

# CITY INTERACTIVE S.A.

MANAGEMENT REPORT  
ON THE OPERATIONS OF  
CITY INTERACTIVE S.A.

FOR 2010



## **Dear Shareholders, Associates and Partners,**

For City Interactive S.A., 2010 was a year of success and further confirmation of our status as Poland's first truly global company in the video gaming industry and thanks to notable profits was a period in which we created a basis for the further development of City Interactive S.A.

We were able to successfully implement a new strategy for the Company, the essence of which is to move away from the development and release of "value" segment games and ensure further growth based on high quality products from the higher price segment. Thanks to changes implemented over the last several years we achieved impressive net profit of PLN 27 million in 2010 and significantly increased our revenues to PLN 89 million, 93% of which are generated outside the Polish market.

Last year's bestseller for City Interactive S.A., "Sniper Ghost Warrior", was independently released by us around the world, placing high on many top-seller lists in the full price category in almost all key sales markets, which resulted in a change in the way the Company is perceived in global markets.

We are a video gaming company which does not just produce games but also releases them around the world, allowing us to increase product profitability. Thanks to our successes in 2010 we have made substantial progress in commercial relations with the largest sales networks around the world, becoming a company which is recognized amongst the largest retailers and distributors. This trust created around the globe should translate into even better results in future years.

Significant diversification in City Interactive S.A.'s global revenues occurred in 2010 – we were able to achieve a share of sales in specific geographic markets close to their share in the global video games market. At the same time growth in the Company's global revenues resulted in a fall in the Polish market share; this tendency will also be visible in subsequent years.

Last year we opened two further development studios – in Bydgoszcz, Poland and Guildford in the UK, adding to our existing studios in Warsaw, Katowice, Poznan and Rzeszow. Work on subsequent projects is divided between all studios, where each game is developed by a team of specialists in a given area. As a developer, publisher and distributor operating on an international scale, City Interactive S.A. has a real chance for effective development and maximization of profits over subsequent years thanks to factors including further dynamic expansion of the game development department.

While appreciating the Company's achievements last year, we will not stop at maximizing revenues from the "Sniper Ghost Warrior" brand but will continue to work intensively on the creation of new high quality projects, ensuring them the highest artistic and technological value. At the same time we are noticing the potential of the smartphone game segment and social games, areas where we also intend to expand.

In thanking our employees for their engagement, our customers and suppliers for support and our shareholders for the trust they have shown us, I would like to promise that we will continue to implement strategies for the dynamic development of City Interactive S.A. and I am convinced that the success which will continue in future years will directly translate into further growth in the Company's market value and maximization of value for shareholders.

With kind regards,

Marek Tymiński

President of the Management Board of City Interactive S.A.

## City Interactive S.A. Management Board Declaration

Pursuant to the Ordinance of the Minister of Finance of 19 February 2009 (Polish Journal of Laws no. 33, item 259 as amended) *on current and periodic information provided by the issuers of securities and the conditions for recognizing information required by the provisions of law of a non-member state as equivalent*, the Management Board of City Interactive S.A. declares that to the best of its knowledge the annual financial statements and comparative data have been drawn up in accordance with binding accounting principles and correctly, reliably and clearly reflect the Company's financial and asset situation together with its financial result, and that the annual report on the Company's operations contains a true depiction of the development, achievements and situation of City Interactive S.A., including a description of principal hazards and risk.

The Management Board of City Interactive S.A. declares that the entity authorized to audit financial statements performing audit of the annual financial statements was selected in accordance with the provisions of law and that such entity and the statutory auditors conducting the audit fulfilled the conditions for issue of an impartial and independent report on audit of the financial statements in accordance with the binding regulations and professional standards.

Management Board of CITY INTERACTIVE S.A.

*Marek Tymiński*  
President of the Management Board

*Wojciech Kutak*  
Member of the Management Board

Warsaw, April 30, 2011

## **I. Introduction**

### **1. General characteristics of City Interactive S.A.'s operations**

City Interactive S.A. operates in the video game development and publishing market, both within Poland and abroad. It is the first publicly traded company in this sector in Central and Eastern Europe and the first to emerge as an international player. City Interactive is focused on developing a high quality product range with different game genres, including action games in particular.

Within its business in the gaming market, the Issuer appears as:

Developer – having its own development studio in which new projects are created,

Publisher – which acquires licenses to games manufactured by external studios, being responsible for translation, marketing policy and releasing them,

Distributor – which sells products directly to retail chains, distributor networks, internet portals and others.

Through fulfilling these three functions, City Interactive S.A. can effectively control the process of creating and distributing games without needing to involve a large number of other companies – agents in the process of introducing its products to the market.

## **2. Share capital**

### **2.1. Company share capital**

As at December 31, 2010 the Issuer's share capital amounted to PLN 1 265 000 (one million, two hundred and sixty-five thousand Polish zloty) and was divided into 12 650 000 (twelve million, six hundred and fifty thousand) shares of a nominal value of PLN 0.10 each, of which:

- 10 000 000 series A shares,
- 40 000 series B shares,
- 250 000 series C shares,
- 110 000 series D shares.

Series A shares were subscribed for by then-current shareholders in City Interactive Sp. z o.o. at the moment the company was transformed into a spółka akcyjna (joint stock company).

Series B shares were issued under an incentive scheme and were subscribed for by the Company's employees and associates. The District Court made registration of the increase in share capital as a result of issuing series B shares on 10 August 2007.

Series C shares were subject to a public offering in November 2007, which was a complete success. All shares on offer have been subscribed for and are paid up. On 17 December 2007 the District Court in Warsaw made registration of the increase in the Company's share capital as a result of issuing series C shares.

Series D shares were issued under an incentive scheme and were subscribed for by the Company's employees and associates. The District Court made registration of the increase in share capital as a result of issuing series D shares on 9 October 2009.

There are no securities carrying special control entitlements in relation to the Issuer, since in accordance with City Interactive S.A.'s articles of association all shares issued are ordinary bearer shares with equal nominal value carrying the same rights and obligations for each shareholder.

## **2.2. Information on agreements known to the Issuer, pursuant to which there may be a change in the proportions of shares held by current shareholders. Indication of limitations concerning transfer of ownership to securities in the Company**

The Company has no information concerning other agreements (including agreements entered into after the end of the reporting period) under which proportions of shares held by existing shareholders might change in the future.

There are also no limitations on exercise of the right to vote carried by the Issuer's shares.

## **2.3. Information on the system for controlling employee share programs**

All shareholders whose stake in the Issuer's share capital as at the date of approving the issue prospectus exceeded 2% undertook towards the Company that during the twelve-month period from the date of the first listing of rights to the Issuer's shares on the Warsaw Stock Exchange they would not encumber or pledge – with the exception of the possibility to establish a pledge for a bank in order to provide collateral for loans, nor dispose nor in any other manner transfer ownership, nor undertake to perform such action in relation to the entirety or part of shares, in any manner for the benefit of any person or entity unless consent for such action is expressed by the Company's Supervisory Board. The obligation was intended to cease being binding in the event that the Company's share price (closing rate on the WSE) exceeded the issue price by at least 20%.

The above obligation concerned a total of 8 987 265 series A shares held by the above-mentioned shareholders, which constituted 90% of shares held by them as at the date on which the prospectus was approved.

All shares which were subject to agreements on limitation of their assignability were deposited in brokerage accounts held by Dom Maklerski IDMSA.

The Company has no information concerning other agreements (including agreements entered into after the end of the reporting period) under which proportions of shares held by existing shareholders might change in the future.

There are also no limitations on exercise of the right to vote carried by the Issuer's shares.

In July 2007 the Company issued 40 000 series B shares at an issue price of PLN 1 under a motivational program for its employees and significant associates. Persons subscribing for series B shares entered into a lock-up agreement with the Company, limiting the assignability of shares for a period of either two or three years. In this manner the Issuer's employees and associates holding a total of 40 000 series B shares in CITY INTERACTIVE S.A., constituting in total 100% of series B shares in the Issuer, entered into an agreement with the Company pursuant to which they undertook not to dispose of any of series B shares held for a period of 1 year and:

- 70% of series B shares held for a period of one subsequent year for a total of 20 150 shares,
- 90% of series B shares held for a period of one subsequent year for a total of 19 850 shares,

Furthermore some persons under the aforementioned motivational program also became the holders of series A shares at a price of PLN 1. Employees and associates holding a total of 35 650 series A shares in CITY INTERACTIVE S.A. submitted an official obligation not to dispose of any of the shares held for a period of 1 year and 90% of shares held for a period of two subsequent years.

All shares which were subject to agreements on limitation of their assignability were deposited in brokerage accounts held by Dom Maklerski IDMSA.

In the event of employment or cooperation being terminated with a shareholder holding shares covered by the motivational program, his/her shares were or are transferred to another person designated by the Company's Management Board.

110 000 ordinary series D shares in the Company were issued on 30 June 2009. These shares were subscribed for by the Company's employees at the issue price – PLN 1 per share.

There are also no limitations on exercise of the right to vote carried by the Issuer's shares subscribed for under the employee scheme.

#### **2.4. Specification of the total quantity and nominal value of shares in the Issuer held by management and supervisory personnel**

<b>Person</b>	<b>Position</b>	<b>Shares held as at Dec 31, 2010</b>	<b>Nominal value of shares held as at Dec 31, 2010</b>
Marek Tyimiński	President of the Management Board	6 480 794	648 079.40
Artur Winiarski	Member of the Management Board	24 000	2 400.00
Lech Tyimiński	Member of the Supervisory Board	9 565	956.50

### **3. Concise description of the Company's significant achievements or failures in 2010, together with events having an impact on the financial result**

- **Sniper: Ghost Warrior – most successful release**

The Company's key and simultaneously the most eagerly awaited release in 2010 – "Sniper Ghost Warrior", was received with enthusiasm by the market, gaining outstanding sales results both globally and in Poland. "Sniper Ghost Warrior" was released on June 25, 2010 in North America, main European markets including Poland and in Australia and New Zealand.

"Sniper Ghost Warrior" is a high quality first-person action game. The product offers the highest quality graphics, advanced game play and an interesting storyline. Players receive sniper rifles with reproduction ballistics, taking into account the wind and the impact of the body on the stability of the shot. Aside from this, there is the possibility to turn off breathing or switch on "sniper mode", making it easy to shoot opponents and stabilize the rifle while taking a shot. A team with many years' experience in producing action games worked on creation of the game.

