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ARCTIC PAPER S.A. CAPITAL GROUP
Consolidated Annual Report
for the year ended 31st December 2011

TRANSLATORS' EXPLANATORY NOTE
The following document is a free translation of the report of the above-mentioned Company.
In the event of any discrepancy in interpreting the terminology, the Polish version is binding.

ARCTIC PAPER

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

Dear Sirs,

Year 2011 was characteristic of great changeability. The first quarter was marked with increasing demand for graphic paper in Europe and, on that basis, optimistic expectations regarding the future development of the situation in subsequent months emerged. However, starting from beginning of April, decrease of demand occurred, particularly material in May and June 2011. Market data show decrease of demand in the second quarter by on average 8% compared to the previous quarter and by approximately 9-10% compared to the previous year. The third quarter of 2011 was a significant shift of negative tendency which influenced unsatisfactory results achieved in the first half of the year. Despite the holiday season a great sales volume was achieved. In the fourth quarter of 2011 the positive tendencies initiated in the previous quarter continued. Sales in December – while usually it is a month with relatively poor sales – turned out to be actually high in 2011. In the year's perspective sales increased by 2.8% compared to 2010 and reached the level of 765 thousand tons. Satisfactory demand for paper produced by Arctic Paper Group allowed for great use of production capacities of the mills – over 90%. In the year's perspective revenues amounted to PLN 2,527 million which is over 10% more than in the previous year. Great fluctuations of demand did not allow for increase of raw materials (particularly pulp) prices to translate to paper prices. However, in several segments a slight increase of prices was achieved.

We succeeded to close the year with net profit. The EBITDA attained is at the level similar to the previous years and after exclusion of single occurrings experienced in 2010, it doubled.

The signs of balancing between demand and supply are more and more distinct. It results from the competitors' decisions, both exercised and planned, to permanently or temporary shut-off the production lines. In year's perspective it amounted to nearly 2 million tonnes throughout Europe. The merge of UPM-Kymmene and Myllykoski approved by European Commission opens new possibilities of consolidation in the industry. The results of European paper producers being currently achieved as well as public statements of executives give premises for further merges and production limitations to occur, not for investments in production capacities.

Because of the market conditions and unsatisfactory financial results, Arctic Paper suspended its investment programme regarding development of production in Kostrzyn mill. The minor projects currently realised focus on improving effectiveness, decrease consumption of energy and decrease production costs. Development works are *continued regarding increase of percentage share of sales of papers for purposes other than printing – medical care, tech-paper, premium packaging. The development project of water plant in Munkedals is at the stage of acquiring proper administrative permits.*

Unsatisfactory financial results force to further seeking of savings and cost reductions as well as organization changes. A programme has been prepared and implemented in all business entities, the purpose of which is to reduce costs by approximately PLN 60 million annually. The effects of these proceedings are already visible, particularly in results of Munkedals mill.

Yours sincerely,

Michał Jarczyński

President of the Management Board
Arctic Paper S.A.

Introduction

Information on the report

This Consolidated Annual Report for 2011 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 authorization 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 Poznań, 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
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, Arctic Paper Mochenwangen, Arctic Paper Verwaltungs GmbH, Arctic Paper Immobilienverwaltungs GmbH & Co. KG
Grycksbo Group	Arctic Paper Grycksbo AB, Grycksbo Paper Holding AB, Grycksbo Paper Deutschland GmbH
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); Arctic Paper Benelux SA seated in Waterloo (Belgium); Arctic Paper Danmark A/S seated in Vallensbaek (Denmark); Arctic Paper France SAS seated in Paris (France); Arctic Paper Deutschland GmbH seated in Hamburg (Germany); Arctic Paper Ireland Ltd seated in Dublin (Ireland); Arctic Paper Italia Srl seated in Milan (Italy); Arctic Paper Baltic States SIA seated in Riga (Latvia); Arctic Paper Norge AS seated in Oslo (Norway); Arctic Paper Polska Sp. z o.o. seated in Warsaw (Poland); Arctic Paper España SL seated in Barcelona (Spain); Arctic Paper Sverige AB seated in Uddevalla (Sweden); Arctic Paper Schweiz AG seated in Zurich (Switzerland); Arctic Paper UK Ltd seated in Caterham (UK); Arctic Paper East Sp. z o.o. seated in Kostrzyn nad Odrą (Poland). Grycksbo Paper Deutschland GmbH;
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 of Arctic Paper S.A.

Extraordinary Shareholders Meeting	
Articles of Association, Issuer's Articles of Association, Company's Articles of Association	Articles of Association of Arctic Paper S.A.
SEZ	Kostrzyńsko-Słubicka Special Economic Zone
Court of Registration	District Court Poznań-Nowe Miasto i Wilda in Poznań
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 Mochenwangen in December 2008
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 2011 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 fifteen Sales Offices providing access to all European markets, including Central and Eastern Europe. The Group's consolidated sales revenues for 2011 totaled PLN 2,527 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 in Poznań, 8th Commercial Department of the Polish Court Register, under KRS number 0000306944. The Parent Company holds statistical number REGON 080262255.

Group Profile

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

Additional businesses of the Group, subsidiary to paper production, cover:

- 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 on 31st December 2011 and as on the day of publishing of this report the Group owned 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 mainly produces 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 Munkedal (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 tons 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 of the Arctic Paper Group includes:

Uncoated wood-free paper, in particular:

- high-white offset paper produced 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 produced under the brand name Munken, used primarily for book publishing;
- high quality graphic paper, used for printing various advertising and marketing materials, produced under the brand name Munken;

Coated wood-free paper, in particular:

- wood-free paper produced 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 produced and distributed under the brand name Pamo, primarily used for printing paperbacks;
- wood-containing offset paper produced 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 23rd 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 in the section Accounting policies and additional notes to the consolidated financial statements (Note 1 and note 2).

Changes in the capital structure of the Arctic Paper Group

In 2011 a new company has been established, belonging to the Capital Group – Arctic Paper Munkedals Kraft AB founded for the purpose of water energy production for Munkedals mill. This subject is covered in details in note 23.2 to the consolidated financial statements. In 2011 two Sales Offices belonging to Grycksbo Group were dissoluted: Grycksbo Paper UK Limited and Grycksbo Paper France URL.

Changes in basic management principles

There were no important changes in basic management principles in 2011.

Shareholder structure

Arctic Paper S.A.'s main shareholder is Swedish company Arctic Paper AB which as on 31st December 2011 held 41,441,500 Shares in our Company representing 74.8% of its 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 27.04.2012				as at 29.02.2012			
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%	41 441 500	74,80%	41 441 500	74,80%
Others	13 962 000	25,20%	13 962 000	25,20%	13 962 000	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%

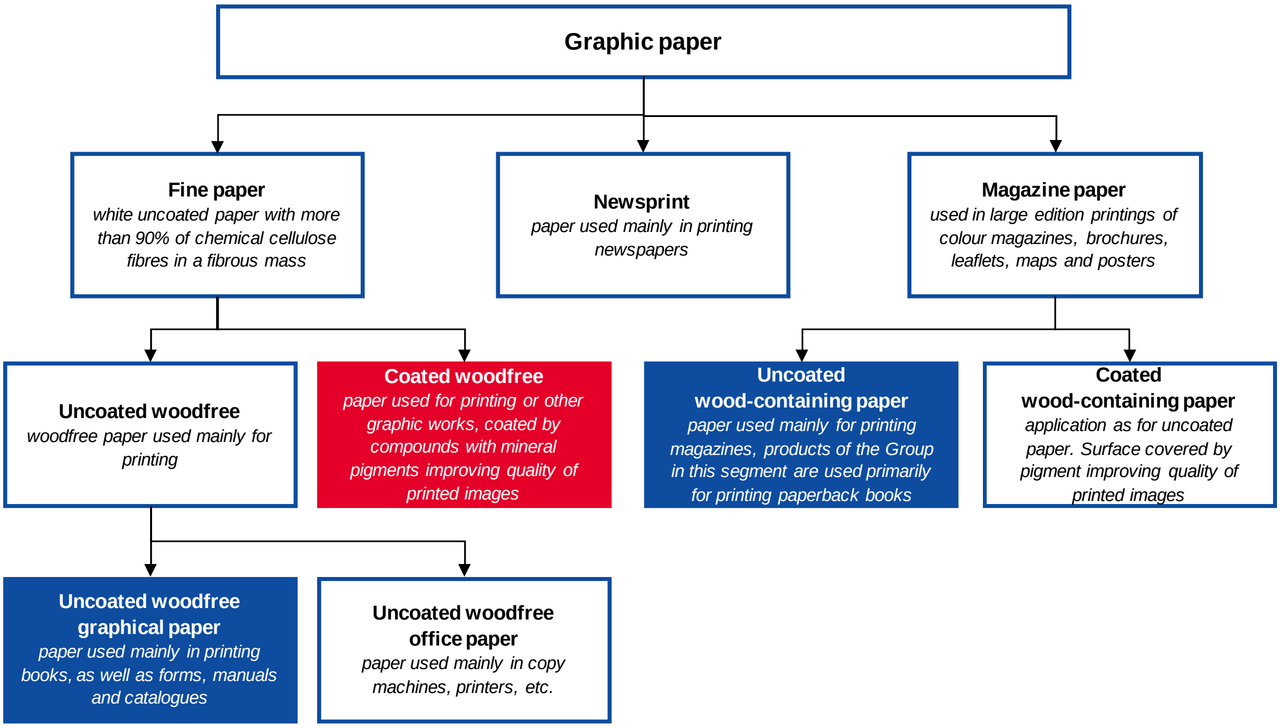
Data in the above table are given as on the date of approval of the hereby report and as on the date of publication of the quarterly report for 4Q 2011.

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 on 31st December 2011. As a result of acquisition of Grycksbo paper mill on 1st 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 produced 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 is paper primarily used to print newspapers, produced 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 section Information on market tendencies.

Development directions and strategy

The Group's main strategies' aims include:

Expansion in Central and Eastern European markets while maintaining leading position in 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.

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Sales structure

In 2011 the sales structure divided to main production lines presented as follows:

Sales structure by products

PLN thousands	2011	share %	2010	share %
Amber	301	39%	297	40%
G-Print	169	22%	159	21%
Munken	109	14%	118	16%
Pamo	66	9%	64	9%
Arctic	80	10%	61	8%
L-Print	25	3%	33	4%
AP Tech	12	2%	11	1%
Other	2	0%	2	0%
Total	765	100%	745	100%

Sales revenues structure by products

PLN thousands	2011	share %	2010	share %
Amber	947 107	37%	860 926	38%
G-Print	549 091	22%	475 415	21%
Munken	446 637	18%	448 274	20%
Arctic	287 644	11%	219 666	10%
Pamo	187 159	7%	171 372	7%
L-Print	62 577	2%	73 711	3%
AP Tech	36 351	1%	31 061	1%
Other	10 623	0%	7 307	0%
Total	2 527 189	100%	2 287 731	100%

In 2011 there were no significant changes in the Group's sales structure by products or in the Group's income structure by products

Output markets

In 2011 the market share of sales outside Poland in metric tonnes was 90% and did not change compared to 2010. This year, as in previous years, sales focused on European markets. The share of those markets in total sales volume was app. 99% in 2011 and similar to 2010.

The geographical structure of sales revenues from the most important sales markets in 2011, as compared to

2010, is shown in note 10.1 to 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 direct customers use the Group's products. Direct and indirect customer groups include:

- printing houses – direct customers that purchase paper produced by the Group directly from the paper mills;
- distributors – direct customers that purchase paper produced by the Group in order to resell it;
- publishing houses – direct and indirect customers that purchase paper produced 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 publishings;
- 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 2011, 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,
- transportation services.

Pulp

The basic raw material used by the Group to produce paper is pulp. Except for the paper mill in Mochenwangen, all the Group's paper mills are so-called non-integrated producers, i.e. they purchase all their pulp from external producers. The paper mill in Mochenwangen is partly integrated and has its own pulp mill with production capacity of approximately 62,100 metric tonnes per year, which accounts for about 62% 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.

The energy source In Arctic Paper Grycksbo AB paper mill is biomass and electricity partly purchased from outside suppliers.

Transportation 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 2011, 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. Lower demand for paper is reported each year during summer holidays and in Christmas season 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 products' 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 8th 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 Kostrzyn, 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 1st 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 17th February 2006 (amended by the decisions of 28th March 2006, 1st June 2006, 13th December 2006, 4th May 2007 and 6th 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.

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 – 85%, and from PEFC (Programme for the

Endorsement of Forest Certification) certified pulp - 15%.

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 Munkedal 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 2nd 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 produce a daily maximum of approximately 475 metric tonnes gross of paper.

Wood used to produce 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 permit in march 2007. The permit is issued by the Swedish Environmental Court and allows production up to 310,000 tonnes per year. In addition, the mill has also a permit to emit carbon dioxide released by authorities of the regional province of Dalarna. Being a paper Mill oriented on environment is a way for Arctic Paper Grycksbo AB to ensure survival in the long term. Since 1997, Arctic Paper Grycksbo AB has had certificate ISO 14001 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 Emissions 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 possible by a substantial reconstruction of the boiler in conjunction with investment in equipment to handle biofuels, electric exhaust particulate filters and conversion turbines to produce electricity from renewable sources.

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

The mill has implemented energy management system in accordance with SS 62 77 50 (Swedish standard for energy management), participates in PFE (Swedish Energy Efficiency Programme) and plans to introduce ISO 50001 standard (Energy Management System) in 2012. Our products are reviewed under the „Chain of Custody" under FSC (Forest Stewardship Council) and in accordance with 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	2011	2010	Change2011/2010 - %
Revenues	2 527 189	2 287 731	10,5
including:			
Sales of paper	*2 527 189*	*2 287 360*	*10,5*
Sales of services	*0*	*371*	*(99,9)*
Gross profit on sales	353 943	258 110	37,1
Gross profit on sales margin %	*14,01*	*11,28*	*(12,1) p.p.*
Sales costs	(294 405)	(272 965)	7,9
Administrative expenses	(71 509)	(57 273)	24,9
Other operating income	72 578	150 180	(51,7)
Other operating cost	(57 492)	(60 372)	(4,8)
EBIT	3 115	17 680	(82,4)
EBIT margin %	*0,12*	*0,77*	*(6,9) p.p.*
EBITDA	141 762	146 294	(3,1)
EBITDA margin %	*5,61*	*6,39*	*(7,1) p.p.*
Financial income	42 682	20 062	112,7
Financial cost	(45 668)	(30 393)	50,3
EBT	128	7 350	(98,3)
Corporate income tax	11 937	21 467	(44,4)
Net profit	12 066	28 817	(58,1)
Net profit margin %	*0,48*	*1,26*	*(8,3) p.p.*
Earnings per share (in PLN)	0,22	0,53	*n.a.*

Revenue

In 2011 consolidated sales revenue amounted to PLN 2,527,189 thousand compared to PLN 2,287,731 thousand in the previous year. LFL consolidated sales revenue (after exclusion of acquisition of Grycksbo factory in Sweden) were higher by 5.3% compared to sales realised in 2010.

The sales volume in 2011 amounted to 765.4 thousand tonnes and was higher by 20.7 thousand tonnes than in the previous year. This change represents an increase of sales volume by 2.8%. The sales volume in 2011 (after exclusion of AP Grycksbo) decreased by 13.7 thousand tonnes and -2.6% compared to the level achieved in 2010.

Cost of sales, selling and distribution expenses and administrative expenses

Profit on sales in 2011 was 37.1% higher than in the previous year. The sales profit margin in the current year stood at 14.01% compared to 11.28% (+2.7 p.p.) in the previous year.

The main reason for the increase of profit on sales in 2011, compared to the previous year, was lower cost of sales resulting from decreasing prices of pulp, especially in 2H 2011.

In 2011 selling expenses amounted to PLN 294,405 thousand which represents an increase by 7,9% compared to costs incurred in 2010. The main reason for the increase in selling expenses in 2011 were costs incurred at AP Grycksbo which were consolidated from March as well as increase in transportation costs. In 2011 selling expenses per tonne of paper sold increased by 5% compared to 2010.

In 2011 administrative expenses amounted to PLN 71,509 thousand compared to PLN 57,273 thousand in 2010, which represents an increase by 24.9%. It also means the rise of administrative expenses per tonne sold. The main reason for increase of these expenses in 2011 was the inclusion of AP Grycksbo in the consolidation since 1st March 2010, as well as the costs incurred for realisation of the Group's projects including costs related to conducting negotiations and preparing merge with another entity as reported in current report no 21/2011 published on 30th August 2011.

Other operating income and expenses

Other operating income in 2011 amounted to PLN 72,578 tys. PLN which means a decrease compared to the same period of previous year by PLN 77,602 thousand. Other operating income in 2011 comprised mostly heat and electricity sales income in AP Kostrzyn as well as income from sales of pulp and other materials.

The most important factor which had impact on material decrease of other operating income in 2011 was the fact that in 2010 occurred the recognition of negative goodwill from occasional acquisition of AP Grycksbo.

Other operating expenses in 2011 amounted to PLN 57,492 thousand compared to PLN 60,372 thousand in 2010. The major share in other operating expenses was the own cost of sales of energy and materials as well as cost of sales of pulp and other materials.

Financial income and cost

In 2011 financial income amounted to PLN 42,682 thousand and were higher comparing to financial income recorded in 2010 by PLN 22,620 thousand. The significantly higher financial income in 2011 was caused mostly by positive foreign exchange differences. A material part of the exchange differences was constituted by its unrealised part resulted from evaluation of the liability of loan to Arctic Paper Investment AB granted in PLN by Arctic Paper S.A. The loan was related to acquisition of AP Grycksbo mill in March 2010. The impact of this evaluation amounted in 2011 to PLN 30,967 thousand.

Financial cost in 2011 amounted to PLN 45,668 thousand PLN compared to PLN 30,393 thousand in 2010. This increase in financial cost in 2011 results from interest costs of PLN 40,829 thousand compared to PLN 30,370 thousand in the previous year.

Income tax

Income tax in 2011 amounted to PLN +11,937 thousand while in 2010 it amounted to PLN +21,467 thousand.

Positive effect of the income tax resulted from the recognition of assets from deferred income tax on temporary differences and tax losses workable in future.

