

# CITY INTERACTIVE GROUP

## INTERIM MANAGEMENT REPORT FOR THE FIRST HALF OF 2011



Warsaw, August 23, 2011

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

Pursuant to the Ordinance of the Minister of Finance of February 19, 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 consolidated interim financial statements and comparative data have been drawn up in accordance with binding accounting principles, and correctly, reliably and clearly reflect the financial and property situation of the City Interactive Group together with its financial result, and that the interim management report of the City Interactive Group contains a true depiction of the development, achievements and situation of the City Interactive Group, including a description of principal threats and risks.

The Management Board of City Interactive S.A. declares that the entity authorized to audit financial statements performing audit of the consolidated interim 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 regulations and professional standards in force.

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

**Marek Tymiński**

**President of the Management Board**

**Michał Sokolski**

**Member of the Management Board**

Warsaw, August 23, 2011

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## 1. General characteristics of City Interactive Group operations

The City Interactive Group operates in the video game development and publishing market, both within Poland and abroad. The Issuer is the first publically traded company in this sector in Central and Eastern Europe and the first to become an international player, achieving outstanding market and financial performance. The City Interactive Group is focused on developing a high quality product range within different game genres, with a special focus on action games.

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

- Developer – having its own development studio in which new projects are created,
- Publisher – acquiring licenses to games manufactured by external studios, being responsible for marketing strategy and product roll-out,
- Distributor – which sells products directly to retail chains, distributor networks, internet portals and others.

Through fulfilling these three functions, the Issuer can effectively control the process of development and distribution of 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. Share capital of the Parent

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,
- 2 500 000 series C shares,
- 110 000 series D shares.

Series A shares were acquired 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 acquired by City Interactive Group employees and associates. The District Court made registration of the increase in share capital under issue of series B shares on August 10, 2007.

Series C shares were subject to a successful public offering in November 2007. All offered shares on offer were purchased and paid for. On December 17, 2007 the District Court in Warsaw made registration of the increase in the Company's share capital through issue of series C shares.

Series D shares were issued under an incentive scheme and were acquired by Company employees and associates. The District Court made registration of the increase in share capital under issue of series D shares on October 9, 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 Parent**

The Parent has no information about any 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 or 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 Parent's Supervisory Board. This obligation was intended to cease being binding in the event that City Interactive Group 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.

In July 2007 the Parent issued 40 000 series B shares at an issue price of PLN 1 under an incentive scheme for its employees and significant associates. Persons acquiring 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 series B shares for a period of 1 year and:

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

Furthermore some persons under the aforementioned incentive scheme also became the holders of series A shares at a price of PLN 1. The Issuer's 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 lock-up agreements 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 incentive scheme, his/her shares were or are transferred to another person designated by the Parent's Management Board.

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

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

**2.4. Presentation of shareholdings in City Interactive S.A. or rights to shares to which the Issuer's management or supervisory personnel are entitled as at the date of publishing the interim report, together with indication of change in shareholdings during the period from publication of the previous quarterly report, presented individually for each person**

Person	Position	Shares held as at May 16, 2011 (publication date of the Q1 2011 report)	Increase in shareholding during the period from May 16 to August 23, 2011	Decrease in shareholding during the period from May 16 to August 23, 2011	Shares held as at August 23, 2011 (publication date of the H1 2011 report)
Marek Tymiński	President of the Management Board	6 480 794	-	-	6 480 794
Michał Sokolski	Member of the Management Board*	n/a	-	-	322 000
Lech Tymiński	Member of the Supervisory Board	9 565	-	-	9 565

\*Mr. Michał Sokolski was appointed Member of the Management Board of City Interactive S.A. as of August 22, 2011

### 3. Selected financial data

Balance sheet figures have been converted into EUR according to the average exchange rate announced by the National Bank of Poland as at the date on which the financial statements were drawn up, which as at the end of the reporting period amounted to:

as at June 30, 2011 – PLN 3.9866  
as at December 31, 2010 – PLN 3.9603

Items in the profit and loss statement and statement of cash flows have been converted into EUR according to the average exchange rate, calculated as the arithmetical average of exchange rates announced by the National Bank of Poland as at the last day of each month:

for the first half of 2011 – PLN 3.9673,  
for the second quarter of 2011 – PLN 3.9604,  
for 2010 – PLN 4.0044,  
for the first half of 2010 – PLN 4.0042,  
for the second quarter of 2010 – PLN 4.0416,

