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ARCTIC PAPER S.A. CAPITAL GROUP
Consolidated Annual Report
for the year ended 31 December 2010

ARCTIC PAPER

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# Letter from the President of Management Board of Arctic Paper S.A.

*Dear Sirs,*

*The year 2010 was different compared to the previous year. Most of the factors which had a positive impact on the previous year's results, reversed the trend in 2010. The market situation, macroeconomic factors, the situation on the commodity markets and extraordinary events adversely affected the results of Arctic Paper S.A. The recovery in the European economy resulted - with several months delay - in slight increase in demand for paper. We managed to improve the sales volume.*

*The year 2010 was dominated by ongoing, since mid-2009, increase in pulp prices. This situation resulted to some extent from the global trend in the commodities market. An extraordinary factor, which significantly destabilized the demand and supply balance on the pulp market, was February earthquake in Chile.*

*As a result the major pulp mills in Chile have been idled and transport, energy and harbour infrastructure blocked the supply of the market pulp from this country for several months. This resulted in decline in global supply of pulp by nearly 10% and continued increase in prices of pulp. In the period from the beginning of January to the end of December 2010 the prices for pulp increased by more than 41.5% for NBSK and by 50.3% for BHKP. For the first time in history, pulp costs exceeded more than 50% of the costs of sales incurred by Arctic Paper S.A. Group.*

*Changes in PLN/EUR and SEK/EUR exchange rates adversely affected the Group's results, in particularly in relation to the generated sales revenue. SEK/EUR average exchange rate in 2010 has strengthened by almost 10.2% and PLN/EUR increased by nearly 7.7%. We use a conservative hedging policy and at this scale of activities it is difficult to fully hedge against changes in currency exchange rates for longer periods based on the products offered by banks which do not require establishing the security on our assets.*

*In response to these unfavorable factors we made changes to the sales strategy. We introduced several increases in paper prices. The level of price increases differed depending on the product, market and customers' segment. We limited the sale on the markets where we achieved the lowest profitability (also due to the adverse currency exchange rates). We increased sales of Pamo brand by 11% and at the same time we reduced sales of the lower profitable L-Print brand by 13%. The APMW share of technical papers, AP –Tech, increased from 7% to over 10%. This segment will be developed as more profitable and less vulnerable to market fluctuations. We increased production capacity of* *our pulp mill in Arctic Paper Mochenwangen by nearly 10% which reduces the costs related to purchases of pulp and recycled paper in this paper mill.*

*Key and positive events definitely include finalization of Arctic Paper Grycksbo acquisition, which took place on 1st of March 2010. As a result of this acquisition, the Group increased its production capacity to more than 800 thousand tons of paper annually and extended the range of products by coated paper sold under the Arctic and G-Print brands. The acquisition strengthened the Group's position on many markets and provides opportunities for achieving synergies, i.e. in logistics. It is worth stressing that the paper mill in Grycksbo does not require significant capital investments. The European Union has introduced protective tariffs on coated paper imported from Asia, which should have positive impact on price level of this type of paper in 2011.*

*From an operational point of view, all paper mills used more than 90% of their production capacity. The observed increase in demand for the paper helped to avoid any stops and the diversification policy related to sources of pulp supply protected from idling production due to lack of pulp which was observed in several European paper mills.*

*An important event was discontinuing of the tax proceedings related to the use of tax reliefs in Arctic Paper Kostrzyn paper mill which operates in special economic zone. This issue was described in the issue prospectus as one of the risk factors. The tax proceedings were resolved in our favor. This event does not have any impact on the financial results, because we were convinced about the correctness of our approach and did not make any provisions for the potential tax charge.*

*The period of reduced demand was utilized to make capital investments in paper machine no. 2 located in Arctic Paper Kostrzyn paper mill. Completed project will result in improvement of production process efficiency and quality of produced paper.*

*At the end of the year it was decided to further reduce personnel costs in the Group and to reduce employment at Arctic Paper Munkedal by around 45 people. The restructuring will take place progressively throughout 2011.*

*Yours sincerely,*

*Michał Jarczyński*

*President of the Board of Directors*
*Arctic Paper S.A.*

# Introduction

## Information on the report

This Consolidated Annual Report for 2010 was prepared in accordance with the Minister of Finance Regulation of 19 February 2009 concerning current and periodical information submitted by issuers of securities and terms and conditions of classifying as equivalent information required by the law of a non-member state (Journal of Laws of 2009 no. 33, item 259, as amended), and consolidated financial statements in accordance with International Financial Reporting Standards (IFRS, especially with IFRS standards approved by the European Union.

At the date of authorisation of these consolidated financial statements, in light of the current process of IFRS endorsement in the European Union and the nature of the Group's activities, there is no difference between the IFRSs applied by the Group and the IFRSs endorsed by the European Union.

IFRSs comprise standards and interpretations accepted by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC").

Certain selected information contained in this report come from the Arctic Group management accounting system and statistics systems.

This Consolidated Annual Report presents data in PLN, and all figures, unless otherwise stated, are given in thousand PLN.

## Definitions and abbreviations

Insofar as the context does not require otherwise, the following definitions and abbreviations are used in the whole document:

Abbreviations applied to business entities, institutions, authorities and documents of the Company

| | |
|---|---|
| Arctic Paper, Company, Issuer, Parent Company, AP | Arctic Paper Spółka Akcyjna seated in Kostrzyn nad Odrą, Poland. |
| Capital Group, Group | Capital group comprised of Arctic Paper Spółka Akcyjna and its subsidiaries. |
| Arctic Paper Kostrzyn, AP Kostrzyn, APK | Arctic Paper Kostrzyn Spółka Akcyjna seated in Kostrzyn nad Odrą and EC Kostrzyn Sp. z o.o. seated in Kostrzyn nad Odrą. |
| Arctic Paper Munkedals, AP Munkedals, APM | Arctic Paper Munkedals AB seated in Munkedal Municipality, Västra Götaland County, Sweden. |
| Arctic Paper Mochenwangen, AP Mochenwangen, APMW | Arctic Paper Mochenwangen GmbH seated in Mochenwangen, Germany. |
| Arctic Paper Grycksbo, AP Grycksbo, APG | Arctic Paper Grycksbo AB seated in Kungsvagen, Grycksbo, Sweden. |
| Paper mills | Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen, Arctic Paper Grycksbo |

| | |
|---|---|
| Arctic Paper Investment | Arctic Paper Investment GmbH seated in Wolpertswende, Germany. |
| Arctic Paper Verwaltungs | Arctic Paper Verwaltungs GmbH seated in Wolpertswende, Germany. |
| Arctic Paper Immobilienverwaltungs | Arctic Paper Immobilienverwaltungs GmbH & Co. KG seated in Ulm, Germany. |
| Kostrzyn Group | Arctic Paper Kostrzyn Spółka Akcyjna seated in Kostrzyn nad Odrą and EC Kostrzyn Sp. z o.o. seated in Kostrzyn nad Odrą. |
| Mochenwangen Group | Arctic Paper Investment GmbH, Mochenwangen, Arctic Paper Verwaltungs GmbH, Arctic Paper Immobilienverwaltungs GmbH & Co. KG. |
| Grycksbo Group | Arctic Paper Grycksbo AB, Grycksbo Paper Holding AB, Arctic Paper Investment AB, Grycksbo Paper Deutschland GmbH, Grycksbo Paper UK Limited, Grycksbo Paper France EURL, Arctic Paper Investment II AB |
| Distribution Companies | Arctic Paper Sverige AB, Arctic Paper Danmark A/S and Arctic Paper Norge AS |
| Sales Offices | Arctic Paper Papierhandels GmbH seated in Vienna (Austria);<br>Arctic Paper Benelux SA seated in Waterloo (Belgium);<br>Arctic Paper Danmark A/S seated in Vallensbaek (Denmark);<br>Arctic Paper France SA seated in Paris (France);<br>Arctic Paper Deutschland GmbH seated in Hamburg (Germany);<br>Arctic Paper Ireland Ltd seated in Dublin (Ireland);<br>Arctic Paper Italia Srl seated in Milan (Italy);<br>Arctic Paper Baltic States SIA seated in Riga (Latvia);<br>Arctic Paper Norge AS seated in Oslo (Norway);<br>Arctic Paper Polska Sp. z o.o. seated in Warsaw (Poland);<br>Arctic Paper España SL seated in Barcelona (Spain);<br>Arctic Paper Sverige AB seated in Uddevalla (Sweden);<br>Arctic Paper Schweiz AG seated in Zurich (Switzerland);<br>Arctic Paper UK Ltd seated in Caterham (UK);<br>Arctic Paper East Sp. z o.o. seated in Kostrzyn nad Odrą (Poland).<br>Grycksbo Paper Deutschland GmbH;<br>Grycksbo Paper UK Limited;<br>Grycksbo Paper France EURL |
| Arctic Paper AB | Arctic Paper AB seated in Göteborg Municipality, Västra Götaland County, Sweden. |
| Management Board, Issuer's Management Board, Company's Management Board, Group's Management Board | Management Board of Arctic Paper S.A. |
| Supervisory Board, Issuer's Supervisory Board, Company's Supervisory Board, Group's Supervisory Board, SB | Supervisory Board of Arctic Paper S.A. |
| SM, Shareholders Meeting, Issuer's Shareholders Meeting, Company's Shareholders Meeting | Shareholders Meeting of Arctic Paper S.A. |

| | |
|---|---|
| ESM, Extraordinary Shareholders Meeting, Issuer's Extraordinary Shareholders Meeting, Company's Extraordinary Shareholders Meeting | Extraordinary Shareholders Meeting of Arctic Paper S.A. |
| Articles of Association, Issuer's Articles of Association, Company's Articles of Association | Articles of Association of Arctic Paper S.A. |
| KSSEZ, SEZ | Kostrzyńsko-Słubicka Special Economic Zone |
| Court of Registration | District Court in Zielona Góra, 8th Commercial Registration Division of the National Court Register. |
| Stock Exchange, WSE | Giełda Papierów Wartościowych w Warszawie Spółka Akcyjna (Warsaw Stock Exchange) |
| KDPW, Depository | Krajowy Depozyt Papierów Wartościowych Spółka Akcyjna seated in Warsaw (National Securities Depository). |
| KNF | Komisja Nadzoru Finansowego (Financial Supervision Authority) |
| CEPI | Confederation of European Paper Industries. |
| Eurostat | European Statistical Office |
| GUS | Polish Central Statistical Office. |
| NBSK | Northern Bleached Softwood Kraft |
| BHKP | Bleached Hardwood Kraft Pulp |

Definitions of selected terms and financial indicators and abbreviations of currencies

| | |
|---|---|
| Sales profit margin | Ratio of sales profit (loss) to sales income. |
| EBIT | Profit on operating activity (Earnings Before Interest and Taxes). |
| EBIT profitability, operating profitability, operating profit margin | Ratio of operating profit (loss) to sales income. |
| EBITDA | Operating profit plus depreciation and amortization (Earnings Before Interest, Taxes, Depreciation and Amortization). |
| EBITDA profitability, EBITDA margin | Ratio of operating profit plus depreciation and amortization to sales income. |
| Gross profit margin | Ratio of gross profit (loss) to sales income. |
| Sales profitability ratio, net profit margin | Ratio of net profit (loss) to sales income. |
| Return on equity, ROE | Ratio of net profit (loss) to equity and net assets attributable to owners |
| Return on assets, ROA | Ratio of net profit (loss) to total assets |
| EPS | Earnings Per Share, ratio of net profit to the number of shares |
| BVPS | Book Value Per Share, ratio of book value to the number of shares |
| Debt-to-equity ratio | Ratio of total liabilities to equity |
| Equity-to-non-current assets ratio | Ratio of equity to non-current assets |

| | |
|---|---|
| Interest-bearing debt-to-equity ratio | Ratio of interest-bearing debt and other financial liabilities to equity |
| Net debt-to-EBITDA ratio | Ratio of interest-bearing debt minus cash to EBITDA |
| EBITDA-to-interest coverage ratio | Ratio of EBITDA to interest cost |
| Current ratio | Ratio of current assets to current liabilities |
| Quick ratio | Ratio of current assets minus inventory and short-term prepayments, accruals and deferred income to current liabilities |
| Acid test ratio | Ratio of total cash assets and other cash assets to current liabilities |
| Days inventory outstanding, DSI, DIO | Days Sales of Inventory or Days Inventory Outstanding, ratio of inventory to cost of sales multiplied by the number of days in the period |
| Days sales outstanding, DSO | Days Sales Outstanding, ratio of trade receivables to sales income multiplied by the number of days in the period |
| Days payable outstanding, DPO | Days Payable Outstanding, ratio of trade payables to cost of sales multiplied by the number of days in the period |
| Operating cycle | DSI + DSO |
| Cash conversion cycle | Operating cycle – DPO |
| FY | Financial year |
| 1Q | 1st quarter of the financial year |
| 2Q | 2nd quarter of the financial year |
| 3Q | 3rd quarter of the financial year |
| 4Q | 4th quarter of the financial year |
| 1H | 1st half of the financial year |
| 2H | 2nd half of the financial year |
| YTD | Year-to-date |
| Like-for-like, LFL | Analogous, with respect to operating result – in the meaning of this report excluding the effect of the purchase of Arctic Paper Grycksbo in March 2010. |
| p.p. | Percentage point – difference between two amounts of one item given in percentage. |
| PLN, zł, złoty | Monetary unit of the Republic of Poland. |
| gr | grosz – 1/100 of one zloty (the monetary unit of the Republic of Poland). |
| Euro, EUR | Monetary unit of the European Union. |
| GBP | Pound sterling – monetary unit of the United Kingdom of Great Britain |
| SEK | Monetary unit of the Kingdom of Sweden. |
| USD | United States dollar, the currency being legal tender in the United States of America. |
| IAS | International Accounting Standards. |
| IFRS | International Financial Reporting Standards. |

| | |
|---|---|
| GDP | Gross Domestic Product. |

Other definitions and abbreviations

| | |
|---|---|
| Series A Shares | 50,000 Arctic Paper S.A. A Series Shares with a par value of PLN 10 each. |
| Series B Shares | 44,253,500 Arctic Paper S.A. B Series Shares with a par value of PLN 10 each. |
| Series C Shares | 8,100,000 Arctic Paper S.A. C Series Shares with a par value of PLN 10 each. |
| Series E Shares | 3,000,000 Series E Shares Arctic Paper S.A. with a par value of PLN 10 each. |
| Shares, Stock, Issuer's Shares, Issuer's Stock | Series A, Series B, Series C and Series E Shares jointly |

Forward-looking statements

The information contained in this report which does not relate to historical facts relates to forward looking statements. Such statements may, in particular concern the Group's strategy, business development, market projections, planned investment outlays, and future revenues. Such statements may be identified by the use of expressions pertaining to the future such as, e.g., "believe", "think", "expect", "may", "will", "should", "is expected", "assume", and any negations and grammatical forms of these expressions or similar terms. The statements contained in this report concerning matters which are not historical facts should be treated only as projections subject to risk and uncertainty. Forward-looking statements are inevitably based on certain estimates and assumptions which, although our management finds them rational, are naturally subject to known and unknown risks and uncertainties and other factors that could cause the actual results to differ materially from the historical results or the projections. For this reason, we cannot assure that any of the events provided for in the forward-looking statements will occur or, if occurred, their impact on the Group's operating activity or financial situation. When evaluating the information presented in this report, one should not rely on such forward-looking statements which are stated only on the date they are expressed. Insofar as the legal regulations do not contain detailed requirements in this respect, the Group will not be obliged to update or verify those forward-looking statements in order to provide for new developments or circumstances. Furthermore, the Group is not obliged to verify or to confirm the analysts' expectations or estimates.

## Statements concerning risk factors

In this report, we have described the risk factors that the Management Board or our Group finds typical for our industry; however, this list may not be complete. It may happen that other factors exist which we have not identified and which could have a material adverse impact on the operations, financial situation, operating results or perspectives of the Arctic Paper Group. In such circumstances, the prices of the Company's shares listed on the Warsaw Stock Exchange may drop and investors may lose all or part of their invested funds, and the payment of dividend by the Company may be limited. Please analyze carefully the information contained in the "Risk factors" part of this report which describes the risks and uncertainties related to Arctic Paper Group's operations.

# Management Board Report on the Operations of Arctic Paper S.A. Capital Group to 2010 report

# Arctic Paper Group profile

## General information

The Arctic Paper Group is the second-largest European producer of bulky book paper in terms of production volume, offering the largest product assortment in this segment, and one of Europe's leading producers of fine graphic paper. The Group produces numerous types of uncoated and coated wood-free paper, as well as wood-containing uncoated paper for printing houses, paper distributors, book and magazine publishing houses and the advertising industry. As at the day of this report, the Arctic Paper Group employs more than 1,600 people in four paper mills and eighteen companies dealing in paper distribution and sales. The Group's paper mills are located in Poland, Sweden and Germany and have total production capacity of more than 800,000 metric tonnes of paper per year. The Group has three Distribution Companies which handle sales, distribution and marketing of products offered by the Group in Scandinavia and fifthteen Sales Offices providing access to all European markets, including Central and Eastern Europe. The Group's consolidated sales revenues for 2010 totaled PLN 2,288 million.

Arctic Paper S.A. is a holding company established in April 2008. The Parent Company is entered in the commercial register of the Polish Court Register maintained by the District Court – Nowe Miasto i Wilda, 8th Commercial Department of the Polish Court Register, pod numerem KRS 0000306944. The Parent Company holds statistical number REGON 080262255.

## Group Profile

The principal business of the Arctic Paper Group is manufacturing and selling of paper.

Additional activities of the Group, related to the production of paper, include:

- Generation of electric energy,
- Transmission of electric energy,
- Distribution of electric energy,
- Production of heat,
- Distribution of heat,
- Logistic services.
- Distribution of paper.

## Our paper mills

As at 31 December 2010 and as at the day of publishing of this report the Group had the following paper mills:

- the paper mill in Kostrzyn nad Odrą (Poland) has a production capacity of about 275,000 metric tonnes per year and produces mainly uncoated wood-free paper for general printing use, such as printing books, brochures and forms, and for making envelopes and other paper products;
- the paper mill in Munkedals (Sweden) has a production capacity of about 160,000 metric tonnes per year and mainly produces uncoated wood-free paper used primarily for printing books and high-quality brochures;
- the paper mill in Mochenwangen (Germany) has a production capacity of about 115,000 metric tonnes per year and mainly produces uncoated wood-containing paper used primarily for printing books and flyers.
- the paper mill in Grycksbo (Sweden) has a production capacity of about 265,000 metric tones per year and produces coated wood-free paper used for printing maps, books, magazines, posters and print advertising materials.

## Our products

The assortment of products manufactured by the Arctic Paper Group includes:

Uncoated wood-free paper, in particular:

- high-white offset paper manufactured and distributed primarily under the brand name Amber, one of the most versatile types of paper that can be used for many different purposes;
- wood-free bulky book paper manufactured under the brand name Munken, used primarily for book printing;
- high quality graphic paper with uniquely smooth surface, used for printing various advertising and marketing materials, manufactured under the brand name Munken;

Coated wood-free paper, in particular:

- wood-free paper manufactured under the brand names G-Print and Arctic, used primarily for book publishing, for printing magazines, catalogues, maps and direct mail.

Uncoated wood-containing paper, in particular:

- wood-containing bulky book paper manufactured and distributed under the brand name Pamo, primarily used for printing paperbacks;
- wood-containing offset paper manufactured and distributed under the brand name L-Print, primarily used for printing low-budget advertising brochures and telephone directories.

## Capital Group structure

The Arctic Paper Capital Group comprises Arctic Paper S.A., as the Parent Company, and its subsidiaries. Since 23 October 2009 Arctic Paper S.A. has been listed on the primary market of the Warsaw Stock Exchange. The Group carries out business through its Paper Mills, Distribution Companies and Sales Offices.

Detailed information about the organization of the Arctic Paper S.A. Capital Group with the names of the companies under consolidation can be found later in the quarterly report (Note 1 and note 2).

## Changes in the capital structure of the Arctic Paper Group

In 2010 there were changes in the capital structure of the Arctic Paper Group.

### Establishment of Arctic Paper Investment AB

On 12 February 2010 a new entity was registered under the name Arctic Paper Investment AB, with its registered office in Gothenburg, Sweden. The entity’s share capital is divided into 100,000 shares of a nominal value of SEK 1 each. All the shares were paid up by Arctic Paper S.A. on 27 January 2010. Arctic Paper Investment AB was incorporated in order to conclude the acquisition of Grycksbo Paper Holding AB.

### Taking control over Grycksbo Paper Holding AB

On 1 March 2010 the acquisition process of Grycksbo Paper Holding AB has been finalized and thus a transfer of legal title to 100% of this company's shares to Arctic Paper S.A. and its subsidiary Arctic Paper Investments AB took place.

As a result of shares’ sale agreement concluded on 7 December 2009 and subsequent agreements concluded between the Arctic Paper S.A. and Accent Equity 2003 LP, Accent Equity 2003 KB, and minority investors, and as a result of meeting the conditions precedent specified in the contract, on 1 March 2010 Arctic Paper S.A. acquired 7,978,007 shares of Grycksbo, representing 26.6% of the total number of shares, while the Arctic Paper AB Investment acquired 22,021,993 shares of Grycksbo, representing 73.4% of the total number of shares of the Company. The acquired shares represent 100% of the total share capital of Grycksbo Paper Holding AB and entitle to 100% of the votes at the general shareholders’ meeting of that Company.

### Establishment of Arctic Paper Investment II AB

On 21 December 2010 a new entity was registered under the name Arctic Paper Investment II AB with its registered office in Göteborg. The entity’s share capital is divided into 50,000 shares of a nominal value of SEK 1 each. Arctic Paper Investment II AB is not a subject to consolidation.

## Changes in basic management principles

There were no important changes in basic management principles in 2010.

## Shareholder structure

Arctic Paper S.A.'s main shareholder is Swedish company Arctic Paper AB which as at 31 December 2010 held 41,553,500 shares in our Company representing 75.0% of its share capital and giving 75.0% of the total number of votes at the General Meeting.

As at the date of this report Arctic Paper AB holds 41,441,500 of the Company's shares representing 74,8% of the Company's share capital and giving 74,8% of the total number of votes at the General Meeting. Thus Arctic Paper AB is the Issuer's parent company.

## Shareholders who hold, directly or indirectly, at least 5% of the total number of votes at the Shareholder Meeting

| | as at 27.04.2011 | | | | as at 01.03.2011 | | | |
|---|---|---|---|---|---|---|---|---|
| Shareholder | Number of shares | Share capital [%] | Number of votes | Of total number of votes [%] | Number of shares | Share capital [%] | Number of votes | Of total number of votes [%] |
| Arctic Paper AB | 41 441 500 | 74,80% | 41 441 500 | 74,80% | 41 553 500 | 74,80% | 41 441 500 | 74,80% |
| Others | 13 962 000 | 25,20% | 13 962 000 | 25,20% | 13 850 000 | 25,20% | 13 962 000 | 25,20% |
| Total | 55 403 500 | 100,00% | 55 403 500 | 100,00% | 55 403 500 | 100,00% | 55 403 500 | 100,00% |
| Own shares | - | 0,00% | - | 0,00% | - | 0,00% | - | 0,00% |
| **Total** | 55 403 500 | 100,00% | 55 403 500 | 100,00% | 55 403 500 | 100,00% | 55 403 500 | 100,00% |

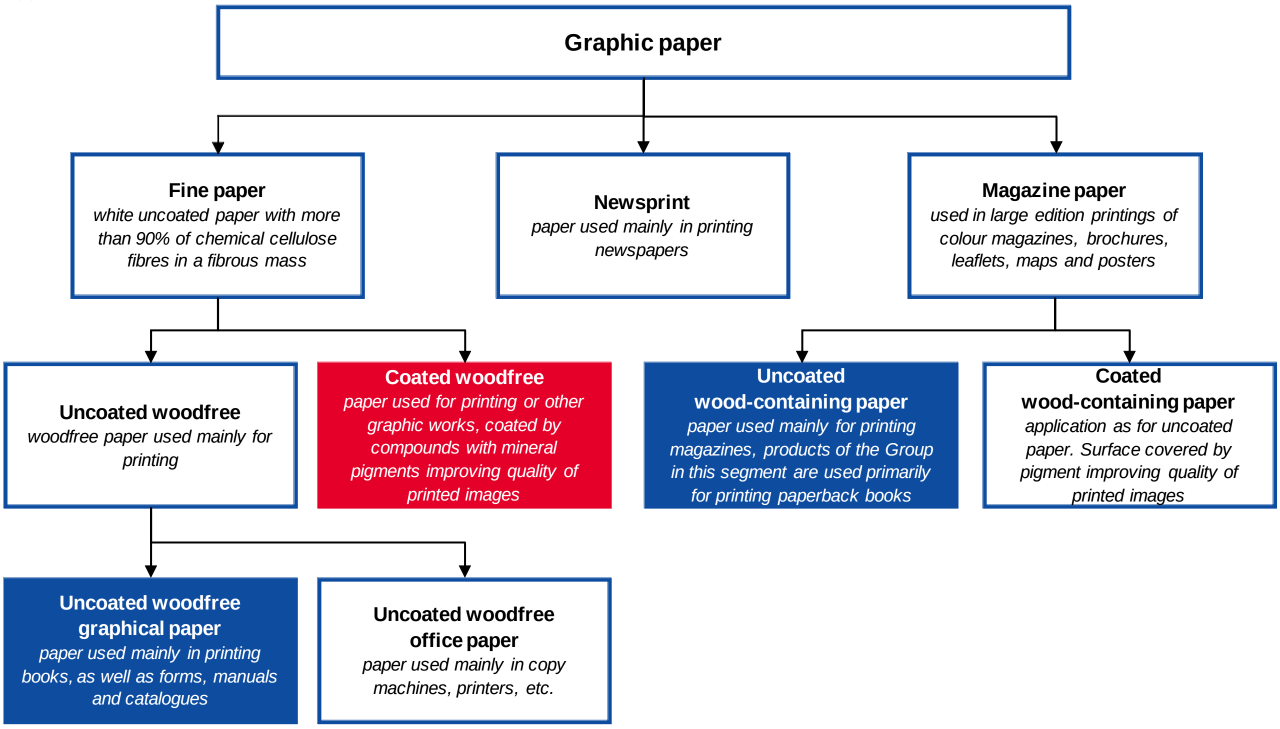
Data on the table are given as at the date of this report and as at the date of publication of the quarterly report for Q4 2010.

## Market environment

### Segments of the graphic paper market

The Group conducts its business in selected segments of the graphic paper market. In line with market practice in Europe, the graphic paper market can be divided into three main categories:

- fine paper,
- newsprint,
- magazine paper.




The above diagram presents situation as at 31 December 2010. As a result of acquisition of Grycksbo paper mill on 1 March 2010 we also produce wood-free coated paper.

- Fine paper is white wood-free paper in which pulp fibers extracted using a chemical method constitute at least 90% of pulp:
  - Uncoated wood-free paper

    Wood-free paper for printing. Uncoated wood-free paper can be manufactured from various types of pulp, with different filler content, and can undergo various finishing enhancing processes, such as surface sizing and calandering. Two main categories of this type of paper are graphic paper (used for example for printing books and catalogues) and office papers (for instance, photocopy paper),
  - Coated wood-free paper

    Wood-free paper for printing or other graphic purposes, one-side or two-side coated with mixtures containing mineral pigments, such as china clay, calcium carbonate, etc. The coating process can involve different methods, both online and offline, and can be supplemented by super-calandering to ensure a smooth surface. Coating improves the printing quality of photographs and illustrations;

- Newsprint paper is primarily used to print newspapers, manufactured mainly from mechanical pulp or waste paper pulp, without or with low filler content. Grammage usually ranges from 40 g/m² to 52 g/m². Newsprint is machine-pressed or slightly calandered, white or slightly dyed. This paper is used in reels for letterpress, offset or flexographic printing.

- Magazine paper is wood-containing paper in which pulp fibers extracted using a chemical method constitute less than 90% of pulp, used for printing color magazines with high circulation, brochures, catalogues, flyers, direct mail, maps and posters:
  - Uncoated wood-containing paper

    Paper from mechanical pulp intended for printing or other graphic purposes. This type of paper is used for printing magazines with the use of rotogravure or offset printing techniques. The Group's products in this segment are usually used for printing paperbacks.

- Coated wood-containing paper
  Coated paper manufactured from pulp produced by mechanical methods. This paper is also known as ground-wood coated paper. Its use is similar to the use of uncoated wood-containing paper.

Additional information about the market environment is provided further on in this report in the "Information on market tendencies" section.

## Development directions and strategy

The Group's main strategies include:

### Expansion on Central and Eastern European markets while maintaining leading position on key markets

Our strategic priority over the next few years is to maintain our present leading position in the field of fine paper intended for Western European markets and also to take advantage of the expected growth on the paper market in Central and Eastern Europe. Given their size, the Western European markets will remain our strategic target although we believe that the paper market in Central and Eastern Europe will grow faster than in Western Europe. We expect this growth to be founded on the long-term rise in paper use per citizen, comparably low at present, and on the expected move of printing houses' production capacity from Western Europe to Central and Eastern Europe. The key elements of this strategy are to take advantage of the competitive edge which we gained thanks to the location and efficient operation of our paper mill in Kostrzyn nad Odrą and our well-developed sales network in Central and Eastern Europe.

### Maximization of production capacity and distribution

One of the key elements for the success of our business will be the ability to sustain cost efficiency. Therefore, we have been taking initiatives to:

- maximize energy efficiency,
- carefully manage human resources,
- take advantage of our strong bargaining position to negotiate lower prices of pulp and other raw materials,
- maximize the capacity of our production lines and the efficiency of the logistics systems.

## Sales structure

In 2010 the sales structure by main production lines was as follows:

## Sales structure by products

| *Thousand tons* | 2010 | share % | 2009 | share % |
|---|---|---|---|---|
| Amber | 297 | 40% | 301 | 52% |
| G-Print | 159 | 21% | - | 0% |
| Munken | 118 | 16% | 118 | 21% |
| Pamo | 64 | 9% | 53 | 9% |
| Arctic | 61 | 8% | 43 | 7% |
| L-Print | 33 | 4% | 49 | 9% |
| AP Tech | 11 | 1% | 8 | 1% |
| Other | 2 | 0% | 2 | 0% |
| Total | 745 | 100% | 573 | 100% |

## Sales structure by products

| *PLN thousands* | 2010 | share % | 2009 | share % |
|---|---|---|---|---|
| Amber | 860 926 | 38% | 891 635 | 49% |
| G-Print | 475 415 | 21% | - | 0% |
| Munken | 448 274 | 20% | 447 747 | 25% |
| Arctic | 219 666 | 10% | 148 828 | 8% |
| Pamo | 171 372 | 7% | 160 548 | 9% |
| L-Print | 73 711 | 3% | 124 336 | 7% |
| AP Tech | 31 061 | 1% | 26 592 | 1% |
| Other | 7 307 | 0% | 9 399 | 1% |
| Total | 2 287 731 | 100% | 1 809 085 | 100% |

### Output markets

In 2010 the market share of sales outside Poland in metric tonnes was 90% and increased by 3% compared to 2009. This year, similarly to the previous years, sales was focused on European markets. The share of those markets in total sales volume in 2009 and 2010 amounted to 99%.

The geographical structure of sales revenues from the most important sales markets in 2010, as compared to 2009, is shown in note 10.1 of the consolidated financial statements.

### Customers

Our customer base includes both direct and indirect customers. Direct customers purchase the Group's products in our paper mills. Indirect customers do not purchase the Group's products themselves but use the agency services of advertising companies or paper distributors. They are, however, an important target group for Arctic Paper's advertising campaigns since it is these indirect customers that recommend or request that direct customers use the Group's products. Direct and indirect customer groups include:

- printing houses – direct customers that purchase paper manufactured by the Group directly from the paper mills;
- distributors – direct customers that purchase paper manufactured by the Group in order to sell it to other users;
- publishing houses – direct and indirect customers that purchase paper manufactured by the Group directly from the Group in order to use it in their publishing activity and order or recommend the use of our paper in printing houses in which they order printing of books or other magazines;
- advertising agencies – mainly indirect customers that do not purchase our products directly yet play an important role in ordering and recommending that printing houses use our products, particularly fine paper to print company annual reports, brochures, flyers and packaging;
- end users – direct and indirect customers that purchase our products directly and play an important role in recommending the use of our products in printing houses in which they have commissioned the printing of materials such as annual reports, catalogues, and advertisements.

In our opinion, we do not depend to a significant extent on any specific customer. Based on the Group's consolidated revenues for 2010, the share of our largest customer was not higher than 10% of total sales revenues.

## Suppliers

The Group uses the following goods and services in its business:

- pulp
- chemicals,
- electricity,
- transport services.

### Pulp

The basic raw material used by the Group to manufacture paper is pulp. Except for the paper mill in Mochenwangen, all the Group's paper mills are so-called non-integrated manufacturers, i.e. they purchase all their pulp from external manufacturers. The paper mill in Mochenwangen is partly integrated and has its own pulp mill with production capacity of approximately 60,300 metric tonnes per year, which accounts for about 60% of the paper mill's total requirements. The Group purchases pulp on the basis of renewable annual contracts executed under framework agreements or in one-off transactions.

### Chemicals

The basic chemicals used in paper manufacturing are fillers (mainly calcium carbonate), starch (corn, potato, tapioca), optical bleaching agents and other chemicals.

## Electric power

The Group uses heat and power in the production process. The Kostrzyn paper mill's total demand for heat and power is satisfied from the mill's combined heat and power plant fuelled by natural gas. Gas is supplied under an agreement with a Polish supplier (PGNiG) at prices adjusted annually to reflect changes in the industry indexes published by the Main Statistics Office (GUS); however, the index formula may be renegotiated if the changes exceed the level set out in the agreement. The gas is mined from gas deposits near Kostrzyn nad Odrą and transmitted to the paper mill through local gas pipes. In the analyzed period, electricity for the paper mill in Munkedal was mainly purchased from external suppliers. The Group also purchased fuel oil in order to satisfy part of the Group's demand for heat. The paper mill in Mochenwangen satisfies the total demand for heat and about a half the electricity demand by using mineral coal. The remaining part of the demand for electricity is satisfied by purchasing from external suppliers.

Energy source In Arctic Paper Grycksbo AB paper mill is biomass and electricity partly purchased from external suppliers.

## Transport services

The Group does not have its own trucks and uses professional outsourcing services to distribute products from paper mills and warehouses to its customers.

The Group entities are not dependent on their suppliers. Based on the Group's consolidated revenues for 2010, the share of the largest supplier was not more than 10% of total sales revenues.

## Business seasonality and cycles

Demand for the Group's products fluctuates slightly during the year. A lower demand for paper is reported each year during the summer holidays and at Christmas when a number of printing houses, particularly those in Western Europe, are closed for business. The changes in the demand for paper are not significant compared to the demand in other months.

## R&D

R&D in the Arctic Paper Group is primarily intended to advance and innovate production processes and to improve product quality and increase product assortment. R&D is carried out at Kostrzyn and Munkedals. In the period covered by this report, both companies carried out R&D work to streamline the production process, particularly by shortening machine idle time, and to improve paper quality along with expanding the assortment range.

## Natural environment

Our Group observes the environmental standards laid down in numerous legal regulations and administrative decisions. These standards are intended to protect soil, air and water against pollution, noise and the impact of electromagnetic fields. We describe below how the environmental regulations affect the operations of our paper mills.

### Kostrzyn Paper Mill

Based on the decision of the Lubuskie Voivode of 8 December 2005, Kostrzyn obtained an integrated permit for a paper production installation combined with a fuel combustion installation located in the mill in Kostrzyn nad Odrą. For Kostrzyń, the requirement to obtain this permit was due to the mill's paper production capacity of over 20 metric tonnes a day. In order to meet the requirements set out in the permit and other environmental waste management standards, Kostrzyn executed a number of agreements for industrial waste collection and utilization.

In May 2008 a new sewage treatment plant was opened in the paper mill in Kostrzyn nad Odrą. Based on the decision of the Lubuskie Voivode of 14 August 2007, Kostrzyn obtained a water permit to discharge rainwater and run-off water and to build a water structure in the form of a dock discharging waters to the Warta River (permit valid until 1 August 2017).

AP Kostrzyn participates in the EU Greenhouse Gas Emissions Trading Scheme (EU Emission Allowances Trading Scheme) based on a permit granted in the decision of the Lubuskie Voivode of 17 February 2006 (amended by the decisions of 28 March 2006, 1 June 2006, 13 December 2006, 4 May 2007 and 6 January 2009) for the paper production installation with production capacity of over 20 metric tonnes a day located in the mill in Kostrzyn nad Odrą. The permit was granted until 31 December 2015. Under the permit, Kostrzyn has to monitor carbon dioxide emissions and submit annual emission reports. Carbon dioxide emissions from the Kostrzyn mill do not exceed the thresholds permitted by law.