Profitability analysis

EBITDA in 2011 amounted to PLN 141,762 thousand while in 2010 it amounted to PLN 146,294 thousand. In the reporting period EBITDA margin amounted to 5.61% compared to 6.39% in 2010.

Profit on operating activities in 2011 amounted to PLN 3,115 thousand compared to PLN 17,680 thousand in the previous year. Operating profit margin in 2011 amounted to 0.12%, while in 2010 it amounted to 0.77%.

Net profit in 2011 amounted to PLN 12,066 thousand compared to PLN 28,817 thousand in 2010. Net profit margin amounted to 0.48% compared to 1.26% in 2010.

Profitability analysis

PLN thousands	2011	2010	Change2011/2010 - %
Gross profit on sales	353 943	258 110	37,1
Gross profit on sales margin %	*14,01*	*11,28*	*2,7 p.p.*
EBITDA	141 762	146 294	(3,1)
EBITDA margin %	*5,61*	*6,39*	*(0,8) p.p.*
EBIT	3 115	17 680	(82,4)
EBIT margin %	*0,12*	*0,77*	*(0,6) p.p.*
Net profit	12 066	28 817	(58,1)
Net profit margin %	*0,48*	*1,26*	*(0,8) p.p.*
ROE - Return on equity (%)	1,8	4,3	(2,5) p.p.
ROA - Return on assets (%)	0,6	1,5	(0,9) p.p.

In 2011 return on equity amounted to 1.8%, while in 2010 it reached a level of 4.3%. In the same period return on assets fell from 1.5% in 2010 to 0.6% in 2011.

Report on financial situation

Selected items of the consolidated balance sheet

PLN thousands	31/12/2011	31/12/2010	Change 31/12/2011 -31/12/2010
Non-current assets	1 132 429	1 148 498	(16 069)
Inventory	315 142	291 048	24 094
Receivables, therein:	300 262	277 297	22 964
Trade and other receivables	*294 452*	*228 993*	*65 459*
Other current assets	10 400	14 525	(4 125)
Cash and equivalents	166 299	179 402	(13 103)
Total assets	1 924 531	1 910 769	13 762
Equity	675 561	667 943	7 618
Short-term liabilities	612 273	742 608	(130 335)
therein:			
Trade and other payables	*403 057*	*365 082*	*37 975*
Interest-bearing loans and borrowings	*67 242*	*292 111*	*(224 869)*
Other financial liabilities	*60 383*	*85 415*	*(25 032)*
Long-term liabilities	636 697	500 219	136 478
therein:			
Interest-bearing loans and borrowings	*317 262*	*192 705*	*124 557*
Other financial liabilities	*44 277*	*307 514*	*(263 238)*
Total equity and liabilities	1 924 531	1 910 769	13 762

As on 31st December 2011 total assets amounted to PLN 1,924,531 thousand compared to PLN 1,910,769 thousand at the end of 2010.

Non-current assets

As at the end of December 2011 non-current assets amounted to PLN 1,132,429 thousand and represented 58.8% of total assets, while as at the end of 2010 it amounted to PLN 1,148,498 thousand (60.1% of total assets). The carrying value of fixed assets slightly decreased in 2011, mainly due to amortization not fully covered by investment expenses.

Current assets

At the end of December 2011 current assets amounted to PLN 792,102 thousand compared to PLN 762,271 thousand as at the end of December 2010. Within the position of current assets there was an increase in inventories by PLN 24,094 thousand, increase in receivables by PLN 22,965 thousand, decrease in other current assets by PLN 4,125 thousand and decrease in cash and cash equivalents by PLN 13,103 thousand. As at the end of December 2011 current assets represented 41.2% of total assets (39.9% at the end of

2010), therein inventories 16.3% (15.2% at the end of 2010), receivables 15.6% (14.5% at the end of 2010), other current assets 0.5% (0.8% at the end of 2010) and cash and cash equivalents 8.6% (9.4% at the end of 2010).

Equity

As at the end of 2011 equity amounted to PLN 675,561 thousand compared to PLN 667,943 thousand as at the end of 2010. As at the end of 2011, equity represented 35.0% of the total equity and liabilities. The share of equity in total equity and liabilities has not changed compared to the end of December 2010.

Current liabilities

As at the end of December 2011 current liabilities amounted to PLN 612,273 thousand (32% of the total balance sheet amount) compared to PLN 742,608 thousand (39% of the total balance sheet amount) at the end of 2010. In 2011 there was a decrease in current liabilities by PLN 130,335 thousand. The change was primarily due to repayment of zero-coupon 1-year old bonds with redemption date in February 2011. For this purpose the Company issued new medium-term 2-year old bonds which were shown as on 31st December 2011 as long-term liabilities.

Non-current liabilities

As at the end of December 2011 long-term liabilities amounted to PLN 636,697 thousand (33% of the total balance sheet amount) compared to PLN 500,218 thousand at the end of 2010 (accordingly 26% of the total balance sheet amount). In the analyzed period, there was an increase of long-term liabilities by PLN 136,479 thousand which resulted mainly from the issue of new medium-term bonds.

Debt analysis

Debt analysis

	2011	2010	Change2011/2010 - %
Debt-to-equity ratio (%)	184,9	186,1	(1,2) p.p.
Equity-to-non-current assets ratio (%)	59,7	58,2	1,5 p.p.
Interest-bearing debt-to-equity ratio (%)	56,9	72,6	(15,7) p.p.
Net borrowings-to-EBITDA (times)	2,26x	2,46x	(0,20)
EBITDA-to-interest (times)	3,5x	4,8x	(1,3)

As at the end of December 2011 debt to equity ratio was 184.9% and was by 1.2 p.p. lower than at the end of December 2010.

Equity to non-current assets ratio at the end of 2011 stood at 59.7% and was higher by 1.5 p.p than at the end of December 2010.

The interest-bearing debt to equity ratio at the end of 2011 stood at 56.9% and was by 15.7 p.p. lower than at the end of December 2010.

Net borrowings to EBITDA ratio for the last 12 months amounted to 2.26x compared to 2.46x for 2010. At the same time, EBITDA to interest ratio for the last 12 months decreased from 4.8x for 2010 to 3.5x in 2011.

Liquidity analysis

Liquidity ratios

	2011	2010	Change2011/2010
Current liquidity ratio	1,3x	1,0x	0,3
Quick liquidity ratio	0,8x	0,6x	0,2
Acid test ratio (cash liquidity)	0,3x	0,2x	0,0
Inventory turnover DSI (days)	52,2	51,6	0,6
Receivables turnover DSO (days)	41,9	36,0	5,9
Liabilities turnover DPO (days)	66,8	64,8	2,0
Operating cycle (days)	94,1	87,7	6,5
Cash conversion cycle (days)	27,4	22,9	4,5

At the end of December 2011 current ratio stood at 1.3x and was by 0.3 higher than at the end of December 2010. The quick ratio reached 0.8x as at the end of 2011 and was higher by 0.2 compared to the end of the previous year. Cash conversion cycle for 2011 was longer compared to 2010 by 4.5 days.

Consolidated cash flow statement

Selected items of the consolidated cash flow

PLN thousands	2011	2010	Change2011/2010 - %
Cash flow from operations	162 247	120 409	34,7
including:			
EBT	*128*	*7 350*	*(98,3)*
Depreciation and impairment of non-current assets	*138 647*	*128 614*	*7,8*
∆ in working capital	*(1 721)*	*57 769*	*(103,0)*
Other corrections	*25 193*	*(73 324)*	*(134,4)*
Cash flow investing activities	(56 375)	(230 583)	(75,6)
Cash flow financing activities	(121 615)	129 973	(193,6)
Total Cash Flow	(15 743)	19 800	(179,5)

Cash flow from operating activities

In 2011 net cash flow from operating activities amounted to PLN 162,247 thousand compared to PLN 120,409 thousand in 2010. Higher cash flow from operating activities in 2011 resulted primarily from utilization of the CO2 emission rights recognized while acquiring AP Grycksbo and AP Mochenwangen and greater gross profit in 2011, compared to the result achieved in 2010 having excluded profit on occasional acquisition of AP Grycksbo.

Cash flow from investment activities

In 2011 cash flow from investment activities amounted to PLN -56,375 thousand compared to PLN -230,583 thousand in 2010. The reported change was mainly due to the acquisition of AP Grycksbo in 2010. Cash flows from investment activities in the whole 2011 comprise mainly expenses for purchasing of property, plant and equipment and intangibles.

Cash flow from financial activities

In 2011 cash flow from financial activities amounted to PLN -121,615 thousand compared to PLN +129,973 thousand in 2010. In twelve months of 2011 cash flow from financial activities related mostly to the refinancing of AP Munkedals debt by Svenska Handelsbanken AB bank as well as issue and repayment of bonds performed in February 2011.

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;
- paper prices;
- pulp and energy prices;
- currency exchange rates fluctuations.

Macroeconomic and other economic factors

We believe that a number of macroeconomic and other economic factors have a profound impact on the demand for high-quality paper and these factors may also influence the demand for the Group's products and our operating results. These factors include:

- 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 such as those indicated above. The prices of paper are also influenced by a number of factors connected with supply, primarily the changes in production capacities on the global and European levels.

Costs of raw materials, energy and transportation

The main elements of the Group's operating expenses are costs of raw materials, energy and transportation. The costs of raw materials include particularly the costs of pulp, timber and chemical agents used for paper production. Our energy costs, historically speaking, include first of costs of electricity, gas, coal and fuel oil. Costs of transportation 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 rates 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 do not match, 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 majority of costs related to the operations of the Mochenwangen paper mill), PLN (the majority of other costs incurred by the Kostrzyn nad Odrą mill) and SEK (the majority of other costs incurred by the Munkedal and Grycksbo mills).

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

In 2011 there were no significant changes in the structure of the Group that would have impact on financial result achieved.

Other material information

During the reported period there were no other material occurrences 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 2011 supplies of high quality paper to the European market were approximately 4.4% lower compared to 2010. During this period, supplies in the segment of uncoated wood-free paper (UWF) were 4.1% lower, while those in the segment of coated wood-free paper (CWF) 4.7% lower.

The dynamics of changes in 2011 as regards supplies level and estimated demand for high quality paper in Europe indicates demand decline.

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

Prices of high quality paper

In 2011 prices of high quality paper decreased.

At the end of 2011 levels of declared prices for uncoated wood-free paper for the selected markets of

Germany, France, Spain, Italy and United Kingdom expressed in EUR and GBP were lower than at the end of the previous year by app. 2.8%. Similarly, prices of coated wood-free paper decreased by app. 5.1%.

Average prices invoiced by Arctic Paper in EUR in the segment of uncoated wood-free paper changed between January and December 2011 within the range from -5.6% to +2%, whereas prices of coated wood-free paper from -9.3% to -1.8%.

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 exclusive 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 the given 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 2011 pulp prices reached a level of USD 834,0 per tonne for NBSK and USD 652,0 per tonne for BHKP.

At the end of 2011 the pulp price was lower by 12.1% (NBSK) and 23.2% (BHKP), compared to prices as at the end of 2010.

Pulp costs are subject to frequent changes. Decrease in prices of raw materials, in particular pulp, has a profound impact on Group's profitability.

The average cost of pulp per tonne sold as calculated for the Group expressed in PLN in 2011 decreased compared to 2010 by 2.4%.

In 2011 the share of pulp costs in own sales cost amounted to 46.7%, whereas in 2010 it amounted to 49.8%.

Arctic Paper Group uses the pulp in the production process according to the following structure: BHKP 59%, NBSK 19% and the remaining 22%.

Source: www.foex.fi, Arctic Paper analysis

Currency exchange rates

The EUR/PLN exchange rate at the end of 2011 amounted to 4.4168 and was higher by 11.5% than at the end of 2010. The average exchange rate EUR/PLN in 2011 was higher by 3.1% compared to 2010.

At the end of 2011 EUR/SEK rate amounted to 8.9228 and was 0.5% lower than at the end of 2010. For this pairing, the average rate in 2011 was lower by as much as 5.4% than in 2010.

These changes mean that in 2011 occurred a depreciation of PLN in relation to EUR, which had very positive impact on the Group's financial results, in particular in connection with sales revenues generated by AP Kostrzyn in EUR and expressed in PLN. A different situation was observed concerning the relation of EUR to SEK where during the year a strong appreciation of Swedish currency occurred and had an adverse impact on levels of revenues realised in Grycksbo and Munkedals mills.

At the end of 2011 USD/PLN exchange rate amounted to 3.4174. In 2011 the average USD/PLN rate amounted to 2.9636 compared to 3.0179 in the previous year which represents a decrease by 1.8%.

At the end of 2011 USD/SEK rate amounted to 6.9038. The average exchange rate in 2011 amounted to 6.4830 compared to 7.2038 in the previous year which means a decrease by 10%.

The changes in USD/PLN and USD/SEK rates had a positive impact on the results of 2011 as they translate to reduction in prices of raw materials purchased in USD.

At the end of December 2011 EUR/USD rate amounted to 1.2924 compared to 1.3361 (-3.3%) at the end of December 2010. In 2011 a depreciation of USD in relation to EUR occurred. In 2011, the average exchange rate equaled 1.3929 compared to 1,3267 in the previous year which means depreciation of USD in relation to EUR by 4.9%.

Depreciation of PLN in relation to EUR and SEK and depreciation of PLN and SEK in relation to USD had a positive impact on the Group's financial results in 2011.

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, being able to further increase paper prices, in connection with pulp prices remaining at high levels and adverse changes in exchange rates determining our sales revenues, particularly in Sweden.
- Pricing of raw materials, including pulp and electricity; in particular, an adverse effect on the financial results may be caused by pulp prices remaining at high levels or its increase. Furthermore, the fluctuations of electricity prices in Sweden, which the Group experienced in 2010, and which translated into lower sales profitability at AP Munkedals and AP Grycksbo, have a material adverse effect on the Group's performance.
- Currency rates fluctuations; in particular, the strengthening of PLN and SEK in relation to EUR and GBP, the strengthening 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

In 2011 there were no significant changes in scope of risk factors.

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 producers operating on a scale larger than our Group. A potential growth of competition resulting from a possible increase in production capacities of our competitors, and thus, in the paper supply in the market, can 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 produced paper to the European markets, generating a significant part of its sales revenues in EUR, GBP, PLN, and SEK. The costs of procurement of raw materials for paper production, in particular pulp, are paid 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 subsidiaries 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 of interest rates

The Group is exposed to the risk of changes of interest rates, mainly due to an existing interest 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. Adverse changes of 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 the 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, bringing 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 in AP Mochenwangen mill. 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 more than 800,000 tonnes 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 23rd October 2008 and of the bonds issued in February 2010 and February 2011 as well as debt under the loan agreement with a bank Svenska Handelsbanken dated 01st and 26th February 2010 and 26th 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 production 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 nad Odrą 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. did not publish forecast of financial results for 2011, and has not published and does not plan to publish forecast of financial results for 2012.

Information on dividend

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

In accordance with the requirements of the Code of Commercial Companies, the parent company is required to create a capital reserve to cover losses. For this category of capital poured into at least 8% profit for the year shown in the standalone financial statement of the parent company until the capital reaches at least one third of the share capital of the parent. The use of capital and reserve is decided by the Shareholders Meeting; however, part of the reserve capital in the amount of one-third of the share capital can be used only to cover the loss shown in the standalone financial statements of the parent and is not subject to the division for other purposes.

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

Payment of dividend by the Company to its shareholders depends on the payments received from its subsidiaries. Risk related to the Company's ability to pay dividend is described in the part Risk factors of this report.

In 2011 the Company did not pay dividend.

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

On 7th February 2011 an annex to the agreement dated 11th February 2010 was concluded between the Company and BRE Bank S.A. regarding Bonds Issue Programme. By the power of the annex, the maximum Value of Bonds Issue Programme was raised from the amount of PLN 200,000 thousand to PLN 300,000 thousand.

On 10th 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 25th 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.

On 24th February 2011 the redemption of zero-coupon bonds series 2/2010 for the total face value of PLN 66,000 thousand occurred.

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

Remuneration paid to Management Board and Supervisory Board Members

The table below presents the information on total remuneration 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 1st January 2011 to 31st December 2011 (figures 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.	Pension plan	Other benefits	Total
Management Board				
Michał Piotr Jarczyński	1 487 593	-	13 521	1 501 114
Michał Jan Bartkowiak	568 465	-	3 681	572 146
Hans Olof Karlander	875 475	471 367	41 627	1 388 469
Per Skoglund	521 433	183 557	22 831	727 822
Jacek Łoś*	413 060	-	1 881	414 940
Supervisory Board				
Rolf Olof Grundberg	192 000	-	-	192 000
Rune Roger Ingvarsson	132 000	-	-	132 000
Thomas Onstad	102 000	-	-	102 000
Fredrik Lars Plyhr	162 000	-	-	162 000
Jan Ohlsson	102 000	-	-	102 000
Wiktorian Zbigniew Tarnawski	102 000	-	-	102 000

*for the period of 01.07.2011-31.12.2011

Agreements with Management Board Members on financial compensation

As on 31 December 2011 and as on 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 27/04/2012	Number of shares or rights thereto as at 29/02/2012	Change
Management Board			
Michał Piotr Jarczyński	86 450	86 450	-
Hans Olof Karlander	n/a	19 124	-
Michał Jan Bartkowiak		-	-
Jacek Łoś		-	-
Per Skoglund	-	-	-
Supervisory Board			
Rolf Olof Grundberg	10 312	10 312	-
Rune Roger Ingvarsson	-	-	-
Thomas Onstad	-	-	-
Fredrik Lars Plyhr	19 000	19 000	-
Wiktorian Zbigniew Tarnawski	-	-	-

Information on system of control over employees' shares

The Company has not issued any convertible or exchangeable securities. On 30th 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 8th June 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, that is: § 3 has been changed and given the following wording: „After entering the register of entrepreneurs of the conditional share 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 to claim of shares series D with a nominal value PLN 10 (ten zloty) each.

§ 4. 1 has been changed and given the following wording: "The entitled to subscribe for the Warrants will be, indicated by the Supervisory Board, people 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 of the Incentive Program"), provided that the eligible to purchase the Warrants will be no more than 30 people."