CONSOLIDATED PROFIT AND LOSS STATEMENT	First half of 2011 period from Jan 1 to June 30, 2011		First half of 2010 period from Jan 1 to June 30, 2010	
	EUR thousands		EUR thousands	
	PLN thousands	EUR thousands	PLN thousands	EUR thousands
<b>Net revenue from sale of products, goods for resale and materials</b>	<b>43 228</b>	<b>10 896</b>	<b>28 883</b>	<b>7 213</b>
Operating profit (loss)	12 482	3 146	11 799	2 947
Distribution costs	5 521	1 392	3 777	943
Administrative expenses	2 804	707	1 745	436
Gross profit (loss)	12 368	3 117	12 551	3 134
<b>Net profit (loss)</b>	<b>10 117</b>	<b>2 550</b>	<b>10 496</b>	<b>2 621</b>
Number of shares (in thousands)	12 650	12 650	12 650	12 650
Profit (loss) per ordinary share	0.80	0.20	0.83	0.21

CONSOLIDATED STATEMENT OF CASH FLOWS	First half of 2011 period from January 1 to June 30, 2011		First half of 2010 period from January 1 to June 30, 2010	
	EUR thousands		EUR thousands	
	PLN thousands	EUR thousands	PLN thousands	EUR thousands
Net cash flows from operating activities	10 751	2 710	7 787	1 945
Net cash flows from investing activities	-7 163	-1 806	-4 877	-1 218
Net cash flows from financing activities	-5 224	-1 317	-2 419	-604
<b>Net cash flows</b>	<b>-1 637</b>	<b>-413</b>	<b>491</b>	<b>123</b>

CONSOLIDATED PROFIT AND LOSS STATEMENT	Q2 2011 period from April 1 to June 30, 2011		Q2 2010 period from April 1 to June 30, 2010	
	EUR thousands		EUR thousands	
	PLN thousands	EUR thousands	PLN thousands	EUR thousands
<b>Net revenue from sales</b>	<b>29 847</b>	<b>7 536</b>	<b>17 457</b>	<b>4 319</b>
Operating profit (loss)	10 956	2 766	7 250	1 794
Gross profit (loss)	10 829	2 734	8 629	2 135
<b>Net profit (loss)</b>	<b>8 985</b>	<b>2 269</b>	<b>7 199</b>	<b>1 781</b>
Number of shares (in thousands)	12 650	12 650	12 650	12 650
Profit (loss) per ordinary share	0.71	0.18	0.57	0.14

CONSOLIDATED BALANCE SHEET	as at June 30, 2011		as at December 31, 2010	
	EUR thousands		EUR thousands	
	PLN thousands	EUR thousands	PLN thousands	EUR thousands
Non-current assets	19 565	4 908	16 789	4 239
Current assets	46 391	11 637	42 828	10 814
<b>Total assets</b>	<b>65 956</b>	<b>16 544</b>	<b>59 617</b>	<b>15 054</b>
Equity	53 086	13 316	42 962	10 848
Share capital	1 265	317	1 265	319
Liabilities and provisions for liabilities	12 869	3 228	16 656	4 206
Non-current liabilities	210	53	201	51
Current liabilities	12 659	3 175	16 454	4 155
<b>Total equity and liabilities</b>	<b>65 956</b>	<b>16 544</b>	<b>59 617</b>	<b>15 054</b>

#### 4. Organizational description of the Issuer's Group with indication of entities subject to consolidation

As at June 30, 2011, the following entities make up the Group:

- **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.** – a company having its registered office in Delaware, US. Share capital of 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 of 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 of 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 of GBP 100.00. 100% of shares held by City Interactive S.A. Company subject to consolidation as of the first quarter of 2011.
- **City Interactive UK, Ltd.** – a company having its registered office in Manchester, UK. Founding capital of GBP 100. 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 Spain S.L.** – a 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 revaluation of 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 Parent level:

- **City Interactive Peru SAC (formerly UCRONICS SAC)** – a company having its registered office in Lima, Peru. 99% share. Share capital PEN 2 436 650. The company was subject to consolidation from the date of acquisition of a controlling stake to the end of 2008.
- **City Interactive Jogos Electronicos LTDA** – a 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.

## **5. Indication of the effects of changes in the structure of the economic entity, including as a result of merging economic entities, acquisition or disposal of Group entities, long-term investments, carve-outs, restructuring and discontinuation of operations**

There were no changes in the structure of the City Interactive Group during this reporting period.