In view of the environmental protection policy, Kostrzyn made significant investments, including an investment in a new gas-fuelled heat and power plant which was opened in 2007 (first stage) and 2009 (second stage). The paper mill in Kostrzyn nad Odrą holds environmental compliance certificates: OHSAS 18001, ISO 14001, ISO 9001 and EMAS. Moreover, the paper manufactured in this mill is FSC and PEFC certified. These certificates are granted to certify that the pulp used to manufacture paper comes from forests managed in a balanced manner. The FSC certificate (Forest Stewardship Council) is one of the most important certificates granted to paper companies. The first FSC certificate for the paper manufactured by the Kostrzyn mill was granted in 2006. At present, the Amber paper from the paper mill in Kostrzyn nad Odrą is manufactured from FSC certified pulp – 90%, and from PEFC (Programme for the Endorsement of Forest Certification) certified pulp - 10%.

### Munkedals Paper Mill

The Munkedals business complies with environmental management systems EMAS and ISO 14001. EMAS (Eco- Management and Audit Scheme) is a voluntary system applied in the EU to distinguish businesses that constantly improve environmental protection levels as part of their operations. Businesses registered in EMAS observe environmental regulations, maintain an environmental management system and inform the public about environmental protection as part of the activity carried out in the form of an independent audited statement on environmental protection compliance. The ISO (International Organization for Standardization) has developed various standards, among them ISO 14000, some of the most recognized standards for environmental protection (i.e. actions taken by business to (i) limit their negative impact on the environment; and (ii) ensure constant improvement of environmental protection levels).

Some of the real properties owned by Munkedals are located in Natura 2000 areas. These Natura 2000 areas are wild nature reserves established on the basis of a decision issued by the Munkedals District Council (Sweden) in 2005 Natura 2000 areas were established to preserve the most endangered natural habitats and fauna and flora in Europe. The scope of protection and the restriction on business activities are laid down in Council Directive 92/43/EEC on the conservation of natural habitats and of wild fauna and flora (the Habitats Directive) and Council Directive 79/409/EEC of 2 April 1979 on the conservation of wild birds (the Birds Directive) and relevant domestic regulations. The level of habitat and bird conservation in the Natura 2000 areas depends on the species and/or habitats in those areas under conservation.

### Mochenwangen Paper Mill

Mochenwangen obtained a permit to manufacture a maximum of approximately 475 metric tonnes gross of paper.

Wood used to pro duce book and specialty papers obtained certificates of FSC and PEFC. The FSC certificate is issued after independent agencies have assessed whether forest production complies with international standards of balanced management, environmental and social welfare protection.

Mochenwangen participates in the EU Emission Allowances Trading Scheme when manufacturing paper and generating power in coal-fuelled power plants. For the years 2008-2012 Mochenwangen was allocated free of charge 118,991 emission allowances per year, which corresponds to the average number of allowances per year required by Mochenwangen over that period. Mochenwangen has to monitor carbon dioxide emissions and submit annual emission reports to the German Emission Allowances Trading Authority.

### Grycksbo Paper Mill

Paper production in the Arctic Paper AB Grycksbo is performed in accordance with the environmental permission issued in March 2007. The permission was issued by the Swedish Environmental Court and allows production up to 310 000 tonnes per year. In addition, the paper mill has a permission for emission of carbon dioxide issued by the regional province od Dalarna. Orientation on environment is for Arctic Paper Grycksbo AB a way to sustain on the market in the long term run. Since 1997, Arctic Paper Grycksbo AB has an ISO 14001 certificate and our environmental activities are reported in accordance with EMAS. The primary objective of EMAS is to encourage member organizations to improve environmental protection in a systematic and consistent way, even in excess of legislative requirements. This is done by setting up a program consisting of specific action programs and evaluate all significant environmental impacts associated with the business. Companies are required to prepare annual reports on the results of their pro-environmental activities. Independent auditors ensure that firms keep their commitments.

Arctic Paper AB Grycksbo takes part In the European Union Emisions Trading Scheme for greenhouse gas pollutant, although the 2010 is a milestone for the factory, because it was the first year in which reported zero carbon dioxide emissions from fossil fuels. This was possibile by a substantial reconstruction of the boiler in conjunction with the investment in the equipment to handle biofuels, electric exhaust particulate filters and conversion turbines to produce electricity from renewable sources

In numbers, a shift to biofuels, means annual reduction in carbon dioxide emissions from fossil fuels by about 70 000 tonnes. Rebuilt turbine allows to meet 20% of our electricity needs through renewable sources of energy, which in turn leads to an annual reduction in carbon dioxide emissions by a further 4 000 tonnes.

The paper mill implemented energy management system in accordance with SS 62 77 50 (Swedish standard for energy management) and participates in PFE (Swedish Energy Efficiency Programme). Our products are reviewed under the „ Chain of Custody" under FSC (Forest Stewardship Council) and in accordance with the PEFC (Programme for the Support of the Principles for Sustainable Forest Management).

# Summary of consolidated financial results

## Consolidated income statement

### Selected items of the consolidated income statement

| *PLN thousands* | 2010 | 2009 | Change % 2010/2009 |
|---|---|---|---|
| Revenues | 2 287 731 | 1 809 085 | 26,5 |
| *including:* | | | |
| *Sales of paper* | *2 287 360* | *1 805 504* | *26,7* |
| *Sales of services* | *371* | *3 581* | *(89,6)* |
| Gross profit on sales | 258 110 | 469 168 | (45,0) |
| *Gross profit on sales margin %* | *11,28* | *25,93* | *(14,7) p.p.* |
| Sales costs | (272 965) | (237 605) | 14,9 |
| Administrative expenses | (57 273) | (59 104) | (3,1) |
| Other operating income | 150 180 | 44 601 | 236,7 |
| Other operating cost | (60 372) | (37 749) | 59,9 |
| EBIT | 17 680 | 179 310 | (90,1) |
| *EBIT margin %* | *0,77* | *9,91* | *(9,1) p.p.* |
| EBITDA | 146 294 | 246 575 | (40,7) |
| *EBITDA margin %* | *6,39* | *13,63* | *(7,2) p.p.* |
| Financial income | 20 062 | 2 104 | 853,7 |
| Financial cost | (30 393) | (28 363) | 7,2 |
| EBT | 7 350 | 153 052 | (95,2) |
| Corporate income tax | 21 467 | (20 652) | (203,9) |
| Net profit | 28 817 | 132 400 | (78,2) |
| *Net profit margin %* | *1,26* | *7,32* | *(6,1) p.p.* |
| Earnings per share (in PLN) | 0,53 | 2,92 | *n.a.* |

## Revenue

In 2010 consolidated sales revenue amounted to PLN 2,287,731 thousand compared to PLN 1,809,085 thousand in the same period of the previous year. LFL consolidated sales revenues (after exclusion of acquisition of Grycksbo paper mill in Sweden) stood at PLN 1,738,353 thousand, which means a decrease by PLN 70,732 thousand (-3,9%) compared to sales realised in 2009. The sales volume in 2010 amounted to 745 thousand tonnes compared to 573 thousand tonnes in the same period of the previous year. This change represents an increase by 172 thousand tonnes and accordingly by 30%. The year-to-date LFL sales volume in 2010 stood at 565 thousand tonnes, which represents a decrease by over 8 thousand tonnes and 1.4% compared to 2009.

The main reason for lower dynamics in increase in total sales, taking into account the revenue from the LFL sales in 2010, were unfavorable exchange rates, in particular EUR/PLN, EUR/SEK and SEK/PLN. Detailed description of the trend in exchange rates is descried in section „factors affecting the development of the Group" ( page 36 of this management report).

## Cost of sales, selling and distribution expenses and administrative expenses

Profit on sales in 2010 was 45,1% lower compared to the same period of the previous year. The sales profit margin in the current year stood at 11.3% compared to 25.9% (-14.7 p.p.) in the same period of the previous year.

The main reason for such dynamic fall of profit on sales in 2010 was significant increase in cost of sales resulting from higher prices of pulp and unfoavorable exchange rates as well as from depreciation in the amount of PLN 21,397 thousand related to fair value of indentifiable assets in Arctic Paper Grycskbo (Note 23) and impairment loss in Arctic Paper Mochenwangen in the amount of PLN 16,186 thousand (Note 25).

In the reporting period selling expenses amounted to PLN 272,965 thousand which represents an increase by more than 14,9% compared to costs incurred in 2009. The main reason for the increase in selling expenses in the analyzed period were costs incurred at AP Grycksbo which were subject to consolidation from March 2010 as well as increase in transport costs. During the same period selling expenses per tone of sold paper decreased year-to-year by 11.6%.

In 2010 administrative expenses amounted to PLN 57,273 thousand compared to PLN 59,104 thousand in 2009, which represents decrease by more than 3.1%. Positive aspect is that administrative expenses decrease despite the consolidation of Grycksbo from 1 March 2010. At this time administrative expenses ( per tone) fell by nearly 25%.

## Other operating income and expenses

Othe operating income in 2010 amounted to PLN PLN 150,180 thousand which means increase compared to the same period of previous year by PLN 105.579 thousand. The major factor which had impact on increase in other operating income in 2010 was the final allocation of the purchase price of Arctic Paper Grycskbo. Details regarding accounting of the final purchase price allocation of Arctic Paper Grycksbo is included in Note 23 of these financial statements. Furthermore, the growth of other operating income resulted from sales of media i.e revenue from sales of heat and electricity as well as revenues from sales of materials In AP Kostrzyn

Other operating expenses in 2010 amounted to PLN 60,372 thousand compared to PLN 37,749 thousand in 2009.

## Financial income and cost

In 2010 financial income amounted to PLN 20,062 thousand and were higher comparing to financial income recorded in 2009 by PLN 17,959 thousand. The higher financial income in the analyzed period was caused by positive foreign exchange differences in 2010 which were accounted in the amount of PLN 18,099 thousand.

Financial cost in 2010 amounted PLN 30,393 thousand PLN compared to PLN 28,363 thousand in 2009. This significant increase in financial cost results from interest costs of PLN 30,369 thousand compared to PLN 20,835 thousand in 2009.

## Income tax expense

Income tax expense in 2010 amounted to PLN +21,467 thousand, and in 2009 to PLN -20,652 thousand.

Positive effect of the income tax resulted from its deferred part which included the effect of final purchase price allocation of Arctic Paper Grycksbo in the amount of PLN +7,816 thousand, positive deferred tax connected with impairment loss in the amount of PLN 4,435 thousand and deferred tax recorded in paper mills in total amount of PLN 14,586 thousand compensated by negative impact of the current income tax.

## Profitability analysis

Profit on operating activities in 2010 amounted to PLN 17,680 thousand compared to PLN 179,311 thousand in the previous year. Operating profit in % in the 2010 amounted to 0,77%, while in 2009 it was equal to 9,91%.

EBITDA in 2010 amounted to PLN 146,294 thousand and in 2009 amounted to PLN 246,575 thousand. In the reporting period EBITDA amounted to 6,39% compared to 13,63% in 2009.

Net profit in 2010 amounted to PLN 28,817 thousand compared to PLN 132,400 thousand in 2009. The net profit in 2010 caused increase of net profit margin to the level of 1,26% compared to 7,32% in 2009.

## Profitability analysis

| *PLN thousands* | 2010 | 2009 | Change % 2010/2009 |
|---|---|---|---|
| Gross profit on sales | 258 110 | 469 168 | (45,0) |
| *Gross profit on sales margin %* | *11,28* | *25,93* | *(14,7) p.p.* |
| EBITDA | 146 294 | 246 575 | (40,7) |
| *EBITDA margin %* | *6,39* | *13,63* | *(7,2) p.p.* |
| EBIT | 17 680 | 179 310 | (90,1) |
| *EBIT margin %* | *0,77* | *9,91* | *(9,1) p.p.* |
| Net profit | 28 817 | 132 400 | (78,2) |
| *Net profit margin %* | *1,26* | *7,32* | *(6,1) p.p.* |
| ROE - Return on equity (%) | 4,3 | 21,4 | (17,1) p.p. |
| ROA - Return on assets (%) | 1,5 | 11,2 | (9,7) p.p. |

In 2010 the return on equity amounted to 4,3%, while in 2009 it reached a level of 21,4%. In the same time return on assets fell from 11,2% in 2009 to 1,5% in 2010.

# Report on financial situation

## Selected items of the consolidated balance sheet

| *PLN thousands* | 31/12/2010 | 31/12/2009 | Change 31/12/2010 -31/12/2009 |
|---|---|---|---|
| Non-current assets | 1 148 498 | 610 059 | 538 439 |
| Inventory | 291 048 | 167 783 | 123 265 |
| Receivables, therein: | 277 297 | 236 004 | 41 294 |
| *Trade and other receivables* | *228 993* | *231 998* | *(3 006)* |
| Other current assets | 14 525 | 26 351 | (11 826) |
| Cash and equivalents | 179 402 | 140 115 | 39 287 |
| Total assets | 1 910 769 | 1 180 310 | 730 459 |
| | | | |
| Equity | 667 943 | 618 036 | 49 907 |
| Short-term liabilities | 742 608 | 240 002 | 502 606 |
| *therein:* | | | |
| *Trade and other payables* | *365 082* | *168 197* | *196 885* |
| *Interest-bearing loans and borrowings* | *292 111* | *16 849* | *275 262* |
| *Financial liabilities* | *85 415* | *54 956* | *30 459* |
| Long-term liabilities | 500 218 | 322 272 | 177 946 |
| *therein:* | | | |
| *Interest-bearing loans and borrowings* | *192 705* | *204 109* | *(11 405)* |
| *Other financial liabilities* | *307 514* | *118 163* | *189 351* |
| Total equity and liabilities | 1 910 769 | 1 180 310 | 730 459 |

As at 31 December 2010 total assets amounted to PLN 1,910,769 thousand compared to PLN 1,180,310 thousand at the end of 2009.

The increase in total assets was primarily caused by consolidation of assets and liabilities of AP Grycksbo according to the balances as at the end of March 2010.

## Non-current assets

As at the end of December 2010 non-current assets represented approximately 60.1% of total assets, while as at the end of 2009 this proportion amounted to 52%.

The value of fixed assets increased in the first 12 months of the year by PLN 538,439 thousand, mainly due to consolidation of fixed assets of AP Grycksbo..

## Current assets

At the end of December 2010 current assets amounted to PLN 762,271 thousand compared to PLN 570,251 thousand as at the end of 2009. This increase was mainly due to consolidation of AP Grycksbo. Within the position of current assets there was an increase in inventories by PLN 123,265 thousand, increase in receivables by PLN 41,294 thousand, decrease in other current assets by PLN 11,826 thousand and increase in cash and cash equivalents by PLN 39,287 thousand. As at the end of December 2010 current assets represented 39,9% of total assets (48,3% at the end of 2009), therein inventories 15,2% (14,2% at the end of 2009), receivables 14,5% (20% at the end of 2009), other current assets 0,8% (2,2% at the end of 2009) and cash and cash equivalents 9,4% (11,9% at the end of 2009).

## Equity

As at the end of the fourth quarter 2010 equity amounted to PLN 667,943 thousand compared to PLN 618,036 thousand as at the end of 2009. As at the end of December 2010, equity represented 35% of the total equity and liabilities, whereas at the end of 2009 the proportion equaled 52% of total balance sheet amount.

## Current liabilities

As at the end of December 2010 current liabilities amounted to PLN 742,608 thousand (39% of the total balance sheet amount) compared to PLN 240,002 thousand (20% of the total balance sheet amount) at the end of 2009. The significant increase in current liabilities by PLN 502,606 thousand was primarily due to consolidation of AP Grycksbo and the issue of bonds necessary to finance the acquisition of AP Grycksbo, of which the short-term part was presented in the amount of PLN 61,187 thousand.

## Non-current liabilities

As at the end of December 2010 long-term liabilities amounted to PLN 500,218 thousand (26% of the total balance sheet amount) compared to PLN 322,272 thousand at the end of 2009 (accordingly 27% of the total balance sheet amount). In the analyzed period, there was a significant growth of long-term liabilities by PLN 177,946 thousand which resulted mainly from consolidation of AP Grycksbo and the issue of bonds used to finance the above mentioned acquisition, of which the long-term part was presented in the amount of PLN 119,475 thousand.

## Debt analysis

### Debt analysis

| | 2010 | 2009 | Change % 2010/2009 |
|---|---|---|---|
| Debt-to-equity ratio (%) | 186,1 | 91,0 | 95,1 p.p. |
| Equity-to-non-current assets ratio (%) | 58,2 | 101,3 | (43,1) p.p. |
| Interest-bearing debt-to-equity ratio (%) | 72,6 | 35,8 | 36,8 p.p. |
| Net borrowings-to-EBITDA (times) | 2,46 | 0,40 | 2,06 |
| EBITDA-to-interest (times) | 4,8x | 11,8x | (7,0) |

As at the end of December 2010 debt to equity ratio was around 186,1% and was by 95,1 p.p. higher than at the end of December 2009. The interest-bearing debt to equity ratio at the end of the current quarter stood at 72,6% and was by 36,8 p.p. higher than at the end of December 2009. Equity to non-current assets ratio at the end of the current quarter stood at 58,2% and was by 43,1 p.p lower than at the end of December 2009.

Net borrowings to EBITDA ratio amounted to 2,46x at the end of analyzed period compared to 0,40x at the end of December 2009. Simultaneously, EBITDA to interest ratio decreased from 11,8x at the end of the fourth quarter of 2009 to 4,8x at the end of the current quarter.

## Liquidity analysis

### Liquidity ratios

| | 2010 | 2009 | Change % 2010/2009 |
|---|---|---|---|
| Current liquidity ratio | 1,0x | 2,4x | (1,4)x |
| Quick liquidity ratio | 0,6x | 1,7x | (1,1)x |
| Acid test ratio (cash liquidity) | 0,2x | 0,6x | (0,4)x |
| Inventory turnover DSI (days) | 51,6 | 45,1 | 6,5 |
| Receivables turnover DSO (days) | 36,0 | 46,2 | (10,2) |
| Liabilities turnover DPO (days) | 64,8 | 45,2 | 19,6 |
| Operating cycle (days) | 87,7 | 91,2 | (3,5) |
| Cash conversion cycle (days) | 22,9 | 46,1 | (23,2) |

At the end of December 2010 current ratio stood at 1,0x and and was by 1,4% lower than at the end of December 2009. The quick ratio reached 0,6x as at the end of December 2010. Cash conversion cycle as at the end of December 2010 amounded to 22,9 days so was shorter compared to the tfourth quarter of 2009 by 23,2 days.

## Consolidated cash flow statement

### Selected items of the consolidated cash flow

| *PLN thousands* | 2010 | 2009 | Change % 2010/2009 |
|---|---|---|---|
| Cash flow from operations | 120 409 | 250 988 | (52,0) |
| *including:* | | | |
| *EBT* | *7 350* | *153 052* | *(95,2)* |
| *Depreciation* | *128 614* | *67 264* | *91,2* |
| *Δ in working capital* | *57 769* | *9 756* | *492,1* |
| *Other corrections* | *(73 324)* | *20 916* | *(450,6)* |
| Cash flow investing activities | (230 583) | (132 540) | 74,0 |
| Cash flow financing activities | 129 974 | (42 231) | (407,8) |
| Total Cash Flow | 19 800 | 76 217 | (74,0) |

## Cash flow from operating activities

In 2010 net cash flow from operating activities amounted to PLN 120,409 thousand compared to PLN 250,988 thousand in the same period of 2009. Lower cash flow from operating activities in 2010 resulted primarily from changes in working capital compensated by significant reduction of profit before tax. Within the working capital, the most significant changes were substantial growth of liabilities with simultaneous growth of inventories and receivables. The cash flow from operating activities was to a high extent influenced by consolidation of AP Grycksbo starting from the 1st of March 2010.

## Cash flow from investment activities

During 12 months of 2010 cash flow from investment activities amounted to PLN -230,583 thousand compared to PLN -132,540 thousand in the same period of the previous year. Investment cash flow in 2010 related primarily to the acquisition of AP Grycksbo paper mill, with a relatively low level of investment expenditures in other paper mills.

### Cash flow from financial activities

During 12 months of 2010 cash flow from financial activities amounted to PLN +129,974 thousand compared to PLN -42,231 thousand in the same period of 2009. In 2010 cash flow from financial activities related mostly to the acquisition of AP Grycksbo and its financing acquired by the way of bond issue and share issue, which are described in the further paragraphs of this report (Note 23) as well as from overdraft in the amount of PLN 41,266 thousand.

# Relevant information and factors influencing financial results and evaluation of financial standing

## Key factors affecting the performance results

The Group's operating activity has been historically and will be in the future influenced by the following key factors:

- macroeconomic and other economic factors;
- high quality paper prices;
- pulp and energy prices;
- currency exchange rate fluctuations.

#### Macroeconomic and other economic factors

We believe that a number of macro-economic and other economic factors have an impact on the demand for high-quality paper, and they may also influence the demand for the Group products and our operating results. Those factors include:

- a GDP growth
- net income – as a measure of income and prosperity of a population,
- production capacities – oversupply lingering in the segment of high quality paper and decline of margins on paper sales;
- paper consumption;
- technological development.

#### Paper prices

The prices of paper undergo cyclic changes and fluctuations, depend on global changes in demand and overall macroeconomic and other economic factors, as those indicated above. The prices of paper are also influenced by a number of factors connected with the supply, primarily changes in production capacities at the international and European level.

#### Costs of raw materials, energy and transport

The main elements of the Group's operating expenses are costs of raw materials, energy and transportation. The costs of raw materials include, first of all, the costs of pulp, timber and chemical agents used for paper production. Our energy costs, historically speaking, include first of all costs of electricity, gas, coal and fuel oil. Costs of transport include the costs of transportation services rendered to the Group by external service providers only.

Taking into account the share of those costs in the total operating expenses of the Group and the limited possibility of controlling those costs by the Company, the fluctuations of the costs may have a significant impact on profitability.

### Currency exchange fluctuations

Our operating results are significantly influenced by currency exchange rates fluctuations. In particular, our revenues and costs are expressed in different foreign currencies and are not matched, therefore, the appreciation of currencies in which we incur costs towards currencies in which we generate revenues, will have an adverse effect on our results. We sell our products in all EURO zone countries, the Nordic countries, Poland and UK, therefore, our revenues are to a great extent expressed in EUR, GBP, SEK and PLN. The Group's operating expenses are primarily expressed in USD (pulp costs), EUR (costs related to pulp, transportation, chemicals and a majority of costs related to the operations of the Mochenwangen paper mill), PLN (the majority of other costs incurred by the Kostrzyn on Odra mill) and SEK (the majority of other costs incurred by the Munkedal and Grycksbo mill).

Exchange rates also have an important influence on results reported in our financial statements because of changes in exchange rates of currencies in which we generate revenues and incur costs, and the currency in which we report our financial results (PLN).

## Unusual developments and factors

During the reported period there were no unusual events and/or factors.

## Impact of changes in the Arctic Paper Group's structure on the financial result

Starting from 1 March 2010, results reported by the Grycksbo Group, which consists of Arctic Paper Grycksbo AB, Arctic Paper Investment AB, Grycksbo Paper Holding AB, Grycksbo Paper Deutschland GmbH, Grycksbo Paper UK Limited, Grycksbo Paper France EURL, are subject to consolidation. All of these entities are consolidated accordingly to the full consolidation method. In the 2010, the impact of consolidation of these entities on the net consolidated result was as follows: sales revenue PLN +643,713 thousand, operating profit PLN +54,087 thousand, EBITDA PLN +96,482 thousand, net profit PLN +58,384 thousand.

## Other material information

During the reported period there were no material events which would affect the evaluation of the HR, property, financial situation or the financial result and their changes, or would be material from the point of view of the Company's ability to perform its obligations.

# Factors influencing Arctic Paper Group development

## Information on market tendencies

### Supplies, demand and capacity

In 2010 supplies of high quality paper to the European market were approximately 3.8% higher compared to the corresponding period of 2009. During the same time, supplies in the segment of uncoated wood-free paper (UWF) were 5.4% higher, while those in the segment of coated wood-free paper (CWF) 2.1% higher.

The dynamics of changes in 2010 with regards to supplies level and estimated demand for high quality paper in Europe indicates recovery of demand, the supplies realized in 2010 were 3.8% higher than those realized in 2009.

Group did not record a significant decline in the level of orders. Sales volume In 2010 was 1.4% lower than in the corresponding period of 2009 ( like-for-like excluding AP Grycksbo).

Data source: Cepifine ,RISI, an analysis of Arctic Paper

### Prices of high quality paper

In 2010 sales prices of high quality paper have risen, however for selected markets and types of paper slight decrease in prices was observed.

Level of prices for uncoated wood-free paper for the selected markets of Germany, France, Spain, Italy and United Kingdom expressed in EUR and GBP increased in December 2010 in comparison with March 2010 in the range of 15-17%. In the same period, prices of coated wood-free paper increased on average by 11%.

Arctic Paper Group continued to implement paper price increases for both segments of the UWF and CWF paper produced .

Prices invoiced in EUR for comparable products of Group in the segment of uncoated wood-free paper increased from March to December 2010 by an average of 17%, whereas prices of coated wood-free paper rose from 11,0%– to 14,0%.

Source: RISI, price changes for chosen markets in Germany, France, Spain, Italy and United Kingdom in local currencies for graphic papers similar to product portfolio of the Arctic Paper Group. Prices are expressed exclusively of specific rebates for individual clients and they include neither additions nor price reductions in relation to publicly available price lists. Estimated prices for particular month reflect orders made in that month, whereas their deliveries may take place in the future. Because of that, RISI price estimations for a particular month do not reflect real prices by which deliveries are made. They only express ordering prices.

For Arctic Paper products average invoiced sales prices for all served markets in EUR.

### Pulp prices

At the end of the fourth quarter of 2010 pulp prices reached a level of USD 949,0 per tonne for NBSK and USD 849,0 per tonne for BHKP. In the fourth quarter of 2010 the average pulp price was higher by 41,5%

(NBSK) and 50,3% (BHKP). Pulp costs are subject to significant fluctuations. An increase in prices of raw materials, in particular pulp, currently leads to a signiifcant decrease in Group's profitability. The average cost per tonne of pulp as calculated for the Group expressed in PLN in 2010 increased by 34% compared to 2009.

In 2010 the relation of pulp costs to cost of goods sold expressed in PLN amounted to approximately 53%, whereas in 2009 this relation amounted to 43%.

Arctic Paper Group uses the pulp in the production process according to the following structure: BHKP 59%, NBSK 18% and the remaining 23%.

Source: www.foex.fi, Arctic Paper analysis.

## Currency Exchange rates

The EUR/PLN exchange rate at the end of the fourth quarter of 2010 amounted to 3,9603 and was lower by 3,6% than at the end of 2009. The average EUR/PLN exchange rate in 2010 was lower by 7,7% compared to the same period of 2009.

EUR/SEK rate amounted to 8,9701 (-2,0%) at the end of the fourth quarter of 2010. For this pairing, the average rate in 2010 was lower by 10,2% compared to the same period of the previous year.

These changes mean, that in 2010 a strong appreciation of PLN and SEK in relation to EUR occurred, which has an adverse impact on the Group's financial results, in particular in connection with generated sales revenues expressed in PLN.

At the end of the fourth quarter USD/PLN rate amounted to 2,9641. In 2010 the average USD/PLN exchange rate amounted to 3,0179, compared to 3,1179 in the analogical period of the previous year, which means a decrease by 3,2%.

At the end of the fourth quarter USD/SEK rate amounted to 6,7137. The average exchange rate in the fourth quarter equaled 6,7830 compared to 7,6489 in the same period of prior year which means decrease by 5,8%.

The change in USD/PLN and USD/SEK rates had a positive impact on the results of the fourth quarter and of the year 2010, because they affect the reduction in prices of raw materials purchased in US dollars.

As at 31 December 2010 EUR/USD exchange rate amounted to 1,3361 compared to 1,4413 (-7,3%) at the end of December 2009. In the fourth quarter of 2010 a material depreciation of USD in relation to EUR occurred. In the fourth quarter of 2010, the average exchange rate equaled 1,3583. In 2010, the average exchange rate amounted to 1,3267, whereas in the analogical period of the previous year it stood at 1,3944, which means appreciation of USD in relation to EUR by merely 4,9%.

Appreciation of PLN and SEK in relation to EUR and GBP, appreciation of PLN towards SEK and depreciation of PLN and SEK in relation to USD may have a material adverse impact on the Group's profitability.

## Factors influencing the financial results in the perspective of the new year

Material factors which have an impact on the financial results in the perspective of the next year include:

- The levels of high quality paper prices, in particular, ability to further increase paper prices, in connection with growing pulp prices and adverse changes in exchange rates determining our sales revenue particularly in

Sweden, will have an impact on the financial results.

- Prices of raw materials, including pulp and electricity; in particular, the high and growing pulp prices may have an adverse effect on the financial results. Furthermore, the fluctuations of electricity prices in Sweden, which the Group experienced in first and fourth quarter may translate into lower sales profitability at AP Munkedals and AP Grycksbo, have a material adverse effect on the Group's performance.
- Currency rates; in particular, the appreciation of PLN and SEK in relation to EUR and GBP, the appreciation of PLN in relation to SEK, and depreciation of PLN and SEK in relation to USD, can have an adverse effect on the financial results.

# Risk factors

## Significant changes in risk factors

Arctic Paper Kostrzyn S.A. has operated in the Kostrzyńsko-Słubicka Special Econimoc Zone (KSSEZ) since 25 August 2006. In the year 2008, the books of account of AP Kostrzyn were subject to a tax inspection. The inspectors of the Tax Office challenged the method of dividing revenues into taxable and non-taxable ones. On 15 October 2010, AP Kostrzyn received a decision of the Head of the Tax Office in Zielona Góra which reversed the decision of the tax office of the first instance in its entirety and ordered to discontinue the underlying proceedings.

The above positive decision causes elimination of the previous risk concerning tax settlements at Arctic Paper Kostrzyn S.A. operating in the KSSEZ.

## Risk factors connected with the Group's environment

The order in which the following risk factors are presented does not reflect the likelihood of their occurrence, scope or significance of the risks.

### Risk of growing competition in the paper market in Europe

Our Group operates in a highly competitive market. The accomplishment of the strategic objectives assumed by the Group can be difficult because of the activities of competitors, in particular, integrated paper manufacturers operating on a larger scale than our Group. A potential growth of competition resulting from a possible increase in production capacities of our competitors, and thus, increase in the paper supply on the market, may have an adverse effect on the achievement of planned revenues and the ability to achieve financial and operating assumptions made.

### Risk of changes in law

Our Group operates in a legal environment characterized by a high level of uncertainty. Regulations concerning our activities are often amended and there is no uniform interpretation, which involves a risk of a breach of applicable regulations and related consequences, even if the breach of law is inadvertent. Furthermore, changes in environmental protection and other regulations may result in significant expenditures to ensure compliance, among other things, with more restrictive regulations or stricter implementation of applicable regulations concerning surface water, ground water, soil and air protection.

### Foreign exchange rates risk

The Group's revenues, costs and results are exposed to the risk of a change of currency exchange rates, in particular, PLN and SEK to EUR, GBP and other currencies. Our Group exports a large part of the manufactured paper to the European markets, generating a significant part of its sales revenues in EUR, PLN, GBP and SEK. The costs of purchases of raw materials for paper production, in particular pulp, are incurred mainly in USD and EUR. Furthermore, we have obligations on account of loans taken in PLN, EUR and SEK. The currency used in financial statements is PLN, and therefore, our revenues, costs and results achieved by the Paper Mills and Distribution Companies situated abroad are dependent on the levels of currency exchange rates. Thus, currency exchange rates may have an adverse effect on the Group's results, financial standing and outlook.

### The risk of changes in interest rate

The Group is exposed to the risk of changes in interest rates, mainly due to an existing coupon debt. This risk results from fluctuation in the benchmark interest rate such as WIBOR for debt in PLN, EURIBOR for the debt in EUR and STIBOR for debt in SEK. Negative changes in interest rates may adversely affect the results , financial situation and prospects of the Group.

### Risk of the growing importance of alternative media

The trends in advertising, electronic transmission and storage of data, as well as Internet, may have an adverse effect on traditional print media, and in consequence, on the products of the Group and its customers, but it is not possible to predict the timing or scope of those trends with a high degree of certainty.

## Risk factors connected with the Group's activities

The order in which the following risk factors are presented does not reflect the likelihood of their occurrence, scope or significance of the risks.

### Risks connected with relative low operating margins

Historically the Group's operating results have been characterized by relatively high volatility and low operating margins. The decline in revenues caused, among other things, by a change of production capacities, productivity, pricing policy or an increase in operating expenses, the main components of which are the costs or raw materials (mainly pulp) and energy, may lead to the loss of Group's ability to generate profits. Material adverse changes of profitability can lead to a decline in the value of our shares and limit our ability to generate working capital, brining about serious damage to our business and significantly worsening our prospects.

### Risk of changes of prices of raw materials, energy and products

We are exposed to the risk of changes of prices of raw materials and energy primarily in connection with the changing prices of pulp, fuel oil, diesel oil, coal and electricity. The Group buys pulp under framework agreements or one-time transaction and does not hedge against pulp price fluctuations. Neither does the Group hedge against the risk of an increase in coal and fuel oil prices used at AP Mochenwangen mills. The risk of change of prices of products is connected primarily with changes of paper prices in markets where we sell our products. Any significant increase in the prices of one or more than one raw material and energy can have an adverse effect on the Group's results on operating activities and financial standing.

### Risk of disturbances in production process

Our Group has four Paper Mills with ten production lines in total, with the aggregate annual production capacities of approx. 800,000 tons of paper. Any lasting disturbance of the production process can be caused by a number of factors, including an emergency failure, human errors, unavailability of raw materials, a natural disaster and other, which often are beyond our control. Any distortion, even relatively short, may have a material impact on our production and profitability and may involve significant costs such as repair, liability towards customers, whose orders we are not able to carry out and other expenditures.

### Risk connected with our investment projects

The Group's investment projects in order to enhance the Group's production capacities generally require significant investments and relatively long period of implementation. Therefore, the market conditions in which we operate can change significantly between the time when we make a decision on making investments in increasing production capacities and the time when the increased production capacities become operational. A change of market conditions can lead to fluctuations of demand for our products, which may be too low in the context of the additional production capacities. The differences between the future demand and investments in new production capacities may lead to the increased production capacities not being fully used. This may have an adverse effect on the Group's operations and financial standing.

### Risk connected with the Group's debt

Our Group has indebtedness on account of a loan agreement with Bank Polska Kasa Opieki S.A. dated 23 October 2008 and of the bonds issued in February 2010 as well as debt under the credit agreement with a bank Swenska Handelsbanken of 01 and 26 February 2010 and 26 January 2011. It is possible that we will not be able to make timely repayments or refinance our debt on account of loan and/or bonds, and also to keep the level of financial ratios that depend on the results generated by the Group accounts, as defined in the loan agreement and the terms of the bond issue, which may give rise to breaches of a loan agreement or the terms of the bond issue and the loss of collateralized assets. If an event of default occurs, it could lead in particular to bring in a state of maturity of our debt, the bank can take over control over critical assets such as the Paper Mills, credibility reduction and a loss of access to external sources of finance, and consequently, a loss of financial liquidity, which may have an adverse effect on our business and outlook, and our stock prices.

### Risk of limitations on natural gas supplies

The only supplier of natural gas used by AP Kostrzyn to generate thermal and electric energy for paper manufacturing purposes is Polskie Górnictwo Naftowe i Gazownictwo S.A. (PGNiG). Therefore, the availability and prices of natural gas have a significant effect on the operations and costs of paper production at AP Kostrzyn. Any distortions in gas supplies to the paper mill at Kostrzyn on Odra may have an adverse effect on the Group's production, operating results and financial standing.

### Risk of loss of tax reliefs in connection with AP Kostrzyn operations

AP Kostrzyn enjoys a significant tax relief thanks to conducting its business activity within the Kostrzyńsko-Słubicka Special Economic Zone. The relief was granted until 2017 and depends on AP Kostrzyn's compliance with the statutory provisions, regulations and other conditions for using a tax relief, including the compliance with certain criteria related to employment and investments. Changes of tax regulations in Poland are particularly frequent. Changes in regulations concerning that tax relief or any breach by AP Kostrzyn of the conditions of the permit based on which the relief has been granted may result in the loss of the relief and have a material adverse effect on the Group's operating results and financial standing.

#### Risk connected with taxation of equity contribution

In 2007, AP Munkedals transferred to Arctic Paper AB (which at the time owned all Munkedals shares) the so-called group contribution (*koncernbidrag* – a Swedish law concept) of SEK 200 million. At the same time, Arctic Paper AB made a cash contribution of SEK 172 million to AP Munkedals. As a result of the above operations, AP Munkedals tax loss increased which can be credited against income in subsequent tax years. Even though under the Swedish tax law such actions are admissible, there is a high risk that as a result of the transfer of AP Munkedals shares to Arctic Paper S.A. and the introduction of Company shares to the WSE regulated market, the Swedish tax authorities will question the settlement of the loss in line with the Swedish Act on Tax Avoidance. If Swedish tax authorities effectively challenge the settlement of the loss, it will not be possible to credit the loss resulting from the transfer of the Group contribution. Furthermore, AP Munkedals can be required by the Swedish tax authorities to pay an additional tax of 10% of the value of the group contribution transferred to Arctic Paper AB, i.e. SEK 20 million, which may have an adverse effect on the Group's financial standing.