Diverse sales channels (including an increase in the share of electronic sales channels), distribution in the largest retail chains in North America and Europe and extensive marketing activities meant that as at the date of drawing up the financial statements the game was being sold at a level exceeding 1.1 million copies. In 2010 the product held high positions in sales in Australia, France, Sweden, Norway, the UK, Germany and the US. Revenues from sales of Sniper: Ghost Warrior had an enormous impact on the result for 2010. We were able to create a remarkably strong brand which the Company can use to maximize revenues (including through release of the game on the Sony PlayStation®3 and production of a sequel) in 2011 and beyond. At the same time City Interactive S.A. became Poland's first truly global game developer and publisher.

- **Cooperation with UBISOFT**

In 2010 City Interactive S.A. expanded cooperation with UBISOFT, a global publisher and distributor of video games, responsible for commercial activities in areas including Switzerland, Germany and Austria. UBISOFT is a partner which has provided strong support for City Interactive S.A.'s publishing activities in German-speaking countries, which are important markets.

- **Agreement with The Producers Limited**

City Interactive S.A. signed an agreement with The Producers Limited, a company belonging to the Mastertronic Group Limited, based in Huntingdon, Great Britain, pursuant to which The Producers Ltd. provides services connected with logistics and distribution of the Issuer's products in the UK, including the Isle of Man and Ireland. The Company ceased cooperation with the bankrupt company Trilogy Logistics Ltd., which previously provided distribution and logistics services for the Company's products in the UK.

- **Conclusion of a distribution agreement with Solutions 2 Go, Inc.**

Subsidiary City Interactive USA, Inc. signed an agreement in February 2010 with Solutions 2 Go, Inc., based in Mississauga, Canada, pursuant to which Solutions 2 Go provides services connected with distribution of some of the Company's products. Solutions 2 Go is known for its sales successes on the Canadian market.

- **Agreement with NAVARRE and COKEM**

Subsidiary City Interactive USA, Inc. signed distribution agreements with NAVARRE and COKEM, which enabled financing by these contracting parties of the costs of creating media and licensing fees for console manufacturers.

- **Agreement with Namco Bandai**

City Interactive S.A. entered into an agreement concerning the distribution of Sniper Ghost Warrior on the Xbox 360 and PC in retail chains located in Holland, Belgium, Italy and Spain.

- **Agreement with Panavision**

City Interactive S.A. entered into an agreement concerning distribution of Sniper Ghost Warrior for the Xbox 360 and PC in retail chains located in Scandinavia (Sweden, Norway, Denmark and Finland)

- **License for the Sony PlayStation®3 in North America**

In August 2010 City Interactive USA Inc., based in the US – a subsidiary of City Interactive S.A., entered into a license agreement with Sony Computer Entertainment America LLC for the manufacture and release of games for the Sony PlayStation®3 in North America. This is a strategic agreement – the Sony PlayStation®3 is one of the most popular video game platforms in the world.

- **Purchase of the license for CryENGINE® 3 game engine**

On 28 October 2010 the Issuer's Management Board entered into a license agreement with Crytec® GmbH with its registered office in Germany. The subject of this agreement is grant to the Company of a license to use CryENGINE® 3 technology (a game engine) in two of the Company's products, including "Sniper: Ghost Warrior 2" and a project with working title "WW II". The Company intends to release both games produced based on CryENGINE® 3 technology for Xbox360® and Sony PlayStation® 3 as well as PC.

CryENGINE®3 is one of the most advanced and state-of-art technologies dedicated for the development of First Person Shooter action games. This technology includes high quality graphics visualization system, advanced module supporting character artificial intelligence, physical engine, support for character animation and video sequence, efficient game world development tools and new version testing tools. CryENGINE® 3 also supports game display in 3D technology (using special television screens and glasses) and multiplayer mode (through the Internet or a local network).

- **Authorization from the Extraordinary General Meeting of Shareholders to buy back own shares**

On 8 November 2010 the Issuer's Extraordinary General Meeting of Shareholders adopted a resolution authorizing the buyback of own shares by City Interactive S.A. The Issuer's

Management Board was granted authorization to draft a detailed buy-back plan and to execute this when in the best interest of the Company. Under the program up to 1 million of its own shares will be repurchased by the parent for a price not exceeding PLN 40 each. Such block constitutes 7.9 percent of the parent's share capital. The aggregate budget for the buy-back transaction is capped at PLN 16 m, i.e. the balance of a reserve fund created for that purpose. Shares bought back by City Interactive S.A. will be canceled or used for investment purposes.

- **Implementation of an incentive scheme**

The City Interactive S.A. Extraordinary General Meeting of Shareholders approved an incentive scheme for executives employed within the Group. The Issuer intends to issue 150,000 free warrants convertible to the same number of series E shares. The scheme is divided into two annual tranches covering the years 2011-2012. The number of persons to whom the proposal is targeted cannot exceed 30. Key employees of the Issuer's Group, excluding the President of the Issuer's Management Board, are eligible to participate in the incentive scheme. Beneficiaries will be allowed to acquire warrants convertible to shares under two equal tranches of 75 000 shares each, for the price equal to the average share price for the last three months, i.e. PLN 16.45. To be authorized to convert warrants to new shares under the first tranche, consolidated earnings per share (EPS) for 2011 have to reach at least PLN 2.77. The achievement of this threshold will entitle holders to convert 75 percent of the pool of warrants allocated for that year, i.e. slightly over 56 000. If EPS reaches PLN 3.16, the beneficiaries will be authorized to convert the remaining warrants. For the pool for 2012 the mechanism is basically the same, however EPS must reach at least PLN 3.14 (75% of warrants allocated for 2012) and PLN 3.54 (25% of warrants allocated for 2012). Warrants will be convertible to shares only after the General Meeting approves the financial statements for the year covered by the scheme.

- **Purchase of a license for the Unreal® Engine 3 game engine**

On 22 November 2010 the Issuer's management board executed a license agreement with Epic Games Inc., based in the United States. The agreement covered grant to the Issuer of a license for use of the latest version of Unreal® Engine 3 technology in the game "Alien Fear", which the Issuer plans to launch for the Xbox360®, PlayStation® and PC. Unreal® Engine 3 is one of the leading technologies used in first person shooters. This technology is used in many games developed by the largest global firms. Unreal® Engine 3 is a proven system for visualizing high quality graphics, an effective artificial intelligence support module, a system for realistic reproduction of physics, animation support and a set of effective tools for game developers.

- **Stuart Black as Creative Director of the Issuer's new development studio in the UK**

In December 2010 the Issuer's management board announced the opening of a new video game development studio in London. Stuart Black became Creative Director. Stuart is an experienced game developer who has been active in the industry for 16 years.

The first project for the new London studio will be a WWII-based shooter with a vivid storyline, developed in collaboration with the studio in Rzeszow. The project, with working title "WW II", is a classic of the genre created on the basis of the most popular theme, however with a modern approach to the latest action games.

## **II. Discussion of primary economic and financial values disclosed in the annual financial statements**

Balance sheet data was converted according to the average exchange rate published by the National Bank of Poland as at the date of drawing up the financial statements, which as at the end of the reporting period amounted to:

- as at December 31, 2009 – PLN 4.1082/EUR,
- as at December 31, 2010 – PLN 3.9603/EUR.

Data in the profit and loss statement and statement of cash flows was converted into EUR according to the exchange rate established as an average of the exchange rates published by the National Bank of Poland as at the last day of each month of the year:

- for 2009 – PLN 4.3406/EUR,
- for 2010 – PLN 4.4404/EUR.

### Selected financial data converted into EUR:

	01.01.2010– 31.12.2010 thousands PLN	01.01.2009– 31.12.2009 thousands PLN	01.01.2010 – 31.12.2010 thousands EUR	01.01.2009 – 31.12.2009 thousands EUR
<b>Profit and loss statement</b>				
<b>Net revenue from sale of products, goods for resale and materials</b>	<b>75 540</b>	<b>27 108</b>	<b>18 864</b>	<b>6 245</b>
Profit (loss) from operating activities	32 866	-14 889	8 208	-3 430
Gross profit (loss)	31 690	-15 534	7 914	-3 579
<b>Net profit (loss)</b>	<b>25 823</b>	<b>-12 961</b>	<b>6 449</b>	<b>-2 986</b>
Number of shares	12 650	12 650	12 650	12 650
Profit (loss) per ordinary share	2,04	-1,02	0,51	-0,24
<b>Balance sheet</b>				
Non-current assets	16 372	14 694	4 134	3 577
Current assets	43 230	20 852	10 916	5 076
<b>Total assets</b>	<b>59 601</b>	<b>35 545</b>	<b>15 050</b>	<b>8 652</b>
Equity	43 557	17 755	10 998	4 322
Share capital	1 265	1 265	319	308
Liabilities and provisions for liabilities	16 044	17 791	4 051	4 331
Non-current liabilities	201	242	51	59
Current liabilities	15 843	17 248	4 000	4 272
<b>Total equity and liabilities</b>	<b>59 601</b>	<b>35 545</b>	<b>15 050</b>	<b>8 652</b>
<b>Statement of cash flows</b>				
Net cash flows from operating activities	27 210	3 671	6 795	846
Net cash flows from investing activities	-10 132	-8 448	-2 530	-1 946
Net cash flows from financing activities	-2 896	3 839	-723	884
<b>Ending cash balance</b>	<b>14 182</b>	<b>-938</b>	<b>3 542</b>	<b>-216</b>

Presented cumulatively for the four quarters, City Interactive S.A. recorded revenue from sales of PLN 75.54 million, which is a 179% increase in comparison with the same period a year earlier.

### 1. Balance sheet

The Company's carrying amount as at December 31, 2010 closed at PLN 59.6 million, which constitutes a 68% increase in comparison with December 31, 2009.

## **Assets**

Non-current assets in the financial statements as at December 31, 2010 amounted to PLN 16.37 million and had increase by 11% in comparison with the situation as at December 31, 2009, constituting 27% of the Company's total property.

The growth in non-current assets results first and foremost from an increase in intangible assets. The difference between intangible assets as at the end of 2010 and as at the end of 2009 amounts to PLN 2.84 million (an increase of 28%).