## **6. Description of the City Interactive Group's significant achievements or failures in the first half of 2011 together with a list of the most important related events**

- **Release of "Sniper: Ghost Warrior" on Sony PlayStation®3**

On April 28, 2011 "Sniper Ghost Warrior" was released for Sony PlayStation®3 in Europe (the game was released a week later in the UK, i.e. on May 5, 2011). During the first few weeks it was on sale, the game became a hit in almost all European markets and has not left the bestseller list despite the fact that it was released in a not particularly favorable environment as regards competition (other products were launched by competing video game producers during the same period). This fact illustrates just how strong a global market brand "Sniper Ghost Warrior" has become.

- **Issuer's subsidiary responsible for the development and release of smartphone games**

In February 2011 the Issuer's Management Board announced its decision to form a new subsidiary in the first quarter of 2011 responsible for the production, release and distribution of high quality games for smartphones, together with online and social games. After performing detailed analysis of the Group's organizational structure in order to make most effective use of subsidiary capabilities, the Issuer's Management decided that content in the smartphone market will be handled by the Issuer's existing subsidiary Business Area Sp. z o.o. The Issuer's Management Board assumes that the subsidiary's projected revenues may emerge as one of several significant factors causing an increase in the Issuer's Group revenues and net profit in the coming years.

- **Execution of a significant agreement with Sony Computer Entertainment Europe Limited**

On March 1, 2011 the Issuer's Management Board received a signed license agreement executed with Sony Computer Entertainment Europe Limited concerning release of the Issuer's games on Sony PlayStation®3 in Europe, Australia, New Zealand and other territories using the PAL (Phase Alternating Line) system.

This is a strategic agreement. Sony PlayStation®3 is one of the most popular gaming platforms in the world. At the same time, under the agreement entered into with Sony Computer Entertainment Europe Ltd., the Issuer will be able to distribute its products through the Sony PlayStation®Network.

- **Timely buyback of City Interactive S.A. series B bonds**

A complete, timely buyback of series B City Interactive S.A. bonds occurred on March 16, 2011, and the Issuer fulfilled all formalities towards bondholders who had acquired 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



złoty), which the Issuer announced in current report no. 69/2010 of September 16, 2010. The total buyback 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).

- **Rescheduling of the release date for "Sniper Ghost Warrior 2"**

On April 12, 2011 the Management Board of City Interactive S.A. decided to delay the release of "Sniper Ghost Warrior 2" by several months in relation to the original launch, which was to have taken place in the third quarter of 2011. The reason for this decision is the desire to ensure the highest artistic and technological quality for this key project.

- **Changes in the Management Board of City Interactive S.A.**

For personal reasons, Mr. Wojciech Kutak resigned as Member of the Management Board of City Interactive S.A. On August 22, 2011 the Supervisory Board of City Interactive S.A. appointed Mr. Michał Sokolski – Director of the Issuer's Development Department – as Member of the Issuer's Management Board. Mr. Michał Sokolski is also a Member of the Management Board of Business Area Sp. z o.o. and Member of the Supervisory Board of Premium Food Restaurants S.A.

- **Withdrawal from the agreement with The Farm 51 Spółka z o.o.**

On 24 February 2011 the Issuer's Management submitted a declaration concerning immediate withdrawal from the agreement executed between the Issuer and The Farm 51 Spółka z o.o., based in Gliwice (the "Contractor"). The subject of the agreement was manufacture of the game "Alien Fear" for the Issuer by the Contractor. The reason for withdrawal from this agreement was non-observance by the Contractor of obligations under the agreement, in particular non-performance of the subject of the agreement in a timely manner and non-consideration of artistic requirements.

The Issuer is continuing production of the game at its own development studios (Bydgoszcz, Warsaw).

## 7. Description of factors and events, in particular extraordinary factors and events, affecting the financial results

In the compared periods, the City Interactive Group sales structure changed significantly.

SALES STRUCTURE	First half of 2011	First half of 2010
Console games	88%	43%
PC games	12%	57%

The costs of products sold amounted to 52% in the first half of 2011 in comparison with 38% in the first half of 2010.

The higher share of these costs in revenues during the first half of 2011 is connected with the higher costs of manufacturing media for consoles than in the case of PCs. These costs include license fees paid to the platform owner. Furthermore, in the first half of 2011 the Group released Sniper: Ghost Warrior on Xbox360® in North America at a lowered price, which resulted in a decreased margin.

However, no significant change occurred in the share of administrative expenses and cost of sales in relation to revenues between the two half-year periods compared.

During the reporting period the City Interactive Group generated a cash surplus from operating activities amounting to PLN 10.8 million (PLN 7.8 million in the first half of 2010). This surplus allowed the Group to provide PLN 6.5 million in finance for R&D work on game development and to repay PLN 5.1 million in liabilities (buyback of bonds).