#### Risk connected with consolidation and liquidity of the key customers

Consolidation tendencies among our present and potential customers may result in the emergence of a more concentrated customer base consisting of several large customers. Those customers may take advantage of a more favorable negotiating position when negotiating conditions of paper purchase or make a decision regarding change of a supplier and buy products of our competitors. Each of the above factors can have an adverse effect on the Group's operating results and financial standing.

#### Risk connected with compliance with environmental regulations and adverse impact of the production process on environment

The Group meets the environmental protection requirements, however, it is not certain that it will always perform its obligations and that in the future it will not incur significant costs or other material obligations in connection with those requirements or that it will be able to obtain all permits, approvals or other authorizations necessary for it to carry out its activities in the intended manner. Similarly, given that paper production involves potential threats related to waste discharged by paper mills or pollution with chemical substances, we cannot be certain that in the future the Group will not be held liable because of environmental pollution or that an event which will be a basis for holding the Group liable has not occurred yet. Thus, the Group may incur significant expenditures when having to remove pollution and reclaim land.

#### Risk connected with CO2 emission limits

Our paper mills get carbon dioxide emission allowances for a given period. Emission allowances are granted as part of the European Union Emission Trading Scheme. Starting from 2013, a new emission trading scheme is expected to be introduced. The nature of the new system has not been determined yet but if free of charge carbon dioxide allowances are eliminated and replaced with a system of buying emission allowances against payment, the energy generation costs incurred by us will increase accordingly. Furthermore, we may be forced to incur other costs, which are now hard to predict, in connection with emission allowances or changes in legal regulations and requirements resulting from that. For that reason we may be forced to reduce the volume of energy generated or to increase the costs of production, which may have an adverse effect on our business, financial standing, operating results or development prospects.

Risk connected with the Company's ability to pay dividend

The Issuer is a holding company, thus its ability to pay dividend depends on the level of distributions it receives from operational subsidiaries and the level of its cash balances. Some of the Group's subsidiaries conducting operating activity may in certain periods be subject to limitations concerning distributions to the Issuer. It is not certain that such limitations will not have a material adverse effect on the Group's activities, operating results and ability to pay dividend.

# Supplementary information

## Management Board position on the possibility to achieve the projected financial results published earlier

The Management Board of Arctic Paper S.A. has not published projections of financial results for 2010, and has not published projections of financial results for 2011 and do not plan to publish forecast for 2011

## Information on dividend

Dividend is paid based on net profit disclosed in the standalone annual financial statements of Arctic Paper S.A. prepared for statutory purposes, taking into account absorption of losses from prior years.

In accordance with provisions of the Code of Commercial Companies, the parent company is obliged to establish a reserve capital to finance possible losses. At least 8% of the profit for the financial year shown in standalone financial statements of parent company should be transferred to this category of capital until this capital has reached the amount of at least one third of the share capital of the parent company. The use of the reserve and supplementary capital is determined by the General Meeting; however the part of the reserve capital equal to one third of the share capital can be used only to finance the losses shown in the standalone financial statements of the parent company and cannot be distributed to other purposes.

As at the date of this report, the Company does not have preferred shares.

The possibility of payment of potential dividend by the Company to shareholders depends on the level of payments received from subsidiaries. Risks associated with the Company's ability to pay dividends have been described in the part "Risk factors" of this report.

On 12 May 2010, the Management Board of Arctic Paper SA adopted a resolution recommending the General Meeting of Shareholders a payment of dividend for the year 2009 in the amount of PLN 0.80 per share.

On 8 June 2010 Regular General Meeting of Shareholders adopted Resolution No. 7 on the distribution of profit for the year 2009, in which part of the profit for the fiscal year 2009 was allocated for distribution among the shareholders in the amount of PLN 49,309 thousand, i.e., it was decided to pay a dividend of PLN 0.89 per share. The number of shares covered by the dividend amounted to 55,403,500.

The dividend on ordinary shares for the year 2009 was paid on 6 July 2010 and amounted to PLN 49,309 thousand.

## Issue, buy-out and repayment of non-equity and equity securities

- On 1 March 2010, the Extraordinary General Meeting adopted resolutions to increase the share capital. Company's share capital was increased from the amount of PLN 524,035,000.00 to PLN 554,035,000.00, that is, the amount of PLN 30,000,000. Increasing the share capital by way of issuing 3,000,000 (three million) shares of Series E, of a nominal value of PLN 10.00 (ten zloty) each. Series E shares, issued pursuant to this resolution of the Board are ordinary bearer shares. Series E shares, issued pursuant to this resolution of the Board, participate in the dividend from the profit-sharing payments for the year 2009, ie. for the year ended 31 December 2009. Pursuant to Art. 447 § 1 in conjunction with. 433 § 2 of the Commercial Companies Code, the consent of the Supervisory Board to deprive existing shareholders pre-emptive rights in full shares of series E as expressed in Management Board Resolution No. 01/02/2010 dated 04 February, 2010 and upon the written opinion of the Management Board justifying the deprivation of preemptive rights of series E and the issue price of those shares, in the interest of the Company, the existing shareholders are deprived of the Company's preemptive rights of Series E shares issued pursuant to this resolution of the Management Board. Series E shares were offered by the Company in a private subscription. Issue price of each share of Series E issued pursuant to this resolution of the Management Board is PLN 17.43 (seventeen zloty and 43 / 100). On 9 March 2010 the increase in share capital resulting from issue of E series shares which was paid in cash, was registered.

- On June 8 2010 Annual General Meeting of the Company adopted Resolution No. 19 concerning amendments to the resolution of the General Assembly of 30 July 2009 on the adoption of assumptions - Incentive Program. Broadly described in this report under the item on the control of information shares.
- On 11 February 2010 a contract was concluded between Arctic Paper SA and BRE Bank SA, by which Bonds issue programme has been established. The Bonds issue programme shall provide the possibility to issue ordinary bearer bonds, in a dematerialised form with planned period of maturity from 7 days to 364 days for zero-coupon bonds and from 365 days for bearer bonds. Bonds issued under Bonds Issue Programme shall be unsecured. The total nominal value of Bonds issued under the Issue programme shall not exceed PLN 200 million.
- Within the confines of the Bonds Issue Programme on 25 February 2010, series 1/2010 coupon bonds and series 2/2010 zero-coupon bonds were issued. The total nominal value of issued bonds of the series 1/2010 and 2/2010 amounted to PLN 186 million.

Apart from the above changes, in the period covered by this report, Arctic Paper S.A. did not issue, buy out or repay any non-equity or equity securities.

## Use of proceeds from share issue

Use of proceeds from share issue was described in detail in note 23.1 of the consolidated financial statements.

## Remuneration paid to Management Board and Supervisory Board Members

Table below presents the information on total remuneration, bonuses for 2009 and bonuses and other benefits paid or to be paid to members of the Management Board and Supervisory Board of the parent entity for the period from 1 January 2010 to 31 December 2010 (in PLN).

### Remuneraton of the Management Board and Supervisory Board Members

| Managing and supervising personnel | Remuneration (including other contributions paid by the employer) for working in : Arctic Paper S.A. | Related parties | Bonus for 2009 | Other benefits | Total |
|---|---|---|---|---|---|
| **Management Board** | | | | | |
| Michał Piotr Jarczyński | 856 000 | 730 718 | 420 000 | 58 672 | 2 065 390 |
| Kent Bjarne Björk | 1 058 467 | - | 199 016 | 5 998 | 1 263 481 |
| Hans Olof Karlander | 960 612 | - | 36 032 | 32 565 | 1 029 209 |
| Michał Jan Bartkowiak | 517 505 | - | 90 000 | 4 000 | 611 505 |
| **Supervisory Board** | | | | | |
| Rolf Olof Grundberg | 143 000 | - | - | - | 143 000 |
| Rune Roger Ingvarsson | 97 000 | - | - | - | 97 000 |
| Thomas Onstad | 84 500 | - | - | - | 84 500 |
| Fredrik Lars Plyhr | 109 500 | - | - | - | 109 500 |
| Jan Ohlsson | 47 100 | - | - | - | 47 100 |
| Wiktorian Zbigniew Tarnawski | 84 500 | - | - | - | 84 500 |

## Agreements with Management Board Members on financial compensation

As at 31 December 2010 and as at the date this annual report is approved, no agreements were executed between the Issuer and managers providing for compensation in the event of their resignation or removal from their position without good cause, or if their removal or resignation is due to the Issuer's merger through acquisition.

## Statement of changes in the issuer's shareholding or rights to shares of persons managing and supervising Arctic Paper S.A.

## Statement of changes to the holdings of the Company's shares and rights thereto by managing and supervising personnel

| Managing and supervising personnel | Number of shares or rights thereto as at 27/04/2011 | Number of shares or rights thereto as at 01/03/2011 | Change |
|---|---|---|---|
| **Management Board** | | | |
| Michał Piotr Jarczyński | 76 500 | 76 500 | - |
| Hans Olof Karlander | 19 124 | 19 124 | - |
| Michał Jan Bartkowiak | - | - | - |
| **Supervisory Board** | | | |
| Rolf Olof Grundberg | 312 | 312 | - |
| Rune Roger Ingvarsson | - | - | - |
| Thomas Onstad | - | - | - |
| Fredrik Lars Plyhr | 19 000 | 19 000 | - |
| Jan Ohlsson | - | - | - |
| Wiktorian Zbigniew Tarnawski | - | - | - |

### Information on system of control over employees' shares

The Company has not issued any convertible or exchangeable securities. On 30 July 2009, the Company's Extraordinary General Meeting adopted Resolution no. 4 to adopt assumptions for an incentive plan for key managers, issue subscription warrants, conditionally increase the share capital through the issue of new shares, deprive the existing shareholders of the preemptive right to subscription warrants and shares and to amend the Articles of Association – see the Company's Issue Prospectus.

On June 8, 2010 Annual General Meeting of the Company adopted Resolution No. 19 concerning amendments to the resolution of the General Assembly of 30 July 2009 on the adoption of assumptions - Incentive Program, and yes: change to § 3 and give it the following: „"After entering the the register of entrepreneurs of the conditional capital increase carried out under point III of this Resolution, the Company will issue A series subscription warrants, hereinafter called "Warrants" in the number of 1,500,000, entitling the bearer shares of series D with a nominal value PLN 10 (ten zloty) each.

Changes in § 4. 1 and gives the following: "entitled to subscribe for the Warrants will be indicated by the Supervisory Board by persons belonging to key executives of the Company and its subsidiaries, including members of the Supervisory Board, regardless of the form and legal basis to perform the duties of these positions (" Participants Incentive Program "), provided that the eligible to purchase the Warrants will be no more than 30 people."

On June 8, 2010 Annual General Meeting of the Company adopted Resolution No. 20 concerning amendments to the Articles of Association in such a way that changes to Article 5.7.1 and 5.7.2, and gives them the following:

„5.7.1 The nominal value of the conditional increase in share capital is 15,000,000.00 zł (fifteen million) and is divided into ordinary bearer shares of series D with a nominal value PLN 10.00 (ten zloty) each. "

„5.7.2 The purpose of the conditional capital increase is to grant rights to subscribe for shares of series D warrants to holders of series A, issued by the Company pursuant to resolution No. 4 of the Extraordinary General Meeting of 30 July 2009 and resolution of the Annual General Meeting of 8 June 2010. "

## Information on key agreements

On 11 February 2010 a contract was concluded between Arctic Paper SA and BRE Bank SA, by which Bonds issue programme has been established. The Bonds issue programme shall provide the possibility to issue ordinary bearer bonds, in a dematerialised form with planned period of maturity from 7 days to 364 days for zero-coupon bonds and from 365 days for bearer bonds. Bonds issued under Bonds Issue Programme shall be unsecured. The total nominal value of Bonds issued under the Issue programme shall not exceed PLN 200 million.

Within the confines of the Bonds Issue Programme on 25 February 2010, series 1/2010 coupon bonds and series 2/2010 zero-coupon bonds were issued. The total nominal value of issued bonds of the series 1/2010 and 2/2010 amounted to PLN 186 million.

On March 1, 2010, an agreement was signed for a loan with a subsidiary Arctic Paper Investment AB ("Borrower"). The loan was granted to a subsidiary in connection with the completion of the acquisition by a Arctic Paper Group of 100% of shares of Grycksbo Paper Holding AB. According to the agreement Arctic Paper Investment AB was granted with a loan for the period from 01.03.2010 to 10.02.2013 in the amount of PLN 195 million for the purpose of purchase of shares of Grycksbo Paper Holding AB.

On 17 June 2010 Arctic Paper SA and its subsidiaries, such as Arctic Paper Kostrzyn, Arctic Paper AB Munkedals, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH concluded with the Bank Polska Kasa Opieki SA Amendment to the facility agreement dated 23 October 2008. Pursuant to Amendment No. 4, Bank Polska Kasa Opieki SA agreed to additionally grant to Arctic Paper Kostrzyn S.A. a an overdraft facility (“facility C”) up to the amount of PLN 50,000,00. The loan will be used to finance current operations of Arctic Paper Kostrzyn. On 30 March 2011, the Company and its subsidiaries, that is Arctic Paper Kostrzyn, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH concluded with the Bank Polska Kasa Opieki SA another amendment (the "Amendment "). Pursuant to the Amendment Bank Polska Kasa Opieki SA agreed to postpone until 30 March 2012 the final repayment date of the current account credit of up to PLN 50,000,000 (“the facility C”) granted to Arctic Paper Kostrzyn S.A. The above information was disclosed in Note 45.4 of these consolidated annual report.

On 23 December 2010, Arctic Paper SA and its subsidiaries, i.e. Arctic Paper Kostrzyn, Arctic Paper AB Munkedals, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH concluded Amendment to the facility agreement with Bank Polska Kasa Opieki SA, Poland dated October 23, 2008. Under Amendment No. 5 Bank Polska Kasa Opieki SA Poland agreed that:

1. Net borrowings to EBITDA ratio calculated based on the consolidated financial statements for the annual periods ending on 30 September 2010 and on 31 December 2010 may exceed 3.5, provided however, that in respect to any such relevant period, the Net Borrowings will not at any time exceed 5.0 times EBITDA.

2. EBITDA to Interest Expense ratio calculated based on consolidated financial statements for the year ended 31 December 2010 may be less than 3:1, provided however, that the ratio of EBITDA to Interest Expense for the relevant period ending on 31 December 2010 will not be less than 1.4:1.

## Financial resources management

In 2010 the Group established Bond Issue Programme which resulted in bonds issue in total nominal value of PLN 186 million. The funds were obtained in order to finance part of the acquisition price of 100% of Grycksbo Paper Holding AB shares as well as to reduce the amount of planned funding of statutory activities from the bank loan.

At 31 December 2010 the Group has an utilized overdraft facility in Arctic Paper Kostrzyn S.A. in the amount of PLN 41,266 thousand. Group has also cash on the current account in the amount of PLN 179,402 thousand.

As at the date of this consolidated annual report, the Company had sufficient cash and creditworthiness to ensure financial liquidity of the Arctic Paper S.A. Group.

## Capital investment and investment

In 2010 the Arctic Paper Group entities used their cash resources only to the standard short-term investments, including overnight deposits. The Group did not make any investment in 2010.

## Bank and other loan agreements

Information on bank and other loan agreements is presented in the additional information in notes 31 and 35 of the consolidated financial statements.

Table below presents information about loans granted by Arctic Paper S.A. to its related parties in 2010.

### Borrowings to related parties in the financial year

| Related party | Maturity date | Interest | Amount of the borrowing in currency (in thousand) | Borrowing currency | As at 31 December 2010 (in PLN thousand) |
|---|---|---|---|---|---|
| Arctic Paper Munkedals | 31-03-2011 | Wibor 3M+ marża | 27 658 | PLN | 27 658 |
| Arctic Paper Mochenwangen | 31-12-2011 | Euribor 3M + marża | 1 500 | EUR | 5 940 |
| Arctic Paper Investment GmbH | 31-12-2011 | Wibor 3M + marża | 19 | PLN | 19 |
| Arctic Paper Investment GmbH | 31-12-2011 | Euribor 3M + marża | 3 437 | EUR | 13 610 |
| Arctic Paper Investment AB | 10-02-2013 | Wibor 6M + marża | 244 275 | PLN | 244 275 |
| Arctic Paper East | 31-12-2011 | Wibor 3M + marża | 250 | PLN | 250 |
| Arctic Paper Ireland Ltd. | 31-12-2011 | Euribor 3M + marża | 1 | EUR | 4 |
| TOTAL | | | | | 291 756 |

The borrowings to related parties are performed on the arms-length basis.

## Information on guarantees

During the period covered by this report, Arctic Paper S.A. and its subsidiaries did not give or receive guarantee for a loan or borrowing and did not receive or give guarantees jointly to one entity or subsidiary of such entity, the total value of which represented the equivalent of at least 10% of the Company's equity.

As at 31 December 2010 the Group reported:

- a bill of exchange guarantee issued by the Group to the amount of loan and lease agreement in favour of the National Fund for Environment Protection and Water Management in the amount of PLN 20,352 thousand;
- a bill of exchange guarantee in favour of Siemens Finance in the amount of PLN 819 thousand;
- a bill of exchange guarantee in favour of Bankowy Leasing in the amount of PLN 9,848 thousand;
- a bill of exchange guarantee in favour of Bankowy Fundusz Leasingowy in the amount of PLN 15,023 thousand;
- a guarantee commitment to FPG in favour of mutual life insurance company PRI in the amount of SEK 500 thousand;
- a bank guarantee in favour of Skatteverket Ludvika in the amount of SEK 66 thousand.

## Significant off-balance sheet items

Information regarding off-balance sheet items is given in the Consolidated Financial Statements (note 45).

## Evaluation of the possibility to implement investment plans

In connection with the achievement of significantly less favorable results in 2010, major investments planned in 2011 were limited.

The most important investment is associated with increased production of cellulose in Mochenwangen. Growth potential is assumed to 52 thousand tonnes per year to 70 thousand tonnes per year.

Other investments are connected with reduction of costs, particularly those associated with the production of energy in paper mills.

## Information on court and arbitration proceedings and proceedings pending before public administrative authorities

During the period covered by this report, Arctic Paper S.A. and its subsidiaries were not a party to any proceedings pending before a court, arbitration or public administrative authority, the unit or joint value of which would equal to or exceed 10% of the Company's equity.

## Information on transactions with related parties executed on non-market terms and conditions

During the period covered by this report, Arctic Paper S.A. and its subsidiaries did not execute any significant transactions with related entities on non-market terms and conditions.

## Information on agreements resulting in shareholding changes

The Issuer is not aware of any agreements which may in the future lead to changes in the present shareholding of shareholders and bondholders.

## Information on acquisition of treasury shares

In 2010 the Company did not acquire any treasury shares.

## Information on entity authorized to audit the financial statements

Information on the entity authorized to audit the financial statements is given in the additional information in note 37 of the consolidated financial statements.

## Employment

Information regarding employment is given in the additional information in note 41 of the consolidated financial statements.

# Statement on application of corporate governance rules

## Corporate governance rules

Pursuant to § 29 item 2 of the Warsaw Stock Exchange Rules adopted by Resolution no. 1/1110/2006 by the Stock Exchange Board on 4 January 2006, as amended, Arctic Paper S.A. is obliged to apply corporate governance rules contained in the document – "Best practices of companies listed on the SE", attached as a schedule to Resolution no. 12/1170/2007 of the Stock Exchange Board of 4 July 2007 ("Best Practices"), available on the website www.corp-gov.SE.pl

## Information on the extent to which the Issuer does not apply corporate governance rules

In 2010 the Issuer abided by all corporate governance rules contained in the Best Practices.

## Internal control and risk management system with regard to the process of preparing financial statements

The Management Board of Arctic Paper S.A. is responsible for the Group's internal control system and its effectiveness in the process of preparing consolidated financial statements and periodical reports prepared and published in accordance with the Regulation of 19 February 2009 on current and periodical information submitted by issuers of securities and terms and conditions of classifying as equivalent information required by the law of a non-member state. The Group's consolidated financial statements and periodical reports are the responsibility of the Company's financial department managed by the Director of Finance Financial data constituting the basis for preparing the Group's consolidated financial statements come from monthly reporting blocks and extended quarterly blocks set to the Issuer by the Group companies. After the accounts of each calendar month are closed, senior management of the Group companies analyzes the financial results of the companies in the light of the budget projections and results achieved in the previous financial year.

The Group carries out an annual review of its strategies and growth perspectives. The process of establishing the budget is supported by medium-level and senior management of the Group companies. The budget for the following year is adopted by the Company's Management Board and approved by its Supervisory Board. During the year, the Company's Management Board compares the financial results achieved with the budget projections.

The Company's Management Board systematically evaluates the internal control and risk management system quality in reference to the process of preparing consolidated financial statements. Based on the evaluation the Company's Management Board states that as at 31 December 2010 there were no weaknesses which could materially impact the effectiveness of internal control in financial reporting.

## Shareholders holding directly or indirectly significant blocks of shares

Information regarding shareholders holding directly or indirectly significant blocks of shares is given in the part of the Management Board Report on the operations of Arctic Paper S.A. Capital Group – Description of Arctic Paper Group's operations.

## Securities carrying special control rights

The Company does not have any securities which carry special control rights, and the Company's shares are non-preferred.

## Restrictions on transfer of ownership of the Issuer's securities any restrictions on exercise of the voting right

The Company's Articles of Association do not provide for any restrictions on the transfer of the ownership of the Issuer's securities. Such restrictions follow from legal regulations, including Chapter 4 of the Act on Offering, articles 11 and 19 and Section VI of the Act on Trading in Financial Instruments of 29 July 2005, the Act on Protection of Competition and Consumers of 16 February 2007, and the (EC) Council Regulation no. 139/2004 of 20 January 2004 on control of concentrations between undertakings. The Company committed that, without the Underwriter's and the Oferror's consent, for a period of 6 (six) months from the day on which the Public Offering ends, it would not issue shares or make public the intent to issue shares (or any securities convertible to or exchangeable for Shares or which carry the right to take up or purchase Shares), execute a transaction (including derivative transactions) with a similar Share market effect as sale, or make public the intent to take any of the above activities - see the Company's Prospectus.

Further, along with the signing of the underwriting agreement, Arctic Paper AB committed to the Underwriter and the Offeror that, without their consent, for a period of 12 (twelve) months from the day on which the Public Offering ends, it would not offer, sell, commit to sell, or give any put option or take any other actions aimed at selling the Shares (or any securities convertible to or exchangeable for Shares or which carry the right to take up or purchase Shares), execute a transaction (including derivative transactions) with a similar Share market effect as sale, or make public the intent to take any of the above activities - see the Company's Prospectus.

Each Arctic Paper S.A. share carries one vote at the General Meeting. The Company's Articles of Association do not provide for any restrictions on the exercise of a vote from Arctic Paper S.A. shares, e.g. restriction on vote by holders of a certain part or number of votes, time restrictions on exercising the voting right, or provisions under which, with the Company's cooperation, equity rights related to securities are separated from possession of securities.

A prohibition on a shareholder to vote may arise from article 89 of the Act on Public Offering and on Terms and Conditions of Introducing Financial Instruments to Organized Trading System and on Public Companies of 29 July 2005 (the "Act on Offering") if the shareholder violates certain regulations contained in Chapter 4 of the Act on Offering.  On the other hand, according article 6 § 1 of the Code of Commercial Companies, if a parent company does not inform a capital subsidiary company that a controlling relationship has arisen within two weeks of such relationship arising, the voting right attached to the shares of the parent company representing more than 33% of the subsidiary's share capital is suspended.

## Principles of amending the Issuer's Articles of Association

The Company's Articles of Association may be amended by the General Meeting only.

If the Code of Commercial Companies or the Company's Articles of Association do not provide otherwise, General Meeting resolutions are adopted by a simple majority of votes cast.

## Description of the action manner of the General Meeting

The operating procedure of a General Meeting and its basic rights arise directly from legal regulations which are partly included in the Company's Articles of Association.

The Company's Articles of Association are available at:

http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Dokumenty-korporacyjne/

General Meetings are held in accordance with the following basic rules:

- General Meetings are held in the Company's registered office or in Warsaw.
- A General Meeting may be annual or extraordinary.
- An annual General Meeting should be held within six months of the end of reach financial year.
- A General Meeting is opened by the Supervisory Board Chairman or a person designated by him, followed by the election of the Chairman of the General Meeting.
- Voting is open unless any Shareholder demands secret ballot or secret ballot is required by the Code of Commercial Companies.
- If the Code of Commercial Companies or the Company's Articles of Association do not provide otherwise, General Meeting resolutions are adopted by a simple majority of votes cast.
- According to the Company's Articles of Association, the following issues are within the General Meeting's exclusive powers:
  - considering and approving the Management Board report on the Company's operations and the Company's financial statements for the previous financial year;
  - acknowledging fulfillment of duties by Management Board members and Supervisory Board members;
  - decisions on allocation or profits or absorption of losses;
  - amending the Company's objects;
  - amending the Company's Articles of Association;
  - increasing or reducing the Company's equity;
  - merging the Company with another company or companies, or transforming the Company;
  - dissolving and liquidating the Company;
  - issuing senior convertible bonds and subscription warrants;
  - acquiring and selling real estate;

- selling and leasing an enterprise or an organized part thereof and establishing a limited property right thereon;
- any other issues which under the Articles of Association or the Code of Commercial Companies require a General Meeting resolution.

A General Meeting may adopt resolutions in the presence of shareholders representing at least half of the Company's share capital. A General Meeting adopts resolutions by an absolute majority of votes cast unless the Articles of Association or legal regulations require a qualified majority of votes.
Shareholders' rights and the way in which they are exercised basically arise directly from the legal regulations which have been partly incorporated into the Company's Articles of Association.

## Activities of the Issuer's managing and supervisory authorities and their committees, and information on the composition of those authorities

### Management Board

Management Board composition

- The Management Board is composed of one to five members, including the Management Board President.
- The Management Board is appointed and removed by the Supervisory Board for a common term of office.
- The term of office of Management Board members is 3 (three) years.
- If the Management Board is composed of more than one member, the Supervisory Board may, at the President's request, appointed up to three Vice Presidents from among Management Board members. A Vice President is removed under a Supervisory Board resolution.
- A Management Board member may be removed at any time by the Supervisory Board.
- A Management Board member may be removed or suspended at any time also by the General Meeting.

Basic powers of the Management Board

- The Management Board runs the Company's affairs and represents it before third parties.
- If the Management Board is composed of more than one member, declarations of intent may be made and documents may be signed on the Company's behalf by the Management Board President individually, or by two Management Board members acting jointly, or one Management Board member acting jointly with a commercial proxy.
- The Management Board is obliged to perform its duties with due care and to abide by the law, the Company's Articles of Association, by-laws and resolutions of the Company's authorities, and to take decisions within reasonable business risk, bearing in mind the interest of the Company and its shareholders.
- The Management Board is obliged to manage the Company's assets and affairs and to perform its duties with due care required in business transactions, in accordance with all legal regulations, the Articles of Association, by-laws, and resolutions adopted by the General Meeting and the Supervisory Board.

- Each Management Board member is labile for damage caused to the Company by his actions or omissions in breach of the law or the Company's Articles of Association.
- According to the Code of Commercial Companies, the powers of the Management Board include all issues of the Company which are not reserved for the General Meeting and the Supervisory Board.
- Guided by the Company's interest, the Management Board sets forth the Company's strategy and main operating goals.
- The Management Board is obliged to abide by the legal regulations on confidential information within the meaning of the Act on Trading and to perform all duties arising from those regulations.

To all other extent, particular Management Board members are liable individually for running the Company's affairs in accordance with the internal allocation of duties and functions set out in a Management Board decision.
The Management Board may adopt resolutions at meetings or without holding a meeting in writing or with the use of distance communication. The Management Board adopts resolutions by a majority of votes cast. Resolutions are valid if at least half the Management Board members are present at the meeting. In the case of a voting deadlock, the Management Board President has the casting vote.

Additional Management Board rights arising from the Company's Articles of Association

Under the Company's Articles of Association, the Management Board is authorized to carry out one or several share capital increases by an amount not higher than PLN 120,000,000 (one hundred twenty million) through the issue of not more than 12,000,000 (twelve million) ordinary bearer shares (Authorized Capital), on the following terms and conditions:

- the Management Board may exercise its authority by effecting one or several share capital increases within the Authorized Capital;
- this authorization was granted for 3 years from the date the amendment to article 5.6 of Articles of Association is registered in the register;
- shares issued as part of Authorized Capital may be taken up in exchange for cash or non-cash contributions;
- the issue price of the shares issued as part of the Authorized Capital will be set by the Management Board in a resolution to increase the share capital as part of this authorization; in this case, Supervisory Board consent is not required, subject to item 5.6 g) of the Company's Articles of Association;
- a Management Board resolution adopted as part of the authorization granted under the Articles of Association in this article supersedes a General Meeting resolution to increase the share capital;
- the Management Board decides on all issues related to share capital increase as part of the Authorized Capital, subject to article 5.6 of the Articles of Association;
- the Management Board is authorized, with the Supervisory Board's consent, to issue the shares in exchange for a non-cash contribution; an issue price of shares by the Management Board for shares issued in exchange for a non-cash contribution requires Supervisory Board consent;
- the Management Board is authorized, with the Supervisory Board's consent, to deprive the existing shareholders of the preemptive right in whole or in part.

The special Management Board procedure is set out in the Management Board By-laws which are available at: http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Dokumenty-korporacyjne/

The composition of the Company's Management Board and any changes thereto are described in the consolidated financial statements.

## Supervisory Board

Composition and organization of Supervisory Board composition and organization

- The Supervisory Board is composed of 5 (five) to 7 (seven) members elected by the General Meeting for a common three-year term of office. A Supervisory Board member may be removed at any time.
- The Supervisory Board is composed of a Chairman, Deputy Chairman, and other members. The Supervisory Board Chairman and Deputy Chairman are elected by the Supervisory Board from among its members at the first meeting or – if needed – during the term f office, in supplementary elections.
- From the moment the General Meeting adopts resolutions constituting grounds for the first public share issue and for introducing the shares to stock exchange trading, two Supervisory Board members should be independent members.
- If an independent Supervisory Board member has been appointed, without the consent of at least one independent Supervisory Board member, the following resolutions cannot be adopted:
  - any performances by the Company or any related entity to Management Board members;
  - consent for the Company or its subsidiary to execute a key agreement with an entity related to the Company, Supervisory Board member or Management Board member and their related entities, other than agreements executed during the normal course of the Company's business on regular terms applied by the Company;
  - election of a certified auditor to audit the Company's financial statements.
- In order to avoid doubts, it is assumed that the loss of independence by a Supervisory Board member, or failure to appoint an independent Supervisory Board member do not result in the invalidity of decisions taken by the Supervisory Board. The loss of independence by an Independent Member during the term of being a Supervisory Board member does not invalidate or extinguish his mandate.
- The Supervisory Board Chairman and Deputy Chairman:
  - maintain contact with the Company's Management Board;
  - manage the Supervisory Board's work;
  - represent the Supervisory Board before third parties and the Company's authorities, including particular Management Board members,
  - implement initiatives and motions addressed to the Supervisory Board,
  - take other activities arising from the By-laws and the Company's Articles of Association.
- A Supervisory Board member should not resign from his position during the term of office if this could prevent the Supervisory Board operations, or preclude the timely adoption of a significant resolution.

- Supervisory Board members should be loyal to the Company. If there is a conflict of interest, a Supervisory Board member is obliged to inform the remaining Board members thereof and to refrain from speaking and voting on the resolution on the matter of conflict of interest.
- Supervisory Board members are obliged to abide by the law, the Company's Articles of Association and the Supervisory Board By-laws.

Supervisory Board powers

- The Supervisory Board exercises permanent supervision over the Company's operations in all areas of its operations.
- The Supervisory Board adopts resolutions, gives instructions and issues opinions and submits motions to the General Meeting.
- The Supervisory Board may not give the Management Board binding instructions regarding the running of the Company's affairs.
- Disputes between Supervisory Board and Management Board are resolved by the General Meeting.
- In order to exercise its rights, the Supervisory Board may review any aspect of the Company's operations, demand presentation of any documents, reports, and explanations from the Management Board and issue opinions on matters concerning the Company, and submit conclusions and initiatives to the Management Board.
- Apart from other issues set out by law of the Company's Articles of Association, the powers of the Supervisory Board include:
  - evaluating the Company's financial statements;
  - evaluating the Management Board report on the Company's operations and Management Board motions regarding allocation of profit or absorption of losses;
  - submitting to the General Meeting an annual written report on the results of the evaluations;
  - appointing and removing Management Board members, including the President and Vice Presidents, and setting remuneration for Management Board members;
  - electing a certified auditor for the Company.
- Each year the Supervisory Board submits to the General Meeting a brief report of the Company's situation, and renders access to this report for all shareholders in a period which allows them to become acquainted with it before the Annual General Meeting.
- The Supervisory Board executes, on the Company's behalf, agreements with Management Board members and represents the Company in disputes with Management Board members. The Supervisory Board may, in a resolution, authorize one or more members to carry out such legal transactions.

The Supervisory Board may adopt resolutions in writing or with the use of direct distance communication. A resolution so adopted is valid if all Board members have been informed of the wording of the draft resolution. The date on which such a resolution is adopted is the date on which the last Supervisory Board member signs it.

Supervisory Board resolutions may be adopted if all members have been notified by registered mail, fax or e-mail, sent at least 15 days in advance and most of the Board members are present at the meeting.

Resolutions may be adopted without a formal convening of a meeting if all Board members consent to a vote on a given issue or to the wording of the resolution which is to be adopted.

Supervisory Board resolutions are adopted by a simple majority of votes cast; in the case of a voting deadlock, the Supervisory Board Chairman has the casting vote.

The detailed operations of the Supervisory Board are laid down in the Supervisory Board By-laws which are available at:

http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Dokumenty-korporacyjne/

The Supervisory Board composition and changes thereto are described in the consolidated financial statements.

The following persons are independent Supervisory Board members:

- Mr. Fredrik Lars Plyhr
- Mr. Wiktorian Zbigniew Tarnawski
- Rune Ingvarsson
- Jan Ohlsson

Thus, 4 of 6 Supervisory Board members are independent members.

## Audit Committee

Audit Committee composition and organization

- The Audit Committee is composed of at least three Supervisory Board members, including the Committee Chairman, appointed by the Supervisory Board from among its members, in accordance with the Articles of Association and the Supervisory Board By-laws. At least one Audit Committee member is an independent member and has qualifications and experience in accounting and finance.
- Audit Committee members are appointed for a three-year term of office; not longer, however, than the Supervisory Board term of office.
- The Audit Committee Chairman elected by a majority of votes from among its members must be an independent member.
- The Audit Committee operates based on the Act on Certified Auditors, Best Practices, Supervisory Board By-laws and Audit Committee By-laws.
- The Audit Committee performs advisory and opinion-giving functions, operates collectively as part of the Company's Supervisory Board.
- The Audit Committee implements its tasks by presenting to the Supervisory Board, in the form of resolutions, motions, opinions, and reports on its tasks.

Audit Committee powers

- The basic task of the Audit Committee is advisory to the Supervisory Board on issues or proper implementation and control of the financial reporting processes in the Company, effectiveness of internal control and risk management systems and cooperating with certified auditors.

- The Audit Committee tasks arising from supervision over the Company's financial reporting process, ensuring effective internal control systems and monitoring financial audit activities include in particular:
  - control of the correctness of financial information delivered by the Company, including the correctness and cohesion of the accounting principles applied in the Company and its Capital Group, and criteria of consolidation of those financial statements,
  - evaluation, at least once a year, the internal control and management system in the Company and its Capital Group in order to ensure proper recognition and management of the Company,
  - ensuring effective functioning of internal control, especially by issuing recommendations to the Supervisory Board with regard to:

    - strategic and operating plans of internal audit and significant corrections to those plans,

    - internal audit policy, strategy and procedures prepared in accordance with the adopted internal audit standards,

    - inspecting specific aspects of the Company's operations.
- The tasks of the Audit Committee arising from monitoring the independence of a certified auditor and the entity authorized to audit financial statements include in particular:
  - giving recommendations to the Supervisory Board on issues concerning, election, appointment and re-appointment and removal of the entity performing the function of a certified auditor,
  - inspection of independence and objectiveness of the entity performing the function of a certified auditor, especially with regard to a change of the certified auditor, remuneration received, and other relation with the Company,
  - verifying the effectiveness of the entity performing the function of a certified auditor,
  - examining the reasons for resignation of an entity performing the function of a certified auditor.
- The Audit Committee may rely on the advice and assistance of external legal, accounting or other advisors if it deems necessary to perform its duties.
- The Audit Committee is obliged to submit annual reports on its operations to the Supervisory Board, by 30 September of each calendar year.

Audit Committee meetings are held at least twice a year.

On 3 December 2009, the following persons were appointed to the Audit Committee:

- Rolf Olof Grundberg
- Fredrik Plyhr
- Rune Ingvarsson

The detailed operations of the Audit Committee are laid down in the Audit Committee By-laws which are available at:

http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Dokumenty-korporacyjne/

## Remuneration Committee

Remuneration Committee composition and organization

- The Remuneration Committee is composed of at least two Supervisory Board members, including the Committee Chairman, appointed by the Supervisory Board from among its members, in accordance with the Articles of Association and the Supervisory Board By-laws.
- Remuneration Committee members are appointed from three-year terms of office, not longer, however, than until the end of the Supervisory Board term of office.
- The Remuneration Committee Chairman is elected by a majority vote from among Committee members.
- The Remuneration Committee operates based on the Supervisory Board By-laws and the Remuneration Committee By-laws.
- The Remuneration Committee performs advisory and opinion-giving functions, acts collectively as part o the Company's Supervisory Board.
- The Remuneration Committee implements its tasks by presenting to the Supervisory Board, in the form of resolutions motions, opinions, recommendations, and reports on issues which are within its powers.