The Company's current assets as at December 31, 2010 amounted to PLN 43.23 million and constituted 73% of total assets; current assets had grown by 107% in comparison with the situation as at December 31, 2009.

The main current asset item which had the greatest impact on this growth are cash and cash equivalents, together with trade receivables. The Company's cash and cash equivalents amounted to PLN 14.18 million, while trade receivables recorded PLN 7.5 million. (an increase of 63%).

## **Equity and liabilities**

As at December 31, 2010 the Company's equity amounted to PLN 43.56 million, which denotes a 141% increase in comparison with December 31, 2009, mainly resulting from the net profit recorded.

The Company's liabilities and provisions for liabilities amounted to PLN 16.04 million and dropped by 8% in comparison with 2009. This drop results from a decrease in current liabilities, first and foremost payment of liabilities under loans by PLN 2.04 million. The book value of Company shares as at December 31, 2010 amounted to PLN 2.04.

## **2. Profit and loss statement**

The Company's net revenue from sales amounted to PLN 75.54 million, which constitutes a 179% increase in comparison with the adjusted statements for 2009.

Profit on operating activities amounted to PLN 32.87. The result was most impacted by revenue from sales of own products, which constituted 83% of the Company's total revenues. The main cost items having impact on results during the current period are production costs at PLN 26.11 million, impairment charges on intangible assets at approx. PLN 1.5 million, impairment charges on receivables at PLN 1.58 million and the liquidation of damaged or economically nonviable stocks at PLN 0.83 million.

Profit on operating activities amounted to PLN 31.69 million. The PLN 1.18 million loss on financing activities results mainly from interest paid on bonds, loans and negative exchange rate differences.

The Company's net profit amounted to PLN 25.82 million.

Net profit per share in the Company in 2010 amounted to PLN 2.04.

## **3. Statement of cash flows**

The Company began 2010 with PLN 457 759.62 in cash and cash equivalents.

Net cash flows from operating activities amounted to PLN 27.21 million. The most significant impact on positive operating cash flows came from impairment charges and interests, which in total amounted to PLN 2.56 million.

Net cash flows from investing activities amounted to PLN –10.13 million. Expenditures connected with financing work on subsequent Company products were significant items here.

Net cash flows from financing activities amounted to PLN – 2.90 million. Expenditures connected with repayment of loans and borrowings had the greatest impact here.

Cash and cash equivalents at the end of the reporting period amounted to PLN 14.64 million.

**III. Information on principal products, goods and services, together with their quantitative and qualitative specification and the share of specific groups within City Interactive S.A. total sales, and also changes here in 2010**

City Interactive S.A.'s operations consist of the creation of video games or the purchase of other companies' titles and their wholesale throughout the world. The Company places emphasis on sales in the form of distributing finished media with computer programs (finished goods), however in some cases sells licenses for the distribution of games within a specific area and a specific time period.

The structure of revenue from sales achieved by the Company over the period 2009 - 2010 with consideration to the type of product offered is as follows:

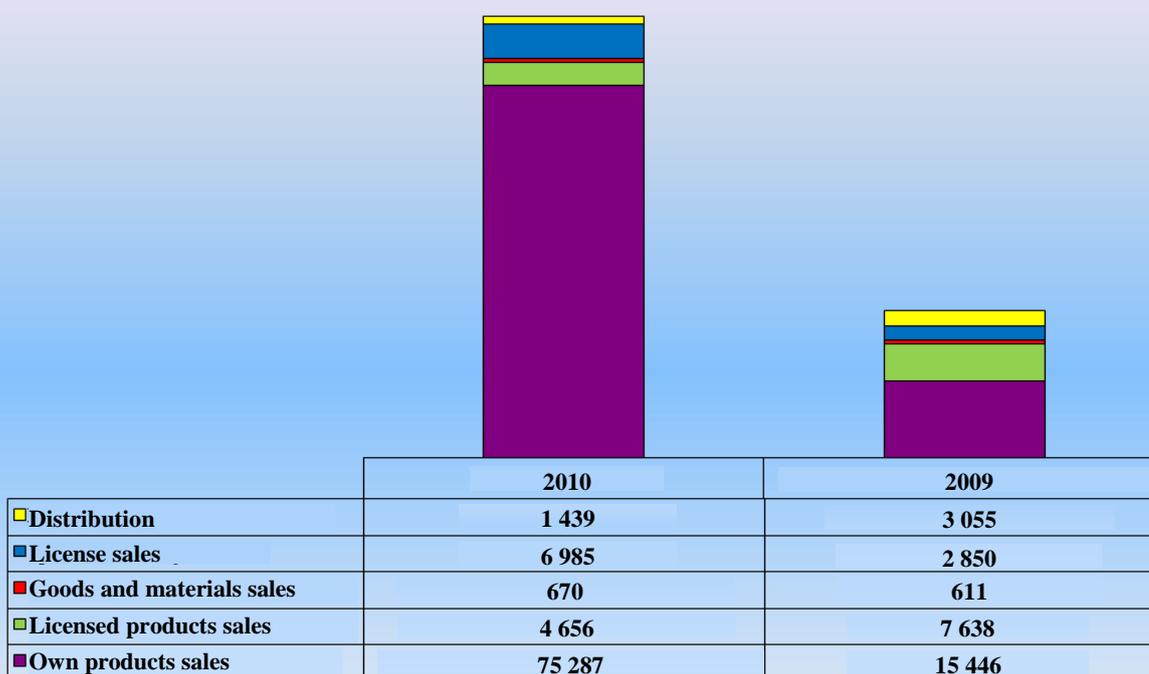
**Product structure of revenue from sales in 2009 – 2010 in terms of revenue**

Revenues	2010	%	2009	%	2010 / 2009
Sales of own products	62 908 995	83.28%	12 954 452	47.79%	385.62%
Sales of licensed products	3 861 493	5.11%	7 638 267	28.18%	-49.45%
Sales of goods for resale and materials	670 271	0.89%	610 566	2.25%	9.78%
License sales	6 660 527	8.82%	2 849 734	10.51%	133.72%
Distribution	1 438 783	1.90%	3 055 112	11.27%	-52.91%
<b>Total</b>	<b>75 540 069</b>	<b>100.00%</b>	<b>27 108 131</b>	<b>100.00%</b>	<b>178.66%</b>

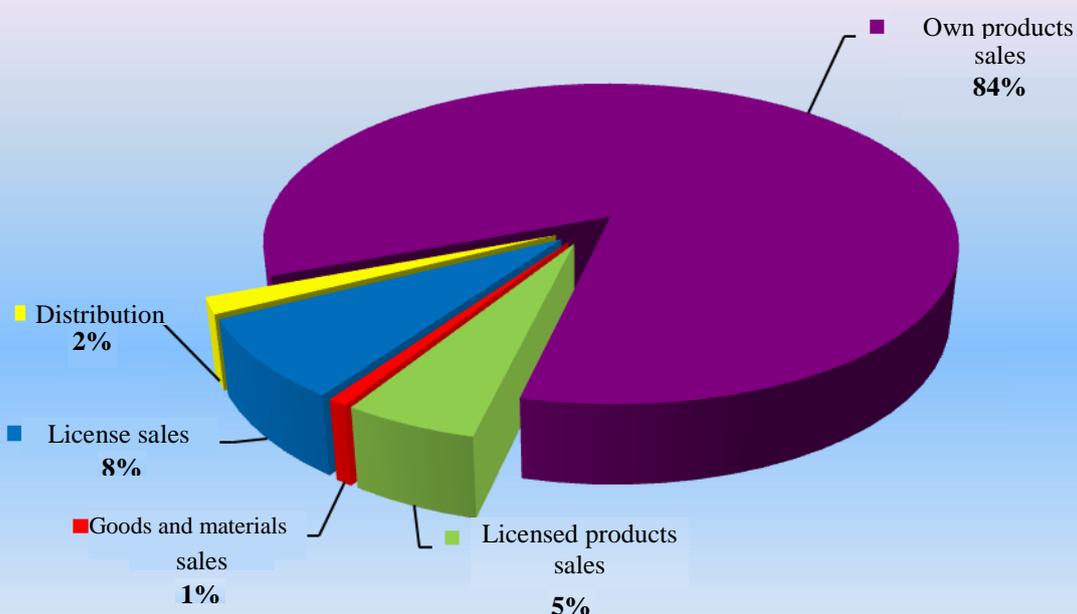
**Product structure of revenue from sales in 2009 – 2010 in terms of quantity**

Revenues	2010	%	2009	%	2010 / 2009
License sales	281	0.01%	213	0.01%	31.92%
Sales of licensed products	753 552	38.35%	849 189	42.38%	-11.26%
Sales of own products	1 211 097	61.64%	1 154 517	57.61%	4.90%
<b>Total</b>	<b>1 964 930</b>	<b>100.00%</b>	<b>2 003 919</b>	<b>100.00%</b>	<b>-1.95%</b>

**Product structure of revenue from sales in 2009 – 2010 in terms of revenue (in PLN)**



**Product structure of revenue from sales in 2009 – 2010 in terms of quantity**



**IV. Information on sales markets, divided into domestic and international, together with sources of supply for production materials, goods and services, with specification of dependence on customers and suppliers**

The share of international sales in total revenues increased in 2010 from 73.37% to 75.72%. This results from development of an international distribution network.

**Share of export in revenues on sale over the period 2009 – 2010**

Sales	2010	2009
International <i>Share</i>	57 196 739 75.72%	19 888 158 73.37%
Domestic <i>Share</i>	18 343 330 24.28%	7 219 973 26.63%
<b>TOTAL</b>	<b>75 540 069</b>	<b>27 108 131</b>

In quantitative terms the share of export amounted to 70.27%. This confirms development of an international distribution network. In the statement showing the level of revenues generated in international markets, the significant difference in margins achieved on sales in Poland and abroad is clear.

**Share of export in revenues in quantitative terms over the period 2009 – 2010**

Sales	2010	2009
International <i>Share</i>	1 380 686 70.27%	1 218 220 60.79%
Domestic <i>Share</i>	584 244 29.73%	785 699 39.21%
<b>TOTAL</b>	<b>1 964 930</b>	<b>2 003 919</b>

The customers whose share in the Company's sales in 2010 exceeded 10% are:

	Customer	Share
1.	City Interactive USA Inc.	28.09%
2.	Business Area Sp. z o.o.	17.04%
3.	Mastertronic Games Ltd	11.44%
4.	Ubisoft GmbH	10.14%

Other customers did not exceed the indicated level of significance.

