

# **Supervisory Board Report on Consolidated Financial Statements of Petrom Group prepared in accordance with International Financial Reporting Standards (“IFRS”)**

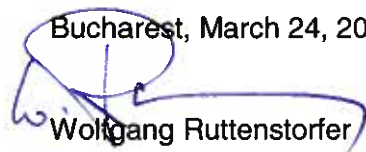
In 2010, the Supervisory Board thoroughly reviewed the position and prospects of the Group and performed its functions according to the relevant laws, the Articles of Association, the applicable Corporate Governance Code and the relevant internal regulations. We coordinated with the Executive Board on the management of Petrom and monitored its work, and we were involved in the Group's key decisions. Where required by law, the Articles of Association, or internal regulations, the Supervisory Board adopted resolutions following a comprehensive analysis.

The consolidated financial statements and audit reports were presented for Supervisory Board examination in a timely manner. Deloitte audited the 2010 consolidated financial statements, reviewed the conformity of the Directors report with the consolidated financial statements and issued unqualified audit opinions. The auditors attended the relevant meeting of the Audit Committee convened to adopt the accounts. The Audit Committee discussed the consolidated financial statements with the auditors and examined them carefully. The Committee reported to the Supervisory Board on its examination and recommended the approval of the annual consolidated financial statements, including the management reports.

Based on our own examination, we confirm to the best of our knowledge that the consolidated financial statements give a true and fair view of the financial position of Petrom Group as of December 31, 2010, and its financial performance and its cash flows for the year then ended in accordance with applicable accounting standards. We have also reviewed and analyzed attached Directors Report presented as Appendix 1 and we confirm that the report gives a true and fair view of the development and performance of the business and the financial position of the Group, together with a description of the principal risks and associated uncertainties as of December 31, 2010.

Hence, the consolidated financial statements of Petrom Group prepared in accordance with IFRS were approved in today's Supervisory Board meeting in line with the Audit Committee's recommendation and will further be submitted for discussion in the General Meeting of Shareholders to be held on April 26, 2011.

Bucharest, March 24, 2011



President of the Supervisory Board

# Appendix 1

## Directors' Report on Consolidated Financial Statements of Petrom Group prepared in accordance with IFRS

### Directors' Report

| Petrom Group financials (RON mn)          | 2010   | 2009   | Δ(%) |
|---|--------|--------|------|
| Sales revenues                            | 18,616 | 16,090 | 16   |
| Earnings before interest and taxes (EBIT) | 2,986  | 1,620  | 84   |
| Net income                                | 2,190  | 833    | 163  |
| Net income after minorities               | 2,201  | 860    | 156  |
| Cash flow from operations                 | 4,630  | 2,726  | 70   |
| Capital expenditures                      | 4,863  | 4,219  | 15   |
| Employees as of December 31, 2010         | 24,662 | 28,984 | (15) |

Against the background of weakening market conditions in our operating region, our strong financial results reflect the effectiveness of optimization initiatives and the favorable crude price environment. Moreover, throughout the year, we achieved several important milestones and took further steps in line with our strategy to become a leading integrated energy player.

Compared to 2009, the operating result (EBIT) increased by 84% to RON 2,986 mn, as high oil prices and stringent cost management, such as optimization of supply in Refining more than offset the one-off charges and lower volumes sold by the R&M business. Net special charges mainly related to the impairment recorded following the technical re-assessment of the Kazakhstan activities and also the re-establishment of an export customs duty in Kazakhstan. The net financial result improved compared to previous year's level, positively influenced by FX gains related to our intercompany USD loans given to our Kazakh subsidiaries. The effective corporate tax rate was 16%, compared to 29% in 2009, mainly due to the provisions related to the tax review recorded in Q4/09, the disposal of Russian operations and the impairment of Kazakh assets where the tax rate is above the Group's effective tax rate level. Consequently, net income after minorities was more than double compared to 2009. As a result, the return on average capital employed (ROACE) indicator increased to 10.7% in 2010, compared to 5.2% registered in 2009. Our gearing ratio improved as new liabilities contracted for financing needs were compensated by the increase in cash and cash equivalents, standing at 12.4% at the end of 2010 compared to 16.2% in December 2009.

Against the backdrop of strong cash generation and a low gearing ratio we were in a position to finance our business without requiring an increase in our share capital, as was authorized by shareholders in April 2010. We do not envisage requesting a renewal of the authorization period at the next AGM as we remain confident going forward about maintaining a strong balance sheet and cash flow generation capacity which will enable us to finance our operations and investments.

In 2010, we maintained our investment momentum in line with our commitment for growth and modernization even in challenging years. We are the largest investor in the energy sector in Romania with capital expenditures of EUR 1.1 bn in 2010.

#### Dividend

The strong 2010 results and financial position not only enable us to invest in the Company's future sustainable growth, but also to propose to the forthcoming General Meeting of Shareholders on April 26, 2011, the payment of a dividend of RON 0.0177 per share, corresponding to a payout ratio of 46% of the net profit.