Remuneration Committee powers

- The basic tasks of the Remuneration Committee is advisory to the Supervisory Board on issues related to remuneration policy, bonus policy, and other issues related to the remuneration of the employees, members of the Company's authorities and Capital Group companies.
- The tasks of the Remuneration Committee arising from supervision of the Company's remuneration policy and ensuring effective functioning of the Company's remuneration policy including giving the Supervisory Board recommendations in particular on:
  - approving and changing the principles of remuneration for members of the Company's authorities,
  - the total remuneration for the Company's Management Board members,
  - legal disputes between the Company and Management Board members on the Committee's tasks,
  - proposal of remuneration and granting additional benefits to particular members of the Company's authorities, especially, as part of management option plan (convertible into Company's shares),
  - remuneration and bonus policy strategy and staff policy.
- The Remuneration Committee may also rely on advice and assistance of external legal or other advisors if it deems necessary to perform its duties.
- The Audit Committee is obliged to submit annual reports on its operations to the Supervisory Board by 30 September of each calendar year.

Remuneration Committee meetings are held at least twice a year, on a date set by the Chairman.

On 3 December 2010, the following persons were appointed to the Remuneration Committee:

- Rolf Olof Grundberg
- Fredrik Plyhr

The detailed operating procedure of the Remuneration Committee is laid down in the Remuneration Committee By-laws which are available at:

http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Dokumenty-korporacyjne/

# Management Board's representations

## Accuracy and reliability of presented reports

Members of the Management Board of Arctic Paper S.A. declare that according to their best knowledge:

- Consolidated Financial Statements of Arctic Paper S.A. Capital Group for the year ended 31 December 2010 and the comparables were prepared in accordance with applicable accounting principles and reflect the true, reliable and fair situation of assets and financial position of the Capital Group and its financial results for 2010,
- Management Board report on the activity of the Arctic Paper S.A. Capital Group to the report for 2010 contains a true picture of development, achievements and situation of Arctic Paper S.A. Capital Group, including a description of major threats and risks.

## Appointment of the Licensed Auditor of the Consolidated Financial Statements

The Management Board Members of Arctic Paper S.A. hereby declares that Ernst & Young Audit Sp. z o.o. - a company entitled to audit financial statements, the licensed auditor of the consolidated financial statements of Arctic Paper S.A. Capital Group, has been appointed in compliance with the relevant regulations and that both the auditor and the chartered accountants carrying out the audit meet the requirements to develop an impartial and independent opinion on the audited statements in compliance with the relevant regulations and professional standards.

Signatures of the Management Board Members

| Position | Name and surname | Date | Signature |
|---|---|---|---|
| President of the Management Board<br>Chief Executive Officer | Michał Jarczyński | 27 April 2011 | |
| Member of the Management Board<br>Chief Operating Officer | Bjarne Björk | 27 April 2011 | |
| Member of the Management Board<br>Marketing and Sales Director | Hans Karlander | 27 April 2011 | |
| Member of the Management Board<br>Chief Financial Officer | Michał Bartkowiak | 27 April 2011 | |

# Consolidated Financial Statements
# for the year ended 31 December 2010
# to the Annual Report for 2010

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Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated financial statements and selected financial data

## Selected consolidated financial data

| | For the period from 01.01.2010 to 31.12.2010 thousand PLN | For the period from 01.01.2009 to 31.12.2009 thousand PLN | For the period from 01.01.2010 to 31.12.2010 thousand EUR | For the period from 01.01.2009 to 31.12.2009 thousand EUR |
|---|---|---|---|---|
| Revenues | 2 287 731 | 1 809 085 | 572 806 | 417 976 |
| Operating profit (loss) | 17 680 | 179 310 | 4 427 | 41 428 |
| Profit (loss) before tax | 7 350 | 153 052 | 1 840 | 35 361 |
| Profit (loss) from continuing operations | 28 817 | 132 400 | 7 215 | 30 590 |
| Profit (loss) for the period | 28 817 | 132 400 | 7 215 | 30 590 |
| Net operating cash flow | 120 409 | 250 988 | 30 148 | 57 989 |
| Net investment cash flow | (230 583) | (132 540) | (57 734) | (30 622) |
| Net financial cash flow | 129 974 | (42 231) | 32 543 | (9 757) |
| Net change in cash and cash equivalents | 19 800 | 76 217 | 4 958 | 17 609 |
| Weighted average number of shares | 54 778 842 | 45 390 884 | 54 778 842 | 45 390 884 |
| Weighted average diluted number of shares | 54 778 842 | 45 390 884 | 54 778 842 | 45 390 884 |
| EPS (in PLN/EUR) | 0,53 | 2,92 | 0,13 | 0,67 |
| Diluted EPS (in PLN/EUR) | 0,53 | 2,92 | 0,13 | 0,67 |
| Average PLN/EUR rate* | | | 3,9939 | 4,3282 |

| | As at 31 December 2010 thousand PLN | As at 31 December 2009 thousand PLN | As at 31 December 2010 thousand EUR | As at 31 December 2009 thousand EUR |
|---|---|---|---|---|
| Assets | 1 910 769 | 1 180 310 | 482 481 | 287 306 |
| Long-term liabilities | 500 218 | 322 272 | 126 308 | 78 446 |
| Short-term liabilities | 742 608 | 240 002 | 187 513 | 58 420 |
| Equity | 667 943 | 618 036 | 168 660 | 150 440 |
| Share capital | 554 035 | 524 035 | 139 897 | 127 558 |
| Number of shares | 55 403 500 | 52 403 500 | 55 403 500 | 52 403 500 |
| Diluted number of shares | 55 403 500 | 52 403 500 | 55 403 500 | 52 403 500 |
| Book value per share (in PLN/EUR) | 12,06 | 11,79 | 3,04 | 2,87 |
| Diluted book value per share (in PLN/EUR) | 12,06 | 11,79 | 3,04 | 2,87 |
| Declared or paid dividend (in PLN/EUR) | 49 309 | - | 12 451 | - |
| Declared or paid dividend per share (in PLN/EUR) | 0,89 | - | 0,22 | - |
| PLN/EUR rate at the end of the period** | - | - | 3,9603 | 4,1082 |

* - Income statements items were coverted using the rate calculated as arithmetical mean of the average exchange rates announced by the National Bank of Poland at the last day of each month.

** - Balance sheet items and book value per share were convenrted using the average exchange rate announced by the National Bank of Poland at the balance sheet date.

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated income statement

| | Note | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|---|
| Continuing operations | | | |
| Sales of paper | 10.1 | 2 287 360 | 1 805 504 |
| Sales of services | | 371 | 3 581 |
| Revenues | 10 | 2 287 731 | 1 809 085 |
| Cost of sales | 11.5 | (2 029 622) | (1 339 917) |
| Gross profit (loss) on sales | | 258 110 | 469 168 |
| Selling and distribution expenses | 11.5 | (272 965) | (237 605) |
| Administrative expenses | 11.5 | (57 273) | (59 104) |
| Other operating income | 11.1 | 150 180 | 44 601 |
| Other operating expenses | 11.2 | (60 372) | (37 749) |
| Operating profit / (loss) | | 17 680 | 179 310 |
| Finance income | 11.3 | 20 062 | 2 104 |
| Finance costs | 11.4 | (30 393) | (28 363) |
| Profit / (loss) before tax | | 7 350 | 153 052 |
| Income tax | 13 | 21 467 | (20 652) |
| Net profit (loss) for the year from continuing operations | | 28 817 | 132 400 |
| Discontinued operations | | - | - |
| Profit (loss) for the period from discontinued operations | | - | - |
| Net profit (loss) for the year | | 28 817 | 132 400 |
| Attributable to: | | | |
| Equity holders of the parent | | 28 817 | 132 400 |
| Minority interest | | - | - |
| | | 28 817 | 132 400 |
| Earnings per share: | | | |
| – basic from the profit (loss) for the period attributable to equity holders of the parent | | 0,53 | 2,92 |
| – basic from the profit (loss) from continuing operations attributable to equity holders of the parent | | 0,53 | 2,92 |


Summary of significant accounting policies and other explanatory notes included on pages 69 to 154 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated statement of comprehensive income

| | Note | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|---|
| Net profit / (loss) for the year | | 28 817 | 132 400 |
| Exchange difference on translation of foreign operations | 30.2 | 12 112 | 2 154 |
| Defered tax | 13.1 | (2 851) | (485) |
| Valutation of derivatives | 30.4 | 10 679 | 1 874 |
| Reversal of defered tax assets | | - | (9 876) |
| Other comprehensive income | | 19 941 | (6 334) |
| Total comprehensive income | | 48 757 | 126 066 |
| Total comprehensive income by: | | | |
| Holders of the parent | | 48 757 | 126 066 |
| Holders of the minority | | - | - |



Summary of significant accounting policies and other explanatory notes
included on pages 69 to 154 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated balance sheet

| | Note | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|---|
| ASSETS | | | |
| Non-current assets | | | |
| Property, plant and equipment | 18 | 1 000 752 | 552 623 |
| Investment properties | 20 | 10 542 | 12 159 |
| Intangible assets | 21 | 127 118 | 42 840 |
| Other financial assets | 24.1 | 5 024 | 1 151 |
| Other non-financial assets | 24.2 | 564 | 584 |
| Deferred tax asset | 13.3 | 4 497 | 702 |
| | | 1 148 498 | 610 059 |
| Current assets | | | |
| Inventories | 27 | 291 048 | 167 783 |
| Trade and other receivables | 28 | 269 448 | 231 998 |
| Income tax receivables | | 7 849 | 4 005 |
| Other non-financial assets | 24.2 | 6 714 | 5 153 |
| Other financial assets | 24.1 | 7 811 | 21 197 |
| Cash and cash equivalents | 29 | 179 402 | 140 115 |
| | | 762 271 | 570 251 |
| TOTAL ASSETS | | 1 910 769 | 1 180 310 |
| LIABILITIES | | | |
| Equity and liabilities | | | |
| Equity attributable to equity holders of the parent company | | | |
| Share capital | 30.1 | 554 035 | 524 035 |
| Share premium | 30.3 | 63 555 | 35 985 |
| Other reserves | 30.4 | 9 217 | 1 388 |
| Foreign currency translation | 30.2 | 22 454 | 10 342 |
| Retained earnings / Accumulated (unabsorbed) losses | 30.5 | 18 457 | 46 060 |
| Minority interest | 30.6 | 225 | 225 |
| Total equity | | 667 943 | 618 036 |
| Non-current liabilities | | | |
| Interest-bearing loans and borrowings | 31 | 192 705 | 204 109 |
| Provisions | 32 | 71 903 | 21 948 |
| Other financial liabilities | 31 | 43 681 | 10 965 |
| Deferred tax liabilities | 13.3 | 154 402 | 45 001 |
| Accruals and deferred income | 33.2 | 37 528 | 40 249 |
| | | 500 218 | 322 272 |
| Current liabilities | | | |
| Interest-bearing loans and borrowings | 31 | 292 111 | 16 849 |
| Provisions | 32 | 13 689 | 9 442 |
| Other financial liabilities | 31 | 11 094 | 6 564 |
| Trade and other payables | 33 | 365 082 | 168 197 |
| Income tax payable | | 1 743 | 769 |
| Accruals and deferred income | 33.2 | 58 889 | 38 182 |
| | | 742 608 | 240 002 |
| TOTAL LIABILITIES | | 1 242 826 | 562 274 |
| TOTAL EQUITY AND LIABILITIES | | 1 910 769 | 1 180 310 |



Summary of significant accounting policies and other explanatory notes included on pages 69 to 154 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated Cash flow statement

| | Note | Period ended 31 December 2010 (audited) | Period ended 31 December 2009 (audited) |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Profit (loss) before taxation | | 7 350 | 153 052 |
| Adjustments for: | | | |
| Depreciation | 11.6 | 128 614 | 67 264 |
| Foreign exchange differences | | (24 686) | (730) |
| Net interest and dividends | | 27 256 | 18 788 |
| Gain/loss from investing activities | | 437 | 1 713 |
| other non-financial assets | | 22 293 | 37 682 |
| Increase / decrease in inventories | | (47 905) | 40 599 |
| Increase / decrease in payables except for loans and borrowings | | 98 917 | (85 396) |
| Change in accruals and prepayments | | (15 536) | 15 976 |
| Change in provisions | | 7 950 | 895 |
| Income tax paid | | (8 628) | (7 931) |
| Bargain purchase at Arctic Paper Grycksbo | | (77 555) | - |
| Derecognition of emission rigths to CO2 identified in a business combination | | 6 686 | 9 064 |
| Cogeneration of certificates | | 284 | 12 |
| Other | | (5 069) | - |
| Net cash flow from operating activities | | 120 409 | 250 988 |
| **Cash flow from investing activities** | | | |
| Proceeds from sale of property, plant and equipment and intangibles | | 35 918 | 18 833 |
| Purchase of property, plant and equipment and intangible assets | | (99 467) | (131 713) |
| Acquisition of subsidiaries, net of cash acquired | | (187 954) | - |
| Prepayments for assets under construction | | 312 | - |
| Granted loans | | 20 600 | (20 000) |
| Other investing inflows and outflows | | 8 | 340 |
| Net cash flow from investing activities | | (230 583) | (132 540) |
| **Cash flow from financing activities** | | | |
| Change in bank overdrafts | | 41 266 | - |
| Proceeds from sale and lease back transactions | | - | - |
| Repayment of finance lease liabilities | | (7 267) | (10 521) |
| Repayment of other finance liabilities | | - | (1 969) |
| Proceeds from loans and borrowings | | 183 448 | 149 181 |
| Repayment of loans and borrowings | | (19 270) | (277 420) |
| Dividends | | (49 309) | - |
| Interest paid | | (20 192) | (18 487) |
| Government grants | | 1 298 | - |
| Issue of shares | 30.1 | - | 116 985 |
| Net cash flow from financing activities | | 129 974 | (42 231) |
| Net increase/(decrease) in cash and cash equivalents | | 19 800 | 76 217 |
| Net foreign exchange differences | | 19 488 | (593) |
| Cash and cash equivalents at the beginning of the period | 29 | 140 114 | 64 491 |
| Cash and cash equivalents at the end of the period | 29 | 179 402 | 140 115 |



Summary of significant accounting policies and other explanatory notes
included on pages 69 to 154 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

# Consolidated statement on changes in equity and net assets attributable to owners

| | Attributable to equityholders of the Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Translation reserve | Other reserves | Retained earnings (losses) | Total | Minority interest | Total equity |
| As at 1 January 2010 | 524 035 | 35 985 | 10 342 | 1 388 | 46 061 | 617 811 | 225 | 618 036 |
| Net profit (loss) for the year | - | - | - | - | 28 817 | 28 817 | - | 28 817 |
| Other comprehensive income | - | - | 12 112 | 7 829 | - | 19 941 | - | 19 941 |
| Total comprehensive income | - | - | 12 112 | 7 829 | 28 817 | 48 757 | - | 48 757 |
| Issue of shares | 30 000 | 27 570 | - | - | - | 57 570 | - | 57 570 |
| Costs of acquisition in equity | - | - | - | - | (7 111) | (7 111) | - | (7 111) |
| Payment of dividends | - | - | - | - | (49 309) | (49 309) | - | (49 309) |
| As at 31 December 2010 (audited) | 554 035 | 63 555 | 22 454 | 9 217 | 18 458 | 667 717 | 225 | 667 942 |



Summary of significant accounting policies and other explanatory notes
included on pages from 69 to 154 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31 December 2010 PLN thousand

| | Attributable to equityholders of the Company | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Translation reserve | Other reserves | Retained earnings (losses) | Total | Minority interest | Total equity |
| As at 1 January 2009 | 443 035 | - | 8 188 | 9 876 | (86 340) | 374 759 | 225 | 374 984 |
| Net profit (loss) for the year | - | - | - | - | 132 400 | 132 400 | - | 132 400 |
| Other comprehensive income | - | - | 2 154 | (8 488) | | (6 334) | - | (6 334) |
| Total comprehensive income | - | - | 2 154 | (8 488) | 132 400 | 126 066 | - | 126 066 |
| Issue of shares | 81 000 | 40 500 | - | - | - | 121 500 | - | 121 500 |
| Costs of acquisition in equity | - | - | - | - | - | - | - | - |
| Costs related to share issue | 0 | (4 515) | 0 | 0 | 0 | (4 515) | 0 | (4 515) |
| As at 31 December 2009 (audited) | 524 035 | 35 985 | 10 342 | 1 388 | 46 060 | 617 811 | 225 | 618 036 |

# Accounting policies and additional notes

## 1. Corporate information

Arctic Paper Group is the second largest in terms of production volume, European manufacturer of paper for books, offering the widest range of products in this segment and one of the leading manufacturers of graphic paper in Europe. We are producing many types of wood-free coated and uncoated paper, wood uncoated paper for printing houses, paper distributors, publishers of books and periodicals and advertising industry. At the day of publication of this report, the Arctic Paper Group employs over 1,600 people in four paper mills and eighteen companies involved in the distribution and sale of paper. Our paper mills are located in Poland, Sweden and Germany and have a combined capacity of more than 800,000 tons of paper annually. The Group has three distribution companies engaged in the sale, distribution and marketing of the products offered by Arctic Paper S.A. Arctic Paper SA is a holding company established in April 2008. As a result of capital restructuring carried out in 2008, the paper mills Arctic Paper Kostrzyn (Poland) and Arctic Paper Munkedals (Sweden), Distribution Companies and sales offices have become the properties of Arctic Paper SA. Previously they were owned by Arctic Paper AB, parent company of the Arctic Paper S.A. In addition ,under the expansion, Nordic Group and 15 sales officies ensure access for all European markets, including Central and Eastern Europe. The Group acquired in November 2008 paper mill Arctic Paper Mochenwangen (Germany) and in March 2010 paper mill Grycksbo (Sweden).

The Parent Company is entered in the Register of Entrepreneurs kept by the District Court in Poznan "Nowe Miasto I Wilda", VIII Economic Department of the National Court Register, Entry No. KRS 0000306944. The Parent Company was granted statistical REGON number 080262255.

### Business activities

The main area of Group's business activities is paper production.

The additional business activities of the Group subordinated to paper production are:

- Production of electric energy,
- Transmission of electric energy,
- Electricity distribution,
- Heat production,
- Heat distribution,
- Logistics services
- Paper distribution

### Shareholding structure

The main shareholder of Arctic Paper S.A. is Arctic Paper AB, a company under Swedish law, holding as at 31 December 2010, 41,553,500 Shares of our Company representing 75% of its share capital corresponding to 75% of the total number of votes at the General Meeting. As at the day of publishing this report Arctic Paper AB owns 41,441,500 Shares of our Company representing 74,8% of its share capital corresponding to 74,8% of the total number of votes at the General Meeting.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

Thus, Arctic Paper AB is the parent company in relation to the Arctic Paper S.A.

The ultimate parent of the Group is Cassandrax Financial S.A. The duration of the Company is unlimited.

## 2. Composition of the Group

The Group is composed of Arctic Paper S.A. and the following subsidiaries:

| Entity | Registered office | Business activities | Share in capital of subsidiaries entities as at | | |
|---|---|---|---|---|---|
| | | | 27 April 2011 | 31 December 2010 | 31 December 2009 |
| Arctic Paper Kostrzyn S.A. | Poland, Fabryczna 1, 66-470 Kostrzyn nad Odrą | Paper production | 100% | 100% | 100% |
| Arctic Paper Munkedals AB | Sweden, SE 455 81 Munkedal | Paper production | 100% | 100% | 100% |
| Arctic Paper Mochenwangen GmbH | Germany, Fabrikstrasse 62, DE-882, 84 Wolpertswende | Paper production | 99,74% | 99,74% | 99,74% |
| Arctic Paper Grycksbo AB | Sweden, Box 1, SE 790 20 Grycksbo | Paper production | 100% | 100% | - |
| Grycksbo Paper (Deutschland) GmbH | Germany, Max-Brauer-Allee 52, 22765 Hamburg | Trading services | 100% | 100% | - |
| Grycksbo Paper UK Limited | Great Britain, 52 Hither Green Lane, Abbey Park, Redditch | Trading services | 100% | 100% | - |
| Grycksbo Paper France EURL | France, 3 rue de Teheran, 75008 Paris 8 | Trading services | 100% | 100% | - |
| Arctic Paper UK Limited | Great Britain, Quadrant House, 47 Croydon Road, Caterham, Surrey | Trading services | 100% | 100% | 100% |
| Arctic Paper Baltic States SIA | Latvia, K. Vardemara iela 33-20, Riga LV-1010 | Trading services | 100% | 100% | 100% |
| Arctic Paper Deutschland GmbH | Germany, Raboisen 3, 20095 Hamburg | Trading services | 100% | 100% | 100% |
| Arctic Paper Benelux S.A. | Belgium, Dreve des Marroniers 28, 1410 Waterloo | Trading services | 100% | 100% | 100% |
| Arctic Paper Schweiz AG | Switzerland, Technoparkstrasse 1, 8005 Zurich | Trading services | 100% | 100% | 100% |
| Arctic Paper Italia srl | Italy, Milano – Via R. Boscovich 14 | Trading services | 100% | 100% | 100% |
| Arctic Paper Ireland Limited | Ireland, 4 Rosemount Park Road, Dublin 11 | Trading services | 100% | 100% | 100% |
| Arctic Paper Danmark A/S | Denmark, Jydekrogen 18, DK-2625 Vallensbaek | Trading services | 100% | 100% | 100% |
| Arctic Paper France SAS | France, 43 rue de la Breche aux Loups, 75012 Paris | Trading services | 100% | 100% | 100% |
| Arctic Paper Espana SL | Spain, Avenida Diagonal 472-474, 9-1 Barcelona | Trading services | 100% | 100% | 100% |
| Arctic Paper Papierhandels GmbH | Austria, Hainborgerstrasse 34A, A-1030 Wien | Trading services | 100% | 100% | 100% |
| Arctic Paper Polska Sp. z o.o. | Poland, Biskupia 39, 04-216 Warszawa | Trading services | 100% | 100% | 100% |
| Arctic Paper Norge AS | Norway, Per Kroghsvei 4, Oslo | Trading services | 100% | 100% | 100% |
| Arctic Paper Sverige AB | Szweden, Kurodsvagen 9, 451 55 Uddevalla | Trading services | 100% | 100% | 100% |
| Arctic Paper East Sp. z o.o. | Poland, Fabryczna 1, 66-470 Kostrzyn nad Odrą | Trading services | 100% | 100% | 100% |

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| Entity | Registered office | Business activities | Share in capital of subsidiaries entities as at | | |
|---|---|---|---|---|---|
| | | | 27 April 2011 | 31 December 2010 | 31 December 2009 |
| Arctic Paper Investment GmbH * | Germany, Fabrikstrasse 62, DE-882, 84 Wolpertswende | Holding company | 100% | 100% | 100% |
| Arctic Paper Investment II AB | Sweden, Box 383, 401 26 Göteborg | Holding company | 100% | 100% | - |
| Arctic Paper Verwaltungs GmbH * | Germany, Fabrikstrasse 62, DE-882 84 Wolpertswende | Holding company | 100% | 100% | 100% |
| Arctic Paper Immobilienverwaltung GmbH& | Germany, Fabrikstrasse 62, DE-882 84 Wolpertswende | Holding company | 94,90% | 94,90% | 94,90% |
| Arctic Paper Investment AB ** | Sweden, Box 383, 401 26 Göteborg | Holding company | 100% | 100% | - |
| Grycksbo Paper Holding AB | Sweden, Box 1, SE 790 20 Grycksbo | Holding company | 100% | 100% | - |
| EC Kostrzyn Sp. z o.o. | Poland, ul. Fabryczna 1, 66-470 Kostrzyn nad Odrą | Property and machinery rental | 100% | 100% | 100% |

* - entities formed for purpose of acquisition of Arctic Paper Mochenwangen GmbH
** - entity formed for purpose of acquisition of Grycksbo Paper Holding AB

All of the subsidiaries comprising the Group are subject to full consolidation for the period from the date of taking control of them by the Group and cease to be consolidated from the date of cessation of control.

As at 31 December 2010 and as well as a day of announcing this report, the percentage of voting rights held by the Group in subsidiaries corresponds to the percentage held in the share capital of those entities.

There were no significant changes in the capital structure of Arctic Paper S.A. Group during the reporting period.

# 3. Management and supervisory bodies

## 3.1. Management Board of the Parent Company

As at 31 December 2010 the following constituted the Company’s Management Board:

- Michał Jarczyński – President of the Management Board appointed on 30 April 2008;
- Kent Bjarne Björk – Member of the Management Board appointed on 4 December 2008;
- Hans Karlander – Member of the Management Board appointed on 4 December 2008;
- Michał Bartkowiak – Member of the Management Board appointed on 17 September 2009.

On 14th December 2010 the Supervisory Board decided to dismiss Mr Kent Bjarne Björk from the Management Board of the Company. The dismissal takes effect from 31 December 2010.

### 3.2. Supervisory Board of the Parent Company

As at 31 December 2010 the Parent Company's Supervisory Board consisted of the following members:

- Rolf Olof Grundberg – President of the Supervisory Board appointed on 30 April 2008;
- Rune Roger Ingvarsson – Member of the Supervisory Board appointed on 22 October 2008;
- Thomas Onstad – Member of the Supervisory Board appointed on 22 October 2008;
- Fredrik Lars Plyhr – Member of the Supervisory Board appointed on 22 October 2008;
- Wiktorian Zbigniew Tarnawski – Member of the Supervisory Board appointed on 22 October 2008.
- Jan Ohlsson – Member of the Supervisory Board appointed on 8 June 2010.

From 31 December 2010 up to the date of publication of this report and these consolidated financial statements there were no changes in the composition of the Supervisory Board.

### 3.3. Audit Committee of the Parent Company

As at 31 December 2010 the Company's Audit Committee consisted of the following members:

- Rolf Olof Grundberg – President of the Audit Committee appointed on 3 December 2009;
- Fredrik Plyhr – Member of the Audit Committee appointed on 3 December 2009;
- Rune Ingvarsson – Member of the Audit Committee appointed on 3 December 2009.

From 31 December 2010 up to the date of publication of this report and these consolidated financial statements there were no changes in the composition of the Audit Committee.

## 4. Approval of the financial statements

These consolidated financial statements were authorized for issue by the Management Board on 27 April 2011.

## 5. Significant Professional judgement and estimates

### 5.1. Professional judgement

In the process of applying the Group's accounting policies, management has made the following professional judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the financial statements.

#### Obligation under operating and finance leases – the Group as a lessee

The Group has leasing agreements, which in the Management Board's judgement meet the criteria of operating leases and agreements, which meet the criteria of finance leases. The Group classifies its lease agreements as finance leases or operating leases based on the assessment of the extent to which substantially all the risks and benefits incidental to ownership have been transferred from the lessor to the lessee. The assessment is based on economic substance of each agreement.

Deferred tax asset

Application of professional judgement allowed to determine the value of the deferred tax asset which the Group may recognize using the forecasted date and amount of future profits and basing on the future tax strategies.

Gas Agreement

The Group enters into „take or pay" transactions in respect of receipt of supplies of gas to Arctic Paper Kostrzyn S.A. for own use purposes. For these transactions, at each balance sheet date, the Management Board, using its professional judgment, assesses the probability of use of outstanding amounts within the granted limits, after considering the production plans for the ensuing periods and the optimum possibilities of utilization of alternative sources of materials for production. Where no real possibility of future use of outstanding amounts of gas are ascertained, the asset arising from paid for but uncollected amounts of gas is subject to the write-down.

## 5.2. Estimates and assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Impairment of Fixed Assets In Arctic Paper Mochenwangen

At 31 December 2010 impairment test was conducted in the production company Arctic Paper Mochenwangen in respect to fixed assets and intangible assets. A detailed description of the impairment test is included in Note 25 of these financial statements.

Retirement benefits and other post-employment benefits

Provisions for retirement benefits are determined using actuarial valuations. The assumptions made are presented in note 26. In actuarial valuation, certain assumptions must be made regarding discounting rate, forecasted rate of return on assets or rate of salary increases, mortality ratio or forecasted growth in retirement benefits. Due to the long-term nature of such programs, actuarial valuations are burdened with a degree of uncertainty.

Deferred tax assets

The Group recognises deferred tax assets based on the assumption that taxable profits will be available against which the deferred tax asset can be utilized. Deterioration of future taxable profits might render this assumption unreasonable.

Depreciation and amortisation rates

Depreciation and amortisation rates are determined based on the anticipated economic useful lives of property, plant and equipment and intangible assets. The economic useful lives are reviewed annually by the Group based on current estimates.

## 6. Basis of preparation of consolidated financial statements

These consolidated financial statements are prepared in accordance with historical cost method with the exception of investment properties, derivative financial instruments and financial assets available for sale, which are measured at fair value. For financial instruments measured at fair value through profit or loss the company include foreign exchange forward contract and a contract for the purchase of electric energy (note 39).

These consolidated financial statements are presented in Polish zloty ("PLN") and all values are rounded to the nearest thousand (PLN '000) except when otherwise indicated.

The consolidated financial statements have been prepared on the assumption that the Group companies will continue as going concerns in the foreseeable future. As at the date of authorisation of these consolidated financial statements, the Company's Management Board is not aware of any facts or circumstances that would indicate a threat to the continued activity of the Group.

### 6.1. Statement of compliance

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"), in particular in accordance with IFRSs endorsed by the European Union ("IFRS EU"). At the date of authorisation of these consolidated financial statements, in light of the current process of IFRS endorsement in the European Union and the nature of the Group's activities, there is no difference between the IFRSs applied by the Group and the IFRSs endorsed by the European Union.

IFRSs comprise standards and interpretations accepted by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC").

Some of the Group entities keep books of accounts in accordance with accounting policies specified in the Accounting Act dated 29 September 1994 ("the Accounting Act") with subsequent amendments and the regulations issued based on that Act ("Polish Accounting Standards") or in accordance with other local accounting policies applicable for foreign entities. The consolidated financial statements includes a number of adjustments not included in the books of account of the Group entities, which were made in order to bring the financial statements of those entities to conformity with IFRS.

### 6.2. Functional currency and presentation currency

Functional currencies of the parent company and other entities included in these consolidated financial statements are: Polish zloty (PLN), Swedish crown (SEK), Euro (EUR), Norway crown (NOK), Latvian lats (LVL), Danish crown (DKK), Pound sterling (GBP), Swiss franc (CHF).

Presentation currency of the consolidated financial statements is Polish zloty (PLN).

## 7. Changes in accounting policies

The accounting policies applied to prepare these consolidated financial statements are consistent with those of the consolidated financial statements of the Company for the year ended 31 December 2009, except for the following amendments to the standards and new interpretations applicable to annual reporting periods beginning on or after 1 January 2010:

- IFRS 2 Share-based payment: Group Cash-settled Share-based Payment Transactions – applicable to annual reporting periods beginning on or after 1 January 2010. The standard has been amended to clarify the accounting for group cash-settled share-based payment transactions. This amendment supersedes IFRIC 8 and IFRIC 11. The adoption of this amendment did not have any impact on the financial position or performance of the Group.
- IFRS 3 Business Combinations (revised) and IAS 27 Consolidated and Separate Financial Statements (amended) – applicable to annual reporting periods beginning on or after 1 July 2009. IFRS 3 (revised) introduces significant changes in the accounting for business combinations occurring after this date. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration, and business combinations achieved in stages. These changes will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results.

  IAS 27 (amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes to IFRS 3 (revised) and IAS 27 (amended) will affect future acquisitions or loss of control in subsidiaries and transactions with non-controlling interests.

  Adaptation of new and changed standards and interpretations has neither resulted in significant changes in accounting policies of the Company nor in presentation of accounts in financial statements with exception of the revised IFRS 3 Business Combinations, which was applied by the Group to settle the acquisition of Grycksbo Paper Holding AB which took place on 1 March 2010. Due to the fact that according to the revised IFRS 3 the transaction costs incurred until 31 December 2009 in amount of PLN 7,111 thousand are not the acquisition costs and due to the lack of transitional provisions, the Group decided to decrease retained earnings as at 1 January 2010 by this amount.

The acquisition of Grycksbo Paper Holding AB and the settlement of the transaction was described in these consolidated financial statements in note 23.

- IAS 39 Financial Instruments: Recognition and Measurement: Eligible Hedged Items – applicable to annual reporting periods beginning on or after 1 July 2009. The amendment addresses the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The adoption of this amendment did not have an impact on the financial position or performance of the Group.
- IFRIC 17 Distribution of Non-cash Assets to Owners – applicable to annual reporting periods

beginning on or after 1 July 2009. This interpretation provides guidance on accounting for arrangements whereby an entity distributes non-cash assets to shareholders either as a distribution of reserves or as dividends. The interpretation did not have any effect on the financial position or performance of the Group.

The changes to IFRS (published in April 2009) did not have any impact on the accounting policies, the financial position or performance of the Group:

- IFRS 2 Share-based Payment
- IFRS 5 Non-current Assets Held for Sale and Discontinued Operations
- IFRS 8 *Operating Segments*
- IAS 1 Presentation of Financial Statements
- IAS 7 *Statement of Cash Flows*
- IAS 17 Leases
- IAS 36 *Impairment of Assets*
- IAS 38 Intangible Assets
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 16 Hedge of a Net Investment in a Foreign Operation

The Group has not early adopted any other standard, interpretation or amendment that was issued but is not yet effective.

## 8. Ammendments to existing standards and new regulations

The following standards and interpretations were issued by the IASB or IFRIC but are not yet effective:

- Amendments to IAS 32 Financial instruments: presentation: Classification of Rights Issues – effective for financial years beginning on or after 1 February 2010,
- IAS 24 Related Party Disclosures (revised in November 2009) – effective for financial years beginning on or after 1 January 2011,
- The first phase of IFRS 9 Financial Instruments: Classification and Measurement – effective for financial years beginning on or after 1 January 2013 – not endorsed by EU till the date of approval of these financial statements. In subsequent phases, the IASB will address hedge accounting and impairment. The completion of this project is expected in the first half of 2011. The application of the first phase of IFRS 9 will have impact on classification and measurement of the financial assets of the Company / Group. The Company / Group will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.
- Amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirments and their Interaction: Prepayments of a Minimum Funding Requirements – effective for financial years beginning on or after 1 January 2011,
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments – effective for financial years beginning on or after 1 July 2010,
- Amendment to IFRS 1 First–time Adoption of International Financial Reporting Standards: Limited Exemption from Comparative IFRS 7 Disclosures for First–time Adopters – effective for financial years beginning on or after 1 July 2010,

- Improvements to IFRSs (issued in May 2010) – some improvements are effective for annual periods beginning on or after 1 July 2010, the rest is effective for annual periods beginning on or after 1 January 2011,
- Amendment to IFRS 7 Financial Instruments – Disclosures: Transfer of Financial Assets – effective for financial years beginning on or after 1 July 2011 – not endorsed by EU till the date of approval of these financial statements,
- Amendments to IAS 12 Income Taxe: Deferred Tax: Recovery of Underlying Assets – effective for financial years beginning on or after 1 January 2012 – not endorsed by EU till the date of approval of these financial statements,
- Amendments to IFRS 1 First–time Adoption of International Financial Reporting Standards: Severe Hyperinflation and Removal of Fixed Dates for First–time Adopters – effective for financial years beginning on or after 1 July 2011 – not endorsed by EU till the date of approval of these financial statements.

The Management Board does not expect the introduction of the above-mentioned amendments and interpretations to have a significant effect on the accounting policies applied by the Group.

# 9. Summary of significant accounting policies

## 9.1. Basis of consolidation

These consolidated financial statements comprise the financial statements of Arctic Paper S.A. and its subsidiaries for the year ended 31 December 2010. The financial statements of the subsidiaries are prepared for the same reporting period as those of the parent company, using consistent accounting policies, and based on the same accounting policies applied to similar business transactions and events. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

All significant intercompany balances and transactions, including unrealised gains arising from intra-group transactions, have been eliminated in full. Unrealised losses are eliminated unless they indicate impairment.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which such control is transferred out of the Group. An entity is controlled by the parent company when the parent has, directly or indirectly, through its subsidiaries, more than half of the votes at the shareholders' meeting of that entity, unless it is possible to prove that such holding does not represent control. Control is also exercised if the company has the power to govern the financial or operating policy of an enterprise so as to obtain benefits from its activities.

Changes in the parent's ownership interest that do not result in loss of control of the subsidiary are accounted for as equity transactions. In such cases, to reflect changes in the relative shares in the subsidiary group revise the value of the shares carrying control and non-controlling interests. Any difference between the amount of correction of non-controlling interests and the fair value of the price paid or received are recognized in equity and attributed to the owners of the parent.

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## 9.2. Foreign currency translation

Transactions denominated in currencies other than functional currency of the entity are translated into functional currency at the foreign exchange rate prevailing on the transaction date.