The suppliers whose share in the Company's purchases exceeds 10% are:

	Supplier	Share
1.	Nintendo of Europe Nintendo Center	11.78%
2.	Microsoft Ireland	11.34%

Other suppliers did not exceed the indicated level of significance.

## **V. Significant risk factors and threats to the Company**

The most significant external risk factors from the Issuer's point of view are as follows:

### **Risk connected with the macroeconomic situation**

The Company's operations in the consumption and entertainment goods market are dependent on the macroeconomic situation in specific markets. Over previous years the entertainment industry has developed dynamically and it is estimated that the value of the video games market will exceed that of the film industry. In order to minimize risk the Issuer significantly diversifies the geographical sources of its revenues.

### **Competition risk**

The Company conducts operations in a market where the leading position is held by companies with strong, established positions. City Interactive S.A. has proved that it can successfully compete with them by using its greatest advantages: an experienced team, cost advantage and global distribution network. Its products are included in all price ranges. Games created for the Xbox360®, NINTENDO Wii™, Nintendo DS™, Sony PlayStation®3 and PC have high commercial potential and will be products which are competitive against others present in the market.

### **Risk of change in trends**

The Issuer operates in the new technology and virtual entertainment fields where a product's life cycle is relatively short. What cannot be counted out is the risk of new solutions appearing which mean that the products offered by the Company cease to be attractive and do not ensure the desired inflows. In order to minimize this risk a strategy has been adopted to follow trends and offer a range on the market which is proven and enjoys success amongst customers, rather than setting trends, a strategy which is a lot more expensive and risky. The Company's principal activities in this field are based on constant monitoring of the market with regard to the development of new technologies (e.g. 3D) and managing new segments created by new consoles.

The number of projects implemented means diversification of the product range and limitation of market risk. The Issuer is able to make effective use of the organization's strong points through a lower profitability threshold in comparison with competitors on the market.

### **Risk of change in legal and tax regulations**

Frequent changes in legal and tax regulations in Poland and other markets constitute a threat to the Issuer's operations. This concerns the regulation and interpretation of regulations connected with the capital market, labor law and social security, tax law and regulations concerning commercial law.

In some countries the issue of banning video games containing elements of violence is frequently raised. There is thus a risk of changes in international regulations or those applicable in a country where the Company sells its products which could turn out to be disadvantageous from the point of view of business. At the same time the Company conducts activities aimed at eliminating risk through cooperating with specialist law firms around the world.

### **Currency risk**

At the current time more than 76% of revenues are generated from export of goods and services to international markets. Sales are settled in foreign currencies, above all in euros but also in US and Australian dollars, British pounds and other currencies. Exchange rates are currently protected mainly through entering into forward contracts.

The risk factors directly connected with the Company's operations include:

### **Risk of losing key employees**

Production operations are conducted on the basis of the knowledge and experience of employees. This is a characteristic feature for businesses operating on the video game manufacturing market. In this market it is difficult to seek out qualified specialists in the industry and project managers.

The Company places particular emphasis on:

- a motivational salary system which builds links between the organization and the employee, together with medical care and a social package,
- an incentive scheme aimed at executives, under which the Issuer intends to issue 150 000 free warrants convertible to the same number of series E shares. The scheme is divided into two annual tranches covering the years 2011-2012.

### **Risk of losing key clients**

Commercial operations are conducted on the basis of a developed retail sales network in Poland and on close cooperation with international distributors headquartered in other countries. In connection with this there is a risk of the termination of distribution agreements or the bankruptcy (or similar) of entities which assist in selling goods.

In order to minimize the possibility of incurring losses, the Company has subsidiaries in the most operationally significant markets such as the United States and Germany, whose task is to constantly expand distribution opportunities. During the current period the market with the greatest potential for the Issuer was North America, generating approx. 35% of revenues.

### **Risk connected with suppliers**

One of the risk categories connected with suppliers is the introduction of titles on specific consoles and cooperation with their owners during the certification process. This process and the potential for termination of agreements by them in the event of non-fulfillment of criteria are two principal elements of risk which exists in reality and may have an impact on the Issuer's financial results. It should however be emphasized that the Company makes specific efforts to meticulously fulfill and perform all obligations under agreements entered into between such entities and the Issuer and additionally develops contact with distributors who already hold licenses for consoles and are able to sub-license to the Issuer.

### **Risk connected with the implementation of development plans**

Financing of publishing operations – the Company has an excess of cash generated by operating activities and the Issuer's development operations are financed from this. The Company has the capability to seek bank and financial sector financing in the event of it becoming necessary to finance additional projects.

### **Risk connected with the existing product portfolio**

Competitive markets are driven by expectations connected with the debut of new products. There is a risk that some products are finished later than planned, which as a consequence has a negative impact on cash flows generated through exceeding project budgets, together with transfer of the planned revenues from sales and financial inflows to subsequent settlement periods. Internal factors which can cause delay include non-fulfillment by the product of quality requirements, especially if we take into consideration products on consoles or problems connected with correct game play. External factors include competitors' products with unique and significant characteristics appearing on the market, meaning that for the Issuer to maintain competitiveness it is forced to take them into consideration in its own product. External factors also include supplier delays in timely preparation of elements essential for creation of a game.

The entertainment software manufacturing industry around the world is well-known for delayed computer and console game launches. Delayed games fulfilling current quality expectations generally have the same sales potential as if they had been released as planned. During additional time caused by a potential delay the project can be supplemented with subsequent elements making the upcoming premiere even more attractive, which as a consequence should translate into the number of sales and thus the profit level. In many cases this leads to a marketing element known as the "long awaited game", which has a beneficial impact on creating product identity. The vast majority of products are completed on time and as planned, however the risk of delays cannot be excluded.

An additional aspect is the risk of companies or external persons appearing against the company with legal actions concerning copyrights to games, their elements, trademarks or reserved names for specific products. Operations in the United States are particularly burdened with this risk since the jurisdiction is characterized by tight legislation. In order to avoid losses here, an application for reservation of copyrights to the game, its title and graphical mark are submitted each time. In submitting such application in order to protect trademarks in the European Union and other countries around the world, its availability in specific markets is verified and the risk of violating the copyrights of third parties is estimated.

A key element of risk connected with products is the certification process, and the release of a given product is dependent on its positive results.

#### **Liquidity risk**

The Company's liabilities are covered by its trade receivables. The significant level of receivables results from the specifics of sales on the market it operates on. Purchasers sell products through paying the Company's receivables from payments made by their purchasers. It is impossible to receive prior, credit payments during execution of sales by customers.

Protection against the risk of purchaser insolvency is ensured through analysis of their financial condition and constant monitoring concerning payment of receivables. It should additionally be emphasized that the Company is able to obtain funds through bank debt or the issue of bonds on very beneficial financial terms and conditions.

## **VI. Information on significant agreements for the business activity of CITY INTERACTIVE S.A., including agreements entered into between shareholders and insurance, collaboration and cooperation agreements**

### **1. Significant agreements for business operations:**

- On January 27, 2010 The Issuer entered into an agreement with The Producers Limited - a company belonging to the Mastertronic Group Limited, having its registered office in Huntingdon, Great Britain. Pursuant to the agreement, the Producers Ltd. provides services connected with logistics and distribution of the Issuer's products in the UK, including the Isle of Man and Ireland.
- On June 7, 2010 the Management Board of City Interactive S.A. signed an annex to the agreement with The Producers Limited – a company belonging to the Mastertronic Group Limited, based in Huntingdon. Pursuant to the annex, the final term of the agreement was changed from August 31, 2010 to December 31, 2010. After lapse of this deadline the agreement will remain in force, however with the possibility for it to be terminated by both parties with observance of a 3-month notice period.



- The game "Sniper Ghost Warrior" intended for the Xbox360® passed the Microsoft Licensing GP certification process on June 9, 2010, which constitutes fulfillment of an important condition of the significant agreement entered into between the Issuer and Microsoft Licensing GP. As a result the product, both in its Xbox360® and PC versions, was put into production and was released on the planned premiere date, June 25, 2010 in the majority of Western European markets, Australia and New Zealand and on June 29, 2010 in the United States and Canada.
- On August 12, 2010 City Interactive USA Inc., based in the US – a subsidiary of City Interactive S.A., entered into a license agreement with Sony Computer Entertainment America LLC for the manufacture and release of games for the Sony PlayStation®3 in North America. This is a strategic agreement. The Sony PlayStation®3 is one of the most popular video game platforms in the world.
- On August 16, 2010 the Issuer entered into an agreement with THE FARM 51 Spółka z o.o., based in Gliwice, for production of a new game entitled "Alien Fear". A science fiction-based shooter with elements of horror, this is intended for the Xbox360®, PlayStation®3 and PC. The premiere is anticipated in 2011.
- On October 28, 2010 the Management Board of City Interactive S.A. entered into a license agreement with Crytec GmbH, with its registered office in Germany. The subject of this agreement is grant to the Company of a license to use CryENGINE® 3 technology (a game engine) in two of the Company's products, including "Sniper: Ghost Warrior 2" and a project with working title "WW II" – an ambitious shooter based on a strong storyline set during the realities of the Second World War. The Company intends to release both games produced based on CryENGINE® 3 technology for Xbox360® and Sony PlayStation® 3 as well as PC.
- On November 22, 2010 City Interactive S.A. executed a license agreement with Epic Games Inc., based in the United States. The agreement covered grant to the Issuer of a license for use of the latest version of Unreal® Engine 3 (game engine) technology in the game "Alien Fear", which the Issuer plans to launch for the Xbox360®, PlayStation® and PC.
- Beginning from November 2, 2010 City Interactive S.A. entered into forward contracts. These contracts are executed for a maximum period of 6 months and their purpose is to hedge currency risk for the Issuer's currency asset items. A presentation of open forward contracts together with their valuation as the end of the reporting period can be found in the table below.

	existing currency contracts	initial forward recognition in PLN	fair value as at 31.12.2010 in PLN	valuation as at 31.12.2010 in PLN	contract maturity date
EUR	200 000.00	791 860.00	792 060.00	-200	03.02.2010
GDP	80 000.00	361 984.00	367 504.00	-5 520.00	03.02.2010
USD	2 000 000.00	6 238 400.00	5 928 200.00	310 200.00	02.06.2010
GDP	250 000.00	1 179 500.00	1 148 450.00	31 050.00	15.06.2010
GDP	250 000.00	1 173 375.00	1 148 450.00	24 925.00	15.06.2010
BALANCE SHEET VALUATION (FINANCE INCOME)				<b>360 455.00</b>	