In **Exploration and Production**, the natural production decline was steadily reduced in the second half of the year by concentrating on reservoir management initiatives, finalization of key wells, increased workovers and infill drilling. We successfully started the Hurezani gas delivery system by mid-year and made further progress with our seven ongoing integrated field redevelopment projects and started production at key gas wells (Mamu, Radinesti). Offshore, additional production came on stream from applying advanced technology at both existing and new key wells. Throughout the year, we embarked on three strategic

partnerships. We signed two long-term production enhancement projects with Petrofac and PetroSantander, for 15 and 17 years respectively. Both partnerships target cumulative production enhancement in the selected mature fields by at least 50% compared to current production decline in the next five years. Continuous revision of mature fields, achievement of the drilling program combined with diversification of the recovery mechanisms applied in 2010 led to an increase of the reserve replacement rate in Romania from 70% in 2009 to 72% in 2010. In Kazakhstan, oil and gas average production increased significantly compared to 2009 mainly due to Komsomolskoe field being gradually brought on stream, in spite of some start-up difficulties. In addition, we acquired 3D seismic data at the Kultuk field that was recently added to our international portfolio. Given the current economic environment and due to our prioritization program for investment projects, we sold our assets in Russia.

In **Refining and Marketing** significant improvements were made, as we increased our clean CCS EBIT by more than RON 500 mn, driven by downstream optimization and cost control efficiency. Throughout the year we capitalized on our efficient response to the prevailing market challenges with flexible utilization of our refining and logistics assets. We processed 100% domestic crude, halted crude imports and optimized operations by keeping the Arpechim refinery in economic shutdown for nearly nine months. Consequently, we increased the utilization rate at our higher conversion refinery at Petrobrazi. One of the major activities was the cycle-end turnaround scheduled at Petrobrazi for approximately one month, in the first part of the year. The turnaround represented a significant effort involving some 750,000 man-hours and no lost time incidents were registered during the period, thus we continued to improve our HSEQ performance. Therefore, our efforts were recognized through a prestigious award – the DuPont Safety Award, granted for the first time to a Romanian company. An important achievement was the finalization of the Brazi terminal construction, and together with the Jilava terminal we reached our target set for 2010 with regards to the modernization of the terminal's infrastructure. In the first part of 2010, we also finalized the divestment of the Arpechim petrochemical business to Oltchim. In Marketing, the economic downturn affected our fuels sales and burdened our margins. In order to optimize our operations and increase the efficiency of cost management, we consolidated our activities in Romania, previously performed through three legal entities, in one single entity - OMV Petrom Marketing SRL, 100% owned by Petrom.

In **Gas and Power**, the year 2010 was marked by progress and new steps taken to become a key integrated energy player. In the Romanian gas market we maintained a strong position within a difficult business environment. In 2010, we consolidated the gas supply and sale activities of OMV Petrom S.A. and OMV Petrom Gas S.R.L. in one company, OMV Petrom Gas S.R.L., 99.99% owned by Petrom. Through the start of operation of the Szeged-Arad pipeline, OMV Petrom Gas S.R.L. seized the opportunity and was the first and only company to import commercial volumes via this interconnection with the Hungarian and West-European gas transportation system. During the year we continued the construction of Brazi power plant which is on track to start commercial operation in late 2011. The plant is the largest private greenfield project for electricity in Romania, with an 860 MW designated capacity and an average gas consumption of 0.8-0.9 bcm per year. An important milestone achieved in 2010 was the acquisition of S.C. Wind Power Park S.R.L., who owns a fully permitted wind generation project – Dorobantu – with a capacity of 45 MW, situated in Dobrogea region, thus extending our power projects portfolio. In line with our strategy to exit non-core segments, we also stopped methanol production at the Doljchim chemical plant in October 2010.

#### **Minor share buybacks**

On January 8, 2010, OMV Petrom S.A. commenced the purchase by the company of a number of its own shares (referred to as 'buy-back program') from the regulated securities market, based on the Decision of the Extraordinary General Meeting of Shareholders of December 16, 2008, published in the Official Gazette, Part IV, no. 359/19.01.2009, with a view to distributing the same shares free of charge to the persons entitled to receive them (former or current employees).

The reason for offering shares was to fulfil the obligation assumed under article 168, paragraph 5 of the Collective Labour Agreement (CLA) applicable in 2008, under which "In case of entering the privatization phase, the employees who are part of this agreement shall benefit from a number of shares negotiated by FSLI Petrom with Petrom SA – granted free of charge [...]", also stipulated under art. 107 of the CLA applicable in 2009.

The buy-back program commenced on January 8, 2010 and was completed on January 18, 2010. OMV Petrom S.A. purchased 6,195,500 shares, representing 0.011% of the company's share capital from the regulated securities market, at a total value of RON 1,772,177. The purchase price varied from RON 0.2730 to RON 0.2930.

The effective allocation of the free-of-charge shares was made between June 23 and December 16, 2010 - according to the simplified prospectus, the period for the effective allocation of the free of charge securities to the entitled persons could run between February 25, 2010 and December 31, 2010. OMV Petrom S.A. distributed free of charge, to each person so entitled a number of 100 (one hundred) ordinary, nominal and dematerialised shares, traded on the first tier of the Bucharest Stock Exchange, with a nominal value of RON 0.1 each.

On January 7, 2011, Petrom announced the completion of the securities distribution to the Entitled Persons. Out of total share purchased of 6,195,500, a total number of securities of 6,133,500 were distributed to 61,335 Entitled Persons.

As per December 31, 2010, the number of shares held in Treasury from buy back totalled 62,000 ordinary, nominal and dematerialised shares, with a nominal value of RON 0.1 each, representing 0.0001% of the company's share capital. No shares were cancelled in the year under review.

#### **New headquarters – Petrom City**

In December, we inaugurated Petrom City, the headquarters that will host the company's central operations. Situated in the Northern part of Bucharest, it will host around 2,500 employees from seven former headquarters of the company in Bucharest and Ploiesti. The employees' relocation process started in the fourth quarter of 2010 and is expected to be finalized in the first half of 2011.