At the balance sheet date, monetary assets and liabilities expressed in currencies other than functional currency of the entity are translated into functional currency using the average foreign exchange rate prevailing for the given currency at the year-end. Exchange differences resulting from translation are recorded under finance revenue or finance costs or under capitalized cost of assets, based on defined examples in accounting policy. Non-monetary foreign currency assets and liabilities recognized at historical cost are translated at the historical foreign exchange rate prevailing on the transaction date. Non-monetary foreign currency assets and liabilities recognized at fair value are translated into Polish zloty using the rate of exchange binding as at the date of re-measurement to fair value.

The functional currencies of the foreign subsidiaries are EUR, SEK, LVL, DKK, NOK, GBP and CHF. At the reporting date, the assets and liabilities of these subsidiaries are translated into the presentation currency of the Group (Polish zloty) using the rate of exchange prevailing at the balance sheet date and their income statements are translated using the weighted average exchange rates for the given reporting period. The exchange differences arising on the translation are taken directly to equity and recognized in a separate line. On disposal of a foreign operation, the cumulative amount of the deferred exchange differences recognized in equity and relating to that particular foreign operation shall be recognized in the income statement.

The following exchange rates were used for valuation purposes:

| | As at 31 December 2010 | As at 31 December 2009 |
|---|---|---|
| USD | 2,9641 | 2,8503 |
| EUR | 3,9603 | 4,1082 |
| SEK | 0,4415 | 0,4000 |
| LVL | 5,5830 | 5,7919 |
| DKK | 0,5313 | 0,5520 |
| NOK | 0,5071 | 0,4946 |
| GBP | 4,5938 | 4,5986 |
| CHF | 3,1639 | 2,7661 |

Average foreign exchange rates for the reporting periods are as follows:

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| | 01/01 - 31/12/2010 | 01/01 - 31/12/2009 |
|---|---|---|
| USD | 3,0179 | 2,8352 |
| EUR | 3,9939 | 4,3282 |
| SEK | 0,4190 | 0,4074 |
| LVL | 5,6357 | 6,1331 |
| DKK | 0,5363 | 0,5812 |
| NOK | 0,4988 | 0,4956 |
| GBP | 4,6587 | 4,8586 |
| CHF | 2,8983 | 2,8667 |

## 9.3. Property, plant and equipment

Property, plant and equipment are measured at cost less accumulated depreciation and impairment losses. The initial cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to working condition for its intended use. Cost also comprises the cost of replacement of fixed asset components when incurred, if the recognition criteria are met. Subsequent expenditures, such as repair or maintenance costs, are expensed in the reporting period in which they were incurred.

Upon purchase, fixed assets are divided into components, which represent items with a significant value that can be allocated a separate useful life. Overhauls also represent asset component.

Property, plant and equipment are depreciated using the straight-line method over their estimated useful lives.

| Type | Period |
|---|---|
| Buildings and constructions | 25 - 50 years |
| Plant and machinery | 5 - 20 years |
| Office equipment | 3 - 10 years |
| Motor vehicles | 5 - 10 years |
| Computers | 1 - 10 years |

Residual values, useful lives and depreciation methods of property, plant and equipment are reviewed annually and, if necessary, adjusted retrospectively i.e. with effect from the beginning of the financial year that has just ended.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its further use. Any gain or loss arising on derecognition of an asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the income statement for the period in which derecognition took place.

Assets under construction (construction in progress) include assets in the course of construction or assembly and are recognized at purchase price or cost of construction less any impairment losses. Assets under construction are not depreciated until completed and brought into use.

## 9.4. Investment properties

Investment properties are initially measured at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time the cost is incurred if the recognition criteria are met; and excludes the costs of day-to-day servicing of an investment property.

Subsequent to initial recognition, the investment properties are valued with fair value. Gains or losses resulting from change of the fair value of investment properties are recognized in profit or loss in the period, in which gains or lossess appeared.

Investment property is derecognized when disposed off or permanently withdrawn from use and no future benefits are expected from its disposal. Any gains or losses on derecognition of investment property are recognized in the income statement for the year in which such derecognition took place.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner occupation, commencement of an operating lease. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under Property, Plant and Equipment (note 9.3) up to the date of change in use. For a transfer from inventories to investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognised in profit or loss.

For a transfer from investment property to owner-occupied property or inventories, the deemed cost of property for subsequent accounting is its fair value at the date of change in use.

## 9.5. Intangible assets

Intangible assets acquired separately or constructed (if they meet the recognition criteria for development costs) are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Expenditures incurred for internally generated intangible assets, excluding capitalised development costs, are not capitalised and are charged against profits in the year in which they are incurred.

The useful lives of intangible assets are assessed by the Group to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Intangible assets with indefinite useful lives and those that are not in use are tested for impairment annually either individually or at the cash generating unit level.

Useful lives are reviewed on an annual basis and, if necessary, are adjusted with effect from the beginning of the financial year that has just ended.

Research and development costs

Research costs are expensed in the profit and loss account as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured. Following the initial recognition, the historical cost model is applied, which requires the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure carried forward is amortised over the period of expected future sales from the related project.

The carrying amount of development costs is reviewed for impairment annually when the asset is not yet in use, or more frequently when an indication of impairment is identified during the reporting period, which may suggest that the carrying amount may not be recoverable.

A summary of the policies applied to the Group's intangible assets is as follows:

| | Customer relationship | Trademarks | Licences and Software |
|---|---|---|---|
| Useful lives | 10 years | Indefinite | 2-5 years |
| Method of amortisation | 10 years on a straight-line basis | Not amortised | 2-5 years on a straight-line basis |
| Internally generated or acquired | Acquired | Acquired | Acquired |
| Impairment testing | Annual assesment to determine whether there is any indication that an assets may be impaired | Annualy and where an indication of impairment exists | Annual assesment to determine whether there is any indication that an assets may be impaired |

After analyzing the relevant factors, for trademarks Group does not define the limit of its useful life. The intention of the Group is to operate for an indefinite period under the same trademark and it is believed that it will not become impaired. Consequently, and in accordance with IAS 38, the Group does not amortise intangible assets with indefinite useful lives. Useful life of such resources should be reviewed in each reporting period, in order to determine whether events and circumstances continue to confirm the assumption of the indefinite useful life of this asset.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds, if any, and the carrying amount of the asset and are recognized in the income statement when the asset is derecognized.

### 9.5.1. Goodwill

Goodwil is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest and in case when business combination is achieved in stages, fair value as at the acquisition date of equity interest in the acquire previously held by the acquirer over the net identifiable assets acquired and liabilities assumed.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. Goodwill is not amortised.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units that is expected to benefit from the combination. Each unit, or set of units, to which the goodwill has been allocated should:

- represent the lowest level within the Group at which the goodwill is monitored for internal management purposes, and
- be not greater than a single operating segment, on the basis of IFRS 8 “Operating segments”.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit to which the goodwill has been allocated. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized. Were goodwill represents part of a cash-generating unit and part of the operations within that unit is disposed of, the goodwill associated with the operations disposed of is included in the carrying amount of the operations when determining gain or loss on disposal of the operation. Goodwill disposed of in such circumstances is measured on the basis of the relative value of the operations disposed of and the value of the portion of the cash-generating unit retained.

### 9.5.2. Emission rights

The Group operating as a business entity owns power plants and for this reason it holds emission rights which are used during the course of its business operations. The group applies the net liability method to recognize emission rights in its books. This means that the rights originally acquired free of charge are recognized in the balance sheet at the “zero” acquisition cost and the provision for the Group obligation to redeem an appropriate number of emission rights is created when the deficit in the emission rights held is ascertained. In the case of emission rights acquired to cover future deficit, such rights are initially recognized at acquisition cost among other intangible assets. Provision for the deficit of emission rights is measured then in accordance with the value of intangibles acquired. Provision is recognized based on the annual limit of emission rights.

#### Policy for CER/EUA swap transactions

The Group enters into forward swap agreements ("EUA/CER swaps") with third parties to exchange the rights to emit CO2 within European Union Emission Allowances ("EUA") at a future date (prior to the date at which the utility needs to satisfy its obligation for that period) for the same quantity of Certified Emission Reductions ("CER"). If the EUA/CER swap is entered into and will continue to be held to use CER for covering own liabilities for write-off of the emission rights (ie, to satisfy obligations resulting from the emission of CO2), it is outside the scope of IAS 39.

#### Accounting when cash is received

If the cash is received before the EUA/CER swap matures deferred income is recognised in respect of that amount as the EUA has not been delivered at this date.

#### Accounting for the EUA/CER exchange at maturity

The CER are recognised at their fair value. Any difference between (i) the total of the cash received and the fair value of the CER received and (ii) the carrying value of the EUA given up is recognised as a gain (or loss). Any deferred income is recognised in the income statement, as part of this net gain (or loss).

#### 9.5.3. Cogeneration certificates

The Group as an entity producing electric energy in cogeneration receives “yellow certificates” of origin. Revenues from these certificates are recognized in the moment of production and valued at current market prices provided the market for such certificates is active. Otherwise, revenues are recognized upon sale of certificates. The value of certificates is recognized under intangible assets. Details concerning the certificates received in the current year were presented in note 43.

## 9.6. Leases

Group as lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the income statement.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease and subsequent lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

## 9.7. Impairment of non-financial assets

An assessment is made at each reporting date to determine whether there is any indication that an asset may be impaired. If such indication exists, or in case an annual impairment testing is required, the Group makes an estimate of the recoverable amount of that asset or the cash generating unit that the asset is a part of.

The recoverable amount of an asset or a cash-generating unit is the higher of the asset’s or cash-generating unit’s fair value less costs to sell and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the income statement in the expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Group makes an estimate of recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation or amortisation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised immediately in the income statement, unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset is adjusted in future periods to allocate the asset's carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

## 9.8. Borrowing costs

Borrowing costs are capitalised as part of the cost of property, plant and equipment, investment properties, intangible assets and finished goods. Borrowing costs include interest calculated using the effective interest method, finance charges in respect of finance leases and foreign exchange differences incurred in connection with the external financing to the extent that they are regarded as an adjustment to interest costs.

## 9.9. Financial assets

Financial assets are classified into one of the following categories:

- financial assets held to maturity,
- financial assets at fair value through profit or loss,
- loans and receivables,
- financial assets available for sale.

### Financial assets held to maturity

Financial assets held to maturity are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the Group has the positive intention and ability to hold until maturity, other than:

- those that upon initial recognition are designated as at fair value through profit or loss;
- those that are designated as available for sale; and
- those that meet the definition of loans and receivables.

Financial assets held to maturity are measured at amortised cost using the effective interest rate. Financial assets held to maturity are classified as non-current assets if they are falling due within more than 12 months from the balance sheet date.

### Financial assets at fair value through profit or loss

A financial asset at fair value through profit or loss is a financial asset that meets either of the following conditions:

a) it is classified as held for trading. A financial asset is classified as held for trading if it is:
   - acquired principally for the purpose of selling it in the near term;
   - part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
   - a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument),
b) According to IAS 39 upon initial recognition it is designated as at fair value through profit or loss.

- Financial assets at fair value through profit or loss are measured at fair value, which takes into account their market value as at the balance sheet date. Any change in the fair value of these instruments is taken to finance costs or finance income. When a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited. Financial assets may be designated at initial recognition as at fair value through profit or loss if the following criteria are met:
- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis; or
- the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a document risk management strategy ,or
- the financial asset contains an embedded derivative that would need to be separately recorded.

As at 31 December 2010 the Group designated as at fair value through profit and loss hedging instruments, further described in the note 39. As at 31 December 2009 the Group designated as at fair value through profit and loss hedging instruments further described in note 39.3 to the consolidated financial statements for the year ended 2009.

### Loans and receivables

Loans and receivables are non derivative financial assets with fixed or determinable payments that are not quoted in an active market. These are classified as current assets, provided their maturity does not exceed 12 months after the balance sheet date. Loans and receivables with maturities exceeding 12 months from the balance sheet date are classified under non-current assets.

### Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories.

Available-for-sale financial assets are measured at fair value, without deducting transaction costs, and taking into account their market value at the balance sheet date. Where no quoted market price is available and there is no possibility to determine their fair value using alternative methods, available-for-sale financial assets are measured at cost, adjusted for any impairment losses. Positive and negative differences between the fair value and acquisition cost, net of deferred tax, of financial assets available for sale (if quoted market price determined on the regulated market is available or if the fair value can be determined using other reliable method), are taken to the revaluation reserve. Any decrease in the value of financial assets available for sale resulting from impairment losses is taken to the income statement and recorded under finance cost.

Purchase and sale of financial assets is recognized at the transaction date. Initially, financial assets are recognized at acquisition cost, i.e. at fair value plus, for financial assets other than classified as financial assets as at fair value through profit and loss, transaction costs.

Financial assets are derecognized if the Group loses its control over contractual rights attached to those assets, which usually takes place upon sale of the asset or where all cash flows attributed to the given asset are transferred to an independent third party.

## 9.10. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired.

### 9.10.1. Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through use of an allowance amount. The amount of the loss shall be recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included on a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss, to the extent that the carrying amount of the asset does not exceed its amortised cost at the reversal date.

### 9.10.2. Financial assets carried at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and has to be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset.

### 9.10.3. Available-for-sale financial assets

If there is objective evidence that an impairment loss has been incurred on an available-for-sale asset, then the amount of the difference between the acquisition cost (net of any principal payment and interest) and current fair value, less any impairment loss on that financial asset previously recognised in the profit or loss, is removed from equity and recognised in the income statement. Reversals of impairment losses on equity instruments classified as available for sale cannot be recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed, with the amount of the reversal recognised in the income statement.

## 9.11. Embadded derivatives

Embedded derivatives are bifurcated from host contracts and treated as derivative financial instruments if all of the following conditions are met:

- the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract,
- a separate instrument with the same terms as embedded derivative would meet the definition of a derivative,
- the hybrid instrument is not recorded at fair value with gains and losses taken to profit or loss.

  Embedded derivatives are recognized in a similar manner to that of separate instruments, which have not been designated as hedging instruments.

The extent to which, in accordance with IAS 39, the economic characteristics and risks of foreign currency embedded derivatives are closely related to those of the host contract covers circumstances where the currency of the host contract is also the common currency of purchase or sale of non-financial items on the market of a given transaction.

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group first becomes party to the contract. In the case of embedded derivatives acquired as part of business combination, the Group does not re-assess the embedded derivatives at the acquisition date (they are assessed upon initial recognition by the acquired company).

## 9.12. Derivative financial instruments and hedges

The Group uses derivative financial instruments such as forward currency contracts and interest rate swaps to hedge against the risks associated with interest rate and foreign currency fluctuations. Such derivative financial instruments are measured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in the fair value of derivatives that do not qualify for hedge accounting are taken directly to the net profit or loss for the period.

The fair value of forward currency contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate swap contracts is determined by reference to market values of similar instruments.

For the purpose of hedge accounting, hedges are classified as:

- fair value hedges, when hedging the exposure to changes in the fair value of a recognised asset or liability, or
- cash flow hedges, when hedging exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a forecast transaction, or
- hedges of a net investment in a foreign operation.

Hedges of foreign currency risk in an unrecognised firm commitment are accounted for as cash flow hedges.

At the inception of a hedge relationship, the Group formally designates and documents the hedge relationship, the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Hedges are expected to be highly effective in offsetting the exposure to changes in the fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed on a regular basis to check if the hedge is highly effective throughout all financial reporting periods for which it was designated.

### 9.12.1. Fair value hedges

Fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. In the case of a fair value hedge, any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item, the hedging instrument is re-measured to fair value and the gains and losses on the hedging instrument and hedged item are recognised in profit or loss.

For fair value hedges relating to items carried at amortised cost, the adjustment to carrying amount is amortised through the income statement over the remaining term to maturity. When an unrecognised firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognised as an asset or liability with a corresponding gain or loss recognised in profit or loss. The changes in the fair value of the hedging instrument are also recognised in profit or loss.

The Group discontinues hedge accounting prospectively if the hedging instrument expires, or is sold, terminated or exercised, or the hedge no longer qualifies for hedge accounting, or the Group revokes the designation. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest method is used is amortised to profit or loss. Amortisation may begin as soon as an adjustment is made, however no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

### 9.12.2. Cash flow hedges

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or financial liability, the associated gains or losses that were recognized directly in equity shall be reclassified into profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss.

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then gains and losses that were recognized directly in equity are reclassified into profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss.

If a hedge of a forecast transaction subsequently results in the recognition of non-financial asset or non, or a forecast transaction for a non-financial asset or financial liability becomes a firm commitment, which will apply fair value hedge, then the gains or losses that were recognized in other comprehensive income are reclassified from equity to profit or loss in the same period or periods during which the non-financial asset acquired or liability assumed affects profit or loss.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or the hedge no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument that has been recognised directly in equity remains recognised in equity until the forecast transaction occurs. If the forecast transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is taken to net profit or loss for the period.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to net profit or loss for the period.

## 9.13. Inventories

Inventories are valued at the lower of cost and net realizable value. Costs incurred in bringing each inventory item to its present location and conditions are accounted for as follows for both the current and previous year:

| | |
|---|---|
| Raw materials | purchased cost determined "weight-averaged" |
| Finished goods and work-in-progres | cost of direct materials and labour and a proportion of manufacturing overheads based on normal operating capacity, excluding borrowing costs |
| Goods for resale | purchased cost determined "weight-averaged" |

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

## 9.14. Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable.

If the effect of the time value of money is material, the value of receivables is determined by discounting the estimated future cash flows to present value using a pre-tax discount rate that reflects current market assessments of the time value of money. Where discounting is used, any increase in the balance due to the passage of time is recognized as finance income.

Other receivables include in prepayments for future purchases of property, plant and equipment and intangible assets. Prepayments are recognized in accordance with the character of underlying assets, i.e.

under non-current or current assets. As non-monetary assets, advances are not discounted.

Receivables from public authorities are presented within other non-financial assets, except for income tax receivables that constitute a separate item in the balance sheet.

## 9.15. Cash and cash equivalents

Cash and short-term deposits in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

## 9.16. Interest-bearing loans and borrowings

All loans and borrowings are initially recognized at the fair value net of transaction costs associated with the borrowing.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method.

Amortised cost is calculated by taking into account any transaction costs, and any discount or premium on settlement.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the effective interest rate method.

## 9.17. Trade and other payables

Short-term trade payables are carried at the amount due and payable.

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Financial liabilities may be designated at initial recognition as at fair value through profit or loss if the following criteria are met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis; or
- the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a document risk management strategy; or
- financial liability contains an embedded derivative that would need to be separately recorded.

As of 31 December 2010 no financial liabilities were classified to fair value through profit and loss category (as of 31 December 2009: nil).

Financial liabilities at fair value through profit or loss are measured at fair value, reflecting their market value at the balance sheet date less directly attributable transaction costs. Gains or losses on these liabilities are recognised in the income statement as finance income or cost.

Financial liabilities other than financial instruments at fair value through profit or loss, are measured at amortised cost, using the effective interest rate method.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

Other non-financial liabilities include, in particular, liabilities to the tax office in respect of value added, advance payment liabilities which will be settled by way of delivery of goods or services, or fixed assets. Other non-financial liabilities are recognized at the amount due.

## 9.18. Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of the provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement.

If the effect of the time value of money is material, provisions are determined by discounting the estimated future cash flows to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as finance cost.

## 9.19. Retirement benefits

In accordance with internal remuneration regulations, employees of Group companies are entitled to retirement benefits. Retirement benefits are paid out as one-off benefit upon retirement. The amount of those benefits depends on the number of years of employment and the employee’s average salary. The Group makes a provision for retirement benefits in order to allocate the costs of those allowances to the periods to which they relate. In accordance with IAS 19 retirement benefits are post-employment defined benefits. The carrying amount of the Group’s liabilities resulting from those benefits is calculated at each balance sheet date by an independent actuary. The balance of these liabilities equals discounted payments which will be made in the future and accounts for staff turnover, and relates to the period to the balance sheet date. Demographic information and information on staff turnover are based on historical information.

On the basis of valuations carried out by professional actuarial companies, the Group creates a provision for future benefits according to the concept of the “corridor”. If the net value of accumulated unrecognized actuarial gains or losses at the end of prior reporting period exceeds 10% of the present value of the liability from defined benefit plans at that date, then a part of actuarial gains or losses is recorded by the Group in the income statement.

## 9.20. Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenues are recognised at the fair value of the consideration received or receivable, net of Value Added Tax, excise duty and discounts. The following specific recognition criteria must also be met before revenue is recognised.

### 9.20.1 Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and the amount of revenue can be reliably measured.

### 9.20.2 Rendering of sales services

The trading companies within the group are rendering sales services to the paper mills. For these services they receive a commission income based on the actual sales of products on each particular market. This means that the income for rendering of services is recognized at the same time as the sales of goods. Only income from paper mills outside the group is presented as sales revenues.

### 9.20.3 Interest

Revenue is recognised as interest accrues (using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

### 9.20.4 Dividends

Revenue is recognised when the shareholders' rights to receive the payment are established.

### 9.20.5 Rental income (operating lease)

Rental income arising on investment properties is accounted for on a straight-line basis over the lease term on ongoing leases.

### 9.20.6 Government grants

Government grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, its fair value is credited to a deferred income account and is released systematically to the income statement over the estimated useful life of the relevant asset by way of equal annual instalments.

## 9.21. Income tax

### 9.21.1 Current income tax

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that have been enacted or substantively enacted at the balance sheet date.

### 9.21.2 Deferred tax

For financial reporting purposes deferred income tax is recognised, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts.

Deferred tax liability is recognised for all taxable temporary differences:

- except where the deferred income tax liability arises from the initial recognition of goodwill, an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.
- Deferred tax asset is recognised for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilized:
- except where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will be available that will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Deferred tax relating to items recognised outside profit or loss is recognised outside profit or loss. Deferred tax items are recognised in correlation to the underlying transaction either in other comprehensive income or directly in equity.

Deferred income tax assets and deferred income tax liabilities are offset, if legally enforceable right exists to set off current income tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

### 9.21.3 Deferred tax relating to operations in the Special Economic Zone

The Group operates in the Kostrzynsko – Slubicka Special Economic Zone and due to this fact it benefits from a tax relief to the amount of the investment expenditure made.

Where the investment expenditure is not covered by the revenue earned in the given fiscal year, then the Group recognizes a deferred tax asset against the discounted excess of the investment expenditure over revenue earned, in accordance with the Decree of the Council of Ministers dated 14 September 2004 concerning the Kostrzynsko – Slubicka Special Economic Zone (Official Journal no.222 item 2252 dated 13 October 2004).

The created deferred tax asset is utilized in the subsequent fiscal year when the appropriate amount of taxable income is earned.

### 9.21.4 Value added tax

Revenues, expenses and assets are recognised net of the amount of value added tax except:

- Where the value added tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case value added tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- Receivables and payables, which are stated with the amount of value added tax included.

The net amount of value added tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

### 9.21.5 Excise tax

The amount of excise tax due in respect of the electric energy produced is recognized in income statement in the period to which it relates and in the balance sheet under liabilities.

The excise tax on the energy used for own needs is recognized among costs of sales in income statement.

## 9.22. Earnings per share

Earnings per share are calculated by dividing the net profit for the period by the weighted average number of shares during the reporting period.

The Group does not present diluted earnings per share, as there are no potential ordinary shares with dilutive effect.

## 10. Operating segments

The principal business of the Group is paper manufacturing, which is produced in four paper mills:

- Arctic Paper Kostrzyn S.A. (Poland) – production of high-quality uncoated fine paper under the brand Amber, with a production capacity of about 275,000 tons per year;
- Arctic Paper Munkedals AB (Sweden) – produces high-quality uncoated fine paper under the brand Munken, with a production capacity of about 160,000 tons per year;
- Arctic Paper Mochenwangen GmbH (Germany) – produces uncoated wood containing offset papers under brands Pamo, & L-Print, with a production capacity of about 115,000 tons per year;
- Arctic Paper Grycksbo (Sweden) – production of coated wood-free paper under brands G-Print and Arctic, annualproduction capacity of 265,000 tons.

Paper mills are the Group's strategic business units. Other Group companies conduct mainly trading or holding activities. Hence the Group identifies five operating segments – four segments comprising paper mills and one comprising all other Group entities.

The results of paper mills and other entities are analyzed by the Group's key management personnel based on internal reporting. Performance is measured based on the EBITDA level.

Transfer prices in transactions between segments are set on an arm's length basis in a manner similar to transactions with third parties.

The following table presents revenue and profit information and certain assets and liabilities information divided into individual Group segments for eriod ended 31 December 2010 and as at 31 December 2010.

## 12-month period ended 31 December 2010 and as at 31 December 2010

| | Continuing Operations | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Arctic Paper Kostrzyn | Arctic Paper Munkedals | Arctic Paper Mochenwangen | Arctic Paper Grycksbo | Other | Total | Eliminations | Total Group |
| **Revenues** | | | | | | | | |
| Sales to external customers | 793 092 | 425 258 | 275 978 | 549 378 | 244 026 | 2 287 732 | - | 2 287 732 |
| Inter-segment sales | 23 904 | 86 370 | 152 | 94 335 | 95 629 | 300 390 | (300 390) | - |
| Total segment revenues | 816 996 | 511 627 | 276 130 | 643 713 | 339 655 | 2 588 121 | (300 390) | 2 287 732 |
| **Segment's Result** | | | | | | | | |
| EBITDA | 69 894 | (2 042) | (18 644) | 96 482 | 6 947 | 152 638 | (6 344) | 146 294 |
| Interest Income | 2 908 | 747 | 16 | 57 | 20 967 | 24 695 | (22 758) | 1 937 |
| Interest Costs | (6 177) | (3 075) | (3 091) | (5 551) | (35 297) | (53 192) | 22 823 | (30 369) |
| Depreciation - without impairment of non-current assets | (45 964) | (13 322) | (9 513) | (42 395) | (1 234) | (112 428) | - | (112 428) |
| Impairments of non-current assets (Note 25) | - | - | (16 186) | - | - | (16 186) | - | (16 186) |
| Income tax | 7 002 | 809 | 6 458 | 8 719 | (1 871) | 21 116 | 351 | 21 467 |
| Segment assets | 700 213 | 274 405 | 127 767 | 462 251 | 849 034 | 2 413 671 | (507 399) | 1 906 272 |
| Segment liabilities | 333 360 | 195 589 | 105 851 | 272 349 | 666 794 | 1 573 942 | (485 518) | 1 088 424 |
| Capital expenditures | 42 091 | 14 993 | 6 007 | 7 747 | 753 | 71 591 | - | 71 591 |

- Inter-segment sales are eliminated on consolidation.
- Segment result does not include finance income (PLN 20,062 thousand of which PLN 1,937 thousand constitute interest income) and finance costs (PLN 30,393 thousand of which PLN 30,369 thousand constitute interest expense), amortization and depreciation (PLN 128,614 thousand), as well as income tax (PLN +21,467 thousand). Segment result includes inter-segment loss (PLN 6,344 thousand).
- Segment assets and liabilities do not include deferred tax asset and liability (deferred tax asset of PLN 4,497 thousand and deferred tax liability of PLN -154,402 thousand) as these items are managed on the Group level. Segment assets do not include investments in the entities operating within the Group.

The following table presents revenue and profit information and certain assets and liabilities information divided into individual Group segments for the 12-month period ended 31 December 2009 and as at 31 December 2009.

12-month period ended 31 December 2009 and as at 31 December 2009

| | Continuing Operations | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Arctic Paper Kostrzyn | Arctic Paper Munkedals | Arctic Paper Mochenwangen | Arctic Paper Grycksbo | Other | Total | Eliminations | Total Group |
| **Revenues** | | | | | | | | |
| Sales to external customers | 799 806 | 460 123 | 311 328 | - | 237 828 | 1 809 085 | - | 1 809 085 |
| Inter-segment sales | 19 159 | 71 103 | 77 | - | 87 386 | 177 726 | (177 725) | 0 |
| Total segment revenues | 818 965 | 531 226 | 311 405 | - | 325 214 | 1 986 810 | (177 725) | 1 809 085 |
| **Segment's Result** | | | | | | | | |
| EBITDA | 165 824 | 72 614 | 6 050 | - | 1 799 | 246 287 | 288 | 246 575 |
| Interest Income | 3 487 | 902 | 9 | - | 2 804 | 7 202 | (5 165) | 2 037 |
| Interest Costs | (7 929) | (3 028) | (2 986) | - | (12 047) | (25 990) | 5 155 | (20 835) |
| Depreciation | (42 995) | (13 218) | (9 617) | - | (1 434) | (67 264) | - | (67 264) |
| Income tax | (4 458) | (15 133) | 1 047 | - | (2 066) | (20 610) | (42) | (20 652) |
| Segment assets | 679 650 | 277 596 | 116 139 | - | 325 231 | 1 398 615 | (219 007) | 1 179 608 |
| Segment liabilities | 266 126 | 161 818 | 85 443 | - | 222 118 | 735 505 | (218 231) | 517 274 |
| Capital expenditures | 85 965 | 7 715 | 13 340 | - | 783 | 107 802 | - | 107 802 |

- Inter-segment sales are eliminated on consolidation.
- Segment result does not include finance income (PLN 2,104 thousand of which PLN 2,037 thousand constitute interest income) and finance costs (PLN 28,363 thousand of which PLN 20,835 thousand constitute interest expense), amortization and depreciation (PLN 67,264 thousand) as well as income tax (PLN 20,652 thousand). Segment result includes inter-segment profit (PLN 288 thousand).
- Segment assets and liabilities do not include deferred tax asset and liability (deferred tax asset of PLN 702 thousand and deferred tax liability of PLN 45,001 thousand) as these items are managed on the Group level. Segment assets do not include investments in the entities operating within the Group.

## 10.1 Revenues by countries and region

The folowing table presents revenues of the Group from external customers divided by countries and regions in the years 2009-2010:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| Geographic information<br>Revenues from external customers: | Year ended<br>31 December 2010 | Year ended<br>31 December 2009 |
|---|---|---|
| Germany | 495 767 | 459 580 |
| France | 232 948 | 213 285 |
| UK | 213 657 | 115 972 |
| Scandinavia | 332 042 | 244 944 |
| Western Europe (other than above) | 312 385 | 312 605 |
| Poland | 233 200 | 224 732 |
| Central and Eastern Europe (other than Poland) | 442 878 | 222 518 |
| Overseas | 24 854 | 15 449 |
| Total Sales | 2 287 731 | 1 809 085 |

The folowing table presents non-current assets of the Group from external customers divided by countries and regions in the years 2009-2010:

| Geographic information<br>Non-current assets: | Year ended<br>31 December 2010 | Year ended<br>31 December 2009 |
|---|---|---|
| Germany | 98 402 | 112 495 |
| France | 345 | 345 |
| Scandinavia | 630 736 | 76 195 |
| Western Europe (other than above) | 370 | 300 |
| Poland | 414 043 | 426 905 |
| Central and Eastern Europe (other than Poland) | 106 | (6 883) |
| Total non-current assets | 1 144 001 | 609 357 |

The non-current assets presented in the table include fixed assets, intangibles, investment properties and other financial and non-financial assets.

In other Western Europe, most of the revenues relates to sales in Belgium, Netherlands, Austria, Switzerland, Italy and Spain. In Central-Eastern Europe, most of the revenues relates to sales in Ukraine, Czech Republic, Slovakia, Hungary and Bulgaria.

# 11. Revenues and expenses

## 11.1. Other operating income

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Relase of provisions | 354 | 749 |
| Compensation received | 4 044 | 945 |
| Rental income | 2 186 | 1 889 |
| Sales of services | 691 | 298 |
| Government grants | 97 | 2 432 |
| Sales of energy and water | 20 469 | 11 645 |
| Sales of materials | 35 832 | 23 078 |
| Net income from emission rights | 84 | - |
| liabilities over cost of business combination | 77 555 | - |
| Profit of sales on tangible assets | 3 136 | - |
| Income on marketing activities | - | 611 |
| Return of tax on civil law transactions | - | 975 |
| Employee conribution company cars | 184 | 203 |
| VAT not confirmed resolved provision | 1 095 | - |
| Other | 4 455 | 1 775 |
| Total | 150 180 | 44 601 |

## 11.2. Other operating expenses

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Property tax | (1 574) | (1 357) |
| Cost of sales of energy and water | (17 953) | (7 945) |
| Cost of slaes of pulp and materials | (29 229) | (21 068) |
| Redundancy costs | (1 112) | (1 049) |
| Cost of ancilary activites (canteen) | - | (737) |
| Loss on sale of disposal of fiexed assets | - | (1 732) |
| VAT receivables write-off | - | (1 145) |
| Revaluation investment property | (1 617) | - |
| Contingent liabilities from purchase price agreement at Arctic Paper Mochenwangen GmbH | (5 232) | - |
| Other | (3 655) | (2 715) |
| Total | (60 372) | (37 748) |

## 11.3. Finance income

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Interest income on cash and cash equivalents | 1 010 | 952 |
| Interest income on loans granted | 312 | 221 |
| interest income on receivables | 518 | 793 |
| Other interest income | 97 | 71 |
| Foreign exchange gains | 18 099 | - |
| Other finance income | 25 | 67 |
| Total | 20 062 | 2 104 |

## 11.4. Finance costs

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Interest on bank loans valued at amortized cost | (25 388) | (17 736) |
| Interest on other financial liablities | (182) | (511) |
| Interest on post-employments provisions | (2 684) | (766) |
| Finance charges pay able under finance leases | (2 116) | (1 822) |
| Foreign exchange losses | - | (7 466) |
| Other finance costs | (24) | (62) |
| Total | (30 393) | (28 363) |

## Cost by nature

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Depreciation / Amortisation | (112 428) | (67 264) |
| Impairment losses | (16 186) | - |
| Change in inventory of finished goods | 25 345 | (10 883) |
| Inventory write-downs | (2 091) | (6 679) |
| Materials and energy | (1 543 833) | (901 679) |
| External services | (322 970) | (273 826) |
| Taxes and charges | (12 522) | (10 581) |
| Employee benefits expense | (302 626) | (211 928) |
| Other | (30 030) | (19 251) |
| Cost of goods for resale | (43 499) | (135 183) |
| Total costs by type, of which: | (2 359 860) | (1 636 627) |
| Items included in cost of sales | (2 029 622) | (1 339 917) |
| Items included in selling and distribution expenses | (272 965) | (237 605) |
| Items included in administrative expenses | (57 273) | (59 105) |

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

### 11.5. Depreciation/ amortization and impairment losses included In the consolidated income statement

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Included in cost of sales: | | |
| Depreciation / Amortisation | (106 705) | (60 599) |
| Impairment of property, plant and equipment | (16 186) | - |
| Impairment of intangible assets | - | - |
| Inventory write-downs | (2 091) | (6 679) |
| Included in selling and distribution expenses: | | |
| Depreciation / Amortisation | (2 900) | (3 105) |
| Impairment of property, plant and equipment | - | - |
| Impairment of intangible assets | - | - |
| Included in administrative expenses | | |
| Depreciation / Amortisation | (2 823) | (3 560) |
| Impairment of property, plant and equipment | - | - |
| Impairment of intangible assets | - | - |

### Employee benefits expenses

| | Note | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|---|
| Wages and salaries | | (232 239) | (168 139) |
| Social security costs | | (65 525) | (41 732) |
| Retirement benefits | 26.2 | (4 862) | (2 057) |
| Total employee benefits expenses, of which: | | (302 626) | (211 928) |
| Items included in cost of sales | | (211 301) | (134 615) |
| Items included in selling and distribution expenses | | (25 137) | (13 375) |
| Items included in administrative expenses | | (66 188) | (63 938) |

## 12. Components of other comprehensive income

Components of other comprehensive income for the years ended 31 December 2010 and 31 December 2009 are as follows:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Exchagne difference on translation of foreign operations | 12 112 | 2 154 |
| Deffered tax on items (exchange differences) from derivatives valuation | (2 851) | (485) |
| Valuation of derivatives | 10 679 | 1 874 |
| Derecognition of deffered tax asset | - | (9 876) |
| Total other comprehensive income | 19 941 | (6 334) |

# 13. Income tax

## 13.1. Tax burdens

Major components of income tax expense for the years ended 31 December 2010 and 31 December 2009 are as follows:

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Consolidated income statement | | |
| Current income tax | | |
| Current income tax charge | (7 942) | (5 552) |
| Adjustments in respect of current income tax of previous years | - | 12 |
| Deferred income tax | | |
| Relating to origination and reversal of temporary differences | 29 409 | (15 112) |
| Income tax expense reported in consolidated income statement | 21 467 | (20 652) |
| Consolidated statement of changes in equity | | |
| Current income tax | | |
| Tax effect of costs related to increase in share capital | - | - |
| Income tax benefit/ (income tax expense) reported in equity | - | - |
| Consolidated statement of other comprehensive income | | |
| Deffered income tax | | |
| Deffered tax in respect of valuation in hedging intruments (exchange differences) | (2 851) | (485) |
| Derecognition of deffered tax asset originally recognised in equity | - | (9 876) |
| Income tax benefit / (income tax expense) reported in other comprehensive income | (2 851) | (10 361) |

## 13.2. Reconciliation of the effective income tax rate

A reconciliation of income tax expense applicable to accounting profit before income tax at the statutory income tax rate to income tax expense at the Group's effective income tax rate for the years ended 31 December 2010 and 31 December 2009 is as follows:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Accounting profit before tax from continuing operations | 7 350 | 153 052 |
| Profit before tax from discontinued operations | - | - |
| Accounting profit before income tax | 7 350 | 153 052 |
| At statutory income tax rate in 2009-2010 of 19% | (1 396) | (29 080) |
| Adjustments in respect of current income tax from previous years | 47 | (10) |
| Difference resulting from different tax rates if different countries | 2 089 | (3 954) |
| Tax losses on which no deferred tax asset has been recognized | (12 104) | (3 170) |
| Tax credits in KSSSE | 11 978 | 18 414 |
| Business combination | 20 896 | - |
| Utilisation of previously unrecognised tax losses | 224 | 232 |
| Reversal of previously recognized tax losses | (297) | (770) |
| Non-taxable income | 6 255 | 604 |
| Non-taxable costs | (6 225) | (2 065) |
| Unrecognized deffered tax asset on temporary diffrences | - | (1 262) |
| Change in tax rates | - | 409 |
| At the effective income tax rate of 292% (2009: -13%) | 21 467 | (20 652) |
| Income tax expense reported in consolidated income statement | 21 467 | (20 652) |
| Income tax attributable to discontinued operations | - | - |

Unrecognised deferred tax asset relates mainly to those tax losses, which are expected to expire rather than to be realised, and temporary differences, which based on the Group's management assessment could not be utilised for tax purposes.