## 2. Insurance agreements

As at December 31, 2010 CITY INTERACTIVE S.A. held insurance policies at Euler Hermes, AIG Europe S.A., ERGO Hestia S.A. and Chartis Europe S.A.:

Insurer	Subject and scope of insurance	Period	Value (in thousands)
ERGO Hestia S.A.	Insurance for electronic hardware and external media	15.09.2009 - 14.09.2010	PLN 1 110
ERGO Hestia S.A.	Insurance for electronic hardware and external media	15.09.2010 - 14.09.2011	PLN 1 110
ERGO Hestia S.A.	Property insurance	15.09.2009 - 14.09.2010	PLN 6 273
ERGO Hestia S.A.	Property insurance	15.09.2010 - 14.09.2011	PLN 6 273
Chartis Europe S.A.	Civil liability insurance for the Company's Management Board	07.11.2009 - 06.11.2010	PLN 20 000
Chartis Europe S.A.	Civil liability insurance for the Company's Management Board	07.11.2010 - 06.11.2011	PLN 25 000
AIG Europe S.A.	Civil liability insurance concerning liability for products	01.09.2009 - 31.08.2010	USD 2 200
Chartis Europe S.A.	Civil liability insurance concerning liability for products	01.09.2010 - 31.08.2011	USD 2 200
Chartis Europe S.A.	Civil liability insurance concerning liability for products	01.01.2010 - 31.12.2010	USD 5 000
Chartis Europe S.A.	Civil liability insurance concerning liability for products	10.06.2010 - 09.06.2011	USD 2 000
Euler Hermes	Trade credit risk insurance policy	01.03.2009 - 28.02.2010	Depending on turnover, up to a limit of PLN 30 000

Furthermore the Company held third party and fully comprehensive insurance policies for four passenger vehicles.

### 3. Agreements entered into between shareholders

The Management Board of City Interactive S.A. is not aware of potential agreements entered into between shareholders in the Company in 2010.

## VII. Description of significant transactions executed with associates

All transactions described below were executed on market terms and conditions. Issuer's transactions with companies belonging to the Group:

	costs	revenues	receivables	payables
<b>City Interactive Germany GmbH</b>	487 364.22	-264 708.93	263 392.14	-28 714.79
<b>City Interactive USA Inc.</b>	2 391 659.24	21 223 852.62	9 019 058.64	-
<b>Business Area</b>	1 937 177.49	12 871 067.06	408 115.97	-
<b>TOTAL</b>	<b>4 816 200.95</b>	<b>33 830 210.75</b>	<b>9 690 566.75</b>	<b>-28 714.79</b>

Issuer's transactions with companies personally connected with Mr. Marek Tymiński, holding a controlling interest in the parent, who directly or indirectly controls the following entities:

	costs	revenues	receivables	payables
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ATS Sp. z o.o.	1 074 000.00	48 336.55	4 392.00	236 689.68
Premium Food Sp. z o.o.	1 471.78	-	-	-
Premium Food Restaurants S.A.	9 491.73	2 500.00	8 369.30	-
Klub Rybny Sp. z o.o.	981.00	0.00	-	759.00
Tech Marek Tymiński	-	684.01	-	-
<b>TOTAL</b>	<b>1 085 944.51</b>	<b>51 520.56</b>	<b>12 761.30</b>	<b>237 448.68</b>

Issuer's transactions with companies personally connected with Members of the Supervisory Board:

	costs	revenues	receivables	payables
KS Konsulting Krzysztof Sroczyński	2 700.00	-	-	1 350.00
IDM S.A. (Grzegorz Leszczyński)	100 550.00	-	-	119 745.00
IDEA (Grzegorz Leszczyński)	575 929.27	-	-	5 022 816.44
STELING M.Dworak	24 000.00	-	-	9 760.00
<b>TOTAL</b>	<b>703 179.27</b>	<b>0.00</b>	<b>0.00</b>	<b>5 153 671.44</b>

Transactions executed directly with Members of the Management Board

	costs	revenues	receivables	payables
Loan – Artur Winiarski	-	1 096.00	101 096.00	-

#### VIII. Informacje o powiązaniach organizacyjnych lub kapitałowych z innymi podmiotami

Composition of the City Interactive Group as at December 31, 2010:

- **City Interactive S.A.** having its registered office in Warsaw. Share capital of PLN 1 265 000. Group parent.
- **City Interactive Germany GmbH** – a company having its registered office in Frankfurt am Main, Germany. Share capital of EUR 25 000. 100% of shares held by City Interactive S.A. Company subject to consolidation as of the second quarter of 2008.
- **City Interactive USA Inc.** – company having its registered office in Delaware, USA. Share capital USD 50 000. 100% of shares held by City Interactive S.A. Company subject to consolidation as of the second quarter of 2008.
- **Business Area Spółka z o.o.** – a company having its registered office in Warsaw, included in consolidation from the third quarter of 2010. Share capital: PLN 5 000. 100% interest held by City Interactive S.A.
- **City Interactive Canada Inc.** – a company based in Ontario, Canada, established in October 2010. Share capital: CAD 10.00. 100% of shares held by City Interactive S.A. The company is not subject to consolidation with regard to the fact that its financial results are not significant for assessment of the Issuer's situation.
- **City Interactive Studio Ltd.** – a company based in London, UK, established in December 2010. Share capital: GBP 100.00. 100% of shares held by City Interactive

S.A. The company is not subject to consolidation with regard to the fact that its financial results are not significant for assessment of the Issuer's situation.

- **City Interactive UK, Ltd.** – company having its registered office in Manchester, UK. Founding capital of GBP 100. 100% of shares held by City Interactive S.A. This company is not subject to consolidation with regard to the fact that its financial results are insignificant for assessment of the Issuer's situation.
- **City Interactive Spain S.L.** – company having its registered office in Madrid, Spain. Share capital of EUR 3 600. 100% of shares held by City Interactive S.A. The company is subject to consolidation as of the fourth quarter of 2008, whereas on January 1, 2010, after creation of revaluation write-offs on receivables, it was excluded from consolidation.

Furthermore, throughout 2008 the parent acquired shares in the following entities operating in South America and subsequently in 2009 opted out of their further development. These entities are currently not subject to consolidation with regard to discontinuation of their operations and the creation of provisions at the parent level:

- City Interactive Peru SAC (formerly UCRONICS SAC) – a company having its registered office in Lima, Peru. 99% share. Share capital 2 436 650 Sol. The company was subject to consolidation from the date of acquisition of a controlling block of shares to the end of 2008.
- City Interactive Jogos Electronicos LTDA – company having its registered office in Sao Paulo, Brazil. Founding capital of BRL 100 000. 90% share, remaining 10% held by City Interactive USA, Inc.
- City Interactive Mexico S.A. de C.V. – company having its registered office in Mexico City, Mexico. Founding capital of MXN 50 000. 95% share, remaining 5% held by City Interactive USA, Inc.

## **IX. Information on City Interactive S.A. loan agreements with consideration to their maturity dates and on guarantee and surety agreements**

### **1. Agreements for loans and borrowings**

Company liabilities under bank loans as at January 1, 2010 totaled PLN 2 038 429.49. These consist of: a loan for financing purchases within a revolving credit limit and for financing a PLN 1 580 686.25 VAT refund together with current account credit used amounting to PLN 457 743.24.

The Company incurred these liabilities pursuant to loan agreement no. CRD/29013/08 and credit limit agreement no. CRD/L/29007/00 of September 24, 2008, entered into with Raiffeisen Bank Polska S.A. Pursuant to annex no. 3 to credit agreement no. 6 to the credit facility agreement of October 29, 2009, the total credit limit in the final period of the agreement's term amounted to PLN 3 800 000.

On November 12, 2010 the Company's Management Board received annexes 4 and 7, duly signed by the other party, terminating credit agreements with Raiffeisen Bank Polska S.A. Under such annexes the following terms and conditions are amended: the final maturity for the facility and revolving credit was changed from February 28, 2011 to November 10, 2010. The repayment was made on time as agreed and thus the Issuer discharged all its credit liabilities.

Collateral for the above loan / limit was also freed, such collateral being in the form of transferring debt claims due to the Company from customers and a registered pledge on stocks held in the Company's warehouse, established in accordance with the registered pledge agreement entered into between the Issuer and Raiffeisen Bank Polska S.A.

## 2. Factoring agreements

Business Area Spółka z o.o., a subsidiary of City Interactive S.A., entered into a factoring agreement on June 11, 2010, together with a loan agreement being an integral part of the factoring agreement, with financial limit of PLN 1.4 million. On November 18, 2010 Business Area Spółka z o.o. terminated the agreement in question, which was finally settled on December 2, 2010.

## 3. Leasing agreements

As at December 31, 2010 the Company had signed the following leasing agreements:

- a) capital leasing agreement entered into with Raiffeisen Leasing Polska S.A., the initial value of which was PLN 114 860, whereas the level of capital repayment installments to be made as at the date of drawing up the financial statements amounted to PLN 82 190;
- b) capital leasing agreement entered into with Volkswagen Leasing Polska S.A., the initial value of which was PLN 75 500, whereas the level of capital repayment installments to be made as at the date of drawing up the financial statements amounted to PLN 4 070;
- c) three capital leasing agreements entered into with SEB Leasing Polska Sp. z o.o., the total initial value of which amounted to PLN 558 800, whereas the level of capital repayment installments to be made as at the date of drawing up the financial statements amounted to PLN 78 920;

## 4. Guarantee and surety agreements

The Company granted the following sureties:

- a) collateral for performance of leasing agreements in the form of a blank promissory note;
- b) collateral for performance of a factoring agreement entered into by Business Area Spółka z o.o. through a surety issued as a blank promissory note. This agreement was terminated at the end of 2010.