#### **Corporate Governance**

In order to consolidate market and stakeholder confidence, we pursue transparency in our management and internal control structures. To meet the expectations placed in Petrom in terms of good corporate governance, we strive to comply with the principles set out in the Code of Corporate Governance (herein after referred to "CGC" or the "Code") issued by the Bucharest Stock Exchange. The code applies to the issuers listed on the Bucharest Stock Exchange and the enclosure of the "Comply or Explain Statement" to the provisions set forth by the CGC became effective starting with 2010. The Corporate Governance Code's requirements are broader than the legal requirements for listed companies. A detailed report on Corporate Governance together with the Comply or Explain Statement is enclosed in our report.

The current version of the CGC is available at the website of the Bucharest Stock Exchange [www.bvb.ro](http://www.bvb.ro), under the item Companies/ Corporate Governance. The website also includes an English translation of the Code of Corporate Governance and the Corporate Governance Code Guidelines.

#### **Earnings before interest and taxes (EBIT)**

| EBIT (RON mn)                                      | 2010         | 2009         | Δ %       |
|--|--------------|--------------|-----------|
| Exploration and Production <sup>1</sup>            | 3,012        | 2,468        | 22        |
| Refining and Marketing                             | 106          | (618)        | n.m.      |
| Gas and Power                                      | 164          | 71           | 130       |
| Corporate and Other                                | (135)        | (140)        | (3)       |
| Consolidation: Elimination of intercompany profits | (161)        | (161)        | 0         |
| <b>Petrom Group reported EBIT</b>                  | <b>2,986</b> | <b>1,620</b> | <b>84</b> |

<sup>1</sup> Excluding intersegmental profit elimination

In **E&P**, **EBIT** increased by 22% compared to 2009, to RON 3,012 mn, due to higher oil and condensate prices, although it was affected by the significant impairment of the Kazakhstan assets in Q3/10. **Total Group hydrocarbon production** decreased by 2% compared to 2009 to 184,000 boe/day, due to lower production in Romania. **Crude oil production** was 29.98 mn bbl, 5% lower than the level recorded in 2009, as a consequence of adverse weather conditions, with heavy snow and flooding in the first part of the year, followed by a delay in drilling activities. Lower drilling activities throughout 2009 also impacted the 2010 production. **Gas production** reached 33.48 mn boe, 3% lower than in 2009 due to the delay in completion of key gas wells (Mamu) coupled with the negative effect of lower drilling activities in 2009. **Oil and gas production in Kazakhstan** increased by 58% to 3.62 mn boe in 2010, due to the Komsomolskoe field being brought gradually on stream.

In **R&M**, **EBIT** improved significantly in 2010, compared to the last 6 years, as it reached a positive figure, for the first time since privatization, of RON 106 mn. The result was driven by flexible refining asset utilization with optimized operations at the Arpechim refinery ("stop-and-go" mode) coupled with increased utilization of our higher conversion refinery at Petrobrazi, which more than compensated for the lower marketing result where margins and volumes, especially in the commercial sector, were negatively affected by the weak economic environment. Despite the increase versus last year's level, in 2010 the **indicator refining margin** remained very low, mainly as a result of increasing crude prices offsetting higher product spreads. On account of the changed operations mode in Refining, the overall **utilization rate** was maintained at 49%, mainly due to the Arpechim refinery being in economic shutdown for most of the period. However, the

Petrobrazil utilization rate increased significantly towards the second half of the year, averaging 70%, three percentage points higher than last year. Total **refining output** was down 24% compared to 2009.

The **EBIT** generated by the **G&P** business more than doubled in 2010 as compared to 2009, when it was impacted by losses recorded at Doljchim and the provisions set up for closing the chemicals business. Adverse market conditions due to the economic downturn negatively affected the gas business, which generated a 10% lower EBIT versus 2009, when the Group benefited from higher margins on import gas extracted from storage. **The negative result in Doljchim** in 2010 was reduced by 72%, as the methanol plant was operated according to the company's integration needs. **Consolidated gas sales volume** increased by around 1.5% compared to 2009, while the increase in total gas consumption in Romania was 4.9%, mainly driven by higher demand from the fertilizer industry and the colder winter. This development offsets the opposite trend experienced in 2009, when Petrom sales decreased at a much lower pace than Romanian total consumption, since the demand for domestically produced gas was less influenced by the market development.

**EBIT** in the **Corporate and Other** (Co&O) segment amounting to RON (135) mn remained similar to the one from previous year (RON (140) mn).

## Financial highlights

### Notes to the income statement

| Summarized income statement (RON mn)                   | 2010         | 2009         | Δ %        |
|--|--------------|--------------|------------|
| Sales revenues   | 18,616       | 16,090       | 16         |
| Direct selling expenses                                | (437)        | (364)        | 20         |
| Production costs of sales                              | (12,791)     | (11,256)     | 14         |
| Other operating income                                 | 514          | 409          | 26         |
| Selling and administrative expenses                    | (1,450)      | (1,503)      | (4)        |
| Exploration expenses                                   | (187)        | (275)        | (32)       |
| Other operating expenses                               | (1,280)      | (1,480)      | (14)       |
| <b>Earnings before interest and taxes (EBIT)</b>       | <b>2,986</b> | <b>1,620</b> | <b>84</b>  |
| Net financial result                                   | (380)        | (451)        | (16)       |
| Taxes on income  | (416)        | (336)        | 24         |
| <b>Net income</b>                                      | <b>2,190</b> | <b>833</b>   | <b>163</b> |
| Thereof attributable to non-controlling interests      | (11)         | (27)         | (59)       |
| <b>Net income attributable to owners of the parent</b> | <b>2,201</b> | <b>860</b>   | <b>156</b> |

**Petrom** is an integrated oil and gas company on its way to become a key integrated energy player. As oil produced by the E&P segment is mainly processed at Petrom refineries, the R&M business segment represents the largest share of the Group's consolidated sales.