On 8th June 2010, Annual General Meeting of the Company adopted Resolution No. 20 concerning amendments to the Articles of Association in such a way that Articles 5.7.1 and 5.7.2, have been changed and given the following wording:

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

Information on key agreements

In the current report no 27/2011 dated 21st December 2011 the Company informed about conclusion of a material agreement – on 20th December 2011 the Company received the agreement dated on 19th December 2011 concluded by and between the Company and Södra Cell International AB ('Supplier'). The subject of the agreement is pulp supplies from the Supplier ('Supply Agreement').

The Supply Agreement was made for the period from 1st January 2012 until 31st December 2012. In the scope of the Supply Agreement the Supplier is obliged to Supply and the Company to reclaim 85,500 tonnes of pulp whereas the parties of the Supply Contract allowed for the possibility of both increasing and decreasing the total quantity of the supplies by 10%. The prices for a metric tonne of pulp was settled on the basis of USD FOEX PIX index for Europe, valid for the month preceding the given supply and discounts agreed by the parties of the Supply Agreement. The FOEX PIX index as on 13th December 2011 amounted to USD 846.38 for a tonne of pulp. The agreement does not stipulate penalties.

Financial resources management

In February 2011 the Group issued within the scope of Bonds Issue Programme a new series of coupon bonds of total face value PLN 80,000 thousand. The funds had been obtained for refinancing of the debt from zero-coupon bonds series 02/2010.

On 30th 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 S.A. another amendment to the facility agreement dated 23rd October 2008. Under the Amendment, the Bank Polska Kasa Opieki SA agreed to postpone until 30th 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.

On 19th October 2011 Arctic Paper S.A. and its subsidiaries, that is Arctic Paper Kostrzyn S.A, Arctic Paper Mochenwangen GmbH, Arctic Paper Investment GmbH, concluded another amendment with Bank Polska Kasa Opieki S.A. to the facility agreement dated on 23rd October 2008 ("Facility Agreement"). Under the Amendment, the Bank Polska Kasa Opieki SA agreed to postpone until 31st January 2013 the final repayment date of the term loan of tranche B ("the facility B") of up to PLN 104,862,803 and the current account credit of up to PLN 50,000,000 ("the facility C"), granted to Arctic Paper Kostrzyn S.A., Arctic Paper Mochenwangen GmbH and Arctic Paper Investment GmbH.

In the scope of the Amendment, quarterly repayments of facility B have been also agreed to 5 installments in the range of from PLN 2.2 million to PLN 3.8 million each, while the due date of the last installment shall be 31st December 2012. The rest due amount of the facility B that is PLN 90,800,000 shall be repaid until 31st January 2013.

Arctic Paper Grycksbo AB concluded on 25th August 2011 an Agreement with Svenska Handelsbanken bank to increase the credit.

Under the Agreement Svenska Handelsbanken bank performed the increase of credit by the amount of SEK 20,000 thousand, that is PLN 9,140 thousand, according to average NBP (National Bank of Poland) exchange rate dated 25th August 2011 amounting to 0.4570.

As on the date of preparing of the hereby consolidated annual report the Company had sufficient cash and credibility to ensure liquidity of Arctic Paper Group.

Capital investment and investment

In 2011 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 2011.

Bank and other loan agreements

Information on bank and other loan agreements is presented in supplementary note 31 of the consolidated financial statements.

The table below presents information about loans granted by Arctic Paper S.A. to its related parties in 2011.

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 2011 (in PLN thousand)
Arctic Paper Mochenwangen GmbH	31-12-2012	Euribor 3M + marża	1 400	EUR	6 184
Arctic Paper Investment GmbH	31-12-2012	Euribor 3M + marża	3 009	EUR	13 290
Arctic Paper Investment GmbH (loan taken over from Arctic Paper Kostrzyn SA - the amount after coversion of debt to shares)	31-12-2013	Euribor 3M + marża	990	EUR	4 373
TOTAL					23 846

In June 2011 Arctic Paper S.A. took over the loan taken by Arctic Paper Investment GmbH from Arctic Paper Kostrzyn, in the amount of PLN 390 thousand and EUR 6,985 thousand. On 30th December 2011 the loan denominated in PLN and partially the loan denominated in EUR were converted to shares in Arctic Paper Investment GmbH. In the above table the loan value after conversion to shares in Arctic Paper Investment GmbH is presented.

The conditions of loan contracts with related entities do not significantly differ from market conditions.

Information on guarantees

As on 31st December 2011 the Group reported the following given guarantees:

- a bill of exchange guarantee issued by the AP Kostrzyn S.A. in favor of the bank for the purpose of securing the payment of the amount granted to the company within the confines of the project “Change in the technology of the heat production as the pre-requisite condition for obtaining the integrated permit Arctic Paper”. The financial support granted to the Company within the confines of this project amounts to PLN 20,352 thousand. Detailed description of this liability was presented in the consolidated financial statements for the year ended 31st December 2011 (note 44.1;

- a bill of exchange guarantee in favor of Bankowy Leasing in the amount of PLN 9,848 thousand;
- a bill of exchange guarantee in favor of Bankowy Fundusz Leasingowy in the amount of PLN 15,023 thousand;
- a pledge on real estates of Paper Munkedals AB resulting from a factoring contract with Svenska Handelsbanken AB amounting to SEK 160,000 thousand;
- a guarantee commitment to FPG in favor of mutual life insurance company PRI in the amount of SEK 50,000 thousand;
- a bank guarantee in favor of Skatteverket Ludvika in the amount of SEK 135 thousand;
- a guarantee dated on 25th March 2010 in favor of Cartiere del Garda S.P.A - paper supplier to the Distribution Companies (Arctic Paper Sweden AB, Arctic Paper Denmark A/S, Arctic Paper Norge AS). The guarantee stands for EUR 900 thousand and is valid until 31st December 2012;
- a bank guarantee in favor of UPM GmbH amounting to EUR 1,000 thousand.

Significant off-balance sheet items

Information regarding off-balance sheet items is given in the supplementary note 35 to the Consolidated Financial Statements.

Evaluation of the possibility to implement investment plans

In connection with negative changes occurring in the market environment and lack of material improvement of the Group's financial results in 2011 compared to 2010, the investments planned for 2012 have been significantly reduced. The main purpose of investments realised in 2012 will be to minimize production costs, including electricity costs, and to improve the efficiency of production process. The decreased investments plan for 2012 is intended to be realised from the Group's own funds.

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 2011 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 annual financial statements.

Employment

Information regarding employment is given in the additional information in note 41 of the consolidated annual 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 4th 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 4th 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 2011 the Issuer observed 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 19th 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 Chief Financial Officer. 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 on 31st December 2011 there were no weaknesses which could materially impact on 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 result 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 29th July 2005, the Act on Protection of Competition and Consumers of 16th February 2007, and the (EC) Council Regulation no. 139/2004 of 20th January 2004 on control of concentrations between undertakings.

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 29th 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 after the end of reach financial year.
- A General Meeting is opened by the Chairman of the Supervisory Board 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 or convertible bonds and subscription warrants;
  - acquiring and selling real estates;
  - selling and leasing an enterprise or an organized part thereof and establishing a limited property right thereon;
  - all 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 President of the Management Board.
- 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 liable 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 President of the Management Board 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 of 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
- Mr. Rune Ingvarsson
- Mr. 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; no 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 3rd 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.

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 of 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 the authorities of 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 30th September of each calendar year.

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

On 3rd December 2009, 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.

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 31st December 2011 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 2011,
- Management Board report on the activity of the Arctic Paper S.A. Capital Group to the report for 2011 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 Chief Executive Officer	Michał Jarczyński	27 April 2012	
Member of the Management Board Chief Financial Officer	Michał Bartkowiak	27 April 2012	
Member of the Management Board Chief Procurement Officer	Jacek Łoś	27 April 2012	
Member of the Management Board Chief Operating Officer	Per Skoglund	27 April 2012	

Consolidated Financial Statements
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Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

Consolidated financial statements and selected financial data

Selected consolidated financial data

	For the period from 01.01.2011 to 31.12.2011 tys. PLN	For the period from 01.01.2010 to 31.12.2010 tys. PLN	For the period from 01.01.2011 to 31.12.2011 tys. EUR	For the period from 01.01.2010 to 31.12.2010 tys. EUR
Revenues	2 527 189	2 287 731	613 456	572 806
Operating profit (loss)	3 115	17 680	756	4 427
Profit (loss) before tax	128	7 350	31	1 840
Profit (loss) from continuing operations	12 066	28 817	2 929	7 215
Profit (loss) for the period	12 066	28 817	2 929	7 215
Net operating cash flow	162 247	120 409	39 384	30 148
Net investment cash flow	(56 375)	(230 583)	(13 684)	(57 734)
Net financial cash flow	(121 615)	129 974	(29 521)	32 543
Net change in cash and cash equivalents	(15 743)	19 800	(3 822)	4 958
Weighted average number of shares	55 403 500	54 778 842	55 403 500	54 778 842
Weighted average diluted number of shares	55 403 500	54 778 842	55 403 500	54 778 842
EPS (in PLN/EUR)	0,22	0,53	0,05	0,13
Diluted EPS (in PLN/EUR)	0,22	0,53	0,05	0,13
Average PLN/EUR rate*			4,1196	3,9939

	As at 31 December 2011 tys. PLN	As at 31 December 2010 tys. PLN	As at 31 December 2011 tys. EUR	As at 31 December 2010 tys. EUR
Assets	1 924 531	1 910 769	435 730	482 481
Long-term liabilities	636 697	500 218	144 153	126 308
Short-term liabilities	612 273	742 608	138 624	187 513
Equity	675 561	667 944	152 953	168 660
Share capital	554 035	554 035	125 438	139 897
Number of shares	55 403 500	55 403 500	55 403 500	55 403 500
Diluted number of shares	55 403 500	55 403 500	55 403 500	55 403 500
Book value per share (in PLN/EUR)	12,19	12,06	2,76	3,04
Diluted book value per share (in PLN/EUR)	12,19	12,06	2,76	3,04
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**	-	-	4,4168	3,9603

* - Income statements items were converted using the rate calculated as arithmetical mean of the average exchange rates announced by the National Bank of Poland in the period being reported.

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

Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

Consolidated income statement

	Note	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Continuing operations			
Sales of paper	10.1	2 527 189	2 287 360
Sales of services		0	371
Revenues	10	2 527 189	2 287 731
Cost of sales	11.5	(2 173 246)	(2 029 622)
Gross profit (loss) on sales		353 943	258 110
Selling and distribution expenses	11.5	(294 405)	(272 965)
Administrative expenses	11.5	(71 509)	(57 273)
Other operating income	11.1	72 578	150 180
Other operating expenses	11.2	(57 492)	(60 372)
Operating profit / (loss)		3 115	17 680
Finance income	11.3	42 682	20 062
Finance costs	11.4	(45 668)	(30 393)
Profit / (loss) before tax		128	7 350
Income tax	13	11 937	21 467
Net profit (loss) for the year from continuing operations		12 066	28 817
Discontinuing operations			
Profit (loss) for the period from discontinuing operations		-	-
Net profit (loss) for the year		12 066	28 817
Attributable to:			
Equity holders of the parent		12 066	28 817
Non-controlling interest		-	-
		12 066	28 817
Earnings per share:			
– basic from the profit (loss) for the period attributable to equity holders of the parent		0,22	0,53
– basic from the profit (loss) from continuing operations attributable to equity holders of the parent		0,22	0,53

Summary of the main accounting policies and other explanatory notes
included on pages 65 to 150 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

Consolidated statement of comprehensive income

	Note	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Net profit / (loss) for the year		12 066	28 817
Exchange difference on translation of foreign operations	30.2	14 198	12 112
Defered tax on derivatives	13.1	6 868	(2 851)
Valutation of derivatives	30.4	(25 515)	10 679
Other comprehensive income		(4 449)	19 941
Total comprehensive income		7 617	48 757

Summary of the main accounting policies and other explanatory notes
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Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

Consolidated balance sheet

	Note	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
ASSETS			
Non-current assets			
Property, plant and equipment	18	992 174	1 000 752
Investment properties	20	10 542	10 542
Intangible assets	21	120 410	127 118
Other financial assets	24.1	791	5 024
Other non-financial assets	24.2	2 151	564
Deferred tax asset	13.3	6 362	4 497
		1 132 429	1 148 498
Current assets			
Inventories	27	315 142	291 048
Trade and other receivables	28	294 452	269 448
Income tax receivables		5 810	7 849
Other non-financial assets	24.2	8 708	6 714
Other financial assets	24.1	1 692	7 811
Cash and cash equivalents	29	166 299	179 402
		792 102	762 271
TOTAL ASSETS		1 924 531	1 910 769
LIABILITIES			
Equity and liabilities			
Equity attributable to equity holders of the parent company			
Share capital	30.1	554 035	554 035
Share premium	30.3	80 060	72 289
Other reserves	30.4	110 849	40 131
Foreign currency translation	30.2	36 652	22 454
Retained earnings / Accumulated (unabsorbed) losses	30.5	(106 259)	(21 190)
Non-controlling interest	30.6	225	225
Total equity		675 561	667 944
Non-current liabilities			
Interest-bearing loans, borrowings and bonds	31	317 262	192 705
Provisions	32	83 827	71 903
Other financial liabilities	31	44 277	43 681
Deferred tax liabilities	13.3	156 520	154 402
Accruals and deferred income	33.2	34 810	37 528
		636 697	500 218
Current liabilities			
Interest-bearing loans, borrowings and bonds	31	67 242	292 111
Provisions	32	10 398	13 689
Other financial liabilities	31	60 383	11 094
Trade and other payables	33	403 057	365 082
Income tax payable		1 286	1 743
Accruals and deferred income	33.2	69 907	58 889
		612 273	742 608
TOTAL LIABILITIES		1 248 970	1 242 826
TOTAL EQUITY AND LIABILITIES		1 924 531	1 910 769

Summary of the main accounting policies and other explanatory notes
included on pages 65 to 150 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

Consolidated Cash flow statement

	Note	12 months period ended 31 December 2011 (audited)	12 months period ended 31 December 2010 (audited)
Cash flow from operating activities			
Profit (loss) before taxation		128	7 350
Adjustments for:			
Depreciation	11.6	127 625	112 428
Foreign exchange differences		(23 020)	(24 686)
Imapirment of non-current assets		11 021	16 186
Net interest and dividends		38 945	27 256
Gain/loss from investing activities		1 333	437
Increase / decrease in receivables and other non-financial assets		(8 029)	22 293
Increase / decrease in inventories		(1 408)	(47 905)
Increase / decrease in payables except for loans, borrowings and bonds		9 569	98 917
Change in accruals and prepayments		(1 853)	(15 536)
Change in provisions		(1 488)	7 950
Income tax paid		(6 667)	(8 628)
Bargain purchase at Arctic Paper Grycksbo		-	(77 555)
Derecognition of emission rigths to CO2 identified in a business combination		15 483	6 686
Sales of yellow certificates		(5 225)	284
Other		5 831	(5 069)
Net cash flow from operating activities		162 247	120 409
Cash flow from investing activities			
Proceeds from sale of property, plant and equipment and intangibles		213	35 918
Purchase of property, plant and equipment and intangible assets		(56 591)	(99 467)
Acquisition of subsidiaries, net of cash acquired		-	(187 954)
Interest received			312
Granted loans		-	20 600
Other investing inflows and outflows		3	8
Net cash flow from investing activities		(56 375)	(230 583)
Cash flow from financing activities			
Change in bank overdrafts		(9 164)	41 266
Repayment of finance lease liabilities		(8 007)	(7 267)
Proceeeds from other finance liabilities		15 405	-
Proceeds from loans, borrowings and bonds		110 318	183 448
Repayment of loans, borrowings and bonds		(192 336)	(19 270)
Payments to owners		-	(49 309)
Interest paid		(38 945)	(20 192)
Other		1 115	1 298
Net cash flow from financing activities		(121 615)	129 973
Net increase/(decrease) in cash and cash equivalents		(15 743)	19 800
Net foreign exchange differences		2 640	19 488
Cash and cash equivalents at the beginning of the period	29	179 402	140 114
Cash and cash equivalents at the end of the period	29	166 299	179 402

Summary of the main accounting policies and other explanatory notes
included on pages 65 to 150 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

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

	Attributable to equity holders of the Parent							
	Share capital	Share premium	Translation reserve	Other reserves	Retained earnings (losses)	Total	Non-controlling interest	Total equity
As at 1 January 2011	554 035	72 289	22 454	40 131	(21 190)	667 717	225	667 942
Net profit (loss) for the year	-	-	-	-	12 066	12 066		12 066
Other comprehensive income	-	-	14 198	(18 646)	-	(4 449)	-	(4 449)
Total comprehensive income	-	-	14 198	(18 646)	12 066	7 617	-	7 617
Profit distribution	-	7 771	-	89 364	(97 135)	-	-	-
As at 31 December 2011 (audited)	554 035	80 060	36 652	110 849	(106 259)	675 335	225	675 561

Summary of the main accounting policies and other explanatory notes

Included on pages from 65 to 150 are an integral part of these consolidated financial statements

Consolidated Financial Statements for the year ended 31st December 2011 PLN thousand

	Attributable to equity holders of the Parent							
	Share capital	Share premium	Translation reserve	Other reserves	Retained earnings (losses)	Total	Non-controlling interest	Total equity
As at 1 January 2010	524 035	35 985	10 342	1 388	46 061	617 812	225	618 037
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)	-	-
Payment of dividends	-	-	-	-	(49 309)	(49 310)	-	(49 310)
Profit distribution	-	8 734	-	30 914	(39 648)	-	-	-
As at 31 December 2010 (audited)	554 035	72 289	22 454	40 131	(21 190)	667 717	225	667 942

Summary of the main accounting policies and other explanatory notes
Included on pages from 65 to 150 are an integral part of these consolidated financial statements

Accounting policies and additional notes

1. General information

Arctic Paper Group is the second largest, in terms of production volume, European producer of paper for books, offering the widest range of products in this segment and one of the leading producers 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 Arctic Paper Grycksbo (Sweden).

The Parent Company is entered in the Register of Entrepreneurs kept by the District Court Poznań - Nowe Miasto i Wilda in Poznań, 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 on 31st December 2011, 41,441,500 Shares of our Company which is 74.8% of its share capital corresponding to 74.8% of the total number of votes at the General Meeting. As on the day of publishing of this report the share of Arctic Paper AB in Company's shares and the share in total number of votes in the

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

General Meeting has not changed. The ultimate parent for the Group is Cassandrax Financial S.A. Arctic Paper SA was established for an indefinite period.

