Directors' Report on the Operations of the LOTOS Group in 2013

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1. INFORMATION ON THE LOTOS GROUP

Grupa LOTOS S.A. and the companies of the LOTOS Group constitute a vertically-integrated oil company whose business consists in the production and processing of crude oil as well as wholesale and retail sale of petroleum products. It is a producer and supplier of such products as unleaded petrol, diesel oil, light fuel oil, aviation fuel and heavy fuel oil. It also specialises in the production and sale of lubricating oils and bitumens.

The current business strategy for the years 2011-2015 provides for consolidation of the LOTOS Group's position as a strong, innovative and successfully developing organisation, which plays a crucial role in ensuring Poland's energy security and operates in compliance with the principles of social responsibility and sustainable growth. The key strategic objectives include:

- reaching a daily crude production volume of 24 thousand boe;
- 10% share in the national retail fuel market;
- 30% share in the wholesale fuel market.

Apart from Grupa LOTOS S.A., which operates the Gdańsk refinery, the LOTOS Group currently comprises 15 other companies operating under the LOTOS brand. The most important of them include:

- Grupa LOTOS S.A., which is a producer and supplier of a number of products, including unleaded gasoline, diesel oil, diesel oil for heating purposes (light fuel oil), aviation fuel and heavy fuel oil. The key asset of Grupa LOTOS S.A. is its Gdańsk-based refinery, whose nominal annual throughput capacity amounts to 10.5m tonnes of crude. In 2013, the refinery processed 8.7m tonnes of crude.
- LOTOS Petrobaltic S.A., which conducts oil exploration and production work on the Baltic Sea, the Norwegian Continental Shelf (through its subsidiary LOTOS Exploration and Production Norge AS) and on-shore projects in Lithuania (through AB LOTOS Geonafta and its group companies).
- LOTOS Paliwa Sp. z o.o., whose business consists in management of service stations (nationwide network of 439 stations, the 4th largest in Poland; through the network, LOTOS markets its products and services in the Premium segment, which also includes motorway service stations, and since 2011 - in the economy segment, with the rapidly expanding LOTOS Optima network), retail sales to business customers, development of the retail and wholesale networks, B2B trade, and sales through a network of self-service Diesel oil and gasoline dispensers (Diesel Service System, DSS).
- LOTOS Oil S.A., which produces and distributes lubricants: engine oils, industrial oils, greases, base oils, as well as car cosmetics and chemicals.
- LOTOS Asfalt Sp z o.o., specialising in manufacturing and sale of bitumens and bitumen road emulsions.
- LOTOS Kolej Sp z o.o., providing rail transport services, mainly to the LOTOS Group companies. The company's share in the Polish market is 8%.
- LOTOS Air BP Polska Sp. z o.o. (a 50% equity interest held by Grupa LOTOS S.A.), whose business consists in the sale of aviation fuel and provision of aircraft refuelling services at Polish airports.

Grupa LOTOS shares have been listed on the Warsaw Stock Exchange since June 2005. Since November 2009 LOTOS shares have also been a constituent of the Warsaw Stock Exchange's RESPECT Index, the first index of socially responsible companies in Central and Eastern Europe.

As at the end of 2013, the LOTOS Group employed 4,983 staff. Its revenue was PLN 28,597m. Operating profit for 2013 was PLN 146m, while net profit came in at PLN 39m. As at the end of 2013, the LOTOS Group's share in retail fuel sales in Poland was 8.5%, while its share in the domestic fuel market stood at 33.3%.

1.1. ORGANISATION AND MANAGEMENT AT THE LOTOS GROUP

1.1.1. ORGANISATIONAL STRUCTURE OF THE LOTOS GROUP AND GRUPA LOTOS S.A. BRANCHES (PLANTS)

Within the LOTOS Group, the role of Grupa LOTOS S.A. as the parent is to integrate the key management and support functions.

To perform its role, Grupa LOTOS has implemented a segmental management model. A segment is a separate area of operations managed within the Group by a designated member of the Management Board of Grupa LOTOS S.A. This model enhances management efficiency, delivering Group-wide cost and revenue synergies. Segmental management provides for consistent implementation of strategy, planning and controlling, integrated operational management and maintenance of uniform corporate standards.

Grupa LOTOS S.A. has no divisions within the meaning of the Polish Accountancy Act.

The Group's operating activity comprises two main reportable operating segments:

- **Upstream segment** – comprising activities related to the acquisition of crude oil and natural gas reserves, and crude oil and natural gas production,
- **Downstream segment** – comprising production and processing of refined petroleum products and their wholesale and retail sale, as well as auxiliary, transport and service activities.

For management purposes, the LOTOS Group is divided into business units which correspond to the business segments.

- **Management segment –** falls within the remit of President of the Management Board, i.e. head of the management segment. The segment's activities are focused on increasing the LOTOS Group's value through overall management of its operations, including coordination of efforts aimed to formulate corporate strategies, define development directions for the individual business areas and coordinate the process support function.

- **Exploration & production segment –** falls within the remit of Vice-President of the Board in charge of Oil and Gas Exploration & Production, i.e. head of the exploration & production segment. The scope of the E&P segment's activities includes formulation of development strategies for the LOTOS Group in the area of oil and gas exploration and production, as well as management and supervision of these activities. LOTOS Petrobaltic and its subsidiaries form the exploration & production segment.

- **Operational segment** – falls within the remit of Vice-President of the Board, Chief Operating Officer, i.e. head of the operational segment. The operational segment's tasks include formulation of strategies to maintain and expand production facilities, as well as supervision and coordination of all matters related to the processing of crude oil, refinery production and technologies. The operational segment also defines policy objectives for refinery production, supervises production-related R&D work, coordinates technical and technological development projects, and ensures the requisite technical performance of the Group's assets, safety processes and physical protection. The segment comprises the following companies: LOTOS Infrastruktura, LOTOS Lab, LOTOS Ochrona, LOTOS Serwis, and LOTOS Straż. Following changes of the business profiles of the companies, in 2013 LOTOS Czechowice was renamed as LOTOS Terminale and was transferred to the marketing segment, while LOTOS Jasło changed its name to LOTOS Infrastruktura.

- **Marketing segment** – falls within the remit of Vice-President of the Board, Chief Commercial Officer, i.e. head of the marketing segment. The marketing segment's tasks include formulation of marketing strategies as well as effective management of sales, supplies and distribution of crude oil and petroleum products. It is also responsible for the development of trading and optimisation activities. The marketing segment comprises the following subsidiaries and affiliates: LOTOS–Air BP Polska, LOTOS Asfalt, LOTOS Kolej, LOTOS Oil, LOTOS Paliwa, and LOTOS Terminale with its subsidiaries. In 2013, Grupa LOTOS sold 50% of shares in LOTOS Tank, which was then renamed as LOTOS–Air BP Polska. Also in 2013, the marketing segment was expanded to include LOTOS Terminale (formerly, in 2012, LOTOS Czechowice), which was transferred from the processing segment (see above).

- **Financial segment** – falls within the remit of Vice-President of the Board, Chief Financial Officer, i.e. head of the financial segment. The segment's tasks include monitoring of the implementation of the Group's strategies and overall management of financial and accounting processes, including formulation of financial, legal and insurance strategies and monitoring of their implementation, management of budgeting and controlling, development and implementation of financial risk management strategies and overall management of assets and restructuring processes. LOTOS Park Technologiczny and LOTOS Gaz w likwidacji (in liquidation) and its subsidiary are part of the financial segment.

The management processes at Grupa LOTOS S.A. and the Group's segments are supported by relevant bodies designated for specific areas:

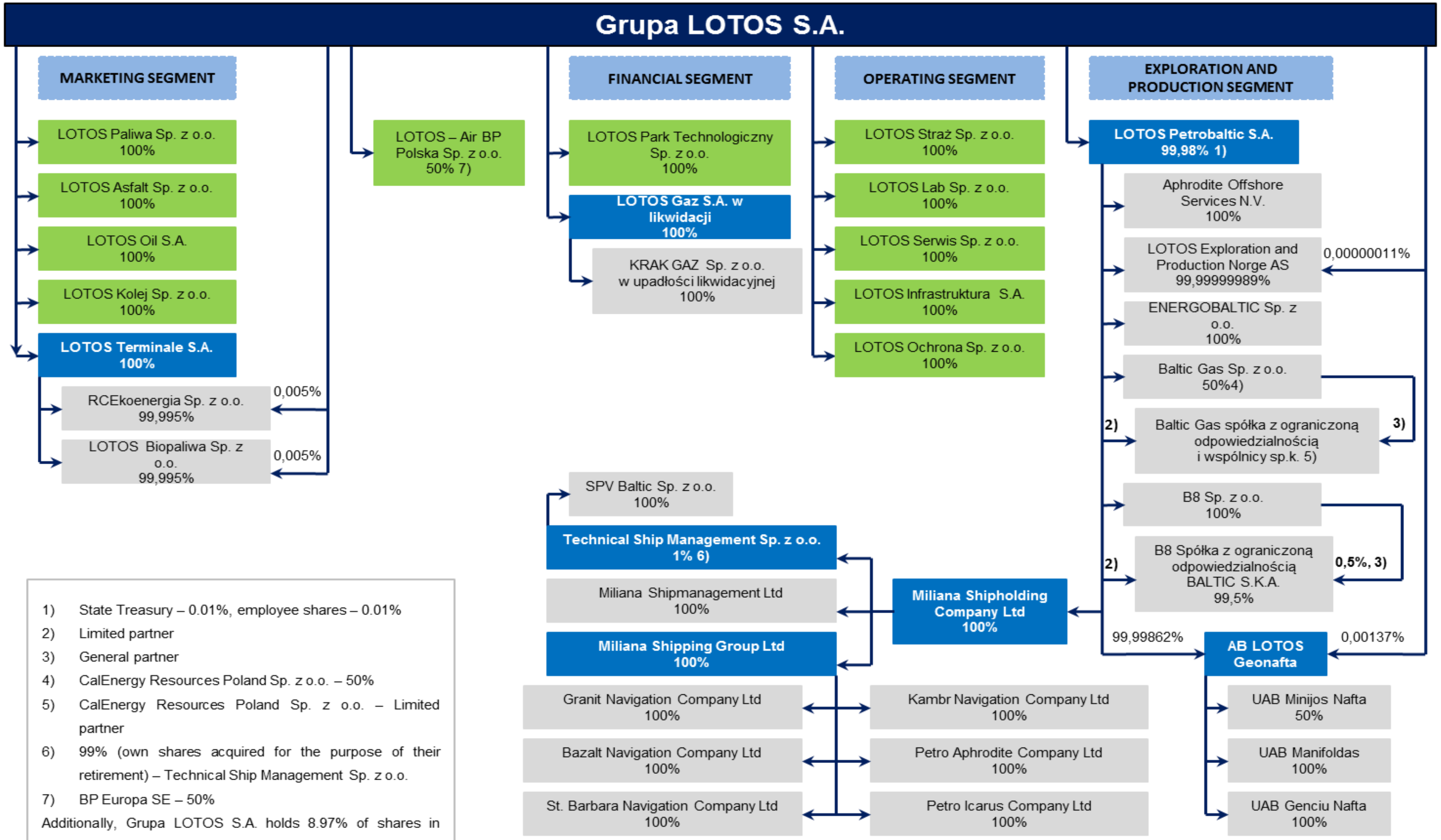
Graph 1.Bodies designated to support the management processes

In 2013, there were significant changes to the Group's organizational structure. The changes were a consequence of changes in the composition of the Management Board of Grupa of LOTOS S.A., and their objectives included:

- raising the standing, decision-making powers, responsibility and effectiveness of the segments,
- enhancing the management model,
- minimise management costs,
- improving segmental reporting,

- enhancing the communication process,
- optimising areas related to financial and accounting support, CSR and sponsorship, IT management, financial risk management and asset management.

Graph 2. Organisational structure of the LOTOS Group by segments − as at December 31st 2013



1) State Treasury – 0.01%, employee shares – 0.01%
2) Limited partner
3) General partner
4) CalEnergy Resources Poland Sp. z o.o. – 50%
5) CalEnergy Resources Poland Sp. z o.o. – Limited partner
6) 99% (own shares acquired for the purpose of their retirement) – Technical Ship Management Sp. z o.o.
7) BP Europa SE – 50%

Additionally, Grupa LOTOS S.A. holds 8.97% of shares in P.P.P.P. NAFTOPORT Sp. z o. o. (a company of the PERN Przyjaźń group of Płock)

1.1.2. OWNERSHIP CHANGES AT THE LOTOS GROUP

Changes in the Group's structure effected in 2013 are discussed below.

Table 1. Change in share capital of LOTOS Exploration and Production Norge* (NOK)

Registration date	Before	Increase	After	Comments
Jan 1 2013	779,718,441	171,000,000	**950,718,441**	issue of 171m Series B shares (par value: NOK 1 per share)
Apr 26 2013	950,718,441	53,000,000	**1,003,718,441**	issue of 53m Series B shares (par value: NOK 1 per share)
Jun 18 2013	1,003,718,441	60,000,000	**1,063,718,441**	issue of 60m Series B shares (par value: NOK 1 per share)
Aug 8 2013	1,063,718,441	20,000,000	**1,083,718,441**	issue of 20m Series B shares (par value: NOK 1 per share)

** LOTOS Petrobaltic S.A. subsidiary*
*** all new issue shares were acquired by LOTOS Petrobaltic S.A.*

Table 2. Changes in share capital of other companies (PLN)

Company	Registration date	Before	Increase/ decrease	After	Comments
LOTOS Tank	Jul 23 2013	6,945,000	6,945,000	**13,890,000**	Issue of 1,000 new shares with a par value of PLN 6,945 per share; the shares were acquired for cash by Grupa LOTOS S.A.
LOTOS Infrastruktura	Jan 7 2014	48,000,000	23 698680	**71,698,680**	Issue of 2,962,335 Series B shares with a par value of PLN 8 per share, acquired by LOTOS Terminale through private placement (issue price: PLN 8.31 per share)
RCEkoenergia	Jan 24 2014(1)	20,061,000	8,245,000	**28,306,000**	Issue of 8,245 new shares with a par value of PLN 1,000 per share; the shares were acquired for cash by Grupa LOTOS S.A.
Technical Ship Management	Jan 23 2014	500,000	(495,000)	**5,000**	Voluntary retirement of 9,900 shares with a total value of PLN 495 thousand(2)

(1)Grupa LOTOS S.A.'s preemptive right to acquire the new shares was waived. All new shares were subscribed for by the Company's existing shareholder LOTOS Terminale S.A., and were paid for in the following manner: 2,000 shares were paid for in cash (PLN 2m) and 6,245 shares were acquired for an in-kind contribution of PLN 6,245 thousand (tangible assets and land).
(2)On September 6th 2013, Technical Ship Management Sp. z o.o. (the buyer) and Miliana Shipholding Company Ltd (the seller) executed an agreement for sale of 9,900 shares with a total value of PLN 495 thousand; the shares were retired.

Table 3. Divestments in the LOTOS Group

Transaction	Date	Seller	Buyer	Comments
Sale of organised part of business, Oddział Jasło	May 10 2013	LOTOS Oil S.A.	Third-party entity	Sale of production unit located in Jasło
Sale of Waterproofing Materials business	Jul 27 2013	LOTOS Asfalt Sp z o.o.	Third-party entity	Sale of production unit manufacturing tar paper

Consolidation of logistics and infrastructure assets

In 2013, the Group continued to consolidate its logistics and infrastructure assets. On December 23rd 2013, Grupa LOTOS S.A. sold the Rypin and Piotrków Trybunalski fuel depots to LOTOS Terminale S.A. The consolidation also consisted in changing the names of LOTOS Terminale S.A. and LOTOS Infrastruktura S.A., and increasing the share capital of LOTOS Infrastruktura S.A. (new issue shares were subscribed for by LOTOS Terminale S.A.; the increase was registered after the end of the reporting period, on January 7th 2014) and RCEkoenergia Sp. z o.o. The consolidation process is to be completed in 2015.

1.1.2. CHANGES IN ORGANISATIONAL OR CAPITAL LINKS BETWEEN GRUPA LOTOS S.A. AND OTHER ENTITIES

The companies of the LOTOS Group, the applied method of consolidation and accounting for equity interests, as well as the Group's ownership interest.

Table 4. The companies of the LOTOS Group

Name	Registered office	Business profile	The Group's ownership interest	
			Dec 31 2013	Dec 31 2012
Parent				
Grupa LOTOS S.A.	Gdańsk	Production and processing of refined petroleum products (mainly fuels) and their wholesale	**Not applicable**	Not applicable
Direct fully-consolidated subsidiaries				
LOTOS Petrobaltic S.A. (parent of another group: LOTOS Petrobaltic Group)	Gdańsk	Acquisition of crude oil and natural gas deposits and hydrocarbon production	99.98%(1)	99.96%
LOTOS Paliwa Sp. z o.o.	Gdańsk	Wholesale and retail sale of fuels and light fuel oil, management of the LOTOS service station network	100.00%	100.00%
LOTOS Oil S.A.	Gdańsk	Production and sale of lubricating oils and lubricants, and sale of base oils	100.00%	100.00%
LOTOS Asfalt Sp. z o.o.	Gdańsk	Production and sale of bitumens	100.00%	100.00%
LOTOS Kolej Sp. z o.o.	Gdańsk	Railway transport	100.00%	100.00%
LOTOS Serwis Sp. z o.o.	Gdańsk	Maintenance of mechanical and electric operations and controlling devices, overhaul and repair services	100.00%	100.00%
LOTOS Lab Sp. z o.o.	Gdańsk	Laboratory analyses	100.00%	100.00%
LOTOS Straż Sp. z o.o.	Gdańsk	Fire service activities	100.00%	100.00%
LOTOS Ochrona Sp. z o.o.	Gdańsk	Security services	100.00%	100.00%
LOTOS Terminale S.A. (2) (spółka posiada swoją grupę kapitałową: GK LOTOS Terminale S.A.)LOTOS Terminale S.A. (2) (parent of another group: LOTOS Terminale Group)	Czechowice-Dziedzice	Storage and distribution of fuels	100.00%	100.00%
LOTOS Infrastruktura S.A. (3)	Jasło	Storage and distribution of fuels Renting and operating of own or leased real estate	100.00%	100.00%
LOTOS Gaz S.A. w likwidacji	Kraków	Dormant	100.00%	100.00%
LOTOS Park Technologiczny Sp. z o.o.	Jasło	Dormant	100.00%	100.00%

Name	Registered office	Business profile	The Group's ownership interest Dec 31 2013	The Group's ownership interest Dec 31 2012
Indirect fully-consolidated subsidiaries				
LOTOS Terminale Group				
RCEkoenergia Sp. z o.o.	Czechowice-Dziedzice	Production and distribution of electricity, heat and gas	**100,00%**	100,00%
LOTOS Biopaliwa Sp. z o.o.	Czechowice-Dziedzice	Production of fatty acid methyl esters (FAME)	**100,00%**	100,00%
LOTOS Petrobaltic Group				
LOTOS Exploration and Production Norge AS	Norwegia, Stavanger	Oil exploration and production on the Norwegian Continental Shelf, provision of services related to oil exploration and production	**99,98%(4)**	99,96%
Aphrodite Offshore Services N.V.	Curaçao	Sea transport services (dormant)	**99,98%(4)**	99,96%
Energobaltic Sp. z o.o.	Władysławowo	Production of electricity, heat, LPG and natural gas condensate	**99,98%(4)**	99,96%
B8 Sp. z o.o	Gdańsk	Support activities for extraction and quarrying operations (dormant)	**99,98%(4,5)**	-
B8 Spółka z ograniczoną odpowiedzialnością BALTIC S.K.A.	Gdańsk	Exploration and production of crude oil and natural gas (dormant)	**99,98%(4,5)**	-
Miliana Shipholding Company Ltd. (parent of another group: Miliana Shipholding Group)	Cypr, Nikozja	Storage and transport of crude oil, other sea transport services	**99,98%(4)**	99,96%
Technical Ship Management Sp. z o.o. (parent of another group: Technical Ship Management Group)	Gdańsk	Sea transport support activities, ship operation advisory services	**99,98%(4)**	99,96%
SPV Baltic Sp.z o.o.	Gdańsk	Provision of sea transport and related services	**99,98%(4,7)**	-
Miliana Shipmanagement Ltd.	Cypr, Nikozja	Provision of sea transport and related services	**99,98%(4)**	99,96%
Miliana Shipping Group Ltd. (parent of another group: Miliana Shipping Group Group)	Cypr, Nikozja	Management of own assets	**99,98%(4)**	99,96%
Bazalt Navigation Co. Ltd.	Cypr, Nikozja	Ship chartering	**99,98%(4)**	99,96%
Granit Navigation Company Ltd.	Cypr, Nikozja	Ship chartering	**99,98%(4)**	99,96%
Kambr Navigation Company Ltd.	Cypr, Nikozja	Ship chartering	**99,98%(4)**	99,96%
St. Barbara Navigation Company Ltd.	Cypr, Nikozja	Ship chartering	**99,98%(4)**	99,96%
Petro Icarus Company Ltd.	Cypr, Nikozja	Ship chartering	**99,98%(4)**	99,96%

Name	Registered office	Business profile	The Group's ownership interest Dec 31 2013	The Group's ownership interest Dec 31 2012
Petro Aphrodite Company Ltd.	Cypr, Nikozja	Ship chartering	**99,98%[(4)]**	99,96%
AB LOTOS Geonafta (parent of another group: AB LOTOS Geonafta Group)	Litwa, Gargždai	Crude oil exploration and production, drilling services, and purchase and sale of crude oil	**99,98%[(4)]**	99,96%
UAB Genciu Nafta	Litwa, Gargždai	Crude oil exploration and production	**99,98%[(4)]**	99,96%
UAB Manifoldas	Litwa, Gargždai	Crude oil exploration and production	**99,98%[(4)]**	99,96%
Equity-accounted entities				
LOTOS - Air BP Polska Sp. zo.o. [(8)]	Gdańsk	Sale of aviation fuel and logistics services	**50,00%[(8)]**	100,00%
GK LOTOS Petrobaltic S.A.				
Baltic Gas Sp. z o.o.	Gdańsk	Oil and gas production (support activities for oil and gas production)	**49,99%[(4,9)]**	99,96%
Baltic Gas spółka z ograniczoną odpowiedzialnością i wspólnicy sp.k.	Gdańsk	Crude oil and gas production	**81,68%[(4,10)]**	99,96%
Proportionately-consolidated entities				
AB LOTOS Geonafta Group				
UAB Minijos Nafta	Litwa, Gargždai	Crude oil exploration and production	**49,99%[(4)]**	49,98%

(1) In 2013, Grupa LOTOS S.A. continued the squeeze-out of shares in LOTOS Petrobaltic S.A. Following the acquisition of shares in LOTOS Petrobaltic S.A. as part of the squeeze-out, as at December 31st 2013 Grupa LOTOS S.A. held a 99.98% interest in the share capital of LOTOS Petrobaltic S.A.

(2) On July 30th 2013, a change of the company's name from LOTOS Czechowice S.A. to LOTOS Terminale S.A was registered.

(3) On April 18th 2013, a change of the company's name from LOTOS Jasło S.A. to LOTOS Infrastruktura S.A. was registered.

(4) The shareholding changes described in item (1) above had effect on the indirect equity interests held by the Group in the LOTOS Petrobaltic Group entities.

(5) On December 30th 2013, LOTOS Petrobaltic S.A. acquired 100% of shares in B8 Sp. z o.o. One of the objectives of the acquisition was to create a vehicle for the financing of development of the B-8 field.

(6) On December 30th 2013, LOTOS Petrobaltic S.A. acquired 99.5% of shares in B8 Spółka z ograniczoną odpowiedzialnością BALTIC spółka komandytowo-akcyjna, and became a limited partner in the company. B8 Sp. z o.o., holding 0.5% of the company shares, is a minority shareholder and the general partner in the company. One of the objectives of the acquisition was to create a vehicle for the financing of development of the B-8 field.

(7) On December 20th 2013, Technical Ship Management Sp. z o.o. acquired 100% of shares in SPV Baltic Sp. z o.o.

(8) On November 25th 2013, Grupa LOTOS S.A. sold to BP Europe SE 1,000 shares in LOTOS Tank Sp. z o.o., representing 50% of LOTOS Tank Sp. z o.o.'s share capital. The sale was connected with a joint venture agreement executed between Grupa LOTOS S.A. and BP Europa SE German Branch on June 25th 2013, providing for the establishment of a new entity on the basis of LOTOS Tank Sp. z o.o. (a Grupa LOTOS subsidiary), through which the two partners could pursue joint operations in the aviation fuel market. On December 17th 2013, a change of the company's name from LOTOS Tank Sp. z o.o. to LOTOS-Air BP Polska Sp. z o.o. was registered.

(9) The sale by LOTOS Petrobaltic S.A. of a 50% interest in Baltic Gas Sp. z o.o. to CalEnergy Resources Poland Sp. z o.o. was registered on May 17th 2013.

(10) The presented ownership interest was determined based on the value of contributions made by individual partners relative to the sum of all contributions as at December 31st 2013:

- Baltic Gas Sp. z o.o. (general partner) (0.002%),
- LOTOS Petrobaltic S.A. (limited partner) (81.693%),
- CalEnergy Resources Poland Sp. z o.o. ("CalEnergy") (limited partner) (18.305%).

The Group's indirect ownership interest in Baltic Gas spółka z ograniczoną odpowiedzialnością i wspólnicy sp. k. (a jointly-controlled entity) is 81.68%.

Baltic Gas spółka z ograniczoną odpowiedzialnością i wspólnicy spółka komandytowa ("Baltic Gas") is a partnership. The partnership agreement defines the profit and loss sharing ratio, whereby Baltic Gas Sp. z o.o. holds 0.001% share in profits and 100% share in losses, LOTOS Petrobaltic S.A. holds 50.9995% share in profits, and CalEnergy holds 48.9995% share in profits. The respective percentage shares in the total vote are not given, as any matters subject to the partners' decision, as set forth in the partnership agreement, require unanimous approval, or the partners are required to unanimously pass a resolution determining the procedure for deciding on other matters not specified in the partnership agreement. For the purposes of the IFRS, Baltic Gas is an entity jointly-controlled by the Group.

1.1.3. CHANGES IN THE KEY MANAGEMENT POLICIES OF GRUPA LOTOS S.A. AND THE LOTOS GROUP

In 2013, there were no changes in the key management policies of Grupa LOTOS S.A. and the LOTOS Group.

1.2. WORKFORCE IN THE LOTOS GROUP

1.2.1. THE LOTOS GROUP WORKFORCE STRUCTURE

Table 5. The LOTOS Group workforce structure by job role

Company	Workforce as at December 31st 2013	
	Blue-collar jobs	White-collar jobs
Grupa LOTOS S.A.	513	832
LOTOS Paliwa Sp. z o.o.	0	272
LOTOS Kolej Sp. z o.o.	591	242
LOTOS Oil S.A.	113	204
LOTOS LAB Sp. z o.o.	109	47
LOTOS Serwis Sp. z o.o.	500	184
LOTOS Straż Sp. z o.o.	75	14
LOTOS Asfalt Sp. z o.o.	86	116
LOTOS Gaz S.A.	0	1
LOTOS Ochrona Sp. z o.o.	141	21
LOTOS Park Technologiczny Sp. z o.o.	0	1
LOTOS Parafiny Sp. z o.o.	0	0
LOTOS Air BP S.A.	33	11
LOTOS Infrastruktura S.A.	41	34
LOTOS Terminale S.A.	78	53
RC Ekoenergia Sp. z o.o.	48	30
LOTOS Biopaliwa Sp. z o.o.	22	14
LOTOS Petrobaltic S.A.	242	143
ENERGOBALTIC Sp. z o.o.	3	30
LOTOS EPN	0	19
AB LOTOS Geonafta	84	24
Miliana Shipping Ltd	0	2
Technical Ship Management	0	10
	2,679	**2,304**
Total		**4,983**

Graph 3. The LOTOS Group workforce structure by key companies (as at December 31st 2013)

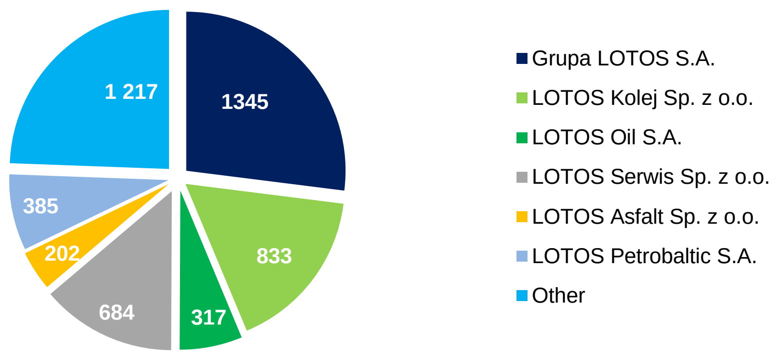


Table 6. The LOTOS Group workforce structure by sex (as at December 31st 2013)

Item	Men	Women	Total
blue-collar jobs	2,512	167	**2,679**
white-collar jobs	1,354	950	**2,304**
Total	3,866	1,117	**4,983**

Table 7. Workforce in the LOTOS Group in 2009 - 2013

Workforce	Dec 31 2009	Dec 31 2010	Dec 31 2011	Dec 31 2012	Dec 31 2013
Grupa LOTOS S.A.	1,305	1,310	1,329	1,349	**1,345**
LOTOS Group	4,949	5,010	5,168	5,015	**4,983**

1.2.2. AGREEMENTS BETWEEN THE COMPANY AND THE MANAGEMENT STAFF AND REMUNERATION, AWARDS OR BENEFITS PAID TO THE MANAGEMENT AND SUPERVISORY STAFF OF GRUPA LOTOS S.A.

Compensation agreements

Apart from standard employment contracts concluded by Grupa LOTOS S.A. with the management staff in 2013, no agreements were executed that would provide for compensation to the management staff in the event they resign or are dismissed without good reason or in the event they resign or are dismissed as a result of the Company’s takeover by another entity.

Table 8. Remuneration paid to members of the Management Board of Grupa LOTOS S.A. for 2013 (PLN '000)

Management Board members	Short-term employee benefits (salaries and wages)	Management Board – subsidiaries*	Total remuneration paid
Paweł Olechnowicz	319	1,086	**1,405**
Marek Sokołowski	358	641	**999**
Mariusz Machajewski	320	641	**961**
Maciej Szozda	323	641	**964**
Zbigniew Paszkowicz	260	553	**813**
Total	**1,580**	**3,562**	**5,142**

**Short-term employee benefits – remuneration paid to the members of the Management Board of Grupa LOTOS S.A. for serving on governing bodies of direct and indirect subsidiaries*

Table 9. Annual bonuses paid to the Management Board Members in 2013 or due for the year

Management Board members	due for 2012 (paid in 2013)**	provision for 2013 bonus
	(PLN '000)	(PLN '000)
Paweł Olechnowicz	62,2	**62,2**
Marek Sokołowski	62,2	**62,2**
Mariusz Machajewski	62,2	**62,2**
Maciej Szozda	62,2	**62,2**
Zbigniew Paszkowicz	-	**62,2**
Total	**248,8**	**311,0**

**Rounded off.*
*** amounts included in the Short-term employee benefits category in Table 8. above (salaries and wages)*

Table 10. Remuneration paid to members of the Supervisory Board of Grupa LOTOS S.A. for 2013 (PLN '000)

Supervisory Board members	Term of office	Total remuneration paid
Wiesław Skwarko	Jan 1 – Dec 31 2013	41
Małgorzata Hirszel	Jan 1 – Dec 31 2013	41
Oskar Pawłowski	Jan 1 – Dec 31 2013	41
Michał Rumiński	Jan 1 – Dec 31 2013	41
Marcin Majeranowski	Jan 1 – Dec 31 2013	41
Agnieszka Trzaskalska	Jan 1 – Dec 31 2013	41
Total		**246**

As at December 31st 2013, the Company had not granted any loans or similar benefits to members of its management and supervisory staff.

As at December 31st 2013 and as at the date of release of this Directors' Report, i.e. March 5th 2014, members of the Grupa LOTOS Supervisory Board did not serve on management or supervisory boards of Grupa LOTOS S.A.'s subsidiaries.

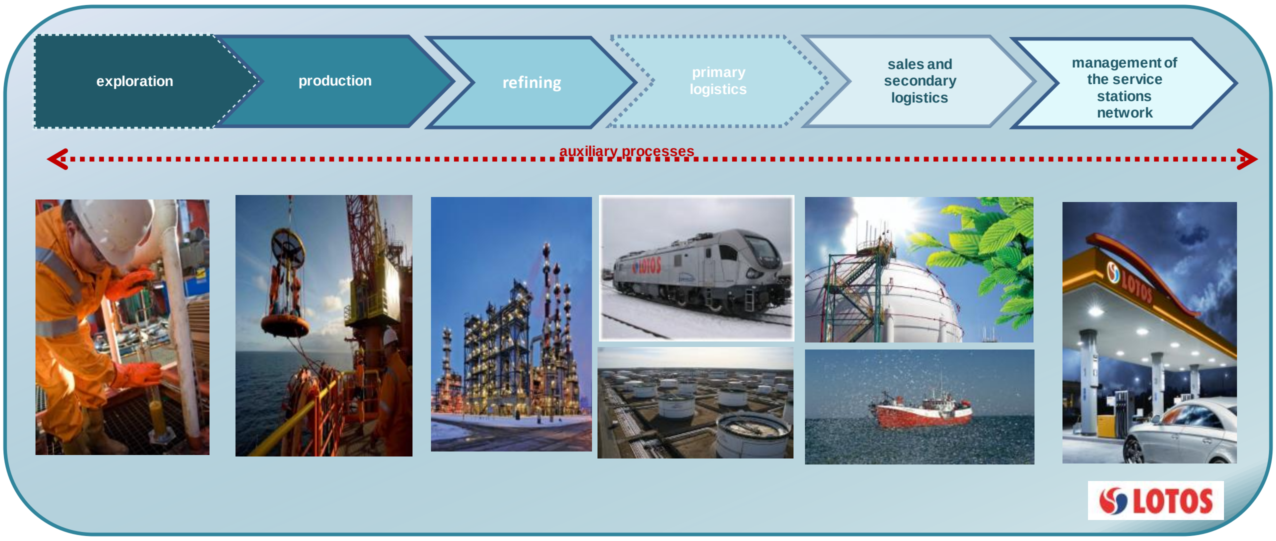
1.2.3. CONTROL SYSTEMS FOR EMPLOYEE STOCK OPTION PLANS

In 2013, the LOTOS Group did not operate any control system for employee stock option plans.

2. LOTOS GROUP'S STRATEGY AND ENVIRONMENT

2.1. LOTOS GROUP'S STRATEGY FOR 2011–2015 AND DEVELOPMENT PROSPECTS

Graph 4. The LOTOS Group value chain



LOTOS Group's operational priorities are set forth in the Group Strategy for 2011–2015 and development directions until 2020. The Group's efforts are focused on the dynamic growth of the hydrocarbons exploration and production segment, and improvement of trading efficiency, with optimisation of the refining and logistics processes.

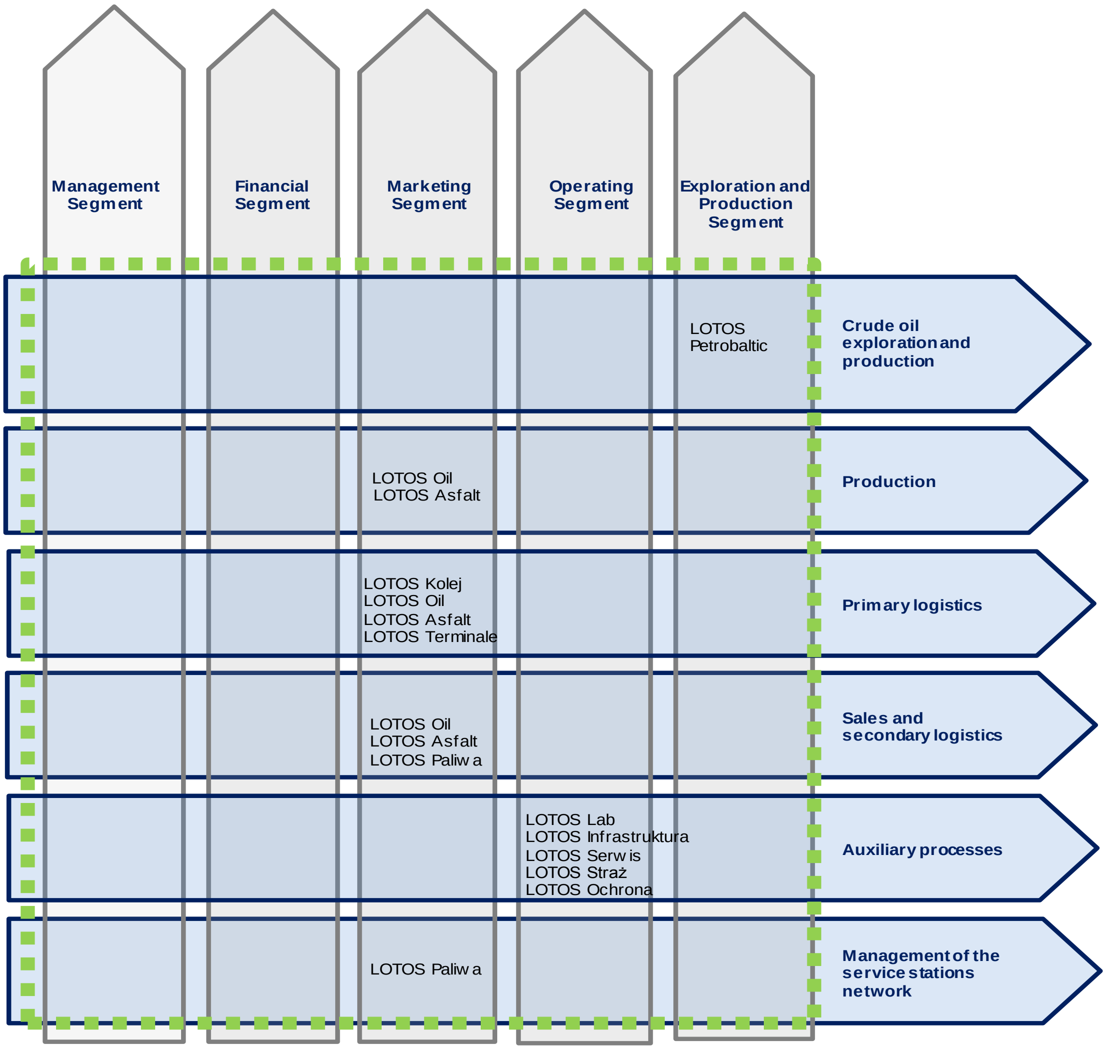
Work on implementation of the strategic objectives has significantly progressed following successful completion of the 10+ Programme in 2010, which has increased the Gdańsk refinery's annual throughput capacity to over 10m tonnes of crude.