As at June 30, 2011, Group companies held PLN 13.9 million in bank accounts.

The Group has no liabilities under borrowings or loans.

During the reporting period, the Group's geographic sales structure did not change in relation to the first half of the previous year. The Group's sales are developing evenly in all of the most significant markets. A new, promising sales area which the Group entered in July 2011 is Japan. The share of revenues achieved in Poland is 5%.

REVENUES geographical structure	First half of 2011		First half of 2010	
	PLN thousands	%	PLN thousands	%
Europe	24 641	57%	17 245	60%
North America	15 173	35%	10 301	35%
Asia and Australia	3 414	8%	1 337	5%
<b>TOTAL</b>	<b>43 228</b>		<b>28 883</b>	

## 8. Explanations concerning the seasonal or cyclical nature of the City Interactive Group's business in the presented period

Due to the variety of revenue streams (domestic distribution, international distribution, sale of licenses) and the specifics of the computer gaming industry, the City Interactive Group is subject to sales revenue volatility during the financial year, which is determined by the release of new products. The Issuer establishes the dates for release of its games in order to select the most beneficial competitive environment and in order for the release to achieve the highest financial result.

## 9. Description of principal risk factors and threats to the City Interactive Group

### 9.1. Risk connected with the macroeconomic situation

The video gaming market in which the City Interactive Group operates is highly competitive, while technology and consumer interests change rapidly. A significant factor which exerts a negative impact on operational efficiency are the macroeconomic fluctuations in specific markets. In order to minimize risk, the Group develops its operations on a global scale, independently releasing products in all of the most significant markets around the world. In recent years the entertainment industry has developed dynamically and it is estimated that the value of the video gaming market will exceed that of the film industry.

### 9.2. Competition risk

The City Interactive Group operates in a market where the leading position is held by companies with strong, established positions. The City Interactive Group has proved that it can successfully compete by using its greatest advantages: an experienced team, a



global distribution network and cost advantage, connected with a lower profitability threshold in relation to other significantly larger manufacturers. A flat organizational structure is an additional advantage – this brings flexibility and the ability to act quickly. The Group's products are included in all price ranges. Games created for Xbox360®, NINTENDO Wii™, Nintendo DS™, Sony PlayStation®3 and PC have high commercial potential and are competitive in relation to others present in the market. The City Interactive Group has taken significant steps to supplement its product portfolio with games from new segments – online games and games for smartphones.

### 9.3. Risk of change in trends

The City Interactive Group operates in the fields of new technology and virtual entertainment, where a product's life cycle is relatively short. What cannot be counted out is the risk of new solutions appearing, meaning that the products offered by the Group 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 product range which is proven and enjoys recognition amongst consumers. A trend-setting strategy would be a lot more expensive and risky.

The City Interactive Group's principal activities in this field are based on constant market monitoring 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.

### 9.4. 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 City Interactive Group's operations. This concerns the regulations and interpretation of regulations connected with intellectual property, 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 regulations applicable in a country where the Group sells its products, which could turn out to be disadvantageous from the viewpoint of the Group's operations.

The City Interactive Group takes actions aimed at eliminating this risk through cooperation with specialist law firms around the world and through product liability insurance covering the entire product portfolio.

### 9.5. Currency risk

In the first half of 2011 95% of the Group's revenues were generated in three currencies: EUR, USD and GBP.

The Parent hedges against currency risk through incurring liabilities in these currencies. The currency with the highest level of exposure is EUR, with USD and GBP following.

Cash surpluses in specific currencies are hedged through FX forward contracts entered into by the Parent, City Interactive S.A.

	outstanding FX contracts	initial forward position in PLN	fair value as at June 30, 2011 in PLN	exchange rate as at June 30, 2011	valuation as at June 30, 2011 in PLN	contract settlement date	contract entry date
EUR	1 000 000.00	3 942 100.00	3 986 600.00	3.9866	-44 500.00	July 29, 2011	Jan 1, 2011
GBP	250 000.00	1 147 950.00	1 102 550.00	4.4102	45 400.00	July 29, 2011	Jan 1, 2011
GBP	350 000.00	1 619 625.00	1 543 570.00	4.4102	76 055.00	Aug 5, 2011	Feb 3, 2011
GBP	100 000.00	462 750.00	441 020.00	4.4102	21 730.00	Aug 5, 2011	Feb 3, 2011

EUR	500 000.00	1 998 500.00	1 993 300.00	3.9866	5 200.00	Sept 9, 2011	March 8, 2011
EUR	500 000.00	1 992 000.00	1 993 300.00	3.9866	-1 300.00	Nov 30, 2011	May 30, 2011
total valuation:					<b>102 585.00</b>		

## 9.6. Risk of losing key employees

The success of the Group's business is to a large extent dependent on the knowledge and experience of its employees. This is a characteristic feature of gaming manufacturers in a business where the key elements are intellectual assets.