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 2012	31 December 2011	31 December 2010
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%	100%
Grycksbo Paper (Deutschland) GmbH	Germany, Max-Brauer-Allee 52, 22765 Hamburg	Trading services	100%	100%	100%
Grycksbo Paper UK Limited	Great Britain, 52 Hither Green Lane, Abbey Park, Redditch	Trading services	-	-	100%
Grycksbo Paper France EURL	France, 3 rue de Teheran, 75008 Paris 8	Trading services	-	-	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 27 April	31 December	31 December
Arctic Paper Investment GmbH *	Germany, Fabrikstrasse 62, DE-882, 84 Wolpertswende	Holding company	100%	100%	100%
Arctic Energy Sverige AB (previous Arctic Paper Investment II AB)	Sweden, Box 383, 401 26 Göteborg	Hydro energy production	100%	100%	100%
Arctic Paper Verwaltungs GmbH *	Germany, Fabrikstrasse 62, DE-882 84 Wolpertswende	Holding company	100%	100%	100%
Arctic Paper Immobilienverwaltung GmbH&Co. KG*	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%	100%
Grycksbo Paper Holding AB	Sweden, Box 1, SE 790 20 Grycksbo	Holding company	100%	100%	100%
EC Kostrzyn Sp. z o.o.	Poland, ul. Fabryczna 1, 66-470 Kostrzyn nad Odrą	Property and machinery rental	100%	100%	100%
Arctic Paper Munkedals Kraft AB	Sweden, 455 81 Munkedal	Hydro energy production	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 on 31st December 2011 and as on 31st December 2010, the percentage of voting rights held by the Group in subsidiaries corresponded to the percentage held in the share capital of those entities.

In 2011 a new company belonging to the Arctic Paper Capital Group was founded – Arctic Paper Munkedals Kraft AB was established for the purpose of generation of water energy for Munkedals mill. This subject has been further described in note 23.2 to the consolidated financial statements.

In 2011 two sales offices belonging to the Grycksbo Group were dissoluted: Grycksbo Paper UK Limited and Grycksbo Paper Finance URL.

3. Management and supervisory bodies

3.1. Management Board of the Parent Company

As on 31st December 2011 the following constituted the Parent Company's Management Board:

- Michał Jarczyński – President of the Management Board appointed on 30th April 2008;
- Hans Karlander – Member of the Management Board appointed on 4th December 2008;
- Michał Bartkowiak – Member of the Management Board appointed on 17th September 2009;
- Jacek Łoś – Member of the Management Board appointed on 27th April 2011;
- Per Skoglund – Member of the Management Board appointed on 27th April 2011.

From 31st December 2011 until the date of announcing the hereby annual consolidated financial statements the Company reported a change in the composition of the Management Board (current report no 02/2012) – on 20th January 2012 Mr Hans Karlander submitted his resignation from being a Member of the Management Board of the Company effective on 31st March 2012.

3.2. Supervisory Board of the Parent Company

As on 31st December 2011 the Parent Company's Supervisory Board consisted of the following members:

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

From 31st December 2011 until the date of publication of the hereby report and consolidated financial statements there were no changes in the composition of the Supervisory Board.

3.3. Audit Committee of the Parent Company

As on 31st December 2011 the Parent Company's Audit Committee consisted of the following members:

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

From 31st December 2011 until the date of publication of the hereby report and 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 27th April 2012.

5. Significant Professional judgement and estimates

5.1. Professional judgement

In the process of applying the Group's accounting policies to the topics listed below, the most significance is attributed to, apart from those involving accounting estimations, the professional judgement of the management officers.

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, on 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 on 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 being discussed below.

Impairment of Fixed Assets In Arctic Paper Mochenwangen

On 31st December 2011 an impairment test was conducted in the production company Arctic Paper Mochenwangen in respect of 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

The cost of the pogramme for retirement benefits is determined using actuarial valuations. The assumptions made are presented in note 26. In making the actuarial valuation, certain assumptions must be made concerning discounting rates, forecasted 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 recognizes 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 amortization rates

Depreciation and amortization 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

The hereby consolidated financial statements have been prepared in accordance with historical cost method with the exception of investment properties and derivative financial instruments which have been valued at fair value. To financial instruments measured at fair value through profit or loss the Company includes foreign exchange forward contract and the contract for purchase of electric energy when they do not follow the hedging principles (note 39).

The hereby consolidated financial statements are being presented in Polish zloty ("PLN") and all values are given in PLN thousand (PLN '000) except indicated otherwise.

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

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. On the date of authorization 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 29th 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 condensed consolidated financial statement are consistent with those applied to prepare the consolidated financial statements of the Company for the year ended 31st December 2010, except for the following amendments to the standards and new interpretations applicable to annual reporting periods beginning on 1st January 2011:

- Amendments to IAS 24 Related Party Disclosures (revised in November 2009) – effective for financial years beginning on or after 1st January 2011. The purpose of this change is simplification and clarification of related party definition. The amendment removes the obligation to disclose information regarding transaction with related entity in reference to the government who controls or jointly controls the reporting entity or has a profound influence on the entity, and in reference to another entity who is a related party as the same government controls or jointly controls the reporting entity and the other entity or has a profound influence on the entities. The adoption of this amendment did not have an impact on the financial position or performance of the Group neither on the scope of information presented in the Group's financial statements.
- Amendments to IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction: Prepayments of a Minimum Funding Requirements – effective for financial years beginning on or after 1st January 2011. The amendment removes an unintended consequence of IFRIC 14 of voluntary prepayments for retirement purposes in a situation when an entity is subject to minimum funding requirements (MFR). The adoption of this amendment did not have an impact on the financial position or performance of the Group.
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments – effective for financial years beginning on or after 1st July 2010. IFRIC 19 clarifies accounting principles applied in a situation when in a result of renegotiating by an entity of the conditions of its debt the liability is being extinguished by issuing equity instruments by the debtor for the creditor. The adoption of this amendment did not have an impact on the financial position or performance of the Group.
- Amendment to IAS 32 Financial instruments: presentation: Classification of right issues. The amendment addresses the accounting for rights issues that are denominated in a currency other than the functional currency of the issuer. The adoption of this amendment did not have an impact on the financial position or performance of the Group.
- Improvements to IFRSs (issued in May 2010) – some improvements are effective for annual periods beginning on or after 1st July 2010, the rest is effective for annual periods beginning on or after 1st January 2011. The adoption of these improvements did not have an impact on the financial position or performance of the Group.

- Amendments to IFRS 1 First–time Adoption of International Financial Reporting Standards: Limited Exemption from Comparative IFRS 7 Disclosures for First-Time Adopters, effective for annual periods beginning on or after 1 July 2010. The adoption of this amendment did not have an impact on the financial position or performance of the Group.

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

7.1. Comparability of data

Consolidated statement of changes in equity as on 31st December 2011 presented in this financial statements includes the change in presentation of equity compared to consolidated statement of changes in equity as on 31st December 2010 presented in the financial statements for the year ended 31st December 2010.

The change in presentation of equity concerns the exclusion of position „Division of financial result" and transferring a part of net profit to „Supplementary capital" and to „Other reserve capitals".

In the consolidated report for the year ended on 31st December 2010 the „Supplementary Capital" as on 31st December 2010 amounted to PLN 63,555 thousand, and after the change of presentation in the hereby report it amounts to PLN 72,289 thousand and includes the amount of PLN 8,734 thousand resulting from the division of standalone net profit for year 2009 and assigning a part of it to "Share premium".

In the consolidated report for the year ended on 31st December 2010, the position „Other Reserves" amounted to PLN 9,217 thousand as on 31st December 2010, after the change of presentation in the hereby report it amounts to PLN 40,131 thousand, and includes the amount of PLN 30,914 thousand, resulting from recording of the rest part of standalone net profit for year 2009 (Resolution no 7 from 8th June 2010).

The resolutions on division of profit are included in the current report of the Company no 18/2011 regarding the division of profit for year 2010 and in the current report of the Company no 27/2010 regarding the division of profit for year 2009.

8. Amendments to existing standards and new regulations

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

- The first phase of IFRS 9 *Financial Instruments: Classification and Measurement* – effective for financial years beginning on or after 1st January 2015 – 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 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,
- Amendment to IFRS 7 *Financial Instruments – Disclosures: Transfer of Financial Assets* – effective for financial years beginning on or after 1st July 2011,
- Amendments to IAS 12 *Income Tax: Deferred Tax: Recovery of Underlying Assets* – effective for financial years beginning on or after 1st 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 1st July 2011 – not endorsed by EU till the date of approval of these financial statements,

- IFRS 10 *Consolidated Financial Statements* – effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- IFRS 11 *Joint Arrangements* – effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- IFRS 12 *Disclosure of Interests in Other Entities* – effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- IFRS 13 *Fair Value Measurement* - effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- Amendments to IAS 19 *Employee Benefits* - effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- Amendments to IAS 1 *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income* - effective for financial years beginning on or after 1st July 2012 – not endorsed by EU till the date of approval of these financial statements,
- IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* - effective for financial years beginning on or after 1st January 2013 – not endorsed by EU till the date of approval of these financial statements,
- Amendments to IFRS 7 *Financial Instruments – Disclosures: Offsetting Financial Assets and Financial Liabilities* - effective for financial years beginning on or after 1st January 2013– not endorsed by EU till the date of approval of these financial statements,
- Amendments to IAS 32 *Financial Instruments – Presentation: Offsetting Financial Assets and Financial Liabilities*- effective for financial years beginning on or after 1st January 2014 – 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: Government loans* - effective for financial years beginning on or after 1st January 2013 – 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, apart from changes in IAS 19. The Management is currently analyzing the influence of changes in IAS 19 on the consolidated financial statements of 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 31st December 2011. 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.

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 the Group revises the carrying value of controlling and non-controlling shares. 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.

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.

On 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 end of the reported period. 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. On the balance sheet 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 accumulated in a separate position of equity. 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.

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

The following exchange rates were used for valuation purposes:

	As at 31 December 2011	As at 31 December 2010
USD	3,4174	2,9641
EUR	4,4168	3,9603
SEK	0,4950	0,4415
LVL	6,3120	5,5830
DKK	0,5941	0,5313
NOK	0,5676	0,5071
GBP	5,2691	4,5938
CHF	3,6333	3,1639

Weighted average foreign exchange rates for the reporting periods are as follows:

	01/01 - 31/12/2011	01/01 - 31/12/2010
USD	2,9636	3,0179
EUR	4,1196	3,9939
SEK	0,4561	0,4190
LVL	5,8339	5,6357
DKK	0,5529	0,5363
NOK	0,5284	0,4988
GBP	4,7470	4,6587
CHF	3,3481	2,8983

9.3. Property, plant and equipment

Property, plant and equipment are measured at cost (price of purchase or construction cost) less accumulated depreciation and impairment losses. The initial value 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 have been met. Subsequent expenditures, such as repair or maintenance costs, are expensed as presented in the income statement 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, presented as below:

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 reporting period that has just ended.

An item of property, plant and equipment is derecognized 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 recognized 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 value of investment properties is presented according to fair value. Any gains or losses resulting from changes of fair value of the investment properties are recognized in gain or loss of the period in which it occurred.

Investment property is derecognized when disposed of 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 of assets are made to investment properties when, and only when, there is a change in use, evidenced by ending of owner occupation, commencement of an operating lease, and 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 of assets from inventories to investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognized 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 on 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 on the date of combination. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and any accumulated impairment write-offs. Expenditures incurred for internally generated intangible assets, excluding capitalized development costs, are not capitalized 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 amortization period and the amortization 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 amortization period or method, as appropriate, and treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized 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 presented 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 amortization 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 and the carrying amount of the asset and are recognized in the income statement when the asset is derecognized.

9.5.1. Goodwill

Goodwill on acquisition is initially measured at cost being the excess of:

- The sum of:
  - payment transferred,
  - the amount of all non-controlling shares in the entity being acquired and
  - in case of combination of entities performed in stages, the fair value of shares being acquired which previously belonged to the acquired entity, as on the date of acquisition,
- over the net amount set as on the day of acquisition of the identifiable value of assets and liabilities acquired.

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 on the acquisition date, any goodwill acquired is allocated to each of the cash-generating units that are 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. If 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 (i.e., 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 recognized in respect of that amount as the EUA has not been delivered on that date.

Accounting for the EUA/CER exchange at maturity

The CER are recognized 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 historical value of the EUA given up is recognized as a gain (or loss). Any deferred income is recognized in the income statement, as part of this 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 as decrease of cost 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 capitalized 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.

Capitalized 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 recognized 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 on each reporting date to determine whether there is any indication that a non-financial non-current 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 on 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. 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 capitalized 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 on 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 recognizing 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 on 31st December 2011 the Group designated the hedging instruments as measured at fair value through profit and loss, further described in the note 39 to the consolidated annual report for year 2011.

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 as on 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 other comprehensive income. 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 that are able to be attributed directly to the acquisition.

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 directly. The amount of the loss shall be recognized 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 recognized 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 recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying amount of the asset does not exceed its amortised cost on 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 recognized in the profit or loss, is removed from equity and recognized in the income statement. Reversals of impairment losses on equity instruments classified as available for sale cannot be recognized 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 recognized in the income statement, the impairment loss is reversed, with the amount of the reversal recognized in the income statement.

9.11. Embedded 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 at its initial recognition. In case of embedded derivatives acquired as part of business combination, the Group does not re-assess the embedded derivatives as on the combination date (they are assessed upon initial recognition by the acquired company).

9.12. Derivative financial instruments and hedges

The Group uses derivative financial instruments to hedge against the risks associated with interest rate and foreign currency fluctuations such as forward currency contracts. Such derivative financial instruments are measured at fair value. Derivatives are carried as assets when its value is positive and as liabilities when its 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 recognized 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 unrecognized 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 recognized asset or liability or an unrecognized 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 recognized 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 unrecognized 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 recognized as an asset or liability with a corresponding gain or loss recognized in profit or loss. The changes in the fair value of the hedging instrument are also recognized 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. Amortization 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

Cash flow hedges are hedges securing for danger of cash flows fluctuations which can be attributed to a particular kind of risk connected with the given item of assets or a liability or with a planned investment of high probability, and which could influence profit or loss. The part of profit or loss connected with the hedging instrument which constitutes effective hedge is recognized directly in other comprehensive income and the non-effective part is recognized in profit or loss.

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-financial liability, 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.

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.

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 recognized directly in other comprehensive income and accumulated in equity remains recognized in equity until the forecast transaction occurs. If the forecast transaction is no longer expected to occur, the net cumulative gain or loss recognized in equity is taken to net profit or loss for the period.

9.13. Inventories

Inventories are valued at the lower of cost and net realisable 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 on a first-in, first-out basis
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 on a first-in, first-out basis

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 recognized 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 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 prepayments for future purchases of property, plant and equipment, intangible assets and inventories. 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 company 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, borrowings and bonds

All loans, borrowings and bonds are initially recognized at the fair value less transaction costs associated with the borrowing.

After initial recognition, interest-bearing loans, borrowings and bonds 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 recognized in net profit or loss when the liabilities are derecognized 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 recognizing 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 on 31st December 2011 no financial liabilities were classified to fair value through profit and loss category (as on 31st December 2010: 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 recognized 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 recognized in the income statement.

Other non-financial liabilities include, in particular, liabilities to the tax office in respect of value added tax, 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 recognized 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 recognized 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 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 recognized 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 recognized 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 recognized 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 recognized.

9.20.1. Sale of goods

Revenue is recognized 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 recognized 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 recognized 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 recognized 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 recognized 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 installments.

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 recognized, using the liability method, on all temporary differences on the balance sheet date between the tax bases of assets and liabilities and their carrying amounts recognized in the financial statements.

Deferred tax liability is recognized 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 recognized 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 recognized 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 utilized.

The carrying amount of deferred tax assets is reviewed on 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 utilized. Unrecognized deferred tax assets are reassessed at each balance sheet date and are recognized 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 as on the balance sheet date.

Deferred income tax relating to items recognized out of profit or loss is recorded out of income statement: in other comprehensive income it related to positions recognized in other comprehensive income. Deferred income tax relating to items recognized directly in equity is recognized in equity.

Deferred income tax assets and deferred income tax liabilities are offset by the Group only 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 14th September 2004 concerning the Kostrzynsko – Slubicka Special Economic Zone (Official Journal no.222 item 2252 dated 13th October 2004).

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

9.21.4. Value added tax

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

- when 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 recognized 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 the 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 production, 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, annual production capacity of 265,000 tons.

Hitherto the Group presented business segments divided into production units. However, considering the changes which take place on the paper market and which are made in each paper mill it was decided to the change of reported business segments.

Starting from 1st January 2011 the Group identifies three business segments:

- Uncoated paper – paper for printing or other graphic purposes, including wood-free and wood-containing. 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 calendering. 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, however the Group currently does not produce office papers. Uncoated 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 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.
- Other – this segment contains results of distribution and sales companies as well as business of Arctic Paper S.A.

The division of business segments to uncoated and coated paper is caused by the following circumstances:

- Demand for products and its supply, as well as the products prices sold on the market are shaped by factors characteristic for each segment, including i.e. level of the production capacity in each segment,
- Key operational factors such as e.g. orders inflow or production costs level are determined by factors which are close to each other within each paper segment,
- Products manufactured in the Group's paper mills can be, with some exceptions, allocated to production in different subsidiaries within the same paper segment, which to some extent disturbs the financial results of each paper mill,
- Arctic Paper Group results are dominated by global market trends in terms of fluctuations of prices of paper and basic raw materials, particularly pulp, and depend on individual conditions of production subsidiaries to lesser extent,
- The changed business segments division will allow better comparability of Arctic Paper Group results to other companies of paper industry.

The results of paper mills and other entities are monthly 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 as if it concerned non related parties.

The following table presents revenue and profit information and certain assets and liabilities information divided into individual Group segments for the period ended 31st December 2011 and as on 31st December 2011.