LOTOS Group's key strategic objective

Building value for shareholders through optimised use of available intellectual and material resources and the implementation of growth programmes in the following areas: exploration and production, crude processing, and marketing, with due regard to sustainable development, which the Group defines as consistent on-going reduction of its environmental footprint, and appreciation of its employees' intellectual potential and expertise.

Grupa LOTOS S.A., as the parent, operates in five management segments, in which it delegates responsibility for the individual processes to subsidiaries, in accordance with the matrix diagram presented below.

Graph 5. LOTOS Group's key processes (including management segments)



LOTOS Group's development directions for 2016−2020

Key areas of focus and development until 2020:

- to have access to proved recoverable reserves of hydrocarbons of approximately 330m boe in 2020,
- to increase output to approximately 110 thousand boe/day (equivalent of 5m tonnes of crude a year),
- to maintain a 30% share in the domestic wholesale fuel market,
- to maintain fuel sales 15% above the refinery's fuel production capacity,
- to maintain a 10% share in the domestic retail market,

UPSTREAM OPERATIONS

In 2013, the exploration and production segment consistently pursued the development directions outlined in the LOTOS Group Strategy for 2011-2015, to take advantage of high margins projected for the oil sector in the long term, in accordance with the objectives of the Group's strategy.

Strategic objectives:

- to achieve in 2015 production volume of 24,000 boe/d (barrel of oil equivalent/day) – equivalent to 1.2m tonnes a year;
- to increase production of hydrocarbons in line with the priorities of Poland’s energy policy until 2030.

The following projects were carried out in 2013 to increase the production capacity and develop the asset portfolio:

- Intensive work on commencing commercial production from the **B8 field** on the Baltic Sea.

  Production launch planned for 2015
- Work on development of the **B4 and B6 gas fields in partnership with CalEnergy Resources Poland,** including selection of the field development concept based on seismic data analysis.

  Production launch planned for 2016/2017
- Crude oil production from the **B3 field**, using the Baltic Beta rig, was continued; in October 2013 the PG-1 unmanned drilling rig was placed in operation after overhaul. This project was justified by a 15% increase in actual production potential of the field versus the original projections.

  Production start: 1993

  The average annual production target to be achieved over the next five years is 150-160 thousand tonnes.
- The asset portfolio on the Norwegian Continental Shelf was expanded following the Heimdal acquisition.

  Heimdal acquisition date: December 30th 2013

  Current average annual production: approximately 240 thousand toe (tonnes of oil equivalent) (approximately 5 thousand boe/d)
- Yme project – as part of the efforts to recover the capital invested in the Yme project, an agreement on removal of the defective rig from the field was reached.
- On-shore licences in Poland – LOTOS Petrobaltic and PGNiG executed an agreement on joint operations on the Kamień Pomorski on-shore licence.

Plans and prospects

The Group's activities and plans for the coming years are focused on further development of its E&P assets on the Baltic Sea, the Norwegian Continental Shelf, as well as onshore areas in Poland and Lithuania.

- **Poland:**
  - Increase production from the existing fields,
  - Fully appraise hydrocarbon potential of the Baltic Sea assets,

  - Expand onshore activities in cooperation with partners, including PGNiG.
- **Norway:**
  - Explore, develop and produce from the existing offshore licence areas,
  - Acquire new producing fields.
- **Lithuania:**
  - Develop the existing onshore licence areas.

Key projects

- Continue production from the B3 oil field on the Baltic Sea, from the Baltic Beta and PG1 rigs,
- Develop and bring on-stream the B8 oil field on the Baltic Sea,
- Expand activities within onshore oil and gas licence areas in Poland in cooperation with partners, including PGNiG,
- Develop the B4 and B6 gas fields in partnership with CalEnergy Resources Poland,
- Steps to recover funds invested in the YME project on the Norwegian Continental Shelf,
- Acquire more production assets on the Norwegian Continental Shelf,
- Increase production from the existing producing assets in Lithuania, e.g. by employing enhanced oil recovery (EOR) techniques.

Capital expenditure in the exploration & production segment in 2011-2015

Total capital expenditure allocated for 2011−2015 to deliver the Strategy in the segment is PLN 3.9bn, which represents almost 70% of the LOTOS Group's total capex budget for the period.

Key areas of focus in the upstream business beyond 2015

The Group's key focus until 2020 will be to increase the production potential to approximately 100 thousand boe *(barrel of oil equivalent)* per day, i.e. the equivalent of 5 million tonnes of oil per year, and to secure approximately 330 million boe of proved recoverable reserves.

By 2016-2020, the development focus will be on the Polish market. The Group intends to fully appraise the Baltic Sea's hydrocarbon potential, while stepping up its onshore activities, and particularly to:

- Continue oil production from the B3 and B8 fields on the Baltic Sea,
- Launch gas production from the B4/B6 fields on the Baltic Sea,
- Complete the seismic survey programme, and drill exploration and appraisal wells on the Baltic Sea's most prospective plays,
- Prepare and carry out projects to develop the Baltic Sea formations with confirmed resources,
- Expand onshore activities based on partnership agreements, e.g. with PGNiG,
- Assess economic viability of potential involvement in unconventional projects.

Key areas of focus of international expansion plans for 2016−2020 are to:

- Carry out projects to develop formations with confirmed resources,
- Acquire production assets and undeveloped assets with confirmed resources which can be brought on-stream by 2020,

- Continue and increase production in Lithuania, e.g. by employing enhanced oil recovery (EOR) techniques and developing new prospects with confirmed resources,
- Explore development opportunities in new geographies.

OPERATIONAL ACTIVITY

In its processing business, in 2014 the LOTOS Group will continue process optimisation, with launch of the coking project at the Gdańsk refining complex being one of the key elements of the process.

Strategic objectives:

- to achieve world-class standards of production and maintain strong competitive position among European refineries;
- to make optimum use of assets held and acquired as part of the growth strategy;
- to ensure safe and stable operation of the production and ancillary facilities, with the target of 98% minimum annual availability;
- to further increase the conversion ratio and intensify feedstock processing.

The year 2013 proved to be a difficult time for the European refining industry. The economic deceleration adversely affected demand for products, which in turn pushed down the refining margins. So it was all the more important that the production potential of the Grupa LOTOS refinery be put to best possible use. It is difficult to predict if and when the refining margins will start to increase, but the expected shutdowns of refineries in Europe may become a contributing factor. For example, according to the IEA, the current utilisation of refining capacities in Italy and the United Kingdom stands at 68% and 69%, respectively.

In the refining business, the key challenge was to adjust the output mix to market expectations, while keeping operating expenses in check. An important factor was to use natural gas as an energy carrier and feedstock for hydrogen production to the largest extent possible. During the entire 2013, natural gas was the cheapest available fuel.

The Company also took steps to further optimise operations of its key refining units. A major success was the increase in the conversion ratio at the MHC, one of the hydrocracking units, built as part of the 10+ Programme. The 90% conversion ratio achieved in August 2013 was a further improvement on the 85% ratio seen in 2012, and marked an enormous progress versus the originally designed nameplate ratio of 60%.

To ensure long-term problem-free operation of the refining units, in spring 2013, a maintenance shutdown took place in the Gdańsk refinery, the first of its type since the refining operations were reconfigured as part of the 10+ Programme. Despite the scope of the maintenance being significantly more extensive than in the past, the refinery benefited from operating two independent crude distillation lines. Thus the period of discontinued feedstock processing was shorter than during past maintenance shutdowns. The shutdown included repairs, inspections and replacements of worn-out parts, so that the refinery might reliably operate for the next four years.

An important aspect of the refinery's operating efficiency is its **energy efficiency**. The Gdańsk complex has for a long time ranked among the most energy efficient European refineries. Nevertheless, each further improvement of energy efficiency notably reduces operating expenses. In 2013, three process furnaces were replaced. Old, worn-out, low-efficiency furnaces were replaced with state-of-the-art units fitted with heat recovery systems, which helped further increase the energy efficiency.

Plans and prospects

Refinery

In order to fully leverage the benefits offered by the successful completion of the 10+ Programme, the LOTOS Group plans to build **a delayed coker unit (DCU)** at the Gdańsk refinery, which will directly enhance processing efficiency by phasing out production of unprofitable heavy fuel oil. The annual output of high-margin motor fuels will grow to 900 thousand tonnes, while the output of coking coal, which will be a new product, will reach approximately 350 thousand tonnes. The DCU is planned to be brought on-stream in 2017. The Company estimates that **the launch of the DCU unit will add over USD 2 per barrel to its refining margin**, attributable to improved yield structure and synergies between the DCU unit and the modernised and extended refinery.

Grupa LOTOS also intends to add a **Hydrogen Recovery Unit** (HRU) to the refinery's setup. This will enable the Company to increase its hydrogen output (key feedstock in the production processes) and further expand the refining margin.

The Company's plans also include construction of an ATS unit (to produce ammonium thiosulfate, which is an important component of sulfur-containing nitrogen fertilisers). Sulfur not only improves nitrogen efficiency in fertilisers, but also adds to the quality and taste of cultivated crops. The ATS unit will output process steam, to be used at the refinery, and approximately 100,000 tonnes annually of a 60% ammonium thiosulfate water solution, to be sold to Grupa Azoty. The new unit will enable Grupa LOTOS to reduce construction costs of the delayed coking unit (DCU), and to replace fuel gas with natural gas, all of which will yield desirable economic and environmental results.

To fully **optimise the assets of its Gdańsk refinery**, Grupa LOTOS S.A. has developed a plan to outsource the handling of supply and collection of non-core products and utilities (such as heat and electricity).

Petrochemicals

Throughout 2013, the work was continued on a new development project, begun in 2012 and involving process diversification with a view to possible development of petrochemical operations. Grupa LOTOS has access to feedstock which may be used for petrochemical production (naphtha and LPG). In 2012, Grupa Azoty S.A. and Grupa LOTOS S.A. agreed to jointly carry out a preliminary feasibility study into construction of a petrochemical production complex. Based on the study results construction of a steam **cracker unit** was proposed as a recommended course of action.

The Management Boards of Grupa Azoty and Grupa LOTOS approved further implementation of the project and on December 3rd 2013 executed an agreement outlining the key terms of their cooperation and financing of further works. A full feasibility study will mark the next stage in development of the petrochemical project. If results of the study are positive, design work on the recommended option can begin. Grupa Azoty will be the main customer for the new units' products.

Capital expenditure in the processing business in 2011-2015

Total capital expenditure allocated for 2011−2015 to deliver the Strategy in the processing business is PLN 0.8bn, which represents 14% of the LOTOS Group's total capex budget for the period.

MARKETING OPERATIONS

The LOTOS Group's focus area in its marketing business is to further develop the retail chain and marketing structures, based on the extended distribution network, and to ensure efficient product logistics.

Strategic objectives:

- to maintain a 30% share in the domestic fuel market,
- to achieve fuel sales 15% above the refinery's fuel production capacity;
- to secure a 10% share in the domestic retail market (in terms of fuel volumes sold) by the end of the period covered by the strategy;
- to develop a network of service stations and intensify the existing network's sales;
- to maintain the leading position on the Polish market for lubricating oils.

The LOTOS brand's share in the domestic wholesale fuel market (diesel oil, gasoline, light fuel oil) expanded to 33.4% as at the end of 2013, thus exceeding the strategic target.

The Group's share in the retail market (diesel oil, gasoline) grew to 8.5%. This strategic objective will be pursued based on further consistent roll-out of the stations network in the premium segment (including motorway stations) and dynamic development of the budget LOTOS Optima franchise.

Plans and prospects

Prospects for the Group's processing and marketing business will depend on market expectations and will be oriented towards more efficient use of the economic potential of the modernised and extended LOTOS refinery in Gdańsk.

Fuels

In the area of fuels, the Group plans to carry on its programme of sustainable development of the service station network in two segments (economy and premium), while further enhancing sales through the existing network.

Engine and industrial oils

In the lubricants segment, the Group wants to maintain its lead in the Polish market, while intensifying its export activity. In engine oils, the Group – in line with market expectations – plans to further expand its foothold in the segment of semi-synthetic and synthetic oils. In industrial oils, it is expected that the Group's competitive advantage offered by its customisable Oil Service will drive robust growth both domestically and on foreign markets.

Bitumens

In the area of bitumens, the Group plans to expand sales on the domestic and export markets to maximise performance. In this segment, the focus is on deployment of new technologies, e.g. on intensive development of modified bitumens.

Logistics

The LOTOS Group's logistics will be developed by optimising the supply chain to maximise integrated margin. Plans for the coming years include further development and integration of storage into a single business entity – LOTOS Terminale. In 2014, a new logistics centre in Poznań will become operational. The Group also intends to look for a strategic partner for LOTOS Kolej.

Trading

Activities in the trading area will focus on optimising crude slates, which will mainly involve increasing the share of crude supplied by sea. Work will continue on improving and further integrating the key functions and competences necessary for integrated margin management. As the Gdańsk refinery's process system for petroleum product exports stabilised, no major movements are expected in the sales structure and volumes. Export sales volumes will depend on the volumes sold on the domestic market, and also on the volumes of crude processed at the Gdańsk refinery and the processing yields.

Capital expenditure in the marketing business in 2011-2015

Total capital expenditure allocated for 2011−2015 to deliver the Strategy in the marketing business is approximately PLN 1bn, which represents 18% of the LOTOS Group's total capex budget for the period.

2.2. OVERVIEW OF INTERNAL AND EXTERNAL DEVELOPMENT FACTORS

External factors

- **Prices of crude oil and petroleum products** – material for the Company's financial performance.
- **PLN/USD exchange rate** – the performance of the Company is also affected by foreign exchange rates, as prices of crude oil and of certain products are quoted in the US dollar, and Grupa LOTOS S.A. also services its debt in that currency.
- **Demand for and supply of petroleum products** – market demand and supply trends have a material effect on the LOTOS Group's financial performance. The demand for diesel oil is expected to continue to grow in the long run, while the demand for motor gasolines is expected to decline. These trends are reflected in the Group's strategy.

Despite the challenging environment in 2013 (adverse effects of the historically low refining margins and the so-called 'grey economy' on the domestic retail fuel market), the Company did not alter its strategic objectives. The strategy' long-term perspective allows the Company to perform its tasks in a well-planned and comprehensive manner and to flexibly respond to threats and opportunities as they arise. Stable crude oil prices additionally support the Company's investment decisions in the upstream segment.

Internal factors

- **Efficiency-enhancing measures** In 2013, Grupa LOTOS S.A. began to implement the 2013−2015 Efficiency and Growth (E&G) Programme. The Programme is geared toward improving the Company's financial indicators, and achieving continued growth through restructuring efforts and investments in the core business. It provides for internal restructuring of the LOTOS Group to dynamise the strategy implementation by focusing on the core business, reducing the use of management resource in support activities, and simplifying the Group's structure. The Programme assumes that the Company will seek ways to dispose of its non-core subsidiaries to unlock their potential and facilitate access to new financing sources.

- **Development of the upstream segment**, designed to strengthen the Company's independence from external feedstock sources, to improve its financial performance and thereby to enhance Grupa LOTOS S.A.'s shareholder value will, in the longer term, largely be based on strengthening the Company's presence in the North Sea and the Norwegian Sea. Building up the offshore footprint will involve securing the YME assets; developing the Company's asset portfolio (interests in exploration and producing fields) in Norway; enhancing the productivity of the B3 field by 15m tonnes per year starting from 2014 following overhaul of the PG-1 unmanned platform, and implementing the B8 crude oil project and the B4 and B6 gas projects in the Baltic Sea. A new element is the Company's marketing relationship and partnership with PGNiG on exploration and production of crude oil and natural gas from conventional and unconventional onshore deposits.
- **Investment projects in the processing area** focus on efficient utilisation of Grupa LOTOS's expanded refining capacities following completion of the 10+ Programme, further increase of the conversion ratio and optimum use of synergies between the refining and the power sectors. Work is underway to begin implementation of the coking project, which in a few years will add volumes to the Company's motor fuel output. Further, in 2013 LOTOS partnered with Grupa Azoty on a preliminary feasibility study into two proposed petrochemical projects – a steam cracker and polyethylene production unit, and an aromatics complex. If results of the study are positive, design work on the recommended option can begin. Some of the new units would be located at the Gdańsk refinery.
- **Strengthening of the LOTOS brand's market position** with special emphasis on the development and improved profitability of retail sales. In its marketing operations, Grupa LOTOS S.A. plans further rapid expansion of its service stations, especially in the budget segment - the LOTOS Optima chain is to include more than 260 stations by 2015. In addition, 18 LOTOS stations will operate in the Motorway Service Area network. The rapid growth of its retail chain will help the Company achieve its strategic target of a 10% share in the retail fuel market. In the area of logistics, LOTOS plans to construct a marine terminal on the Martwa Wisła, which will handle the Company's components and products deliveries and diversify the product shipment and raw material import channels, thus helping to reduce transport costs.

2.3. LOTOS GROUP'S BUSINESS RISKS

The LOTOS Group strives to improve its tools and methods used to identify and assess risks and implement adequate risk hedging/mitigating strategies. The measures taken helped reduce exposure to risks in 2013. Even so, some risks did materialise, which triggered procedures to reduce their impact. New risks were identified, including those related to changes in the technologies used at the Gdańsk refinery.

Risk management system at the LOTOS Group

The LOTOS Group implemented an enterprise risk management (ERM) system based on the COSO II integrated framework released in 2004, which is compliant with ISO 31 000 guidelines and requirements.

Relevant internal standards have been developed and implemented, including:

- **LOTOS Group Enterprise Risk Management Policy**, which defines the general scope of responsibility within the system and key risk management policies operated by the organisation,

- **The procedure for LOTOS Group Enterprise Risk Management**, which specifies detailed rules for risk identification and assessment, monitoring and reporting methods, and reviews aimed to check if the mitigation measures taken have brought the expected results.

Key risk management instruments

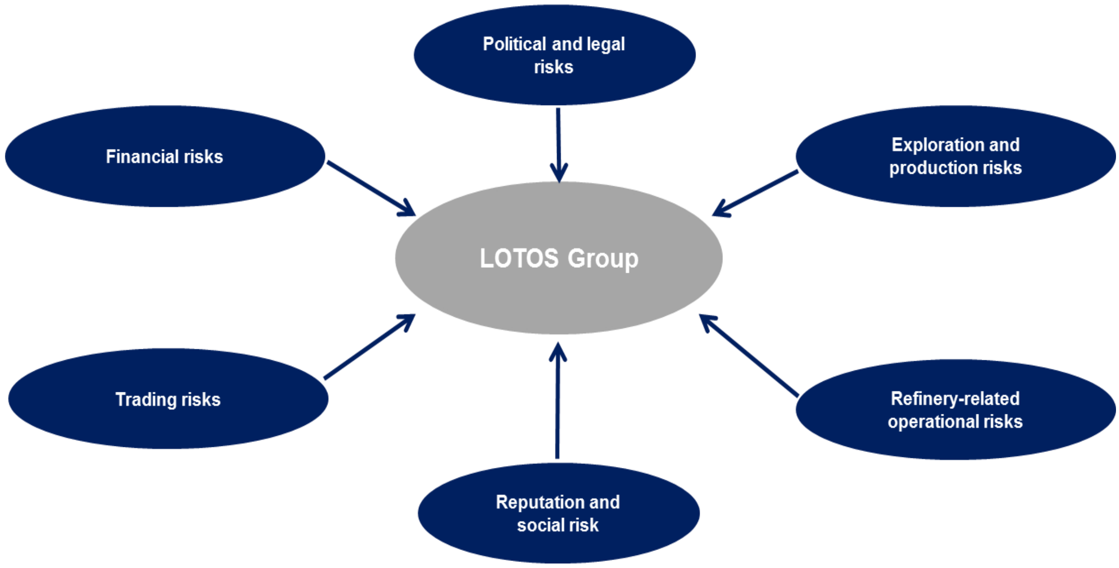
The LOTOS Group identifies risks which may affect the achievement of its strategic, process and operational objectives. Risks are assessed using the Risk Matrix approved by the Management Board of Grupa LOTOS S.A. Based on the rating criteria of the Risk Matrix, risks are classified as high, moderate or low. The strategy for dealing with a particular risk is devised depending on the results of a detailed risk analysis and the extent of its possible impact on the Company and its environment.

Risk assessment is undertaken from two different time perspectives – the following year and until the end of the period covered by the LOTOS Group's strategy (until the end of 2015). For each risk, the probability of its occurrence is estimated, followed by an assessment of its possible impact on the Company's financial standing and reputation. The assessment takes into account the expected impact on the safety of people, the environmental impact and its perception by key stakeholders.

Relevant controls and security measures are then recommended for these risks. Each risk is assigned an owner, who is responsible for overseeing the risk, monitoring it in line with the adopted criteria and implementing agreed mitigation measures.

The existing rules of risk identification and assessment enable prompt response to threats, their mitigation or elimination. Thanks to the response plans in place, the occurrence of a given risk can be adequately prepared for. The LOTOS Group also identifies newly emerging opportunities and possibilities, and pursues them. The enterprise risk management policy enables the Company to undertake activities optimal for its business (within the accepted risk limits).

Graph 6. Key risks in the LOTOS Group



Political and legal risks

Political and legal risks are considered the greatest barriers to investment in the oil industry. The passing of relevant and effective laws, particularly where 80% of new business legislation is drafted at the EU rather than national level, is one of the most pressing problems faced by the entire corporate sector.

The year 2013 was busy for lawmakers working on regulations with direct or indirect implications for the oil sector. Their work was driven by the need to implement the enacted EU directives into the national law, recognise plans for new EU regulations, and align the Polish legal framework with the new operating conditions of the Polish oil industry (including in the upstream segment). Although a lot has already been done, risks stemming from laws and government policies for the oil sector remain real. These include:

- Lack of a comprehensive legal framework and inconsistent law − the oil sector is regulated under multiple legal acts, compliance with which is overseen by different departments, which hampers the industry's smooth functioning.
- With delays in the implementation of EU directives and protracting law-making processes and despite the immense effort of the Polish administration, a number of EU directives still remain to be incorporated into the national law. Moreover, many areas are under-regulated and the legislative process is lengthy. Since the legislator is not inclined to share clear outlines of planned laws, the latter is a source of considerable risk and uncertainty, often forcing participants in the Polish oil industry to incur excessive costs.
- Weak position of Poland in the EU arena − although members of the government administration and representatives of the oil industry are engaged in regular consultations on draft EU legislation, in many cases the Polish voice has gone unheard. This stems from an inability to forge alliances with other countries to back certain views and initiatives. As the interests of individual EU member states vary considerably, the adopted legislation does not always correspond with the needs and expectations of the Polish refiners.

Presented below is a detailed description of risks related to national and EU regulations, which were the focus of attention in 2013 and which will have a bearing on the oil industry's operations in 2014.

Regulations on mandatory stocks

The drafting of amendments to the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market of February 16th 2007, gathered pace in 2013. The primary purpose of the amendments is to implement Council Directive 2009/119/EC imposing an obligation on Member States to maintain minimum stocks of crude oil and/or petroleum products.

The amendments were passed by the Polish government after many months of industry consultations and drafting work at the Ministry of Economy. Among other measures, the legislative proposals put in place a mechanism enabling companies to gradually reduce their mandatory stocks (by a total of approximately 30% by the end of 2017) in exchange for a stock charge, to be paid by them on a monthly basis.

The amendments also introduce long-awaited non-discriminatory rules for building and maintaining mandatory stocks, applicable to all producers and importers of crude oil and petroleum products operating in the Polish market.

Regulations on hydrocarbon exploration and production

Regulations on hydrocarbon exploration and production were an important focus for the LOTOS Group in 2013.

The required implementation of Directive 2009/31/EC of the European Parliament and of the Council of April 23rd 2009 on the geological storage of carbon dioxide, as well as the Polish government's increased interest in developing unconventional gas industry, accelerated work on regulations governing upstream operations in Poland. Assisted by industry experts, the Ministry of the Environment drafted amendments to the Geological and Mining Law.

The drafting consisted of two parallel processes to enable faster implementation of Directive 2009/31/EC and to adjust the law to cover unconventional hydrocarbon exploration.

The directive on carbon dioxide storage demonstration projects was implemented into Polish law by an act of September 27th 2013, which came into force as of November 24th 2013. In contrast, a bill on hydrocarbon exploration and production is at the drafting and consultation stage. Although work on the bill continued throughout 2013, many issues require further clarification and more precise formulation, as transparent and investor-friendly regulatory framework is key to development of the upstream segment. The final draft of amendments to the Geological and Mining Law (hydrocarbon act) should be ready as soon as possible, but it is important that they incorporate the proposals and recommendations put forward by the industry. The bill in its current form presents risks to the upstream segment, the most serious of which are outlined below:

- The proposed split of the exploration, appraisal and production process into separate licences will slow down the progress of work, with upstream companies required to secure additional licences.
- The proposed amendments allow operators to conduct exploration operations without a licence, which gives rise to uncertainty as to whether the licence will be awarded after a large amount of expenditure has been incurred to complete the exploration programme. This will increase risk for the operators, and inhibit exploration activity in Poland.
- The proposed establishment of National Energy Minerals Operator (Narodowy Operator Kopalin Energetycznych, NOKE) will lead to function overlaps between various departments and agencies (e.g. the Ministry of Environment and the State Mining Authority). NOKE's involvement will hinder other licence holders, increase red tape and cause delays in exploration and production programmes.
- A considerably higher mineral production royalty will increase costs of exploration and production operations.
- The draft amendments to the Geological and Mining Law are not fully consistent with a bill on special hydrocarbon tax. The mineral production royalty provided for in the Geological and Mining Law and tax on the production of certain minerals proposed in the bill on special hydrocarbon tax put the burden of double taxation on upstream companies.

EU regulations for biofuels

In 2013, the European Commission and the European Parliament continued the work on amendments to Directive 2009/28/EC, proposed in 2012 by the European Commission. However, no final decisions were made. The individual Commissions, the European Parliament, the member states, as well as international industry organisations had differing views on matters of key importance to the future of renewable energy sources in transport, which prevented a consensus. Work on the proposed amendments will continue. The European Commission's proposal to amend Directive 2009/28/EC with respect to biofuels stems from a discussion, ongoing for a few years now, about the indirect impact of biofuels on changes of land use, and biofules competing for land suitable for cultivating food crops and animal feed.

In 2013, the Polish government continued work on amendments to the Act on Fuel Quality Monitoring and Control Systems and the Act on Liquid Biocomponents and Biofuels in order to implement Directive 2009/28/EC and Directive 2009/30/EC.

Also, the Regulation of the Council of Ministers on National Indicative Targets for 2008-2013 was issued. It should be noted that all the National Indicative Targets for 2013-2016 have been set at 7.10%. In addition, the Council of Ministers issued a Regulation on the level of reduction rates for 2014 and 2015. In 2013, Grupa LOTOS S.A. availed itself of the right to reduce the National Indicative Targets, which helped to decrease the costs of achieving the Targets.

CO2 emission allowances

In 2013, the EU Council approved the European Commission's proposal, earlier adopted by the European Parliament, to suspend the auction for 900m CO2 allowances in 2013-2015 (backloading). The number of allowances in the years until 2020 is to be increased by the same amount. The purpose of these steps is to raise the price of emission allowances. There is a risk that as the next step the Commission will propose a permanent removal of suspended allowances from the market. In 2013, the government continued the work on amendments to the Act on Monitoring and Control of Fuel Quality, which are designed to introduce into the Polish legal system the National Reduction Target following from Article 7a of Directive 2009/28/EC. No transparent regulations on the methodology for calculating emission reductions have been developed so far, either at the EU or the national level. This will therefore require greater involvement of the industry representatives in providing support to the state administration in the process of developing the EU and Polish laws in this area.

Reputation and social risk

- **Reputation risk** is related to events that may affect the perception of the LOTOS Group and the value of the LOTOS brand. As most of the risks in each business segment described further in this Report may affect this perception, they have been evaluated in the context of both finance and reputation. As both evaluation criteria are equally important, risks with potentially significant effect on reputation are subject to detailed analyses, and mitigation plans are developed in accordance with relevant risk-management rules.
- **Social risks** relate to the environment of the LOTOS Group and its employees. In 2013, the implementation commenced of the 2013−2015 Efficiency and Development Programme to increase efficiency and support continued dynamic development of all LOTOS Group companies. The planned changes, in particular those involving restructuring, may cause concerns and be disapproved of by employees and the immediate environment. For this reason a series of meetings were held between the LOTOS Group employees and members of the Management Boards of Grupa LOTOS S.A. and its subsidiaries, focused on discussing the Programme objectives, anticipated doubts and concerns. As its implementation progresses, an open communication campaign of the Programme and its individual projects has been conducted.
- **Misconduct** is construed at the LOTOS Group to mean an intentional act or omission which constitutes a violation of the generally applicable laws or a breach of the Company values or policies, committed to secure an unlawful gain or leading to the Company sustaining a loss (including any forms of corruption). To minimize this risk, a systematic approach to preventing misconduct has been implemented, consisting in comprehensive and organised efforts aimed at identifying and assessing the risk. This includes solutions for preventing and identifying misconduct and minimizing its consequences. The Misconduct Prevention system is subject to an annual survey as part of an analysis of the Company's organizational maturity, to assess the effectiveness of the solutions applied.

Project-related risks

- **Project risks** are related to the possibility that a given project may fail, may be implemented with a delay, or may suffer budget overruns. As the Group implements various significant projects, any materialisation of project risks may adversely affect operations and financial performance of the LOTOS Group as a result of budget overruns or project's failure to bring the expected profits or to bring such profits at the expected time. In the case of key projects, materialisation of such risks may also prevent the achievement of strategic objectives. In order to minimise these risks, uniform project management policies have been implemented across the Group. The policies require that a risk management plan is in place for each project. Individual risks are analysed and assessed in detail, risk mitigation measures are identified, and responsibility for the implementation of these measures is assigned to specific individuals. Implementation of each project is monitored and reported on in line with the applied policies.

Exploration risks

- **Risks from estimating the resources and reserves of hydrocarbons discovered by exploration wells** − due to uncertainty involved in the evaluation of formation properties affecting the volume of resources, the Group provides three estimate cases for reserves (1P/2P/3P) and for undiscovered prospective resources (P10/P50/P90), in accordance with the SPE 2007 international classification framework. It is possible that the presence of resources inferred from geological and seismic data is not confirmed after a well is drilled and the estimated resources will be smaller than expected. After a discovery is tested through successive wells, there is also a risk that its estimated resources will be reduced due to unfavourable changes in the formation properties. One of the methods of ongoing risk management in the estimation of reserves and resources is to identify and map the distribution of formation properties indicating the presence of hydrocarbon accumulations, i.e. area and thickness, porosity and hydrocarbon saturation. Estimates are also made after a new well is drilled on a prospect or after events occur that may affect the size of reserves.
- **Risk of drilling a dry well (without hydrocarbon flow)** – in assessing the chance of success and discovery of a hydrocarbon accumulation, we use the PoS (probability of success) ratio. PoS is calculated on the basis of four factors, which are assigned probability on a scale of 0% – 100%.

Another method of ongoing risk management is to perform geological analyses for an exploration well. For a production well, reservoir engineering analyses and depleted zone simulations are performed before a decision is made whether and where to drill a production well.

Technical and production risks

- **Risk of failure of production equipment and facilities due to their limited durability or improper operation** – should this risk materialise, it may result in financial losses due to production stoppages. To effectively manage this risk, a number of measures are taken, including regular overhauls and repairs, vibration and SPM measurements (the latter to check the wear of bearings), and certification bodies (the Polish Register of Shipping, the Mining Authority, the Office of Technical Inspection) perform periodic inspections of the equipment.
- **Risks from infrastructure operation, such as the risk of oil spill, sea collision, fire or blowout** – which may cause environmental contamination, death of personnel, downsizing or stoppage of production, and entail significant costs to remedy the resulting damage or pay fines. This production-related risk is the function of the quality of E&P infrastructure operation, use of adequate technical solutions as well as staff awareness and skills, and so the Group takes measures to prevent such accidents from occurring. Should they nevertheless occur, relevant action plans have been prepared to mitigate their consequences.

Exploration risks

- **Risk of limited control of jointly executed projects** – since at least two partners are involved in such projects, there is a risk that they will not be executed in accordance with the LOTOS Group's expectations. This risk is mitigated by properly defining the acceptable conditions on which we can get involved in a project, and by vetting the other interest holders, their goals, motivation, financial standing, ownership structure and perception, relying on our in-house market research resources and/or business intelligence agencies. Another important thing for the LOTOS Group is to properly define the common interests, analyse the legal, tax and business regulations in a due diligence process, and thoroughly study the provisions of partnership agreements to ensure its own interests are secured. The risk is also minimised by devising an appropriate negotiation strategy at the time when the Group enters into a new partnership and while its continues, as well as by ongoing monitoring of contractual provisions/evaluating and approving budgets and schedules/appointing internal and/or external committees, and recommending decisions to be made by the relevant governing bodies. All this was done in 2013 in the case of licences held jointly with partners in both Norway and Poland. A case in point in Poland is the operation of the B4/B6 gas fields in partnership with CalEnergy Resources.
- **Risk of involving capital in projects which yield unsatisfactory returns** – each risk identified in the E&P operations and execution of partnership agreements which may result in financial losses. To counteract this risk, the Group ensures to properly define goals and acceptable conditions on which it can participate in a project. Proper tools for assessing each such project are identified and internal and/or external multidisciplinary teams are set up to perform its economic, legal, tax or technical analysis (e.g. at the due diligence stage).
- **Risk of failure to fully recover funds invested in the YME project** – given the significance of the YME project, it is under the Group's special supervision, with a number of measures implemented to mitigate the attendant risks. Currently, efforts are made to sell the interests in the YME field. Two sub-projects have been defined – removal of the MOPU (Mobile Offshore Production Unit) from the field and submission of a new YME field development plan to Norway's Ministry of Petroleum and Energy to raise the value of the interests we intend to sell. To mitigate the associated risk, an agreement was signed with SBM, the MOPU's producer, in which SBM agreed to cover the costs of the unit's removal from the field and paid compensation to the consortium members. In 2013, we also held a process to select a contractor for the MOPU's removal. We evaluated the quality of work performed by the operator, and helped to build an agreement between those partners that were not consortium operators to strengthen our position. The Group engaged international advisers and, to ensure it has greater control, seconded an employee to work with the operator. Talks were also held with the Norwegian authorities to clearly confirm the intention of continuing activities on the Norwegian Continental Shelf, outlining the planned steps.
- **Risk of bad weather conditions** – this is a crucial risk factor in a marine environment, which may delay projects and, in extreme cases, force us to suspend production. To minimise the adverse effect of this risk, systems are deployed to monitor weather conditions and trigger appropriate safety procedures when necessary.

Operational risks

- **Technical risk** is related to the possibility of occurrence of serious industrial failures or irreparable damage to infrastructure. Any materialisation of this risk may seriously affect operations and financial performance of the LOTOS Group by necessitating additional expenditure on repair or replacement of installations or equipment, or by causing interruptions and interferences in the production process. A number of measures are implemented within the LOTOS Group to mitigate the risk. The Group continues to prioritise the installations and equipment based on criticality analysis. The technologies and installations used by the Group meet the criteria of Best Available Techniques. Emergency shutdown systems are in place to prevent uncontrollable escalation of incidents; process units are also fitted with independent safety and protection systems. In addition, in order to raise standards for assessment of the technical condition of high-pressure installations and equipment, work began to implement the Risk-Based Inspection methodology. Work is also underway on implementing the Risk-Based Work Selection methodology, which involves planning the maintenance of continuous operation based on previous risk analyses for individual units. As a result of these efforts, the LOTOS Group's infrastructure will be managed in a better and more efficient way. In 2013, the **Spring 2013 Maintenance Shutdown** was completed. It was the largest maintenance operation in the history of the Gdańsk refinery. Preparations for the shutdown started as early as in 2011. Over a period of four weeks, thousands of various tasks were performed, and a total of over five thousand pieces of equipment were reviewed, repaired or replaced. The maintenance shutdown also provided an opportunity to carry out all the necessary inspections and tests of installations and equipment subject to certification by the Office of Technical Inspection. All the apparatus and piping required to meet the Office of Technical Inspection standards successfully did so and obtained relevant validation extensions. This proves the good operating condition of the refinery's critical infrastructure and enhances its process safety. Findings of the analyses will be used in the planning and performance of the next maintenance shutdown in four or five years.

- **Risk of lack of availability or limited availability of natural gas**. Currently, natural gas is the main energy carrier in the refinery's fuel gas network, through which it feeds process furnaces and, separately, the refinery's own power plant. Natural gas is also a feedstock processed at two hydrogen production plants. If the risk materialises, it could temporarily affect sales of selected products and result in higher operating costs. To reduce the potential impact of this risk, we continue to maintain infrastructure allowing us to revert to the fuels which we used before natural gas was introduced at the refinery.
- **Work safety risk** relates to potential occurrence of accidents and other threats involving exposure of employees to dangerous and onerous factors. At the LOTOS Group, new technical and organisational measures are continuously improved and implemented to ensure safe working conditions for anyone visiting the premises or working there for or on behalf of the Company. The Group's internal requirements in this respect are communicated to its trading partners via a dedicated website. Relevant rules of conduct are regularly monitored for compliance and post-inspection requirements are enforced. Education programmes are also operated to raise the employees' awareness of safety standards and to encourage them to observe these standards at work.
- **Risks related to CO2 emission allowance limits** involve insufficient allocation of CO2 emission allowances, which would force the Company to incur certain costs in order to purchase a sufficient number of the allowances. 2013 was the first year of operation of the National Allocation Plan 2013−2020 (phase three NAP), and was in many respects a very unusual year. Thus far, oil refineries had been allocated allowances on the basis of their throughput capacity utilization. Starting from 2013, for the first time refineries were to be assigned allowances according to the CWT (Complexity Weighted Tonnage) benchmarking. Another unusual development was that the European Commission not only declined to approve free allocation of allowances to installations covered by the Emission Trading Scheme, but also from time to time changed the general rules of such allocation. Therefore, Grupa LOTOS S.A., just like other EU ETS participants, faced the risk of having to make decisions without knowing the precise rules.

According to unofficial information from the Ministry of Environment, the Company is to be assigned 1,521,342 CO_2 emission allowances to cover its emissions for 2013, and will be granted 11,303,332 allowances for the entire 2013−2020 trading period. This will result in a shortage of allowances and the Company will have to purchase them from other participants of the scheme. With a view to, inter alia, minimising the volume of CO_2 emission allowances purchases, in recent years the Group has embarked on a number of projects, such as switchover to natural gas as the fuel used for power generation and as the key feedstock in hydrogen production; recapturing of discharge gases; upgrades of process furnaces, and implementation of a continuous energy efficiency improvement programme for the refinery's production units.