Compared to 2009, **consolidated sales revenues** increased by 16% to RON 18,616 mn, mainly driven by high crude and product prices. After the elimination of intra-group transactions of RON 8,862 mn, the contribution of the **E&P** segment to consolidated sales revenues was RON 673 mn or about 4% of the Group's total sales revenues (2009: RON 698 mn). Consolidated sales in the **R&M** segment amounted to RON 15,050 mn or 81% of total consolidated sales (2009: RON 12,620 mn). After elimination of intra-group sales to refineries, the G&P segment's contribution was RON 2,880 mn or approximately 15% of total sales (2009: RON 2,769 mn).

In line with IFRS 8 "Operating segments", sales to external customers are split up by geographical areas on the basis of where the delivery of goods or services is effective. Romania represents the Group's most important **geographical market** with sales of RON 14,484 mn or 78% of the Group's total sales (2009: RON 13,237 mn or 82%). Sales in the Rest of Central and Eastern Europe were RON 3,508 mn or 19% of Group sales revenues (2009: RON 2,577 mn) and sales revenues in the Rest of the World increased to RON 624 mn, representing 3% of total sales revenues (2009: RON 276 mn)

**Direct selling expenses**, mainly consisting of third-party freight-out expenses, increased by 20% to RON 437 mn. **Cost of sales**, which include variable and fixed production costs, as well as costs of goods and materials employed, increased by 14% to RON 12,791 mn in line with the increase in sales. **Other operating income** went up by 26%, positively impacted by FX exchange gains and gains on disposal of assets. **Selling expenses** of RON 1,218 mn were reduced by 5% compared to last year, while **administrative expenses** increased by 3% to RON 231 mn.

**Exploration costs** were down by 32% to RON 187 mn, mainly driven by decreased activities in Romania partially compensated by the increase of geological and geophysical expenses in the Kazakh company acquired in 2009, Korneo LLP.

**Other operating expenses** decreased by 14% compared to 2009, amounting to RON 1,280 mn. This positive effect is mainly due to lower provisions for restructuring, and lower FX losses.

**Net financial result** show an expense of RON 380 mn, improved in comparison with the previous year (2009: expense of RON 451 mn), due to an increase of RON 191 mn in net financial income by and in spite of higher net interest expenses by RON 121 mn. Other financial income and expenses in 2010 amounted to RON 150 mn, while in 2009 it showed an expense balance of RON 41 mn. This positive effect results mainly from FX gains made by Petrom, driven by the USD appreciation against RON in relation with the USD loans



given to its Kazakh subsidiaries. As the USD is the functional and reporting currency of the Kazakh subsidiaries, FX effects resulting in Petrom are not compensated by a corresponding effect in Kazakhstan.

**Taxes on income** increased by RON 80 mn to RON 416 mn compared to 2009. **Current taxes on income** went up by RON 82 mn, mainly driven by higher profits resulting from the increase in oil prices. In 2010, **deferred tax income** of RON 86 mn (2009: RON 83 mn) was recognized. The Group's effective tax rate decreased to 16% (2009: 29%). This improvement in the effective tax rate was mainly due to the disposal of Russian operations and the impairment of Kazakh assets where the tax rate is above the Group's effective tax rate level. Furthermore, the previous year's effective tax rate was burdened by one-time negative impacts such as non-deductible expenses following the tax review of Petrom.

## Capital expenditure

| Capital expenditure <sup>1</sup> (RON mn)  | 2010         | 2009         | Δ (%)      |
|--|--------------|--------------|------------|
| Exploration and Production   | 2,774        | 2,869        | (3)        |
| Refining and Marketing   | 758          | 601          | 26         |
| Gas and Power  | 1,211        | 348          | 248        |
| Corporate and Others   | 120          | 401          | (70)       |
| <b>Total capital expenditure <sup>1</sup></b>  | <b>4,863</b> | <b>4,219</b> | <b>15</b>  |
| +/- Other adjustments  | 338          | 250          | 35         |
| - Investments in financial assets  | (35)         | 0            | n.m.       |
| <b>Additions according to statement of non-current assets (intangible and tangible assets)</b> | <b>5,166</b> | <b>4,469</b> | <b>16</b>  |
| +/- Non-cash changes   | (844)        | (66)         | n.m.       |
| <b>Cash outflow due to investments in intangible and tangible assets</b>                       | <b>4,322</b> | <b>4,403</b> | <b>(2)</b> |
| + Cash outflow due to investments in securities, loans and other financial assets              | 2            | (199)        | n.m.       |
| <b>Investments as shown in the cash flow statement</b>   | <b>4,324</b> | <b>4,204</b> | <b>3</b>   |

<sup>1</sup> Includes acquisitions as well as investments in associated companies and other interests; adjusted for capitalized decommissioning costs, exploration wells that have not found proved reserves, borrowing costs and other additions which by definition are not considered as capital expenditures.

**Capital expenditure** increased to RON 4,863 mn (2009: RON 4,219 mn), with substantially increased investments in G&P and slightly lower CAPEX in Corporate & Other (Co&O) and E&P.