12-month period ended 31st December 2011 and as on 31st December 2011

	Continuing Operations					
	Uncoated	Coated	Other	Total	Eliminations	Total Group
Revenues						
Sales to external customers	1 798 698	728 491	-	2 527 189	-	2 527 189
Inter-segment sales	166 474	186 877	26 032	379 384	(379 384)	-
Total segment revenues	1 965 172	915 368	26 032	2 906 572	(379 384)	2 527 189
Segment's Result						
EBITDA	105 574	35 860	(2 970)	138 463	3 299	141 762
Interest Income	4 281	156	28 253	32 690	(30 983)	1 707
Interest Costs	(37 777)	(15 390)	(18 468)	(71 635)	30 807	(40 829)
Depreciation	(71 283)	(56 206)	(137)	(127 625)	-	(127 625)
Impairments of non-current assets	(11 021)	-	-	(11 021)	-	(11 021)
Positive FX and other financial income	33 104	-	21 040	54 144	(13 169)	40 975
Negative FX and other financial costs	(3 052)	(708)	(414)	(4 174)	(667)	(4 840)
Profit / (loss) before tax	19 826	(36 289)	27 305	10 842	(10 714)	128
Segment assets	1 098 841	414 449	403 564	1 916 854	1 316	1 918 169
Segment liabilities	1 007 763	433 631	238 685	1 680 080	(587 630)	1 092 450
Capital expenditures	51 971	7 417	42	59 430	(1 836)	57 594

- Inter-segment sales are eliminated on consolidation.
- Segment result does not include financial income (PLN 42,682 thousand of which PLN 1,707 thousand constitute interest income) and financial costs (PLN 45,668 thousand of which PLN 40,829 thousand constitute interest expense), amortization and depreciation (PLN 138,646 thousand), as well as income tax credits (PLN +11,937 thousand). Segment result includes inter-segment profit (PLN 3,299 thousand).
- Segment assets and liabilities do not include deferred tax asset and liability (deferred tax asset of PLN 6,362 thousand and deferred tax liability of PLN -156,520 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 31st December 2010 and as at 31st December 2010.

12-month period ended 31st December 2010 and as on 31st December 2010

	Continuing Operations					
	Uncoated	Coated	Other	Total	Eliminations	Total Group
Revenues						
Sales to external customers	1 494 328	549 378	244 026	2 287 732	-	2 287 732
Inter-segment sales	110 425	94 335	95 629	300 390	(300 390)	-
Total segment revenues	1 604 754	643 713	339 655	2 588 121	(300 390)	2 287 732
Segment's Result						
EBITDA	49 209	96 482	6 947	152 638	(6 344)	146 294
Interest Income	3 671	57	20 967	24 695	(22 758)	1 937
Interest Costs	(12 344)	(5 551)	(35 297)	(53 192)	22 823	(30 369)
Depreciation - without impairment of non-current assets	(68 799)	(42 395)	(1 234)	(112 428)	-	(112 428)
Impairments of non-current assets	(16 186)	-	-	(16 186)	-	(16 186)
Positive FX and other financial income	11 617	6 455	91 157	109 229	(91 105)	18 124
Negative FX and other financial costs	(4 168)	-	(146)	(4 314)	4 290	(24)
Profit / (loss) before tax	(36 999)	55 048	82 394	100 442	(93 094)	7 350
Segment assets	1 102 386	462 251	849 034	2 413 671	(507 399)	1 906 272
Segment liabilities	634 799	272 349	666 794	1 573 942	(485 518)	1 088 424
Capital expenditures	63 090	7 747	753	71 591	-	71 591

- Inter-segment sales are eliminated on consolidation.
- Segment result does not include financial income (PLN 20,062 thousand of which PLN 1,937 thousand constitute interest income) and financial 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 credit (PLN +21,467 thousand). Segment result includes, however, 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.

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

10.1. Revenues by countries and region

The following table presents revenues of the Group from external customers divided by countries and regions in the years 2010-2011 as well as non-current assets of the Group divided by countries and regions in the years 2010-2011:

Geographic information Revenues from external customers:	Year ended 31 December 2011	Year ended 31 December 2010
Germany	573 808	495 767
France	260 057	232 948
UK	229 275	213 657
Scandinavia	386 878	332 042
Western Europe (other than above)	315 679	312 385
Poland	259 009	233 200
Central and Eastern Europe (other than Poland)	478 392	442 878
Oversease	24 091	24 854
Total Sales	2 527 189	2 287 731

Geographic information Non-current assets:	Year ended 31 December 2011	Year ended 31 December 2010
Germany	57 876	98 402
France	367	345
Scandinavia	653 387	630 736
Western Europe (other than above)	341	370
Poland	414 012	414 043
Central and Eastern Europe (other than Poland)	86	106
Total non-current assets	1 126 068	1 144 001

Sales revenues of the position 'Western Europe' relate mostly to sales in Belgium, Netherlands, Austria, Switzerland, Italy and Spain. Sales revenues of the position 'Central-Eastern Europe' relate to sales in Ukraine, Czech Republic, Slovakia, Hungary and Bulgaria.

The above mentioned non-current assets comprise property, plant and equipment, intangibles, investment properties as well as other financial and non-financial assets.

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

11. Revenues and expenses

11.1. Other operating income

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Relase of provisions	129	354
Compensation received	3 750	4 044
Rental income	2 426	2 186
Sales of services	660	691
Government grants	360	97
Sales of energy and water	24 255	20 469
Sales of materials	35 678	35 832
Net income from emission rights	-	84
Excess of aquirer's interest in the net fair value of acquiree's identifiable assets, liabilites and contingent	-	77 555
Profit of sales on tangible assets	139	3 136
Employee conribution company cars	172	184
VAT not confirmed resolved provision	-	1 095
Profit on sales of CO2 emission rights	724	-
Other	4 285	4 455
Total	72 578	150 180

11.2. Other operating expenses

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Provisions created	-	-
Property tax	(3 229)	(1 574)
Cost of sales of energy and water	(20 071)	(17 953)
Cost of sales of pulp and materials	(28 904)	(29 229)
Redundancy costs	(3 241)	(1 112)
Loss on sale of disposal of fiexed assets	(17)	-
Revaluation investment property	-	(1 617)
Contingent liabilities from purchase price agreement at Arctic Paper Mochenwangen GmbH	-	(5 232)
Other	(2 031)	(3 655)
Total	(57 492)	(60 372)

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

11.3. Financial income

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Interest income on cash and cash equivalents	1 163	1 010
Interest income on loans granted	-	312
Interest income on receivables	528	518
Other interest income	16	97
Foreign exchange gains	40 944	18 099
Other finance income	31	25
Total	42 682	20 062

11.4. Financial costs

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Interest on bank loans and bonds valued at amortized cost	(35 129)	(25 388)
Interest on other financial liablities	(144)	(182)
Interest on post-employments provisions	(3 143)	(2 684)
Finance charges payable under finance leases	(2 411)	(2 116)
Foreign exchange losses	(4 411)	-
Other finance costs	(429)	(24)
Total	(45 668)	(30 393)

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

11.5. Cost by nature

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Depreciation / Amortisation	(127 626)	(112 428)
Impairment losses	(11 021)	(16 186)
Change in inventory of finished goods	(1 393)	25 345
Inventory write-downs	(3 756)	(2 091)
Reversed inventory write-down	-	981
Materials and energy	(1 634 744)	(1 543 833)
External services	(376 495)	(322 970)
Taxes and charges	(11 513)	(12 522)
Employee benefits expense	(315 200)	(302 626)
Other	(33 542)	(30 030)
Cost of goods for resale	(23 870)	(43 499)
Total costs by type, of which:	(2 539 159)	(2 359 860)
Items included in cost of sales	(2 173 245)	(2 029 622)
Items included in selling and distribution expenses	(294 405)	(272 965)
Items included in administrative expenses	(71 509)	(57 273)

11.6. Depreciation/ amortization and impairment losses included in the consolidated income statement

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Included in cost of sales:		
Depreciation / Amortisation	(121 784)	(106 705)
Impairment of property, plant and equipment	(11 021)	(16 186)
Impairment of intangible assets	-	-
Inventory write-downs	(3 756)	(2 091)
Included in selling and distribution expenses:		
Depreciation / Amortisation	(2 996)	(2 900)
Impairment of property, plant and equipment	-	-
Impairment of intangible assets	-	-
Included in administrative expenses		
Depreciation / Amortisation	(2 846)	(2 823)
Impairment of property, plant and equipment	-	-
Impairment of intangible assets	-	-

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

11.7. Employee benefits expenses

	Note	Year ended 31 December 2011` (audited)	Year ended 31 December 2010 (audited)
Wages and salaries		(241 567)	(232 239)
Social security costs		(72 017)	(65 525)
Retirement benefits	26.2	(5 837)	(4 862)
Total employee benefits expenses, of which:		(319 421)	(302 626)
Items included in cost of sales		(225 537)	(211 301)
Items included in selling and distribution expenses		(25 073)	(25 137)
Items included in administrative expenses		(68 810)	(66 188)

12. Components of other comprehensive income

Components of other comprehensive income for the year ended 31st December 2011 and the year ended 31st December 2010 are as follows:

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Exchagne difference on translation of foreign operations	14 198	12 112
Deffered tax on items from derivatives valuation	6 868	(2 851)
Valuation of derivatives	(25 515)	10 679
Total other comprehensive income	(4 449)	19 941

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13. Income tax

13.1. Tax burdens

Major components of income tax expense for the year ended 31st December 2011 and the year ended 31st December 2010 are as follows:

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Consolidated income statement		
Current income tax		
Current income tax charge	(6 402)	(7 942)
Adjustments in respect of current income tax of previous years	-	-
Deferred income tax		
Relating to origination and reversal of temporary differences	18 339	29 409
Income tax expense reported in consolidated income statement	11 937	21 467
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)	6 868	(2 851)
Derecognition of deffered tax asset originally recognised in equity	-	-
Income tax benefit / (income tax expense) reported in other comprehensive income	6 868	(2 851)

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 year ended 31st December 2011 and the year ended 31st December 2010 is as follows:

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Accounting profit before tax from continuing operations	128	7 350
Profit before tax from discontinuing operations	-	-
Accounting profit before income tax	128	7 350
At statutory income tax rate in 2008-2011 of 19%	(24)	(1 396)
Adjustments in respect of current income tax from previous years	(84)	47
Difference resulting from different tax rates if different countries	7 801	2 089
Tax losses on which no deferred tax asset has been recognized	1 982	(12 104)
Tax credits in KSSSE	8 457	11 978
Business combination	-	20 896
Utilisation of previously unrecognised tax losses	580	224
Reversal of previously recognized tax losses	-	(297)
Non-taxable income	7 526	6 255
Influence of tax groups	(10 975)	-
Non-taxable costs	(3 324)	(6 225)
At the effective income tax rate of 9300% (2010: -292%)	11 938	21 467
Income tax expense reported in consolidated income statement	11 937	21 467
Income tax attributable to discontinuing operations	-	-

Unrecognized 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 utilized for tax purposes.

Deferred tax asset is recognized 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 utilize 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 2011 (audited)	Year ended 31 December 2010 (audited)
With an indefinite life	41 374	73 981
ended 31 December 2012	-	127
ended 31 December 2013	19 022	19 149
ended 31 December 2014	12 336	12 406
ended 31 December 2015 and later	3 654	4 758
Razem	76 387	110 419

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

13.3. Deferred income tax

Deferred income tax relates to the following:

	Consolidated balance sheet as at		Consolidated income statement for the year ended	
	31 December 2011 (audited)	31 December 2010 (audited)	31 December 2011 (audited)	31 December 2010 (audited)
Deffered income tax liabilities				
Tangible fixed assets	72 020	71 013	(1 007)	607
Inventories	493	585	92	(147)
Trade receivables	(18)	99	117	49
Accruals and provisions	(2 535)	82	2 617	12
Cogeneration certificates	1 808	816	(992)	118
Untaxed reserves (Swedish tax regulation)	7 818	6 805	(1 013)	(1 087)
Fair value adjustments on acquisition of subsidiary	88 148	97 493	9 345	10 042
Losses utilized on the level of separate financial statements, unrecognized in consolidated financial statements	19 759	17 624	(2 135)	-
Hedging instruments	321	-	(321)	
Gross deffered income tax liabilities	187 813	194 516	6 702	9 595

	Consolidated balance sheet as at		Consolidated income statement for the year ended	
	31 December 2011 (audited)	31 December 2010 (audited)	31 December 2011 (audited)	31 December 2010 (audited)
Deferred income tax assets				
Post-employment benefits	3 151	4 090	(939)	358
Accruals and provisions	2 868	4 656	(1 788)	(3 265)
Tangible fixed assets	172	4 517	(4 345)	4 467
Inventories	670	1 242	(572)	444
Trade receivables	4 040	3 767	273	3 298
Tax credits in Kostrzynsko - Kostrzynsko Słubicka Special Economic Zone	25 640	25 004	636	11 956
Loss available for offset against future taxable income	1 114	1 335	(221)	(113)
Gross deferred income income tax assets	37 655	44 611	(6 956)	17 145
Foreign exchange differences			18 594	2 669
Deferred income tax charge			18 339	29 409
Net deferred tax assets / liability therein:				
- Deferred tax assets	6 362	4 497		
- Deferred tax liability	156 520	154 402		

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

14. Non-current assets held for sale

As on 31st December 2011 and as on 31st December 2010 the Group did not report any non-current assets held for sale.

15. Social assets and social fund liabilities

The Social Fund Act dated 4th March 1994, with subsequent amendments, requires the companies whose full-time 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 compensated 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 3 thousand on 31st December 2011 (on 31st December 2010: PLN 10 thousand).

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

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Cash	25	20
Social Fund liability	(22)	(10)
Expenditure of Fund are covered by own funds		
Net balance	3	10

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Transfers made to the Social Fund during the period	563	588

16. Earnings per share

Earnings per share ratio is calculating by dividing the net profit for the year attributable to the Company's' 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 2011 (audited)	Year ended 31 December 2010 (audited)
Net profit (loss) for the year from continuing operations	12 066	28 817
Profit (loss) for the period from discontinued operations	-	-
Net profit (loss) for the year	12 066	28 817
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	3 000 000
Total number of shares (in thousand)	55 403 500	55 403 500
Weighted average number of shares	55 403 500	54 778 842
Profit per share (in PLN)	0,22	0,53

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

Between the balance sheet date and the date of preparing of the hereby consolidated financial statements there were no transactions of such matter.

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.

As on 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 27th April 2011 the Management Board of Arctic Paper SA adopted a resolution approving the net profit for the year 2010 distribution proposal and recommending to Supervisory Board of Arctic Paper S.A. The above proposal does not provide dividend payment.

On 26th May 2011 Shareholders Meeting approved the resolution no 7 regarding the division of profit for financial year 2010, in which a part of profit from 2010 assigned, according to Polish Commercial Companies Code, to supplementary capital (Share premium) in the amount of PLN 7,770,812.64, whereas the rest amount of undivided net profit assigned to reserve capital (Other reserves) in the amount of PLN 89,364,345.37 with the possibility to make use of it to pay dividend or for other legally permissible purpose.

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18. Property, plant and equipment

	As at 31 December 2011 (audited)			
	Land and buildings	Plant and equipment	Assets under construction	Total
Net carrying amount at 1 January 2010	155 957	361 133	35 533	552 623
Additions due to purchase	1 972	10 817	58 517	71 307
Additions due to transfer of tangible assets from work in progress	5 211	47 505	(52 716)	-
Additions due to acquisitions	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 25)	(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
Net carrying amount at 1 January 2011	286 219	671 305	43 230	1 000 754
Additions due to purchase	899	6 850	47 563	55 313
Additions due to transfer of tangible assets from work in progress	4 360	37 275	(41 635)	0
Disposals	-	(114)	-	(114)
Liquidations	(116)	(162)	-	(278)
Depreciation charge for the period	(15 344)	(107 402)	-	(122 746)
Impairment losses (Note 25)	(310)	(10 711)	-	(11 021)
Foreign exchange differences	20 493	48 725	1 049	70 268
Net carrying amount at 31 December 2011	296 201	645 767	50 207	992 175
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
At 1 January 2011				
Gross carrying amount	351 106	1 305 258	43 230	1 699 594
Accumulated depreciation and impairment	(64 886)	(633 953)	-	(698 841)
Net carrying amount	286 219	671 305	43 230	1 000 753
At 31 December 2011				-
Gross carrying amount	382 072	1 467 312	50 207	1 899 590
Accumulated depreciation and impairment	(85 871)	(821 545)	-	(907 416)
Net carrying amount	296 202	645 767	50 207	992 174

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Impairment loss in amount of PLN 11,021 thousand was included in consolidated income statement for the period ended 31st December 2011 in cost of sales (2010: PLN 16,186 thousand).

The carrying amount of property, plant and equipment held under finance lease agreements or hire purchase contracts on 31st December 2011 totaled PLN 3,348 thousand (on 31st December 2010: PLN 5,363 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 296,201 thousand (on 31st December 2010: PLN 286,218 thousand) in respect of bank loans taken out by the Company (note 31).

The value of capitalized borrowing costs in the financial year ended 31st December 2011 amounted to PLN 204 thousand (year ended 31st December 2010: PLN 70 thousand).

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 on 31st December 2011 and 31st December 2010 are as follows:

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Within 1 year	5 089	3 416
Within 1 to 5 years	9 423	10 061
More than 5 years	-	267
Total	14 512	13 744

19.2. Finance lease and hire purchase commitments

As on 31st December 2011 and 31st December 2010 future minimum rentals payable under finance leases and hire purchase contracts and the present value of the net minimum lease payments are as follows:

Consolidated financial statements for the year ended 31st December 2011 PLN thousand

	Year ended 31 December 2011		Year ended 31 December 2010	
	Minimum payments	Present value of payments	Minimum payments	Present value of payments
Within 1 year	8 293	7 987	8 641	7 913
Within 1 to 5 years	12 484	11 243	16 388	15 148
More than 5 years	41 265	30 298	35 513	28 533
Minimum lease payments, total	62 041	49 528	60 542	51 594
Less amounts representing finance charges	(7 292)		(8 948)	
Present value of minimum lease payments, of which:	54 749	49 528	51 594	51 594
- short-term		7 987		7 913
- long-term		41 541		43 681

20. Investment properties

	2011 (audtied)	2010 (audited)
Opening balance at 1 January	10 542	12 159
Addititons (subsequent expenditure)	-	-
Net loss from a fair value adjustment	-	(1 617)
Closing balance at 31 December	10 542	10 542

Investment properties are recognized at fair value determined by a valuation performed by accredited appraiser “DWN” Doradztwo i Wycena Nieruchomości Karina Drzazgowska. In relation to year 2010 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 professional 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 method of use (WRU0) was estimated 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,
- condition of property,
- available data on prices of similar properties.