In this market it is difficult to seek out qualified industry specialists. The recruitment of new employees is furthermore combined with the period of their introduction to work, resulting in a temporary period of decreased work efficiency.

The Group 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,
- a working environment which encourages communication and sharing of experience,
- management training for key employees,
- an incentive scheme for executives which is conditional on the financial results achieved.

## 9.7. 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. There is a risk of the termination of distribution agreements or the bankruptcy of entities assisting in distribution, which are formal purchasers of goods and for which the Group is a creditor.

In order to minimize the possibility of incurring losses, the Parent has subsidiaries in the most operationally significant markets such as the United States, the United Kingdom and Germany, whose task is to constantly expand distribution opportunities and to work closely with distributors.

During the first half of 2011, the City Interactive Group's sales were made:

- to the largest customer at a level of 25% of total sales,
- to the 5 largest customers at a level of 68% of total sales.

## 9.8. Risk connected with suppliers

One of the risk categories connected with suppliers is the release of titles on specific consoles and cooperation with their owners during the certification process. Non-acquisition of certification and the potential for termination of release agreements for consoles are two main elements of risk which exist in reality and may have an impact on the Group's financial results. It should however be emphasized that the Group makes specific efforts to meticulously fulfill and perform all obligations under agreements entered into between such entities and the Issuer or its subsidiaries. Payments connected with the release of games for consoles formed the main part of the Group's commercial liabilities during the reporting period and are always paid on time.

## 9.9. Risk connected with the implementation of development plans

The Parent, City Interactive S.A., has an excess of cash from operating activities, which is used to finance the Group's game releases. The Parent, City Interactive S.A., has the

capability to seek bank and financial sector financing in the event of this becoming necessary to finance additional projects.

Risk connected with opening new production studios in Poland and abroad

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

The video gaming market is driven by expectations connected with the release 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 and the financial result in specific periods.

Internal factors which can cause the delay of a release include difficulties in specifying the time needed to finish production and inspect the quality of a game in order for it to fulfill all expectations relating to quality. The release of a game which does not fulfill the high standards adopted by the Group could have a negative impact not just on the anticipated revenues from sale of this specific product but could also weaken the Company's image.

An external factor capable of resulting in the decision to postpone a release is the market situation, since an important element of the decision-making process is release of a game when competition from other products is at its lowest. Amongst other external factors a significant element is supplier delays in timely preparation of ordered game components.

In many instances rescheduling of a release is connected with an element of marketing known as the "long-awaited game", which is beneficial in creating a product image.

The majority of the Group's products are finished on time and as planned, although the risk of delays cannot be ruled out.

An additional aspect is the risk of companies or external persons threatening Group companies with legal action concerning copyrights to games, their elements, trademarks or reserved names for specific products. Operations in the United States are particularly exposed to this risk since this jurisdiction is characterized by strict legislation. In order to avoid losses here, the Group hires law firms specializing in intellectual property law and registers the trademarks of its products. In submitting such an application to protect trademarks in the European Union and in other countries around the world, availability in specific markets is verified and the risk of violating third party trademarks is estimated.

#### **9.11. Liquidity risk**

The City Interactive Group currently has a financial surplus and receivables completely cover its payables, which eliminates liquidity risk.

Protection against the risk of purchaser insolvency is ensured through analysis of their financial condition and through constantly monitoring the payment of receivables.

### **10. Information concerning the issue, buyback and repayment of equity and debt securities**

In Q3 2009 the Parent issued bonds in the total amount of PLN 5 million. Bond par value 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 totaling 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 the newly issued series B so that the aggregate level of obligations contracted by the Issuer remained unchanged.

The issued bonds are bearer securities in a certificated form. The issue included 100 (hundred) series B bonds with a total par value of PLN 5 000 000 (five million Polish zloty). The issue price of one series B bond was PLN 50 000 (fifty thousand Polish zloty).