- **Environmental risks** relate to a potential adverse environmental impact of the LOTOS Group. The environmental risks are interrelated with a number of other risks, in particular the technical and process risks whose materialization may cause a threat to the environment (e.g. through increased emission of flue gases, leakage of hydrocarbons into the ground, etc.). For these reasons, each risk identified within the LOTOS Group is assessed also in terms of potential damage to the environment, and appropriate preventive measures are taken. To ensure compliance with all environmental regulations and standards, the Group also monitors the national and community laws on a daily basis, and where possible the Group actively participates in the legislative process. Applications for any requisite permits and decisions are made well in advance, in consideration of the risk that administrative proceedings may last longer than expected.
- **Risk related to legislative changes with respect to REACH** (Registration, Evaluation, Authorisation and Restriction of Chemicals). At present this risk is related in particular to the possibility that the EDC (1,2-dichloroethane) solvent, used by the LOTOS Group, might be listed among the priority substances to be included in Annex XIV to the REACH Regulation. If this solvent is finally listed in Annex XIV, a relevant permit to use will be sought. The Group has taken a number of measures to minimise the risk in this respect. In February 2013 Grupa LOTOS S.A. joined the EDC DU Consortium, an association of EDC users. The association will develop the documentation necessary to apply for the permit. An in-house project to coordinate the actions taken was also launched. In parallel, relevant installations are being upgraded with a special focus on the impact of regulatory changes on the use of the EDC solvent.
- **Risk of introduction of stricter quality requirements for petroleum products**. This risk involves potential difficulties to ensure timely compliance with future quality standards. To mitigate the risk, new draft standards and regulations which might affect the Group's processing and marketing business are being monitored. The Group's work on Technical Committee 222 at the Polish Committee for Standardisation, responsible for petroleum products and process liquids, has provided the Group with an opportunity to voice its opinions on the proposed European standards during their drafting. The Group also has a say on quality requirements, in particular requirements applicable to engine fuels, through its participation in the work of the Polish Organisation of Oil Industry and Trade (POPiHN).

Financial risks

Grupa LOTOS S.A. operates a Financial Risk Management Office responsible for coordinating and supervising steps taken to ensure that decisions made by LOTOS Group companies are optimised in terms of financial risks.

The aim of these efforts is to ensure that the financial risk management policy is up-to-date, coherent and consistent with Grupa LOTOS S.A.'s strategic objectives, and to provide for operational efficiency, effectiveness and security of the financial risk management process.

The Company also has a Price Risk and Trading Committee, whose task is to supervise and coordinate price risk management at Grupa LOTOS S.A. in relation to prices of crude oil, petroleum products (including biofuels and biocomponents), natural gas and other raw materials, as well as prices of carbon emission allowances and electricity.

In order to ensure that financial risks are effectively managed and to minimise the risk of error, all data used to support the assessment process are thoroughly verified, and the decisions made are based on in-depth analyses in accordance with risk management policy, credit structure and operating procedures. Financial risk management policies, instruments and the impact of risk factors on individual items of the financial result are presented in the Notes to the consolidated financial statements. The financial risks include:

- **Feedstock and petroleum products price risk** – to manage the risk, the Company continues work to develop a new risk management policy. Our efforts in this respect depend on implementation of the Energy Trading and Risk Management (ETRM) system. In 2012, work on implementation of the Allegro 8.0 system began; the project is to be completed in 2014.
- **CO2 allowances price risk** − in 2013, Grupa LOTOS S.A. managed phase III of the EU CO2 Emissions Trading Scheme covering the 2013−2020 trading period. Given the lack of liquidity on the futures market and the instability of the underlying position in the period until 2020, the end of the risk management period for the risk related to the prices of CO2 emission allowances in phase III was set at the end of 2019. However, with the passage of time, the risk management period will be extended until 2020. For detailed information on exposure and transactions open as at December 31st 2013, see the consolidated financial statements.
- **Liquidity risk** – this is one of the key risks to the security of the LOTOS Group’s operations, and involves its ability to discharge all liabilities in a timely manner. Liquidity is managed for the entire Group based on current liquidity forecasts. The process consists in using an appropriate selection of financial instruments (including cash pooling and diversified sources of financing), optimising the working capital position (including payment terms at Group companies and under trading contracts) and applying IT solutions to improve the security and effectiveness of the process.
- **Currency risk** – this risk is managed based on the Strategy of Currency Risk Management at Grupa LOTOS S.A. The US dollar (USD) is the currency of the market on which we operate. Thus we have a structurally long position in US dollars. The US dollar was chosen as the most adequate currency for contracting and repaying long-term facilities, including those used to finance the 10+ Programme. The LOTOS Group operates a group bank, which allows the Group companies to enter into FX transactions with Grupa LOTOS S.A., improving the efficiency of currency risk management.
- **Interest rate risk** − this risk is related to the expected schedule of payments under the loans taken out to finance inventories and the 10+ Programme, with the resulting interest accruing at floating rates (USD LIBOR).
- **The risk of restricted access to external financing or changes in lending terms** − this risk is minimised by maintaining relationships with a diversified group of creditworthy partners, use of a wide range of financial instruments, fulfilment of disclosure obligations, as well as monitoring of and compliance with financial ratios, covenants and any other obligations towards the banks. The financial position and overall standing of the banks providing financing for the LOTOS Group are also monitored, as are any factors driven by developments on the global financial markets that may threaten the Group's ability to raise financing.
- **Credit risk in financial transactions** − to mitigate this risk, the Company enters into transactions only with financial institutions or companies that meet the following requirements:
    - have a minimum acceptable rating assigned by a rating agency;

- if the rating requirement is not met, they must provide an appropriate guarantee issued by a financial institution or firm holding a minimum acceptable rating assigned by a rating agency and meeting the requirements set by Grupa LOTOS S.A. and defined in relevant agreements.

Credit limits in financial transactions are determined in reference to the Company's equity and a ratio calculated based on agency credit ratings updated on an ongoing basis. The utilisation of credit limits is regularly monitored.

- **Credit risk in trade transactions** − The LOTOS Group operates an internal procedure whereby creditworthiness of trading partners seeking an open credit limit must be verified. The LOTOS Group grants such limits based on assessment of the partners' creditworthiness, taking into account available data and information on a given trading partner. The final decision on the amount of trade credit limit is made by persons responsible for credit decisions in line with the assigned profile of responsibilities. The utilisation of credit limits is monitored on an ongoing basis.
- **Risk of adverse changes in tax regulations, interpretations or court rulings** – this risk may result in higher tax burden (excise duty, real estate tax, CIT), and give rise to tax risk in transactions where such risk was previously non-existent. Differing legal interpretations of the tax regulations also increase uncertainty, and in international trading may affect our credibility and force us to withdraw from profitable projects and transactions. The level of tax risk faced by businesses in Poland is high, and continues to grow. One of the risk factors is non-observance by the legislator of the vacatio legis principle when enacting amendments to tax laws. This prevents businesses from adjusting to the new requirements in time and may expose them to the risk of additional costs or sanctions. Where a tax risk arises from possible disparate interpretations of a law, the Group requests the Minister of Finance to present a binding interpretation of such law. As a member of respectable organisations of employers and entrepreneurs, the Group also voices its opinions on proposed bills and is thus able to respond appropriately to the changing legal environment.

Trading risks

- **Risks related to diversification of supply sources** − at Grupa LOTOS S.A., feedstock is supplied mainly via a system of pipelines and by sea, which means that the key risks in this area lie in the political situation of the countries exporting crude oil and the condition of the infrastructure. Grupa LOTOS S.A. is thus consistently pursuing its policy to diversify the directions and sources of crude oil supplies, by focusing on the following aspects:
  - security of supplies − through progressive expansion of its presence on the international oil markets, regular contracting of various crudes transported by sea, creating conditions to radically increase the share of such crudes in total supplies to the refinery in case of any disruption of supplies from the main import market, and expanding the share of own production in total feedstock volumes.
  - improvement of competitive position − by fully capitalising on the coastal location of the Gdańsk refinery and the possibility of sourcing crude supplies through two independent channels: Russian oil through the Druzhba Pipeline and various types of oil available through Naftoport (an offshore oil terminal).

  An appropriate selection of crude types and supply directions is a result of continuous efforts to maximise the integrated margin.
- **Competition risk** – as market conditions need to be factored into the pricing policy, this type of risk may lead to margin and profit erosion. The relevant risk factors include the unrelenting price competition on the fuel market, but also the strong volatility of global macro variables. Therefore, the Group is continuously refining its tools for monitoring variables affecting prices and margins. In retail sales, market diversification is

being pursued, including diversification into segments less prone to competition-induced margin erosion, as are other initiatives aimed at winning and retaining customers.

- **Risk of decline in domestic demand** − due, among other things, to macro factors, such as an economic slowdown, a decline in investments and shrinking industrial output. Various factors, such as growing unemployment, could adversely affect consumption of LOTOS products and services. Therefore a variety of distribution channels are used to sell the products while pursuing a pricing policy designed to ensure they remain competitive, and operating expenses are continuously optimised.
- **Risk from grey market expansion** − in recent years, Poland has seen an increase in illegal trade, especially of diesel oil and gasoline, which significantly affects also the LOTOS Group's sales. According to the Polish Organisation of Oil Industry and Trade (POPiHN), the resulting losses for legitimate businesses may continue to grow. Whether the situation improves will depend chiefly on new legal regulations, which are now being developed by the government. The legislative work is being supported by POPiHN, of which Grupa LOTOS S.A. is a member, working with the other members to support and fund initiatives aimed at supplying market data and analysis that could later be used to assess the size of the grey market and the associated risks.
- **Risk related to sea freight safety** − at the LOTOS Group, measures are being put in place to mitigate the risk of an environmental disaster in the event of hydrocarbon spills from ship tankers. The Group has established relationships with providers of sea shipping services which operate fleets meeting high technical standards and properly observe maritime conventions. The shipping companies meet very strict requirements regarding safety and prevention of accidents at sea. Moreover, in 2013 the possibility of implementing much more stringent sea freight safety standards was evaluated.

3. OPERATIONS OF THE LOTOS GROUP

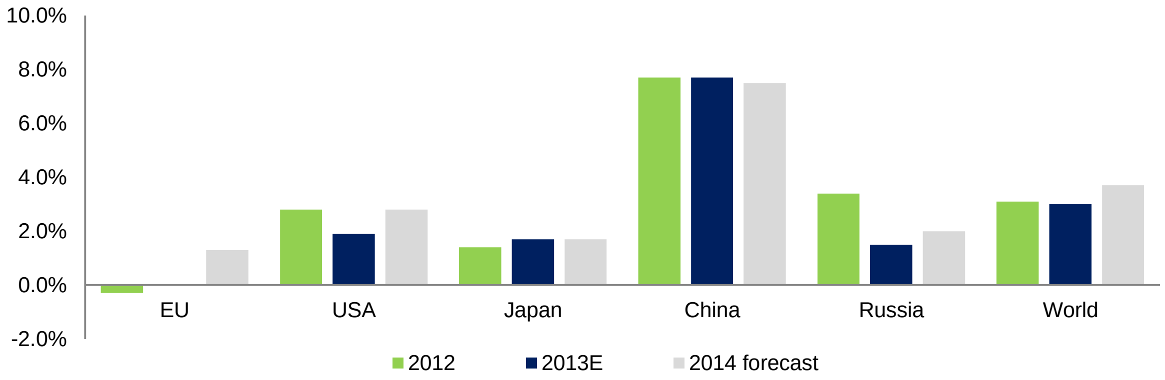
3.1. MACROECONOMIC ENVIRONMENT

The global economic situation in 2013 was below market expectations. The key economies of the world continued growing, however often at rates lower than in previous years. Developed economies were supported by loose monetary policies and efforts to maintain market liquidity.

While in 2013 the global economy continued to grow, the estimated growth rate (+3.0%) was lower than expected in forecasts published in April and July 2013, though it came in slightly above the October 2013 estimates. Similarly, the forecast for the 2014 GDP growth rate has been revised upward by the same amount of 0.1pp, and now stands at 3.7%.

Despite a number of remedial steps and reforms undertaken in the eurozone countries, the euro area suffered and an estimated 0.4% decline of the GDP in 2013. However, the GDP growth rate in the eurozone is expected to return to the positive territory in 2014.[1]

Graph 7. GDP growth in 2012−2014

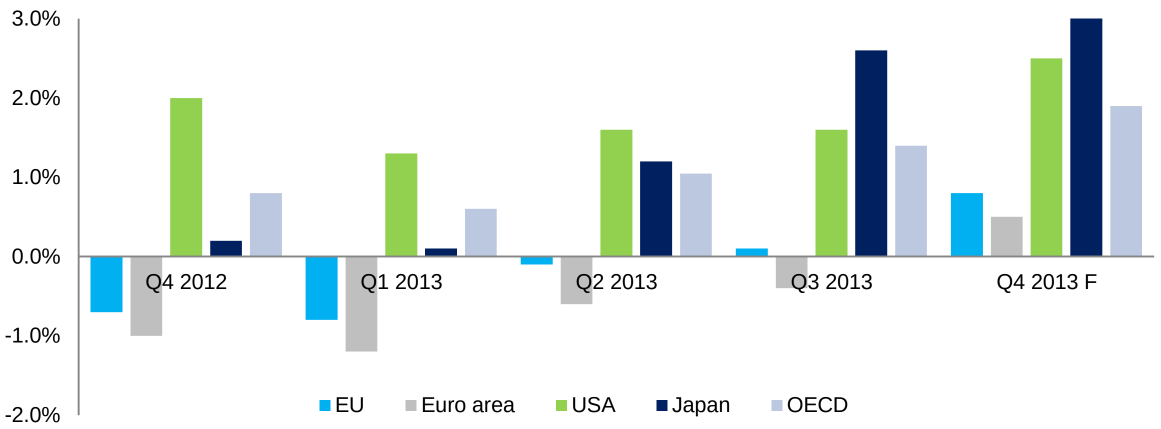


Source: In-house analysis based on IMF data (January 2014).

Developed countries may be expected to further stimulate economic growth by continued support from monetary policy (without further loosening), balanced fiscal policy and further structural reforms, to address key economic concerns, including high unemployment.

[1] *World Economic Outlook, IMF, October 2012*

Graph 8. GDP growth in 2012 and 2013 (y-o-y change)

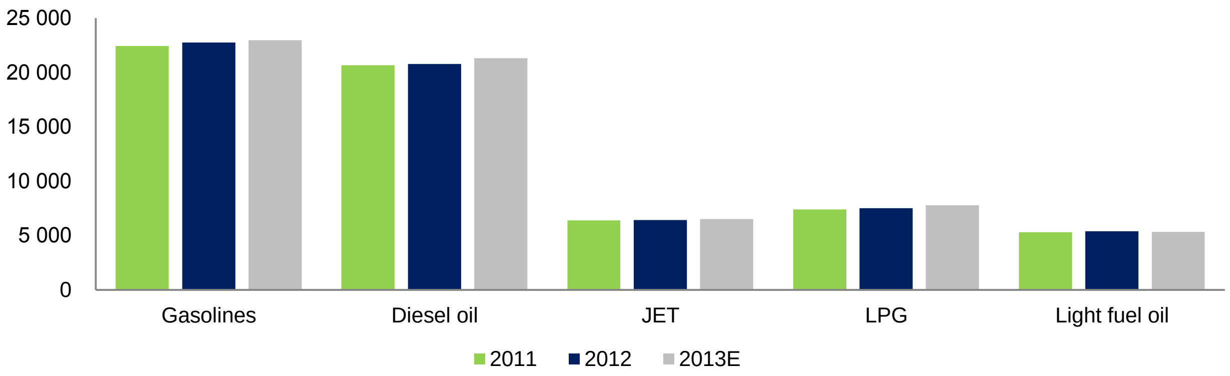


Source: In-house analysis based on Eurostat, OECD, and International Monetary Fund data.

International fuel market[2]

It is estimated that demand for oil refinery products in 2013 rose by 1.1% globally. Stronger demand was seen in the gasolines (1.0%) and diesel oil (2.5%) segments. The estimated consumption of LPG and jet fuel also increased (by 3.3% and 1.2%, respectively). However, the demand for light fuel oil slightly fell (by -1.5%).

Graph 9. Global consumption of fuels (ths b/d)

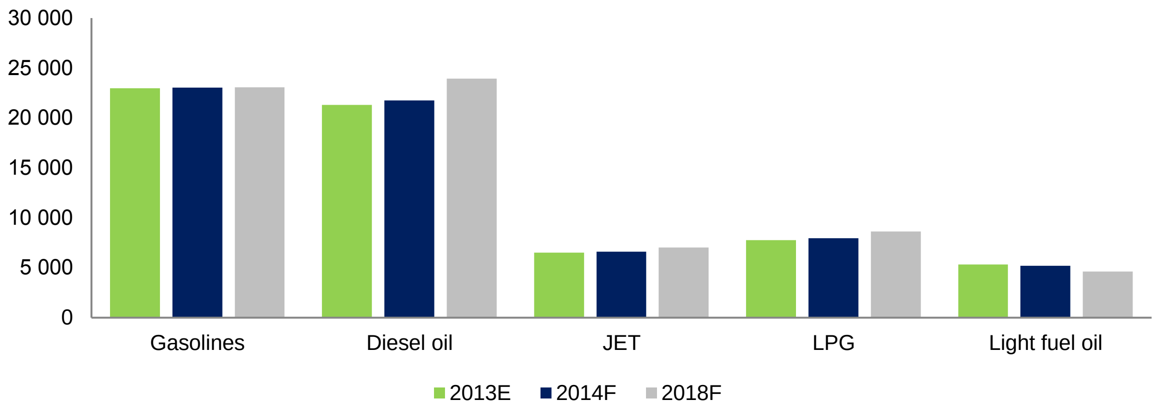


Source: In-house analysis based on JBC data, October 2013.

According to forecasts, the overall global consumption of refinery products is expected to grow by over 5% until 2018. It is estimated that demand for diesel oil, LPG and JET fuel will grow significantly over the 2013 consumption (up 12%, 11% and 8%, respectively). The global consumption of gasolines should remain relatively unchanged. Light fuel oil consumption is expected to fall by 13%.

[2] *Mid-Term Oil Market Outlook 2012-2017, JBC Energy, October 2012*

Graph 10. Forecast global consumption of fuels (ths b/d)

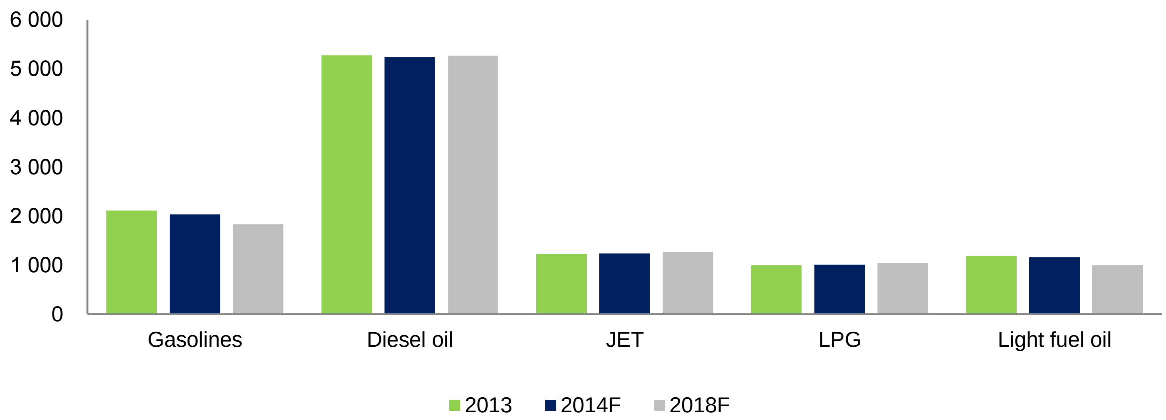


Source: In-house analysis based on JBC data, October 2013.

According to estimates, consumption of petroleum products in Europe declined in 2013 by nearly 1.5%. However, LPG, diesel oil, and light fuel oil saw an increase of 2.8%, 0.2%, and 0.1%, respectively. Consumption of gasolines and JET fuel fell by 4.0% and 0.7%. The restrained growth of fuels consumption in Europe reflects the still unresolved economic issues in certain EU Member States and the eurozone.

The demand for oil refining products is forecast to fall in Europe by 3.7% until 2018. According to estimates, one of the reasons behind the decline will be a significant drop in consumption of gasolines, exceeding 13%. Lower consumption is also expected to affect the light fuel oil market (-16%). Concurrently, a strong increase is expected in consumption of JET fuel - by 3.0%, and LPG - by 4.8%.

Graph 11. Forecast consumption of fuels in Europe (ths b/d)



Source: In-house analysis based on JBC data, October 2013.

In the European car market, new passenger car registrations fell by nearly 2% in 2013, to 12.3m new cars. Similarly, in the utility vehicles segment new registrations also declined by 2%, to 1.6m vehicles (January-November). In the group of registered new passenger cars, there is a continued growing interest in diesel-fuelled cars. The share of such cars in the total new car registrations in Western Europe was nearly 55% (compared with 46% in 2009).[3]

[3] *European Automobile Manufacturers' Association, www.acea.be*

Macroeconomic environment in Poland

2013 proved to be another year of economic slowdown in Poland. According to preliminary estimates, the GDP in real terms grew by 1.3%-1.5% over 2012, marking the slowest growth since 2009. This was chiefly attributable to weaker domestic demand and lower manufacturing and construction output. Inflation was down to 0.9%.

The economic slowdown in Poland in 2013 is expected to be accompanied by higher unemployment. According to market estimates, the unemployment rate as at the end of 2013 was 13.4% and remained unchanged relative to the end of 2012. In 2013, salaries and wages in the manufacturing was up by nearly 3% compared with 2012.

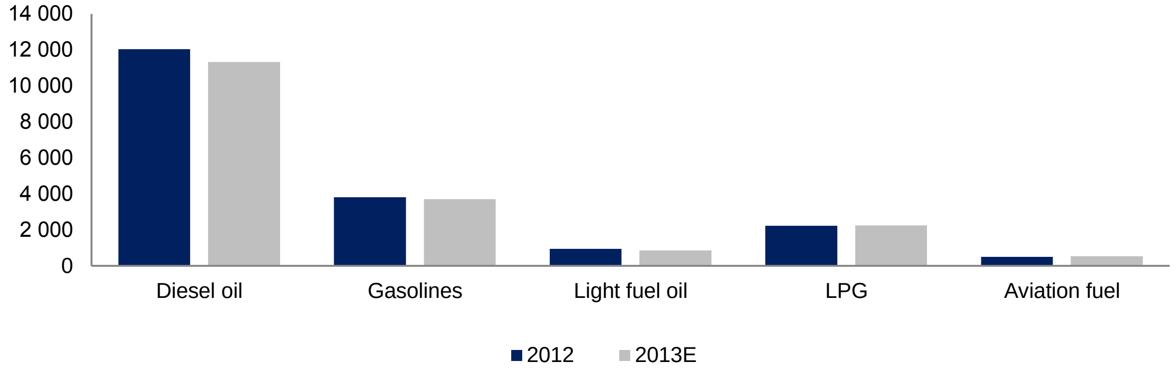
Polish fuel market

The economic slowdown in Poland in 2013 is expected to be accompanied by higher unemployment. Estimated unemployment rate as at the end of 2013 was 13.4%. Domestic demand for fuels is shaped by the general economic situation in Poland and the region. In the last two years, the Polish fuel market has been faced with the challenge of the growing grey market driven by high fuel prices and the economic slowdown. Illegally imported diesel oil, which fails to be captured by official statistics, is the main commodity on the grey market. Officially, the consumption of diesel oil in 2013 was 11.3m tonnes, 6% down on 2012. POPiHN[4] estimates that in 2013 fuels sold on the grey market accounted for as much as 12% of the total volumes. Despite the unfavourable trends on the domestic market, diesel oil remained the primary transport fuel in Poland, with a 65.5% share in domestic consumption in 2013 (estimated). Gasoline sales on the Polish market in 2013 followed the trends prevailing in other parts of Europe and continued to fall. As in the previous years, demand for gasolines in 2013 fell by nearly 3% (100 thousand tonnes), down to 3.7m tonnes, on the back of high retail prices. Also, such adverse economic trends as unemployment and the related limited mobility of motorists, but also the improving fuel efficiency caused by fleet upgrades depressed the demand.

Given the high prices of gasoline in 2013, LPG, a less expensive alternative fuel, gained popularity. In 2013, the estimated fuel consumption was 2.3m tonnes (up 1.5% year on year), with stronger demand seen in the LPG segment and other segments of the gas market (including heating). Demand for light fuel oil in 2013 continued declining, and contracted by 8%, to 862 thousand tonnes. This segment of the market was affected by increased interest in alternative heating fuels. 2013 brought about growth of demand for aviation fuel. The nearly 9% increase was caused by stronger competition on the domestic aviation fuel market and overcoming of the dominating position of Petrolot, which helped improve the competitiveness of the Polish aviation fuel market vis a vis alternative markets offering aviation fuel.

[4] *Polish Organisation of Oil Industry and Trade*

Graph 12. Consumption of fuels in Poland ('000 tonnes)



Source: In-house analysis based on Polish Organization of Oil Industry and Trade (POPiHN) data.

3.2. HYDROCARBON EXPLORATION AND PRODUCTION

3.2.1. TRENDS IN THE EXPLORATION AND PRODUCTION INDUSTRY

The last decade has seen an unprecedented growth in costs in the exploration and production sector (except 2008, when it suffered a deep recession). According to the most recent E&Y estimates[5], oil companies' spending on geological surveys, R&D and production has more than tripled since the beginning of the 21st century.

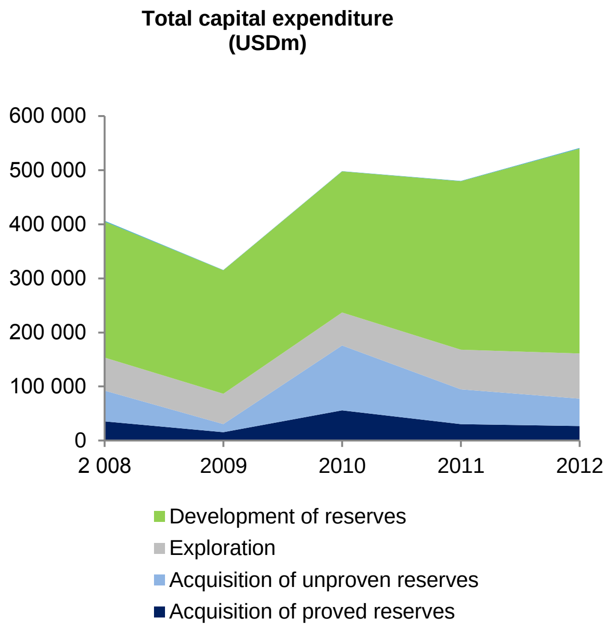
The growing costs stem from the progressing depletion of conventional resources. Growing demand for hydrocarbons forces companies to develop unconventional reserves, which is very costly. Unconventional hydrocarbons production will be the main driver of future growth in crude oil output.

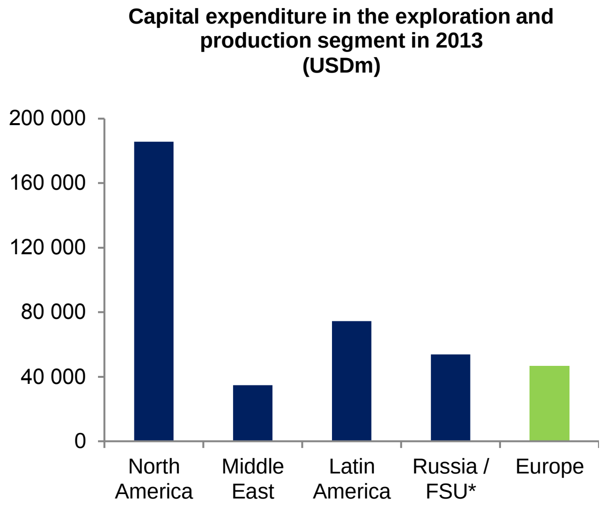
In 2012, total global capital expenditure grew by 13%, from USD 480bn in 2011 to USD 541bn in 2012. E&Y estimates that in 2013 the exploration and production capex will see a double-digit growth for the fourth year running since the segment's rebound in 2010. In 2013, the expenditure should grow by approximately 11%, to more than USD 680bn, a strong 65% increase on 2009.

The strongest capex growth in the sector is seen in the Middle East (up 21%). The next fastest growing region is Europe (up approximately 20%), followed by the Asia and Pacific region (up 17%) and Latin America (up 14%). After three robust years enjoyed by the industry, the growth rate in North America shrank to only 2%.

[5] *E&Y Global oil and gas reserves study, 2013*

Graph 13. Capital expenditures developmrnt anasysis in E&P sector



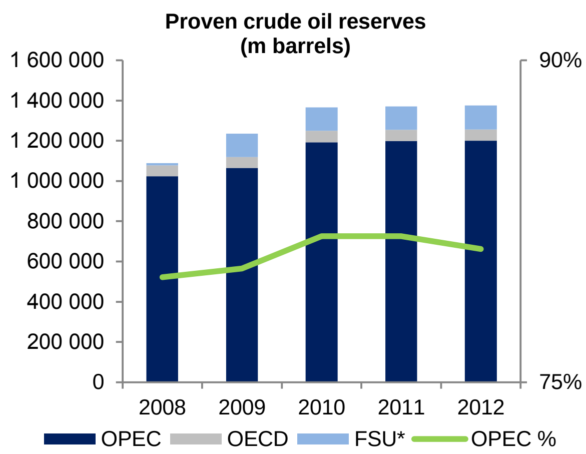


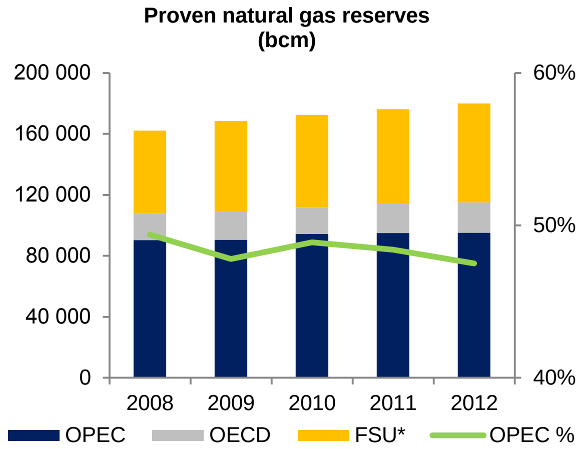
Source: E&Y Global oil and gas reserves study, 2013; Barclays, Global 2014 E&P Spending Outlook.

** FSU – Former Soviet Union*

Crude oil reserves as at the end of 2012 grew by 3%, to 152.5 billion barrels, having increased in 2012 in all regions except Europe, Africa and Middle East.

Graph 14. Global proven crude oil and gas reserves

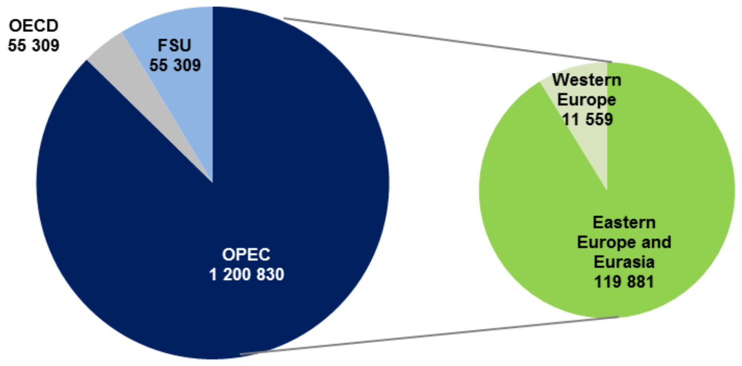




Source: OPEC, Annual Statistical Bulletin, 2013.

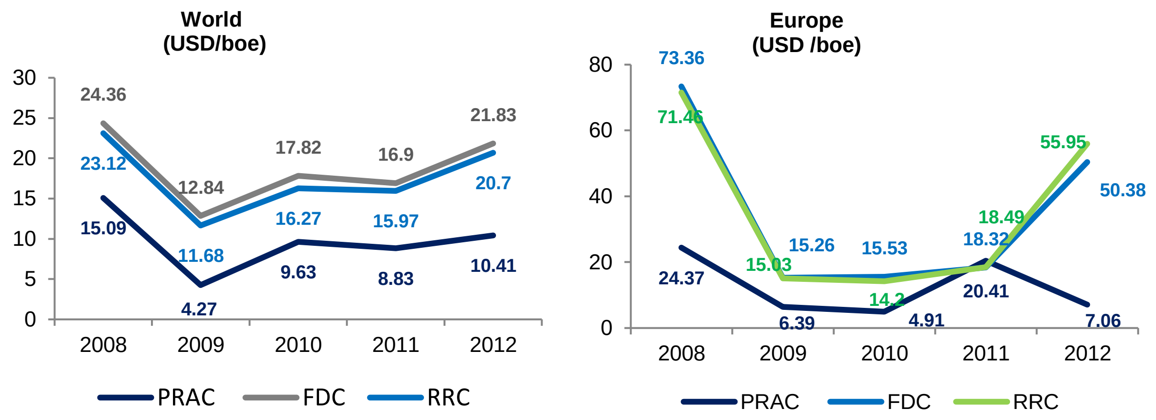
** FSU – Former Soviet Union*

Graph 15. Proven crude oil reserves for 2012 (m bbl)



Source: OPEC, Annual Statistical Bulletin, 2013.
** FSU – Former Soviet Union*

Graph 16. Efficiency ratios



Source: E&Y Global oil and gas reserves study, 2013.

** PRAC (Proved Reserve Acquisition Costs) - proved property acquisition costs and identified related asset retirement obligation costs divided by proved reserves purchased.*

FDC (Finding and Development Costs) - unproved property acquisition costs, exploration costs, development costs and identified related asset retirement obligation costs divided by extensions and discoveries, revisions and improved recovery of proved reserves. The calculation excludes the effect of proved reserves purchased.

RRC (Reserve Replacement Costs) - calculated as total costs incurred divided by extensions and discoveries, revisions, improved recovery and purchases of proved reserves.

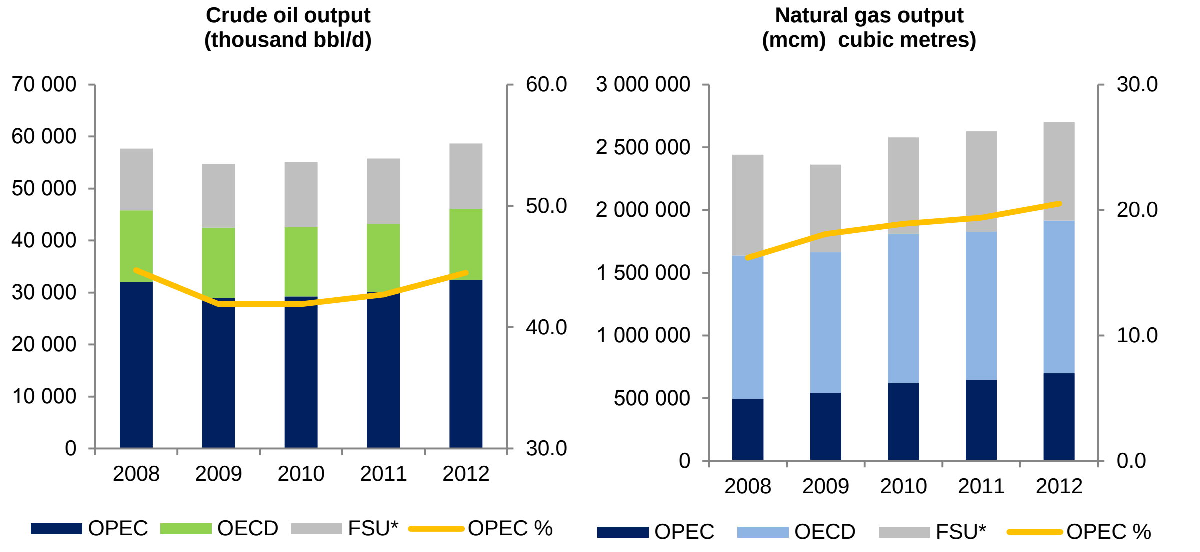
OPEC countries currently control approximately 42% of the world's oil production. Through their coordinated actions, members of the cartel respond quickly to market developments by imposing production quotas. The actions taken by OPEC stabilised crude oil prices during the 2008 global financial crisis.

In 2013, the total estimated crude oil output by the OPEC countries fell by 860 thousand bbl/d, which was driven mainly by reduced output in Libya and Iran, which was under sanction. Instability and deteriorating political situation in Libya led to unrest at the oil fields and export terminals. Crude oil output fell from 1.42 million bbl/d in April to only 230 thousand bbl/d in December 2013 (or down by 490 thousand bbl/d year on year).

Crude oil output in Iran fell during 2013 by 320 thousand bbl/d, to 2.68 million bbl/d. The far-reaching sanctions imposed on Iran have reduced the country's crude oil output by 1 million bbl/d since 2011. Diplomatic relations between Iran and the international community improved in the third quarter of 2013. However, any meaningful return of Iranian crude oil to the global markets will depend on Teheran's negotiations with the so-called P5+1 group (five permanent members of the UN Security Council, including the United States, Russia, China, the United Kingdom, and France, plus Germany).

The total crude oil output by non-OPEC countries accounted for ca. 60% of global production in the fourth quarter of 2013. Although oil supply from those countries grew in recent years, their shares in the global output of both crude oil and fuels have remained relatively unchanged since 2010. In its Oil Market Report released in January 2014, the IEA estimates that crude oil supply from non-OPEC countries grew in 2013 by 1.35 million bbl/d.