In 2011 revenues received from investment properties amounted to PLN 23 thousand. Costs incurred in 2011 consists of cost of property tax amounting to PLN 20 thousand.

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21. Intangible assets

	As at 31 December 2011 (audited)					
	Customer relationship	Trademarks	CER Certificate	CO2 emission rights	Other *	Total
Net carrying amount at 1 January 2011	33 540	55 977	4 293	18 768	14 540	127 118
Additions	-	-	25 133	653	69	25 855
Disposals	-	-	(19 908)	(7 364)	(12 879)	(40 151)
Depreciation charge for the period	(3 952)	(0)	-	-	(927)	(4 879)
Foreign exchange differences	3 726	6 598	-	1 869	274	12 467
Net carrying amount at 31 December 2011	33 315	62 574	9 518	13 926	1 077	120 410
At 1 January 2011						-
Gross carrying amount	37 028	55 977	4 293	18 768	42 789	158 854
Accumulated depreciation and impairment	(3 487)	-	-	-	(28 248)	(31 736)
Net carrying amount	33 540	55 977	4 293	18 768	14 540	127 118
At 31 December 2011						-
Gross carrying amount	41 507	62 574	9 518	13 926	30 438	157 964
Accumulated depreciation and impairment	(8 193)	-	-	-	(29 361)	(37 554)
Net carrying amount	33 315	62 574	9 518	13 926	1 077	120 410

* - 'Other' position includes computer software

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As at 31 December 2010 (audited)

	Customer relationship	Trademarks	CER Certificate	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	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	4 061	-	333	(592)	6 253
Net carrying amount at 31 December 2010	33 540	55 977	4 293	18 768	14 540	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	18 768	42 789	158 854
Accumulated depreciation and impairment	(3 487)	-	-	-	(28 248)	(31 736)
Net carrying amount	33 540	55 977	4 293	18 768	14 540	127 118

* - 'Other' position includes computer software

In the financial year ended 31st December 2011, emission rights with a carrying amount of PLN 653 thousand were used as guarantee in respect of bank loans drawn by the Group. In 2010 their value amounted to PLN 6,926 thousand.

The Company performed a test on impairment of the value of Arctic Paper corporate trademark as on 31st December 2011. As a result of an analysis performed, no need for allowance on the grounds of value loss was confirmed.

Another test has been scheduled to 31st December 2012.

The Company performed a test on impairment of the value of corporate trademarks purchased at acquisition of AP Grycksbo as on 31st December 2011. As a result of an analysis performed, no need for allowance on the grounds of value loss was confirmed. The impairment test was performed at Arctic Paper Grycksbo level, as the company was considered one unit generating cash flows. The details of the test have been presented in note 25.

Another test has been scheduled to 31st December 2012.

22. Investment in related parties valued using the equity method

During the years ended 31st December 2011 and 31st December 2010 the Group did not have any associates.

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23. Business combinations and acquisition of minority interests

23.1. Acquisition of Grycksbo Paper Holding AB (currently Arctic Paper Grycksbo AB) in 2010

On 1st 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 operate as sales offices. Those entities, together with Arctic Paper Investment AB, form the Grycksbo group. As a result of the final accounting as on 31st December 2010, the Group recorded a gain from a bargain purchase in the amount of PLN 77,555 thousand which was included in the consolidated income statement for the year ended 31st December 2010 in other operating income.

23.2. Founding of Arctic Paper Munkedals Kraft AB

In October 2011 Arctic Paper Munkedals Kraft with the registered office in Munkdedals, 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 Munkedals Kraft AB was established for the purpose of water energy production for Munkedals mill.

23.3. Dissolution of sales offices from Grycksbo Group.

In 2011 two sales companies belonging to Grycksbo Group: Grycksbo Paper UK Limited and Grycksbo Paper France URL were dissoluted.

24. Other assets

24.1. Other financial assets

	Note	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Derivatives	39.3	1 692	11 917
Guarantee deposits		791	916
Other		-	3
Total		2 482	12 836
- current		1 692	7 811
- non-current		791	5 024

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24.2. Other non - financial assets

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Insurance costs	698	579
Leasing charges	103	124
Cogenaration certificates	1 133	361
Prepayments for services	3 980	3 352
Rental charges	1 462	1 363
Receivables due from pension fund	1 711	-
Other	1 772	1 497
Total	10 859	7 276
- current	8 708	6 714
- non-current	2 151	564

25. Impairment test of tangible and intangible assets

As on 31st December 2011 the Group performed impairment test of tangible and intangible assets in the paper mill Arctic Paper Mochenwangen.

The performance of the test in Arctic Paper Mochenwangen was connected with achieving by the mill a lower result than expected by the management of the Group. This was influenced by market conditions such as increase of raw materials prices, strengthening of competition in the segment of paper produced by Mochenwangen mill.

In respect of the above, a decision had been made to perform a test on impairment using discounted cash flows method. The performed test resulted in creating an allowance on the grounds of impairment to the amount of PLN 11,021 thousand (PLN 16,186 thousand in 2010). The description of the process as well as key assumptions have been presented as below.

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 2012 – 2016. The pre-tax discount rate applied to the cash flow projections is 9.80% and the cash flows beyond the five-year period are extrapolated using a 1.0% 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 8.40%. 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 volatility.
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 Mochenwangen.

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 0.7194.

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

General assumption	2011	2010
Prognosis based on year	2012-2016	2011-2015
Income tax rate	27,40%	27,40%
Pre-tax discount rate	9,80%	10,32%
Weighted average cost of capital	8,40%	8,10%
Growth in residual period	1,00%	1,60%

The following table presents the impairment loss recognized as on 31st December 2011:

	Balance vaue as at 31.12.2011	Vaule in used by 31.12.2011
Tangible assets, therein:	59 371	48 349
- land	15 278	15 278
- buildings	1 223	912
- machinery and equipment	40 565	29 854
- assets under construction	2 306	2 306
Intangible assets	8 562	8 562
Working capital	17 031	17 031
Cash and equivalents	2 827	2 827
Total value	87 790	76 769
Impairment recognized in Profit and loss in 2011, therein:		11 021

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The table below present the changes in impairment loss dependent on changes of particular parameters adopted for testing.

Parameters	Increase in basis points	Effect on impairment
Weighted average cost of capital	+0,1 p.p.	(1 121)
Growth in residual period	+0,1 p.p.	815
Sales volume in first year	+ 0,1%	2 186
Sales prices in first year	+ 0,1%	3 518
		-
Weighted average cost of capital	-0,1 p.p.	1 152
Growth in residual period	-0,1 p.p.	(794)
Sales volume in first year	- 0,1%	(2 186)
Sales prices in first year	- 0,1%	(3 518)

The impairment loss amounting to PLN 11,021 thousand was recognized in consolidated income statement for the year ended 31st December 2011 in the position cost of sales.

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

The Company performed a test on impairment in AP Grycksbo as on 31st December 2011 regarding property, plant and equipment as well as intangibles.

As a result of an analysis performed, no need for allowance on the grounds of impairment was confirmed as on 31st December 2011.

The table below presents main assumptions used in calculation of value in use:

General assumption	2011	2010
Prognosis based on year	2012-2016	2011-2015
Income tax rate	26,30%	26,30%
Pre-tax discount rate	8,40%	8,40%
Weighted average cost of capital	8,00%	8,00%
Growth in residual period	1,00%	1,00%

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The below table presents sensitivity of value in use dependent on changes of particular parameters adopted for testing:

Parameters	Increase in basis points	Effect on value in use
Weighted average cost of capital	+0,1 p.p.	(11 352)
Growth in residual period	+0,1 p.p.	9 113
		-
Weighted average cost of capital	-0,1 p.p.	11 681
Growth in residual period	-0,1 p.p.	(8 856)

26. Employees benefits

26.1. Employee share incentive plan

On 30th 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.

Until 31st December 2011 there were agreements regarding acquiring these warrants executed to dispense 365 thousand warrants. Until the date of preparing of the consolidated financial statements none of the entitled persons has exercised the right to payable conversion of the warrants to the Company's shares.

26.2. Retirement and other post-employment benefits

The Group companies provide retirement benefits to retiring employees in accordance with the Labor Code in Poland applicable to Arctic Paper Kostrzyn S.A. and agreements with labor unions applicable to Arctic Paper Munkedals AB and Arctic Paper Mochenwangen GmbH. Arctic Paper Kostrzyn S.A. and Arctic Paper Grycksbo AB also operate Social Funds 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 recognizes 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:

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	Year ended 31 December 2011 (badane)	Year ended 31 December 2010 (badane)
Current service cost	2 212	2 015
Interest on obligation	3 336	2 619
Recognized actuarial gain or loss	289	229
Total pension cost for defined benefit plans	5 837	4 862

The table below summarizes the amounts of the provision and movements in the benefit liability over the years ending 31st December 2011 and 31st December 2010. The table also includes information about unrecognized actuarial losses and total pension obligations.

	Benefit plan in Sweden (AP SA branch office)	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 2011	-	13 520	45 147	4 514	5 445	68 626
Cost of employment during current period	1 892	661	1 170	236	146	4 104
Interest costs	-	870	1 860	253	353	3 336
Actuarial gains or losses	-	306	(8)	-	(9)	289
Pensions paid	-	(183)	(2 168)	(253)	(155)	(2 758)
Foreign exchange diffrences	-	1 638	5 471	0	625	7 735
Pension provision at 31 December 2011	1 892	16 812	51 472	4 750	6 406	81 332
Unrecognized actuarial losses (+) and gains (-)	-	6 863	(2 713)	413	(579)	3 984
Pension obligation at 31 December 2011	1 892	23 674	48 759	5 163	5 827	85 316

* - value as on the date acquisition (the acquisition of the company occurred on 1st March 2010)

The value of unrecognized actuarial losses in 2011 in Sweden was influenced mainly by the change of discount rate value used in calculation of the provision.

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	Benefit plan in Sweden (AP SA branch office)	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
Acquisition of subsidiaries	-		-	-	-	-
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	71 815

The principal assumptions used by the actuaries, in the particular balance sheet dates, in determining the retirement benefit obligations are presented below:

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Discount rate (%)		
Plan in Sweden	3,8%	3,7%
Plan in Poland	5,5%	5,5%
Plan in Germany	5,0%	5,3%
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	15,3	14,6
Plan in Poland	15,5	15,5
Plan in Germany	13,6	13,9

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 2011 amounted to PLN 1,210 thousand. The cost of redundancy program in 2010 amounted to PLN 899 thousand.

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As on 31st December 2011, the Group has not recognized a provision on redundancy payments.

27. Inventories

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Raw materials (at cost)	151 683	138 685
Work-in-progress (at cost of development)	9 017	6 604
Finished goods and goods for resale, of which:		
At cost / cost of development	147 279	133 286
At net realisable value	7 128	12 474
Prepayments for supplies	34	-
Total inventories, at the lower of cost (or costs of development) and net realisable value	315 142	291 048
Inventory write-down	8 767	5 011
Inventory before write-down	323 909	296 059

In the year ended 31st December 2011, the Group made a write-down of inventory of PLN 3,756 thousand (2010: PLN 2,091 thousand). In 2011 write-offs were not released (2010: PLN 981 thousand). The change of write-downs of inventories is recognized in cost of sales in the income statement. The write-down recognized related to finished goods and raw materials, slow-moving and burdened with the risk of being impaired, unsold or unusable for own need.

In the financial years ended 31st December 2011 and 31st December 2010, 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 on 31st December 2011 inventories of finished goods in the amount of PLN 7,128 thousand were stated at net realisable value (as on 31st December 2010: PLN 12,474 thousand).

28. Trade and other receivables

	Year ended 31 December 2011 (audtied)	Year ended 31 December 2010 (audtied)
Trade receivables	254 331	228 993
Budget receivables - VAT receivables	23 342	26 826
Other receivables from third parties	5 127	3 814
Other receivables from related parties	11 652	9 815
Total receivables, net	294 452	269 448
Doubtful debts allowance	21 653	22 122
Total receivables, gross	316 105	291 570

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

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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 on 31st December 2011 trade receivables amounting to PLN 21,653 thousand (as on 31st December 2010: PLN 22,122) were considered irrecoverable, impaired and fully provided for.

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

	Year ended 31 grudnia 2011 (audtied)	Year ended 31 grudnia 2010 (audtied)
Provision for bad debts as at 1 January	22 122	22 492
Charge for the year	1 497	2 708
Utilisation	(633)	(1 610)
Unused amounts reversed	(1 807)	(1 771)
Result on translation of foreign entities	474	302
Provision for bad debts as at 31 December	21 653	22 122

The table below presents the analysis of trade receivables which as on 31st December 2011 and 31st December 2010 were past due but not considered irrecoverable:

	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 2011	254 331	213 802	32 280	3 591	569	524	3 564
As at 31 December 2010	228 993	191 110	30 649	3 225	567	641	2 801

In the section of '>120 days' the vast majority is constituted by receivables of Arctic Paper Munkedals AB amounting to PLN 3,074 thousand. Those receivables have not been impaired because, in long-term perspective's assessment of the Management, the receivables are recoverable.

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 on 31st December 2011 amounted to PLN 166,299 thousand (31st December 2010: PLN 179,402 thousand).

As on 31st December 2011, the Group had un-drawn committed borrowing facilities in the amount of PLN 36,735 thousand (as on 31st December 2010: PLN 30,809 thousand).

As on 31st December 2011 the Group had an overdraft in the amount of PLN 33,069 thousand (as on 31st December 2010: PLN 41,260 thousand).

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

	Year ended 31 December 2011 (audited)	Year ended 31 December 2010 (audited)
Cash at bank and in hand	166 299	179 073
Short-term deposits	-	329
	166 299	179 402

30. Share capital and reserve/other capital

30.1. Share capital

	As at 31 December 2011 (audited)	As at 31 December 2010 (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	30 000
	554 035	554 035

	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 2011 (audited)		55 403 500	554 035 000

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.

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30.1.3. Shareholders with significant shareholding

	As at 31 December 2011 (audited)	As at 31 December 20010 (audited)
Arctic Paper AB		
Share in equity	74,80%	75,00%
Share in votes	74,80%	75,00%
Other shareholders		
Share in equity	25,20%	25,00%
Share in votes	25,20%	25,00%

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. Supplementary capital

Supplementary capital (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 supplementary capital in the amount of PLN 4,515 thousand PLN.

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

In 2010 a supplementary capital was created to cover loss in the amount of PLN 8,734 thousand as a result of dividing the financial result of Arctic Paper S.A. in compliance with Code of Commercial Companies article 396 (8% of profit for the given financial year).

In 2011 a supplementary capital was created to cover loss in the amount of PLN 7,771 thousand as a result of dividing the financial result of Arctic Paper S.A. in compliance with Code of Commercial Companies article 396 (8% of profit for the given financial year).

As on 31st December 2011 the total value of the Group's supplementary capital is PLN 80,060 thousand (31st December 2010: PLN 72,289 thousand).

30.4. Other reserve capital

Other reserve capital consists of the capital from the valuation of hedges. The Group started using hedging transactions in the year 2009.

The following table shows changes in other reserve capital in the year ended 31st December 2011, as well as comparatives:

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	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Other reserves at the beginning of the reporting period	40 131	1 388
Changes in cash flow hedges		
Valuation of financial instruments, therein:	(25 515)	10 679
- FX forward	2 152	(2 154)
- Forward for electricity	(27 667)	12 833
Deferred tax, therein:	6 868	(2 851)
- FX forward	(408)	526
- Forward for electricity	7 276	(3 377)
Other changes		
Currency translation differences	-	-
Distribution of profits	89 364	
Derecognition of deffered tax asset originally	-	-
Other reserves at the end of the reporting period	110 849	40 131

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 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 ad shall not be used for any other purpose.

Retained earnings/Accumulated losses presented in the balance sheet as on 31st December 2011 consist of the following items:

a) Accumulated losses in the amount of PLN -10,358 thousand.

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b) Consolidated profit for the year 2010 in the amount of PLN 28,816 thousand,

c) Division of standalone profit for 2009 in the amount of PLN 39,648 thousand and for 2010 in the amount of PLN 97,135 thousand,

d) Consolidated profit for 2011 in the amount of PLN 12,066 thousand.

As on 31st December 2011 there are no other limitations concerning the payout of the dividend.

30.6. Non-controlling interests

	As at 31 December 2011 (audited)	As at 31 December 2010 (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, borrowings and bonds

Current liabilities	Maturity	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Other financial liabilities			
Obligations under finance leases and hire purchase contracts	till 31-12-2012	7 987	7 913
Factoring in SEK in SHB		46 507	2 606
Factoring in EUR inGE capital		1 378	-
Derivatives		4 292	-
Other liabilities	31-12-2012	219	575
Interest-bearing loans, borrowings and bonds:			
BRE Bank bonds	till 31-12-2012	6 200	68 723
PLN bank overdraft in Bank Polska Kasa Opieki S.A.		20 749	41 260
PLN bank loan in Bank Polska Kasa Opieki S.A. (current part)	till 31-12-2012	13 711	28 716
SEK bank loan in Bank Polska Kasa Opieki S.A. (current part)		-	1 562
EUR bank loan in Bank Polska Kasa Opieki S.A. (current part)	till 31-12-2012	14 263	88 458
SEK bank loan in Bank Svenska Handelsbanken		-	22 075
EUR bank loan in Bank HypoVereinsbank		-	9 525
SEK bank overdraft in SHB		12 320	
SEK bank loan in Accent Equity		-	31 792
Total current financial liabilities		127 625	303 205

Non-current	Maturity	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Other financial liabilities			
Obligations under finance leases and hire purchase contracts	15-01-2015	41 541	43 681
Derivatives		2 736	
Interest-bearing loans, borrowings and bonds:			
BRE Bank bonds	25-02-2013	199 814	119 571
PLN bank loan in Bank Polska Kasa Opieki S.A. (current part)	23-10-2014	17 754	10 210
SEK bank loan in Bank Polska Kasa Opieki S.A. (current part)	-	-	10 083
EUR bank loan in Bank Polska Kasa Opieki S.A. (current part)	23-10-2014	99 694	52 841
Total non-current financial liabilities		361 540	236 386

31.1. Loans and borrowings

On 23rd October 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 installments over 5 years;
- PLN 196,400 thousand of which PLN 85,800 are to be repaid by installments 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 was distributed to partly finance the acquisition of Mochenwangen Paper GmbH; PLN 196,400 thousand for refinancing of existing debt and providing working capital for the Arctic Paper S.A. Group further activities.