Deferred tax asset is recognised for tax losses carried forward to the extent that realisation of the related tax benefit through future taxable profits is probable. The Polish tax system has restrictive provisions for grouping of tax losses for multiple legal entities under common control, such as those of the Group. Thus, each of the Group's subsidiaries may only utilise its own tax losses to offset taxable income in subsequent years.

The amounts and expiry dates of unused tax losses are as follows:

| Year of expiration of tax losses | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| With an indefinite life | 73 981 | 19 287 |
| ended 31 December 2011 | - | - |
| ended 31 December 2012 | 127 | - |
| ended 31 December 2013 | 19 149 | 19 482 |
| ended 31 December 2014 | 12 406 | 12 336 |
| ended 31 December 2015 and later | 4 758 | - |
| Total | 110 419 | 51 105 |

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

## 13.3. Deffered income tax

Deferred income tax relates to the following:

| | Consolidated balance sheet as at | | Consolidated income statement for the year ended | |
|---|---|---|---|---|
| | 31 December 2010 (audited) | 31 December 2009 (audited) | 31 December 2010 (audited) | 31 December 2009 (audited) |
| **Deffered income tax liabilities** | | | | |
| Tangible fixed assets | 71 013 | 37 638 | 607 | (89) |
| Inventories | 585 | 438 | (147) | 235 |
| Trade receivables | 99 | 148 | 49 | 570 |
| Benefit funds | - | - | - | - |
| Accruals and provisions | 82 | 94 | 12 | (94) |
| Cogeneration certificates | 816 | 934 | 118 | (934) |
| Untaxed reserves (Swedish tax regulation) | 6 805 | - | (1 087) | - |
| Fair value adjustments on acquisition of subsidiary | 97 493 | 11 935 | 10 042 | 2 382 |
| Losses utilized on the level of separate financial statements, unrecognized in consolidated financial statements | 17 624 | 15 967 | - | (14 731) |
| Foreign exchange gains | - | - | - | 311 |
| Gross deffered income tax liabilities | 194 516 | 67 153 | 9 595 | (12 349) |

| | Consolidated balance sheet as at | | Consolidated income statement for the year ended | |
|---|---|---|---|---|
| | 31 December 2010 (audited) | 31 December 2009 (audited) | 31 December 2010 (audited) | 31 December 2009 (audited) |
| **Deferred income tax assets** | | | | |
| Post-employment benefits | 4 090 | 901 | 358 | (976) |
| Accruals and provisions | 4 656 | 6 450 | (3 265) | 225 |
| Tangible fixed assets | 4 517 | 50 | 4 467 | 50 |
| Inventories | 1 242 | 798 | 444 | 798 |
| Trade receivables | 3 767 | 159 | 3 298 | 159 |
| Tax credits in Kostrzynsko - Kostrzynsko Słubicka Special Economic Zone | 25 004 | 13 048 | 11 956 | (963) |
| Loss available for offset against future taxable income | 1 335 | 1 448 | (113) | (1 628) |
| Gross deferred income income tax assets | 44 611 | 22 854 | 17 145 | (2 335) |
| Foreign exchange differences | | | 2 669 | (428) |
| Deferred income tax charge | | | 29 409 | (15 112) |
| **Net deferred tax assets / liability** therein: | | | | |
| - Deferred tax assets | 4 497 | 702 | | |
| - Deferred tax liability | 154 402 | 45 001 | | |

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

## 14. Non-current assets held for sale

As at 31 December 2010 and as at 31 December 2009 the Group did not report any non-current assets held for sale.

## 15. Social assets and social fund liabilities

The Social Fund Act dated 4 March 1994, with subsequent amendments, requires the companies whose employees' number exceeds 20 to establish and run a Social Fund. Arctic Paper Kostrzyn S.A. creates such a Fund and makes periodical transfers in the basic amounts. The Funds purpose is to subsidize social activities of Arctic Paper Kostrzyn and cover social cost. Arctic Paper Kostrzyn has compenstated the assets and liabilities related to the Social Fund, because the assets are not a separate asset of this company. In relation to the fact mentioned above, the net balance of Social Fund amounted to PLN 10 thousand at 31 December 2010 (at 31 December 2009: PLN 12 thousand).

The composition and nature of assets, liabilities and costs related to the Social Fund are presented in the following.

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Cash | 20 | 10 |
| Social Fund liability | (10) | (22) |
| Expenditure of Fund are covered by own funds | | |
| Net balance | 10 | (12) |

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Transfers made to the Social Fund during the period | 588 | 571 |

## 16. Earnings per share

Earnings per share ratio is calculating by dividing the net profit for the year attributable to the Companys' shareholders by weighted average number of shares during the reporting period. Information regarding net profit and number of shares, which was the base for calculation of earnings per share and diluted earnings per share are presented below:

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Net profit (loss) for the year from continuing operations | 28 817 | 132 400 |
| Profit (loss) for the period from discontinued operations | - | - |
| Net profit (loss) for the year | 28 817 | 132 400 |
| Number of share - serie A | 50 000 | 50 000 |
| Number of share - serie B | 44 253 500 | 44 253 500 |
| Number of share - serie C | 8 100 000 | 8 100 000 |
| Number of share - serie E | 3 000 000 | - |
| Total number of shares (in thousand) | 55 403 500 | 52 403 500 |
| Weighted average number of shares | 54 778 842 | 45 390 884 |
| Profit per share (in PLN) | 0,53 | 2,92 |

On 1 March 2010 the Management Board adopted a resolution to increase the share capital to PLN 554,035,000 through the issuance of 3,000,000 ordinary bearer Series E shares with a nominal value of PLN 10 each. As a result of the issuance of Series E shares, share capital of the Company is divided into:

- 50,000 Series A shares,
- 44,253,500 oridinary bearer Series B shares,
- 8,100,000 oridinary bearer Series C shares,
- 3,000,000 oridinary bearer Series E shares.

Series A, B, C and E shares have been paid full in cash.

The changes were registered by the Court of Registration in Zielona Góra on 9 March 2010.

## 16.1. Transactions on ordinary shares, which had taken place between the balance sheet date and the date of authorization of these consolidated financial statements

On 14 February 2011 a total number of 112 thousand shares of Arctic Paper S.A. were acquired free of charge i.e.:

- Free of charge acquisition of 19 thousand shares of Arctic Paper S.A. by member of Managament Board
- Free of charge acquisition of 19 thousand shares of Arctic Paper S.A. by member of Supervisory Board
- Free of charge acquisition of 74 thousand shares of Arctic Paper S.A. by entity accociated with member of Managament Board.

## 17. Dividend paid and proposed

Dividends are paid out based on the net profit shown in the standalone annual financial statements of Arctic Paper S.A. prepared for statutory purposes, after covering losses carried forward from the previous years.

In accordance with the provisions of the Code of Commercial Companies, the parent company is required to create reserve capital for possible losses. Transferred to this capital category is 8% of profit for the given financial year recognized in the standalone financial statements of the parent company until such time as the balance of the reserve capital reaches at least one third of the share capital of the parent company. Appropriation of the reserve capital and other reserves depends on the decision of the General Meeting of Shareholders; however, the reserve capital in the amount of one third of the share capital may be used solely for the absorption of losses reported in the standalone financial statements of the parent company and shall not be used for any other purpose.

At the date of this report, the Company had no preferred shares.

The possibility of payment of potential dividend by the Company to shareholders depends on the level of payments received from subsidiaries. Risks associated with the Company's ability to pay dividends have been described in the part "Risk factors" of this report.

On 12 May 2010, the Management Board of Arctic Paper SA adopted a resolution recommending the General Meeting of Shareholders a payment of dividend for the year 2009 in the amount of PLN 0.80 per share.

On 8 June 2010 Regular General Meeting of Shareholders adopted Resolution No. 7 on the distribution of profit for the year 2009, in which part of the profit for the fiscal year 2009 was allocated for distribution among the shareholders in the amount of PLN 49,309 thousand, i.e., it was decided to pay a dividend of PLN 0.89 per share. The number of shares covered by the dividend amounted to 55,403,500.

The dividend on ordinary shares for the year 2009 was paid on 6 July 2010 and amounted to PLN 49,309 thousand (for 2008: no dividend payment was made due to the generated loss).

## 18. Property, plant and equipment

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| | As at 31 December 2010 (audited) | | | |
|---|---|---|---|---|
| | Land and buildings | Plant and equipment | Assets under construction | Total |
| Net carrying amount at 1 January 2009 | 139 071 | 314 422 | 55 051 | 508 544 |
| Additions | 246 | 14 833 | 92 269 | 107 347 |
| Other additions | 22 198 | 90 452 | (112 649) | - |
| Disposals | - | (552) | - | (552) |
| Liquidations | - | (1 753) | | (1 753) |
| Depreciation charge for the period | (7 159) | (56 696) | - | (63 854) |
| Foreign exchange differences | 1 601 | 428 | 862 | 2 891 |
| Net carrying amount at 31 December 2009 | 155 957 | 361 134 | 35 533 | 552 623 |
| Net carrying amount at 1 January 2010 | 155 957 | 361 133 | 35 533 | 552 623 |
| Additions | 1 972 | 10 817 | 58 517 | 71 307 |
| Other additions | 5 211 | 47 505 | (52 716) | - |
| Acquisition through business combination (Note 23) | 129 878 | 334 259 | - | 464 137 |
| Disposals | (5 226) | (313) | - | (5 540) |
| Liquidations | - | (21) | - | (21) |
| Depreciation charge for the period | (12 984) | (92 272) | - | (105 257) |
| Impairment losses (Note 26) | (486) | (15 700) | - | (16 186) |
| Foreign exchange differences | 11 897 | 25 896 | 1 896 | 39 688 |
| Net carrying amount at 31 December 2010 | 286 219 | 671 305 | 43 230 | 1 000 753 |
| At 1 January 2010 | | | | |
| Gross carrying amount | 206 150 | 904 576 | 35 533 | 1 146 260 |
| Accumulated depreciation and impairment | (50 193) | (543 443) | - | (593 636) |
| Net carrying amount | 155 957 | 361 133 | 35 533 | 552 623 |
| At 31 December 2010 | | | | - |
| Gross carrying amount | 351 106 | 1 320 958 | 43 230 | 1 715 294 |
| Accumulated depreciation and impairment | (64 887) | (649 654) | - | (714 541) |
| Net carrying amount | 286 218 | 671 304 | 43 230 | 1 000 753 |

Impairment loss in amount of PLN 16,186 thousand was included in consolidated income statement for the period ended 31 December 2010 in cost of sales.

The carrying amount of property, plant and equipment held under finance lease agreements or hire purchase contracts at 31 December 2010 is PLN 5,363 thousand (at 31 December 2009: PLN 9,404 thousand).

Leased assets and assets under hire purchase contracts are pledged as security for the related finance lease and hire purchase liabilities.

A mortgage security was established on land and buildings with a carrying amount of 286,218 thousand (2009: PLN 155,957 thousand) in respect of bank loans taken out by the Company (note 31). The value of capitalized borrowing costs in the financial year ended 31 December 2010 amounted to PLN 70 thousand (year ended 31 December 2009: PLN 34 thousand).

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# 19. Leases

## 19.1. Operating lease commitments – Group as the lessee

The Group entered into operating lease agreements on certain vehicles and technical equipment. Entering into these contracts does not result in any restrictions for the lessee.

Future minimum rentals payable under non-cancellable operating leases as at 31 December 2010 and 31 December 2009 are as follows:

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Within 1 year | 3 416 | 2 810 |
| Within 1 to 5 years | 10 061 | 5 353 |
| More than 5 years | 267 | 13 |
| Total | 13 744 | 8 176 |

## 19.2. Finance lease and hire purchase commitments

As at 31 December 2010 and 31 December 2009 future minimum rentals payable under finance leases and hire purchase contracts and the present value of the net minimum lease payments are as follows:

| | Year ended 31 December 2010 | | Year ended 31 December 2009 | |
|---|---|---|---|---|
| | Minimum payments | Present value of payments | Minimum payments | Present value of payments |
| Within 1 year | 8 641 | 7 913 | 6 309 | 5 201 |
| Within 1 to 5 years | 16 388 | 15 148 | 11 825 | 10 964 |
| More than 5 years | 35 513 | 28 532 | - | - |
| Minimum lease payments, total | 60 542 | 51 594 | 18 134 | 16 165 |
| Less amounts representing finance charges | (8 948) | | (1 969) | |
| Present value of minimum lease payments, of which: | 51 594 | 51 594 | 16 165 | 16 165 |
| - short-term | | 7 913 | | 5 201 |
| - long-term | | 43 681 | | 10 964 |

Incresease in lease payments is associated with inclusion of paper mill Grycksbo from 1 March 2010. A finance lease agreement is concluded between Arctic Paper Paper Grycksbo AB and Svenska Handelsbanken. Termination date of this agreement is 01 April 2021.

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## 20. Investment properties

| | 2010 (audtied) | 2009 (audited) |
|---|---|---|
| Opening balance at 1 January | 12 159 | 12 159 |
| Addititons (subsequent expenditure) | - | - |
| Net loss from a fair value adjustment | (1 617) | - |
| Closing balance at 31 December | 10 542 | 12 159 |

Investment properties are recognised at fair value determined by a valuation performed by accredited appraiser "DWN" Doradztwo i Wycena Nieruchomości Karina Drzazgowska. In relation to year 2009 no factors affecting the valuation have been changed. The valuation used a comparative approach, the adjusted average method.

DWN – Doradztwo i Wycena Nieruchomości Karina Drzazgowska is an expert in Real estate, holding a proffesional certification in the field of property valuation awarded by the President of the Housing and Urban Development.

The market value of property constitutes the price that is most likely to obtain in the market, determined taking into account transaction prices for adoption of the following assumptions:

- parties of the contract were independent of each other, did not act under constraint and had a firm intention to conclude a contract,
- the time necessary to display a property in the market and to negotiate contract terms elapsed.

The market value for valid metod of use (WRU0) was etsimated taking into account:

- purpose of the valuation,
- the nature and location of the property,
- function in land development plan,
- level of equipment in the technical infrastructure,stanu nieruchomości,
- condition of property
- available data on prices of similar properties.

In 2010 revenues received from investment properties amounted to PLN 21 thousand. Costs incurred in 2010 consists of cost of property tax amounting to PLN 19 thousand.

## 21. Intangible assets

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As at 31 December 2010 (audited)

| | Customer relationship | Trademarks | Cogeneration certificates | CO2 emission rights | Other * | Total |
|---|---|---|---|---|---|---|
| Net carrying amount at 1 January 2010 | 986 | 2 911 | 4 915 | 6 588 | 27 440 | 42 840 |
| Additions | - | - | 26 874 | 2 304 | 339 | 29 517 |
| Disposals | - | - | (27 496) | (1 966) | (10 625) | (40 087) |
| Acquisition of subsidiaries (Note 23) | 33 179 | 49 005 | - | 11 509 | 2 073 | 95 767 |
| Depreciation charge for the period | (3 076) | - | - | - | (4 095) | (7 172) |
| Foreign exchange differences | 2 451 | 4 060 | - | 333 | (591) | 6 253 |
| Net carrying amount at 31 December 2010 | 33 540 | 55 976 | 4 293 | 18 768 | 14 541 | 127 118 |
| | | | | | | |
| At 1 January 2010 | | | | | | - |
| Gross carrying amount | 1 257 | 2 911 | 4 915 | 6 588 | 51 483 | 67 154 |
| Accumulated depreciation and impairment | (271) | - | - | - | (24 043) | (24 314) |
| Net carrying amount | 986 | 2 911 | 4 915 | 6 588 | 27 440 | 42 840 |
| | | | | | | |
| At 31 December 2010 | | | | | | - |
| Gross carrying amount | 37 028 | 55 977 | 4 293 | 6 926 | 54 631 | 158 854 |
| Accumulated depreciation and impairment | (3 487) | - | - | - | (28 248) | (31 736) |
| Net carrying amount | 33 540 | 55 977 | 4 293 | 6 926 | 26 382 | 127 118 |

* - Other position included software

As at 31 December 2009 (audited)

| | Customer relationship | Trademarks | Cogeneration certificates | CO2 emission rights | Other * | Total |
|---|---|---|---|---|---|---|
| Net carrying amount at 1 January 2009 | 1 257 | 1 528 | 1 378 | 5 925 | 39 191 | 49 279 |
| Additions | - | 1 311 | 21 778 | 754 | 503 | 24 346 |
| Disposals | - | - | (18 241) | - | (9 068) | (27 309) |
| Depreciation charge for the period | (264) | - | - | - | (3 142) | (3 406) |
| Foreign exchange differences | (7) | 72 | - | - | (136) | (71) |
| Net carrying amount at 31 December 2009 | 986 | 2 911 | 4 915 | 6 679 | 27 349 | 42 840 |
| | | | | | | |
| At 1 January 2009 | | | | | | - |
| Gross carrying amount | 1 289 | 1 528 | 1 378 | 5 925 | 60 096 | 70 215 |
| Accumulated depreciation and impairment | (32) | - | - | - | (20 905) | (20 936) |
| Net carrying amount | 1 257 | 1 528 | 1 378 | 5 925 | 39 191 | 49 279 |
| | | | | | | |
| At 31 December 2009 | | | | | | - |
| Gross carrying amount | 1 257 | 2 911 | 4 915 | 6 588 | 51 483 | 67 153 |
| Accumulated depreciation and impairment | (271) | - | - | - | (24 043) | (24 314) |
| Net carrying amount | 986 | 2 911 | 4 915 | 6 588 | 27 440 | 42 839 |

* - Other position included software

In the financial year ended 31 December 2010, emission rights with a carrying amount of PLN 6,926 thousand were used as collateral in respect of bank loans drawn by the Group. In 2009 their value amounted to PLN 6,588 thousand.

The Company performed impairment test of Arctic Paper trademark as at 31 December 2010. The impairment test confirmed that Arctic Paper trademark is not impaired. The next impairment test is planned for 31 December 2011.

## 22. Investment in related parties valued using the equity method

During the years ended 31 December 2010 and 31 December 2009 the Group did not have any associates.

## 23. Business combinations and acquisition of minority interests

### 23.1. Acquistion of Grycksbo Papier Holding AB

On 7 December 2009 the agreement was concluded to purchase a 100% stake in Grycksbo Paper Holding AB ("Grycksbo") with a registered office in Grycksbo, Sweden, which was a 100% shareholder of the Grycksbo Paper AB paper mill. The share purchase agreement was concluded between Arctic Paper S.A. and Grycksbo Paper Holding AB shareholders, i.e. Accent Equity 2003 L.P., Accent Equity 2003 KB and minority shareholders ("Seller").

Grycksbo manufactures superior graphic paper and has the annual manufacturing capacity of 260,000 tons. The portfolio of paper mill's products contains various types of coated papers, including paper sold under the brand known in the industry as G-Print. Paper manufactured by Grycksbo is designated for printing maps, books, magazines, posters and mailing advertising materials.

The Company's Management Board considers the inclusion of Grycksbo Paper Holding AB to the Arctic Paper S.A. Capital Group as a long-term investment.

The agreement, which has been signed, provides for the purchase of 30,000,000 shares of Grycksbo Paper Holding AB with a nominal value of SEK 1 (PLN 0.40) each and the total nominal value of SEK 30,000,000 (PLN 12,132,000). The shares being purchased constitute 100% of the Grycksbo Paper Holding AB's share capital and give rights to 100% of votes at the company's shareholder meeting.

On 1 March 2010, the Group acquired 100% of the voting shares of Grycksbo Paper Holding AB seated in Grycksbo, Sweden, a non-listed company. Grycksbo Paper Holding AB is the owner of 100% of the voting shares of paper mill Grycksbo Paper AB, the parent company of Grycksbo Paper Deutschland GmbH, Grycksbo Paper UK Ltd and Grycksbo Paper France EURL, which business activities is trading services. Those entities, together with Arctic Paper Investment AB, form the Grycksbo group ("the Grycksbo Group").

On 1 March 2010 the final purchase price for the assets indicated in the agreement was determined, comprising:

- a cash payment of SEK 519.2 million;
- issuance of 3,000,000 shares of Arctic Paper S.A. to the Sellers at a value equal to the average price of the Company's shares for the 20 trading days immediately prior to the closing, i.e. PLN 17.43, multiplied by 3,000,000.

The total price, comprising cash and issuance of 3,000,000 of the Company's shares to the Sellers, was SEK 647.1 million. Payment of the total price was financed by issuance of 3,000,000 shares of Arctic Paper S.A. to the Sellers, from the proceeds obtained

from the issue of bonds, as well as the Company's own resources.
Above information is included in current report no. 14/2009 dated 8 December 2009

As at the date of authorisation of these consolidated financial statements the Group completed the process of purchase price allocation to fair value of indentifiable assets, liabilities and contingent liabilities.

Consequently, the Company conducted the final accounting of asstes and liabilities. The effect of the final accounting for business combination is preseneted in the table below.

The fair value assumed for the final accounting as well as the goodwill resulting from provisional accounting and the carrying value directly before the acquisition are as follows:

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| | Fair Vaule assumed in final settlement as at 31 December 2010 (audited) | Carrying amount assumed in interim settlement as at 30 June 2010 (unaudited) | Carrying amount assumed in interim settlement as at 28 February 2010 (unaudited) |
|---|---|---|---|
| Property, plant and equipment | 464 137 | 224 513 | 224 513 |
| Intangible assets | 95 767 | 6 381 | - |
| Cash and cash equivalents | 24 412 | 24 412 | 24 412 |
| Trade and other receivables | 68 961 | 68 961 | 68 961 |
| - of which receivables from Arctic Paper Group | (12 664) | (12 664) | (12 664) |
| Inventories | 64 397 | 60 118 | 60 118 |
| | 717 674 | 384 385 | 378 004 |
| Trade payables and other current liabilities | 83 840 | 83 840 | 83 840 |
| - of which payables to Arctic Paper Group | (110) | (110) | (110) |
| Interest-bearing loans and borrowings and other financial liabilities | 90 337 | 90 337 | 90 337 |
| Provision and accruals | 72 422 | 72 422 | 72 422 |
| Contingent liabilities | - | - | - |
| Deffered income tax liability | 123 584 | 34 250 | 34 250 |
| | 370 183 | 280 850 | 280 850 |
| Carrying value of identifiable assets, liabilities and contingent liabilities | 334 937 | 90 871 | 84 490 |
| Goodwill arosen from business combination | (77 555) | 166 512 | 172 893 |
| Total consideration | 257 383 | 257 383 | 257 383 |
| Consideration: | | | |
| Shares issued (3.000.000 shares), at fair value (share price as at 1 March 2010) | 57 570 | 57 570 | 57 570 |
| Cash paid | 212 367 | 212 367 | 212 367 |
| Receivables and liabilities against Grycksbo, directly before acquisation | (12 554) | (12 554) | (12 554) |
| Total payment | 257 383 | 257 383 | 257 383 |
| The cash outflow on acquisition: | | | |
| Net cash acquired with the subsidiary | (24 412) | (24 412) | (24 412) |
| Cash paid | 212 367 | 212 367 | 212 367 |
| Net cash outflow | 187 955 | 187 955 | 187 955 |

In the period starting from the date of the acquisition, the contribution of Grycksbo Group's net profit in total net profit of the Group amounted to PLN 2,496 thousand. Had the acquisition taken place at the beginning of the year, the Group's net profit would have increased by PLN 3,154 thousand and the revenues from continuing operations would have increased by PLN 119,518 thousand.

The fair value of trade receivables as at 31 December 2010 amounted to PLN 32,468 thousand. The gross value of trade receivables directly prior to the takeover on 28 February 2010 amounted to PLN 41,401 thousand. Allowance for doubtful debts directly prior to the takeover on 28 February 2010 amounted to PLN 5,047 thousand comparing to PLN 5,034 thousand as at 31 December 2010.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

As a result of the final accounting as at 31 December 2010, the Group recorded a gain from a bargain purchase in the amount of PLN 77,555 thousand.

Recognized gain from a bargain purchase is not taxable income.

Gain from a bargain purchase was included in the consolidated income statement in other operating income.

Costs of the acquisition incurred before 31 December 2009, which could have been elements of the acquisition price, according to prevailing in that period IFRS 3 directly decreased the Group's retained earnings in amount of PLN 7,111 thousand as at 1 January 2010.

Occurrence of gain from bargain purchase.

Private Accent Equity Fund 2003 LP, Accent Equity 2003 KB, and minority investors were the sellers of the paper mill Grycksbo Paper AB. Grycksbo Paper AB paper mill was in the fund's investment portfolio as a result of Accent Equity divestment made in 2006 by Stora Enso paper mill. Stora Enso has taken a strategic decision to exit from the coated papers segment, and focus only on plants with a capacity of over 500 thousand tonnes per year. Sale of paper Grycksbo to private Accent Equity Fund enabled to avoid a large expenses related to the closure of plant and redundancy of more than 400 employees. Private equity fund was considering publishing of the paper mill on the Stockholm Stock Exchange or the disposal to industry investor. The crisis in 2009 reduced the possibilities, since on the one hand, investors were not interested in shares of a single paper mill, devoid of its own distribution channels and on the other sector investors abstained from the acquisition of new production assets. Consequently, the Arctic Paper has become one of the few entities interested in buying the paper Grycksbo.

Interest of Arctic Paper S.A. resulted from a desire to maintain the offer of coated papers, which after the closure of the paper mill Hafestrom were purchased from other suppliers. These factors led to negotiations between the Arctic Paper and Accent Equity ended up reaching an agreement. Arctic Paper has acquired an effective paper-producing high-quality coated paper mill at an attractive price and the Accent Equity fund came out from investments with profit and in due time.

Fair value of tangible assetes assumed in final accounting is presented in table below:

| | Land | Buildings | Machinery and equipment | Total |
|---|---|---|---|---|
| Previous carrying value | 6 186 | 31 585 | 186 742 | 224 513 |
| Increasing | 2 178 | 89 929 | 147 518 | 239 624 |
| Decreasing | - | - | - | - |
| Fair value taking to final settelement | 8 364 | 121 514 | 334 259 | 464 137 |

Fair value of intangible assets assumed in final accounting is presented in table below:

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| | Trademarks | Order backlog | CER and CO2 emission rights | Customer relationship | Total |
|---|---|---|---|---|---|
| Fair value taking to final settlement | 49 005 | 2 073 | 11 509 | 33 179 | 95 767 |

## 23.2. Incorporation of Arctic Paper Investment AB

On 12 February 2010 Arctic Paper Investment AB with the registered office in Göteborg, Sweden, has been registered. The share capital of the company consists of 100 thousand shares with a nominal value of SEK 1 each. All the shares were paid for on 27 January 2010 by Arctic Paper S.A. Arctic Paper Investment AB was established to facilitate the Grycksbo Paper Holding AB acquisition transaction.

## 23.3. Incorporation of Arctic Paper Investment II AB

On 21 December 2010 Arctic Paper Investment II AB with the registered office in Göteborg, Sweden, has been registered. The share capital of the company consists of 50 thousand shares with a nominal value of SEK 1 each. Arctic Paper Investment II AB is not subject to consolidation.

# 24. Other assets

## 24.1. Other financial assets

| | Note | Year ended 31 grudnia 2010 (audited) | Year ended 31 grudnia 2009 (audited) |
|---|---|---|---|
| Loans granted | | (0) | 20 000 |
| Derivatives | 39.3 | 11 917 | 1 388 |
| Guarantee deposits | | 916 | 949 |
| Other | | 3 | 11 |
| Total | | 12 836 | 22 348 |
| - current | | 7 811 | 21 197 |
| - non-current | | 5 024 | 1 151 |

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## 24.2. Other non - financial assets

| | Year ended 31 grudnia 2010 (audited) | Year ended 31 grudnia 2009 (audited) |
|---|---|---|
| Insurance costs | 579 | 492 |
| Leasing charges | 124 | 163 |
| Expenditures for the acquisition of Grycksbo | - | 1 919 |
| Cogenaration certificates | 361 | 192 |
| Prepayments for services | 3 352 | 1 564 |
| Rental charges | 1 363 | 1 079 |
| Other | 1 497 | 328 |
| Total | 7 276 | 5 737 |
| - current | 6 714 | 5 153 |
| - non-current | 564 | 584 |

## 25. Impairment test of tangible and intangible assets

As at 31 December 2010 the Group performed impairment test of tangible and intangible assets in the paper mill Arctic Paper Mochenwangen.

Impairment test in Arctic Paper Mochenwangen was performed in connection with lower than expected results generated by the paper mill in Mochenwangen. Financial results in Arctic Paper Mochenwangen were influenced by the market conditions including increase in prices of raw materials and intensification of competition in the segment of paper produced by Arctic Paper Mochenwangen.

With regards to the above indications the Group's Management made decision to perform impairment test using discounted cash flows method. Impairment test revealed impairment loss in the amount of PLN 16,186 thousand. Details regarding impairment test and its assumptions were presented in the following point.

The recoverable amount of the cash-generating unit selling AP Tech, L-Print and Pamo paper has been determined based on the value in use calculation using cash flow projections from financial budgets approved by the key management covering a five-year period from 2011 – 2015. The pre-tax discount rate applied to the cash flow projections is 10.3% and the cash flows beyond the five-year period are extrapolated using a 1.6% growth rate.

### Key Assumptions used in value in use calculations

The calculation of value in use for Arctic Paper Mochenwangen cash-generating unit is most sensitive to the following factors:

- Discount rates
- Increase in sales prices
- Increase in energy prices
- Currency risk

Discount rate represents the assessment made by the management of the risks specific to the cash-generating unit. The discount rate is used by the management to assess the operating efficiency (results) and future investment propositions. In the budgeted period the discount rate amounts to 8.1%. The discount rate was determined using the weighted average cost of capital (WACC).

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Increase in raw material prices (primarily prices of pulp) - assessments of change in raw materials prices are made using the ratios published based on the data regarding pulp prices. The main source of data used as a base for assumptions is Internet site: www.foex.fi. It should be mentioned that pulp prices are featured with high volitality.

Increase in energy prices - increase in energy prices, in particular coal which is a basic source of the energy, results from the assumptions used in the projections approved by the local management of Arctic Paper Mochenangen.

Currency risk - the risk relates to the purchase cost of raw materials used for production of paper, in particular to the purchase of pulp where costs are incurred mainly in USD. In projected period the USD/EUR exchange rate was set at the level of 0.7143.

Below table presents main assumptions used in calculation of value in use

| | Key assumption |
|---|---|
| Prognosis based on year | 2011-2015 |
| Income tax rate | 27,40% |
| Pre-tax discount rate | 10,32% |
| Weighted average cost of capital | 8,10% |
| Growth in residual period | 1,60% |

The following table presents the impairment loss recognized as at 31 December 2010:

| | Balance vaue as at 31.12.2010 | Vaule in used by 31.12.2010 |
|---|---|---|
| Tangible assets, therein: | 72 969 | 56 783 |
| - land | 13 699 | 13 699 |
| - buildings | 1 754 | 1 269 |
| - machinery and equipment | 55 040 | 39 340 |
| - assets under construction | 2 475 | 2 475 |
| Intangible assets | 15 813 | 15 813 |
| Working capital | 19 671 | 19 671 |
| Cash and equivalents | 6 958 | 6 958 |
| Total value | 115 411 | 99 225 |
| Impairment recognized in Profit and loss, therein: | 16 186 | |
| - machinery and equipment | 15 700 | |
| - buildings | 486 | |

The impairment loss amounting to PLN 16,186 thousand was recognized in consolidated income statement for the year ended 31 December 2010 in the position cost of sales.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

## 26. Empolyee benefits

On 30 July 2009 the Extraordinary General Shareholders' Meeting adopted Resolution Number 4 on approving the assumptions of an incentive programme for key managers, issuing subscription warrants, entitling them to take up D Series shares excluding the pre-emptive rights.

### 26.1. Employee share incentive plan

In the year ended 31 December 2010 no agreements with the entitled persons regarding acquiring these warrants was executed.

### 26.2. Retirement and other post-employment benefits

The Group companies provide retirement benefits to retiring employees in accordance with the Labour Code in Poland applicable to Arctic Paper Kostrzyn S.A. and agreements with labour unions applicable to Arctic Paper Munkedals AB and Arctic Paper Mochenwangen GmbH. Arctic Paper Kostrzyn S.A. also operates Social Fund for future retirees.

As a result, based on the valuation made by professional actuarial companies in each country, the Group have created a provision for these future commitments.

The Group recognises these provisions in accordance with the corridor method. According to this method, actuarial gains or losses are only recognized if, at the end of the previous reporting period, they exceed 10% of the present value of the obligation.

Net pension costs for the defined benefit plans are summarized in the following table:

| | Year ended 31 grudnia 2010 (badane) | Year ended 31 grudnia 2009 (badane) |
|---|---|---|
| Current service cost | 2 015 | 897 |
| Interest on obligation | 2 619 | 1 082 |
| Recognized actuarial gain or loss | 229 | 78 |
| Total pension cost for defined benefit plans | 4 862 | 2 057 |

The table below summarises the amounts of the provision and movements in the benefit liability over the years ending 31 December 2010 and 31 December 2009. The table also includes information about unrecognized actuarial losses and total pension obligations.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Benefit plan in Sweden (Munkedals) | Benefit plan in Sweden (Grycksbo) | Benefit plan in Poland (Kostrzyn) | Benefit plan in Germany (Mochenwangen) | Total |
|---|---|---|---|---|---|
| Pension provison at 1 January 2010 | 10 803 | 44 518 | 4 252 | 5 378 | 64 951 |
| Cost of employment during current period | 747 | 858 | 287 | 123 | 2 015 |
| Interest costs | 714 | 1 340 | 263 | 301 | 2 619 |
| Actuarial gains or losses | 258 | - | 9 | (38) | 229 |
| Pensions paid | (123) | (1 570) | (297) | (123) | (2 112) |
| Foreign exchange diffrences | 1 121 | - | - | (196) | 925 |
| Pension provision at 31 December 2010 | 13 520 | 45 147 | 4 514 | 5 445 | 68 626 |
| Unrecognized actuarial losses (+) and gains (-) | 6 110 | (2 426) | 230 | (725) | 3 189 |
| Pension obligation at 31 December 2010 | 19 629 | 42 721 | 4 744 | 4 720 | 71 814 |

Significant increase of unrecognized actuarial losses in 2010 in Sweden was caused mainly by the countinuing level of the budgeted employees turnover ratio, in entities in which the PRI program is functioning. The ration is set at 3,5% in the valuation as at 31 December 2010.

The increase in provision for retirement is a result of the acquisition of Arctic Paper AB Grycksbo (Note 23). Provision recognized in connection to the inclusion of Arctic Paper AB Grycksbo was PLN 44,518 thousand, the cost of the current employment of PLN 858 thousand, interest expense on liabilities for employee benefits PLN 1,340 thousand. As at 31 December 2010, the provision for retirement benefits Arctic Paper Grycksbo was PLN 45,147 thousand.

| | Benefit plan in Sweden (Munkedals) | Benefit plan in Poland (Kostrzyn) | Benefit plan in Germany (Mochenwangen) | Total |
|---|---|---|---|---|
| Pension provison at 1 January 2009 | 9 617 | 3 811 | 5 207 | 18 635 |
| Cost of employment during current period | 227 | 540 | 130 | 897 |
| Interest costs | 532 | 234 | 316 | 1 082 |
| Actuarial gains or losses | 94 | 44 | (61) | 77 |
| Pensions paid | (106) | (377) | (121) | (604) |
| Foreign exchange diffrences | 437 | - | (93) | 344 |
| Pension provision at 31 December 2009 | 10 803 | 4 252 | 5 378 | 20 433 |
| Unrecognized actuarial losses (+) and gains (-) | 5 401 | 639 | (1 122) | 4 918 |
| Pension obligation at 31 December 2009 | 16 204 | 4 891 | 4 256 | 25 351 |

The principal assumptions used by the actuaries in determining the retirement benefit obligations are presented below:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) | Year ended 31 December 2009 (audited) |
|---|---|---|
| Discount rate (%) | | |
| Plan in Sweden | 3,7% | 3,9% |
| Plan in Poland | 5,5% | 5,5% |
| Plan in Germany | 5,3% | 5,5% |
| | | |
| Future salary increases (%) | | |
| Plan in Sweden | 3,0% | 3,0% |
| Plan in Poland | 3,0% | 3,0% |
| Plan in Germany | - | - |
| | | |
| Remaining time of duty (in years) | | |
| Plan in Sweden | 14,6 | 16,7 |
| Plan in Poland | 15,5 | 13,4 |
| Plan in Germany | 13,9 | 14,4 |

## 26.3. Redundancy payments

During 2008 a redundancy program was initiated in Arctic Paper Munkedals AB. The program consisted of an offer of early retirement for employees aged 63 or more. The cost of the redundancy program in 2009 amounted to PLN 1,049 thousand and PLN 147 thousand. The cost of redundancy program in 2010 amounted to PLN 899 thousand.