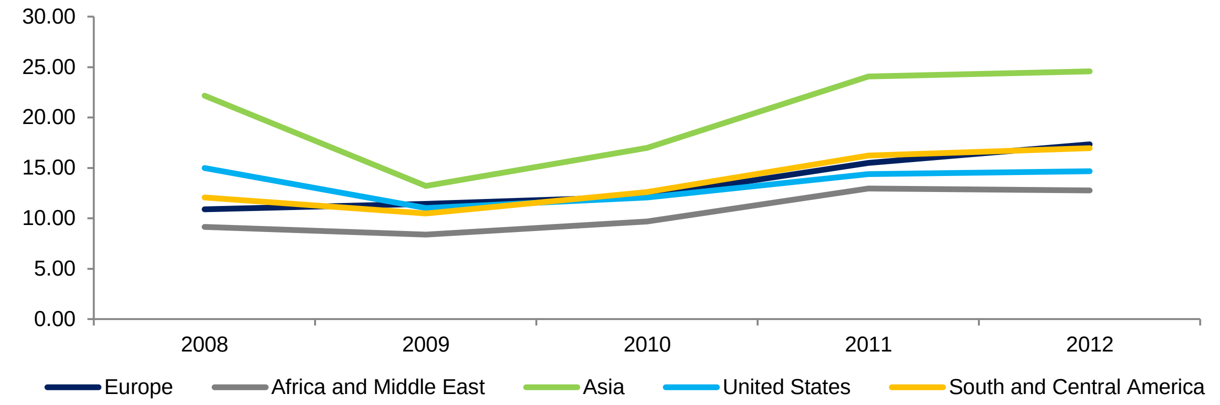
Graph 17. Global oil and gas production



Source: OPEC, Annual Statistical Bulletin, 2013.
** FSU − Former Soviet Union*

In 2012, production costs per barrel of oil equivalent grew slightly, by 3%, to USD 18.88 per boe.

Graph 18. Production costs (USD/boe)



Source: E&Y Global oil and gas reserves study, 2013.

** Production costs are calculated as total production costs, including production taxes, transport costs and production-related administrative expenses, divided by production volume.*

3.2.2. LEGAL ENVIRONMENT FOR EXPLORATION AND PRODUCTION ACTIVITIES IN POLAND

Exploration and production activities in Poland may be conducted under licence from the Minister of Environment. The procedure of applying for a licence for hydrocarbons exploration, appraisal and production is regulated by the Polish Geological and Mining Law, effective since January 1st 2012. The solutions contained in the Law are consistent with Directive 94/22/EC of the European Parliament and of the Council on the conditions for granting and using authorizations for the prospection, exploration and production of hydrocarbons.

As at December 31st 2013, the following E&P licences were valid[6]:

- 218 licences for exploration for and/or appraisal of conventional and unconventional hydrocarbon deposits,
- 239 licences for production of hydrocarbons from conventional sources.

Table 11. Entities holding the largest number of licences for exploration for and/or appraisal of conventional and unconventional sources of hydrocarbons

Entity	Number of licences for exploration for and/or appraisal of conventional and unconventional hydrocarbon deposits,
PGNIG S.A.	84
DPV Service Sp z o.o.	10
FX Energy Sp z o.o.	10
Orlen Upstream Sp z o.o.	10
LOTOS Petrobaltic S.A. (including 1 licence held through Baltic Gas Sp. z o.o. i Wspólnicy spółka komandytowa)	**9**

Table 12. Entities holding the largest number of licences for production of hydrocarbons from conventional sources

Entity	Number of licences
PGNIG S.A.	228
LOTOS Petrobaltic S.A. (including 2 licences held through Baltic Gas Sp. z o.o. i Wspólnicy spółka komandytowa)	**4**
FX Energy Sp z o.o.	2
ZOK Sp. z o.o.	2

In terms of production volume, LOTOS Petrobaltic's only competitor is PGNiG, whose 2013 production totalled 4.6bcm of natural gas and ca. 1.1m tonnes of crude oil and condensate. FX Energy's 2013 production reached ca. 2 thousand boe/d (on the Płotki licence in Poznań Province).

LOTOS Petrobaltic S.A., a subsidiary of Grupa LOTOS S.A. since 2005, is the only Polish enterprise engaged in hydrocarbons production in the Polish economic zone of the Baltic Sea. The company also operates in Lithuania and Norway.

[6] *Source: Ministry of Environment, January 1st 2014.*

3.2.3. COMPETITION IN THE EXPLORATION AND PRODUCTION BUSINESS

Continued high margins seen in the upstream industry, relative to the refining industry, have significantly spurred companies' activity on this market, which is highly demanding both financially (high capital expenditure) and in terms of access to products (licence requirements). In the short term, it creates high entry barriers in the sector. Nonetheless, competition in the sector is very intense. In both short- and medium-time horizons, there is no actual threat that crude oil and natural gas would be substituted with other energy carriers. Further, it is the market that shapes oil prices, hence individual customers have limited influence on the sector. In the upstream industry, suppliers of materials and services (e.g. drilling services providers, specialist submerged services providers and specialist consultancy firms) have very high bargaining power, which affects the time and cost of project execution.

The analysis of competition covers companies operating in the areas of the LOTOS Group's strategic interests, that is in the Polish Economic Zone of the Baltic Sea, in the inland territory of Poland and on foreign markets (Norway and Lithuania).

Baltic Sea, Polish Economic Zone

All exploration and appraisal licences and production licences in the Polish zone of the Baltic Sea are held by LOTOS Petrobaltic S.A. (or its subsidiaries). The Exploration and Production segment of the LOTOS Group carries out work on nine exploration and appraisal licences and on four production licences. Work on the exploration and appraisal licence Gaz Północ and production licences B4 and B6 is carried out in partnership with CalEnergy (through Baltic Gas Sp. z o.o. i Wspólnicy spółka Komandytowa).

Inland operations in Poland

LOTOS Petrobaltic launched onshore operations in Poland in partnership with PGNiG, which holds the largest number of hydrocarbon production, exploration and appraisal licences in the country.

PGNiG dominates the onshore licences market in Poland. In 2013, LOTOS Petrobaltic and PGNiG agreed to conduct joint operations in the Kamień Pomorski licence area and adopted a joint exploration programme. The possibility of further collaboration with PGNiG in more licence areas is being analysed.

Inland operations in Lithuania

AB LOTOS Geonafta, a company operating in Lithuania as part of the Group's exploration and production segment, is the leader of crude oil production in the country.

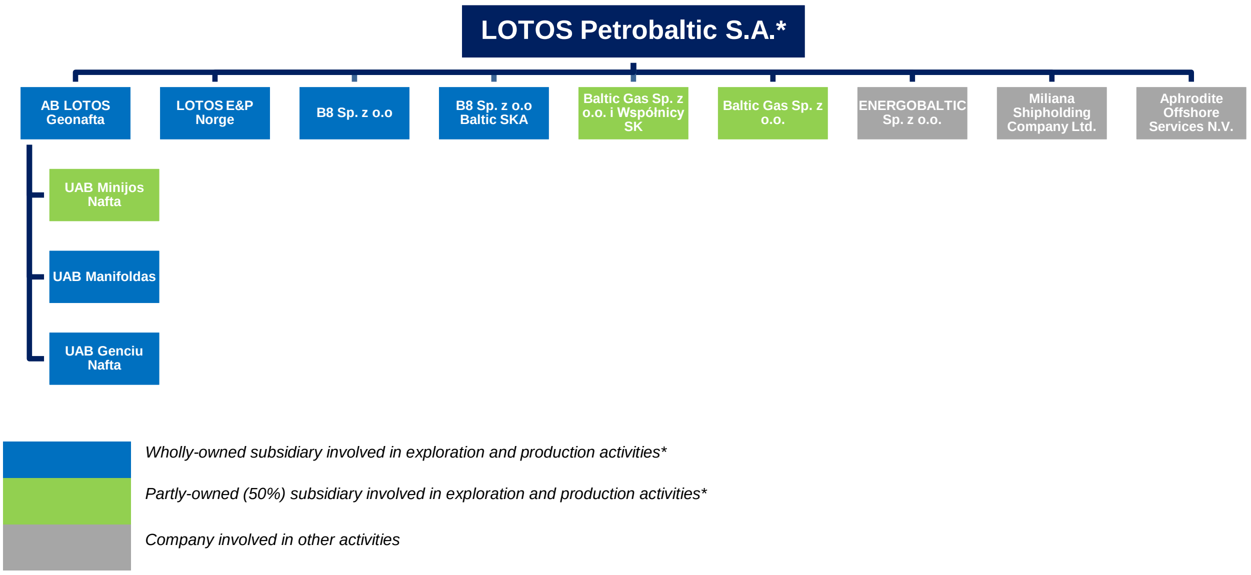
Chevron, which acquired a 50% interest in LL Investicios in 2012, also entered the Lithuanian market. Other active companies include Tethys Oil AB and Odin Energy AS, with shareholdings in UAB Minijos (where AB LOTOS Geonafta holds a 50% interest) and UAB LL Investicos, which holds the Garzdai, Raiseniani and Rietavas licences.

Norwegian Continental Shelf

Rich reserves and ongoing production of hydrocarbons make the Norwegian Continental Shelf a prospective area for the exploration and production industry. There are 57 international companies operating in the area, five of which launched their operations in 2013. Altogether, the largest companies, i.e. Statoil, Petoro, Total, Shell, Conoco, Exxon, Eni, BP, and Chevron, hold 65% of producing fields on the Norwegian Continental Shelf. From among 23 large companies, which hold 3.8% of the producing fields in total, LOTOS EPN is the 13th largest, next to Marathon, OMV, Lundin, BG Group, Lukoil, Repsol. The list of nine largest gas producing companies on the Norwegian Continental Shelf includes GDF Suez, Centrica, RWE, PGNiG, and BayernGas which hold a total of 5.9% of the recoverable natural gas reserves (bbl of crude oil). Among the 19 companies recognised for best practices in group transactions concluded in 2013 on the Norwegian Continental Shelf, LOTOS EPN was listed 11th, next to Lundin, RWE, Marathon, BG Group, Ithaca, Chevron, and Skagen 44. Companies whose scale of operations is similar to that of the LOTOS Group include Centrica, Valiant-Petroleum Company, Maersk Oil, Suncor Energy and Svenska Petroleum Exploration AB.

3.2.4. EXPLORATION AND PRODUCTION ACTIVITIES BY GEOGRAPHICAL REGION

Graph 20. Structure of the LOTOS Petrobaltic Group



**Grupa LOTOS S.A. holds a 99.98 interest in LOTOS Petrobaltic S.A.*

Poland – Baltic Sea

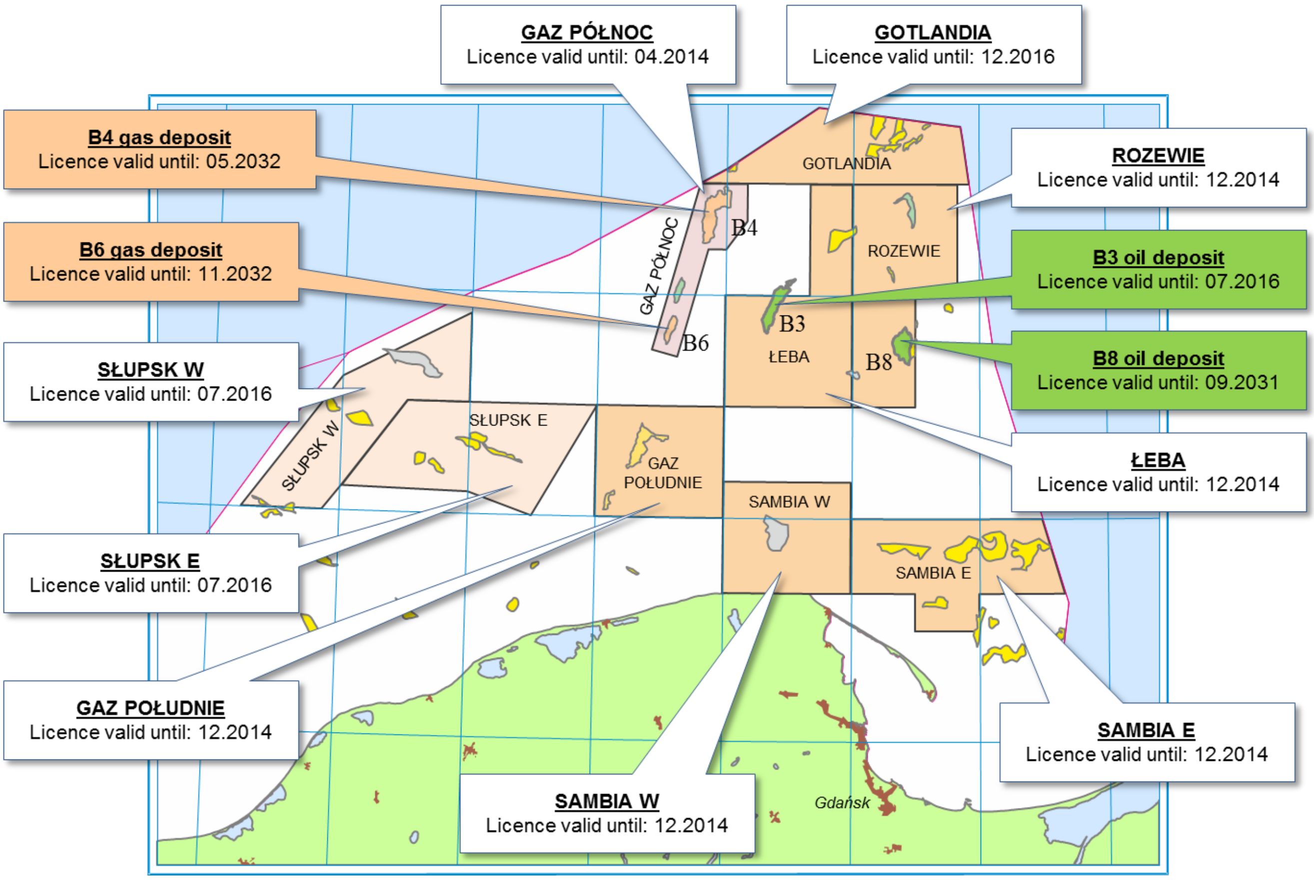
LOTOS Petrobaltic S.A. holds **nine oil and gas exploration and/or appraisal licences** covering areas in the Polish economic zone of the Baltic Sea. These include Gotlandia, Łeba, Rozewie, Gaz Północ (licence held by subsidiary Gas Sp. z o.o. i Wspólnicy Spółka komandytowa), Gaz Południe, Sambia E, Sambia W, Słupsk W and Słupsk E. The Słupsk E and Słupsk W licences were added to the company's portfolio in 2013. The total area of LOTOS Petrobaltic S.A.'s licences is more than 8.5 thousand km^2.

LOTOS Petrobaltic S.A. holds **four licences for hydrocarbon production** in the Baltic Sea, including:

- Production licence for the B-3 field; the licence allows extraction of crude oil and associated natural gas in an area located around 73 km north off Cape Rozewie. The field has been producing since 1992 and the licence remains valid until 2016. Currently, a process is underway to extend the validity of the licence until 2026.
- production licence for the B-8 field; the licence provides for extraction of crude oil and associated natural gas in an area located approximately 70 km north of Jastarnia. The field is currently being developed, and the licence remains valid until 2031.
- B4 and B6 production licences (held by subsidiary Baltic Gas Sp. z o.o. i Wspólnicy Spółka komandytowa); the licences allow extraction of natural gas north of Łeba. Preparations are underway to develop the fields in partnership with CalEnergy Resources Poland Sp. z o.o. Under a cooperation agreement, a 100% interest in

the licence is held by Baltic Gas sp. z o.o. i Wspólnicy Spółka komandytowa. The licences are valid until 2032.

Graph 21. LOTOS Group's licences in Poland



In 2013, in the Baltic Sea, LOTOS Petrobaltic S.A. conducted production in the B3 field. Total production of crude oil from the Baltic Sea fields in 2013 was 145.6 thousand tonnes, while production of the associated natural gas was reported at 16mcm.

As at the end of 2013, LOTOS Petrobaltic S.A.'s 2P reserves of crude oil in the Baltic Sea were 5.06m tonnes, whereas its 2P reserves of natural gas were 0.37 bcm.

Lithuania:

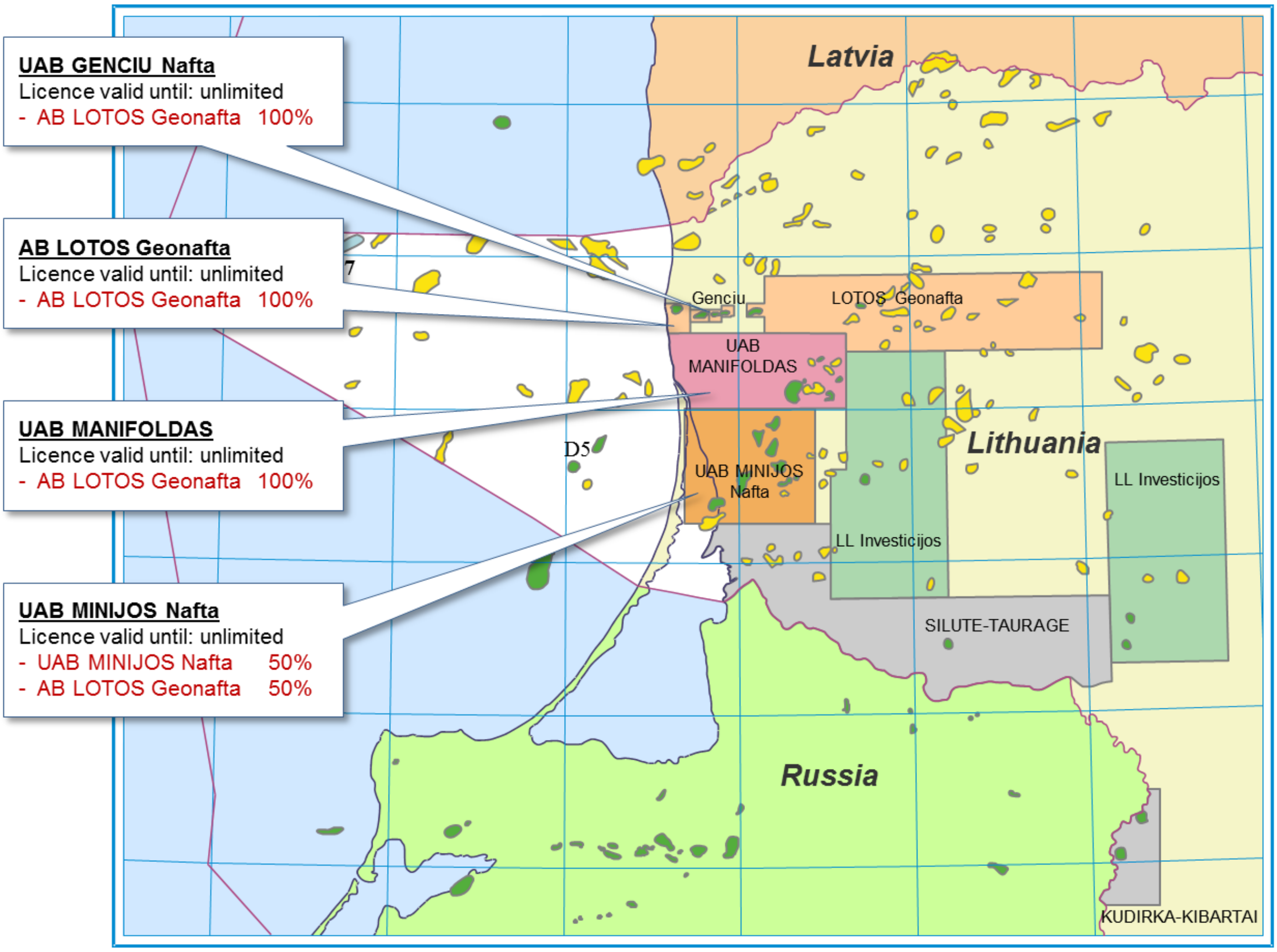
The Group's presence in Lithuania is AB LOTOS Geonafta, a 99.99% subsidiary of LOTOS Petrobaltic (1 share in the company is held by Grupa LOTOS S.A.).

The AB LOTOS Geonafta Group comprises:

- UAB Genciu Nafta (wholly-owned by AB LOTOS Geonafta),
- UAB Minijos Nafta (50% owned by AB LOTOS Geonafta),
- UAB Manifoldas (wholly-owned by AB LOTOS Geonafta).

AB LOTOS Geonafta conducts exploration for and production of crude oil and provides drilling services in Lithuania. The company is also engaged in crude oil trading. In aggregate, companies of the AB Geonafta Group extract hydrocarbons from 14 oil fields.

Graph 22. LOTOS Group's licences in Lithuania



In 2013, the AB LOTOS Geonafta Group produced 73.5 thousand tonnes of crude oil (attributable to the licence interests held by the AB LOTOS Geonafta Group).

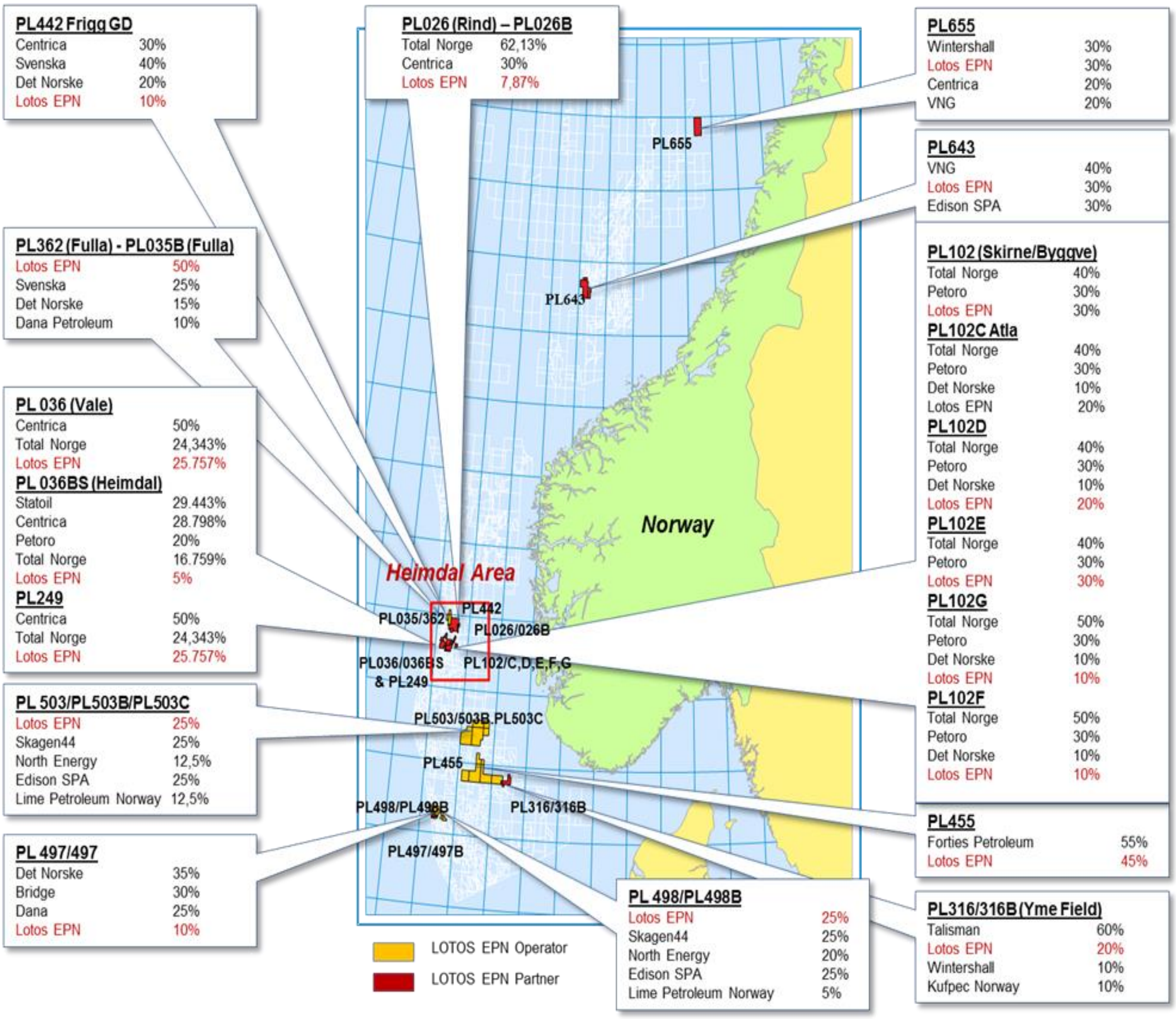
As at the end of 2013, the AB LOTOS Geonafta Group's 2P reserves of crude oil were to 0.98m tonnes.

Norway – Norwegian Continental Shelf:

LOTOS Exploration & Production Norge AS (LOTOS EPN) of Stavanger, Norway, is the subsidiary responsible for the development of operations on the Norwegian Continental Shelf. Following the **Heimdal acquisition**, LOTOS EPN holds interest in 24 licences for oil exploration and production on the Norwegian Continental Shelf: PL 316, PL316B, PL 455, PL 498, PL 497, PL497B, PL 503, PL503B, PL 643, PL 655; and the licences acquired as part of Heimdal portfolio: PL026, PL026B, PL035B, PL036BS, PL036, PL102, PL102D, PL102E, PL102G, PL102F, PL102C, PL249, PL362, and PL442.

LOTOS EPN is the operator on six licences: PL035B and PL362 (since January 16th 2014), PL455, PL 498, PL 503, and PL503B.

Graph 23. LOTOS Group's licences in Norway



On January 21st 2014, following analysis of applications filed by 50 companies that participated in the APA 2013 round (Awards in Pre-defined Areas), the Norwegian authorities decided to award to LOTOS EPN **two new licences: 503C and 498B**, on which LOTOS EPN will act as the operator.

Once all formal requirements are fulfilled, LOTOS EPN will hold a portfolio of 26 licences and will act as operator on eight of them.

LOTOS EPN holds a 20% interest in **PL316/316B − YME licence**, developed by a consortium which includes Talisman Energy, a Canadian company, as the operator. In March 2013, as part of efforts to recover funds invested in the YME project, Talisman (the operator) and SBM Offshore entered into agreement on removal of the defective platform and payment of compensation by the platform's owner, SBM.

On December 30th 2013, following the acquisition of Heimdal production assets, LOTOS EPN commenced production from Vale, SkirneByggve, and Atla fields on the Norwegian Continental Shelf. Production from LOTOS EPN's interest is estimated at 5 thousand boe/d (approximately 240 thousand toe − tonnes of oil equivalent) a year.

As at December 31st 2013, crude oil and natural gas reserves classified as 2P held by LOTOS EPN were 2.04m tonnes and 0.72bcm, respectively.

Increase in the LOTOS Group's oil and gas reserves

LOTOS Petrobaltic S.A. (in which Grupa LOTOS S.A. holds a 99.98% interest) re-evaluated its crude oil and natural gas reserves as at the end of 2013, in accordance with the internationally recognised SPE 2007 classification. The re-evaluation was approved by the Ministry of Environment in 'Supplement No. 1 to the geological documentation of the B3 oil field', which showed increased values of LOTOS Petrobaltic S.A.'s 2P reserves.

Another development which significantly added to the LOTOS Group's 2P reserves was the acquisition of new assets by LOTOS EPN. The reclassification takes into account the interests held by the Petrobaltic Group in hydrocarbon exploration, evaluation and production licences.

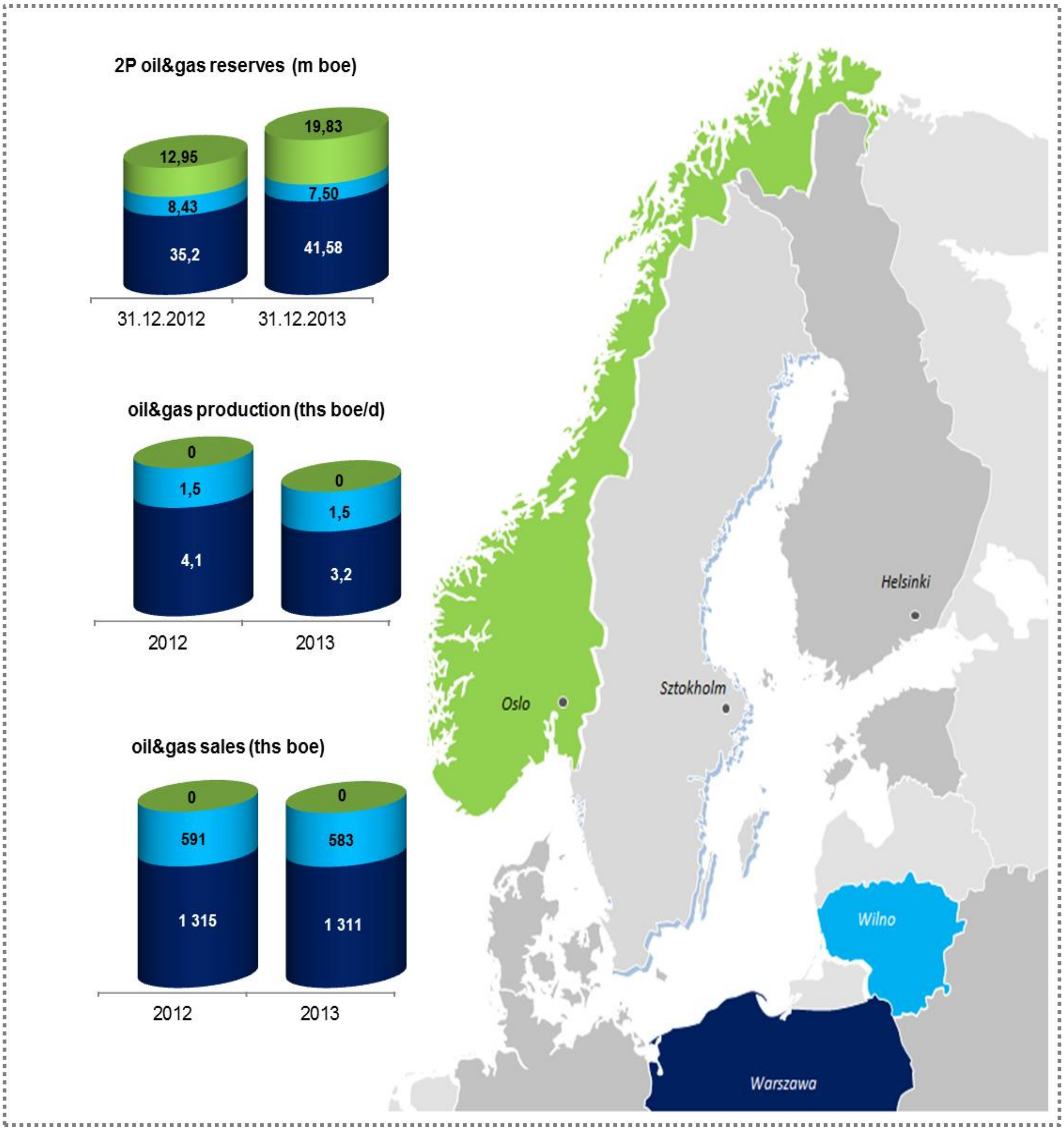
Table 13. Reserves (m boe)**

As at	Domestic sales	Crude oil	Natural gas	Total crude oil and natural gas
Dec 31 2013	Poland	39.28	2.30	**41.58**
	Norway	15.30	4.53	**19.83**
	Lithuania:	7.50	0.00	**7.50**
Dec 31 2012	Poland	32.16	3.04	**35.20**
	Norway	12.95	0.00	**12.95**
	Lithuania	8.43	0.00	**8.43**

The LOTOS Group’s recoverable (2P) reserves of crude oil and natural gas increased to 8.08m tonnes and 1.09bcm – approximately by 16% and 125%, respectively − relative to the amounts disclosed as at December 31st 2012 in the Directors’ Report on the Operations of the LOTOS Group.

** 2P – proved and probable reserves (according to the SPE 2007 international classification),*
***boe – barrels of oil equivalent*

Graph 19. Reserves, production and sales of oil & gas by LOTOS Petrobaltic Group



Source: Grupa LOTOS S.A.

3.2.5. IMPORTANT EVENTS IN THE UPSTREAM SEGMENT IN 2013

Poland

Baltic Sea

- Following the on-schedule completion of the **PG-1 rig overhaul** and the workover of producer and injector wells, the PG-1 node on the Baltic B3 oil and gas field was launched at improved capacity.

- LOTOS Petrobaltic completed the **development plan for the B8 oil field in the Baltic Sea** on schedule. The company also carried out drilling work on the B8-5K well, selected a contractor for key design, procurement and management of shipyard operations, as well as the construction design for the conversion of the Petrobaltic rig into a Production Centre. On October 7th 2013, Polskie Inwestycje Rozwojowe S.A. and LOTOS Petrobaltic S.A. executed an agreement on the financing of the B8 field development.
- Jack-up (self-elevating) **GSF Monitor platform** was purchased. The platform, named LOTOS Petrobaltic, will take over the drilling operations following the conversion of the existing Petrobaltic rig into a production centre on the B8 field. The platform will be moved to the Baltic Sea in Q1 2014, where it will begin drilling within LOTOS Petrobaltic's licences. At present, the platform is capable of drilling in offshore areas at depths of 350 ft. (105 m), but the unit's legs can be extended by 50 feet, which means that it can operate in depths of up to 120 m.
- The Company was engaged in **preparatory work on the B4 and B6 gas fields** in partnership with CalEnergy Resources Poland. Following approval by the Ministry of Environment, the exploration and appraisal licence for the Gas Północ area and the B4 and B6 production licences were transferred to Baltic Gas Sp. z o.o. i Wspólnicy Spółka Komandytowa on March 13th 2013. In April 2013, CalEnergy became a limited partner in Baltic Gas Sp. z o.o. i Wspólnicy Spółka Komandytowa, a partnership established by LOTOS Petrobaltic S.A. for the purposes of the investment agreement with CalEnergy of October 30th 2012. In 2013, 3D seismic surveys were completed in the Gaz Północ licence area. The company analysed optimum development concepts, looked into the possibility of using existing offshore and onshore infrastructure, and held negotiations with potential customers for natural gas. Negotiations with CalEnergy concerning the FEED design phase, scheduled for 2014, were finalised in December 2013.
- LOTOS Petrobaltic carried out intensive exploratory and appraisal activities in the Baltic Sea. The Minister of Environment granted the Company **two new exploratory licences: Słupsk W and Słupsk E**. At present, the total area of the Company's Baltic Sea licences is over 8.5 thousand km². In 2013, 2D and 3D seismics were collected in six licence areas (Gaz Południe, Gaz Północ, Łeba, Rozewie, Sambia W and Sambia E) for 400 km^2 and 870 km², respectively.

Inland operations

- On August 14th 2013, LOTOS Petrobaltic and PGNIG executed an agreement on joint operation in one of the most prospective licences in the region, the **Kamień Pomorski onshore licence**, which is located in the Szczecin Province and has an area of 217 km². The exploratory work covered by the agreement will allow the partners to appraise the reserves and decide whether to launch production.

Lithuania

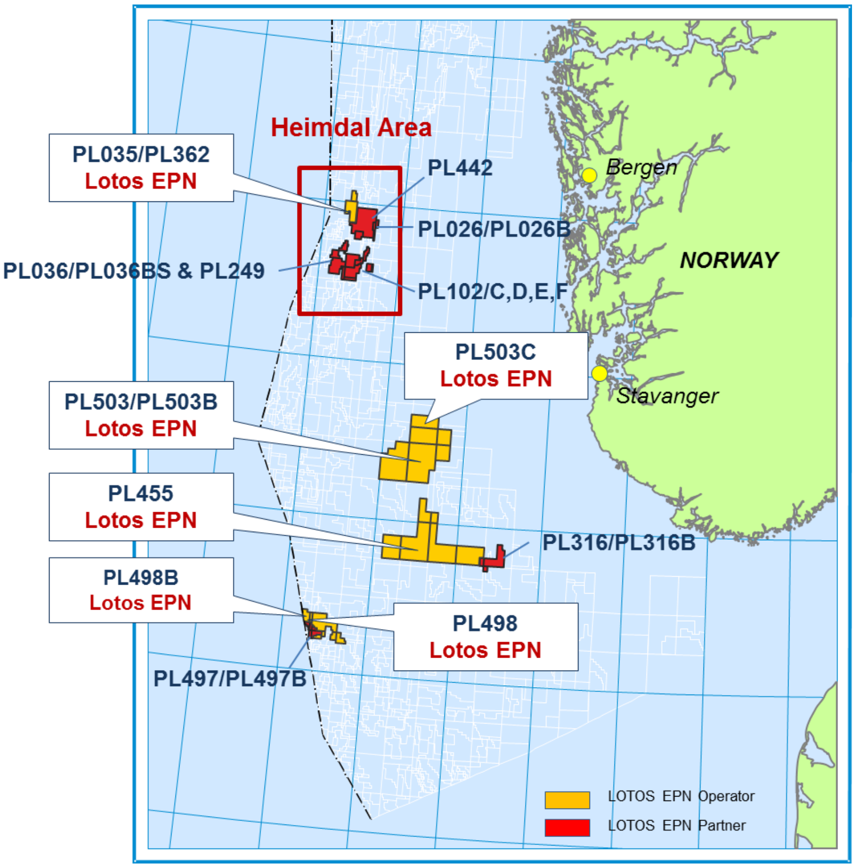
- Five new wells were completed as part of the production well drilling programme;
- Seismic surveys were carried out in Klaipėda, Ablinga, and Lizai/Auksoras areas;
- Potential for production intensification using Enhanced Oil Recovery was reviewed.

Norway

- On October 18th 2013, LOTOS EPN signed with Centrica an agreement to purchase **a portfolio comprising Heimdal exploration and production assets**. On December 18th 2013, all conditions precedent to the purchase were satisfied, and on December 30th 2013 the transaction was closed with an effective date of January 1st 2013 (valuation date, i.e. the start of settlement of pre-tax cash flows between the Purchaser and the Seller as part of the pro and contra mechanism). The transaction covers 14 licences in the central part of the North Sea, including: Heimdal gas hub (operated by Statoil), three production fields (Byggve/Skirne, Atla, and Vale), three fields to be developed (Frigg GammaDelta, Fulla and Rind), as well as exploration prospects. As at the effective date of the transaction, i.e. January 1st 2013, proved recoverable volumes of the producing fields were 9m boe, with contingent reserves in undeveloped fields amounting to 31m boe. The value of the transaction was USD 175.8m. By 2016, the transaction will allow LOTOS EPN to recover two-thirds of its tax shield.

- On March 1st 2013, **Talisman Energy (the Yme field operator) and SBM Offshore (rig owner)** reached an agreement on removal of the defective rig from the Yme field. The agreement was the final point of negotiations and made the start of technical operations possible. Under the agreement, SBM Offshore paid the joint venture partners an amount of USD 470m. On behalf of the licence holders, Talisman Energy agreed to make the necessary preparations and remove the platform from the field. SBM Offshore will be responsible for towing and scrapping the platform onshore. Further, ownership of the subsea structure supplied by SBM Offshore will be transferred to the joint venture partners. The parties will cover the costs of decommissioning work as set out in the agreement.

