RELATED PARTY TRANSACTIONS

In the third quarter of 2010 the Company and its subsidiary concluded no significant transactions with related entities which would be individually or jointly significant and would be concluded on terms other than market terms.

Information on the transactions of LW BOGDANKA Group with affiliated companies is set out in Section 10 of the abridged consolidated quarterly financial statements of the LW BOGDANKA Group for the third quarter of 2010.

## 11. OTHER INFORMATION WHICH IN THE OPINION OF THE MANAGEMENT BOARD IS SIGNIFICANT FOR ASSESSING THE EMPLOYEES, ASSETS, FINANCIAL STANDING AND FINANCIAL RESULT AND CHANGES THERETO AND INFORMATION WHICH IS SIGNIFICANT FOR ASSESSING THE POSSIBILITY OF THE LW BOGDANKA GROUP SETTLING ITS LIABILITIES

### 11.1 Tender offer to acquire shares in BOGDANKA S.A.

On 5 October 2010, New World Resource N.V. ("NWR"), a company with its registered office in Amsterdam, the Netherlands, announced a tender offer for shares in LW BOGDANKA S.A. in connection with NWR's plans to acquire shares in the Company conferring the right to 100% of the total votes in the Company, under Article 74.1 of the Act on public offering and on conditions for introducing financial instruments into organised trading and on public companies of 29 July 2005 and in accordance with the Regulation of the Minister of Finance of 19 October 2005 laying down provisions for the form of tender offers for the sale or exchange of shares in public companies, detailed rules for announcing such offers, and the conditions for acquiring shares as a result of such offers. As of the date of submission of this Report and as announced, the shares covered by the Tender Offer will be acquired for the price of PLN 100.75 (one hundred zlotys 75 groszy) per share in the Company.

The original deadline for subscribing for the shares (i.e. 25 October 2010) was extended on 22 October 2010, to 29 October 2010.

On 21 October 2010, the Company's Management Board, under Article 80.1 of the Act on Public Offering, communicated its position on the tender offer in Current Report No. 41. The Management Board of Lubelski Węgiel BOGDANKA S.A. stated that NWR's plans had not been consulted on or discussed with the Company's Management Board before the date of announcing the Tender Offer. The Management Board firmly opposed to the takeover attempt and pointed out the risk of a significant adverse impact that the acquisition may have on the Company as well as the lack of any financial, technological and organisational benefits from the acquisition. In addition, the Management Board emphasised that the price proposed by the Offeror is far below the fair value of the Company. The Management Board concluded its statement with the recommendation that the Company's shareholders should not respond to the Tender Offer and should continue to be shareholders in the Company.

The Company's Current Report No. 41/2010 was accompanied by a statement containing the opinion of the trade unions at the Company and an opinion, requested by the Management Board from Rothshild, regarding the cash consideration for shares in the Company as proposed in the Tender Offer.

In their statement, the trade unions expressed their concern that if the Company was acquired by NWR, it would no longer be an independent business entity. Moreover, in the opinion of Rothschild, the cash consideration proposed in the Tender Offer is not the fair, from a financial point of view.

## 11.2 Distribution of the resources from the budget subsidies to co-finance initial investments in 2010:

Under the Act on the operation of the hard coal mining sector in the period 2008–2015 of 7 September 2007 (Dz.U. of 19 October 2007), a mine may receive a budget subsidy to co-finance an initial investment on terms and conditions set forth in the Regulation of the Council (EC) no. 1407/2002 of 23 July 2002 on state aid to the coal industry (Official Journal L 205 of 02/08/2002, EU Official Journal, special Polish edition, chapter 8, vol. 2, p. 170).
The main criteria in allocating such subsidies include the effectiveness of the planned investment projects, the quantity of coal to be made available as a result of implementing the projects, and improvements in work safety as a result of such projects.
The Company applied for a subsidy for the construction of a shaft hoist for shaft 2.1 in the Stefanów Field operated by the Lubelski Węgiel BOGDANKA S.A. mining plant and for an extension of the Mechanical Coal Processing Plant, including transport and loading equipment at the Lubelski Węgiel BOGDANKA S.A. The total subsidy granted to the Company for the construction of the shaft hoist was PLN 19,451,437.

## 11.3 Conclusion of a significant agreement with ENERGA Elektrownie Ostrołęka S.A.

On 19 October 2010, the Company signed a Long-Term Agreement on the sale of power coal with ENERGA Elektrownie Ostrołęka with registered office in Ostrołęka.