At 31 December 2010, Arctic Paper SA had established a provision for severance payment for Bjarne Bjork. The value of a provision amounts to PLN 2,296 thousand and is presented in the balance sheet as short-term provisions.

At 31 December 2010, Arctic Paper SA had established a provision for severance payment for Lars Ake Fritzon. The value of a provision amounts to PLN 625 thousand and is presented in the balance sheet as short-term provisions. The cost regardig mentioned provision in 2010 amounted to PLN 2,478 thousand and is presented in the income statement in the position of administrative expenses.

## 27. Inventories

| | Year ended 31 grudnia 2010 (audited) | Year ended 31 grudnia 2009 (audited) |
|---|---|---|
| Raw materials (at cost) | 138 685 | 79 753 |
| Work-in-progress (at cost of development) | 6 604 | 4 721 |
| Finished goods and goods for resale, of which: | | |
| At cost / cost of development | 133 286 | 82 775 |
| At net realisable value | 12 474 | 534 |
| Prepayments for supplies | - | |
| Total inventories, at the lower of cost (or costs of development) and net realisable value | 291 048 | 167 783 |

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

In the year ended 31 December 2010, the Group made write-down of inventory of PLN 2,091 thousand (2009: PLN 6,679 thousand). In 2010 the resolved write-down amounted to PLN 981 thousand (in 2009 it amounted to PLN 647 thousand). Net change of write-downs of inventories is recognized in cost of sales in the income statement. The write-down recognized related to the slow-moving and burdened with the risk of being impaired, unsold or unusable for own need finished goods and raw materials.

In the financial years ended 31 December 2010 and 31 December 2009, the Group had a pledge on all tangible assets amounting to SEK 600,000 thousand, PLN 171,600 thousand, EUR 20,000 thousand, and PLN 221,200 thousand, part of which was inventory.

As at 31 December 2010 finished goods in the amount of PLN 12,474 thousand were stated at net realizable value (2009: PLN 534 thousand).

## 28. Trade and other recivables

| | Year ended 31 grudnia 2010 (audtied) | Year ended 31 grudnia 2009 (audtied) |
|---|---|---|
| Trade receivables | 228 993 | 203 082 |
| Budget receivables - VAT receivables | 26 826 | 17 125 |
| Other receivables from third parties | 3 814 | 2 454 |
| Other receivables from related parties | 9 815 | 9 337 |
| Total receivables, net | 269 448 | 231 998 |
| Doubtful debts allowance | 22 122 | 22 492 |
| Total receivables, gross | 291 570 | 254 490 |

For terms and conditions relating to related party transactions, refer to note 36.

Trade receivables are non-interest bearing and are usually due within 30-90 days.

The Group has a policy to sell only to customers who have undergone an appropriate credit verification procedure. Thanks to that, as Management believes, there is no additional credit risk that would exceed the doubtful debts allowance recognised for trade receivables of the Group.

As at 31 December 2010 trade receivables at nominal value of PLN 22,122 thousand (as at 31 December 2009: PLN 22,492) were impaired and fully provided for.

Movements in the provision for impairment of receivables were as follows:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 grudnia 2010 (audtied) | Year ended 31 grudnia 2009 (audtied) |
|---|---|---|
| Provision for bad debts as at 1 January | 22 492 | 6 757 |
| Charge for the year | 2 708 | 19 077 |
| Utilisation | (1 610) | (183) |
| Unused amounts reversed | (1 771) | (3 202) |
| Result on translation of foreign entities | 302 | 43 |
| Provision for bad debts as at 31 December | 22 122 | 22 492 |

The table below presents the aging analysis of trade receivables which as at 31 December 2010 and 31 December 2009 were past due but not impaired:

| | Total | Neither past due nor impaired | Past due but nor impaired | | | | |
|---|---|---|---|---|---|---|---|
| | | | < 30 days | 30 - 60 days | 60 - 90 days | 90 - 120 days | >120 days |
| As at 31 December 2010 | 228 993 | 191 109 | 30 649 | 3 225 | 567 | 641 | 2 801 |
| As at 31 December 2009 | 203 082 | 182 105 | 14 375 | 3 001 | 779 | 469 | 2 353 |

## 29. Cash and cash equivalents

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three month depending on the immediate cash requirements of the Group and earned interest at the respective short-term deposit rates. The fair value of cash and cash equivalents as at 31 December 2010 is PLN 179,402 thousand (31 December 2009: PLN 140,115 thousand).

As at 31 December 2010, the Group had un-drawn committed borrowing facilities in the amount of PLN 30,809 thousand. At 31 December 2010 and 31 December 2009, the Group had none un-drawn committed borrowing facilities.

At 31 December 2010 the Group had an overdraft in the amount of PLN 41,266 thousand.

Balance of cash and cash equivalents disclosed in the statement of cash flows consisted of the following:

| | Year ended 31 grudnia 2010 (audited) | Year ended 31 grudnia 2009 (audited) |
|---|---|---|
| Cash at bank and in hand | 179 073 | 139 879 |
| Short-term deposits | 329 | 235 |
| Cash in transit | - | - |
| | 179 402 | 140 114 |

## 30. Share capital and reserve/other capital

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

## 30.1. Share capital

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| 'A' class ordinary shares of PLN 10 each | 500 | 500 |
| 'B' class ordinary shares of PLN 10 each | 442 535 | 442 535 |
| 'C' class ordinary shares of PLN 10 each | 81 000 | 81 000 |
| 'E' class ordinary shares of PLN 10 each | 30 000 | - |
| | 554 035 | 524 035 |

| | Date of registration of capital increase | Volume | Value in PLN |
|---|---|---|---|
| Ordinary shares issued and fully covered | | | |
| Issued on 30 April 2008 | 2008-05-28 | 50 000 | 500 000 |
| Issued on 12 September 2008 | 2008-09-12 | 44 253 468 | 442 534 679 |
| Issued on 20 April 2009 | 2009-06-01 | 32 | 321 |
| Issued on 30 July 2009 | 2009-11-12 | 8 100 000 | 81 000 000 |
| Issued on 01 March 2010 | 2010-03-17 | 3 000 000 | 30 000 000 |
| As at 31 December 2010 | | 55 403 500 | 554 035 000 |

On 1 March 2010 the Managaement Board adopted a resolution to increase the share capital to PLN 554,035,000 through the issuance of 3 million ordinary bearer Series E shares with a nominal value of PLN 10 each. Consequently the share capital of the Company is divided into:

- 50,000 Series A shares,
- 44,253,500 oridinary bearer Series B shares,
- 8,100,000 oridinary bearer Series C shares,
- 3,000,000 oridinary bearer Series E shares.

Series A, B, C and E shares have been paid full in cash.

The changes were registered by the Court of Registration in Zielona Góra on 9 March 2010.

As at the day of these financial statements the Company did not have any preferred shares.

By the means of the issue of 3,000,000 shares the Company settled part of the consideration for purchase of Grycksbo Paper Holding.

### 30.1.1. Nominal value of shares

All issued shares have a nominal value of PLN 10 and have been fully paid.

### 30.1.2. Shareholders rights

All series shares give right to one vote per share. There are no shares with preferences relating to distribution of dividends or repayment of capital.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

30.1.3. Shareholders with significant shareholding

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Arctic Paper AB | | |
| Share in equity | 75,00% | 79,30% |
| Share in votes | 75,00% | 79,30% |
| Other shareholders | | |
| Share in equity | 25,00% | 20,70% |
| Share in votes | 25,00% | 20,70% |

## 30.2. Foreign currency translation reserve

The foreign currency translation reserve is adjusted with the exchange differences arising from translation of the financial statements of foreign subsidiaries.

## 30.3. Share premium

Share Premium was created from the excess of emission value above the nominal value in 2009 in the amount of PLN 40,500 thousand, less cost of issue recognized as a reduction of share premium in the amount of PLN 4,515 thousand PLN.

In 2010 the capital premium was increased by PLN 27,570 thousand resulting from the excess of issue value above the nominal value related to the issue of Series E shares.

By the means of the issue of 3,000,000 shares the Company settled part of the consideration for purchase of Grycksbo Paper Holding.

As at 31 December 2010 the total value of the Company's share permium is PLN 63,555 thousand (31 December 2009: PLN 35,985 thousand).

## 30.4. Other reserves

Other reserves consist of the capital from the valuation of hedges. The Group started using hedging tansactions in the year 2009.

The following table shows changes in other reserves in 2010, as well as comparatives:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Other reserves at the beginning of the reporting period | 1 388 | 9 876 |
| Changes in cash flow hedges | | |
| Valuation of financial instruments, therein: | 10 679 | 1 874 |
| - FX forward | (2 154) | 104 |
| - Forward for electricity | 12 833 | 1 770 |
| Deferred tax, therein: | (2 851) | (485) |
| - FX forward | 526 | (20) |
| - Forward for electricity | (3 377) | (465) |
| Other changes | | |
| Currency translation differences | - | - |
| Derecognition of deffered tax asset originally | - | (9 876) |
| Other reserves at the end of the reporting period | 9 217 | 1 388 |

## 30.5. Retained earnings and limits to its distribution

Retained earnings in consolidated financial statements may include amounts that are not subject to distribution i.e. cannot be distributed in the form of dividend. Statutory financial statements of Group subsidiaries are prepared in accordance with local national accounting standards (except of Arctic Paper Kostrzyn S.A.) and companies' articles of association. Dividends may be distributed to the parent company based on the net profits in the local financial statements prepared for statutory purposes. Such local definition of retained earnings available for distribution are very often different from the definition of retained earnings in accordance with IFRS, which can be one factor of limitation of profit distribution. For example, local legal regulations often require certain reserve capital to be created of profits for possible future losses. Different accounting policies might also create different results between statutory local accounts and accounts for consolidation purposes.

Dividends may be distributed based on the net profit reported in the standalone annual financial statements of Arctic Paper S.A. prepared for statutory purposes.

In accordance with the provisions of the Code of Commercial Companies, the parent company is required to create reserve capital for possible losses. Transferred to this capital category is 8% of profit for the given financial year recognised in the standalone financial statements of the parent company until such time as the balance of the reserve capital reaches at least one third of the share capital of the parent company. Appropriation of the reserve capital and other reserves depends on the decision of the General Meeting of Shareholders; however, the reserve capital in the amount of one third of the share capital may be used solely for the absorption of losses reported in the standalone financial statements of the parent company ad shall not be used for any other purpose.

Retained earnings/Accumulated losses presented in the balance sheet as at 31 December 2010 consist of the following items:

a) Accumulated losses in the amount of PLN 10,359 thousand.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

b) Profit for the year 2010 in the amount of PLN 28,816 thousand.

As at 31 December 2010 there are no other limitation concerning the payout of the dividend.

## 30.6. Minority interests

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| At the beginning of the period | 225 | 225 |
| Dividends paid by subsidiaries | - | - |
| Acquisition of a company | - | - |
| Changes in the shareholding structure of subsidiaries | - | - |
| Shares in subsidiaries' net profit or loss | - | - |
| At the end of the period | 225 | 225 |

# 31. Interest-bearing loans and borrowings

| Current liabilities | Maturity | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|---|
| **Other financial liabilities** | | | |
| Obligations under finance leases and hire purchase contracts | 15.01.2015 | 7 913 | 5 195 |
| Factoring in EUR in Heller Bank | 31.12.2010 | 2 606 | 1 368 |
| Other liabilities | 31.12.2011 | 575 | - |
| **Interest-bearing loans and borrowings:** | | | |
| BRE Bank bonds | 24.02.2011 | 68 723 | - |
| PLN bank overdraft in Bank Polska Kasa Opieki S.A. (current part) | 31.03.2011 | 41 260 | - |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (current part) | 23.10.2014 | 28 716 | 1 401 |
| SEK bank loan in Bank Polska Kasa Opieki S.A. (current part) | 31.12.2014 | 1 562 | 1 415 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (current part) | 23.10.2014 | 88 458 | 14 033 |
| SEK bank loan in Bank Svenska Handelsbanken | 31.12.2010 | 22 075 | - |
| EUR bank loan in Bank HypoVereinsbank | 30.03.2011 | 9 525 | |
| SEK bank loan in Accent Equity | 31.12.2010 | 31 792 | - |
| Total current financial liabilities | | 303 205 | 23 412 |

| Non-current | Maturity | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|---|
| **Other financial liabilities** | | | |
| Obligations under finance leases and hire purchase contracts | 15.01.2015 | 43 681 | 10 965 |
| **Interest-bearing loans and borrowings:** | | | |
| BRE Bank bonds | 25.02.2013 | 119 571 | - |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (current part) | 23.10.2014 | 10 210 | 38 676 |
| SEK bank loan in Bank Polska Kasa Opieki S.A. (current part) | 31.12.2014 | 10 083 | 10 540 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (current part) | 23.10.2014 | 52 841 | 145 429 |
| EUR bank loan in Bank HypoVereinsbank | 30.03.2011 | - | 9 464 |
| Total non-current financial liabilities | | 236 386 | 215 074 |

## 31.1. Loans and borrowings

On October 23, 2008 Arctic Paper S.A., Arctic Paper Kostrzyn S.A., Arctic Paper Munkedals AB and Arctic Paper Investment GmbH entered into a facility agreement with Bank Polska Opieki consisting of three tranches:

- SEK 300,000 thousand; repayment in 2009 as a result of an Initial Public Offering,
- EUR 10,000 thousand to be repaid in equal instalments over 5 years;
- PLN 196,400 thousand of which PLN 85,800 are to be repaid by instalments over 6 years and PLN 110,600 thousand to be repaid on termination in 3 years.

The purpose of the loans has been to: repay SEK 300,000 thousand promissory notes for the acquisition of Arctic Paper Munkedals AB and Arctic Paper sales offices; EUR 10,000 thousand to partly finance the acquisition of Mochenwangen Papier GmbH; PLN 196,400 thousand for refinancing of existing debt and providing working capital for the Arctic Paper S.A. Group further activities.

As a collateral for the repayment of the loan to Bank Polska Kasa Opieki S.A. the Company has pledge on all bank accounts as well as pledge of shares of Arctic Paper Kostrzyn, Arctic Paper Munkedals and Arctic Paper Investment GmbH.

Interest of loans and borrowings had by the Group as at 31 December 2010 was as follows:

- bank loan from Bank Polska Kasa Opieki S.A. – base rate EURIBOR increased by bank margin, which depends on net debt in relation to EBITDA for specified period (dependable from tranche and currency of the loan);
- agreement with Hypovereinsbank (in EUR) – effective rate equals 3,5%.

Up to 31 December 2010 the companies did the following currency translations of tranches drawn from Bank Polska Kasa Opieki S.A.:

- on 20 May 2009, a translation was made (at Arctic Paper Kostrzyn S.A. and Arctic Paper Munkedals AB) of PLN 81,000 thousand to EUR 18,716 thousand,
- on 25 May 2009, a translation was made (at Arctic Paper Mochenwangen) of PLN 33,000 thousand to EUR 7,498 thousand,
- on 25 June 2009, a translation was made (at Arctic Paper Munkedals AB) of PLN 18,435 thousand and EUR 6,967 thousand to SEK 122,052 thousand.
- on 30 October 2009, a translation was made (at Arctic Paper Kostrzyn S.A.) of PLN 18,260 thousand to EUR 4,400 thousand and (at Arctic Paper Munkedals) of SEK 87,635 thousand to EUR 8,500 thousand.

After finalization of IPO process, on 30 November 2009 the Company repaid tranche A1 of loan facility grantem by Bank Polska Kasa Opieki S.A. in the amount of SEK 300,000 thousand, which is an equivalent of PLN 120,450 thousand.

As at 31 December 2009 the Group repaid the following amounts of loans:

- PLN 139,349 thousand to Polska Kasa Opieki S.A. (PLN, EUR, SEK),
- EUR 5,000 thousand (PLN 22,371 thousand) to Baden-Württembergischen bank, and
- EUR 41 thousand (PLN 183 thousand) to Mr. Ernst Almquist.

There were three annexes to the loan agreement with Bank Polska Kasa Opieki S.A. signed during the reporting period:

- On 17 June 2010 the Company and its subsidiaries i.e. Arctic Paper Kostrzyn S.A., Arctic Paper Munkedals AB, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH signed with Bank Polska Kasa Opieki S.A. amendment agreement no. 4 to the facility agreement dated 23 October 2008. Under the amendment agreement Bank Polska Kasa Opieki S.A has obliged to provide, in addition to loans already provided in the Credit Agreement to the company Arctic Paper Kostrzyn overdraft facility (the "Facility C") to a maximum of PLN 50,000 thousand. Loan C will be used to finance current activity of Arctic Paper Kostrzyn. It was secured by joint capped mortgages to a maximum of PLN 100,000 thousand and a mandate for the bank accounts of Arctic Paper Kostrzyn conducted in Bank Polska Kasa Opieki SA.

- On 23 December 2010 the Company and its subsisiaries i.e. Arctic Paper Kostrzyn S.A., Arctic Paper Munkedals AB, Arctic Paper

Investment GmbH and Arctic Paper Mochenwangen GmbH signed amendment agreement no. 5 to facility agreement dated 23 October 2008. In the Amendment Agreement no. 5 Bank Polska Kasa Opieki S.A. agreed that net borrowings to EBITDA ratio calculated based on the consolidated financial statements for the annual periods ending on 30 September 2010 and on 31 December 2010 may exceed 3.5, provided however, that in respect to any such relevant period, the Net Borrowings will not at any time exceed 5.0 times EBITDA and EBITDA to Interest Expense ratio calculated based on consolidated financial statements for the year ended 31 December 2010 may be less than 3:1, provided however, that the ratio of EBITDA to Interest Expense for the relevant period ending on 31 December 2010 will not be less than 1.4:1.

Changes regarding above mentioned amendments agreements no. 4 and no. 5 have been fully described and published in currents reports no. 30/2010 dated 17.06.2010 and 34/2010 dated 24.12.2010.
During the reporting period the Group repaid the loan in Polska Kasa Opieki S.A in the amount of PLN 19,270 thousand (tranches in PLN, EUR, SEK).

Other changes in the value of loans as at 31 December 2010 compared to 31 December 2009 arose mainly from the balance sheet valuation and consolidation of AP Grycksbo.

## 31.2. Bonds

On 11 February 2010 a contract was concluded between Arctic Paper SA and BRE Bank SA (as an organizer of the issue dealer and payment and custodian agent), by which a Issue Programme of Arctic Paper SA Shares has been established.

On 25 February 2010, series 1/2010 coupon bonds and series 2/2010 zero-coupon bonds were issued. The total nominal value of the issued series 1/2010 and 2/2010 bonds is PLN 186 million. Net proceeds from the issue, up to the amount of PLN 150 million were used to finance part of the acquisition price paid for the 100% stake in Grycksbo Paper Holding AB. The remaining part of the net funds raised in the course of the issue allowed the Company to reduce the planned funding of its statutory business activity with bank loans.

Series 1/2010 bonds are the Coupon Bonds with the nominal value of PLN 100,000 per bond and quantity of 1200 bonds to be issued for the total nominal value of the series of PLN 120,000,000. The issue price of the bonds was set at PLN 100,000. The funds raised by the bond issue were used by the Group to acquire the 100% stake in Grycksbo Paper Holding AB. The interest rate of the coupon bond is composed of a WIBOR 6M and nominal margin. The redemption date is 25 February 2013.

Series 2/2010 bonds are the Zero-Coupon Bonds with the nominal value of PLN 100,000 per bond and quantity of 660 bonds to be issued for the total nominal value of the series of PLN 66,000,000. The issue price of the bonds was set at PLN 92,994.90. For 2/2010 series bonds no purpose for the issue was established. The interest rate of the coupon bond is composed of a one-year WIBOR and nominal margin. The redemption date is 24 February 2011.

Both series of issued bonds are bearer bonds, unsecured with pledge or mortgage on the objects and rights.

Information on the bond issue is included in current reports No. 6/2010 dated 11.02.2010 and 7/2010 dated 26.02.2010.

## 31.3. Collaterals

2010

- blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Fundusz Leasingowy S.A.,
- blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Leasing S.A.,
- blank bill of exchange, as collateral for the lease agreement concluded with Siemens Finance,
- warranty of blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Fundusz Leasingowy (EC),
- Pledge of shares of Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen in favor of Bank Polska Kasa Opieki S.A.
- assignments of rights from Insurance Policies of Arctic Paper Kostrzyn, and Arctic Paper Munkedals in favor of Bank Polska Kasa Opieki
- registered mortgages of value : 600 000 thousand of SEK, 171 600 thousand of PLN, 221 200 thousand of PLN, 20 000 thousand of EUR for Arctic Paper Kostrzyn, Arctic Paper Munkedals, and Arctic Paper Mochenwangen in favor of Bank Polska Opieki S.A.
- Registered pledges over the total assets of value: 600 000 thousand of SEK, 171 600 thousand of PLN, 221 200 thousand of PLN, 20 000 thousand of EUR for Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen in favor of Bank Polska Opieki S.A.
- joint capped mortgage as collateral for the loan C to a maxiumum amount of PLN 100,000 thousand over the property held in perpetual usufruct of Arctic Paper Kostrzyn, land registers no. GW1S/00027787/3, GW1S/00005360/1 and GW1S/00025698/5
- Emission rights with a carrying amount of EUR 1,420 thousand in favour of Hypovereinsbank.

2009

- blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Fundusz Leasingowy S.A.,
- blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Leasing S.A.,
- blank bill of exchange, as collateral for the lease agreement concluded with Siemens Finance,
- warranty of blank bill of exchange, as collateral for the lease agreement concluded with Bankowy Fundusz Leasingowy (EC),
- Pledge of shares of Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen in favor of Bank Polska Kasa Opieki S.A.
- Pledge on bank accounts of Arctic Paper SA, Arctic Paper Kostrzyn, Arctic Paper Munkedals,

Arctic Paper Mochenwangen in favor of Bank Polska Kasa Opieki S.A.

- Assignments of rights from Insurance Polisies of Arctic Paper Kostrzyn, and Arctic Paper Munkedals in favor of Bank Polska Kasa Opieki
- Registered mortgages of value : 600 000 thousand of SEK, 171 600 thousand of PLN, 221 200 thousand of PLN, 20 000 thousand of EUR for Arctic Paper Kostrzyn, Arctic Paper Munkedals, and Arctic Paper Mochenwangen in favor of Bank Polska Opieki S.A.
- Registered pledges on chattels and rights of value: 600 000 thousand of SEK, 171 600 thousand of PLN, 221 200 thousand of PLN, 20 000 thousand of EUR for Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen in favor of Bank Polska Opieki S.A.
- Emission rights with a carrying amount of PLN 5,834 thousand in favour of Hypovereinsbank.

# 32. Provisions

## 32.1. Movements In provisions

The table below presents movements In provisions in the years 2010-2009.

| | Post-employment benefits | Other provisions | Total |
|---|---|---|---|
| At 1 January 2010 | 20 433 | 10 957 | 31 390 |
| Acquisition of subsidiaries* | 44 518 | - | 44 518 |
| Recognised during the year | 4 862 | 12 517 | 17 379 |
| Utilised | (2 112) | (2 483) | (4 595) |
| Unused amounts reserved | - | (4 851) | (4 851) |
| Foreign exchange adjustment | 925 | 825 | 1 750 |
| At 31 December 2010, therein: | 68 626 | 16 965 | 85 591 |
| - current | - | 13 689 | 13 689 |
| - non-current | 68 626 | 3 277 | 71 902 |
| | | | |
| At 1 January 2009 | 18 635 | 11 627 | 30 262 |
| Acquistion of subsidiary | - | - | - |
| Recognised during the year | 2 057 | 7 765 | 9 822 |
| Utilised | (604) | (2 035) | (2 639) |
| Unused amounts reserved | - | (6 289) | (6 289) |
| Foreign exchange adjustment | 344 | (111) | 233 |
| At 31 December 2009, therein: | 20 433 | 10 957 | 31 389 |
| - current | - | 9 442 | 9 442 |
| - non-current | 20 432 | 1 516 | 21 948 |

*Value as at the acquisition date 1 March 2010

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The single largest item among other provisions are obligations to redeem emission rights with a carrying amount of PLN 6,290 thousnad in the financial year ended 31 December 2010 and PLN 7,734 in the financial year ended 31 December 2009.

## 32.2. Warranty provisions

A provision is recognised for expected warranty claims and returns of products, based on past experience of the level of repairs and returns. Warranty provision at the end of 2010 amounted to PLN 246 thousand, and related only to Arctic Paper Mochenwangen.

# 33. Trade and other payables, other liabilities, accruals and deferred income

## 33.1. Trade and other payables (short-term)

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Trade payables: | | |
| To related parties | 10 631 | 4 873 |
| To third parties | 309 884 | 133 950 |
| | 320 515 | 138 823 |
| Taxations, customs duty, social security and other payables | | |
| VAT | 2 333 | 3 063 |
| Excise tax | 323 | 299 |
| Personnel withholding tax (Personnel income tax) | 4 956 | 3 038 |
| Property taxes | 730 | 347 |
| Liabilities for social security contributions | 6 869 | 6 563 |
| Customs liabilities | 533 | 372 |
| | 15 744 | 13 682 |
| Other liabilities | | |
| Renumeration payable to employees | 3 904 | 3 671 |
| Pension liabilities | 8 111 | - |
| Investment liabilities | 11 295 | 10 739 |
| Environmental liabilities | 250 | 234 |
| Other liabilities | 1 075 | 1 048 |
| | 28 823 | 15 692 |
| TOTAL | 365 082 | 168 197 |

Terms and conditions of financial liabilities presented above:

- for terms and conditions of transactions with related parties, refer to note 36.3.
- trade payables are non-interest bearing and are normally settled within 60 days.
- other payables are non-interest bearing and have an average term of 1 months.

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- the amount which results from the difference between liabilities and VAT receivables is paid to appropriate tax authorities on a monthly basis.

## Accruals and deferred income

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Accruals | | |
| Employee costs | 46 997 | 28 753 |
| Audit and legal services | 927 | 778 |
| Freight costs | 3 623 | 660 |
| Marketing costs | - | 1 340 |
| Insurance costs | - | 637 |
| Claims | 917 | 668 |
| Other | 3 627 | 2 625 |
| | 56 089 | 35 461 |
| Deferred income | | |
| Grant from Ekofundusz | 22 332 | 23 736 |
| Grant from NFOŚiGW | 17 919 | 19 234 |
| Other | 76 | - |
| | 40 327 | 42 970 |
| TOTAL | 96 416 | 78 431 |
| - short-term | 58 889 | 38 182 |
| - long-term | 37 528 | 40 249 |

The main items included in accruals for employee costs are vacation pay liabilities, bonuses to employees and redundancy payments.

## 34. Capital commitments (audited)

At 31 December 2010, the Group has commitments of PLN 11,295 thousand for capital expenditures related to property, plant & equipment. These expenditures will be incurred for acquisition of new plant and equipment.

At 31 December 2009, the Group's commitments to purchase property, plant & equipment amounted to PLN 10,739 thousand.

## 35. Contingent liabilities

As at 31 December 2010, the Capital Group reported:

- a bill of exchange guarantee issued by the AP Kostrzyn S.A. to the amount of credit and lease agreement in favour of the National Fund for Environment Protection and Water Management in the amount of PLN 20,352 thousand, A detailed description was presented in these consolidated financial statement( Note 44.1)
- a bill of exchange in favour of Siemens Finance in the amount of PLN 819 thousand,

- a bill of exchange in favour of Bankowy Leasing in the amount of PLN 9,848 thousand,
- a guarantee of a bill of exchange in favour of Bankowy Fundusz Leasingowy in the amount of PLN 15,023 thousand,
- a guarantee commitment to FPG for the mutual life insurance company PRI in the amount of SEK 2,012 thousand,
- a bank guarantee in favour of Skatteverket Ludvika in the amount of SEK 135 thousand.

On 25 March 2010 Company issued a guarantee for Cartiere del Garda S.P.A. – supply of paper distribution companies (Arctic Paper Sweden AB, Arctic Paper Danmark A/S, Arctic Paper Norge AS). The guarantee amounted to EUR 900 thousand and is valid until 31 December 2012.

As at 31 December 2009, the Capital Group reported:

- a bill of exchange guarantee issued by the Group to the amount of credit and lease agreement in favour of the National Fund for Environment Protection and Water Management in the amount of PLN 20,352 thousand,
- a bill of exchange in favour of Siemens Finance in the amount of PLN 819 thousand,
- a bill of exchange in favour of Bankowy Leasing in the amount of PLN 9,848 thousand,
- a guarantee of a bill of exchange in favour of Bankowy Fundusz Leasingowy ( EC) in the amount of PLN 15,023 thousand,
- a guarantee commitment to FPG for the mutual life insurance company PRI in the amount of SEK 500 thousand,
- a bank guarantee in favour of Skatteverket Ludvika in the amount of SEK 66 thousand.

## 35.1. Legal claims

### Court case against Cezex Sp. z o.o.

On 8 October 2009 and on 27 november 2009 Arctic Paper Kostrzyn S.A. filed a claims against Cezex Sp. z o.o. with the District Court in Gorzów Wielkopolski.

The value of the dispute includes

- the principal of PLN 11,240 thousand and interest of PLN 325 thousand accrued till the date of filing the claim.
- The principal of PLN 174 thousand and interest of PLN 2 thousand.

The case pertains to the failure of Cezex Sp. z o.o. to pay its liability to Arctic Paper Kostrzyn S.A. for the purchase of goods in the period from 11 February 2009 to 1 July 2009. Receivables from Cezex Sp. z o.o. were secured in favour of Arctic Paper Kostrzyn S.A. by mortgage on the counterparty's real property. Moreover, a allowance for doubtful debts was established for their entire value.

On 21 December 2009 the court declared bankruptcy of Cezex Sp. z o.o. with an option of concluding a settlement by the parties. According to the initial settlement proposals, amounts due to Arctic Paper Kostrzyn S.A. will be covered by a separate agreement providing for their full repayment, because the receivables secured with mortgage on the real property owned by Cezex Sp. z o. o. are not covered by the settlement.

On 23 August 2010 Arctic Paper Kostrzyn filed for bankruptcy liquidation for Cezex Sp.z.o.o.

As at 31 December 2010 the Group has established an allowance for doubtful debts for the full value of receivables from Cezex Sp. z o.o.

### Court case against Jakon S.A. in liquidation

On 15 April 2010 a lawsuit was filed against Jakon SA in liquidation and Jan Dziedzic, the lawsuit includes a claim of Arctic Paper Kostrzyn SA against Jakon SA in liquidation.

The claim concerns the total receivable amounting to PLN 2,004 thousand. This claim is secured by a mortgage on the property of a guarantor Mr Jan Dziedzic to the amount of PLN 2,000 thousand. On 07 February 2011 a liquidation bankruptcy was announced in relation to Jakon S.A. Currently there are proceedings held against Jan Dziedzic as a guarantor. The Court issued the payment order in the writ-of-payment proceedings.

As at 31 December 2010 the Group has established an allowance for doubtful debts for the full value of receivables from Jakon S.A. in liquidation.

### Court case against PGNiG S.A.

On 26 August 2010 Arctic Paper Kostrzyn S.A. entered into claim regarding setting the sales prices for gas fuel sold to Arctic Paper Kostrzyn S.A. by PGNiG S.A. The legal case is heard by the Court of Arbitration at the Polish Chamber of Commerce. The claim is based on the provisions of the contract between Arctic Paper Kostrzyn S.A. and PGNiG S.A. which state that when the gas price increases by more than 10% in the given contract year the Company is allowed to submit request to renegotiate the prices with PGNiG S.A. and to refer the matter for final settlement to the arbitration court.

As at 31 December 2010 Group companies are not parties to any other lawsuits.

## 35.2. Tax settlements

### Arctic Paper Kostrzyn S.A.

Arctic Paper Kostrzyn S.A. has been conducting business in the Kostrzynsko-Słubicka Specjalna Strefa Ekonomiczna (KSSSE) business zone since 25 August 2006. In 2008, the accounting records of the Company were subject to a tax inspection regarding operations in Kostrzyńsko-Słubicka Special Economic Zone. The Tax Audit Authority (UKS) inspectors challenged the method of dividing income into taxable and exempt from taxation. AP Kostrzyn did not agree with this approach and filed an appeal to the Tax Chamber.

On 15 October 2010, AP Kostrzyn received a decision of the Head of the Tax Office in Zielona Góra which reversed the decision of the tax office of the first instance in its entirety and ordered to discontinue the underlying proceedings.

The above positive decision causes elimination of the previous risk concerning tax settlements at Arctic Paper Kostrzyn S.A. operating in the KSSSE.

This event had no impact on the financial result. Given the above, the Company’s Management Board made no decision to make provisions related to the results of the tax inspection.

Tax settlements, together with other areas of legal compliance (e.g. customs or foreign exchange law) are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. The lack of reference to well established regulations in Poland results in a lack of clarity and integrity in the regulations. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems.

Tax authorities may examine the accounting records within up to five years after the end of the year in which the final tax payments were to be made. Consequently, the Group may be subject to additional tax liabilities, which may arise as a result of additional tax audits.In Group's opinion as at 31 December 2010 proper provision was created to cover recognized and countable tax risk.

## 36. Related party disclosures

Arctic Paper S.A. Group's related parties are:

- Arctic Paper AB – parent company of Arctic Paper S.A. Group,
- Arctic Paper Håfreströms – paper mill (within the proces of liquidation), subsidiary of Arctic Paper AB.
- Rottneros – group of entities, operating in pulp-paper industry, related with Nemus Holding AB.

The table below presents the total values of transactions with related parties entered into during the years 2009-2010:

Data for the period from 1 January 2010 to 31 December 2010 and as at 31 December 2010 (PLN thousands)

| Related party | Sales to related parties | Purchases from related parties | Interest – financial income | Interest – financial costs | Receivables from related parties | Loans granted | Payables to related parties |
|---|---|---|---|---|---|---|---|
| Arctic Paper AB | 322 | 801 | 312 | - | 3 570 | - | - |
| Arctic Paper Håfreström | 691 | (2) | - | - | 6 245 | - | 27 |
| Rottneros | - | 54 479 | - | - | - | - | 10 604 |
| Total | 1 013 | 55 278 | 312 | - | 9 815 | - | 10 631 |

Data for the period from 1 January 2009 to 31 December 2009 and as at 31 December 2009 (PLN thousands)

| Related party | Sales to related parties | Purchases from related parties | Interest – financial income | Interest – financial costs | Receivables from related parties | Loans granted | Payables to related parties |
|---|---|---|---|---|---|---|---|
| Arctic Paper AB | 46 | 5 747 | 294 | 4 | 3 573 | 20 000 | 74 |
| Arctic Paper Håfreström | 7 963 | 493 | - | - | 5 764 | - | 1 259 |
| Rottneros | - | 53 713 | - | - | - | - | 3 540 |
| Total | 8 009 | 59 953 | 294 | 4 | 9 337 | 20 000 | 4 873 |

### 36.1. The ultimate parent

The ultimate parent of the Group is Casandrax Financials S.A. There were no transactions between the Group and Casandrax Financials S.A. during the years ended 31 December 2010 and 31 December 2009.

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## 36.2. Parent company

The parent company of the Arctic Paper S.A. Group is Arctic Paper AB, which as of 31 December 2010 holds 75% of ordinary shares in Arctic Paper S.A.

## 36.3. Terms and conditions of transactions with related parties

Trade receivables and payables are normally settled within 60 days with related parties. Related party transactions are made at an arm's length.

## 36.4. Remuneration of the Group's key management personnel

### 36.4.1. Remuneration paid or due to the members of the Management Board and the memebers of the Supervisory Board

Key management personnel as at 31 December 2010 comprise four persons: President of the Management Board and three Members of the Management Board. The financial data for the reporting period include remuneration of the aforesaid four persons.

Remuneration of the executives during the 12-month period ended 31 December 2010 amounted to PLN 4,970 thousand (PLN 3,174 thousand during the 12-month period ended 31 December 2009).

On 14th December 2010 the Supervisory Board decided to dismiss Mr Kent Bjarne Björk from the Management Board of the Company. The dismissal takes effect from 31 December 2010. During the period covered by these consolidated financial statements, no entities within the Group granted any loans to their executives and no such items were reported in the comparative period.