Graph 24. Assets acquired as part of the Heimdal transaction

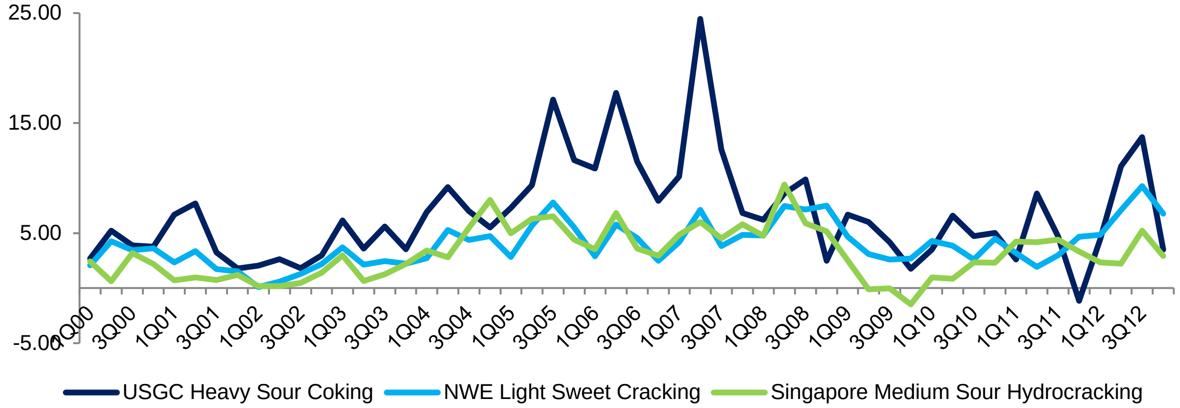


3.3. REFINERY

3.3.1. TRENDS ON THE GLOBAL REFINING MARKET

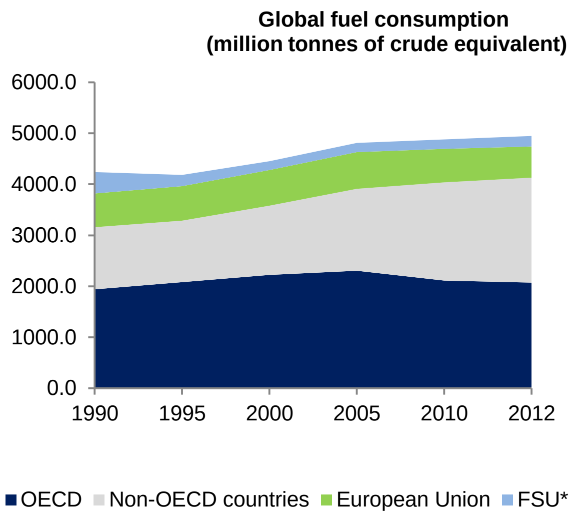
Between 2004 and 2008, European refineries experienced a period of prosperity, when stable demand for petroleum products and limited conversion opportunities drove profitability up. However, the European refining sector changed significantly in the wake of the 2008 global financial crisis. The 2009 drop in demand for petroleum products forced European refineries to reduce their output. This coincided with the construction of several conversion projects, which meant that the gap between low- and high-margin (white) products started to narrow. Furthermore, the United States, the largest gasoline buyer, reduced imports. All of these developments had a negative impact on the financial situation of European manufacturers. Consequently, the European downstream sector is experiencing a major crisis.

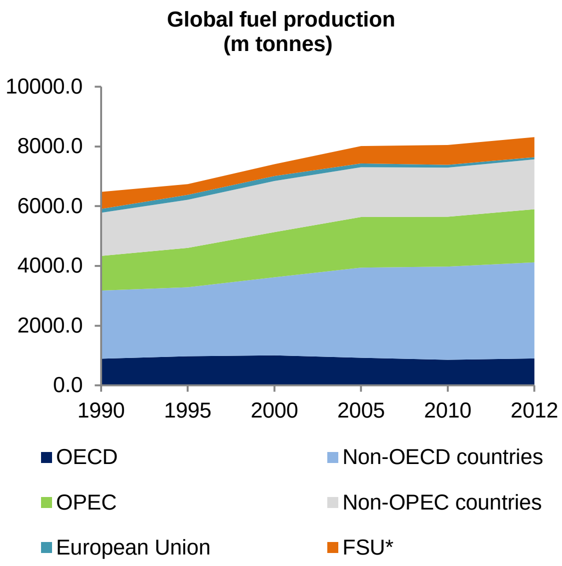
Graph 25. Refining margins globally (USD/bbl)



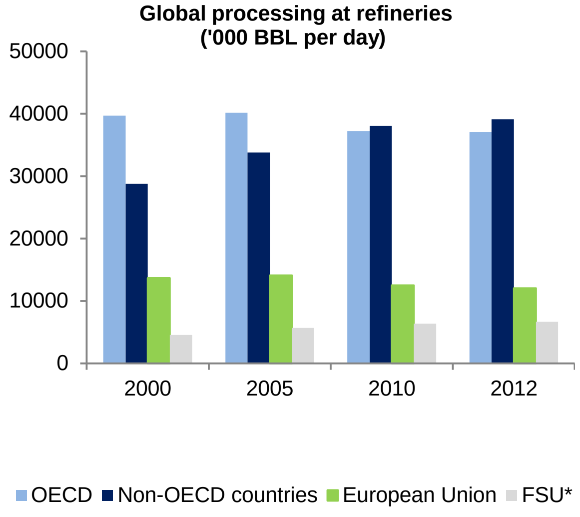
Source: In-house analysis based on BP data. The presented refining margins are benchmark margins for three major global refining centres: US Gulf Coast (USGC), North-West Europe (NWE – Rotterdam) and Singapore.

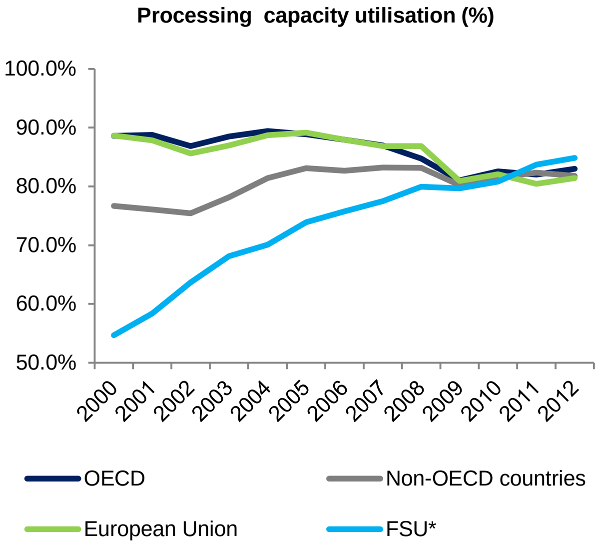
Graph 26. Global fuel consumption and production





Graph 27. Global throughput and refining capacity





Source: In-house analysis based on BP data.

** FSU − Former Soviet Union*

Since 2009, several refineries with a combined processing capacity of 3.7m barrels per day have been closed down in the Atlantic area. However, this scaling back still seems to be insufficient, as many European refineries generate low returns, and their processing capacities are relatively low. Small refineries with very low complexity are particularly exposed to the risk of closure, given their high unit operating costs. The shutting down of European refineries poses a risk to Europe's energy security, in its various aspects. It may render the continent more dependent on imports of refining products, increase its susceptibility to disruptions in supplies and dependence on import terminals and refining product storage facilities.

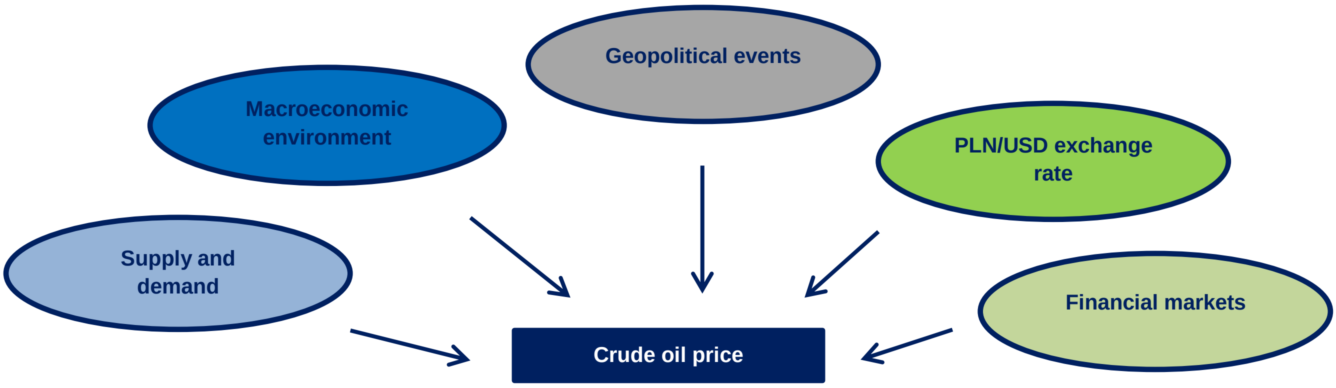
Table 14. Refinery shutdowns in Europe in 2009−2013

Refinery	Owner / Company	Country	Capacity ('000 bbl/d)	Date
Wilhelmshaven	Hestya Energy	Germany	260	2009
Coryton	Petroplus	United Kingdom	220	2012
Petit Couronne	Petroplus	France	162	2012
Lisichansk	Rosneft	Ukraine	160	2012
Dunkirk	Total	France	140	2009
Teesside	Petroplus	United Kingdom	117	2009
Harburg	Shell	Germany	110	2013
Gela	Eni	Italy	105	2013
Cremona	Tamoil	Italy	90	2011
Rome	Total	Italy	86	2012
Reichstett	Petroplus	France	85	2010
Falconara	API	Italy	83	2013
Porto Marghera	Eni	Italy	80	2013
Arpechim	Petrom	Romania	70	2012
Paramo	Unipetrol	Czech Republic	20	2012

** Source: www.platts.com, Insight, December 2013*

3.3.2. CRUDE OIL PRICING FACTORS

Graph 28. Pricing factors in the oil market



Urals-Brent differential

As its main feedstock, Grupa LOTOS S.A. uses Russian REBCO crude (Russian Export Blend Crude Oil). Compared with the global Brent benchmark, REBCO is a heavier crude with higher sulfur content, and yields more middle distillates (diesel oil, aviation fuel).

Brent Blend is a light sweet crude produced in the North Sea, with approximately 38 API gravity* and sulfur content of approximately 0.4%.

Russian Export Blend (a Russian crude benchmark) is a blend of several crude types used domestically or exported. Russian crude is a medium sour crude with approximately 32 API gravity and sulfur content of approximately 1.4%.

Lower parameters of this feedstock are the cause of the discount against the Brent crude benchmark. The difference in prices between the two types of crude is called Urals-Brent differential (USD/bbl). The higher the spread, the higher the refining margins earned by Polish refiners.

Table 15. Characteristics of crude oils

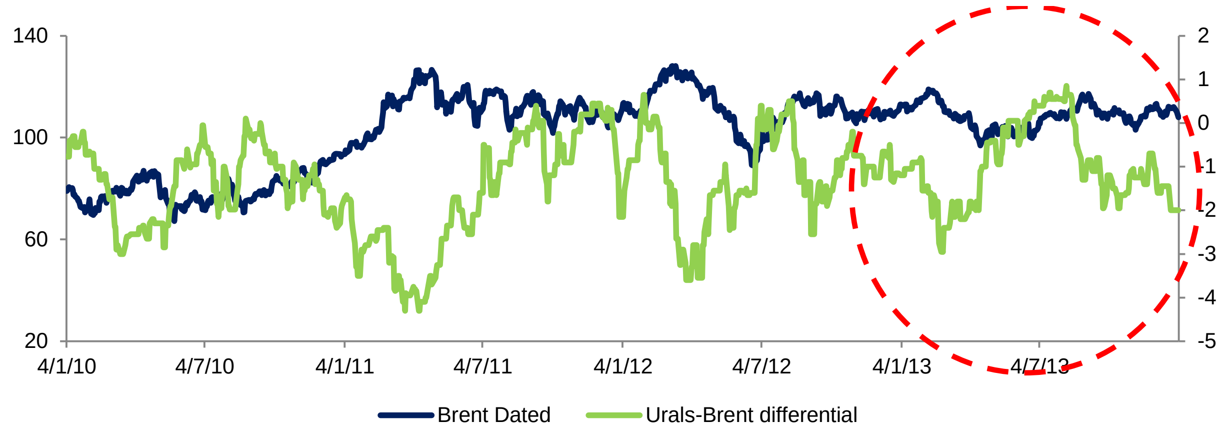
	Brent Blend	Urals
Source	United Kingdom	Russia
Density (g/ml)	0.833	0.866
API*	38.3	31.9
Sulfur (wt %)	0.42	1.43

Table 16. Fractional content (wt %)

	Brent Blend	Urals
Gases	2.5	1.6
Gasolines	20.8	12.9
Oil	11.9	10.4
Diesel oils	23.7	22.9
Vacuum oils	26.5	29.3
Vacuum residue	14.7	22.9

* API gravity – crude oil density measure developed by the American Petroleum Institute (API). The higher the API gravity, the lighter the crude oil. Light crude oils have API gravity of 38 or more, whereas heavy crude oils – of 22 or less. Crude oils with API gravity between 22 and 38 are generally referred to as medium.

Graph 29. Urals-Brent differential



Source: In-house analysis based on Thomson Reuters data.

The decline of Urals-Brent differential from the mid-2013 levels to USD -1.45/bbl as at the end of the year increased pressures on Grupa LOTOS S.A.'s margins. The discount-to-premium conversion in prices of the Russian crude resulted from geopolitical factors (one-off events), such as the embargo on the Iranian crude, collapse in production in Libya, terrorist attacks on the Kirkuk-Ceyhan pipeline (which affected supplies of Kirkuk crude from Iraq and pushed up prices of Ural crude), and increase in processing capacities of the Russian refineries.

3.3.3. REFINING INDUSTRY IN 2013 – OVERVIEW

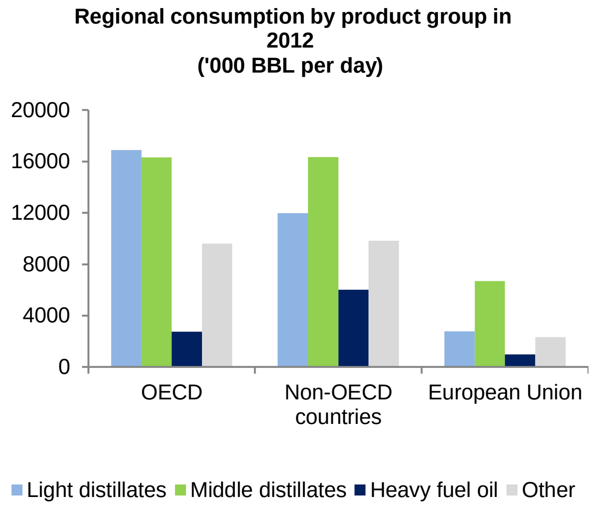
The year 2013 saw an increase in the global demand for crude oil, with differences in growth rates between individual continents continuing. Global demand grew by an estimated 0.9m bbl/d, while in Europe, the demand fell by 0.22m bbl/d, on the back of the lingering economic crisis in several European countries. In 2013, the global supply (OPEC countries excluded) increased. This supply expansion is estimated at 1.2m bbl/d, including approximately 1.0m bbl/d contributed by the increased production in the US and Canada. In Europe, the supply declined.

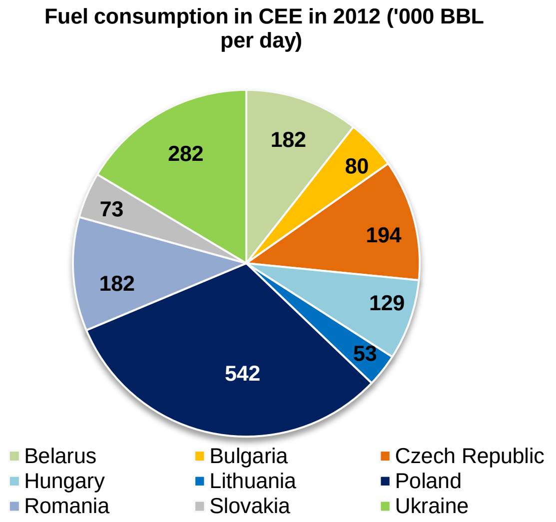
The key drivers of the situation in the refining sector include the skyrocketing supply in North America and increased demand seen in non-OPEC countries. The rising supply accompanied by declining domestic consumption have transformed the United States from the largest global importer of refining products into the largest net exporter. The shale revolution and low gas prices have enhanced the competitiveness of US refineries.

The average refining capacity utilisation in Europe was approximately 71% in October 2013, with the daily output falling below 9m bbl, one of the lowest values in recent years. The change was a result of a decrease in refining margins, seen in H2 2013, despite a large number of maintenance shutdowns at West European refineries (especially in Belgium and Sweden).

The average refining capacity utilisation in the US was approximately 88.4% in November 2013, with several refineries placed in operation following completion of maintenance shutdowns.

Graph 30. Fuel consumption in 2012





Source: In-house analysis based on BP data.
** FSU – Former Soviet Union*

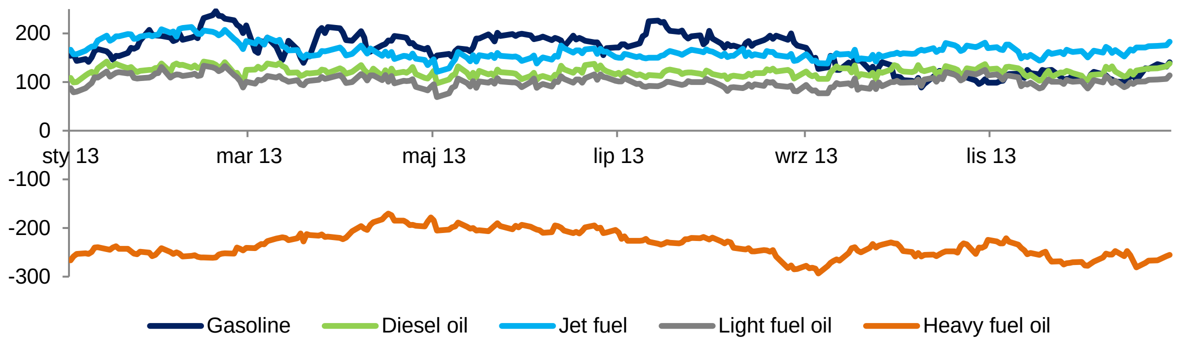
In 2013, refining margins in Europe declined under heavy stress from sustained high prices of crude oil, stoked by such factors as supply interruptions and lack of stability in deliveries caused by geopolitical factors.

The crack margin erosion was not equally spread among all product groups. Gasoline crack proved the weakest, which was a consequence of poor macroeconomic data from the US (including depressed fuel consumption). The lowest gasoline crack margin of USD 88.84 per tonne was recorded on October 10th 2013, while the highest crack of USD 245.73 per tonne - on February 19th 2013; the crack change for the year was -8.4% or -USD 12.9 per tonne.

The other crack margins were as follows:

- Diesel oil – low: USD 96.18/t (February 28th 2013), high: USD 141.86/t (January 14th 2013) – annual change: +26.9% or USD +29.3/t
- Jet fuel – low: USD 120.75/t (May 3rd 2013), high: USD 213.16/t (February 11th 2013) – annual change: +9.8% or USD +16.3/t
- Light fuel oil – low: USD 69.25/t (May 3rd 2013), high: USD 133.49/t (February 15th 2013) – annual change: +30.2% or USD +26.3/t
- Heavy fuel oil – low USD -293.11/t (September 6th 2013), high: USD -170.37/t (April 17th 2013) – annual change: +4.3% or USD +11.6/t.

Graph 31. 2013 crack margins (USD/t)



Source: In-house analysis based on Thomson Reuters data.

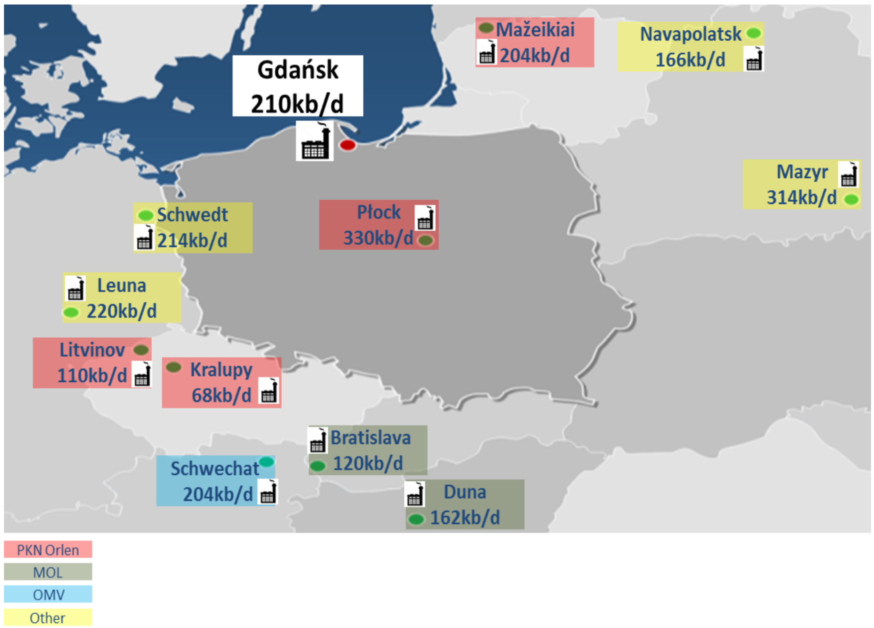
3.3.4. GRUPA LOTOS S.A.'S REFINERY IN GDAŃSK

The refinery operated by Grupa LOTOS S.A. in Gdańsk is one of the newest and most advanced plants in Europe, with an annual processing capacity of 10.5m tonnes of crude. Its excellent condition is chiefly attributable to the 10+ Programme, completed in 2011. Even though the refinery has been in operation for nearly 40 years, the average in-service life of its units is approx. 11 years.

With the cost of EUR 1.43bn, the +10 Programme has been the largest industrial investment project in Poland of the last decade. During its implementation, LOTOS cooperated with global suppliers of state-of-the-art solutions for the petrochemical industry, such as Shell, ABB, CB&I, KBR, Technip and Lurgi. Through the application of the latest technologies, the refinery became a “green”, environmentally-friendly and safe production plant.

Grupa LOTOS S.A. has implemented an Integrated Management System compliant with the standards for quality (ISO 9001), environmental protection (ISO 14001) and occupational health and safety (ISO 18001).

Graph 32. Gdańsk refinery vs. local competitors



Source: In-house analysis; daily production capacity in thousands of barrels.

Key competitors in the region:

- Płock refinery (PKN Orlen), Poland – processing capacity of approximately 16m tonnes
- Schwedt refinery (PCK Raffinerie GmbH), Germany – approximately 12m tonnes
- Leuna refinery (TOTAL Group), Germany – approximately 11m tonnes
- Schwechat refinery (OMV), Austria – approximately 10m tonnes
- Mažeikiai refinery (PKN Orlen), Lithuania – approximately 10m tonnes
- Bratislava refinery (Slovnaft, MOL Group), Slovakia – approximately 6m tonnes
- UniPetrol refineries in Kralupy, Litvinov and Pardubice (PKN Orlen), the Czech Republic – approximately 4m tonnes

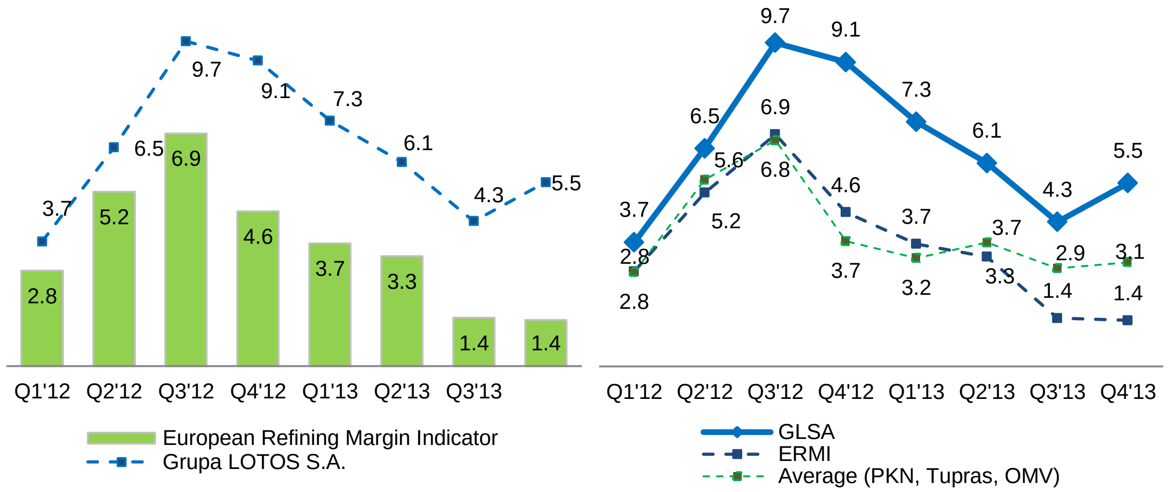
The level **model refining margin** confirms high efficiency of the technological configuration of the Grupa LOTOS refinery.

The model margin is calculated for a yield structure estimated in the averaged scenario (excluding the annual seasonality) of typical annual operation of the refinery. Annual throughput has been assumed to correspond to the capacity utilisation of 95% if Urals crude was the only feedstock, whose value is determined as the sum of Dtd Brent price and the Urals vs. Brent spread.

The method takes into account the efficiency improvement brought about by the +10 Programme and the Gdańsk refinery's switch to natural gas as the fuel source, which have led to:

- improved product mix,
- reduced consumption of crude oil for own needs thanks to the enhanced energy efficiency profile, achieved through modernisation (maintenance shutdown).

Graph 33. Grupa LOTOS S.A.'s model refining margin vs. competitors' margins (USD/bbl)



Source: In-house analysis based on the data from the companies.

More information on the method of calculating the model refining margin and data updates are available at:

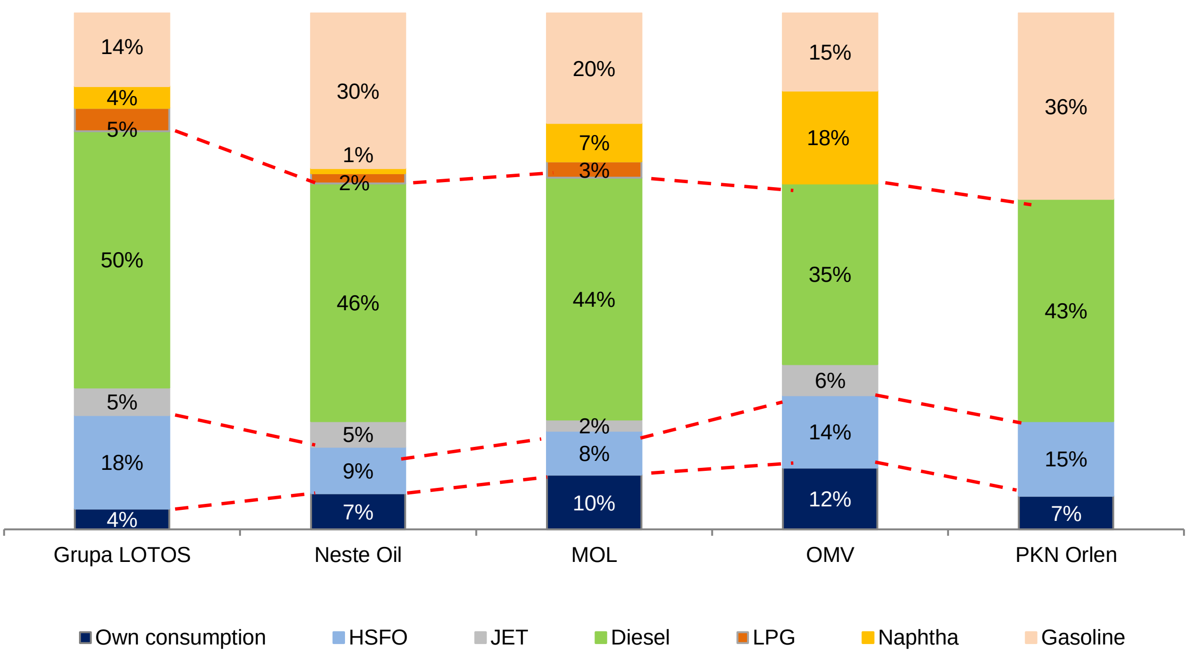
http://inwestor.lotos.pl/1439/strefa_inwestora/modelowa_marza_rafineryjna

In 2013, individual product margins were defined by lower cracks on motor gasolines, driven by growing imports of motor gasolines to Europe, especially from North America. This situation allows refineries focusing on middle distillates (especially diesel oil), such as the Grupa LOTOS refinery in Gdańsk, to improve their market position.

The lower share of motor gasolines in our refinery's output is conducive to maximising the refining margin relative to competitors. Diesel oil has the largest share in the yields structure, which is consistent with the growing popularity of diesel oil observed in the past several years. The relatively high share of heavy fuel oil in the output justifies the delayed coking unit project, which is currently being considered by the Company (for more information on the DCU, see page 21), which will enable conversion of negative-margin heavy residues to high-margin products, such as diesel oil or LPG.

The chart below presents differences between the product yields of refineries operated by Grupa LOTOS S.A.'s direct competitors.

Graph 34. Yield structure of refineries operated by local competitors of Grupa LOTOS S.A.

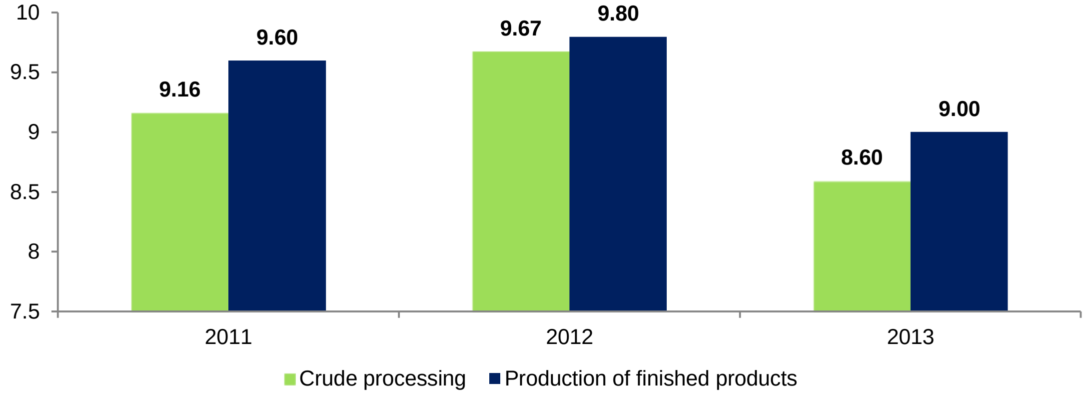


Source: In-house analysis based on competitors' data.

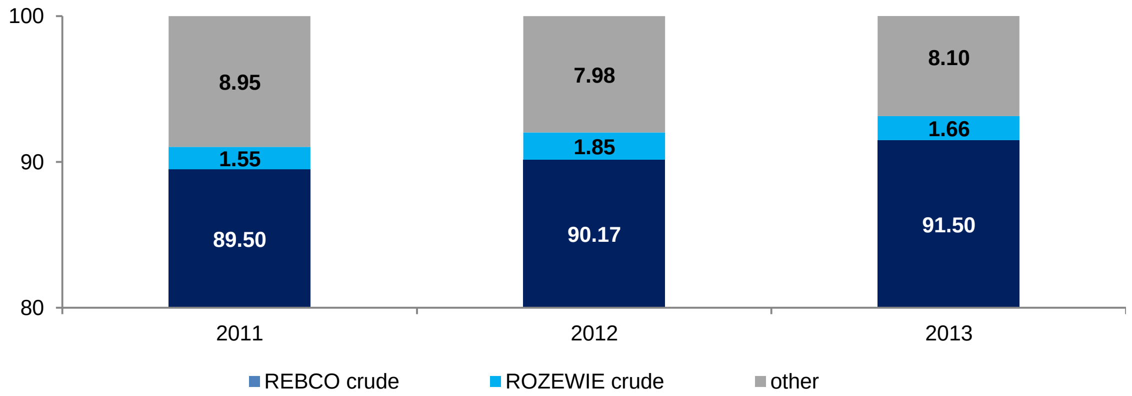
3.3.5. KEY PRODUCTS, MERCHANDISE AND SERVICES

In 2013, the Grupa LOTOS refinery processed 8.7 million tonnes of crude, which means that **the average annual utilisation rate of the installed capacities was approximately 90%.** As in previous years, the main type of crude processed was Russian REBCO. Its share in the total volume was approx. 90.4% and remained relatively flat on previous years. Crude oil imported by sea, including approx. 140 thousand tonnes of Rozewie crude supplied by LOTOS Petrobaltic, accounted for the balance of the crude feed. Following LOTOS Petrobaltic's acquisition of AB Geonafta, the Gdańsk refinery also began processing crude oil supplied from Lithuania. In 2013, the Grupa LOTOS refinery processed 48 thousand tonnes of Lithuanian crude.

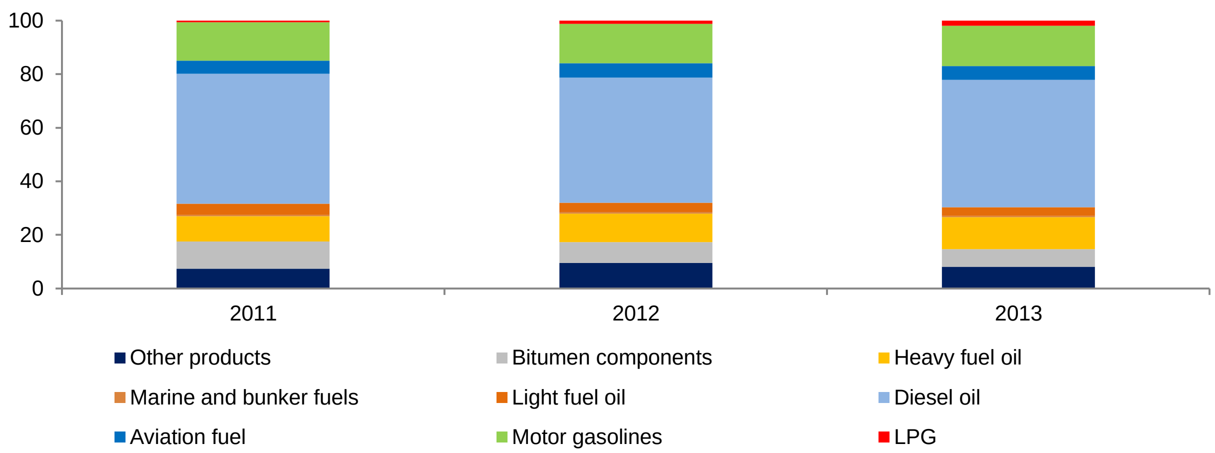
Graph 35. Crude oil processing and production of finished products at the Grupa LOTOS refinery (million tonnes)



Graph 36. Crude slate, by weight (%)



Graph 37. Finished products, by weight (%)



Key products

- **LOTOS DYNAMIC 98 unleaded gasoline** – modern fuel offering better performance and engine protection than standard products. The gasoline contains antioxidants and washing additives which support better cleaning of the engine, lengthen its useful life and economise fuel consumption.
- **LOTOS DYNAMIC DIESEL diesel oil** – fuel for diesel engines, especially valued by operators of delivery vehicle and lorry fleets. Owing to the use of friction-reducing components, it offers more power efficiency of the engine and guarantees start-up at -32°C. The additives significantly improve nozzle flow capacity and engine lubricity, extend useful life and improve performance of the engine.
- **LOTOS RED heating diesel oil** (ONDCO) – owing to its unique additives and low sulfur content, the product has exceptional parameters in terms of oxidation resistance, anti-corrosive action and maintaining cleanness of nozzles, thus extending the useful life of heating equipment. In addition, emissions of noxious combustion products have been significantly reduced.
- **IZ40 diesel oil** – arctic fuel, guarantees engine start-up at very low temperatures (CFPP of -32°C).
- **LPG** – mixture of liquefied hydrocarbons, consisting primary of propane and butane. With both gasses mixed in correct proportions, the LPG can offer optimum working parameters.
- **LOTOS Quazar engine oils** – premium product based on state of the art technologies. The product line, which was designed for distribution through the chain of Authorised Service Stations, is for cars which have been used for less than three years. The LOTOS Quazar LLIII 5W-30 oil meets one of the most stringent technical specifications for passenger cars in the world – the German VW 504.00/507.00 norm. It is an example of the modern engine oil concept, which is no longer universal, but dedicated to specific users of specific car makes. In 2012, LOTOS executed a cooperation agreement with the Association of Volkswagen and Audi Dealers in Poland, which brings together authorised dealers of cars manufactured under VW's German, Spanish and Czech marques. Thus the two brands joined the group of partner brands, which previously comprised Subaru and KIA.
- **LOTOS Thermal Control engine oils** – product line comprising synthetic, semi-synthetic and mineral products dedicated to passenger cars.
- **LOTOS TURDUST engine oils** – product line for HGVs. The oils meet the requirements of leading engine producers such as Man, Scania, Tatra, MB, Volkswagen, Volvo and Renault and have been approved by them.
- **Industrial oils** is a category comprising gear, hydraulic, turbine and machine oils, as well as industrial lubricants. Grupa LOTOS is consistently expanding the range of products in the hydraulic (**Hydromil**), transmission (**Transmil**) and turbine oil (**Remiz**) product lines.
- **TDAE and RAE** class plasticizers marketed under the **QUANTILUS T50 and QUANTILUS T60** brands, used by European and Asian tire and rubber manufacturers. These products meet the requirements of the EU REACH directive and have been approved by global tire manufacturers.
- **MODBIT modified bitumens** – state-of-the-art bitumens enhancing pavement resistance to rutting, extending pavement durability and increasing resistance to extreme weather conditions. In 2012, the production technology for rubber-modified bitumen was developed. The new product will be commercialised in 2013.
- **Xylene fraction** is a product launched in 2012, obtained through reformate splitting. It is used as feedstock in plastics production. The xylene separation will further diversify the Grupa LOTOS product portfolio and reduce the share of aromatic hydrocarbons in the range of gasoline components produced by the Gdańsk refinery. This will contribute to greater technological flexibility of the refinery, while allowing it to sell some of

the components on the fuel or petrochemical market.