Redemption of series B bonds was scheduled for March 16, 2011. Series B bonds carry 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 3M WIBOR, 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 equaled 3M WIBOR, as published on December 14, 2010, plus a 6.5% margin. Interest was accrued on the basis of 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 the above, PLN 128 647 has been repaid as of December 16, 2010, while interest paid as at March 16, 2011 amounted to PLN 128 342.

A complete, timely buyback 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 5 000 000 (five million Polish zloty). The total buyback 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).

#### **11. Information concerning paid (or declared) dividends, together with calculation per share with division into ordinary and preference shares**

During the reporting period the Group did not pay out dividends, nor did it declare their payment.

#### **12. Additional information on change in contingent liabilities or assets which have occurred since the end of the last financial year**

As at June 30, 2011 the parent had no contingent liabilities except promissory notes issued by City Interactive S.A. for the following lessors: Raiffeisen Leasing Polska, Volkswagen Leasing Polska and SEB Leasing Polska in order to secure payments under concluded leasing agreements.

#### **13. Indication of events which occurred after the date as of which the interim financial statements were drawn up such as were not recognized in the statements and which may have a significant impact on the future financial results of the Issuer's Group**

The most significant event taking place after the end of the reporting period was the release of "Sniper: Ghost Warrior" on Sony PlayStation®3 in Japan, which took place on July 21, 2011. In the opinion of the Management Board, pursuant to currently available sales data this game was a success in the Japanese market, which will lead to an increase in revenues and profits achieved in this country.

#### **14. Management's position concerning the possibility to meet previously published earnings forecasts for a given financial year in light of results presented in the interim report in relation to forecast results**

In relation to the results presented in this interim report, the Issuer's Management has not published any estimates or forecasts concerning the City Interactive Group's consolidated revenues and results.

**15. Indication of shareholders directly or indirectly through subsidiaries holding at least 5% of total votes at the Parent's General Meeting as at the date of publishing the interim report, with indication of the number of shares held by such entities, their percentage in share capital, the number of votes carried and their percentage share in the total number of votes at the Shareholder Meeting, together with indication of changes in the ownership structure of significant blocks of the Issuer's shares during the period after publication of the previous quarterly report**

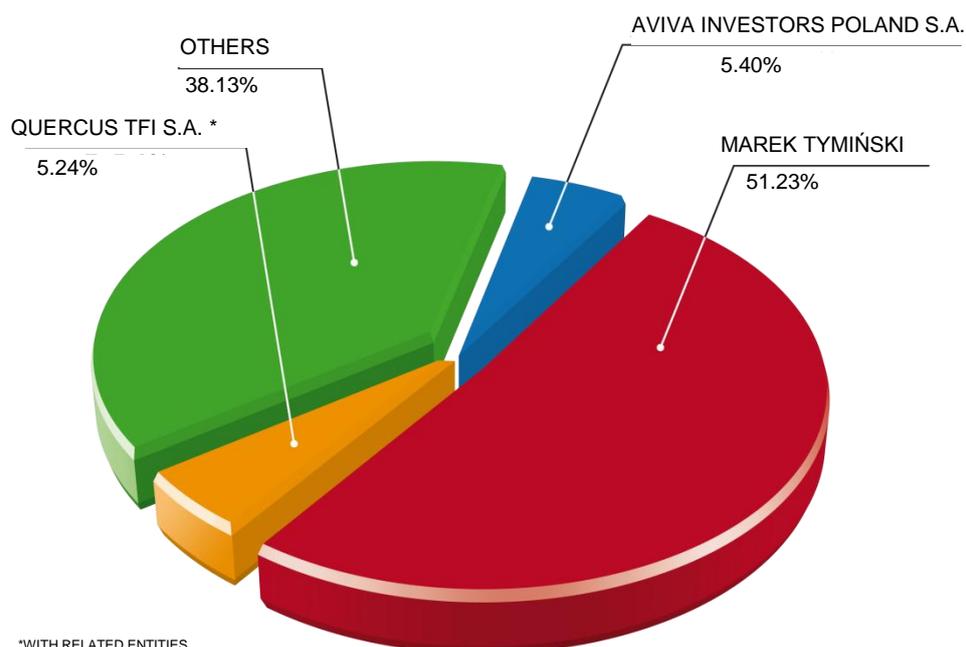
The Company's share capital amounts to PLN 1 265 000 (one million, two hundred and sixty-five thousand Polish zloty) and is divided into 12 650 000 shares of a nominal value of PLN 0.10 each. The total number of votes at the Issuer's general meeting of shareholders is 12 650 000.