## X. Information on loans granted by City Interactive S.A.

Borrower	Amount in foreign currency granted as at December 31, 2010	Total contractual amount	Repayment date	Interest due charged
CITY INTERACTIVE GERMANY GmbH	EUR 29 851.58	EUR 200 000	31.03.2011	EUR 1 650.34
Roy Campbell	PLN 89 000.00	EUR 90 000	30.06.2010	-
Marcin Kwaśnica	PLN 300 000.00	EUR 300 000	30.08.2011	PLN 4 537.00
Artur Winiarski	PLN 100 000.00	PLN 100 000	06.10.2011	PLN 1 096.00

The Company recognized an impairment charge on receivables under a loan granted to subsidiary CITY INTERACTIVE SPAIN S.L. in connection with the adoption by the Management Board on November 13, 2009 of a Resolution concerning abandonment of the operational development of CITY INTERACTIVE SPAIN S.L. A loss of PLN 61 805.09 is likely. The Company recognized an impairment charge amounting to PLN 258 558.79. For these same reasons an impairment charge of PLN 29 385.32 was created in connection with a loan granted to subsidiary City Interactive Mexico S.A. de C.V. The

total value of impairment charges on this asset element amounts to PLN 287 944.11. A PLN 2 016 784.92 loan granted to City Interactive Jogos Electronicos LTDA Peru, completely covered by a impairment charge, was transferred to the subsidiary's primary capital and as such is transferred to the item "Interests in subsidiaries" in non-current assets. The carrying value of this item amounts to PLN 0.00.

#### **XI. In the case of issuing securities in the period covered by the financial statements – description of the use of proceeds from issue**

In Q3 2009 City Interactive S.A. issued bonds in the total amount of PLN 5 million. The nominal value of one bond was PLN 50 000. The issued bonds are bearer securities and carry a 12% annual rate of interest. The bonds matured on September 16, 2010 and on the same date the parent issued series B bonds in the total amount of PLN 5 million. Series B bonds were issued in order to roll over series A bonds, i.e. in order to replace series A bonds to be redeemed for newly issued, series B, so that the aggregate level of liabilities contracted by the Issuer remained unchanged.

The issued bonds are bearer securities in a certificated form. The issue covered 100 (one hundred) series B bonds of a total nominal value of PLN 5 000 000 (five million Polish zloty). The issue price per series B bond amounted to PLN 50 000 (fifty thousand Polish zloty).

Redemption of series B bonds is scheduled for March 16, 2011. Series B bonds carried interest at a variable rate: in the first interest period (i.e. from the issue date until December 16, 2010) the interest rate was equal to the 3M WIBOR rate, as published on September 14, 2010, plus a 6.5% margin. In the second interest period (i.e. from December 16, 2010 until the redemption date) the interest rate was equal to the 3M WIBOR rate, as published on December 14, 2010, plus a 6.5% margin. Interest accrued based on the actual number of days in a given interest period and on a 365-day year basis. Interest was calculated by the Issuer through applying the interest rate to bond par value.

Interest was payable on interest payment dates, i.e. December 16, 2010 and March 16, 2011 – of which interest paid on December 16, 2010 amounted to PLN 128 647.00, whereas interest paid on March 16, 2011 amounted to PLN 128 342.00.

As of the end of the reporting period, i.e. December 31, 2010, accrued undue interest on bonds amounted to PLN 22 816.44.

A complete, on-time redemption of series B City Interactive S.A. bonds occurred on March 16, 2011, and the Issuer fulfilled all formalities towards bondholders who had subscribed for series B bonds in a quantity of 100 (one hundred) of a nominal value per bond of PLN 50 000 (fifty thousand Polish zloty) and a total nominal value of PLN 5 000 000 (five million Polish zloty). The total redemption price of series "B" City Interactive S.A. bonds together with interest amounted to PLN 5 256 989 (five million, two hundred and fifty-six thousand, nine hundred and eighty-nine Polish zloty).

#### **XII. Explanation of variances between the financial result indicated in the annual report and previously published result forecasts**

The Parent's Management Board did not publish any forecasts concerning 2010.

#### **XIII. Assessment together with justification concerning management of City Interactive S.A. financial resources and specification of potential threats, together with actions which the Company has taken or intends to take in order to combat such threats. Information on the current and anticipated financial situation**

## Profitability ratios

	Item	unit of measurement	2010	2009
1.	Sales margin	%	64.50%	25.67%
2.	EBITDA margin	%	51.40%	-15.47%
3.	EBIT operating margin	%	43.51%	-53.85%
4.	Operating margin	%	41.95%	-56.22%
5.	Gross margin	%	41.95%	-56.22%
6.	Net margin	%	34.18%	-46.73%
7.	Return on assets	%	43.33%	-35.64%
8.	Return on equity	%	59.29%	-70.19%

### Method of ratio calculation

1.	Sales margin	=	profit from sales / revenue from sales
2.	EBITDA margin	=	EBITDA / revenue from sales
3.	EBIT operating margin	=	EBIT / revenue from sales
4.	Operating margin	=	operating profit / revenue from sales
5.	Gross margin	=	gross profit / revenue from sales
6.	Net margin	=	net profit / revenue from sales
7.	Return on assets	=	net profit / assets
8.	Return on equity	=	net profit / equity

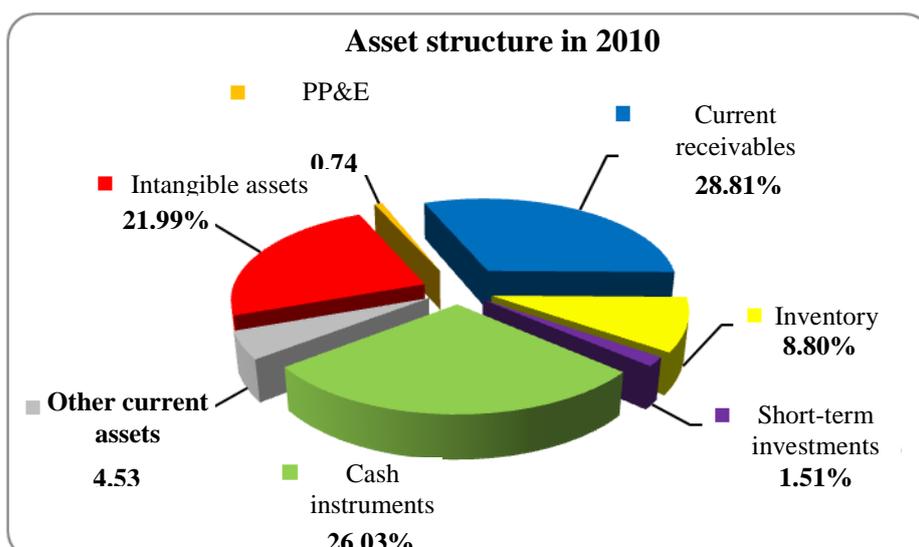
The profitability ratios for sales, assets and equity in 2010 are characterized by positive values and achieved a respectable level.

Sales margin in 2010 reached a level of 64.50% and increased by 38.83% in relation to 2009. This is caused by growth in the result on sale by PLN 41.76 million. Profit on sales in 2010 amounted to PLN 48.72 million. It was possible to achieve this result thanks to a 179% increase in revenues from sale of products, goods and services, whereas the costs of products, goods and services sold increased by only 33%.

Return on assets increased in 2010 by 43.33%, whereas the return on equity increased by 59.29%.

## Asset structure

	Item	unit of measurement	2010	2009
1.	Intangible assets / assets	%	22.00%	28.89%
2.	Property, plant and equipment / assets	%	0.72%	1.55%
3.	Current receivables / assets	%	32.68%	33.70%
4.	Inventories / assets	%	7.19%	12.05%
5.	Short-term investments / assets	%	1.72%	4.17%
6.	Cash instruments / assets	%	24.56%	1.29%
7.	Other current assets / assets	%	4.30%	6.36%



Within the structure of assets as at the end of 2010 the dominating item was current receivables, constituting 32.68% of the balance sheet total. This is connected with a very high level of sales in the third and fourth quarters of 2010 and fairly long payment deadlines for customers. In comparison with the previous year the share of current receivables is 1.02% lower, which in turn is a result of intensifying debt recovery procedures. Intangible assets also constitute a significant asset item, comprising mainly expenditures on production of computer programs.

### Turnover ratios

Item	unit of measurement	2010	2009
1. Asset turnover ratio	times turned over	1.27	0.76
2. Inventory turnover ratio		17.63	6.33
3. Receivables collection period	number of days	94.11	161.31
4. Payables payment period		44.46	115.55

#### Method of ratio calculation

1. Asset turnover ratio = revenue from sales / assets
2. Inventory turnover ratio = revenue from sales / inventory at the end of reporting period
3. Receivables collection period = (current receivables / revenue from sales) \* number of days in period
4. Payables payment period = (current payables less borrowings / revenue from sales) \* number of days in period

The receivables collection period has decreased in 2010. Despite the phenomenon of extended payment deadlines for customers, which is standard for a manufacturing company, intensification of the debt recovery process, particularly during the period of intense sales development, brought the desired effect. The receivables collection period is longer than the payables payment period, which are paid on systematically (first and foremost employee and associate salaries or the costs of purchased licenses, which are covered in their entirety when a game is released). The costs of materials and services in preparing media containing games for sale (discs, boxes, burning) are paid with a deferred payment deadline, generally 30-60 days in the Polish market, whereas for manufacture in the USA where the trade credit limit with suppliers is at USD 250 000 the payment deadline is 30 days and for a limit of USD 200 000 this is 90 days.

### Debt ratio

Item	2010	2009

Debt ratio	0.27	0.49
Debt to equity	0.37	0.96
Equity to assets	2.67	1.24
Quick ratio	0.27	0.49
Long-term debt ratio	0.003	0.01

#### Method of ratio calculation

Debt ratio = (current liabilities + non-current liabilities + provisions for payables) / total equity and liabilities

Debt to equity = (current liabilities + non-current liabilities) / equity

Equity to assets = (equity + non-current liabilities) / assets

Quick ratio = current liabilities / total equity and liabilities

Long-term debt ratio = non-current liabilities / total equity and liabilities

Debt ratios have decreased in relation to the previous year. Only the equity to assets ratio increased to a level of 2.67. As at the end of 2010 the share of liabilities in the Company's financing structure decreased.