As 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 on 31st December 2011 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),
- credit in the current account in Svenska Handelsbanken – interest rate 6.85%, does not depend on financial indicators.

During twelve months period ended on 31st December 2011 the Group repaid the credits and loans in the amount of PLN 126,336 thousand.

The repayments were mostly related to settlement of a credit from Bank Polska Kasa Opieki S.A. in amount of PLN 60,183 thousand (tranches in PLN, EUR, SEK), credit from Svenska Handelsbanken bank in amount of

PLN 22,804 thousand (tranches in SEK), loan from Accent Equity in the amount of PLN 33,088 thousand (tranches in SEK), loan from HVB in the amount of PLN 10,011 thousand (tranches in EUR.

On 15th 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 23rd October 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.

On 30th 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 23rd October 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 30th 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 remained unchanged. The Company informed about the terms of the Facility C in the current report no. 30/2010 dated 17th June 2010.

In connection with the extension of Facility C repayment date, the validity for the loan security, i.e. joint-capped mortgage of up to PLN 100 million and authorization to manage bank accounts of Arctic Paper Kostrzyn S.A. held at Bank Polska Kasa Opieki S.A. has been modified accordingly.

Following the conclusion of the Amendment dated 30th 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.

On 19th October 2011 Arctic Paper S.A. ("Company") and its subsidiaries, that is Arctic Paper Kostrzyn S.A, Arctic Paper Mochenwangen GmbH, Arctic Paper Investment GmbH, concluded another amendment with Bank Polska Kasa Opieki S.A. to the facility agreement dated on 23rd October 2008 ("Facility Agreement"). The Facility Agreement was disclosed in the prospectus shares of B series and C series.

Under the Amendment, the Bank Polska Kasa Opieki SA agreed to postpone until 31st January 2013 the final repayment date of the term loan of tranche B ("the facility B") of up to PLN 104,862,803 and the current account credit of up to PLN 50,000,000 ("the facility C"), granted to Arctic Paper Kostrzyn S.A., Arctic Paper Mochenwangen GmbH and Arctic Paper Investment GmbH.

In the scope of the Amendment quarterly repayments of facility B have been also agreed to 5 installments in the range of from PLN 2.2 million to PLN 3.8 million each, while the due date of the last installment shall be 31st December 2012. The remaining due amount of the facility B that is PLN 90,800,000 shall be repaid until 31st January 2013.

Other terms of Facility B and Facility C as well as the provisions of Facility Agreement remained unchanged.

In connection with the extension of the due term of repayment of the Facility B and Facility C, the periods for which the guarantees for Facility B and Facility C had been established, that is

1. joint capped mortgages, each of up to PLN 221,200,000, ensuring the repayment of the Facility B by the Company, Arctic Paper Kostrzyn S.A. and Arctic Paper Mochenwangen GmbH;

2. joint capped mortgage of up to PLN 100,000,000 PLN, ensuring the repayment of Facility C by the Company;

have been extended accordingly.

Following the conclusion of the Amendment, the Company and Arctic Paper Kostrzyn S.A. submitted themselves to execution pursuant to Article 777 § 1 item 5 of the Code of Civil Procedure for the benefit of Bank Polska Kasa Opieki S.A.

There are no provisions concerning contractual penalties in the Annex.

In connection with concluding of the another amendment on 19th October 2011 by Arctic Paper S.A. ("Company") with its subsidiaries, that is Arctic Paper Kostrzyn S.A., Arctic Paper Investment GmbH and Arctic Paper Mochenwangen GmbH, with Bank Polska Kasa Opieki S.A. to the facility agreement dated on 23rd October 2008 ("Facility Agreement"). On 20th October 2011 Arctic Paper Kostrzyn S.A., on the basis of a statement of a notary act, changed the content of:

1. joint capped mortgage up to PLN 221,000,000 established for Bank Polska Kasa Opieki S.A. to guarantee the repayment of the Company's liability for Bank Polska Kasa Opieki SA on the grounds of Facility B (as stated in paragraph 19.1. of the hereby report) ("Mortgage 1"), disclosed in land and mortgage register under no GW1S/00025123/4, GW1S/00026787/3, GW1S/00005360/1 and GW1S/00025698/5. The change consists in disclosing the date of 31st January 2013 as the due date of Facility B;

2. joint capped mortgage up to PLN 221,000,000 established for Bank Polska Kasa Opieki S.A. to guarantee the repayment of Arctic Paper Kostrzyn SA liability for Bank Polska Kasa Opieki SA on the grounds of Facility B (as stated in paragraph 19.1. of the hereby report) ("Mortgage 2"), disclosed in land and mortgage register under no GW1S/00025123/4, GW1S/00026787/3, GW1S/00005360/1 and GW1S/00025698/5. The change consists in disclosing the date of 31st January 2013 as the due date of Facility B;

3. joint capped mortgage up to PLN 221,000,000 established for Bank Polska Kasa Opieki S.A. to guarantee the repayment of Arctic Paper Mochenwangen GmbH liability for Bank Polska Kasa Opieki SA on the grounds of Facility B (as stated in paragraph 19.1. of the hereby report) ("Mortgage 3"), disclosed in land and mortgage register under no GW1S/00025123/4, GW1S/00026787/3, GW1S/00005360/1 and GW1S/00025698/5. The change consists in disclosing the date of 31st January 2013 as the due date of Facility B; and

4. joint capped mortgage up to PLN 100.000.000 established for Bank Polska Kasa Opieki S.A. ("Mortgage 4") disclosed in land and mortgage register under no GW1S/00025123/4, GW1S/00026787/3, GW1S/00005360/1 and GW1S/00025698/5. The change consists in disclosing the date of 31st January 2013 as the due date of Facility C.

Mortgage 1, Mortgage 2, Mortgage 3 and Mortgage 4 are hereinafter referred to as "Mortgages".

The land and mortgage register no GW1S/00025123/4 is kept for real estate of Arctic Paper Kostrzyn S.A. property, whereas the land and mortgage registers no GW1S/00026787/3, GW1S/00005360/1 and GW1S/00025698/5 are kept for real estates of Arctic Paper Kostrzyn S.A. perpetual usufruct. Mortgage 1, Mortgage 2 and Mortgage 3 have equal highest priority, whereas Mortgage 4 is recorded in the land and mortgage register in secondary position. The real estates that have been encumbered with mortgages are located in Kostrzyn nad Odrą and serve for conducting primary business activity of Arctic Paper Kostrzyn S.A. The recorded value in the land and mortgages register of the Arctic Paper Kostrzyn S.A. real estates that have been encumbered with mortgages amounts to PLN 110,635,000.

The other changes in value of loans and borrowings as on 31st December 2011, compared to 31st December 2010, result only from balance sheet evaluation

31.2. Bonds

In the 12-month period ended 31st December 2011 the Group performed the redemption of zero-coupon bonds series 02/2010 in the amount of PLN 66 million.

On 10th 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 25th 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.

Information on the bond issue is included in current reports No. 3/2011 dated 8th February 2011 and 4/2011 dated 10th February 2011.

31.3. Collaterals

2011

In connection with loans taken in Polska Kasa Opieki S.A. bank the Group had:

- pledge on shares of Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen for the benefit of Polska Kasa Opieki S.A. bank;
- pledge on bank accounts of Arctic Paper S.A., Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen for the benefit of Polska Kasa Opieki S.A. bank;
- assignments of rights from Insurance Policies of Arctic Paper Kostrzyn, and Arctic Paper Munkedals in favor of Bank Polska Kasa Opieki

- mortgages amounting to the following: SEK 600,000 thousand, PLN 171,600 thousand, PLN 221,200 thousand, EUR 20,000 thousand, 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: SEK 600,000 thousand, PLN 171,600 thousand, PLN 221,200 thousand, EUR 20,000 thousand, 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 B to a maximum amount of PLN 221,000 thousand over the property held in perpetual usufruct of Arctic Paper Kostrzyn S.A., as disclosed in land registers no. GW1S/00025123/4, GW1S/00027787/3, GW1S/00005360/1 and GW1S/00025698/5,
- joint capped mortgage as collateral for the loan C to a maximum amount of PLN 100,000 thousand over the property held in perpetual usufruct of Arctic Paper Kostrzyn S.A., as disclosed in land registers no. GW1S/00025123/4, GW1S/00027787/3, GW1S/00005360/1 and GW1S/00025698/5.

Arctic Paper Kostrzyn S.A. had also in 2011 blank bills of exchange as collateral for the lease agreement concluded with Bankowy Leasing S.A. and with Bankowy Fundusz Leasingowy S.A.

Apart from the mentioned above, the Group reports collaterals on assets on the grounds of loan taken in Arctic Paper Grycksbo in Svenska Handelsbanken bank, that is:

- pledge on assets in the amount of SEK 65,000 thousand,
- mortgage on real estates in the amount of SEK 20,000 thousand,
- pledge on assets of Grycksbo Paper Holding AB in the amount of SEK 254,743 thousand.

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.
- pledge on bank accounts of Arctic Paper S.A., Arctic Paper Kostrzyn, Arctic Paper Munkedals, Arctic Paper Mochenwangen for the benefit of Polska Kasa Opieki S.A. bank,
- assignments of rights from Insurance Policies of Arctic Paper Kostrzyn, and Arctic Paper Munkedals in favor of Bank Polska Kasa Opieki
- mortgages amounting to the following: SEK 600,000 thousand, PLN 171,600 thousand, PLN 221,200 thousand, EUR 20,000 thousand, 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: SEK 600,000 thousand, PLN 171,600 thousand, PLN 221,200 thousand, EUR 20,000 thousand, for Arctic Paper Kostrzyn, Arctic Paper Munkedals,

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

- joint capped mortgage as collateral for the loan C to a maximum 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 in the amount of EUR 1,420 thousand in favor of Hypovereinsbank.

32. Provisions

32.1. Movements in provisions

The table below presents movements In provisions in the years 2010-2011.

	Post-employment benefits	Other provisions	Total
At 1 January 2011	68 626	16 965	85 591
Recognised during the year	7 729	5 437	13 167
Utilised	(2 758)	(10 335)	(13 094)
Unused amounts reserved	-	-	-
Foreign exchange adjustment	7 735	827	8 561
At 31 December 2011, therein:	81 332	12 894	94 226
- current	-	10 398	10 398
- non-current	81 332	2 495	83 827
At 1 January 2010	20 433	10 957	31 390
Acquistion of subsidiary	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

* - value as on the date of acquisition (the acquisition of the company occurred in 1st March 2010)

The single largest item among other provisions are liabilities on redemption of emission rights with a carrying amount of PLN 7,858 thousand in the financial statements for the year ended 31st December 2011 and PLN 6,290 thousand in the financial statements for the year ended 31st December 2010.

32.2. Warranty provisions

A provision is recognized 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 2011 amounted to PLN 530 thousand (as on 31st December 2010: PLN 246 thousand), and related only to Arctic Paper Mochenwangen.

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

33.1. Trade and other payables (short-term)

	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Trade payables:		
To related parties	9 425	10 631
To third parties	351 731	309 884
	361 156	320 515
Taxations, customs duty, social security and other payables		
VAT	3 832	2 333
Excise tax	510	323
Personnel withholding tax (Personnel income tax)	5 424	4 956
Property taxes	678	730
Liabilities for social security contributions	8 116	6 869
Customs liabilities	34	533
	18 593	15 744
Other liabilities		
Renumeration payable to employees	4 530	3 904
Pension liabilities	6 541	8 111
Investment liabilities	8 978	11 295
Environmental liabilities	232	250
Liabilities due to Golzern	13	3 181
Prepayments	1 931	1 007
Other liabilities	1 083	1 075
	23 308	28 823
TOTAL	403 057	365 082

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 payment term of 1 month.
- the amount which results from the difference between liabilities and VAT receivables is paid to appropriate tax authorities on a monthly basis.

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33.2. Accruals and deferred income

	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Accruals		
Employee costs	51 335	46 997
Audit and legal services	530	927
Freight costs	2 256	3 623
Claims	1 014	917
Costs of energy certificates	5 705	-
Costs of energy	4 315	679
Other	2 031	2 948
	67 186	56 089
Deferred income		
Grant from Ekofundusz	20 930	22 332
Grant from NFOŚiGW	16 601	17 919
Other	-	76
	37 531	40 327
TOTAL	104 717	96 416
- short-term	69 907	58 889
- long-term	34 810	37 528

The main items included in accruals for employee costs are vacation pay liabilities, bonuses to employees and redundancy payments.

34. Capital commitments (unaudited)

As on 31st December 2011, the Group has commitments of PLN 8,977 thousand for capital expenditures related to property, plant & equipment. These expenditures will be incurred for acquisition of new plant and equipment. As on 31st December 2010, the Group's commitments to purchase property, plant & equipment amounted to PLN 11,295 thousand.

35. Contingent liabilities

As on 31st December 2011, 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 favor 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 statements (Note 44.1)
- a bill of exchange in favor of Bankowy Leasing in the amount of PLN 9,848 thousand,
- a guarantee of a bill of exchange in favor of Bankowy Fundusz Leasingowy in the amount of PLN 15,023 thousand,
- a pledge on movables of Arctic Paper Munkedals AB resulting from factoring agreement with

Svenska Handelsbanken AB in the amount of SEK 160,000 thousand;

- a guarantee commitment to FPG for the mutual life insurance company PRI in the amount of SEK 50,000 thousand,
- a bank guarantee in favor of Skatteverket Ludvika in the amount of SEK 135 thousand.
- a guarantee in favor of Cartiere del Garda S.P.A. dated 25th March 2010 – the supplier of paper to Distribution Companies (Arctic Paper Sweden AB, Arctic Paper Danmark A/S, Arctic Paper Norge AS). The guarantee amounts to total EUR 900 thousand and expires on 31st December 2012;
- a bank guarantee in favor of UPM GmbH in the amount of EUR 1,000 thousand.

35.1. Legal claims

The case against PGNiG S.A

On 26th August 2010 Arctic Paper Kostrzyn S.A. filed a lawsuit to determine the price for fuel gas sold to Arctic Paper Kostrzyn S.A. by PGNiG S.A. The case was examined by Arbitrary Court to the Polish Chamber of Commerce. The claim was based on the provisions of the agreement concluded by and between Arctic Paper Kostrzyn S.A. and PGNiG S.A., which allows, in case of gas prices increase more that 10% in the particular contractual year, to apply for negotiations and further to address the case to be decided by the Arbitrary Court. The case was ended with an unfavorable decision for Arctic Paper Kostrzyn S.A.

The case against Cezex Sp. z o.o.

On 8th October 2009 and on 27th November 2009 Arctic Paper Kostrzyn S.A. filed a claim against Cezex Sp. z o.o. with the District Court in Gorzów Wielkopolski.

The value of the dispute includes respectively:

- the principal of PLN 11,240 thousand and interest of PLN 325 thousand accrued until the date of filing the claim,
- the principal of PLN 174 thousand and interest accrued in the amount 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 11th February 2009 to 1st July 2009. Receivables from Cezex Sp. z o.o. were secured in favor of Arctic Paper Kostrzyn S.A. by mortgage on the counterparty's real property. Moreover, an allowance for doubtful debts was established for their entire value.

On 21st 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 18th May 2011 the Court declared the liquidation bankruptcy of Cezex Sp. z o.o. As a result of the bankrupt complaint, the Court cancelled the decision from 18th May 2011. On 7th February 2012, the District Court declared the liquidation bankruptcy of Cezex Sp. z o.o again.

As on 31st December 2011 the Group has established an allowance for doubtful debts for the full value of receivables from Cezex Sp. z o.o.

The case against Jakon SA in liquidation

On 15th 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 7th February 2011 a bankruptcy liquidation of Jakon S.A. was announced. Currently there are proceedings held against Jan Dziedzic as a guarantor. The Court issued the payment order in the writ-of-payment proceedings, there was an objection raised by the defendant, the case is still in progress.

As on 31st December 2011 the Group made allowance for doubtful debts for full amount of receivables from Jakon S.A. in liquidation.

As on 31st December 2011 the companies of the Group are not parties to any other lawsuits.

35.2. Tax settlements

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 on 31st December 2011 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 process of liquidation), subsidiary of Arctic Paper AB.
- Rottneros – a group of companies operating in pulp and paper industry, related by capital with Nemus Holding AB.
- Galileus Sp.z o.o. Sp.k. – company related to the Member of the Management Board

The table below presents the total values of transactions with related parties entered into during the years 2010-2011:

Data for the period from 1 January 2011 to 31 December 2011 and as at 31 December 2011 (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	-	-	-	-	3 957	-	-
Arctic Paper Håfreström	-	1 552	-	-	7 696	-	-
Rottneros	-	54 400	-	-	-	-	9 425
Galileus Sp.z o.o.Sp.k.	-	116	-	-	-	-	4
Total	-	56 068	-	-	11 652	-	9 429

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

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 31st December 2011 and 31st December 2010.

36.2. The parent company

The parent company of the Arctic Paper S.A. Group is Arctic Paper AB, which as on 31st December 2011 holds 74,80% 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.

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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 members of the Supervisory Board

Key management personnel as on 31st December 2011 comprise five people: President of the Management Board and four Members of the Management Board. The financial data for the reporting period include remuneration of the aforesaid five people.

Remuneration of the executives in the year ended 31st December 2011 amounted to PLN 3,950 thousand (PLN 4,970 thousand in the year ended 31st 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 table below presents the remuneration of key executives of the Group:

Management Board	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Short-term employee benefits	3 950	4 970
Post-employment pension and medical benefits	655	-
Termination benefits	-	3 103
Total compensation paid to key management personnel	4 604	8 073
Supervisory Board		
Short-term employee benefits	792	566

36.4.2. Directors' interests (including members of Management and Supervisory Boards) in employee share incentive plan

On 30th 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.