3.3.6. MATERIAL EVENTS IN THE REFINERY BUSINESS

The spring 2013 overhaul shutdown at the Grupa LOTOS refinery was one of the year's more significant developments. It was the first major shutdown since the refinery's expansion under the 10+ Programme. The purpose of such shutdowns is to ensure safe operation of refinery equipment by restoring their full functional efficiency. It is only during these stoppages that certain inspections required by the Office of Technical Inspection can be carried out. In addition, the downtime was an opportunity to implement a number of upgrades, which could not be done while the unit was operational. In the Gdańsk refinery, overhaul shutdowns are carried out at four year intervals.

The overhaul schedule was prepared in accordance with refining industry benchmarks, with the target overhaul duration across key process units within the European average. Additionally, in the refinery's current configuration, works could be divided between two independent oil distillation lines, the overhaul of which was phased. As the total downtime was reduced, with the 2013 overhaul's duration being shorter than in the previous years, the shutdown's impact on the market availability of the refinery's products was limited.

During the shutdown, certain new units were brought onstream a number of investment projects finalised, including:

- Installation of new process furnaces on the gasoline desulfurisation unit,
- Modernisation of the unit's gasoline separation column,
- Process integration of a new liquid gas separation column,
- Process connections at the flare gas recovery unit.

The oil processing downtime was 30 days, which affected the total output in 2013. The Gdańsk refinery processed 8.6m tonnes of crude, which means that **the average annual utilisation rate of the installed capacities was approximately 82%.**During the year, the refinery’s workload was adjusted to accommodate difficult market conditions.

3.4. RETAIL SALE OF FUELS

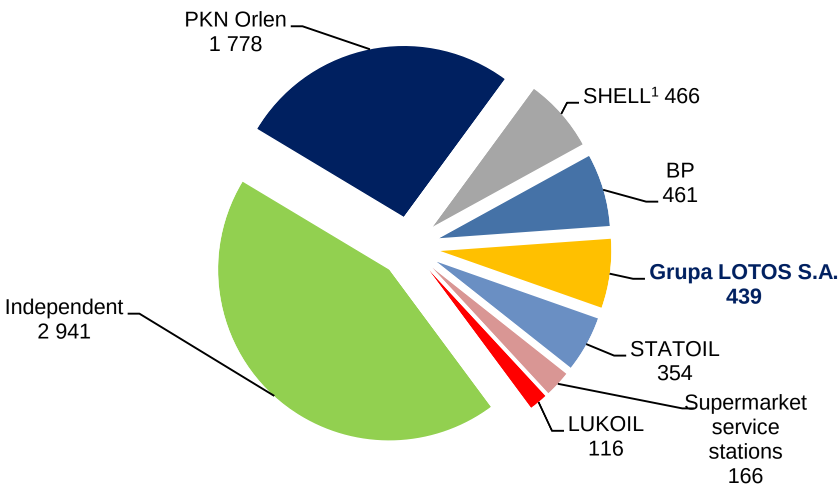
3.4.1. OVERVIEW OF THE RETAIL BUSINESS

According to the Polish Organisation of Oil Industry and Trade (POPiHN), there were more than 6.7 thousand service stations operating on the Polish fuel market in 2013. As in the previous years, nearly one third of the stations belonged to domestic operators, 21% were owned by international corporations, while almost 44% operated independently. The network's expansion was centred around Company-Owned Dealer-Operated (CODO) stations – with Shell recording the largest increase in the number of stations following purchase of the Neste chain of 88 stations – as well as Dealer-Owned Franchise-Operated (DOFO) stations. Relative to its competitors, LOTOS has the second fastest growing service station chain in Poland, surpassed only by Shell.

The number of service stations in corporate chains continues to rise, while the network of independently-operated stations is gradually consolidating and shrinking. These tendencies will be particularly apparent in the following year as the Ministry of Economy's regulation on the obligatory modernisation of service station storage tanks comes into effect.

Expansion of Poland's motorway network has been accompanied by the appearance of a growing number of motorway service stations. At the end of the year, there were 55 Motorway Service Areas (MSAs) in Poland, including 14 under the LOTOS brand.

Graph 38. Poland's retail fuel market as at the end of 2013



Source: Polish Organisation of Oil Industry and Trade (POPiHN).

(1) Including 88 Neste Oil stations acquired in 2013

LOTOS Group's position on the retail market

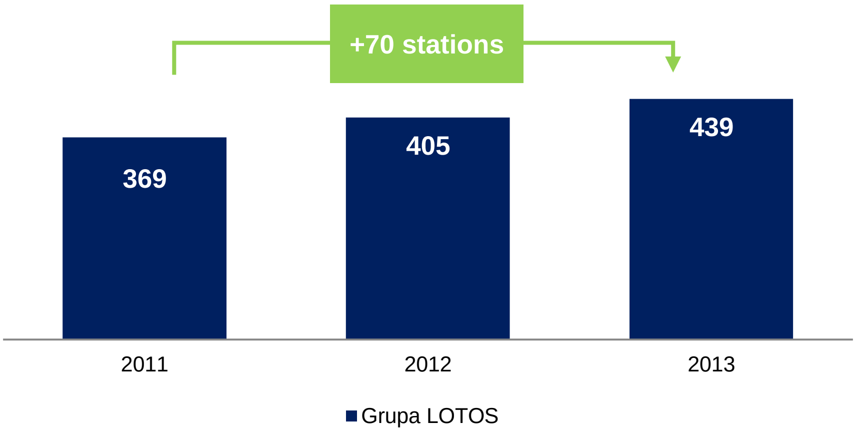
LOTOS Paliwa sells fuels through a chain of service stations organised into Economy and Premium segments.

The dynamic expansion of the LOTOS network, which in 2013 was the second fastest growing service station chain in Poland, strengthened the LOTOS Group's presence on the retail market, pushing its share up to 8.5% at the end of 2013 (8% in 2012). The current rate of growth in retail sales will help LOTOS to pursue its strategic goal of achieving a 10% share in the market by the end of 2015.

In 2013, in response to customers' expectations, the service station network underwent final segmentation, with individual stations being assigned either to the Premium or the Economy segments, and a uniform visual design was implemented across the entire Premium chain to standardise the LOTOS' branding. As in the previous years, the premium segment offered its customers a varied range of fuels (LOTOS Dynamic brand) and food products, as well as other products under the LOTOS Navigator loyalty programme.

LOTOS Optima recorded a marked growth in the economy segment. At the end of 2013, there were 151 stations operating under this brand, which is 50 more than at the beginning of the year.

Graph 39. Change in the number of stations – 5 largest players on Poland's retail fuel market (2011–2013)

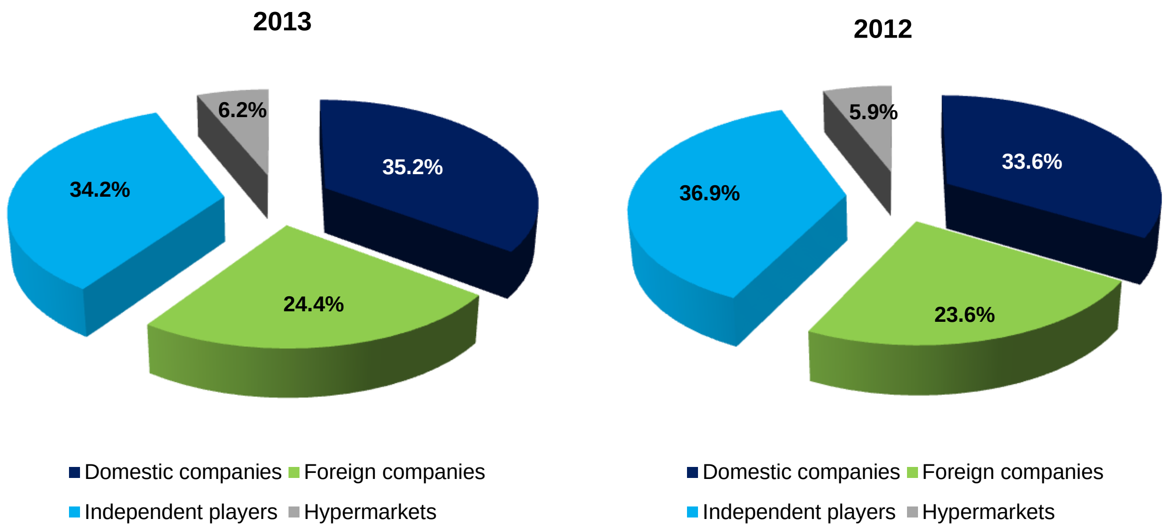


Source: In-house analysis based on Polish Organization of Oil Industry and Trade (POPiHN) data.

Grupa LOTOS S.A. concentrated on organic growth, increasing its number of service stations by 70 relative to the end of 2011. By contrast, the Shell network's expansion was attributable to its acquisition of the Neste self-service franchise in June 2013.

Also oil majors and hypermarkets enhanced their positions on the retail fuel market in 2013. The network of stations owned by independent operators shrank, reducing their market share by nearly 3pp.

Graph 40. Structure of liquid fuel retail sales in 2012



Source: Polish Organisation of Oil Industry and Trade (POPiHN).

3.4.2. LOTOS SERVICE STATION NETWORK

In 2013, as in previous years, work continued on expanding the LOTOS network by adding new stations to the CODO (company owned) and DOFO (franchise operated) chains. The concept of OPTIMA budget stations was also dynamically developed. As a consequence of the decisions made in previous years, retail sales from DODO stations were gradually scaled down in 2013, with only 17 outlets remaining in the chain at the end of the year.

As at December 31st 2013, the following stations operated under the LOTOS and LOTOS Optima brands:

LOTOS Premium

142 CODO stations

14 MSAs

115 DOFO stations

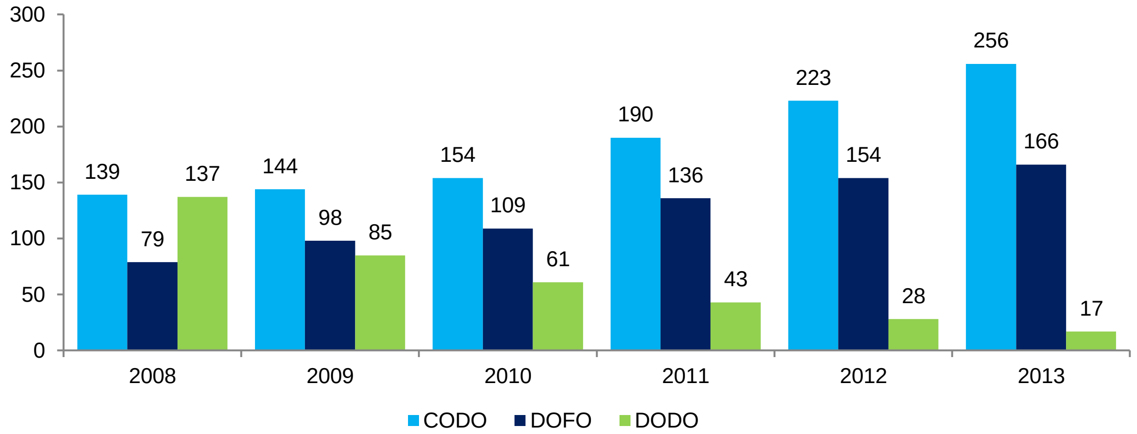
17 DODO stations

LOTOS Optima

100 CODO stations

51 DOFO stations

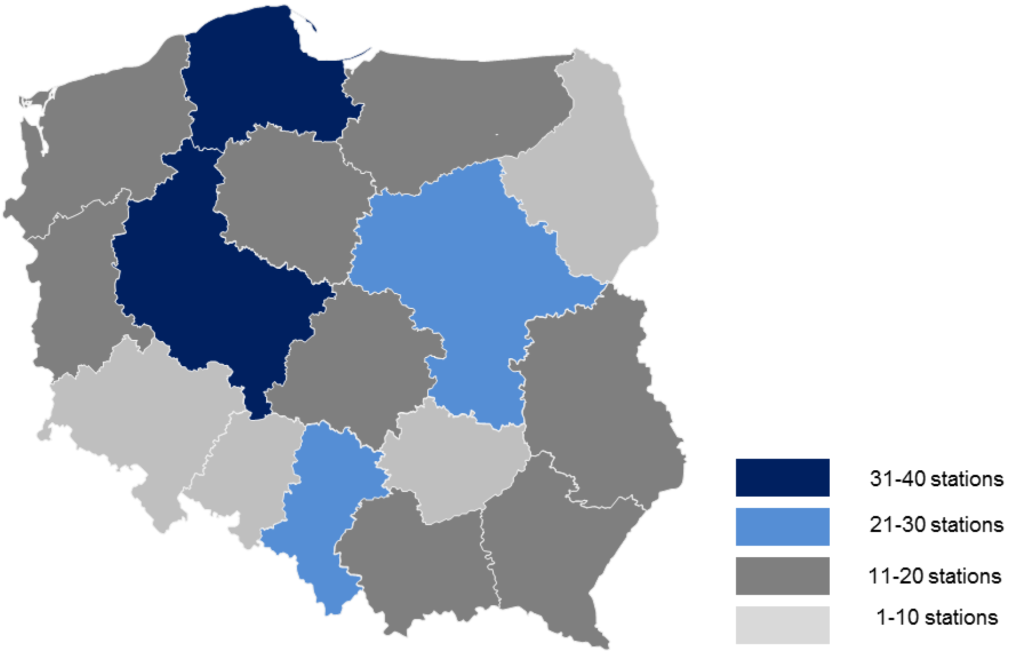
Graph 41. The LOTOS network's structure by distribution channels – CODO, DOFO and DODO



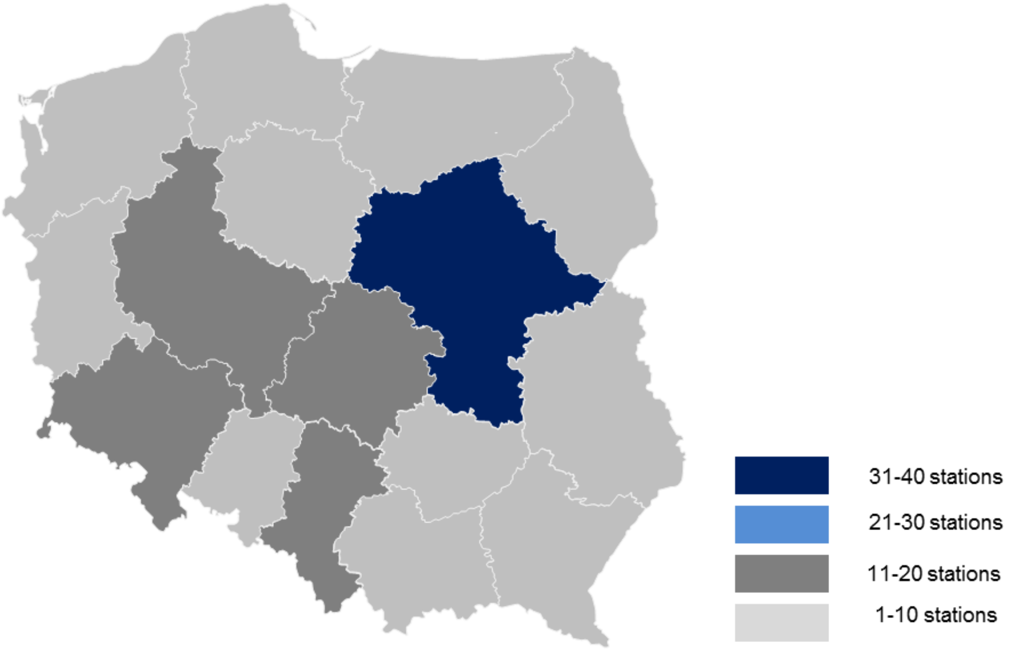
Source: In-house analysis by LOTOS Paliwa

As regards the expansion of the network of CODO stations, the process of acquiring properties is currently in progress, with the most important selection criterion location being the sales potential of the local market. 33 service stations (including 3 MSAs) were added to the CODO network in 2013, while the DOFO franchise expanded by 11 service stations in the reported period.

Graph 42. LOTOS Premium stations



Graph 43. LOTOS Optima stations



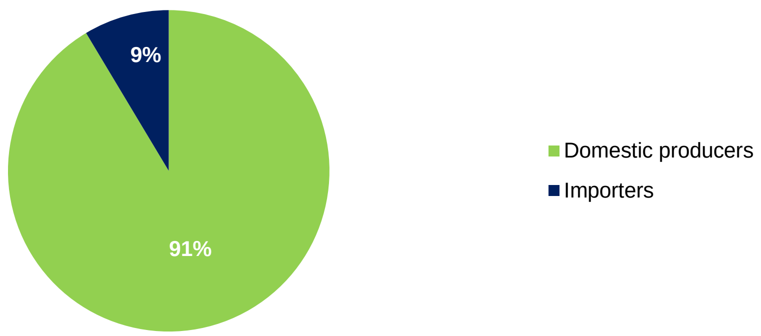
Graph 44. Motorway Service Areas (MSAs)

3.5. WHOLESALE OF FUELS

3.5.1. OVERVIEW OF THE WHOLESALE MARKET AND LOTOS GROUP’S POSITION

Poland's wholesale market is supplied from two sources: domestic producers (PKN Orlen S.A. and Grupa LOTOS S.A.) and importers. The LOTOS Group's wholesale customers, from its perspective as a fuel producer, are foreign companies and B2B customers, i.e. independent operators. Both customer groups operate in wholesale as well as retail segments of the Polish market.

Graph 45. Estimated structure of domestic market supplies



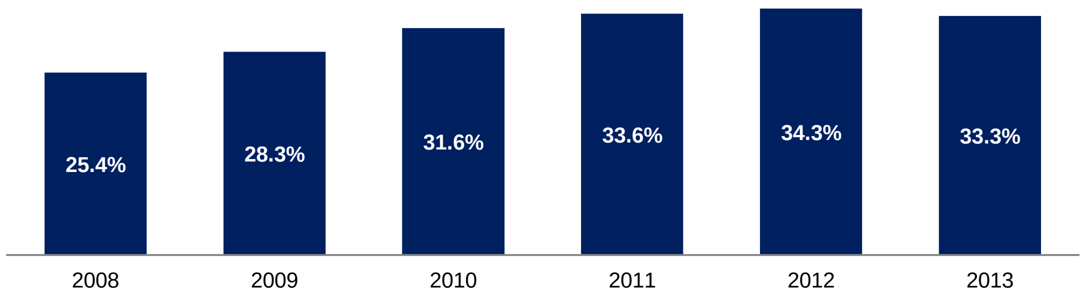
Source: Polish Organisation of Oil Industry and Trade (POPiHN).

Considering the conditions on the Polish market in 2013 – which included an over 5% drop in demand for fuels – the processing capacities of two domestic producers (ca. 26.5m tonnes) were sufficient to fully satisfy the national demand. According to the 2013 data provided by POPiHN, Poland was a net exporter of petroleum products.

Based on estimates by the LOTOS Group and POPiHN, the decline in demand seen in 2013 was largely attributable to the rapid growth of the grey market, which remains one of the fuel industry's main concerns.

In the face of the grey market's continuous expansion, the LOTOS Group has enjoyed a stable position for several years and has been able to maintain its share in the domestic fuel market above the target level (30%). In 2013, the LOTOS Group's share of the market was 33.3% (2012: 34.3%).

Graph 46. LOTOS Group's share in the domestic fuels market



Source: In-house analysis based on Polish Organization of Oil Industry and Trade (POPiHN) data.

3.5.2. PRODUCTS, MERCHANDISE AND SERVICES

The part of the LOTOS Group's production which is not distributed via its own chain of retail service stations is sold on the domestic fuel market or exported.

The key customers on the domestic fuel market are:

- international oil companies present on the Polish market, including Statoil, Shell, BP, and Lukoil,
- B2B customers operating independent service stations or conducting wholesale operations on local markets,
- National institutions – as part of nationwide tenders.

Key export customers are international trading companies.

Table 16. LOTOS Group's sales by products, merchandise and services ('000 t)

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012		change 2013/2012
	thousand tonnes	% share	thousand tonnes	% share	%
Gasolines	1,514	**16.2%**	1,508	**14.8%**	**0.4%**
Naphtha	286	**3.1%**	356	**3.5%**	**-19.7%**
Reformate	-	**-**	130	**1.3%**	**-100.0%**
Diesel oils	4,371	**46.8%**	4,592	**45.2%**	**-4.8%**
Bunker fuel	40	**0.4%**	34	**0.3%**	**18.80%**
Light fuel oil	293	**3.1%**	338	**3.3%**	**-13.3%**
Heavy fuel oil	1.086	**11.6%**	1,075	**10.6%**	**1.0%**
JET A-1 fuel	450	**4.8%**	543	**5.3%**	**-17.1%**
Lubricants	72	**0.8%**	69	**0.7%**	**4.2%**

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012		change 2013/2012
	thousand tonnes	% share	thousand tonnes	% share	%
Base oils	152	**1.6%**	152	**1.5%**	-0.1%
Bitumens	610	**6.5%**	753	**7.4%**	-19.0%
LPG	220	**2.4%**	173	**1.7%**	27.5%
Other petroleum materials	246	**2.6%**	434	**4.3%**	-43.3%
Total petroleum products, merchandise and materials	**9,340**	**100.0%**	**10,158**	**100.0%**	-8.17%

The volume of products sold by the LOTOS Group in 2013 was 9,340 thousand tonnes, 8.17% down year on year. The decline was chiefly a result of the adverse conditions on the domestic market, and lower demand for transport fuels and bitumen.

Like in the previous years, diesel oil had the largest share in the total sales volume. In 2013, the sales volume of diesel oil was 4,371 thousand tonnes, which accounted for 46.8% of total sales. The second largest item in the structure of the LOTOS Group's sales were gasolines, whose share in total sales volume was 16.2%. The sales volume of gasolines in 2013 was 1,514 thousand tonnes, having grown year on year by 0.4%. Another items with a large share in the LOTOS Group's sales volume was heavy fuel oil (11.6%); its sales volume was up 1% (from 1,075 thousand tonnes in 2012 to 1,086 thousand tonnes in 2013).

Table 17. LOTOS Group's revenue by products, merchandise and services

	in the period Jan 1 - Dec 31 2013		in the period Jan 1 - Dec 31 2012	
	PLN '000	**% share**	**PLN '000**	**% share**
Gasolines	5,010,064	**17.5%**	5,221,788	**15.9%**
Naphtha	824,241	**2.9%**	1,097,071	**3.3%**
Reformate	-	**0.0%**	458,827	**1.4%**
Diesel oils	14,365,265	**50.1%**	16,374,326	**49.6%**
Bunker fuel	124,661	**0.4%**	111,347	**0.3%**
Light fuel oil	942,434	**3.3%**	1,145,857	**3.5%**
Heavy fuel oil	2,037,899	**7.1%**	2,226,874	**6.7%**
Aviation fuel	1,474,528	**5.2%**	1,855,654	**5.6%**
Lubricants	380,218	**1.3%**	367,701	**1.1%**
Base oils	485,887	**1.7%**	568,804	**1.7%**
Bitumens	1,246,061	**4.4%**	1,730,266	**5.2%**
LPG	564,540	**2.0%**	502,388	**1.50%**
Crude oil	32,094	**0.1%**	239,828	**0.7%**
Other refinery products, merchandise and materials	517,155	**1.8%**	765,660	**2.3%**
Other products, merchandise and materials	300,683	**1.1%**	180,823	**0.5%**
Services	304,064	**1.1%**	280,877	**0.8%**

	in the period Jan 1 - Dec 31 2013		in the period Jan 1 - Dec 31 2012	
	PLN '000	% share	PLN '000	% share
Effect of cash flow hedge accounting	(12,452)	0.0%	(17,091)	-0.1%
Total	28,597,342	100.0%	33,111,000	100.0%

Table 18. LOTOS Group's sales by products and markets

		in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012		Change 2013/2012
		thousand tonnes	% share	thousand tonnes	% share	%
Domestic sales	Gasolines	974	**10.4%**	1,105	**10.9%**	**-11.9%**
	Diesel oils	3,950	**42.3%**	4,256	**41.9%**	**-7.2%**
	Bunker fuel	40	**0.4%**	34	**0.3%**	**18.80%**
	Light fuel oil	293	**3.1%**	338	**3.3%**	**-13.3%**
	Heavy fuel oil	70	**0.7%**	117	**1.2%**	**-40.5%**
	JET A-1 fuel	84	**0.9%**	110	**1.1%**	**-24.0%**
	Lubricants	49	**0.5%**	50	**0.5%**	**-1.7%**
	Base oils	7	**0.1%**	7	**0.1%**	**-10.4%**
	Bitumens	457	**4.9%**	532	**5.2%**	**-14.1%**
	LPG	197	**2.1%**	163	**1.6%**	**21.1%**
	Other petroleum materials	137	**1.5%**	300	**3.0%**	**-54.2%**
Domestic sales, total		**6 258**	**67,0%**	**7,012**	**69,0%**	**-10.8%**
Export sales	Gasolines	540	**5.8%**	403	**4.0%**	**34.0%**
	Naphtha	286	**3.1%**	356	**3.5%**	**-19.7%**
	Reformate	-	**0.0%**	130	**1.3%**	**-100.0%**
	Diesel oils	421	**4.5%**	337	**3.3%**	**25%**
	Bunker fuel	-	**0.0%**	0	**0.0%**	**0.0%**
	Heavy fuel oil	1,016	**10.9%**	958	**9.4%**	**6.1%**
	JET A-1 fuel	366	**3.9%**	433	**4.3%**	**-15.3%**
	Lubricants	23	**0.2%**	19	**0.2%**	**19.7%**
	Base oils	145	**1.6%**	145	**1.4%**	**0.4**
	Bitumens	153	**1.6%**	221	**2.2%**	**-30.8%**
	LPG	23	**0.2%**	10	**0.1%**	**133.3%**
	Other petroleum materials	109	**1.2%**	135	**1.3%**	**-18.91%**
Total export sales		**3 082**	**33,%**	**3,146**	**,31.0%**	**-2.0%**
Total		**9,340**	**100.0%**	**10,158**	**100.0%**	**-8.1%**

In 2013, the LOTOS Group sold 6,258 thousand tonnes of products in Poland (2012: 7,012 thousand tonnes) and exported 3,082 thousand tonnes (2012: 3,146 thousand tonnes).

The key factor behind lower domestic sales was a decline in diesel oil sales (down 306 thousand tonnes or 7.2% year on year), chiefly attributable to a 6.0%[7] decrease in the reported domestic demand for the product. On the back of declining fuel demand in Poland, sales of gasolines and light fuel oil also shrank (to 974 thousand tonnes, or by 11.9%; and to 293 thousand tonnes, or by 13.3%, respectively). The LOTOS Group's total sales were significantly affected by a 14% (75 thousand tonnes) decrease in bitumen sales attributable to limited spending on road construction projects.

The LOTOS Group recorded an increase in export sales of gasolines (up 34%, to 540 thousand tonnes), diesel oil (up 25%, to 421 thousand tonnes), and heavy fuel oil (up 6.1%, to 1,016 thousand tonnes). An increase was also seen in sales of liquid gas (from 10 thousand tonnes in 2012 to 23 thousand tonnes in 2013) and lubricants (from 19 thousand tonnes in 2012 to 23 thousand tonnes in 2013). Reduced export sales of other products were chiefly associated with production optimisation, as supply was adjusted to match the refining margins, and the maintenance shutdown of the refinery in the first half of the year.

Table 19. LOTOS Group's net revenue by markets

	in the period Jan 1 - Dec 31 2013		in the period Jan 1 - Dec 31 2012	
	PLN '000	% share	PLN '000	% share
Domestic sales:	20,384,352	**71.3%**	24,150,082	**72.9%**
- products and services	18,818,128	**65.8%**	23,115,448	**69.8%**
- merchandise and materials	1,566,224	**5.5%**	1,034,634	**3.1%**
- export sales:	8,212,990	**28.7%**	8,960,918	**27.1%**
- products and services	7,873,561	**27.5%**	8,576,400	**25.9%**
- merchandise and materials	339,429	**1.2%**	384,518	**1.2%**
Total	28,597,342	**100.0%**	33,111,000	**100.0%**

LOTOS Group's key customers

In both 2013 and 2012, Shell group companies were the LOTOS Group's only customers whose shares in the Group's total revenue exceeded 10%. The companies' total share was 10.88% in 2013 and 11.04% in 2012. To the best of the Company's knowledge, as at the date of release of this Director's Report there were no formal links between Grupa LOTOS S.A. and the Shell group companies, except for trade contracts.

Trading and optimisation

Crude oil supply

In 2013, Grupa LOTOS S.A. purchased 8.73m tonnes of crude oil, 89.8% of which was Russian REBCO crude. Other crudes, including oil produced in Poland by LOTOS Petrobaltic and Lithuanian oil supplied by LOTOS Geonafta, accounted for the balance of the crude used.

[7] *Preliminary data for 12 months*

Petroleum product exports

In 2013, the LOTOS Group exported 3,082 thousand tonnes of petroleum products, for a total value of PLN 8,213m. Export revenue fell 8.3% year on year, chiefly due to lower refining margins in Europe.

Grupa LOTOS petroleum products were exported mainly to Northern and Western European countries. Naphtha was sold to integrated oil and petrochemical companies in the Netherlands, Germany and Belgium, whereas motor gasolines were exported chiefly to the Rotterdam oil hub, as well as to Sweden and the United Kingdom. Grupa LOTOS sold aviation fuel mostly to buyers from Scandinavian and Baltic countries. On the other hand, the Company launched another major export route by delivering air fuel to the Czech Republic by land.

2013 also saw a substantial increase in export sales of diesel oil, up 29% year on year, which was exported mostly to Germany, France, the Netherlands, and the United Kingdom. As in the previous years, heavy fuel oil was the Company's most important export product in volume terms, which in 2013 exceeded 1m tonnes. Heavy fuel oil was sold to storage depots of global trading companies in Estonia, Denmark and the Netherlands, and for further sale outside of Europe.

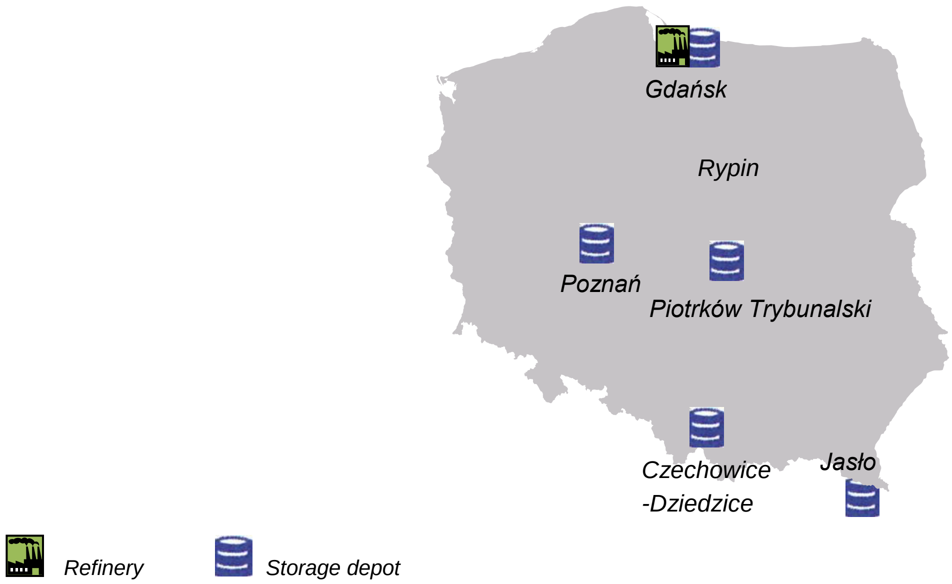
Export sales by land have gained importance. The value of exports delivered by land in 2013 was up by almost 17% year on year, though export by land still accounts for less than 5% of the Company's total export sales. The Company used this channel chiefly to distribute aviation fuel to the Czech Republic and industrial-grade butane to Germany.

Most of Grupa LOTOS's export customers were international vertically integrated oil companies and trading houses. None of the customers accounted for more than 5% of total revenue. The Company's largest export customers were trading companies Mercuria Energy Trading of Switzerland and O.W. Supply & Trading A/S of Denmark, as well as Neste Oil, BP Oil and Shell.

Optimisation of processing and marketing operations

Exports and supplementary purchases of petroleum products are a part of the integrated margin optimisation process. The volumes and types of exported products depended on optimisation decisions, made to adjust the volume and structure of crude oil refining to the existing market conditions. As part of the same process, LOTOS purchased supplementary petroleum products, delivered by land, from domestic and foreign manufacturers. Another crucial element of trading and optimisation efforts consists in purchasing semi-products for processing in the refining units, which help optimise raw material selection. In 2013, the Gdańsk refinery was shut down for maintenance. The purpose of the Supply, Trading & Optimization Division was to ensure continuity of sales during the maintenance period and secure optimum supply costs. This objective was achieved by purchasing petroleum products from external suppliers and distributing products stocked prior to the shutdown.

3.6. LOGISTICS



The LOTOS Group consistently adapts its logistics operations to the requirements of its trading operations and builds an efficient distribution system that meets expectations of its customers, but also helps reduce costs. The purpose of those measures is to build a logistics chain that would function optimally in the constantly changing external and internal environments.

- The biggest logistics challenge faced by the Company in 2013 was the need to adapt the distribution system to new supply sources during the maintenance shutdown of the Gdańsk refinery. The entire operation was supported by the Material Reserves Agency (Agencja Rezerw Materiałowych) and fully secured the continuity of fuel deliveries from the terminal, with no disruption to quality customer service.
  The structure of mandatory stocks was optimised to ensure that the cost of their maintenance was minimised, with revenue from the provision of stock ticket service, based on the Company's crude oil processing capacities, taken into account.
- In 2013, to ensure that its logistics assets operate with optimum efficiency, the LOTOS Group began consolidation of its fuel terminals. The first stage of the process consisted in reorganising Group companies in the south of Poland, changing their business profiles and, consequently, changing their names to LOTOS Terminale and LOTOS Infrastruktura. The next stage culminated in the transfer of ownership of the Rypin and Piotrków Trybunalski fuel terminals to LOTOS Terminale. Also, construction work on comprehensive upgrading of Grupy LOTOS S.A.'s fuel terminal in Poznań was begun. The consolidation process is expected to be completed in 2014.
- In 2013, work continued on fully automating road tanker filling operations at own depots. A self-service road tanker filling unit was commissioned at the Gdańsk terminal at the end of the year. Similar systems will be gradually rolled out at other locations in 2014. The LOTOS Group pursues homogeneous solutions in its companies to achieve work standardisation and to implement uniform interfaces for the exchange and reporting of data and processes relating to the release of products at its fuel terminals.
- In the area of secondary logistics, the supply of the JET A-1 aviation fuel for the Warsaw airport was begun. Fuel deliveries to hypermarket service station operators were also launched.

Table 20. The LOTOS Group's purchases of raw materials, merchandise and petroleum materials by region

	in the Jan 1–Dec 31 2013		in the Jan 1 2012–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Domestic purchases	3,211,570	**12.8%**	2,862,204	**10.1%**
Foreign purchases	21,942,259	**87.2%**	25,599,534	**89.9%**
Total	**25,153,829**	**100.0%**	**28,461,738**	**100.0%**

Table 21. The LOTOS Group's structure of purchases

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012	
	PLN '000	share (%)	PLN '000	share (%)
Raw materials	23,630,633	**82.9%**	27,738,738	**88.5%**
Merchandise	1,826,816	**6.4%**	931,061	**3.0%**
Services	1,609,414	**5.6%**	1,519,350	**4.8%**
Raw materials and consumables	374,074	**1.3%**	363,918	**1.2%**
Other purchases*	1,074,569	**3.8%**	778,944	**2.5%**
Total	28,**515,506**	**100.0%**	31,332,011	**100.0%**

** Including: property, plant and equipment; property, plant and equipment under construction; prepayments for property, plant and equipment under construction and intangible assets.*

Table 22. The LOTOS Group's structure of purchases – petroleum products for resale

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012	
	PLN '000	% share	PLN '000	% share
Liquid gas	547	**0.0%**	409	**0.1%**
Gasolines	518,172	**34.3%**	222,083	**31.2%**
Diesel oils	925,466	**61.3%**	393,018	**55.2%**
Other	67,033	**4.4%**	96,307	**13.5%**
Total	**1,511,218**	**100.0%**	**711,817**	**100.0%**

Table 23. The LOTOS Group's structure of purchases – raw materials, semi-finished products, chemicals and petroleum materials

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012	
	PLN '000	% share	PLN '000	% share
Crude oil	21,057,218	**89.0%**	24,667,252	**88.9%**
Diesel oil	9,358	**0.0%**	8,102	**0.1%**
MTBE/ETBE gasoline components	283,190	**1.2%**	332,258	**1.2%**

	in the period Jan 1–Dec 31 2013		in the period Jan 1–Dec 31 2012	
	PLN ’000	% share	PLN ’000	% share
FAME	688,481	2.9%	926,524	3.3%
Gasolines	35,489	0.2%	359	0.0%
Heavy fuel oil	14,885	0.1%	58,339	0.2%
Ethyl alcohol	130,694	0.6%	181,691	0.7%
Additives	116,641	0.5%	119,417	0.4%
Gasoil	185,405	0.8%	149,369	0.5%
Diesel oil components	-	-	342,900	1.2%
Natural gas	691,259	2.9%	406,005	1.5%
Bitumens, bitumen components and additives	36,280	0.2%	55,215	0.2%
Feedstock for FAME production	384,559	1.6%	475,795	1.7%
Other	9,152	0.0%	26,695	0.1%
Total	**23,642,611**	**100.0%**	**27,749,921**	**100.0%**

LOTOS Group’s key suppliers

The LOTOS Group's key suppliers, whose supplies exceeded 10% of total revenue both in 2012 and 2013, were: MERCURIA ENERGY TRADING of Geneva and UK-based Petraco Oil Company Ltd. Their shares in the LOTOS Group's purchases were 33.34% (2012: 51.64%) and 20.89% (2012: 11.67%), respectively. To the best of the Company’s knowledge, as at the date of release of this Director’s Report there were no formal links between Grupa LOTOS S.A. and any of the suppliers named above, except for trade contracts.

3.6.1. SEA TRANSPORT

Freight transport by sea is a vital element of the LOTOS Group's logistics chain. The Company enjoys considerable advantages thank to lower transport costs resulting from the direct access to product pipelines linking the Gdańsk refinery to the liquid fuel handling facilities at Port Północny. Maritime transport is the Company's main mode of exporting petroleum products and also accounts for a significant portion of deliveries of raw materials and components. 2013 was a record year for the LOTOS Group both in terms of the volume of cargo handled at sea ports and the number of tankers handled at the ports, which for the first time in the Group's history exceeded 300.