#### Liquidity ratios

Item	2010	2009
Current ratio	2.73	1.21
Quick ratio	2.46	0.96
Cash ratio	0.99	0.11

#### Method of ratio calculation

Current ratio = current assets / current liabilities

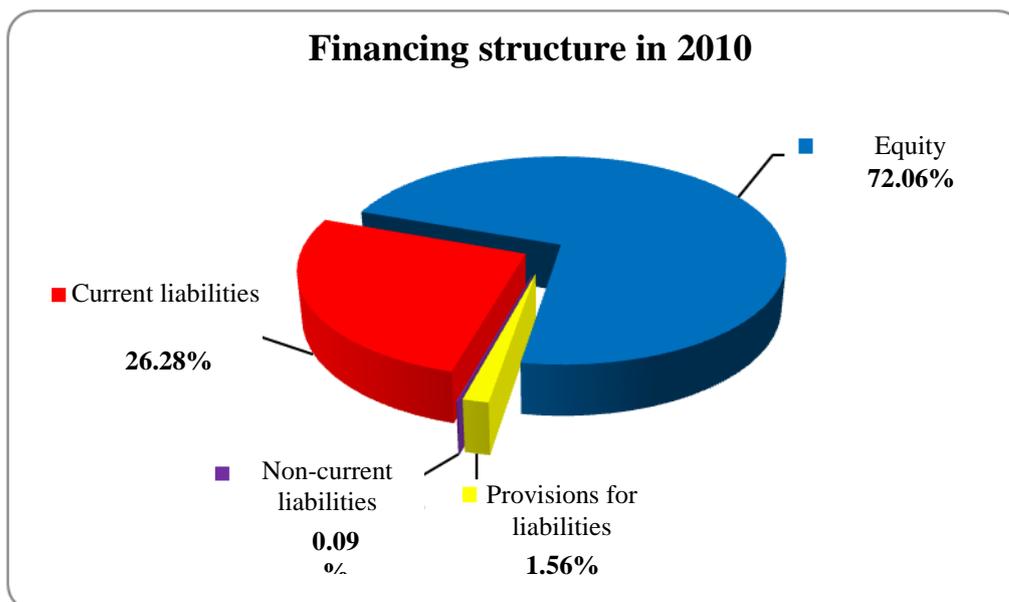
Quick ratio = (current assets - inventory) / current liabilities

Cash ratio = (cash instruments and securities held for trading) / current liabilities

Liquidity ratios in 2010 show a higher level than in 2009, which means better capability for the Company to pay its liabilities. This level of ratios is caused both by a drop in current liabilities and an increase in current assets, including an increase in cash and cash equivalents of PLN 14.18 million.

#### Financing structure

EQUITY AND LIABILITIES (in PLN)	2010	%	2009	%
Equity	43 556 832	73.08%	18 047 200	50.77%
Provisions for liabilities	910 471	1.53%	1 577 219	4.44%
Non-current liabilities	67 556	0.11%	96 262	0.27%
Current liabilities	15 066 267	25.28%	15 824 788	44.52%
Accruals and prepayments	0	0.00%	0	0.00%
<b>Total equity and liabilities</b>	<b>59 601 126</b>	<b>100.00%</b>	<b>35 545 468</b>	<b>100.00%</b>



In the Company's financing structure the largest share is taken by equity, which constitutes 73% of total equity and liabilities, whereas liabilities constitute only 27%.

All operating ratios and the asset and financial situation show the excellent financial condition of the Company and constitute a stable basis for further development and implementation of the Company's key objectives together with its product strategy.

**XIV. Assessment of the possibility to implement investment goals, including capital expenditures in comparison to the amount of funds held with consideration given to the possibility to change the structure for financing such operations**

The Company has the capability to finance investment projects. In 2011 the Company intends to maintain the current level of investment. Own funds and funds sourced from the banking or financial sector will be used to finance investment projects.

**XV. Description of atypical factors and events with an impact on the result on operations for 2010**

In 2010 the Company recorded cumulative revenue from sales at a level of PLN 75.54 million, which constitutes a 179% increase in comparison with the same period the year before.

**Impairment charges and provisions**

The Company recognized impairment charge on intangible assets. The basis for the write-down is valuation of the useful value of these asset elements. The costs of this amounted to PLN 1.5 million.

A subsequent write-down made during the reporting period is an impairment charge on the value of receivables. This increases the cost item by PLN 1.6 million.

The Company also created a provision for return of products. This write-down decreased the Company's revenues by PLN 1.5 million. Adjusting the cost of manufacture in connection with the above provision, the Company's net financial result decreased by PLN 1.3 million.

The three write-downs referred to above had a total impact on the financial result as at the end of 2010 amounting to PLN 4.4 million.

Aside from the events described in point 1, sub-point 3, there were no atypical events during the reporting period which could have had a significant impact on the *financial result achieved by City Interactive S.A.*

#### **XVI. Indication of proceedings in progress before a court, competent authority for arbitration proceedings or public administration authority**

During the reporting period proceedings were in progress before the Supreme Administrative Court in connection with a cassation appeal brought by the Minister of Finance against the ruling of the Provincial Administrative Court in Warsaw of 20 April 2009 (case file no. III SA/Wa 3276/08).

##### **DETAILS OF THE PROCEEDINGS:**

On August 8, 2008 the Minister of Finance issued an individual interpretation to the Company (IP-PB3-423-754/08-2/JG), which recognized the Company's position concerning recognition of tax-deductible expenses connected with implementation of a development strategy as incorrect.

In the ruling of April 20, 2009, (Case file no. SA/Wa 3276/08), the Provincial Administrative Court upheld the Company's appeal and overruled the above interpretation.

The Minister of Finance lodged a cassation appeal to the Supreme Administrative Court against the above ruling.

On February 9, 2010 the Supreme Administrative Court overruled the appealed verdict and transferred the case for re-examination to a court of lower resort.

On December 16, 2010, the Provincial Administrative Court in its ruling recognized expenses borne by the Company for increasing share capital as essential expenses connected with acquisition of revenues pursuant to the provisions of the corporate income tax act.

On January 24, 2011 a resolution of seven judges of the Supreme Administrative Court (ref. II FPS 6/10) was adopted, recognizing all expenses indirectly connected with increasing share capital as tax-deductible expenses. The resolution was adopted in a specific administrative court case. It does however have an impact on further rulings issued by administrative courts on the same subject.

The Company has no information concerning other judicial or administrative proceedings in progress against it.

#### **XVII. Characteristics of significant factors for business development and description of the perspectives for development of business operations**

The Group consistently pursues its development strategy aimed at regularly releasing high quality video games. Currently, quality of the game development, promotion and sales process will be the decisive factor affecting product planning and development activities. In the opinion of the Issuer's Management Board, this will result in a further improvement in City Interactive S.A.'s results in subsequent years.

The Issuer produces more and more games for new generation consoles. This is an important step towards entering key world markets where sales are based mainly on console products. In 2011 the share of games for consoles in the Group's portfolio will increase further. At the same time the Issuer plans to expand new products in the smartphone market and the Issuer's management board believes that the strategy adopted concerning the development and release of smartphone games will begin to make revenues as early as 2011, while in 2012 these should constitute a significant part of revenues for the Company and the Issuer's entire Group.

In the opinion of the Issuer's Management Board, this strategy will allow the Group to strengthen its position in global markets.

An important growth factor is the global success of "Sniper Ghost Warrior", which had a decisive effect on expanding the Issuer's distribution capacity in relation to all of its products. The success effectively translates into higher volumes of orders for the Issuer's games through distribution networks abroad and in Poland. To date over 1.1 million copies of the game have been sold, which translated into the Issuer's record results last year. In April 2011 the Company began to sell a new updated version of "Sniper Ghost Warrior" on the PlayStation® 3, the sales success of which will undoubtedly be one of the most significant factors having an impact on the Company's financial results in 2011.

Intensive work is also taking place on the creation of "Sniper Ghost Warrior 2", based on CryENGINE® 3 technology, which has a great chance of becoming the biggest production and publishing success for the Issuer. This shows that over the coming years City Interactive S.A. will continue to develop and maximize revenues from the SNIPER GHOST WARRIOR brand.

The Management Board of City Interactive S.A. believes that subsequent high quality releases will lead to even better results in 2011 and beyond. In the opinion of the Company's Management Board, the above strategy, together with the Group's decisions described below, will bring further financial success to City Interactive S.A. and establish its international position.

In 2011 the Issuer plans to release several products with high commercial potential, including the dynamic action game "Alien Fear" – based on a science fiction theme, which will be released on PC, Xbox360®, Sony PlayStation® 3, together with the WWII aviation game "Combat Wings: The Greatest Battles of World War II", to be released simultaneously for the NINTENDO Wii™, Xbox360®, Sony PlayStation® 3 and PC. This is intended as a completely new brand – the best game in the aviation shooter segment which, like "Sniper Ghost Warrior", will fill a market niche.

A subsequent significant factor which should improve City Interactive S.A.'s results will be the intensification of the Company's international sales. The North American market will constitute the largest share of Group revenues in 2011 and beyond. The United States is the biggest video gaming market in the world. The Group actively collaborates with all major retail networks offering video games. Released in June 2010, "Sniper: Ghost Warrior" achieved substantial sales success, which provides justification for the decision to implement a strategy based on developing high quality games.

In the Management Board's opinion, City Interactive S.A. has the competences to create and release high quality games intended for new generation consoles, PCs and smartphones which offer major commercial potential and will successfully compete against the products already on the market. The Group expects most of these to succeed, which will contribute to the improvement in financial results in 2011 and subsequent years. At the same time the Issuer is maximizing sales revenues on previously released games (back catalog).

## Release plan for 2011:

### Q1 2011

- **Chronicles of Mystery: The Secret of Lost Kingdom – premiere for PC.** A sequel to the story told in Chronicles of Mystery: The Legend of the Sacred Treasure. As background to this adventure game serves the story of Alexander the Great. In the storyline full of adventures and riddles, the player, again as Chelsea Connor, will learn the secret of victories of the great leader and will solve the plots originating in Chronicles of Mystery: The Legend of the Sacred Treasure.
- **Chronicles of Mystery: The Secret Tree of Life – Nintendo Dual Screen™ premiere.** The Secret Tree of Life is the next part in the series; its storyline leads the player to extraordinary places such as Venice, Cairo and a secret island in the Bermuda Triangle. This time the heroine is a talented archeologist and adventurer, Sylvie Leroux, who joins forces with the mysterious Count Saint-Germain to examine an intriguing legend of the Tree of Life. The player sets out on a trip full of difficult puzzles, hidden hints and dangers lurking around every corner.
- **Art of Murder: Deadly Secret – premiere for PC.**  
Murder abounds in New York; the death toll rises. The FBI agent assigned to this case, Nicole Bonnet, is not able to find any tracks – it seems that the victims are not related. So begins the next epic Art of Murder story. This time the storyline centers around a mysterious bank holdup and robbery. A seemingly simple case gains a new dimension after a retired subway employee is murdered. Players have to use their detective skills to combine all leads into one cohesive picture. Connections between the victims have to be discovered before another one is murdered.