The Agreement concerns the supply of power coal for the purposes of a new power unit in Ostrołęka - Unit C with the power of approx. 1000MW.

The term of this Agreement shall commence on the date of concluding the Agreement and expire upon completion of supplies due for the entire period of 19 years during which Unit C will be operated. The supplies as well as the operation of Unit C are to commence in 2016.

The price of coal shall be estimated for quarterly periods on the basis of the pricing formula connected with the prices of coal on global markets.

According to current prices, the net value of the entire Agreement amounts to approx. PLN 12.5 billion.

The Agreement provides for the following liquidated damages:

The Party to the Agreement which fails to collect or supply the contracted amount of coal in quarterly periods, shall pay the other Party the equivalent of its value.

The Agreement provides for the following terms of termination:

The Company may terminate the Agreement in the event of failure to conclude an agreement on designing, contracting and constructing planned Unit C as well as failure to complete the financing of power unit investment by 30 June 2012. The Parties may not terminate the Agreement during the first 12 years from the date on which the new unit starts to be operated. After this period the Parties are entitled to terminate the Agreement at a three years' notice period.

Terms and conditions of the Agreement do not differ from the standards applied in agreements typical for Project finance scheme.

### 11.4 Conclusion of a significant agreement with Elektrownia Połaniec S.A. – GDF SUEZ ENERGIA POLSKA Group

On 20 September 2010 the Company signed Annex No. 6 (the "Annex") to the Long-Term Agreement on Sale of Power Coal No. 3/W/2007, concluded on 30 October 2007 between the Company and Elektrownia Połaniec Spółka Akcyjna – Grupa GDF SUEZ ENERGIA POLSKA (the "Połaniec Power Plant"), with registered office in Zawada 26, 28-230 Połaniec, and described in the Issue Prospectus in section 8.6.3.2 (the "Agreement"), amended with Annex No. 5 (described in Current Report No. 2/2010 of 15 January 2010).

The Annex extends the dates of supplies agreed for 2010, described in the previous Annex, until 31 January 2011. Further, the Annex specifies the volume of supplies of power coal and price, and sets the schedule of quarterly supplies in 2011 performed following the end of supplies in 2010. Under the trade terms defined in the Annex, the Company's net revenue on coal supplies to the Połaniec Power Plant in 2011, to be performed following the end of supplies in 2010, will amount to PLN 290.7 million. The Annex is in effect from the day of the conclusion until 31 December 2011.

The signing of the Annex was announced by the Company in Current Report No. 36/2010 of 20 September 2010.

### 11.5 Fulfilment of the objectives of the issue/use of proceeds from the issue of series C shares

The purpose of the issue of series C shares was for the Company to obtain funds to finance the completion of selected key investment tasks being implemented as part of an investment programme commenced in previous years (starting from 1999) associated with increasing the production capacities of LW BOGDANKA S.A. with regard to the extraction of power coal by extension the Stefanów Field, which was previously financed from the Company's own funds.

Investments associated with completing the construction of the Company's technical infrastructure enabling new production capacities to be started up include the following objectives, as described in the Issue Prospectus, which we plan to carry out in the period 2009-2010 and, with regard to increasing the processing capacities of the Mechanical Coal Processing Plant, in 2009-2011:

- Building the excavation and ventilation shaft 2.1,
- Extension Mechanical Coal Processing Plant, including:
  - a) Increasing the processing capacity of the Mechanical Coal Processing Plant from the current level of 1,200 t/h to 2,400 t/h;
  - b) Construction of a system for transporting excavated material from the Stefanów Field to the Mechanical Coal Processing Plant;
  - c) Coal storage area extension.
- Other investments in the Stefanów Field's technical infrastructure, including:
  - a) Construction of structures in the Stefanów Field,
  - b) Air-conditioning of the underground part of the Mine,
- Extension of the Bogdanka station's track system.

In connection with the issue of series C shares, the Company obtained proceeds of PLN 528,000,000 (after deducting the costs of issue, LW BOGDANKA S.A.'s proceeds amounted to PLN 521,051,000). The proceeds from the issue of the Company shares will allow it to finance, except for investment tasks specified in the Issue Prospectus (objectives of the issue), additional projects, i.e. performance of mining excavations in the Stefanów Field, construction of storage silos in the Stefanów Field as well as the purchase of a coal mine face complex.