Until 31st December 2011 there were agreements regarding acquiring these warrants executed to dispense 365 thousand warrants. Until the date of preparing of the consolidated financial statements none of the entitled persons has exercised the right to payable conversion of the warrants to the Company's shares.

36.5. Loans granted to the Management Board members

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.

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36.6. Other transactions with the Management 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 18th July 2011 the Company concluded 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.

The table below presents the audit company's fees, paid or payable for the year ended 31st December 2011 and 31st December 2010 by category of services:

	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Service		
Obligatory audit of annual financial statement	265*	190
Obligatory audit of annual financial statement (AP S.A. branch)	31	43
Tax advisory	-	-
Other services	50	65
Total	346	298

* - 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 also uses recourse factoring in scope of trade receivables. The main purpose of this financial instrument is quick obtaining of financial means.

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 summarized below.

In the Management Board opinion – compared to consolidated financial statements prepared as on 31st December 2010 there were no significant changes of financial risk. Moreover, there were no changes of goals and principles of risk management.

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38.1. 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 does not have direct impact on the Group's equity.

	Increase in basis points	Effect on profit before tax
Year ended 31 December 2011		
PLN	+1%	(2 176)
EUR	+1%	(226)
SEK	+1%	(838)
Year ended 31 December 2010		
PLN	+1%	(155)
EUR	+1%	(718)
SEK	+1%	(1 096)

38.2. 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 grouped 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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2011

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%	384	-5%	(384)
PLN – USD	+5%	(1 470)	-5%	1 470
PLN – GBP	+5%	311	-5%	(311)
PLN – SEK	+5%	357	-5%	(357)
PLN-CHF	+5%	47	-5%	(47)
SEK – EUR	+5%	1 016	-5%	(1 016)
SEK – USD	+5%	(3 769)	-5%	3 769
SEK – GPB	+5%	757	-5%	(757)
SEK - DKK	+5%	331	-5%	(331)

Impact on total comprehensive income (on foreign entities translation)	FX rate increase	Total financial impact	FX rate decrease	Total financial impact
PLN – SEK	+5%	2 166	-5%	(2 166)
PLN – EUR	+5%	(122)	-5%	122

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 – GPB	+5%	1 035	-5%	(1 035)
EUR – GBP		113		(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)

38.3. Commodity prices risk

The Group is exposed to the risk of drop in selling price due to higher market competition and due to the risk of increase of raw materials prices because of restricted access to commodities on the market.

38.4. Credit risk

The Group trades only with recognized, creditworthy third parties with good credibility. 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.

38.5. 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 summarizes the maturity profile of the Group's financial liabilities as on 31st December 2011 and 31st December 2010 based on contractual undiscounted payments.

As at 31 December 2011	On demand	Less than 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest bearing loans, borrowings and bonds	2 261	9 436	42 085	342 046	-	395 828
Financial leasing	-	1 505	6 688	11 243	30 092	49 528
Trade and other payables	2 652	394 884	30 268	3 774	2 682	434 261
	4 914	405 826	79 041	357 063	32 774	879 618

As at 31 December 2010	On demand	Less than 3 months	3-12 months	1-5 years	Over 5 years	Total
Interest bearing loans, borrowings and bonds	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	360 693
	4 767	457 053	212 174	230 676	31 460	936 130

39. Financial instruments

The Group has the following financial instruments: cash on hand and cash in bank, loans and borrowings, issued bonds, 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 all financial instruments in their balance sheet amounts, divided by class and category of financial assets and liabilities.

	Category complaint with IAS 39	Book value As at 31 December 2011	Book value As at 31 December 2010	Fair value As at 31 December 2011	Fair value As at 31 December 2010
Financial Assets					
Granted loans	*L&R*	-	20 600	-	20 600
Trade and other receivables	*L&R*	271 110	242 622	271 110	242 622
Hedging instruments*		1 692	11 917	1 692	11 917
Other financial assets (excluding loans and hedgingintruments)	*L&R*	791	919	791	919
Cash and cash equivalents	*FVTPL*	166 299	179 402	166 299	179 402
Financial Liabilities					
Interest bearing bank loans and borrowings therein:	*OFL*	384 504	296 522	384 504	296 522
- long-term interest-bearing with variable interest rate	*OFL*	317 262	73 134	317 262	73 134
- other short-term	*OFL*	67 242	223 388	67 242	223 388
Liabilities from financial lease and lease agreement with purchase option, therein:		49 528	51 594	49 528	51 594
- long-term		41 541	43 681	41 541	43 681
- short-term		7 987	7 913	7 987	7 913
Trade and other financial payables		384 468	349 338	384 468	349 338
Hedging instruments	*OFL*	7 028	373	7 028	373
Debt securities, therein:	*OFL*	206 014	188 294	206 014	188 294
- long-term Coupon bonds	*OFL*	199 814	119 571	199 814	119 571
- short-term Zero-Coupon bonds	*OFL*	6 200	68 723	6 200	68 723

* derivative hedging instruments complying to hedging principles

Abbreviations used:

HtM – Financial assets held to maturity,
FVTPL – Financial assets/ financial liabilities at fair value through profit or loss,
L&R – Loans and receivables,
AFS – Available-for-sale assets,
OFL – Other financial liabilities measured at amortised cost.

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As on 31st December 2011 and as on 31st December 2010, the Group had the following financial instruments evaluated at fair value:

	31 December 2011	Level 1	Level 2	Level 3
Financial assets valued at a fair value through financial result				
Derivative instruments		-	1 692	-
Financial liabilities valued at a fair value through financial result				
Derivative instruments			8 189	

	31 December 2010	Level 1	Level 2	Level 3
Financial assets valued at a fair value through financial result				
Derivative instruments		-	11 917	-
Financial liabilities valued at a fair value through financial result			373	
Derivative 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 2011 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	7 987	2 743	2 767	2 833	2 900	30 298	49 529
Loans, borrowings and bonds:							
Bonds in Bank BRE	6 200	199 814	-	-	-	-	206 014
PLN bank loan in Bank Polska Kasa Opieki S.A. (A2)	2 306	2 320	5 601	-	-	-	10 227
PLN bank loan in Bank Polska Kasa Opieki S.A. (B)	11 403	9 833	-	-	-	-	21 236
EUR bank loan in Bank Polska Kasa Opieki S.A. (A2)	3 362	3 361	7 185	-	-	-	13 908
EUR bank loan in Bank Polska Kasa Opieki S.A. (B)	-	48 539	31 973	-	-	-	80 512
EUR bank loan in Bank Polska Kasa Opieki S.A. (A3)	10 901	8 635	-	-	-	-	19 536
SEK bank loan in SHB (overdraft)	12 320	-	-	-	-	-	12 320
PLN bank loan in Bank Polska Kasa Opieki S.A. (C, overdraft)	20 751	-	-	-	-	-	20 751
Sum loans, borrowings and bonds	67 242	272 502	44 759	-	-	-	384 503
TOTAL	75 229	275 245	47 526	2 833	2 900	30 298	434 032

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31 December 2010 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, borrowings and bonds:							
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	-	-	-	
SEK bank loan in Bank Polska Kasa Opieki S.A. (A2)	1 562	2 366	2 366	5 351	-	-	
PLN bank loan in Bank Polska Kasa Opieki S.A. (C)	41 260	-	-	-	-	-	
SEK bank loan in Bank Svenska Handelsbanken	22 075	-	-	-	-	-	
EUR bank loan in Bank HypoVereinsbank	9 525	-	-	-	-	-	9 525
SEK bank loan in Accent Equity	31 792	-	-	-	-	-	31 792
Sum loans, borrowings and bonds	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

39.3. Hedge accounting

As on 31st December 2011 the Group used cash flow hedge accounting for the following hedging relations:

- on 11th 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 1st October 2009 Arctic Paper Munkedals AB designated for cash flow hedge accounting the forward electricity derivatives hedging the future purchases of electricity.
- In December 2006 Arctic Paper Grycksbo designated for the Cash flow hedge accounting the forward electricity derivatives hedging the future purchases of electricity.
- On 27th May 2010 Arctic Paper Grycksbo AB designated for cash flow hedge accounting the FX forward derivatives aimed at securing foreign currency portion of the proceeds from the SEK related to export sales.

39.3.1. Cash flow hedge accounting

As on 31st December 2011 as well as on 31st December 2010 the Group held FX forward contract and forward contract to purchase electricity, as cash flow hedge instruments

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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:

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	11.4.2011
Delivery date	depending on the contract, since 27.01.2012 till 29.03.2012
Hedged amount	7.5 mln EUR
Forward ratio	from 1.4175 to 1.4215

The table below presents detailed information concerning the hedging relationship in the cash flow hedge accounting on the sales EUR/ PLN:

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 PLN
Forward contract parameters	
Trade date	15.9.2011
Delivery date	depending on the contract, since 30.03.2012 till 31.08.2012
Hedged amount	15.0 mln EUR
Forward ratio	from 4.369 to 4.3957

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 31.12.2014
Hedged amount	392.568 MWh
Forward price	from 35.75 to 48,80 EUR/MWh

The table below presents the fair value of hedging derivatives in the cash flow hedge accounting as on 31st December 2011 and the comparative data:

	As at 31 December 2011		As at 31 December 2010	
	(audited)	(audited)	(audited)	(audited)
	Assets	Liabilities	Assets	Liabilities
FX forward	1 692	-	306	373
Electricity forward	-	8 189	11 611	-
Total hedging derivatives	1 692	8 189	11 917	373

The table below presents the nominal value of hedging derivatives as on 31st December 2011:

	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)	3 554	7 093		-	-	10 647
Currency sold (in EUR thousand)	2 500	5 000		-	-	7 500
Currency purchased (in SEK thousand)	-		65 744	-	-	65 744
Currency sold (in GBP thousand)	-	-	15 000	-	-	15 000
Electricity forward:						-
Electricity purchased (in PLN thousand)	1 377	7 835	28 211	40 601	-	78 023

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The table below presents cash flow hedge accounting amounts which were recognized by the Group in 2011 in the profit and loss account and in comprehensive income statement:

	Year ended 31 December 2011 (audited)
Revaluation reserve capital as at 31 December 2011 - revaluation to fair value of hedging derivatives on account of the hedged risk, corresponding to the effective hedging	(9 429)
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 2011 - 31 December 2014

The table below presents changes in the revaluation reserve capital on account of cash flow hedge accounting in 2011:

	Year ended 31 December 2011 (audited)
Revaluation reserve capital as at 1 January 2011	9 217
Deferral of revaluation to fair value of hedging derivatives on account of the hedged risk, corresponding to the effective hedge	(18 646)
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 2011	(9 429)

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 maximize 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 ended 31st December 2011 and 31st December 2010.

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.

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Compared to financial statements for year 2010, there was no significant change of gearing ratio.

Arctic Paper S.A. Group	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Interest bearing loans, borrowings and bonds	489 164	539 590
Trade and other payables	403 057	365 082
Less cash and short term deposits	(166 299)	(179 402)
Net debts	725 923	725 270
Equity	675 561	667 943
Capital and net debt	1 401 483	1 393 213
Gearing ratio	0,52	0,52

41. Employment structure

The average employment in the Group in the years ended 31st December 2011 and 31st December 2010 was as follows:

	As at 31 December 2011 (audited)	As at 31 December 2010 (audited)
Management Board of the parent entity	3	3
Management Boards of subsidiary companies	23	25
Administration department	148	150
Sales department	192	199
Production department	1 090	1 081
Other	141	138
Total	1 597	1 596

42. CO2 Emission rights

Arctic Paper Kostrzyn S.A., Arctic Paper Munkedals AB, Arctic Paper Grycksbo AB and Arctic Paper Mochenwangen GmbH are all part of the European Union Emission Trading Scheme. The current trading period lasts from 1st January 2008 to 31st December 2012. The tables below specify the allocation and usage of emission rights by each of the four entities.

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(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 unused from previous years	-	98 511	115 865	183 411	261 812
Amount used	109 643	131 094	143 659	136 564	-
Amount purchased	-	14 000	47 800	21 000	-
Amount sold	-	74 000	45 043	14 483	-
Amount unused	98 511	115 865	183 411	261 812	-

(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 unused from previous years	-	-	-	-	
Amount used	28 243	38 066	42 775	37 422	-
Amount purchased	-	7 400	19 200	17 700	-
Amount sold	-	-	11 940	-	-
Amount unused	(14 232)	(16 655)	(21 504)	(5 711)	

(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 unused from previous years	-	6 448	-	9 152	(110 424)
Amount used	112 543	105 587	109 839	109 142	-
Amount purchased	100 000	-	-	9 142	-
Amount sold	100 180	19 500	-	138 567	-
Amount unused	6 448	-	9 152	(110 424)	-

(in tonnes) dla Arctic Paper Grycksbo AB	2010	2011	2012
Amount granted	69 411*	69 411	69 411
Amount unused from previous years	-	11	422
Amount used	-	-	-
Amount purchased	-	-	-
Amount sold	69 400	69 000	-
Amount unused	11	422	-

* - quantity as on the date of acquisition (the acquisition of the company occurred on 1st March 2010)

On 1st 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 1st 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 30th 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 recognized as intangible assets at cost (fair value of the CERs at date of transaction). During 2011 AP MW repurchased and sold 100,000 CERs.

As a consequence of recognition of emission rights granted to Mochenwangen as a result of purchase price allocation, as on 31st December 2008 the Group recognized provision for actual consumption of CO2 in the amount of PLN 7,706 thousand. Provision as on 31st December 2011 amounted to PLN 7,858 thousand compared to PLN 6,922 thousand as on 31st December 2010.

43. Cogeneration certificates

Based on the provisions of article 91 paragraph 1 point 1 of the act dated 10th April 1997, Energy Law, the Company 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.

The change in law since 10th September 2011 modified the subject of granting the certificates for electricity produced from purchased heat and from gas.

Before the changes were introduced for the total energy produced yellow certificates had been granted. After the change, yellow certificates are only for electricity produced from gas, while for electricity produced from purchased heat red certificates are being granted.

Due to producing electric energy in cogeneration, in 2011 the Group received the rights in the amount of: yellow certificates kWh 154,604,654 and red certificates 70,578,470 kWh (in 2010 kWh 219,420,350). In 2011, revenues from sale of cogeneration certificates amounted to PLN 19,143 thousand (in 2010 PLN 26,890 thousand). The certificates of cogeneration corresponding to the energy produced are recognized as reduction of cost of sales in the income statement.

The changes in law may cause the certificates originally recognized and valued as yellow to be accounted as red certificates of lesser value.

For that reason, the Company made accruals (liabilities) in proper amount.

44. Government grants and subsidies

44.1. Subsidy from the Ekofundusz Foundation

On 6th July 2006 the Company signed an agreement with Ekofundusz Foundation for financial support in the scope of eco-conversion of Polish debt that is funds 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. Out of this agreement, the Company received PLN 7,482 thousand for the project: „construction of natural gas combined heat and power plant in Arctic Paper Kostrzyn S.A.”. As on the date of the preparation of these condensed consolidated financial statements, the construction of the new heat power plant has been completed and the Company uses the facility for its business operation.

The transfer of the funds to the Company’s account was as follows: PLN 1,401 thousand on 1st August 2006, PLN 3,705 thousand on 3rd November 2006, PLN 2,375 thousand on 20th December 2006. The financial support was granted to the Company and the Company committed to comply with the specific conditions, the realisation 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 2nd October 2008 the Company signed an agreement with Ekofundusz Foundation for financial support in the scope of eco-conversion of Polish debt that is funds 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. By the power of the agreement, the Company received PLN 17,643 thousand for the project "construction of natural gas combined heat and power plant in Arctic Paper Kostrzyn S.A.". As on the date of the preparation of these consolidated financial statements, the construction of the new power plant has been completed and the Company uses the facility for its business operation.

The transfer of the funds to the Group's account was as follows: PLN 1,176 thousand on 15th October 2008, PLN 856 thousand on 13th November 2008, PLN 6,307 thousand on 30th December 2008, PLN 3,850 thousand on 25th March 2009 and PLN 4,383 thousand on 11th May 2009, PLN 1,072 thousand on 15th October 2009. The financial support was granted to the Company and the Company committed to comply with the specific conditions, the realisation 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.

In 2011 the companies of the Group have not received any grants or subsidies.

44.2. Operations in the Special Economic Zone

Arctic Paper Kostrzyn S.A. operates in the Kostrzyńsko-Słubicka Special Economic Zone (the „KSSSE") and based on the permission issued by the Kostrzyńsko – Słubicka Special Economic Zone S.A. benefits from the corporate income 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,
- 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. receives 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 25th August 2006, Arctic Paper Kostrzyn S.A. may benefit from exemption to 15th 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 14th 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 31st 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 31st December 2011 and maintaining the employment level at 453 people during the period from 1st January 2012 to 31st 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 25th August 2006 to 31st December 2011, Arctic Paper Kostrzyn S.A. incurred capital expenditure classified as expenditure of the KSSSE in the amount of PLN 182,427 thousand. During this period, the amount of public assistance used was PLN 44,718 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. Concluding an amendment to a material contract

On 16th January 2012 an annex was concluded to a material loan agreement concluded on 1st March 2010, then amended with an annex dated 12th April 2011, by and between Arctic Paper S.A. and a subsidiary Arctic Paper Investment AB ("Borrower") with its seat in Göteborg, Sweden.

The annex dated 16th January 2012 prolongs the date of total repayment of the loan with interest until 31st December 2016 and, at the same time, it allows for another prolongation of the repayment date. The other provisions of the contract remained unchanged.

45.2. Resignation of a Member of the Management Board

As mentioned in point 3.1 of the hereby report, (The Management Board of the Parent Company), on 20th January 2012 Mr Hans Karlander filed his resignation from being a Member of the Management Board effective on 31st March 2012. The Company reported this in the current report no 02/2012.

Signatures of Members of the Management Board

Position	Name and surname	Date	Signature
President of the Management Board Chief Executive Officer	Michał Jarczyński	27 April 2012	
Member of the Management Board Chief Financial Officer	Michał Bartkowiak	27 April 2012	
Member of the Management Board Chief Procurement Officer	Jacek Łoś	27 April 2012	
Member of the Management Board Chief Operating Officer	Per Skoglund	27 April 2012	

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