### Q2 2011

- **Sniper: Ghost Warrior – Sony PlayStation® 3 premiere**  
A new and improved version of the hit game for PC and Xbox360, Sniper: Ghost Warrior. Breathtaking action and a dynamic system with life-like ballistics create a realistic vision of war through the eyes of a sniper. The PlayStation® 3 version includes the original game with all the latest patches and exclusive add-ons.
- **Murder in Venice – premiere on the Nintendo Dual Screen™**  
Release for the portable Nintendo DS™ console. The action takes place in picturesque Venice. "Murder in Venice" is an adventure game where the player learns of superpower conspiracies. The quest to solve the conspiracy falls to the heroes of the game – the student Vera who is on holiday in Venice and former Russian spy Juria. The release is full of logic puzzles and beautiful locations and the action takes place in the present and in the 1960s simultaneously.
- **Jewel of the Ages – premiere for the Nintendo Dual Screen™**  
"Jewels of Ages" Island is a release in the particularly popular logic games segment. These games have a faithful following among users of the Nintendo DS™. In actual fact, players will find that they've bought two games. In the first of these they become the ancient warrior and ruler of all Greece, Olim and Hades on a quest to find magic crystals. In the second they guide the fate of a brave hunter facing up to gods and monsters to break the Pharaoh's curse.

### Q3 2011

- **Combat Wings: The Greatest Battles of World War II" – premiere for NINTENDO Wii™, Xbox360®, Sony PlayStation® 3 and PC**  
"Combat Wings: The Greatest Battles of World War II" is an aircraft action game set during World War II. The genre has its faithful fans on both, consoles and PCs. The game presents spectacular air duels from major air battles of the Second World War

era. It features the largest number of air strikes having taken place on the fronts of the Second World War of all WW2 aircraft games ever published.

- **Alien Fear – premiere on the PC, Xbox360®, Sony PlayStation® 3**  
"Alien Fear" is representative of the extremely popular shooter games segment and is intended mainly for online distribution on the Xbox360®, Sony PlayStation® 3 and PC. The player assumes the role of the surviving member of a marine detachment sent to rescue the crew of the lost space station Deep Space One. Using a wide range of weapons, the player must face up to hordes of terrifying aliens.

## **XVIII. Changes in the basic corporate management principles**

There were no changes in 2010 in the organization or the basic principles of corporate management.

## **XIX. Changes in the composition of management and supervisory personnel in 2010**

### **Management Board of City Interactive S.A.**

Mr. Marek Tymiński – President of the Management Board throughout 2010.

Mr. Artur Winiarski – Member of the Management Board throughout 2010.

### **Supervisory Board of City Interactive S.A.**

Mr. Krzysztof Sroczyński      President of the Supervisory Board throughout 2010.

Mr. Marek Dworak              Member of the Supervisory Board throughout 2010.

Mr. Lech Tymiński              Member of the Supervisory Board throughout 2010.

Mr. Grzegorz Leszczyński      Member of the Supervisory Board throughout 2010.

Mr. Tadeusz Kirstyn            Member of the Supervisory Board until November 8, 2010.

Mr. Tomasz Litwiniuk          Member of the Supervisory Board until November 8, 2010.

## **XX. Agreements entered into between the Issuer and management personnel providing for compensation in the event of their resignation or dismissal without valid cause or if their dismissal or redundancy occurs as a result of the Issuer's merger**

No such agreements were entered into.

## **XXI. Level of salaries, awards, benefits paid out, due or potentially due to the Company's management or supervisory personnel.**

Level of (gross) remuneration for the Company's management and supervisory personnel paid out in 2010:

### **Level of (gross) remuneration paid out to Members of the Management Board**

Marek Tymiński – President of the Management Board	345 000.00
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Artur Winiarski – Member of the Management Board	48 290.31
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#### Level of (gross) remuneration paid out to Members of the Supervisory Board

Krzysztof Sroczyński – President of the Supervisory Board	45 500.00
Marek Dworak – Member of the Supervisory Board	32 500.00
Grzegorz Leszczyński – Member of the Supervisory Board	32 500.00
Lech Tymiński – Member of the Supervisory Board	32 500.00
Tadeusz Kistryn – Member of the Supervisory Board	30 583.30
Tomasz Litwiniuk – Member of the Supervisory Board	1 916.70

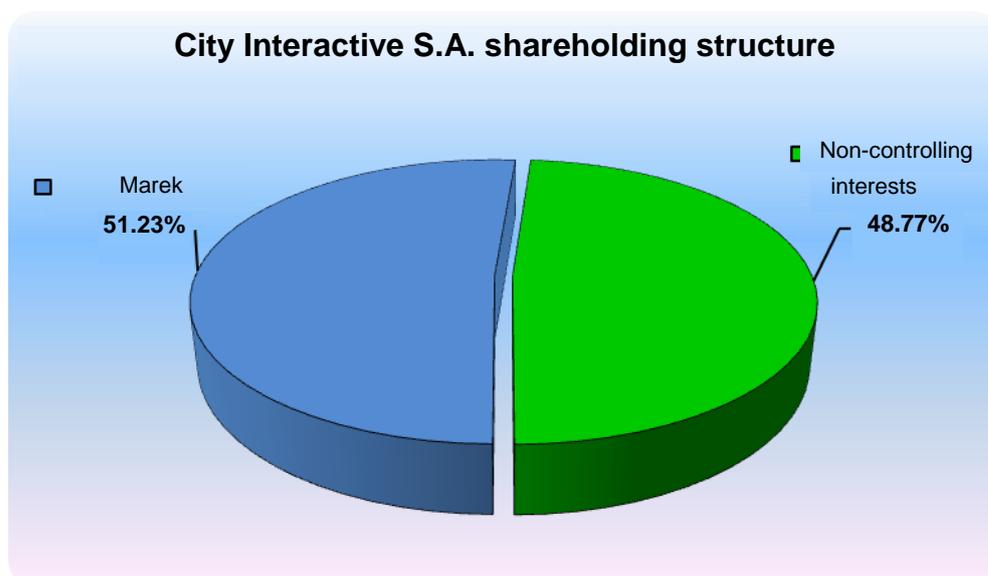
#### **XXII. Indication of shareholders directly or indirectly through subsidiaries holding at least 5% of total votes at the Company's General Meeting as at the date of publishing the annual report, with indication of the number of shares held by such entities, their share in capital, the number of votes carried thereby and their share in the total number of votes at the Shareholder Meeting**

The Company's share capital amounts to PLN 1 265 000 (say: one million, two hundred and sixty-five thousand Polish zloty) and is divided into 12 650 000 shares of a nominal value of PLN 0.10 each.

The total number of votes at the general meeting of shareholders carried by all issued shares is 12 650 000.

#### **City Interactive S.A. shareholding structure as at December 31, 2010:**

Item	number of shares held	number of votes held	% of share capital
Marek Tymiński	6 480 794	51.23%	51.23%
Total other shareholders	6 169 206	48.77%	48.77%



The following changes in the proportion of shares held by current shareholders took place after the end of the reporting period (December 31, 2011):

- On January 19, 2011 the Company received notification from QUERCUS Towarzystwo Funduszy Inwestycyjnych S.A., acting on behalf of QUERCUS Parasolowy SFIO and QUERCUS Absolutnego Zwrotu FIZ (the "Funds") concerning an increase by the Funds of their share in the total number of votes at City Interactive S.A. As at February 14, 2011 the Funds held 632 557 shares in the Issuer, which constitutes 5% of the Issuer's share capital and 5% of total votes at the General Meeting of Shareholders.
- On February 23, 2011 the Company received notification from QUERCUS Towarzystwo Funduszy Inwestycyjnych S.A., acting on behalf of managed investment fund QUERCUS Parasolowy SFIO (the "Fund") concerning an independent increase by the Fund of its share in the total number of votes at City Interactive S.A. and of crossing the 5% threshold of total votes at City Interactive S.A. As at February 22, 2011 the Funds held 657 896 shares in the Issuer, which constitutes 5.20% of the Issuer's share capital and 5.20% of total votes at the General Meeting of Shareholders.
- On February 19, 2011 the Company received notification from QUERCUS Towarzystwo Funduszy Inwestycyjnych S.A., acting on behalf of the managed investment fund QUERCUS Parasolowy SFIO (the "Fund") concerning independent decrease by the Fund of its share in the total number of votes at City Interactive S.A. and a drop below the 5% threshold of total votes at City Interactive S.A., which took place due to the disposal of shares in the Company on the regulated market on April 13, 2011. On April 18, 2011 the Fund held 564 745 shares in the Issuer, which constituted 4.46% of the Issuer's share capital and 4.46% of total votes at the General Meeting of Shareholders and acting on behalf of the managed investment funds QUERCUS Parasolowy SFIO and QUERCUS Absolutnego Zwrotu FIZ (the "Funds") concerning decrease by the Funds of their mutual share in the total number of votes at City Interactive S.A. and a drop below the 5% threshold of total votes at City Interactive S.A., which took place due to the disposal of shares in the Company on the regulated market on April 14, 2011. On April 18, 2011 the Funds held 592 816 shares in the Issuer, which constituted 4.69% of the Issuer's share capital and 4.69% of total votes at the General Meeting of Shareholders and acting on behalf of the managed investment funds

### **XXIII. Information on agreements with an entity authorized to audit financial statements**

- a) Name of the entity: Mistery Audytor Sp. z o.o.
- b) Date of entering into the agreement on audit of the separate financial statements for 2010 – June 30, 2010. The agreement concerns audit of the financial statements of the Company and Group for 2010 (semi-annual review and annual audit).
- c) Total remuneration due for review and audit of the Company's and Group's financial statements in 2010 – PLN 38 800 net.

**Marek Tymiński**

President of the Management Board

**Wojciech Kutak**

Member of the Management Board

Warsaw, April 30, 2011