**Investments in E&P** RON 2,774 mn (2009: RON 2,869) represented 57% of the total figure for 2010 and were predominantly spent on development wells, to sustain the continuous field development strategy, workover activities and subsurface operations in Romania and Kazakhstan. Approximately 25% of investments were realized in **G&P** RON 1,211 mn, (2009: RON 348 mn), mainly comprising the investments related to the Brazi power plant, including the connection pipeline to the National Gas Transportation System and construction works for the Dorobantu wind park within a newly acquired subsidiary Wind Power Park SRL. Capital expenditure in **R&M** segment RON 758 mn (2009: RON 601 mn) accounted for 16% of the 2010 group total investments. In Refining, investments were mainly related to quality enhancement projects in Romania, such as the rehabilitation of storage tanks for oil products, crude unit modernization, the cycle end turnaround in Petrobrazi and the Brazi terminal. Investments in the Marketing division accounted for signage, rebranding and the modernization of filling station complementary equipment at various sites. CAPEX for Corporate & Other (**Co&O**) segment amounted to RON 120 mn (2009: RON 401 mn). This refers mainly to the finalization of construction works at "Petrom City" in Bucharest, Petrom's new headquarters inaugurated in December 2010, and also other small investments that were realized for IT projects.

The reconciliation of total capital expenditure to additions according to the statement of non-current assets (intangible and tangible) mainly relates to investments in financial assets, and additions which by definition are not considered capital expenditure, such as reassessment of decommissioning asset and interest capitalized. The difference between the additions shown in the statement of non-current assets and the investments reported in the cash flow statement partly arise from investments that did not affect cash flows during the period (including change of liabilities arising from investments and from financial leasing and reassessment of decommissioning provisions). In addition, cash outflows due to investments in financial assets are included in the overall investments shown in the cash flow statement.

## Balance sheet

| Summarized balance sheet (RON mn)                   | 2010          | %          | 2009          | %          |
|---|---------------|------------|---------------|------------|
| <b>Assets</b>                                       |               |            |               |            |
| Non-current assets                                  | 27,725        | 80         | 25,228        | 83         |
| Intangible assets and property, plant and equipment | 25,147        | 72         | 22,791        | 75         |
| Investments in associated companies                 | 41            | 0          | 36            | 0          |
| Other non-current assets                            | 2,537         | 7          | 2,401         | 8          |
| Deferred tax assets                                 | 734           | 2          | 713           | 2          |
| Current assets                                      | 6,306         | 18         | 4,586         | 15         |
| Inventories   | 2,500         | 7          | 2,583         | 8          |
| Trade receivables                                   | 1,398         | 4          | 1,048         | 3          |
| Other current assets                                | 2,408         | 7          | 955           | 3          |
| <b>Equity and liabilities</b>                       |               |            |               |            |
| Equity  | 18,459        | 53         | 16,191        | 53         |
| Non-current liabilities                             | 10,701        | 31         | 9,567         | 31         |
| Pensions and similar obligations                    | 297           | 1          | 283           | 1          |
| Interest-bearing debts                              | 3,466         | 10         | 2,810         | 9          |
| Decommissioning and restoration obligations         | 5,918         | 17         | 5,564         | 18         |
| Provisions and other liabilities                    | 1,020         | 3          | 910           | 3          |
| Deferred tax liabilities                            | 27            | 0          | 62            | 0          |
| Current liabilities                                 | 5,578         | 16         | 4,707         | 15         |
| Trade payables                                      | 3,453         | 10         | 2,295         | 8          |
| Interest-bearing debts                              | 391           | 1          | 188           | 1          |
| Provisions and other liabilities                    | 1,734         | 5          | 2,224         | 7          |
| <b>Total assets/ equity and liabilities</b>         | <b>34,765</b> | <b>100</b> | <b>30,527</b> | <b>100</b> |

**Total assets** increased slightly by RON 4,239 mn to RON 34,765 mn. **Non-current assets** grew by RON 2,497 mn to RON 27,725 mn, out of which RON 2,356 mn related to the increase in **intangible assets and property, plant and equipment**. Additions to intangible assets and property, plant and equipment (RON 5,166 mn) exceeded the total of depreciation, amortization and impairments, as well as disposals by RON 2,227 mn. The ratio of intangible assets and property, plant and equipment to total assets amounted to 72% (2009: 75%).

**Investments in associated companies** rose moderately by a total of RON 5 mn, with positive results from the associated company Congaz.

The slight increase of **other non-current assets**, which primarily comprise receivables of OMV Petrom S.A. over the Romanian State, was driven mainly by the unwinding effect of provisions partially offset by the discounting of the receivable amount.

The strong increase in **current assets** of RON 1,720 mn is mainly related to positive evolution in cash and cash equivalents of RON 1,205 mn, presented within **other current assets**. **Current trade receivables** increased by RON 350 mn following the increased sales in R&M segment and increase of crude oil sold from production obtained from the Kazakhstan region, and were partially compensated by slight decrease of **inventories**.

**Equity** (including minorities) improved by RON 2,268 mn, maintaining the equity ratio at 53%. Equity increased due to net income generated during the year and also due to the positive effect from hedges and slightly reduced by exchange rate differences.

Non-current **decommissioning and restoration obligations** rose by RON 354 mn, because of parameter changes and unwinding effects.

Additional amounts drawn from EBRD (European Bank for Reconstruction and Development), EIB (European Investment Bank), BSTDB (Black Sea Trade Development Bank) and the second club deal (facility obtained in December 2009) exceeded the repayment of loan taken from OMV AG and partial repayment of the first club deal loan, thereby increasing **long term borrowings** by RON 655 mn.