- The liquid fuel handling terminal owned by Naftoport can receive tankers with a maximum draught of 15 metres and the capacity to load up to 150,000 tonnes of crude oil or petroleum products. This allows Grupa LOTOS S.A. to export surplus products and sell them mainly on the markets of Scandinavia, Northern and Western Europe and the Baltic states. The direct connection to the port also facilitates import deliveries of additional feedstock, including semi-finished products for further deep processing at the Gdańsk refinery, and fuel components. The coastal location allows Grupa LOTOS S.A. to respond quickly and flexibly to changing market conditions. Apart from the Naftoport Fuel Depot, Grupa LOTOS S.A. also uses the Maritime Bulk Terminal in Gdynia and the Siarkopol terminal in Gdańsk to handles smaller cargoes.
- Grupa LOTOS S.A. enjoys an advantageous position of having a refinery in a short distance from a cargo handling terminal, which allows it to diversify the sources of supply and facilitates the shipping of crude oil

from the Company's own reserves under the Baltic Sea and in Lithuania and, in the near future, crude oil produced from the reserves under the North Sea.

- Grupa LOTOS S.A. is consistent in its efforts to **control the transport process along as much of the supply chain as possible**, from the affreightment of ships to the formal handling of sea transport. This ensures greater control and helps streamline the planning of cargo handling at sea ports, thus allowing the LOTOS Group to reduce the frequency of ship detention and optimise the related costs. In 2013, **preparations continued for the project involving construction of a petroleum product handling terminal on the Martwa Wisła**. When completed, the terminal will handle exports and imports of feedstock components and product loads with unit volumes of up to 5,000 tonnes from Grupa LOTOS' own wharf.

3.6.2. RAIL TRANSPORT

To guarantee safe, cost-efficient and timely distribution of the Group's products by rail, the LOTOS Group is supported by LOTOS Kolej,

whose innovative transport solutions suitably adapted to the entire supply chain ensure economical, effective and safe rail transport in Poland. Thanks to its well-developed freight forwarding operations, LOTOS Kolej also ships products by rail throughout the European Union. The company's extensive range of services includes:

- Management and railway siding services for the LOTOS Group,
- Rail freight transport,
- Maintenance of rail infrastructure,
- Maintenance of rolling stock,
- Eco-friendly cleaning of rail tank cars.

LOTOS Kolej, whose human resources include highly qualified and competent personnel, operates European-class rolling stock, environmentally friendly rail tank cleaning facilities, and cutting-edge IT systems, all of which ensures the highest service quality. The company's IT systems make it the only rail carrier in Poland to offer real-time tracking of cargo.

Thanks to its state-of-the-art technologies and innovative rail logistics solutions, LOTOS Kolej is able to offer both full-train and single-car freight services, which is a significant competitive advantage on the market.

LOTOS Kolej's position on the Polish rail freight transport market is as follows:

- First in rail transport of hazardous materials,
- Second in rail freight transport (in terms of tonne-kilometres),
- Second in intermodal transport services.

Openness, innovation, transparency, and high working standards enable LOTOS Kolej to offer first-rate services to the LOTOS Group and other customers in the European Union.

3.7. ENVIRONMENTAL PROTECTION

For approximately two years now, Grupa LOTOS S.A., as a signatory of the *Declaration of Polish Businesses for Sustainable Development*, has been fulfilling the commitments contained in the Declaration by ensuring that its production facilities are operated in full compliance with the environmental protection standards and by incorporating innovative technological projects in its development plans. Grupa LOTOS S.A. also implements technical solutions that meet the stringent requirements of best available techniques in terms of environmental impact and rational use of natural resources.

- In comparative studies by the consulting firm Solomon Associates (which prepares the most important ranking of refineries in the world) released in September 2013, Grupa LOTOS S.A. was placed at the beginning of the first quartile in the energy efficiency category, and ranked first among Central and Southern Europe refineries.
  Running on its current feedstock, Grupa LOTOS SA's hydrocracking unit (MHC) has achieved a conversion rate of 90% vs. the 60% designed by the licensor.
- In 2013, the use of natural gas in the refinery's fuel gas network increased. Substantial increase in the use of gas in the refinery's energy system and as feedstock for production of hydrogen, replacement of furnaces at two production units, and redirecting of flare gas to the heating network allowed the Company to achieve better-than-expected results in implementation of the strategic objective for carbon dioxide emissions. At the end of 2013, the average emission was 31.3kg CO_2/CWT versus the originally planned 33.8kg CO_2/CWT.

Table 24. Air emissions in 2013

Action	Emission reduction in 2013 [t]			
	CO_2	SO_2	Dust	NO_x
Replacement of fuel oil with natural gas in the fuel gas network	35,000	1,960	150	190
Replacement of fuel oil with natural gas at the CHP plant	68,000	1,420	60	220
Replacement of light petrol/LPG with natural gas in the HGU	82,000	0	0	0
Total	**185,000**	**3,380**	**210**	**410**

- Grupa LOTOS S.A. monitors the environmental footprint of the Group's infrastructure beyond the mandatory obligations. To reduce the environmental risk, the Company continued review of its service stations' documentation begun in 2012. In 2013, the review covered 70% of the locations (vs. 30% in 2012). Stations were selected environmental impact assessment (with particular focus on stations located in Natura 2000 sites).
- The Company seeks to maintain the level of pollutants in treated wastewater and discharged water at lowest possible level. In 2013 and previous years, the average annual ratio of pollutants discharged into the reservoirs neighbouring with the Gdańsk refinery to the permitted levels of monitored indicators was at safe levels (save for one measure). The exception was the boron concentration, which exceeded the permitted level by 50%, a result of the composition of received wastewater.

3.8. R&D ACHIEVEMENTS

Research and development activities of the LOTOS Group focused on further optimisation of technologies for the Oils Unit's products. The most important R&D achievement in 2013 was the development of production technology for bright stock oil with increased viscosity index of 95 or more, followed by successful production launch and marketing of the product. The viscosity index was increased by using paraffin fraction residue.

In road bitumen production technologies:

- In 2013, LOTOS's new product, MODBIT 45/80-55 CR - polymer-modified bitumen with added rubber (recovered from waste rubber), designed for construction of hard-wearing and environmentally friendly roads, obtained industrial validation.
- The R&D projects completed in 2013 focused on production technologies and applications for innovative products used in construction of modern asphalt paving based on rubber-modified asphalts.

Laboratory validation of the MODBIT 25/55-60 CR bitumen confirmed its usefulness as a solution minimizing the effects of stiffening of road structure during periods of very low temperatures, and bitumens modified with advanced polyurethane polymers.

In 2013, development work also focused on LOTOS oil products. The most important lubricant-related R&D activities in 2013 included:

- completion of testing of L-HV hydraulic oils for compliance with the Denison HF-0 requirements, to obtain approvals,
- field tests for oils for stationary natural gas engines, to obtain formal approval for use by selected engine manufacturers,
- introduction of new classes of motor and industrial oils, suitable for climate conditions in export markets,
- extension of 27 approvals for lubricants,
- obtaining of 16 approvals for new oils.

3.9. MATERIAL EVENTS IN 2013

Table 25. Material events at the LOTOS Group in 2013

Period	Event
January – February	• Launch of aviation fuel sales at Okęcie Airport • Agreement with LOTOS Geonafta for annual supplies of 100 thousand tonnes of crude oil to Grupa LOTOS S.A.'s refinery
March – April	• Start of the Spring 2013 maintenance shutdown
May – June	• Completion of the maintenance shutdown and launch of new furnaces on Unit 200 • Joint-venture agreement between Air BP and Grupa LOTOS, establishing LOTOS Air BP
July – August	• Launch of the flare gas recovery unit and VRU unit – waste recovery • Agreement with PGNiG for joint exploration in the Kamień Pomorski license area
September – October	• Grupa LOTOS refinery recognised by Solomon Associates as the most energy efficient in Central and Eastern Europe in 2012 • Agreement for financing of development of the B8 crude oil field in the Baltic Sea between Polskie Inwestycje Rozwojowe S.A. (PIR) and LOTOS Petrobaltic S.A. • PG-1 rig production capacity restored after efficiency-enhancing overhaul
November – December	• Agreement between LOTOS Norge and Centrica Norge on acquisition of interests in 14 licence areas on the Norwegian Continental Shelf − Heimdal package • Agreement with Grupa AZOTY S.A. to conduct full feasibility study of the petrochemical complex (preliminary agreement with Polskie Inwestycje Rozwojowe as potential financial investor in above project was also signed) • Agreement with PGNiG for crude oil deliveries to the Gdańsk refinery • Purchase of a new drilling rig

3.10. MATERIAL AGREEMENTS AND COURT PROCEEDINGS IN 2013

3.10.1. AGREEMENTS SIGNIFICANT FOR THE LOTOS GROUP'S OPERATIONS

Table 26. Agreements significant for the lotos group's operations

No.	Counterparty	Date	Subject matter of the agreement/largest agreement	Estimated net value of all agreements (PLN)	More information	Link
1	ADM Group	Jan 15 2013	Purchase of biocomponents	745m[2]	Current Report No. 2/2013	http://inwestor.lotos.pl/en/1186/p,972,i,705/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_adm_group_companies
2	AB LOTOS Geonafta	Jan 17 2013	Purchase of crude oil	822m[2]	Current Report No. 3/2013	http://inwestor.lotos.pl/en/1186/p,972,i,706/reports_and_key_data/current_reports/execution_of_crude_oil_supply_contract_between_grupa_lotos_sa_and_ab_lotos_geonafta
3	Neste Group	Jan 22 2013	Sale of gasoline	813m[2]	Current Report No. 5/2013	http://inwestor.lotos.pl/en/1186/p,972,i,709/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_neste_group_companies
4	DEVONOIL S.A.	Apr 26 2013	Purchase of crude oil	874m[1]	Current Report No. 10/2013	http://inwestor.lotos.pl/en/1186/p,972,i,716/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_devonoil_sa
5	Statoil Group	Jun 28 2013	Purchase of crude oil	819m[1]	Current Report No. 17/2013	http://inwestor.lotos.pl/en/1186/p,972,i,726/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_statoil_group_companies
6	VITOL S.A.	Aug 28 2013	Purchase of crude oil	859m[2]	Current Report No. 18/2013	http://inwestor.lotos.pl/en/1186/p,972,i,730/reports_and_key_data/current_reports/execution_of_a_significant_contract_between_grupa_lotos_sa_and_vitol_sa
7	BP Oil International Limited	Aug 28 2013	Sale of naphtha	668m[1]	Current Report No. 19/2013	http://inwestor.lotos.pl/en/1186/p,972,i,731/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_bp_oil_international_limited
8	The Shell Group	Sep 25 2013	Purchase of crude oil	714m[1]	Current Report No. 20/2013	http://inwestor.lotos.pl/en/1186/p,972,i,733/reports_and_key_data/current_reports/execution_of_a_significant_agreement_between_grupa_lotos_sa_and_shell_group_companies
9	Petraco Oil Company Ltd.	Oct 24 2013	Crude oil supply contract discontinued	17,700 m	Current Report No. 22/2013	http://inwestor.lotos.pl/en/1186/p,972,i,736/reports_and_key_data/current_reports/discontinuing_of_crude_oil_supply_contract_between_grupa_lotos_sa_and_petraco_oil_company_ltd

No.	Counterparty	Date	Subject matter of the agreement/largest agreement	Estimated net value of all agreements (PLN)	More information	Link
10	Mercuria Energy Trading S.A.	Oct 24 2013	Termination of crude oil supply contract	746m	Current Report No. 23/2013	http://inwestor.lotos.pl/en/1186/p,972,i,737/reports_and_key_data/current_reports/termination_of_crude_oil_supply_contract_between_grupa_lotos_sa_and_mercuria_energy_trading_sa
11	DEVONOIL S.A.	Oct 28 2013	Purchase of crude oil	865m[1]	Current Report No. 24/2013	http://inwestor.lotos.pl/en/1186/p,972,i,739/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_devonoil_sa
12	Mercuria Energy Trading S.A.	Dec 4 2013	Purchase of crude oil	822m[1]	Current Report No. 29/2013	http://inwestor.lotos.pl/en/1186/p,972,i,747/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_mercuria_energy_trading_sa
13	Tatneft Europe AG	Dec 6 2013	Purchase of crude oil	18,000 m	Current Report No. 30/2013	http://inwestor.lotos.pl/en/1186/p,972,i,749/reports_and_key_data/current_reports/execution_of_a_significant_contract_between_grupa_lotos_sa_and_tatneft_europe_ag
14	Mercuria Energy Trading S.A.	Dec 16 2013	Sale of heavy fuel oil	755m[1]	Current Report No. 31/2013	http://inwestor.lotos.pl/en/1186/p,972,i,750/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_mercuria_energy_trading_sa
15	PGNiG S.A.	Dec 20 2013	Purchase of crude oil	3,200 m	Current Report No. 34/2013	http://inwestor.lotos.pl/en/1186/p,972,i,756/reports_and_key_data/current_reports/execution_of_a_significant_contract_between_grupa_lotos_sa_and_pgnig_sa
16	The Shell Group	Dec 20 2013	Sale of liquid fuels	4,120 m[1]	Current Report No. 35/2013	http://inwestor.lotos.pl/en/1186/p,972,i,757/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_the_shell_group
17	Rosneft Oil Company	Dec 20 2013	Purchase of crude oil	18,000 m	Current Report No. 36/2013	http://inwestor.lotos.pl/en/1186/p,972,i,758/reports_and_key_data/current_reports/execution_of_a_significant_contract_between_grupa_lotos_sa_and_rosneft_oil_company
18	VITOL S.A.	Dec 23 2013	Purchase of crude oil	6,000 m	Current Report No. 37/2013	http://inwestor.lotos.pl/en/1186/p,972,i,759/reports_and_key_data/current_reports/execution_of_a_significant_contract_between_vitol_sa_and_grupa_lotos_sa
19	O.W. Supply & Trading SA	30.12.2013	Sale of liquid fuels	715m[1]	Current Report No. 38/2013	http://inwestor.lotos.pl/en/1186/p,972,i,760/reports_and_key_data/current_reports/execution_of_significant_contracts_between_ow_supply__trading_sa_and_grupa_lotos_sa
20	BP Group	Dec 31 2013	Sale of liquid fuels	1,300 m[1]	Current Report No. 39/2013	http://inwestor.lotos.pl/en/1186/p,972,i,761/reports_and_key_data/current_reports/execution_of_significant_contracts_between_grupa_lotos_sa_and_bp_group_companies

1) total value of agreements with the counterparty since the release of the previous current report (following the execution of the described agreement, the criterion of value of a significant agreement was met).

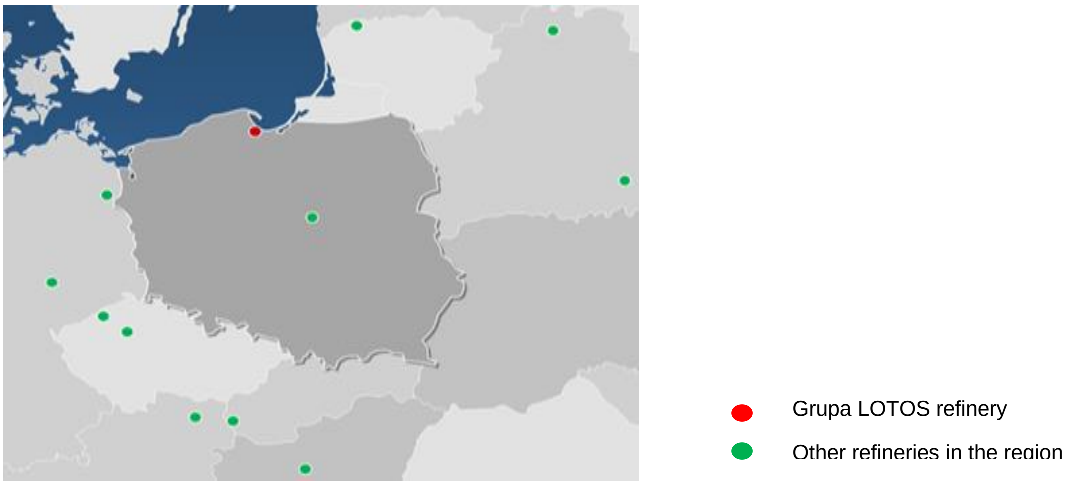
No.	Counterparty	Date	Subject matter of the agreement/largest agreement	Estimated net value of all agreements (PLN)	More information	Link

2) total value of agreements with the counterparty in 12 months preceding the agreement (following the execution of the described agreement, the criterion of value of a significant agreement was met).

Purchase of crude oil

The coastal location of Grupa LOTOS S.A.'s refinery on the Baltic Sea (proximity of the Primorsk i Ust-Luga, from where Urals oil is exported by sea, and access to Urals supplies over the Druzhba Pipeline), the number of Urals oil shipments available on the market, as well as the technological configuration of the Gdańsk refinery make Russia the main and most economically viable source of crude supplies to the refinery.

Graph 47. Coastal location of Grupa LOTOS S.A.'s refinery in Gdańsk vs. other refineries in the region

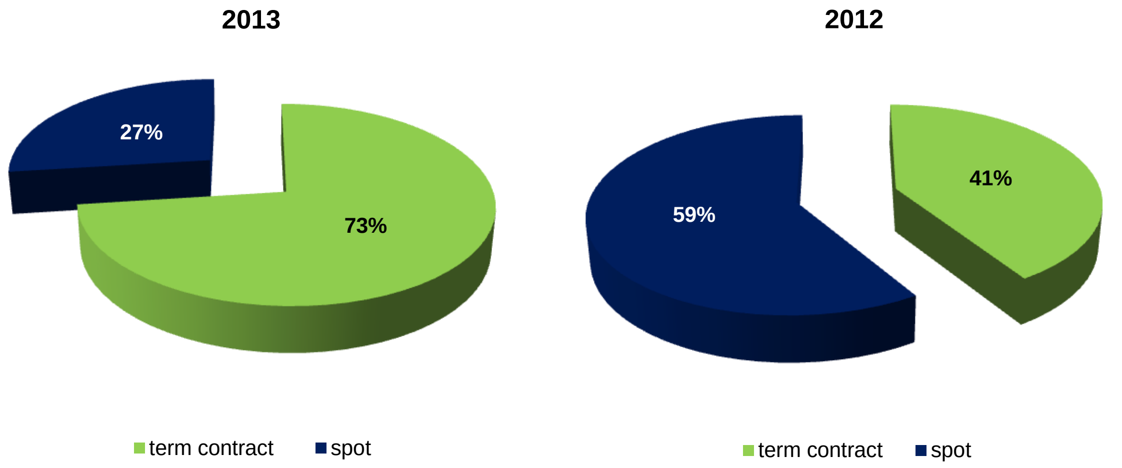


In 2013, at times when the Urals price was strengthening against Dated Brent on the back of higher demand for Russian oil from European refineries or the limited supply of Urals oil caused by various factors (such as growing volumes of Urals oil processed by Russian refineries and growing exports of the crude to the Far East), the Company capitalised on its logistically-advantageous location, strong trading capabilities and the Gdańsk refinery's processing flexibility by increasing the share of non-Russian crude feeds; in late July and early August 2013 (when the spread Urals Rdam vs fwd Dated Brent was positive) there was a 25% increase in the share of non-Russian crudes processed.

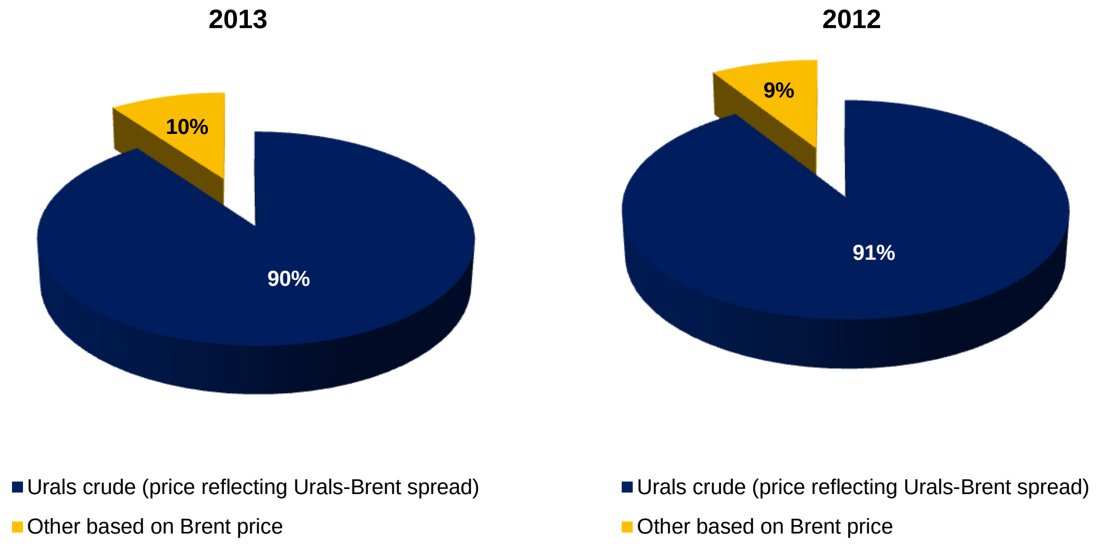
In 2013, the Company, having reviewed the economics of its then-existing dated contracts for Russian crude deliveries, decided to terminate the relationships on the then applicable terms, and to begin negotiations with a view to signing new dated contracts. These steps enabled the Company to conclude new contracts on better logistics terms and at better prices.

In 2013, the Company secured crude supplies to the refinery by entering into high-value contracts and executing spot transactions with Devonoil S.A., the Statoil Group, Shell, Vitol S.A., Mercuria Trading Energy S.A., Tatneft Europe AG, Rosneft Oil Company, PGNiG S.A, and the LOTOS Group's AB LOTOS Geonafta.

Graph 48. Crude oil purchases with futures contracts and on the spot market



Graph 49. Crude oil purchase structure according to the ARA market's general pricing formula



Sales to petroleum companies

In 2014, the Company will supply fuels to Statoil, Shell, BP, and Lukoil. The achievement of sales volume targets is supported by an optimum customer structure designed to maximise margins.

Despite adverse macroeconomic conditions, i.e. the falling number of international oil majors operating organised service station networks in Poland, the LOTOS Group will strive to maintain its 30% share in the wholesale fuels market in the coming years by continuing its current collaboration with the largest customers, extending cooperation with hypermarket chains, and seeking opportunities to maximise margins.

The LOTOS Group is a fuel producer enjoying a steadfast market hold as well as well-structured and stable business relations with the largest customers on the domestic market. The extent of the collaboration so far undertaken in the B2B segment, as well as other areas of operation, reinforces the Group's credibility as a high-quality fuel supplier which is able to deliver its products on time and without interruptions. In addition to having a well-developed logistics network, which is being continuously expanded to reflect the geographical structure of fuel consumption, the Group offers prices at market levels, while maintaining top-rate service quality and implementing technical solutions designed to facilitate collaboration (electronic exchange of data, e-invoicing).

3.10.2. MATERIAL RELATED-PARTY TRANSACTIONS EXECUTED ON NON-ARMS' LENGTH TERMS

In the year ended December 31st 2013, no related-party transactions were concluded on non-arms' length terms.

3.10.3. AGREEMENT WITH QUALIFIED AUDITOR OF FINANCIAL STATEMENTS

Based on the resolution passed by the Grupa LOTOS Supervisory Board on October 31st 2012, Ernst &Young Audit Sp. z o.o., entered in the register of entities qualified to audit financial statements maintained by the National Board of Chartered Auditors under entry No. 130, was selected as the qualified auditor to audit the Company’s financial statements for 2013, 2014 and 2015.

On July 30th 2013, Grupa LOTOS S.A. and Ernst & Young Audit Sp. z o.o. of Warsaw executed a service contract, which provides, inter alia, for:

- review of the separate and consolidated financial statements for the first six months of 2013, 2014 and 2015,
- audit of the separate and consolidated financial statements in 2013–2015.

Table 27. Total fees for audit, review and verification procedures (PLN '000)

	2013	2012
Audit of the annual separate and consolidated financial statements of Grupa LOTOS S.A.	**215**	351
Audit of the annual separate and consolidated financial statements of selected companies of the LOTOS Group (1)	**982**	971
Assurance services, including:	**472**	555
- review of the half-year separate and consolidated financial statements of Grupa LOTOS S.A.	**136**	284
Tax advisory services	**156**	217
Other services	**107**	139
Total	**1,932**	2,233

1) Remuneration for the audit of accounts of selected LOTOS Group companies is paid under separate agreements between the auditor and each of the LOTOS Group companies.

3.10.4. COURT, ARBITRATION OR ADMINISTRATIVE PROCEEDINGS

In 2013 no court, arbitration or administrative proceedings were pending concerning Grupa LOTOS S.A.’s or its subsidiaries' liabilities or debts whose value pertaining to the LOTOS Group companies would equal or exceed 10% of the Company’s equity. Material court proceedings are presented in Note 35.1 of the Consolidated Financial Statements.

4. FINANCIAL STANDING OF THE LOTOS GROUP

4.1. DISCUSSION OF KEY FINANCIAL AND ECONOMIC DATA AND ASSESSMENT OF MATERIAL FACTORS AND NON-RECURRING EVENTS

4.1.1. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Operating profit/(loss)

In 2013, the LOTOS Group posted PLN 28,597.3m in revenue (down 13.6% on 2012), driven mainly by lower sales volumes (down 8.1%), lower prices of petroleum products on global markets, and lower average annual USD/PLN exchange rate (down 3.1% on 2012). Average net revenue per tonne of volume sold in 2013 was PLN 3,062 (down PLN 198, or 6.1%, on 2012).

Table 28. Macroeconomic data

USD/bbl	2013	2012	2011	2013 / 2012
DATED Brent FOB prices	**108.62**	111.62	111.26	**-2.7%**
Urals-Brent spread	**0.96**	1.27	1.68	**-24.4%**
Model refining margin	**5.70***	8.45*	3.41	**-32.5**

**Based on the new model refining margin formula.*

Crack margins (USD/t)	2013	2012	2011	2013 / 2012
Gasoline	**162.21**	190.5	142.91	**-14.9%**
Naphtha	**76.65**	88.41	85.06	**-13.3%**
Diesel oil (10 ppm)	**120.88**	140.13	118.88	**-13.7%**
Light fuel oil	**101.7**	109.93	91.68	**-7.5%**
Aviation fuel	**164.36**	179.85	169.8	**-8.6%**
Heavy fuel oil	**-233.8**	-217.33	-235.84	**-7.6%**

Currency (USD/PLN)	2013	2012	2011	2013 / 2012
PLN/USD exchange rate at end of period	**3.01**	3.1	3.42	**-2.9%**
Average PLN/USD exchange rate	**3.16**	3.26	2.96	**-3.1%**

The volume of products, merchandise and petroleum materials sold in 2013 by the LOTOS Group was 9,339.6 thousand tonnes (down 818.0 thousand tonnes on 2012). The largest drop, seen diesel oil and bitumen sales, followed from weaker domestic demand.

Tabela 29. Financial highlights of the LOTOS Group (PLNm)

	2013	2012	2011	2013-2012	2013/2012
Sales volume (thousand tonnes)	**9,339.6**	10,157.6	10,021.0	-818.0	**-8.1%**
Revenue	**28,597.3**	33,111.0	29,259.6	-4,513.7	**-13.6%**
Cost of sales	**-26,913.2**	-30,340.0	-26,572.4	3,426.8	**-11.3%**
Gross profit	**1,684.1**	2,771.0	2,687.2	-1,086.9	**-39.2%**
Distribution costs	**-1,106.7**	-1,052.0	-1,000.3	-54.7	**5.2%**
Administrative expenses	**-434.0**	-446.4	-432.3	12.4	**-2.8%**
Other income	**30.3**	42.0	41.7	-11.7	**-27.9%**
Other expenses	**-40.7**	-1,084.5	-337.9	1,043.8	**-96.2%**
Effect of accounting for step acquisition of control (AB LOTOS Geonafta)	**0.0**	61.7	126.4	-61.7	**-100.0%**
Loss of control over subsidiary	**13.5**	21.0	0.7	-7.5	**-35.7%**
Operating profit	**172.9**	312.8	1,085.5	-139.9	**-44.7%**
LIFO EBIT	**549.5**	367.7	94.3	181.8	**49.4%**

In 2013, cost of sales of the LOTOS Group was PLN 26,913.2m (down 11.3% on 2012). In the same period, the unit cost of sales was PLN 2,882/t (down PLN 105/t; -3.5% on 2012). The unit sales margin in 2013 was PLN 180/t (down 34.1% on 2012). In 2013, the LOTOS Group's consolidated gross profit was PLN 1.684.1m (down PLN 1,086.9m on 2012).
The PLN 54.7m increase in distribution costs (up 5.2% on 2012) was primarily caused by the amended terms of operation of service stations and settlement at LOTOS Paliwa, and as by higher costs of sports sponsorship and advertising at the Parent.
Administrative expenses were down by PLN 12.4m (down 2.8% on 2012), mainly in the upstream segment.

Negative result on other operating activities in 2013 amounted to PLN 10.4m, and contained among other things, write-downs of assets associated with B-28 field in the amount of PLN -26.8m, write-downs of fuel stations in the amount of PLN 11.9m, impairment losses Lithuanian assets related to the deposits of the Group AB LOTOS Geonafta of PLN -26.4m, and the reversal of write-downs of assets related to the deposits of B-4 and B-6 contributed in kind to the Baltic-Gas at the level of PLN 48.3m. The negative result of 2012 on the level of PLN -1.042,5m included a PLN 935.2m impairment loss on LOTOS Exploration and Production Norge AS's interest in hydrocarbon reserves as part of the YME project in the amount of PLN 935.2m.

The 2013 operating profit of the LOTOS Group reflects the effect of the loss of control of a subsidiary (sale of 50% shares in LOTOS TANK Sp. z o.o.), which added PLN 13.5m to the operating profit.

For 2013, the LOTOS Group posted operating profit of PLN 146.m (down PLN 166.3m; down 53.2% vs. 2012), which comprised:

- PLN 153.9m operating profit in the upstream segment,
- PLN 13.9m operating profit in the downstream segment.

Operating segments

Table 30. Upstream segment's key financial data (PLNm)

	2013	2012	2011	2013-2012	2013/2012
Sales of crude oil (thousand tonnes)	**233.8**	270.0	233.4	-36.2	**-13.4%**
Sales of gas (mcm)	**11.5**	10.4	9.6	1.1	**10.6%**
Revenue	**623.9**	759.8	582.3	-135.9	**-17.9%**
Operating profit/(loss)	**153.9**	-675.2	21.7	829.1	-
Depreciation and amortisation	**147.2**	137.9	120.0	9.3	**6.7%**
EBITDA	**301.1**	-537.3	141.7	838.4	-

The decrease in upstream segment's revenue in 2013 (down 17.9% on 2012) was driven primarily by a 13.4% decline in crude sales volumes (resulting from temporary production from the B8 field in the Baltic Sea in H1 2012), lower crude prices driven down by a drop in Brent crude prices (down 2.7% on 2012), and the lower average PLN/USD exchange rate for the year (down 3.1% on 2012).

In 2013, the upstream segment posted a PLN 153.9m operating profit, i.e. PLN 829.1m up on 2012; the 2012 result included LOTOS Exploration and Production Norge AS PLN 935.2m impairment loss on its interest in hydrocarbon reserves in the acquired YME field production licenses, a PLN 74.5m impairment loss on the Norwegian exploration licences, a PLN 14.5m impairment loss on licenses held by AB Geonafta, and a PLN 61.7m effect of accounting for the step acquisition of control of UAB Manifoldas.

Table 31. Downstream segment's key financial data PLNm)

	2013	2012	2011	2013-2012	2013/2012
Sales volume (thousand tonnes)	**9,327.3**	10,066.8	9,929.8	-739.5	**-7.3%**
Revenue	**28,587.3**	32,899.9	29,062.3	-4,312.6	**-13.1%**
Operating profit	**13.9**	984.1	1,061.3	-970.2	**-98.6%**
Amortisation and depreciation	**500.8**	520.1	480.3	-19.3	**-3.7%**
EBITDA	**514.7**	1,504.2	1,541.6	-989.5	**-65.8%**

The lower revenue earned by the downstream segment in 2013 relative to 2012 was mostly due to a 7.3% year-on-year decline in sales volume, a 6.2% fall of average selling prices caused by lower prices of petroleum products on global markets, as well as the lower average USD/PLN exchange rate for the year.

The low operating result of the downstream segment in 2013 is primarily attributable to:

- low crack margins on fuels and heavy fuel oil,
- low average annual USD/PLN exchange rate,
- low Urals-Brent differential,
- year-on-year decline of sales, particularly of own products,
- lower crack margin on other refining products,
- cost of the maintenance shutdown at the Gdańsk refinery in H1 2013 (ca. PLN 92.1m),

- the weighted average method used by the Group to measure changes in inventories, which contributed to the lower operating result in 2013.

Net profit/(loss)

Table 32. Net profit/(loss) of the LOTOS Group (PLNm)

	2013	2012	2011	2013-2012	2013/2012
Operating profit	**146.5**	312.8	1 085.5	-166.3	**-53.2%**
Finance income	**135.1**	302.0	22.3	-166.9	**-55.3%**
Finance costs	**-342.6**	-248.4	-559.3	-94.2	**37.9%**
Share in profit of equity-accounted jointly-controlled entities	**-1.0**	0.0	2.9	-1.0	**-**
Pre-tax profit/(loss)	**-62.0**	366.4	551.4	-428.4	**-**
Income tax expense	**101.4**	561.5	97.9	-460.1	**-81.9%**
Net profit	**39.4**	927.9	649.3	-888.5	**-95.8%**

The Group posted a loss on financing activities of PLN 207.5m chiefly as a result of:

- net loss on interest on debt, interest income and commission fees of PLN -205.1m (2012: PLN -218.0m);
- net foreign exchange losses (relating mainly to the measurement of borrowings and other debt instruments) of PLN -115.6m (2012: gains of PLN +156.1m),
- net gain on measurement and settlement of market risk hedging derivative instruments of PLN +112.9m (2012: gain of PLN +117.8m).

On January 1st 2011, Grupa LOTOS S.A. introduced cash flow hedge accounting with respect to foreign-currency denominated loans contracted to finance the 10+ Programme, designated as hedges of future USD-denominated petroleum product sales transactions. As a consequence, in the period from January 1st to December 31st 2013, foreign exchange gains taken to the cash flow hedging reserve were PLN 120.8m.

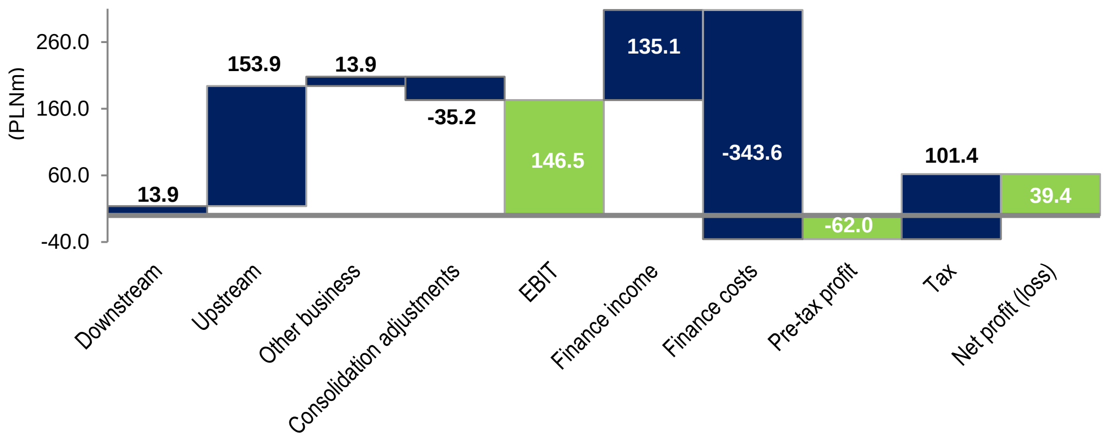
In 2013, the net gain on measurement and settlement of market risk hedging transactions at the LOTOS Group was PLN 112.9m and included:

- net gain on settlement and measurement of derivative instruments hedging the foreign exchange risk of PLN +63.5m,
- net gain on settlement and measurement of transactions hedging petroleum products prices of PLN +28.8m,
- net gain on settlement and measurement of interest rate hedging IRS transactions of PLN +15.1m,
- net gain on settlement and measurement of futures hedging the risk of changes in prices of CO_2 emission allowances of PLN 6.1m.

Corporate income tax (its deferred portion related mainly to impairment losses in the upstream segment) added PLN 101.4m to pre-tax profit.

Net profit of the LOTOS Group for 2013 was PLN 39.4m (down PLN 888.5m on 2012).

Graph 50. 2013 results bridge



4.1.2. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Table 33. Assets (PLNm)

	Dec 31 2013	Dec 31 2012	Dec 31 2011	change in 2013	%
Assets (PLNm)	**20 299,6**	20 027,6	20 396,6	272,0	**1,4%**
Non-current assets	**12 038,8**	11 509,8	11 582,2	529,0	**4,6%**
Property, plant and equipment	**10 048,4**	9 685,9	10 523,5	362,5	**3,7%**
Goodwill	**46,7**	46,7	46,7	0,0	0,0%
Other intangible assets	**686,2**	548,7	475,6	137,5	**25,1%**
Equity-accounted entities	**66,2**	0,0	0,0	66,2	**-**
Deferred tax assets	**980,3**	1 121,3	400,1	-141,0	**-12,6%**
Other non-current assets	**211,0**	107,2	136,3	103,8	**96,8%**
Current assets	**8 260,0**	8 515,4	8 705,3	-255,4	**-3,0%**
Inventories	**5 731,9**	5 966,2	5 855,8	-234,3	**-3,9%**
Trade receivables	**1 594,7**	1 632,9	2 071,3	-38,2	**-2,3%**
Current tax assets	**30,7**	90,6	132,9	-59,9	**-66,1%**
Derivative financial instruments	**73,9**	121,3	37,2	-47,4	**-39,1%**
Other current assets	**325,1**	436,1	224,4	-111,0	**-25,5%**
Cash and cash equivalents	**503,7**	268,3	383,7	235,4	**87,7%**
Assets held for sale	**0,8**	2,4	109,1	-1,6	**-66,7%**

As at December 31st 2013, the LOTOS Group carried total assets of PLN 20,299.6m (up PLN 272.0m on December 31st 2012).