The following table presents remuneration of key management personnel:

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Short-term employee benefits | 4 970 | 3 174 |
| Pension and medical benefits after employment | - | - |
| Termination benefits | 3 103 | - |
| Total remuneration paid to the key management personnel | 8 073 | 3 174 |

### 36.4.2. Directors' interests (including members of Management and Supervisory Boards) in employee share incentive plan

On 30 July 2009 the Extraordinary General Shareholders' Meeting adopted the resolutions number 4 on approving the assumptions of an incentive programme for key managers, consisting of the opportunity to acquire free-of-charge subscription warrants that will enable the holders to take up series D shares with excluded pre-emptive rights.

In spite of the resolution of the Special General Shareholders' Meeting dated 30 July 2009 relating to assumption of Key Management motivation program, till the date of these financial statements there have been no Program Participation Agreements executed .

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## 36.5. Director's loan

During the period covered by these consolidated financial statements, no entities within the Group granted any loans to members of the Management Board and no such receivables were reported in any of the periods presented.

## 36.6. Other transactions with the Managament Board's members

During the period covered by these consolidated financial statements, there were no other transactions between subsidiaries and the Management Board members and no such transactions were reported in any of the periods presented.

# 37. Information about the contract and remuneration of auditor or audit company

On 23 August 2010 the Company executed an agreement with Ernst & Young Audit Sp. z.o.o. with registered office in Warsaw to audit the annual standalone financial statements of the Company and the annual consolidated financial statements of the Group for the year ended 31 December 2010.

The table below presents the remuneration of the audit company's, paid or payable for the year ended 31 December 2010 and 31 December 2009 by category of services:

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Accruals | | |
| Employee costs | 190 | 209 |
| Audit and legal services | 43 | 87 |
| Accruals for price adjustment | - | - |
| Freight costs | 65 | 689 |
| Insurance costs | 298 | 985 |

* - relates to Ernst&Young Audit Sp. z o.o

The fees do not include services provided to other Group companies.

# 38. Financial risk management objectives and policies

The Group's principal financial instruments comprise bank loans, finance leases and hire purchase contracts, cash and short-term deposits. The main purpose of these financial instruments is to raise finance for Group operations. The Group has various other financial instruments such as trade debtors and trade creditors, which arise directly from operations. The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk. The Management Board reviews and agrees policies for managing each of these risks and they are summarised below.

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During the year ended 31 December 2009 the currency of selected financing tranches was converted, as described in detail in these financial statements. The above changes aimed to better matching of the structure of liabilities used by the Group and the structure of asseets expressed in foreign currency. In the opinion of the Management Board, these changes reduce the risk of unfavourable impact of the exchange rate fluctuations on the profit of the Arctic Paper Group.

## Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations.

### Interest rate risk – sensitivity to changes

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings). Included in the calculation are foreign currency loans with variable interest rate. For each currency, the same increase in interest rate, i.e. by 1pp, was adopted. At the end of each reporting period, loans and borrowings were grouped by currency and on each total currency value and increase of 1pp was calculated. Change of interest rate didn't have direct impact on the Group's equity.

| | Increase in basis points | Effect on profit before tax |
|---|---|---|
| Year ended 31 December 2010 | | |
| PLN | +1% | (155) |
| EUR | +1% | (718) |
| SEK | +1% | (1 096) |
| | | |
| Year ended 31 December 2009 | | |
| PLN | +1% | (562) |
| EUR | +1% | (1 595) |
| SEK | +1% | (120) |

## 38.1. Foreign currency risk

The Group is exposed to transactional foreign currency risk. The risk arises from transactions run by an operating unit in currencies other than its functional currency.

The following table demonstrates the sensitivity of profit before tax and total comprehensive income on reasonably possible change of exchange rate of USD, EUR, GBP and SEK with all other variables held constant. In the estimation were taken every balance positions measured in foreign currencies, than for every currency was adopted an increase or decrease of 5% in exchange rate. At the end of each reporting period assets and liabilities were grupped in the same currencies and for every currency balance "assets deduct liabilities" an increase or decrease of 5% in exchange rate were counted. During the year assets and liabilities measured in foreign currencies remained at comparable level.

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2010

| Impact of change in exchange rates on profit before tax | FX rate increase | Total financial impact | FX rate decrease | Total financial impact |
|---|---|---|---|---|
| PLN – EUR | +5% | (742) | -5% | 742 |
| PLN – USD | +5% | (432) | -5% | 432 |
| PLN – GBP | +5% | 259 | -5% | (259) |
| PLN – SEK | +5% | 180 | -5% | (180) |
| SEK – EUR | +5% | 2 932 | -5% | (2 932) |
| SEK – USD | +5% | (3 114) | -5% | 3 114 |
| SEK – GBP | +5% | 1 035 | -5% | (1 035) |
| EUR - GBP | +5% | 113 | -5% | (113) |

| Impact on total comprehensive income (on foreign entities translation) | FX rate increase | Total financial impact | FX rate decrease | Total financial impact |
|---|---|---|---|---|
| PLN – SEK | +5% | 4 593 | -5% | (4 593) |
| PLN – USD | +5% | 4 398 | -5% | (4 398) |

2009

| Impact of change in exchange rates on profit before tax | FX rate increase | Total financial impact | FX rate decrease | Total financial impact |
|---|---|---|---|---|
| PLN – EUR | +5% | (846) | -5% | 846 |
| PLN – USD | +5% | (87) | -5% | 87 |
| PLN – GBP | +5% | 226 | -5% | (226) |
| PLN – SEK | +5% | 437 | -5% | (437) |
| SEK – EUR | +5% | 513 | -5% | (513) |
| SEK – USD | +5% | 28 | -5% | (28) |
| SEK – GPB | +5% | 750 | -5% | (750) |

| Impact on total comprehensive income (on foreign entities translation) | FX rate increase | Total financial impact | FX rate decrease | Total financial impact |
|---|---|---|---|---|
| PLN – SEK | +5% | 5 319 | -5% | (5 319) |
| PLN – EUR | +5% | 911 | -5% | (911) |

## 38.2. Commodity price risk

The Group is exposed to the risk of drop in selling price due to higher market competition and due to therestricted access to commodities on the market.

## 38.3. Credit risk

The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The Group assesses and recognizes all receivables which are not overdue and which are not subject to impairment write-downs as recoverable.

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With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents and available-for-sale financial assets the Group's exposure to credit risk arises from default of the counter party, with a maximum exposure equal to the carrying amount of these instruments.

There are no significant concentrations of credit risk within the Group.

## 38.4. Liquidity risk

The Group monitors its risk to a shortage of funds using a recurring liquidity planning tool. This tool considers the maturity of both its financial investments and financial assets (e.g. accounts receivables, other financial assets) and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of various sources of financing, such as bank overdrafts, bank loans, finance leases and hire purchase contracts.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2010 and 31 December 2009 based on contractual undiscounted payments.

| As at 31 December 2010 | On demand | Less than 3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Interest bearing loans and borrowings | 2 063 | 103 419 | 202 176 | 215 297 | - | 522 955 |
| Financial leasing | - | 1 578 | 6 994 | 15 379 | 28 531 | 52 482 |
| Trade and other payables | 2 704 | 352 056 | 3 004 | - | 2 929 | 360 692 |
| | 4 767 | 457 053 | 212 174 | 230 676 | 31 460 | 936 130 |

| As at 31 December 2009 | On demand | Less than 3 months | 3-12 months | 1-5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Interest bearing loans and borrowings | - | 6 488 | 19 359 | 215 867 | - | 241 714 |
| Financial leasing | - | 751 | 4 904 | 11 251 | - | 16 906 |
| Trade and other payables | - | 166 451 | 1 746 | - | - | 168 197 |
| | - | 173 690 | 26 009 | 227 118 | - | 426 817 |

# 39. Financial instruments

The Group does not have any material financial instruments except cash on hand and cash in bank, loans and borrowings, receivables and liabilities, as well as currency forward contract and electricity purchase contract.

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## 39.1. Fair values of each class of financial instruments

Due to the fact that the carrying amounts of financial instruments do not materially differ from their fair values, the table below shows financial instruments by class and category of financial assets and liabilities.

| | Category according to IAS 39 | Book value As at 31 December 2010 | Book value As at 31 December 2009 | Fair value As at 31 December 2010 | Fair value As at 31 December 2009 |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Granted loans | *L&R* | 20 600 | 20 000 | 20 600 | 20 000 |
| Trade and other receivables | *L&R* | 242 622 | 214 873 | 242 622 | 214 873 |
| Hedging instruments* | | 11 917 | 1 388 | 11 917 | 1 388 |
| Other financial assets (excluding loans and hedging intruments) | *L&R* | 919 | 960 | 919 | 960 |
| Cash and cash equivalents | *FVTPL* | 179 402 | 140 115 | 179 402 | 140 115 |
| **Financial Liabilities** | | | | | |
| Interest bearing bank loans and borrowings therein: | *OFL* | 296 522 | 222 326 | 296 522 | 222 326 |
| - long-term interest-bearing with variable interest rate | *OFL* | 73 134 | 211 495 | 73 134 | 211 495 |
| - other short-term | *OFL* | 223 388 | 10 831 | 223 388 | 10 831 |
| Liabilities form financial leasing title and lease agreement with purchase option, therein: | | 51 594 | 16 160 | 51 594 | 16 160 |
| - long-term | | 43 681 | 10 965 | 43 681 | 10 965 |
| - short-term | | 7 913 | 5 195 | 7 913 | 5 195 |
| Trade and other financial and non-financial payables | | 349 338 | 154 515 | 349 338 | 154 515 |
| Hedging instruments | *OFL* | 373 | - | 373 | |
| Debt securities, therein: | *OFL* | 188 294 | - | 188 294 | - |
| - long-term Coupon bonds | *OFL* | 119 571 | - | 119 571 | - |
| - short-term Zero-Coupon bonds | *OFL* | 68 723 | - | 68 723 | - |

*Hedging instruments meeting the requirements of hedge accounting

Used abbreviations:

HTM – Financial assets held to maturity
FVTPL – Financial assets/liabilities measured at fair value through profit & loss
L&R – Loans and receivables
AFS – Other financial liabilities measured at amortized cost
OFL – Other financial liabilities measured at amortized cost

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As at 31 December 2010 and 31 December 2009 the Group had the following financial instruments valued at fair value:

| | 31 December 2010 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets valued in fair value through profit and loss | | | | |
| Hedging instruments | | - | 11 917 | - |
| Financial liabilities valued in fair value through profit and loss | | | | |
| Hedging instruments | | | 373 | |

| | 31 December 2009 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Financial assets valued in fair value through profit and loss | | | | |
| Hedging instruments | | - | 1 388 | - |
| Financial liabilities valued in fair value through profit and loss | | | - | |
| Hedging instruments | | | | |

## 39.2. Interest rate risk

The following table sets out the carrying amount, by maturity, of the Group's financial instruments that are exposed to interest rate risk:

| 31 December 2010<br>Floating rate | <1 year | 1-2 years | 2-3 years | 3-4 years | 4-5 years | >5 years | Total |
|---|---|---|---|---|---|---|---|
| **Other financial liabilities** | | | | | | | |
| Obligations under finance lease and hire purchase contracts | 7 913 | 7 688 | 2 425 | 2 482 | 2 536 | 28 550 | 51 594 |
| **Loans and borrowers:** | | | | | | | |
| Bonds in Bank BRE | 68 723 | - | 119 571 | - | - | - | 188 294 |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (A2) | 1 398 | 2 298 | 2 314 | 5 598 | - | - | 11 608 |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (B) | 27 318 | - | - | - | - | - | 27 318 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (A2) | 5 769 | 8 906 | 8 906 | 19 545 | - | - | 43 126 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (B) | 72 874 | - | - | - | - | - | 72 874 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (A3) | 9 810 | 7 746 | 7 738 | - | - | - | 25 294 |
| SEK bank loan in Bank Polska Kasa Opieki S.A. (A2) | 1 562 | 2 366 | 2 366 | 5 351 | - | - | 11 645 |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (C) | 41 260 | - | - | - | - | - | 41 260 |
| SEK bank loan in Bank Svenska Handelsbanken | 22 075 | - | - | - | - | - | 22 075 |
| EUR bank loan in Bank HypoVereinsbank | 9 525 | - | - | - | - | - | 9 525 |
| SEK bank loan in Accent Equity | 31 792 | - | - | - | - | - | 31 792 |
| Sum loans and borrowers | 292 106 | 21 316 | 140 895 | 30 495 | - | - | 484 811 |
| TOTAL | 300 019 | 29 004 | 143 319 | 32 977 | 2 536 | 28 550 | 536 405 |

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| 31 December 2009<br>Floating rate | <1 year | 1-2 years | 2-3 years | 3-4 years | 4-5 years | >5 years | Total |
|---|---|---|---|---|---|---|---|
| **Other financial liabilities** | | | | | | | |
| Obligations under finance lease and hire purchase contracts | 5 195 | 5 582 | 5 383 | - | - | - | 16 160 |
| **Loans and borrowers:** | | | | | | | |
| Loan granted to Arctic Paper AB | 20 000 | - | - | - | - | - | 20 000 |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (A2) | 1 401 | 844 | 2 307 | 2 322 | 5 603 | - | 12 477 |
| PLN bank loan in Bank Polska Kasa Opieki S.A. (B) | - | 27 600 | - | - | - | - | 27 600 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (A2) | 5 997 | 5 980 | 9 254 | 9 254 | 21 247 | - | 51 732 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (B) | - | 75 596 | - | - | - | - | 75 596 |
| EUR bank loan in Bank Polska Kasa Opieki S.A. (A3) | 8 036 | 8 036 | 8 036 | 8 027 | - | - | 32 134 |
| SEK bank loan in Bank Polska Kasa Opieki S.A. (A2) | 1 415 | 1 405 | 2 144 | 2 143 | 4 848 | - | 11 955 |
| Sum loans and borrowers | 36 849 | 119 461 | 21 740 | 21 747 | 31 697 | - | 231 495 |
| TOTAL | 42 044 | 125 043 | 27 123 | 21 747 | 31 697 | - | 247 655 |

## 39.3. Hedge accounting

As at 31 December 2010 the Group used cash flow hedge accounting for the following hedging relations:

- On 11 December 2009 Arctic Paper Kostrzyn S.A. designated for cash flow hedge accounting the FX forward derivatives hedging part of the proceeds in EUR related to export sales;
- On 1 October 2009 Arctic Paper Munkedals AB designated for cash flow hedge accounting the forward electricity derivatives hedging the future purchases of electricity.
- On December 2006 Arctic Paper Grycksbodecignated for the Cash flow hedge accounting the forward electricity derivatives hedging the future purchases of electricity.
- On 27 May 2010 Arctic Paper Grycksbo AB designated for cash flow hedge accounting the FX forward aimed at securing foreign currency portion of the proceeds from the SEK related to export sales.

### 39.3.1. Cash flow hedge accounting

As at 31 December 2010 the Group held FX forward contract and forward contract to purchase electricity, as cash flow hedge instruments

## The hedging relationship in the cash flow hedge accounting on the currency trading with the use of FX forward

The table below presents detailed information concerning the hedging relationship in the cash flow hedge accounting on the sales EUR/USD:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | |
|---|---|
| Hedge type | Hedging the cash flow variations related to the planned sales in foreign currencies |
| Hedge item | Hedged item is part of the future highly probably cash flows resulting from export sales |
| Hedging instruments | Hedging instruments are FX forward transactions in which the Company commits to sell EUR for USD |
| Forward contract parameters | |
| Trade date | depending on the contract, since 20.09.2010 till 18.10.2010 |
| Delivery date | depending on the contract, since 27.01.2011 till 28.04.2011 |
| Hedged amount | 23.2 mln EUR |
| Forward ratio | from 1,3005 to 1,3840 |

The table below presents detailed information concerning the hedging relationship in the cash flow hedge accounting on the sales GBP/ SEK:

| | |
|---|---|
| Hedge type | Hedging the cash flow variations related to the planned sales in foreign currencies |
| Hedge item | Hedged item is part of the future highly probably cash flows resulting from export sales |
| Hedging instruments | Hedging instruments are FX forward transactions in which the Company commits to sell GBP for SEK |
| Forward contract parameters | |
| Trade date | depending on the contract, since 29.10.2010 till 31.10.2010 |
| Delivery date | depending on the contract, since 29.01.2011 till 30.03.2011 |
| Hedged amount | 5.4 mln GBP |
| Forward ratio | 10,7200 |

## The hedging relationship in the cash flow hedge accounting on the electricity purchase with the use of forward transactions

The table below presents detailed information concerning the hedging relationship in the cash flow hedge accounting on the electricity purchase with the use of forward transactions:

| | |
|---|---|
| Hedge type | Hedging the cash flow variations related to electricity purchases |
| Hedge item | Hedged item is part of the future highly probably cash flows resulting from electricity purchases |
| Hedging instruments | Hedging instruments are forward transactions for electricity purchases on the Nord Pool Stock Exchange |
| Forward contract parameters | |
| Trade date | depending on the contract, since 01.12.2006 |
| Delivery date | depending on the contract, untill 31.12.2013 |
| Hedged amount | 285.073 MWh |
| Forward price | from 34.50 to 44,80 EUR/MWh |

The table below presents the fair value of hedging derivatives in the cash flow hedge accounting as at 31 December 2010 and the comparable data:

| | As at 31 December 2010 | | As at 31 December 2009 | |
|---|---|---|---|---|
| | (audited) | (audited) | (audited) | (audited) |
| | Assets | Liabilities | Assets | Liabilities |
| FX forward | 306 | 373 | 104 | - |
| Electricity forward | 11 611 | - | 1 770 | - |
| Total hedging derivatives | 11 917 | 373 | 1 874 | - |

The table below presents the nominal value of hedging derivatives as at 31 December 2010:

| | Up to 1 month | 1 to 3 months | 3 months to 1 year | 1 to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| FX forward: | | | | | | |
| Currency purchased (in USD thousand) | 4 855 | 18 198 | 7 804 | - | - | 30 857 |
| Currency sold (in EUR thousand) | 3 600 | 13 600 | 6 000 | - | - | 23 200 |
| Currency purchased (in SEK thousand) | - | 57 888 | 19 296 | - | - | 77 184 |
| Currency sold (in GBP thousand) | 1 800 | 3 600 | - | - | - | 5 400 |
| Electricity forward: | | | | | | - |
| Electricity purchased (in PLN thousand) | 352 | 4 881 | 18 474 | 43 381 | - | 67 088 |

The table below presents cash flow hedge accounting amounts which were recognized by the Group in 2010 in the profit and loss account and in the statement of comprehensive income:

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| | Year ended 31 December 2010 (audited) |
|---|---|
| Revaluation reserve capital as at 31 December 2010 - revaluation to fair value of hedging derivatives on account of the hedged risk, corresponding to the effective hedging | 9 217 |
| Inefective part of the revaluation to fair value of hedging derrivatives on account of the hedged risk, captured in financial income or expenses | - |
| Period, in which the hedged cash flows are expected to occur | 31 December 2010 - 31 December 2013 |

The table below presents changes in the revaluation reserve capital on account of cash flow hedge accounting in 2010:

| | Year ended 31 December 2010 (audited) |
|---|---|
| Revaluation reserve capital as at 1 January 2010 | 1 388 |
| Deferral of revaluation to fair value of hedging derivatives on account of the hedged risk, corresponding to the effective hedge | 7 829 |
| Amount of the deferred revaluation to fair value of hedging derivatives on account of the hedged risk, removed from revaluation reserve capital and transferred to financial income or expenses | - |
| Revaluation reserve capital as ast 31 December 2010 | 9 217 |

## 40. Capital management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximise shareholder value.

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years end 31 December 2010 and 31 December 2009.

The Group monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Group's policy is to keep the gearing ratio between 10% and 30%. The Group includes within net debt, interest bearing loans and borrowings, trade and other payables, less cash and cash equivalents, excluding discontinued operations.

Compared to 2009 financial statement for 2009 there was a significant change of leverage ratio.

In 2010 leverage ratio represented 52% (2009: 30%). This increase is related to the issuance of bonds which took place in February 21, entered into an overdraft in Arctic Paper Kostrzyn S.A. as well as exclusion from March 2010 Arctic Paper Grycksbo and assumption of liabilities by the group. In April 2010 Arctic Paper Grycksbo AB signed also a agreement of financial leasing.

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| Arctic Paper S.A. Group | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Interest bearing loans and borrowings | 539 590 | 238 487 |
| Trade and other payables | 365 082 | 168 197 |
| Less cash and short term deposits | (179 402) | (140 115) |
| Net debts | 725 270 | 266 569 |
| Equity | 667 943 | 618 035 |
| Capital and net debt | 1 393 213 | 884 604 |
| Gearing ratio | 0,52 | 0,30 |

## 41. Employment structure

The average employment in the Group in the years ended 31 December 2010, 31 December 2009 was as follows:

| | As at 31 December 2010 (audited) | As at 31 December 2009 (audited) |
|---|---|---|
| Management Board of the parent entity | 3 | 3 |
| Management Boards of subsidiary companies | 25 | 27 |
| Administration department | 150 | 117 |
| Sales department | 199 | 169 |
| Production department | 1 081 | 690 |
| Other | 138 | 135 |
| Total | 1 596 | 1 141 |

## 42. CO2 Emission rights

Arctic Paper Kostrzyn S.A., Arctic Paper Munkedals AB and Arctic Paper Mochenwangen GmbH are all part of the European Union Emission Trading Scheme. The current trading period lasts from 1 January 2008 to 31 December 2012. The tables below specify the allocation and usage of emission rights by each of the three entities.

| (in tonnes) for Arctic Paper Kostrzyn S.A. | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Amount granted | 208 448 | 208 448 | 208 448 | 208 448 | 208 448 |
| Amount used | 109 937 | 131 094 | 143 661* | - | - |
| Amount purchased | - | 14 000 | 47 800 | - | - |
| Amount sold | - | 74 000 | 45 043 | - | - |
| Amount unused | 98 511 | 17 354 | 67 544 | - | - |

Consolidated financial statements for the year ended 31 December 2010 PLN thousand

| (in tonnes) for Arctic Paper Munkedals AB | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Amount granted | 14 011 | 14 011 | 14 011 | 14 011 | 14 011 |
| Amount used | 28 234 | 38 066 | 42 775 | - | - |
| Amount purchased | - | 7 400 | 19 200 | - | - |
| Amount sold | - | - | 11 940 | - | - |
| Amount unused | - | - | - | - | - |

| (in tonnes) for Arctic Paper Mochenwangen GmbH | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Amount granted | 118 991 | 118 991 | 118 991 | 118 991 | 118 991 |
| Amount used | 112 543 | 105 587 | 109 839 | - | - |
| Amount purchased | 100 000 | - | - | - | - |
| Amount sold | 100 180 | 19 500 | - | - | - |
| Amount unused | 6 448 | - | 9 152 | - | - |

| (in tonnes) dla Arctic Paper Grycksbo AB | 2010 | 2011 | 2012 |
|---|---|---|---|
| Amount granted | 69 411* | 69 411 | 69 411 |
| Amount used | - | - | - |
| Amount purchased | - | - | - |
| Amount sold | 69 400 | - | - |
| Amount unused | 11 | - | - |

* - volume as at the acquisition date (1 March 2010)

On 1 December 2008 Artic Paper Mochenwangen GmbH (AP MW) carried out a swap of Certified Emission Reductions (CERs) in exchange of European Union Emission Allowances (EUAs). In this swap, AP MW received 100.000 CERs and EUR 776 thousand in cash in exchange of 100.000 EUAs which were received (granted) from the government.

On 1 December 2008 AP MW sold 100.000 CERs received in the transaction described above to a bank (Bayerische Hypo- und Vereinsbank AG, Munich) for EUR 2,200 thousand. AP MW is obliged to repurchase 100.000 CERs on 30 March 2011 at EUR 2,430 thousand (Maturity SWAP CER/CER). Since AP MW is obliged to repurchase 100.000 CERs for a fixed price there has been no transfer of risks and rewards of ownership of the CERs to the bank. Due to this fact AP MW has not recognized the revenue from the sale (IAS 18.14). The cash received (EUR 2,200 thousand) was recorded as a non-current interest bearing loan. The 100.000 CERs are recognised as intangible assets at cost (fair value of the CERs at date of transaction).

As a consequence of recognition of emission rights granted to Mochenwangen as a result of purchase price allocation, as described in note 24, at 31 December 2008 the Group recognized provision for actual consumption of CO2 in the amount of PLN 7,706 thousand. Provision as at 31 December 2010 amounted to PLN 6,922 thousand and as at 31 December 2009 amounted to PLN 6,845 thousand.

## 43. Cogeneration certificates

Based on the provisions of article 9l paragraph 1 point 1 of the act dated 10 April 1997, Energy Law, Arctic Paper Kostrzyn S.A. obtained property rights to the Certificates of Origin being the confirmation of the amount of energy produced in the heavy duty (high performance) cogeneration unit using the gas fuels.

Due to producing electric energy in cogeneration, in 2010 the Group received the rights in the amount of kWh 219,420,350 (in 2009 kWh 177,534,396). In 2010, revenues from sale of cogeneration certificates amounted to PLN 26,890 thousand (in 2009 PLN 21,722 thousand). The certificates of cogeneration corresponding to the energy produced are recognized as reduction of cost of sales in the income statement.

## 44. Government grants and subsidies

### 44.1. Subsidy from the Ekofundusz Foundation

On 06 July 2006 the Company signed agrement with Ekofundusz Foundation for financial support were assigned for the projects in the field of natural environment protection realised as part of foreign debt conversion, in accordance with the agreement concerning reduction and restructuring of debt of the Republic of Poland. As part of this agreement, the Company received PLN 7,482 thousand for the project. „budowa elektrociepłowni gazowej w Arctic Paper Kostrzyn S.A.”. As at the date of the preparation of these condensed consolidated financial statements, the construction of the new power station was in progress.

The transfer of the funds to the Group’s account was as follows: PLN 1,401 thousand on 1 August 2006, PLN 3,705 thousand on 3 November 2006, PLN 2,375 thousand on 20 December 2006. The financial support was granted to the company and the company committed to comply with the specific conditions, the realization of which may be subject to control, within 3 years of handing the Project over for use, by appropriate authorities authorized to issue a decision under which the subsidy granted and received may have to be returned together with interest.

On 02 october 2008 the company signed agrement with Ekofundusz Foundation for financial support were assigned for the projects in the field of natural environment protection realised as part of foreign debt conversion, in accordance with the agreement concerning reduction and restructuring of debt of the Republic of Poland. As part of this agreement, the Company received PLN 17,643 thousand for the project. As at the date of the preparation of these condensed consolidated financial statements, the construction of the new power station was ended. The transfer of the funds to the Group’s account was as follows: PLN 1,176 thousand on 15 October 2008, PLN 856 thousand on 13 November 2008, PLN 6,307 thousand on 30 December 2008, PLN 3,850 thousand on 25 March 2009 and PLN 4,383 thousand on 11 May 2009, PLN 1,072 thousand on October 2009. The financial support was granted to the Arctic Paper Kostrzyn and the Arctic Paper Kostrzyn committed to comply with the specific conditions, the realization of which may be subject to control, within 3 years of handing the Project over for use, by appropriate authorities authorized to issue a decision under which the subsidy granted and received may have to be returned together with interest.

## 44.2. Operations in the Special Economic Zone

Arctic Paper Kostrzyn S.A. operates in the Kostrzyńsko-Słubicka Specjalna Special Economic Zone (the „KSSSE") and based on the permission issued by the Kostrzyńsko – Słubicka Special Economic Zone S.A. benefits from the investment tax relief as regards the activities carried out in the KSSSE. The tax exemption is of conditional nature. The provisions of the act on special economic zones provide that Arctic Paper Kostrzyn S.A. loses its tax relief if at least one of the following occurs:

- Arctic Paper Kostrzyn S.A. ceases to conduct business operations in the KSSSE for which it obtained the permission,
- it violates the conditions of the permission, or
- it does not remove errors/ irregularities identified during the course of control within the period of time specified in the order issued by appropriate minister for economic affairs,
- it transfers, in any form, the ownership right to assets to which the investment tax relief related within the period shorter than 5 years of introducing those assets to the fixed assets register,
- if the machines and equipment is transferred to conduct business activities outside the KSSSE,
- if Arctic Paper Kostrzyn S.A. receive compensation, in any form, of the investment expenditure incurred,
- if Arctic Paper Kostrzyn S.A. goes into liquidation or if it petitioned for bankruptcy.

Based on the permit issued on 25 August 2006, Arctic Paper Kostrzyn S.A. may benefit from exemption to 15 November 2017.

The pre-requisite condition for this tax relief is that appropriate investment expenditure is made in the Special Economic Zone within the meaning of § 6 of the Decree of the Council of Minister dated 14 September 2004 concerning Kostrzyńsko – Słubicka Special Economic Zone, being the basis for the calculation of public assistance in accordance with § 3 Decree with a value exceeding EUR 40,000,000 to 31 December 2013 calculated using the average EUR announced by the President of the National Bank of Poland as prevailing on the date the expenditure is made. Creation in the territory of the KSSSE of at least 5 new workplaces within the meaning of § 3 paragraph 3 and paragraph 6 of the Decree by 31 December 2011 and maintaining the employment level at 453 people during the period from 1 January 2012 to 31 December 2013.

The conditions of the exemption have not changed in the reporting period. The Group was not a subject to any inspection by the KSSSE authorities.

During the period from 25 August 2006 to 31 December 2010, Arctic Paper Kostrzyn S.A. incurred capital expenditure classified as expenditure of the KSSSE in the amount of PLN 164,386 thousand. During this period, the amount of public assistance used was PLN 37,234 thousand.

If there is insufficient tax income to utilize the qualified investment expenditure during the year, then Arctic Paper Kostrzyn S.A. recognizes a deferred tax asset for the difference ascertained.

# 45. Events after the reporting period

## 45.1. Bond issue program

On 7 February 2011 the annex has been executed to the contract dated 11 February 2010 between the Company and BRE Bank S.A. (managers of the bond issue). Under the annex the Issue Program was changed: the total face value of Bonds issued under the Program has been increased and will never exceed PLN 300,000,000 ("Maximum Program Value"). According to the signed annex, the Company is permitted to make repeated issues of Bonds up to the Maximum Program Value. Should any bonds be redeemed, the Company may issue new bonds, provided that the combined face value of bonds to be issued and outstanding cannot exceed the Maximum Program Value. .

## 45.2. Issue of bonds of 1/2010 series

On 10 February 2011 the coupon bonds of 1/2011 series were issued. The bonds are unsecured bearer bonds with PLN 100,000 face value each. The total number of bonds issued under the 1/2011 series is 800 with combined face value of PLN 80 million. The issue price of each bond is PLN 100,000.

Net proceeds from the issue amounting to PLN 80 million will be used for re-financing of the Issuer's debt.

On 25 February 2013 („Redemption Date") the Issuer, acting through the Payment Agent, will pay the Principal Amount (face value) of each bond. Payments for the bonds will be made to bondholders entered in the Register as of the Rights Attribution Date. If however the Redemption Date is not a Working Day, the Principal Amount will be paid on the first Working Day immediately after the Redemption Date without any claim for delay interest or other charges. All redeemed bonds will be immediately remitted.

The bonds are bearing interest from the Issue Date (inclusive) until the Redemption Date at a variable rate comprising the base rate – WIBOR 6M – and a commission. On every Interest Payment Date the Issuer, acting through the Payment Agent, will pay the Interest Amount to bondholders entered in the Register as of the Rights Attribution Date. Interest will be paid in arrears.

The bonds do not include any non-monetary rights to the Issuer.

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## 45.3. Repayment of debt

On 15 February 2011 the subsidiary of Arctic Paper S.A. - Arctic Paper Munkedals AB - repaid its debt to Bank Polska Kasa Opieki S.A. utilized under the facility agreement dated 23 August 2008 (with subsequent amendments) ("Facility Agreement"). The Company informed about the Facility Agreement in the prospectus regarding issue of B and C Series Shares.

Due to the repayment of the debt to Bank Polska Kasa Opieki S.A. Arctic Paper Munkedals AB was released from any obligations under the Facility Agreement and ceased to be party of the Facility Agreement.

Funds for repayment of the debt to Bank Polska Kasa Opieki S.A. were raised by Arctic Paper Munkedals AB from Svenska Handelsbanken AB.

Total limit of the debt to Svenska Handelsbanken AB amounts to PLN 57,573,477.72.

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## 45.4. Amendment of major contract

On 30 March 2011, the Company and its subsidiaries, that is Arctic Paper Kostrzyn, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH concluded with the Bank Polska Kasa Opieki SA another amendment (the "Amendment ") to the facility agreement dated October 23, 2008 ("Facility Agreement").

The Facility Agreement was disclosed in the prospectus shares of series B and series C. Under the Amendment, the Bank Polska Kasa Opieki SA agreed to postpone until 30 March 2012 the final repayment date of the current account credit of up to PLN 50,000,000 ("the facility C") granted to Arctic Paper Kostrzyn S.A.

Other terms of Facility C and provisions of Facility Agreement remain unchanged. The Company informed about the terms of the Facility C in the current report no. 30/2010 dated 17 June 2010.

In connection with the extension of Facility C repayment date, the vadility for the loan security, i.e. mortgage of up to PLN 100 million and authorization to manage bank accounts of Arctic Paper Kostrzyn S.A. henld at Bank Polska Kasa Opieki S.A. has been modified accordingly.

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Following the conclusion of the Amendment dated 30 March 2011, Arctic Paper Kostrzyn further submitted itself to execution pursuant to Article. 777 § 1 item 5 of the Code of Civil Procedure up to the amount of PLN 100 million for the benefit of Bank Polska Kasa Opieki S.A.

There are no provisions concerning contractual penalties in the Annex.

## 45.5. Encumbrance of significant assets

On 30 March 2011, the Company and its subsidiaries, that is Arctic Paper Kostrzyn, Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH concluded with the Bank Polska Kasa Opieki SA another amendment (the "Amendment ") to the facility agreement dated October 23, 2008 ("Credit Agreement").

Following the conclusion of the Amendment, on 31 March 2011, the company Arctic Paper Kostrzyn S.A. on the basis of a declaration made by notarial deed has amended the deposit mortgage up to the amount of PLN 100 million established for the Bank Polska Kasa Opieki SA ("Mortgage") encumbering land registers number GW1S/00025123/4, GW1S/00027787/3, GW1S/00005360/1 and GW1S/00025698/5. The amendment consists in specifying the date of repayment of facility C as 30 March 2012 (pursuant to report number 9 / 2011 of 31 March 2011).

Land register number GW1S/00025123/4 relates to land owned by Arctic Paper S.A., while registers numbers GW1S/00027787/3, GW1S/00025698/5 GW1S/00005360/1 are maintained for property in perpetual usufruct by Arctic Paper Kostrzyn S.A.

The mortgage is recorded in the land registers in second place. Mortgaged property is located in Kostrzyn nad Odrą and is used to conduct core business of the Arctic Paper Kostrzyn S.A. The book value of the mortgaged real estate in Arctic Paper Kostrzyn is PLN 112,498,472.75.

Relationship between the Company and its subsidiaries, and Bank Polska Kasa Opieki SA result from the financial services rendered by the bank on their behalf.

## 45.6. Major contract – FX forward transactions

On 11 April 2011 the subsiriary Arctic Paper Kostrzyn S.A. conducted foreign exchange forward transactions. The above transactions are made for the purpose of hedging the fluctuation of EUR/USD exchange rate for the reporting year 2011/2012.

The transactions were conducted on the arms' length basis which was defined in the general contract about derivative forward transactions. Transactions were conducted between Bank Polska Kasa Opieki S.A. and Arctic Paper Kostrzyn S.A. Total value of 10 transactions is EUR 17,400,000, which is equal to PLN 69,178,920 (with the average NBP exchange rate dated 11 April 2011 1 EUR – 3.9758 PLN). The settlement date of the contract are set for the periods from July 2011 to March 2012.

## 45.7. Amendment to the major contrach with subsidiary

On 12 April 2011 Arctic Paper S.A. concluded amendment to the major loan agreement between Arctic Paper S.A. and its subsidiary Arctic Paper Investment AB seated in Goteborg, Sweden. The amendment postpones the payment date of the first installment with interest to the 10 February 2013 and defines this date as repayment date of the total loan with interest.

Detailed information regarding the contract was included in the current reports no. 14/2009 dated 8 December 2009 and 8/2010 dated 1 March 2010 as well as 10/2010 dated 2 March 2010 published also on Arctic Paper S.A. Internet site, in Investor Relations section:

http://www.arcticpaper.com/pl/PL-Local-Site/Relacje-inwestorskie2/Raporty/2011/-RAPORTY-BIECE/-RAPORTY-BIECE/

# Signatures of Board Members

| Position | Name and surname | Date | Signature |
|---|---|---|---|
| President of the Management Board<br>Chief Executive Officer | Michał Jarczyński | 27 April 2011 | |
| Member of the Management Board<br>Chief Operating Officer | Bjarne Björk | 27 April 2011 | |
| Member of the Management Board<br>Marketing and Sales Director | Hans Karlander | 27 April 2011 | |
| Member of the Management Board<br>Chief Financial Officer | Michał Bartkowiak | 27 April 2011 | |

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