**City Interactive S.A. shareholding as at August 23, 2011 (publication date of this interim report):**

SHAREHOLDER	NUMBER OF SHARES	% IN SHARE CAPITAL	NUMBER OF VOTES AT THE GENERAL MEETING	% SHARE IN VOTES AT THE GENERAL MEETING
Marek Tymiński	6 480 794	51.23	6 480 794	51.23
Aviva Investors Poland S.A.	683 104	5.40	683 104	5.40
Quercus TFI S.A.*	663 100	5.24	663 100	5.24
Other	4 823 002	38.13	4 823 002	38.13

\* with related parties

## CITY INTERACTIVE S.A. SHAREHOLDERS



\*WITH RELATED ENTITIES

During the period from publication of the Issuer's preceding quarterly report (i.e. the period from May 16, 2011), the following changes took place in the ownership structure of significant shareholdings:

- On July 6, 2011 the Parent received a notification from Quercus Towarzystwo Funduszy Inwestycyjnych S.A., acting on behalf of QUERCUS Parasolowy SFIO, QUERCUS Absolute Return FIZ and QUERCUS Absolutnego Zwrotu FIZ, (the "Funds") concerning an increase by the Funds of their joint share in the total number of votes in City Interactive S.A. and exceeding of the 5% threshold of total votes in City Interactive S.A. The Funds exceeded the 5% threshold of total votes in the Company as a result of a regulated market transaction on July 1, 2011. As at July 5, 2011 the Funds held 663 100 shares in the Issuer, which constituted 5.24% of the Issuer's share capital and 5.24% of total votes at the General Meeting of Shareholders.
- On August 16, 2011 the Company received a notification from Aviva Investors Poland S.A., acting: a) as an entity to which Aviva Investors Poland Towarzystwo Funduszy Inwestycyjnych S.A. had commissioned management of fund investment portfolios; b) for and on behalf of Aviva Investors Funduszu Inwestycyjnego Otwartego (the "Fund"), concerning an increase by the Fund of its share in the total number of votes in City Interactive S.A. and exceeding of the 5% threshold of total votes in City Interactive S.A. The Funds exceeded the 5% threshold of total votes in the Company as a result of a purchase transaction on August 4, 2011 (cleared on August 10, 2011). As a consequence of the above event, the Fund held 683 104 shares in the Issuer, which constitutes 5.40% of the Issuer's share capital and 5.40% of total votes at the General Meeting of Shareholders.

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

The Issuer's Management has no information concerning any proceedings in progress against it or its subsidiaries, the value of which (separately or in total) constitutes a minimum 10% of the Issuer's equity.

**17. Information on conclusion by the Issuer or its subsidiary of one or more transactions with related entities, if these are individually or jointly significant and have been executed on conditions other than market conditions, with indication of their values**

During the reporting period the parent and subsidiaries did not execute transactions which were atypical, exceeded the normal course of business with related entities or which were significant either individually or jointly.

**18. Information on grant by the Issuer or its subsidiary of sureties for credit or loans or grant of guarantees – to an entity or subsidiary of such entity if the total value of existing sureties or guarantees constitutes the equivalent of at least 10% of the Company's equity**

During the period from January 1 to June 30, 2011, neither the Issuer nor any of its subsidiaries issued loan sureties or guarantees, the value of which could constitute at least 10% of the Issuer's equity.

**19. Other information which the Company's Management believes is essential for assessment of its HR, property or financial situation, financial result and related changes, as well as information essential for assessing the ability of the Issuer's Group to satisfy its liabilities**

In the opinion of the Management of City Interactive S.A., no information other than that included in this report will appear which could be significant for assessing the Issuer's HR, property and financial situation (including financial result) or related changes and for assessing the Issuer's ability to satisfy its obligations.

**20. Indication of factors which, in the opinion of the Issuer's Management, may have an impact on achievement by the Company of financial results in the perspective of at least the subsequent half year**

- **Releases of new versions and sequels of games under the "Sniper Ghost Warrior" brand**

The spectacular market success of "Sniper Ghost Warrior" has enabled the development of a global brand, meaning that the City Interactive Group is in a position to maximize its revenues in 2011 and beyond. At the same time City Interactive S.A. became Poland's first truly global game developer and publisher.

April 28, 2011 saw the release of a new, improved version of "Sniper: Ghost Warrior" for PlayStation®3, the sales success of which is one of the most significant factors impacting the Company's financial results in Q2 2011. This is confirmation of the strong and established position of the "Sniper Ghost Warrior" brand in the market.