In the first three quarters of 2010, the Company used PLN 111,642,000 from the proceeds from the issue of series C shares (in the third quarter of 2010, the Company spend PLN 52,654 from that amount), to perform the following investment tasks:

- construction of lifting and ventilation shaft 2.1 in the Stefanów Field;
- construction of the excavated material haulage system from the Stefanów Field to the Mechanical Coal Processing Plant;
- construction of structures in the Stefanów Field (lifting machine building and switch room for shaft 2.1, as well as main fans station at shaft 2.1);
- Air-conditioning of the underground part of the mine.

## 11.6 Head count

Employment at the Company as at 30 September 2009 and 2010 is presented in the table below:

Table 21 Employment at the Company as at 30 September 2009 and 2010

| **Head count** | **III quarter of 2009** | **III quarter of 2010** | **Dynamics III quarter of 2010/ III quarter of 2009 [%]** |
|---|---|---|---|
| Total workers | 3,267 | **3,384** | 103.58% |
| Underground workers | 2,492 | 2,586 | 103.77% |
| Surface workers | 775 | 798 | 102.97% |
| Full-time employees underground | 275 | 291 | 105.82% |
| Full-time employees on the surface | 262 | 274 | 104.58% |
| Total underground | 2,767 | 2,877 | 103.98% |
| **Total staff** | 3,804 | 3,949 | 103.81% |

Employment in the third quarter of 2010 increased by 145 persons, i.e. by 3.81 % in relation to the employment at the end of the third quarter of 2009.

In the third quarter of 2010, 203 persons were employed at LW BOGDANKA S.A.; these are persons employed from outside the mining industry.
At the same time 139 employees left the Company:

- 91 persons retired (pension or disability retirement),
- 1 person deceased,
- 47 persons - other dismissals (including termination by mutual consent of the parties, disciplinary dismissals, expiration of temporary employment contracts, termination by an employer giving notice, termination by an employee giving notice, unpaid leave, military service).

The Group's employee turnover rate, calculated as the product of (a) the difference between the number of people taken on and the number of people dismissed in a given period divided by (b) the number of employees as of the end of the third quarter of 2010, is 0.0162, which shows that the Group employs more people than it dismisses. The Company values employees with many years of service for the Company and treats them as its key resource. The positive value of the employee turnover rate shows that the Group benefits from its efforts to improve the qualifications of its personnel. Employment stability improves the employees' morale. Also, the Company can make full use of its personnel's innovative ideas. Knowledge of the Company's organisational structure helps to improve its internal processes.

## 11.7 Record efficiency of the ploughing system

On 26 August 2010 Lubelski Węgiel Bogdanka S.A. has reached a record level of daily yield at 16,800 tonnes from the panel excavated by the newly-launched ploughing system meant for mining thin coal seams.
Bogdanka's ploughing system was launched in late March 2010. It is intended for mining thin coal seams, that is seams no more than 1.5 metres high. The investment in that technology, valued at nearly EUR 40 million, was one of the Company's issue objectives upon her stock market debut in June 2009. Due to the ploughing system Bogdanka achieved a large increase in commercial coal yield.

## 11.8 Appointment of a chartered auditor

On 28 September 2010, the Company's Supervisory Board appointed PricewaterhouseCoopers Sp. z o.o. with registered office in Warsaw to carry out an audit of the Company's financial statements for 2010 and the consolidated financial statements of the Group for 2010 drawn up in accordance with the International Accounting Standards (IAS).

The agreement period was set as enabling the subject matter of the agreement to be performed.

The Company made use of the services of PricewaterhouseCoopers Sp. z o.o. with regard to the audit of the consolidated financial statements of the Group for three financial years covering jointly the period from 1 January 2006 until 31 December 2008 and with regard to the examination of the forecasts of the Group's financial results for the period from 1 January until 31 December 2009, which was related to the preparation of the Issue Prospectus. In addition, PricewaterhouseCoopers Sp. z o.o. audited the Company's financial statements for 2009, consolidated financial statements of the Group for 2008 and 2009, and reviewed financial statements for the first half of 2009 and the first half of 2010.

| | | |
|---|---|---|
| Mirosław Taras | President of the Management Board | ................................ |
| Krystyna Borkowska | Vice-President for Economic and Financial Affairs | ................................ |
| Waldemar Bernaciak | Vice-President for Commerce and Logistics | ................................ |
| Zbigniew Stopa | Vice-President for Technical Affairs | ................................ |

Bogdanka, 5 November 2010