Repayments of the overdraft at the beginning of the year and the change of maturity profile of financing sources were reflected into a net increase of short term **interest bearing debts** by RON 204 mn.



Significant investments carried out, especially in E&P activities, combined with higher environmental restoration works led to a significant increase in **trade payables**, which was partially offset by a reduction of **other liabilities and provisions** by RON 380 mn, as a result of settlement of hedging contracts signed for year 2010 and also due to the reduction in provisions for announced personnel restructuring plans.

### Gearing ratio

Considering that new liabilities contracted for financing needs were compensated by the positive free cash flow (defined as excess of net cash from operating activities over net cash used in investing activities), Petrom Group's **net debt** shows a slight decrease to RON 2,299 mn, compared to RON 2,614 mn at the end of 2009. Consequently, as of December 31, 2010, the **gearing ratio** decreased to 12.4%, from 16.2% in December 2009.

### Cash flow

The Group's cash flow statement is prepared using the indirect method, whereby adjustments are made for changes in the group of consolidated companies, foreign exchange differences and other non-cash transactions.

**Cash flow from operating activities** increased by RON 1,904 mn or 70% from RON 2,726 mn to RON 4,630 mn. The reconciliation of profit before taxation for the year to the cash flow from operating activities (before changes in working capital) resulted in a net upward adjustment of RON 2,458 mn for 2010 (2009: RON 2,550 mn). While depreciation, amortization and write-ups added RON 2,812 mn (2009: RON 2,466 mn), net movement in provisions (including decommissioning and restoration obligations and other provisions for risks and charges) contributed a decrease of RON 325 mn (2009: RON 221 mn) to the cash flow. Result on the disposal of non-current assets and other adjustments led to a decrease of RON 28 mn (2009: RON 305 mn increase).

In 2010, net working capital, interest and taxes generated a cash outflow of RON 434 mn (2009: cash outflow of RON 994 mn). Receivables increased by RON 523 mn (2009: increase by RON 148 mn) and liabilities increased by RON 559 mn (2009: decreased by RON 652 mn). Net interest and tax on profit paid generated a cash outflow of RON 474 mn (2009: cash outflow of RON 323 mn), encompassing a higher level of financing and positive evolution of results in current year.

**Cash outflows for investments in non-current assets** of RON 4,322 mn (2009: RON 4,403 mn) were partly offset by proceeds from the sale of non-current assets amounting to RON 135 mn (2009: RON 141 mn).

Acquisitions and increases in interests in consolidated subsidiaries less cash acquired caused cash outflows of RON 68 mn (2009: RON 9 mn). **Net cash outflow from investment activities** totaled RON 4,264 mn (2009: RON 4,071 mn).

Cash inflows from the net increase of short-term and long-term borrowings amounted to RON 832 mn (2009: RON 1,164 mn). Cash outflows for dividend payments were below RON 1 mn (2009: RON 15 mn).

**Net cash inflow from financing activities** amounted to RON 832 mn (2009: RON 1,149 mn).

## **Information required by Ministry of Finance Ordinance no 3055/2009 under Chapter II, Section 10**

### **Risk management**

As an integrated oil and gas company with international operations, Petrom's business extends from hydrocarbon exploration and production and processing through to marketing of oil products and gas. Furthermore, Petrom is on its way to becoming an integrated energy player through its power projects portfolio – the Brazi gas-fired power plant and Dorobantu wind farm.

#### **Comprehensive risk management system**

The Enterprise Wide Risk Management (EWRM) system in Petrom has been designed to identify and counteract uncertainty through the risk management process. The system comprises a dedicated and representative risk organization working under a robust internal regulation framework, well integrated into the OMV risk management umbrella.

Petrom, as would any blue chip oil and gas company, is continuously reassessing its existing inventory of risks, identifying its new exposures and adding value to the business by properly enforcing the best available and cost efficient countermeasures. Some of the risks currently managed within Petrom's system are focused on market risks, financial risks, project risks, process risks, health safety and security risks, tax risks, compliance risks, personnel risks, legal risks and reputational risks.

Through the existing risk management process, Petrom secures its long-term sustainability and lowers the uncertainty over its strategic objectives and financial targets.

#### **Objectives**

The general objective of Petrom's risk management system is to provide a professional risk mitigation process by reducing the uncertainty of Petrom's objectives, through the very best available risk management techniques for securing the sustainability of the organization. Some of the main specific objectives of the system are to closely monitor and safeguard Petrom's exposure to market risk, credit risk, liquidity risks and cashflow risk and enforce proper countermeasures for limiting their effects.

#### **Organization**

Petrom's risk management system is fully embedded in the business and all personnel have the general responsibility of identifying and reporting risks. Formally, there are four levels of management in a pyramid-type risk organization. The first layer are the risk owners represented in all areas of activity, second levels are the divisional risk coordinators who manage and coordinate the risk process and all risk owners in their division, the third layer is the risk manager represented by the Risk Management department who manages all divisional risk coordinators and the entire risk management process. The top level is represented by Petrom's Executive Board who approves the risk reports in accordance with its objectives, risk perception and steers the process effectively.

#### **Risk management process**

Risk Management in Petrom is a continuous cycle where all risks (existing and new) are identified, analyzed, evaluated and managed or treated through the following steps "avoid", "decrease" and/or "accept". Each phase of the risk management process is documented and recorded into a risk register. Risk control and mitigation of identified and assessed risks takes place at all organizational levels using clearly defined risk policies and responsibilities. Most risks are managed locally in the business units. However, the management of some key risks is strictly governed by Corporate Directives, for example those relating to health, safety, security and environment, legal matters and compliance, human resources and corporate social responsibility with special emphasis on human rights and market price risks.