The City Interactive Group maximizes revenues from the sale of previously released games in expanded versions and at lower retail prices, as was seen in the case of "Sniper: Ghost Warrior Gold Edition" and "Sniper: Ghost Warrior Classics".



From halfway through 2010 intensive work has been in progress on the production of "Sniper: Ghost Warrior 2". The game is based on advanced CryENGINE® 3 technology and its revenues will constitute a significant element of 2012 financial results. The release of "Sniper: Ghost Warrior 2" is planned for Q1 2012.

- **"WWII" (working title) – an FPS genre game set during the Second World War**

The second flagship project after "Sniper: Ghost Warrior 2" with the greatest commercial potential – currently in the production phase – is a video game with the working title "WWII".

"WWII" is a game with a well-developed plot based in the realities of the Second World War, which is being produced in two of the Issuer's studios: in Rzeszow, Poland, and Guildford in the UK. The "WWII" project is a classic of the genre, created on the most popular topic, however with a modern approach, using one of the most modern and highly advanced technologies for the creation of first person shooter games – the CryENGINE®3.

The release of "WWII" on Xbox360®, Sony PlayStation®3 and PC is planned for Q2 2012.

- **Release of "Combat Wings: The Greatest Battles of World War II" and "Alien Fear"**

In Q4 2011 the City Interactive Group is planning to release another product with high commercial potential – "Combat Wings: The Greatest Battles of World War II", which will be launched simultaneously on NINTENDO Wii™, Xbox360®, Sony PlayStation® 3 and PC. "Combat Wings: The Greatest Battles of World War II" presents spectacular dogfights from major air battles of the Second World War era. It features the largest number of air missions on the fronts of the Second World War of all WW2 aircraft games ever published.

The release of "Alien Fear" – an FPS game produced on the basis of the newest version of Unreal® Engine 3 (game engine) technology – is set for Q1 2012. The game is intended mainly for online distribution on Xbox360®, Sony PlayStation®3 and PC.

- **Expansion of the product portfolio in accordance with the latest market trends**

The Issuer's Management plans to expand operations in current video gaming market segments, both in the Company's current product categories and those new to it, as well as to expand its product portfolio with games from new segments, including games for mobile platforms and online games.

In the opinion of the Issuer's Management Board, this strategy will allow the City Interactive Group to strengthen its position in global markets and diversify revenues. In the view of the Management Board, the City Interactive Group has the technical competences and opportunities to create and release high quality games for next generation consoles, PCs and mobile platforms (including smartphones).

These have strong commercial potential and will be competitive in relation to products already present in the market. The Parent's Management Board assumes that the majority of these will achieve market success, which will contribute to a significant increase in financial results in the coming years and will underline the Group's industry position in global markets.

## RELEASE PLAN

### Second half of 2011:

- **Sniper: Ghost Warrior Gold Edition – Xbox360® – Q3 2011**
- **Sniper: Ghost Warrior Gold Edition – PC – Q3 2011**



- **Sniper: Ghost Warrior Classics – Xbox360® – Q3 2011**
- **Combat Wings: The Great Battles of WW II – Sony PlayStation® 3 – Q4 2011**
- **Combat Wings: The Great Battles of WW II – Xbox360® – Q4 2011**
- **Combat Wings: The Great Battles of WW II – NINTENDO Wii™ – Q4 2011**
- **Combat Wings: The Great Battles of WW II – PC – Q4 2011**

**First half of 2012:**

- **Sniper: Ghost Warrior 2 – Sony PlayStation® 3 – Q1 2012**
- **Sniper: Ghost Warrior 2 – Xbox360® – Q1 2012**
- **Sniper: Ghost Warrior 2 – PC – Q1 2012**
- **Alien Fear – Sony PlayStation® 3 – Q1 2012**
- **Alien Fear – Xbox360® – Q1 2012**
- **Alien Fear – PC– Q1 2012**
- **WW II – Sony PlayStation® 3 – Q2 2012**
- **WW II – Xbox360® – Q2 2012**
- **WW II – PC – Q2 2012**

**21. Information concerning agreements with an entity authorized to audit financial statements**

- a) Entity name: CSWP Audyt Spółka z o.o.
- b) Date of entering into the agreement on audit of the separate and consolidated financial statements for 2011 – June 30, 2011. The agreement concerns audit of the financial statements of the Parent and the Group for 2011 (interim review and annual audit).
- c) Total remuneration due for review and audit of the Group's financial statements in 2011 – PLN 40 000 net.

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

**Marek Tymiński**  
President of the Management Board

**Michał Sokolski**  
Member of the Management Board

Warsaw, August 23, 2011