Risk treatment consists of proactive countermeasures implemented for decreasing the risk's occurrence likelihood but also reactive countermeasures which reduce the risk's impact. The reactive countermeasures are done either through transfer (insurance policies and hedging for financial risk) or through containment of effects and risk retention. The treatment of risks focuses on reaching the optimal risk balance of the company under economically efficiency constraints.

A special focus is awarded to the market and financial risks such as crude oil price risk, gas price risk, FX risks, interest rate risk, price risk, credit risk, liquidity risk and cashflow risk. These risks are closely monitored by the entire risk organization and treated as high risks. Petrom does not enter into or trade financial instruments, including derivative financial instruments for speculative purposes.

Various financial instruments are used for the purposes of managing exposure to currency, commodity price and interest rate movements, being evaluated at OMV Group level, considering Petrom's needs and being approved by Petrom's Executive Board.

In order to protect the company's cash flow in 2010, Petrom entered into crude oil hedges for a volume of 38,000 bbl/d (approximately 41% of total production) securing a price floor of USD 54/bbl via the sale of a price cap of USD 75/bbl (zero cost collar), whereby the Group would not be able to profit from oil prices above USD 75/bbl in 2010 for the above stated volume.

As part of the continuous examination of options to ensure financial stability, Petrom has decided at the end of January 2011 to hedge part of its crude production for the third consecutive year by entering into oil price swaps, locking in a Brent price of around USD 97/bbl for a production volume of 25,000 bbl/day, which counts for approximately 30% from the planned crude oil production in 2011. Settlement takes place quarterly for the difference between the fixed price and the arithmetic average of the Brent Commodity Reference Price.

With regard to hazard risks, Petrom is an integrated company with a wide asset base, most of these assets being hydrocarbon production and process plants. Therefore relevant hazard risks (e.g. explosions, earthquakes, etc.) were identified and incident scenarios were developed and assessed. In addition to the operational preventive and proactive countermeasures, Petrom's policy is to transfer these risks through high rating insurance placements to the international insurance market.

Decision risk wise, in addition to the EWRM process, all executive decisions of the company go through an individual risk assessment process prior to their approval. This way, all executive approvals are made based on a transparent view of the risks associated with each decision.

For any newly identified exposures, the risk management cycle is triggered ad-hoc and the new risk is analyzed, evaluated and mitigated in accordance with the risk management process and company's risk perception.

Regularly, all risks are reported on a Petrom Group consolidated basis for the Executive Board's approval and for the Audit Committee's information. Further, the consolidated Petrom Group regular risk reports are submitted to the OMV Enterprise Operating Risk Committee for including them in the risk profile presented to OMV's Executive Board and Supervisory Board.

### **Results**

The awareness and understanding of the companies' risk profile as well as risk management skills improved substantially throughout Petrom. With regard to tools and techniques, Petrom follows the best international practices in risk management and uses stochastic models (Monte Carlo simulation) to quantify the range of potential deviations from the company's planned cash flow under a 95% confidence level and a 3 year horizon. All risks are analyzed based on their historical trends and volatilities and quantified based on their most likely future estimates.

In 2010, 175 risks were analyzed, evaluated, managed and reported, ten of them representing more than 90% of the total exposure (mainly market price, business processes risks, financial risks). Petrom being in continuous development, all new business processes are fully integrated in the risk management process, with systematic understanding and analysis of the risks. Based on the consolidated risk report for 2010, the risk profile has been approved by Petrom's Executive Board in accordance with company's risk perception.

### **Risk Management Audit**

For a healthy process, Petrom's risk management system uses back testing and is also regularly audited by internal audit. These audit reports are used for the risk management system's benchmarking and steering purposes.

Another important role played by the Internal Audit with regard to the risk management process is supporting the quality of the process. This is done by providing assurance services on risk management process, giving assurance that risks are evaluated correctly, assessing the reporting process of the risks as well as checking the existence and implementation of the relevant risk management guidelines.

## **Description of internal control main characteristics**

The Supervisory Board is responsible for the Group's system of internal control and for reviewing its effectiveness and has delegated authority to the Audit Committee to assist it in fulfilling its responsibilities in relation to internal control and financial reporting.

The control framework in place is designed to manage rather than eliminate the risk of failure to achieve business objectives. It therefore only provides a reasonable assurance against material misstatement or loss. In general, OMV Petrom S.A.'s Control Framework applies to all the companies where the Company, directly or indirectly, has a controlling interest.

### **Comprehensive set of standards, prerequisite for a proper internal control**

For OMV Petrom S.A., an important prerequisite to set a comprehensive set of standards is establishing and maintaining a rigorous Business Management System (BMS) designed so as to match the integrated set of processes and tools used by the Company in developing its strategy, translated into actual actions and in monitoring and improving effectiveness of both.

BMS includes the following documentation areas: Business Management Manual, which is a description of the Business Management System and OMV Petrom S.A. Corporate Regulations; a special designated department - Corporate Affairs and Compliance - is responsible for the BMS coordination. This department provides support to the various entities in view of achieving regulatory requirements, coordinates the elaboration of corporate regulation drafts and provides a quality check, ensures posting of Executive Board approved corporate regulations on OMV Petrom S.A.'s intranet and communicates their enactment. There is a corporate directive in place that sets out the classification, definition and standardized structure of corporate regulations (e.g. instructions, standards, directives, guidelines, recommendations etc.) as well as their elaboration, communication, monitoring and reporting process.

Corporate regulations ensure that appropriate internal controls are designed and implemented for all business cycles that responsibilities are clearly defined within the organization in order to achieve necessary reviews and checks for all processes within the Group.

Internal Audit assesses the effectiveness and efficiency of the organization's policies, procedures and systems which are in place to ensure: proper identification and management of risks, reliability and integrity of information, compliance with laws and regulations, safeguarding of assets, economical and efficient use of resources and accomplishment of established objectives and goals.

Internal Audit carries out regular audits of individual group companies and informs the Audit Committee about the results of the audits performed.

### **Established group-wide standards for the preparation of annual and interim financial statements**

The most important elements of the internal control and risk management system regarding the accounting process consist in the standards for the internal control systems that are defined by internal Corporate Guidelines.

The Group has an Accounting Manual that is applied consistently in all group companies in order to ensure consistent accounting treatment is applied for the same business cases. The Group Accounting Manual is updated regularly with changes in International Financial Reporting Standards. Furthermore, the organization of the accounting and financial reporting departments is set up in order to achieve a high quality financial reporting process. Roles and responsibilities are specifically defined and a revision process – "four eyes principle" – is applied for business processes with effects in financial reporting, accounting and reporting operations as well as for the set up of the financial statements.

The establishment of group-wide standards for the preparation of annual and interim financial statements by means of the corporate IFRS Accounting Manual is also regulated by an internal Corporate Guideline. The Group uses a comprehensive risk management system. The essential processes of the financial reporting system have been identified and analyzed. The effectiveness of these processes is evaluated based on a rolling time schedule and benchmarked against best practice (e.g. derivatives, debtors' management, accounting for fixed assets). In addition, the effectiveness of the risk management system is regularly evaluated by external auditors. The results of the evaluation are reported to the Audit Committee.

## **Information required as per Regulation no. 1/2006 issued by the National Securities Commission**

### **1. The relationship between management and employees as well as of any conflict elements which characterize this relationship**

The dialog between unions and management continues on a regular basis. The key elements of the framework outlining the relationship between management and employees consist in the Collective Labor Agreement, Internal Rules and Parity Commissions. All the steps of the reorganization process that the company has entered were discussed and agreed by both parties.

The defective wording of stipulations from the Collective Labor Agreement of Petrom resulted in a chain of labor litigations through which several employees requested the payment of bonuses allegedly unpaid to them. These litigations are in progress at various stages, in Bucharest and across the country. Petrom's defence is based on the argument that the respective bonuses were included and maintained in the base salary of the employees, therefore the claims are unjustified.

Throughout 2010, Petrom continued to receive claims relating to this matter, although there were fewer claims than in previous years. Following the management assessment of the potential liabilities with respect to ongoing cases, the provision of RON 1.3 bn, booked in 2008 to cover the risk in line with prudence principles, was not increased. Petrom has taken all possible action and committed all necessary resources to defend itself against these lawsuits, and also to prevent a further increase in litigation.

### **2. Potential issues related to ownership rights over the company's tangible assets**

The company received notifications regarding the restitution of the assets confiscated by the state between March 6, 1945 and December 22, 1989, which falls under the incidence of the Law no. 10/2001; this law provides the modalities, the terms and the legal framework for the restitution of these assets. The summarized status and the resolutions to these notifications as of December 31, 2010 are the following – 1,126 notifications were transmitted to Petrom, out of which:

- ▶ 16 buildings were restored;
- ▶ 1,075 notifications were rejected;
- ▶ 27 notifications were redirected towards other entities;
- ▶ 8 notifications (files) are currently under analysis.

As per Article 7.2, in conjunction with the provisions of Article 26 of the Methodological Norms for the application of Law no. 10/2001, approved through Government Decision no. 498/2002, the City Halls or the notified Prefectures are under the obligation to identify the owning entity and to direct the notifications to these entities for resolution. At the same time, those who submitted the notifications are communicated that the requested asset is not under administration of these entities and also the name of the entity in charge to solve the notification. Due to the fact that up to this date is still in progress the activity of solving notifications within the City Halls' and Prefectures' Commissions, part of the notifications received may be further directed to Petrom.

Petrom's governance follows a two-tier system, with the Executive Board ensuring the management of the company under the control and supervision of the Supervisory Board.

### **3. Any agreements, understanding or family connection between the company's administrators and another person who is responsible for appointing the respective person in the position of administrator**

There are no such agreements and understandings. Members of the Supervisory Board are not appointed by certain persons or certain shareholders. They are appointed by the Ordinary General Shareholders Meeting based on shareholders' votes and in compliance with the statutory requirements relating to quorum and majority.

### **4. The participation of the Supervisory Board members in the share capital of the Company**

Petrom does not have knowledge of any member of the Supervisory Board holding shares issued by the Company throughout the year under review.

### **5. Any agreement, understanding or family connection between the members of the executive management and another person who is responsible for appointing him/her member of the executive management**

There are no such agreements or understandings.

**6. The participation of the executive management members in the share capital of the Company**

Petrom does not have knowledge of any member of the Executive Board holding shares issued by the Company throughout the year under review.

**7. Potential litigations and administrative procedures in which the company's administrators and the members of the Executive Board were involved over the last 5 years**

Petrom does not have knowledge of the existence of such litigation or administrative procedure having a significant impact on the management and operation of the Company.