Key changes in assets:

- a PLN 362.5m increase in property, plant and equipment, following the acquisition of Heimdal assets, and recognition of a related asset on decommissioning of the offshore oil and gas facilities,

- a PLN 137.5m increase in other intangible assets, relating primarily to the Norwegian exploration licences in the North Sea,
- a PLN 103.8m increase in other non-current assets, primarily due to a hold on cash in connection with the agreement between the parties involved in the YME project in Norway,
- a PLN 141.0m decrease in deferred tax assets, mainly in the upstream segment,
- a PLN 234.3m decrease in the value of inventories, relating to the lower volume of mandatory stocks, lower prices of petroleum products and crude oil, and lower inventories of semi-finished products at the Parent, which in 2012 were stockpiled prior to the maintenance shutdown,
- a PLN 111.0m decrease in other current assets, mainly receivables from the state budget other than income tax (value added tax),
- a PLN 235.4m increase in cash and cash equivalents.

Table 34 Financial position – equity and liabilities (PLNm)

	Dec 31 2013	Dec 31 2012	Dec 31 2011	change in 2013	%
Equity and liabilities (PLNm)	**20 299,6**	20 027,6	20 396,6	272,0	**1,4%**
Equity	**9 189,6**	9 066,4	7 782,4	123,2	**1,4%**
Share capital	**129,9**	129,9	129,9	0,0	0,0%
Share premium	**1 311,3**	1 311,3	1 311,3	0,0	0,0%
Cash flow hedging reserve	**61,0**	-36,8	-419,3	97,8	**-265,8%**
Retained earnings	**7 666,8**	7 627,4	6 700,4	39,4	**0,5%**
Exchange differences on translating foreign operations	**20,3**	33,9	59,1	-13,6	**-40,1%**
Non-controlling interests	**0,3**	0,7	1,0	-0,4	**-57,1%**
Non-current liabilities	**5 693,6**	5 415,4	5 847,5	278,2	**5,1%**
Borrowings, other debt instruments and finance lease liabilities	**4 496,2**	4 462,1	5 161,5	34,1	**0,8%**
Derivative financial instruments	**52,9**	88,3	127,4	-35,4	**-40,1%**
Deferred tax liability	**281,3**	322,9	105,2	-41,6	**-12,9%**
Employee benefit obligations	**151,4**	129,9	115,9	21,5	**16,6%**
Other liabilities and provisions	**711,8**	412,2	337,5	299,6	**72,7%**
Current liabilities	**5 416,4**	5 545,8	6 726,3	-129,4	**-2,3%**
Borrowings, other debt instruments and finance lease liabilities	**1 715,2**	2 094,6	2 427,2	-379,4	**-18,1%**
Derivative financial instruments	**21,3**	91,0	140,4	-69,7	**-76,6%**
Trade payables	**2 396,1**	2 174,5	2 812,3	221,6	**10,2%**
Current tax payables	**8,8**	5,8	7,4	3,0	**51,7%**
Employee benefit obligations	**105,1**	110,9	94,7	-5,8	**-5,2%**
Other liabilities and provisions	**1 169,9**	1 069,0	1 244,3	100,9	**9,4%**
Liabilities directly associated with assets held for sale	**0,0**	0,0	40,4	0,0	**-**

The PLN 123.2m year-on-year increase in the LOTOS Group's equity to PLN 9,189.6m as at the end of 2013 was mainly a result of:

- PLN 97.8m foreign exchange gains on measurement of cash flow hedges adjusted for the tax effect and charged to reserve capital,
- a PLN 39.4m increase in retained earnings.

The 45.3% share of equity in total equity and liabilities remained unchanged relative to 2012.

In 2013, non-current liabilities increased by PLN 278.2m, mainly due recognition of a provision for future costs of decommissioning of the purchased production assets on the Norwegian Continental Shelf, and a provision for future costs of removal of the MOPU from the YME field.

Year on year, current liabilities as at December 31st 2013 were down PLN 129.4m, due to:

- a PLN 396.5m drop in current borrowings, chiefly in the upstream segment and at the Parent,
- a PLN 221.6m increase in trade payables related to crude oil purchases, mainly at the Parent.

As at December 31st 2013, the LOTOS Group's financial debt totalled PLN 6,211.4m, down PLN 345.3m on December 31st 2012. The decrease was chiefly attributable to the lower USD exchange rate (down PLN 0.09/USD on December 31st 2012) and debt repayment. The ratio of financial debt (adjusted for free cash) to equity was 62.1% (down 7.3pp on December 31st 2012).

In the reporting period, the Group carried no material consolidated off-balance-sheet items other than described in Note 35 to the financial statements of the LOTOS Group for 2013.

4.1.3. CONSOLIDATED STATEMENT OF CASH FLOWS

Table 35. Cash flows (PLNm)

	2013	2012	Change
Cash flows from operating activities	**1,436.5**	1,347.1	89.4
Cash flows from investing activities	**-938.4**	-838.1	-100.3
Cash flows from financing activities	**-251.1**	-883.3	632.2
Change in net cash	**245.4**	-402.3	647.7
Cash and cash equivalents at beginning of the period	**-240.6**	161.7	-402.3
Cash and cash equivalents at end of the period	**4.8**	-240.6	245.4

As at December 31st 2013, the LOTOS Group's cash balance (including current account overdrafts) was PLN 4.8m. In 2013, net cash flows were PLN 245.4m (up PLN 647.7m on 2012).

The Group generated positive cash flows from operating activities of PLN 1,436.5m (up PLN 89.4m on 2012).

Cash flows from investing activities of PLN -938.4m primarily involved PLN 977.0m expenditure on acquisition of property, plant and equipment and other intangible assets (mainly in the upstream segment).

Cash flows from financing activities of PLN -251.1m mainly included the negative balance of proceeds from borrowings and other debt instruments (PLN -476.9m) and outflows on principal and interest payments, as well as proceeds from the issue of notes of PLN 203.1m.

4.1.4. NON-RECURRING FACTORS AND EVENTS AFFECTING FINANCIAL PERFORMANCE

The key factors and non-recurring events affecting the Group's performance in 2013 were as follows:

- net proceeds from the sale of shares in LOTOS Tank of PLN 13.5m;
- reversal of impairment losses on assets associated with the B-4 and B-6 fields, contributed to Baltic Gas, of PLN 48.3m;
- impairment losses on well and structure at the B-28 field of PLN 26.8m;
- Lithuanian assets write off of PLN -26,4m.

4.1.5. EXPLANATION OF DIFFERENCES BETWEEN ACTUAL FINANCIAL PERFORMANCE AND PREVIOUSLY PUBLISHED FORECASTS FOR 2013

The LOTOS Group did not publish any performance forecasts for 2013.

4.2. KEY CAPITAL EXPENDITURE AND EQUITY INVESTMENTS IN POLAND AND ABROAD

4.2.1. EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT

Total expenditure on property, plant and equipment incurred by the LOTOS Group in 2013 was PLN 1,132m, up 39% on 2012. The upstream segment accounts for the largest investing expenditure: purchase of Heimdal assets, development of the B8 field, and repair of the PG-1 unmanned drilling rig. In the downstream segment, capital expenditure focused on expansion of the service station network and the Spring 2013 maintenance shutdown.

Table 36. The LOTOS Group's investments in tangible and intangible assets in 2013 (PLN '000)

	Capital expenditure Jan 1–Dec 31 2012
Construction and assembly work	560,049
Procurement from external suppliers – purchases	235,529
Purchases of intangible assets	221,338
Other capital expenditure	113,530
Total	**1,130,446**

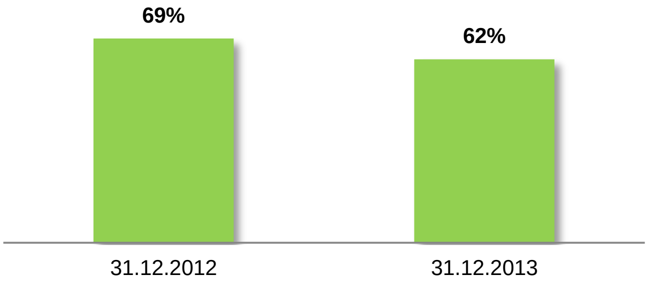
4.2.2. EQUITY INVESTMENTS

In 2013, Grupa LOTOS S.A. did not make any equity investments outside of the group of related entities, described in detail in Section 1.1.2. Ownership changes at the LOTOS Group.

4.2.3. FEASIBILITY OF PLANNED INVESTMENTS, INCLUDING EQUITY INVESTMENTS, IN THE CONTEXT OF AVAILABLE FUNDING

In 2013, the LOTOS Group companies managed their liquidity position in an effective manner. The high debt of Grupa LOTOS S.A.'s is serviced on a regular basis. In 2013, the Company repaid part of its debt incurred to finance the 10+ Programme. The net debt to equity ratio fell in 2013 by 7pp (from 69% to 62%).

Graph 51. Gearing ratio – the ratio of net debt (financial debt adjusted for free cash) to equity



The improvement of the debt ratio confirms the Company's ability to manage its liquidity position and the current debt level, and proves the financing strategy to be correct.

The Group's strategy for 2011–2015 provides for total capital expenditure of PLN 5.7bn. Given the LOTOS Group's current potential to generate positive cash flows from operating activities, the low level of indebtedness of its subsidiaries, which may potentially become borrowers, the ability to finance projects through SPVs, and the agreement executed with PIR (see Current Report No. 21/2013 of October 7th 2013), the planned investments are feasible and the Group should be able to finance the key projects material to the implementation of its current business strategy.

As at the date of release of this Directors' Report, i.e. as at March 5th 2014, the Company did not expect any significant changes in its financing structure.

4.3. FINANCING SOURCES

4.3.1. BORROWINGS INCURRED AND LOANS ADVANCED IN 2013

Table 37. LOTOS Group's bank borrowings as at December 31st 2013:

Bank name; form of incorporation	Amount as per agreement		Outstanding amount (current portion)		Outstanding amount (non-current portion)		Repayment date of the current portion	Repayment date of the non-current portion	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)				
Bank Syndicate (1)*	-	**400.000 USD**	753.296	250.099 USD	-	-	20.12.2014	-	interest based on 3M or 6M LIBOR USD, depending on the interest period selected at a given time + bank margin	registered pledge over inventories, registered pledge over bank accounts, assignment of rights under inventory insurance agreements, assignment of rights under inventory storage agreements, voluntary submission to enforcement
Bank Syndicate (2)**	-	**1.125.000 USD**	270.050	89.857 USD	2.598.132	860.307 USD	15.10.2014	15.01.2021	interest based on 1M, 3M or 6M LIBOR USD, depending on the interest period selected at a given time + bank margin	mortgage, registered pledge over existing and future movables, registered pledge over bank accounts, assignment of rights under insurance agreements relating to the Gdańsk refinery, assignment of licence and sale agreements with a value of over PLN 10m per year, submission to enforcement
Bank Syndicate (3)***	-	**425.000 USD**	105.438	35.943 USD	940.647	310.960 USD	15.10.2014	15.01.2021	fixed interest rate	
Bank Syndicate (4)****	**USD 200,000 or equivalent**		328.505	-	-	-	Overdraft facility	-	interest based on 3M LIBOR USD for USD funds, 3M WIBOR	
			115.760	38.433 USD	-	-				

Bank name; form of incorporation	Amount as per agreement		Outstanding amount				Repayment date of the		Financial terms (interest rate, interest payment schedule, etc.)	Type of security
			(current portion)		(non-current portion)					
	PLN	Currency	PLN	Currency	PLN	Currency	current portion	non-current portion		
	('000)	('000)	('000)	('000)	('000)	('000)				
			3	1 EUR	-	-			PLN for PLN funds and 3M EURIBOR for EUR funds + bank margin for each currency (identical with the Borrowing A margin). Interest payable every three months on Jan 15, Apr 15, Jul 15, or Oct 15.	
Bank Syndicate (5)*****	**490.000**	**-**	51.818	-	141.667	-	31.12.2014	30.06.2024	1M WIBOR + bank margin	mortgages
Bank PEKAO S.A.	**20.000**	**-**	1.500	-	13.625	-	31.12.2014	31.12.2018	1M WIBOR + bank margin	mortgages
PKO BP S.A.	**20.000**	**-**	1.500	-	13.625	-	31.12.2014	31.12.2018	1M WIBOR + bank margin	mortgages
PKO BP S.A.	**75.000**	**-**	40.044	-	-	-	Overdraft facility	-	1M WIBOR + bank margin	representation on voluntary submission to enforcement, power of attorney over bank account,
Nordea Bank Polska S.A.	**7.379**	**-**	7.379	-	-	-	Overdraft facility	-	1M WIBOR + bank margin	promissory note
Bank Millennium	**30.000**	**-**	6.529	-	-	-	Overdraft facility	-	1M WIBOR + bank margin	representation on voluntary submission to enforcement, power of attorney over bank account,
Provincial Fund for Environmental Protection and Water Management in Gdańsk	**5.000**	**-**	1.000	-	3.250	-	30.11.2014	30.11.2017	0.8 of the promissory note rediscount rate	blank promissory note, assignment of claims

Bank name; form of incorporation	Amount as per agreement		Outstanding amount				Repayment date of the		Financial terms (interest rate, interest payment schedule, etc.)	Type of security
			(current portion)		(non-current portion)					
	PLN	Currency	PLN	Currency	PLN	Currency	current portion	non-current portion		
	('000)	('000)	('000)	('000)	('000)	('000)				
PEKAO S.A.	-	**7.060 EUR**	2.446	589 EUR	2.444	589 EUR	31.10.2014	31.10.2015	1M EURIBOR + bank margin	mortgage, assignment of claims and registered pledge over the object of investment project with assignment of rights under insurance policy
PEKAO S.A.	**44.754**	-	32	-	32	-	31.10.2014	31.10.2015	1M WIBOR + bank margin	mortgage, assignment of claims and registered pledge over the object of investment project with assignment of rights under insurance policy
National Fund for Environmental Protection and Water Management	**35.000**	-	6.056	-	-	-	20.12.2014	-	0.8 of the promissory note rediscount rate	bank guarantee and promissory note
ING Bank Śląski	**35.000**	-	298	-	-	-	Overdraft facility	-	1M WIBOR + bank margin	epresentation on voluntary submission to enforcement
BRE Bank S.A.	**50.000**	-	396	-	-	-	Overdraft facility	-	O/N WIBOR + bank margin	blank promissory note
Bank Ochrony Środowiska S.A.	**10.900**	-	4.844	-	4.844	-	31.12.2014	31.12.2015	3M WIBOR + bank margin	blank promissory note, assignment of claims
PKO BP	-	**80.000 USD**	152.972	50.767 USD	-	-	31.12.2014	-	1M LIBOR + bank margin	pledge, guarantee
PKO BP	-	**105.000 USD**	-	-	403.797	134.007 USD	-	31.12.2016	LIBOR 1M + marża bankowa	pledge, guarantee

Bank name; form of incorporation	Amount as per agreement		Outstanding amount				Repayment date of the		Financial terms (interest rate, interest payment schedule, etc.)	Type of security
			(current portion)		(non-current portion)					
	PLN	Currency	PLN	Currency	PLN	Currency	current portion	non-current portion		
	('000)	('000)	('000)	('000)	('000)	('000)				
Bank Syndicate (6)******	**-**	**57.298 USD**	59.723	19.993 USD	32.723	10.993 USD	31.12.2014	31.12.2015	6M LIBOR + bank margin	LOTOS Petrobaltic's assets, LOTOS Geonafta's tangible assets, LOTOS Geonafta shares
Nordea Bank Litwa	**-**	**19.300 USD**	14.418	4.825 USD	28.836	9.650 USD	31.12.2014	31.12.2015	3M LIBOR + bank margin	shares in subsidiaries, assignment of rights under crude oil sales agreements
Funds in bank deposits securing payment of interest and principal*******			- 245.516	-81.513 USD	-	-	-	-	-	-
			449.901	**-**	**177 043**	**-**				
RAZEM			**1.226.142**	**408.404 USD**	**4.004.137**	**1.325.917 USD**				
			2.448	**590 EUR**	**2.444**	**589 EUR**				
			1.678.491		**4.183.624**					

The bank margins on the contracted borrowings and other debt instruments are within the range of 0.30pp. – 3.75pp.

**Bank Syndicate (1): Pekao S.A., BRE Bank S.A., ING Bank Śląski S.A., Société Générale S.A., Bank Handlowy w Warszawie S.A., Bank Zachodni WBK S.A.; on December 20th 2013, there was a change in the composition of the syndicate; see below for details.*

***Bank Syndicate (2): Banco Bilbao Vizcaya Argentaria S.A., Bank of Tokyo-Mitsubishi UFJ (Holland) N.V., Pekao S.A., BNP Paribas S.A., Caja de Ahorros y Monte de Piedad de Madrid, Credit Agricole CIB (formerly Calyon), DnB Nor Bank ASA, DnB Nord Polska S.A., ING Bank Śląski S.A., KBC Finance Ireland, Kredyt Bank S.A., Nordea Bank AB, PKO BP S.A., The Royal Bank of Scotland plc, Société Générale S.A., Bank Zachodni WBK S.A., Rabobank Polska S.A., Bank Gospodarki Żywnościowej S.A. and Sumitomo Mitsui Banking Corporation Europe Ltd.*

****Bank Syndicate (3): Banco Bilbao Vizcaya Argentaria S.A. and BNP Paribas S.A.*

*****Bank Syndicate (4): Pekao S.A., PKO BP S.A., BNP Paribas S.A., ING Bank Śląski S.A., Nordea Bank Polska S.A., Rabobank Polska S.A. and Bank Gospodarki Żywnościowej S.A.*

******Bank Syndicate (5): Pekao S.A. and PKO BP S.A.*

*******Bank Syndicate (6): Nordea Bank Finland Plc. Lithuania Branch, Nordea Bank Polska S.A.*

********As at December 31st 2013, Grupa LOTOS S.A. offset a financial asset (cash reserved for repayment of the facilities) against a financial liability under the facilities and, in accordance with IAS 32 Financial Instruments: Presentation, it disclosed the relevant net amount in the statement of financial position (the Company holds a valid legal title to set off the amounts and intends to realise the asset and settle the liability simultaneously). The objective of this procedure is to reflect the expected future cash flows from settlement of two or more financial instruments.*

4.3.2. LOANS ADVANCED BY THE LOTOS GROUP COMPANIES

Table 39. Loans advanced to subsidiaries in the year ended December 31st 2013

Related entity	Agreement date	Principal as per loan agreement PLN '000	Loan repayment date	Security	Interest terms
LOTOS Petrobaltic S.A.	Jan 30 2013	23,000	Dec 31 2015	blank promissory note with a 'protest waived' clause and promissory note declaration	The loan bears interest at a variable rate based on 6M WIBOR plus margin.
	Mar 5 2013	7,000	Dec 31 2015		
LOTOS Gaz S.A. w likwidacji (in liquidation)	Dec 17 2013	150	Oct 31 2014	blank promissory note with a 'protest waived' clause and promissory note declaration	The loan bears interest at a variable rate based on 3M WIBOR plus margin.
	Dec 23 2013	70	Aug 31 2014		

Furthermore, in 2013 annexes were signed whereby the final repayment dates of the loans granted to LOTOS Petrobaltic S.A. and LOTOS Gas S.A. w likwidacji (in liquidation) were extended.

Loans advanced to LOTOS Petrobaltic S.A.

For the USD 10,000 thousand loan agreement of August 29th 2012 and the USD 9,500 thousand loan agreement of September 27th 2012 the repayment date was extended until December 31st 2015.

Loans advanced to LOTOS Gaz S.A. w likwidacji (in liquidation)

For the following loan agreements:

- loan agreement of March 8th 2011 (for PLN 247 thousand), loan agreement of March 29th 2011 (for PLN 352 thousand), and loan agreement of August 5th 2011 (for PLN 160 thousand) − the repayment date was extended until April 30th 2014,
- loan agreement of June 29th 2010 (for PLN 2,000,000), loan agreement of May 26th 2011 (for PLN 123,000) − the repayment date was extended until September 30th 2014.

Other intercompany loans

- On June 6th 2013, under an annex of May 24th 2013 to an agreement of October 17th 2012 on the grant of loan of USD 10m (PLN 31.261m, translated at the USD mid-exchange rate quoted by the National Bank of Poland for October 17th 2012) to LOTOS Exploration and Production Norge AS by LOTOS Petrobaltic S.A., the loan principal was repaid in full.
- On July 3rd 2013, an annex was executed to the agreement of September 14th 2012 under which a loan of USD 10m (PLN 31.131m translated at the USD mid rate quoted by the National Bank of Poland for

September 14th 2012) was advanced to LOTOS Exploration and Production Norge AS by LOTOS Petrobaltic S.A.; the annex provided for earlier repayment of a USD 3,300,000 loan instalment.

- On July 5th 2013, another annex was executed to the agreement of October 24th 2011 under which a loan of USD 20m (PLN 63.410m translated at the USD mid rate quoted by the National Bank of Poland for October 24th 2011) was advanced to LOTOS Exploration and Production Norge AS by AB LOTOS Geonafta. Under the annex, the repayment date was extended until December 31st 2017.
- On May 31st 2013, the Miliana Shipmanagement Co. Ltd. made an early repayment of the outstanding portion (USD 902,000) of an unsecured loan provided under the agreement of October 10th 2011 between the Miliana Shipping Company Ltd. (currently the Miliana Shipholding Company Ltd.) (as the lender) and Miliana Shipmanagement Ltd. (as the borrower) in the amount of USD 1.8m (PLN 5.736m, translated at the USD mid rate quoted by the National Bank of Poland for October 10th 2011). The loan was to be repaid in 18 equal monthly instalments, with the payment date of the first instalment falling on August 31st 2012.
- On October 30th 2013, LOTOS Petrobaltic S.A. executed an agreement to grant a loan of PLN 9,927,000 to LOTOS Energobaltic Sp. z o.o., to be used to repay LOTOS Energobaltic's liabilities under the arrangement of June 29th 2009, approved by the District Court for Gdańsk-Północ on September 1st 2009. The loan is to be repaid by December 31st 2017. The loan bears interest at a variable annual interest rate based on 1M WIBOR plus margin. Repayment of the loan is secured with a blank promissory note with a 'protest waived' clause and promissory note declaration.
- On November 5th 2013, Energobaltic Sp. z o.o. paid PLN 12,259 thousand to LOTOS Petrobaltic S.A., thus repaying its obligations under the loan agreement of November 12th 2001 between Energobaltic Sp. z o.o. and LOTOS Petrobaltic S.A., and the loan agreement of November 12th 2001 between Energobaltic Sp. z o.o. and Stablewood Power Ventures (Władysławowo) Ltd., whereby the debt of Energobaltic Sp. z o.o. was purchased by LOTOS Petrobaltic S.A. pursuant to a share purchase and debt assignment agreement of November 27th 2009 executed between LOTOS Petrobaltic S.A. and Stablewood Power Ventures (Władysławowo) Ltd., and a debt assignment agreement of March 1st 2010.
- On November 12th 2013, LOTOS Petrobaltic S.A. granted a loan of USD 4,500,000 to LOTOS Exploration and Production Norge AS. The final repayment date of the loan principal was set at December 31st 2013. The loan was fully repaid on December 30th 2013. The loan bore interest at a floating rate based on 6M LIBOR plus margin.
- On December 23rd 2013, LOTOS Petrobaltic S.A. executed an agreement to grant a loan of USD 14,000,000 to SPV Baltic Sp. z o.o. Repayment of the loan is secured with a blank promissory note with a 'protest waived' clause and promissory note declaration. The loan agreement provides for the repayment of the loan principal by January 31st 2022, with an early repayment option. The loan bears interest at a variable annual interest rate based on 6M LIBOR plus margin.
- On May 29th 2013, Miliana Shipmanagement Ltd. (the borrower) executed loan agreements for a total amount of USD 2,080,000 with the following lenders:
    - St. Barbara Navigation Company Ltd. (USD 440,000),
    - Kambr Navigation Company Ltd. (USD 210,000),
    - Granit Navigation Company Ltd. (USD 175,000),
    - Bazalt Navigation Company Ltd. (USD 160,000),

- Petro Icarus Company Ltd. (USD 1,095,000).

The repayment date of the loans was set at June 30th 2016.

In 2013, the parties signed annexes changing the repayment date of the PLN 400,000 loan of August 7th 2012 between Technical Ship Management Sp. z o.o. (former LOTOS Ekoenergia Sp. z o.o.) and Miliana Shipholding Company Ltd. (the borrower). The repayment date of the loan was changed to January 31st 2014.

Other information

In 2013, LOTOS Petrobaltic S.A. issued medium-term notes under an agreement with Bank Pekao S.A. of October 29th 2013. Pursuant to the agreement, LOTOS Petrobaltic S.A. issued notes for up to the equivalent of PLN 200m in USD. The notes were acquired by Bank Pekao S.A.

4.3.3. MATERIAL SURETIES, GUARANTEES AND OTHER SECURITY INSTRUMENTS

- As at December 31st 2013, the Parent had a PLN 240,000 thousand blank promissory note deposited at the Customs Office in Gdańsk as lump-sum security for excise duty of PLN 800,000 thousand. The security is valid until August 19th 2014.
- An unconditional and irrevocable guarantee issued by LOTOS Petrobaltic S.A. for the benefit of the government of Norway on June 17th 2008, concerning the activities of LOTOS Exploration and Production Norge AS related to its exploration and production operations on the Norwegian Continental Shelf, was effective as at December 31st 2013 and December 31st 2012. In the guarantee, LOTOS Petrobaltic S.A. undertook to assume any financial liabilities which may arise in connection with the operations of LOTOS Exploration and Production Norge AS on the Norwegian Continental Shelf, consisting in exploration for and extraction of the natural resources from the sea bottom, including their storage and transport using means of transport other than ships.
- On March 29th 2013, LOTOS Petrobaltic S.A. executed a loan commitment agreement with LOTOS Exploration and Production Norge AS, to further secure a multi-purpose credit facility advanced to LOTOS Exploration and Production Norge AS by Bank PKO BP S.A. Under the commitment agreement, LOTOS Petrobaltic S.A. agreed to advance loans to LOTOS Exploration and Production Norge AS if: (1) LOTOS Exploration and Production Norge AS fails to acquire an interest in the Draugen field or any similar production field on the Norwegian Continental Shelf by December 31st 2013, and (2) LOTOS Exploration and Production Norge AS does not have sufficient funds to repay the credit facility of USD 80,000 thousand, as well as to assign the amounts receivable under the agreement to the lending bank. In addition, the multi-purpose credit facility advanced to LOTOS Exploration and Production Norge AS by Bank PKO BP S.A. is secured by a surety granted by LOTOS Petrobaltic S.A. to Bank PKO BP S.A. in respect of the liabilities of LOTOS Exploration and Production Norge AS. The surety is for the lower of USD 80,000 thousand and PLN 293,828 thousand. The change of the date as of which LOTOS Petrobaltic S.A. would be required to advance loans to LOTOS Exploration and Production Norge AS from September 30th 2013 to December 31st 2013 results from an amendment to the loan commitment agreement of September 27th 2013. Following the execution and performance of the agreement for the purchase of Heimdal assets on the Norwegian Continental Shelf, the requirement of LOTOS Petrobaltic S.A. to advance loans to LOTOS E&P Norge AS under this agreement expired and had no further merit.

4.3.4. FINANCIAL RESOURCES MANAGEMENT

In 2013, the LOTOS Group was able to meet all of its liabilities towards third parties. In the period from January 1st to December 31st 2013, the LOTOS Group used investment and working capital overdraft facilities. As at December 31st 2013, the LOTOS Group had PLN 683.1m in funds available under working capital facilities. As at December 31st 2013, the balance of overdraft facilities was PLN 498.9m.

For more information on balance of bank borrowings see Note 27 of the LOTOS Group's consolidated financial statements for 2013.

In connection with the credit facilities incurred to finance the 10+ Programme and the facility for the refinancing of inventories, Grupa LOTOS S.A. is required to maintain the Tangible Consolidated Net Worth ratio of no less than specified in the facility agreements.

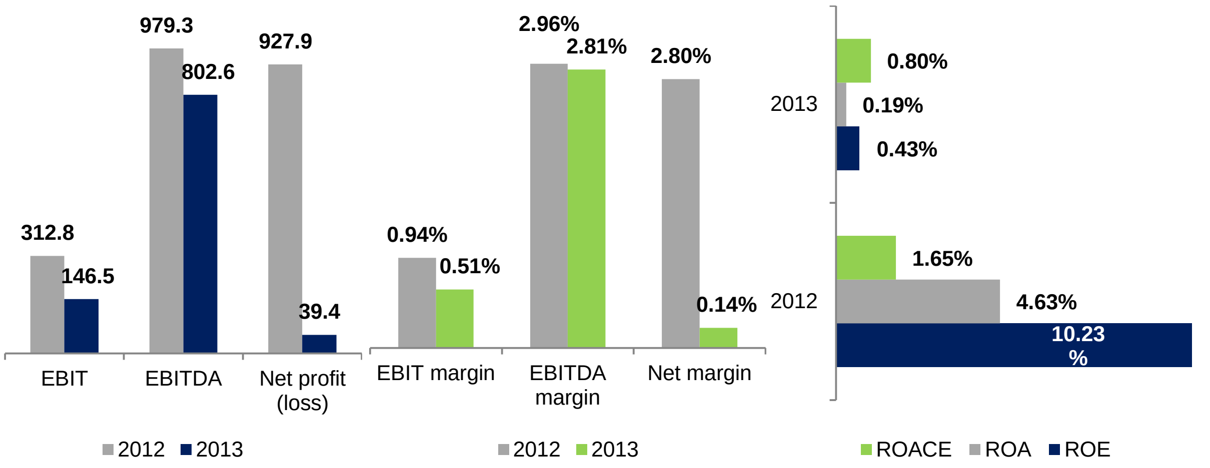
In connection with the refinancing facility, the Company is also required to meet a financial covenant of maintaining the Loan to Pledged Inventory Value ratio of no more than specified in the facility agreement.

As at December 31st 2013 and December 31st 2012, the covenants were complied with.

A brief assessment of the LOTOS Group's overall economic and financial standing has been prepared in the form of a ratio analysis covering margins, liquidity, turnover and debt levels.

Profitability ratios

(PLNm or %)

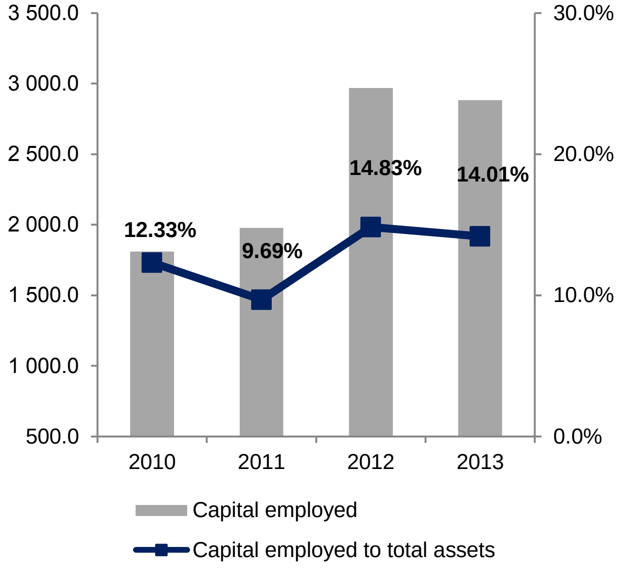


- lower EBIT and EBITDA margins due to lower operating profit/(loss) (down 53.2%) and lower revenue (down 13.6%),
- lower net profit (down 95.8%) on lower revenue (down 13.6%), higher total assets (up 1.4%) and equity (up 1.4%), eroded net margin, as well as ROE and ROA ratios reflecting the rate of return on invested equity and the profitability of assets,
- lower EBIT (down 53.2%) and higher equity (up 1.4%), besides the lower net debt (down 9.2%), drove ROACE down by 0.85pp despite net financial debt being lower by 9.2%.

Profitability ratio formulas	
EBIT margin	operating profit/(loss) to net sales
EBITDA	EBIT before amortisation/depreciation
EBITDA margin	EBITDA to net sales
Net margin	net profit/(loss) to net sales
ROE	net profit/(loss) to equity at end of period
ROA	net profit/(loss) to assets at end of period
Return on average capital employed (ROACE)	operating profit/(loss) after tax to equity plus net debt at end of period

Liquidity ratios

(PLNm, in absolute terms or in %)

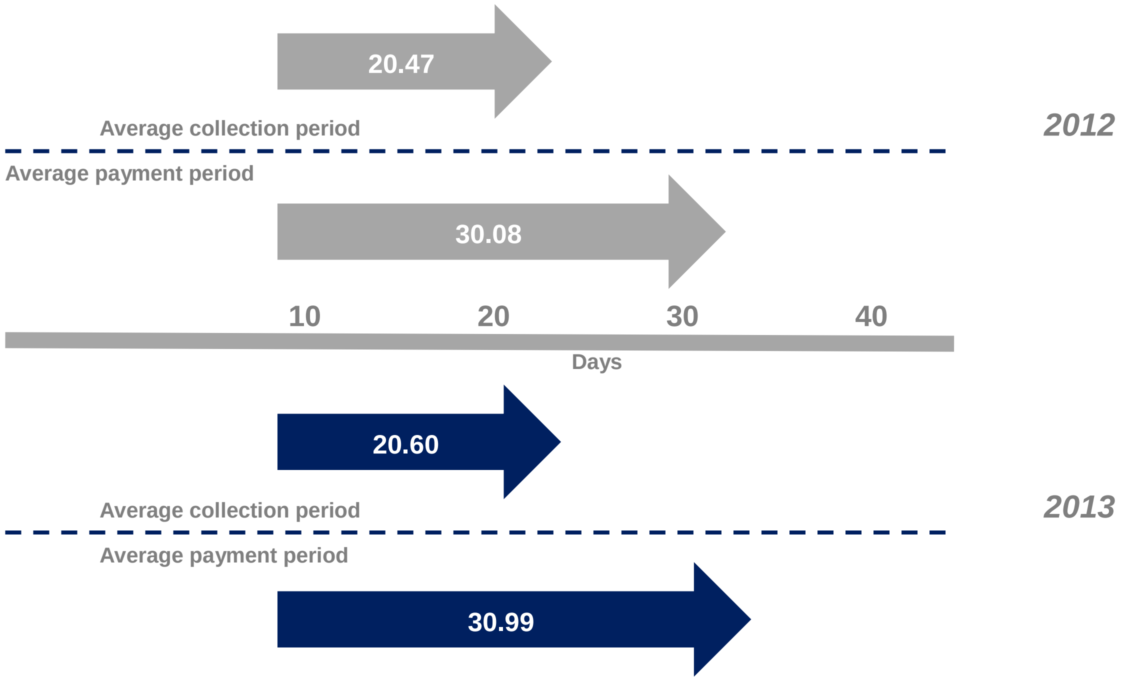


- current ratio (1.52) and quick ratio (0.47) remained flat year on year (2012: 1.54 and 0.46, respectively),
- PLN 126.2m decrease in capital employed, following stronger decrease in current assets (down PLN 255.4m) than the decrease in current liabilities (down PLN 129.4m), and a slight decrease of the share of capital employed in total assets.

Liquidity ratio formulas	
Current ratio	current assets to current liabilities (at the end of the period)
Quick ratio	current assets less inventory to current liabilities (at the end of the period)
Capital employed	current assets less current liabilities (at the end of the period)
Capital employed to total assets	capital employed to total assets (at the end of the period)

Collection and payment periods

(days)

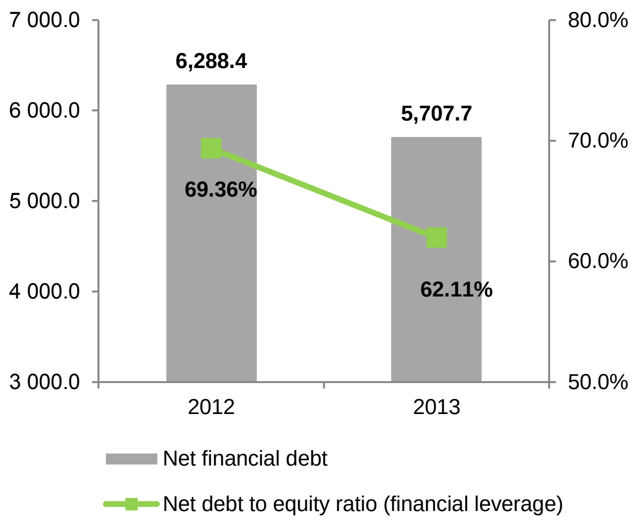


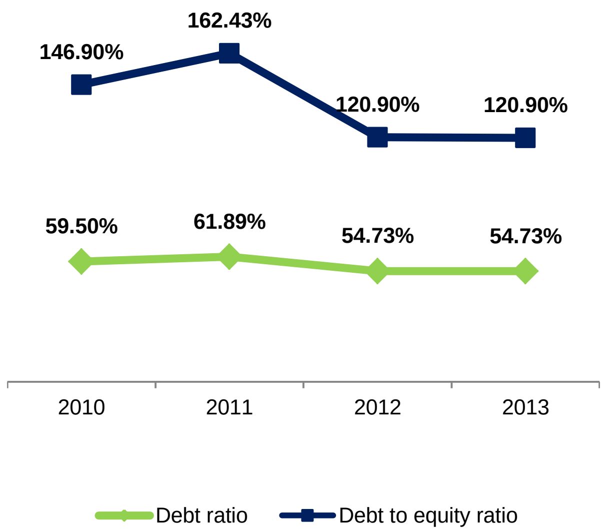
- average collection and payment periods remained relatively unchanged compared with 2012.

Collection and payment period formulas	
Average collection period (days)	average trade receivables to net sales times 365 (or 366) days of a given period
Average payment period (days)	average trade payables to cost of sales times 365 (or 366) days of a given period

Capital structure and debt ratios

(PLNm or %)





- the share of liabilities in financing of the assets and the debt to equity ratio remained relatively unchanged year on year,
- decrease in net debt to equity ratio (financial leverage) by 7.2pp, as net financial debt fell (by 9.2%) while equity grew (by 1.4%).

Capital structure and debt ratio formulas	
Total debt ratio	total liabilities to total assets (at the end of the period)
Net financial debt	long-term and short-term borrowings, other debt instruments, and finance lease liabilities net of cash (at the end of the period)
Net debt to equity ratio (financial leverage)	financial debt to equity ratio (at the end of period)
Debt to equity ratio	total liabilities to equity (at the end of the period)

4.3.5. USE OF ISSUE PROCEEDS TO IMPLEMENT THE ISSUE OBJECTIVES

In 2013, LOTOS Petrobaltic S.A. issued medium-term notes under an agreement with Bank Pekao S.A. Pursuant to the agreement, LOTOS Petrobaltic S.A. issued notes for up to the equivalent of PLN 200m in USD. The notes were acquired by Bank Pekao S.A.

The total value of liabilities under the issues notes was PLN 198.2m. Apart from the carrying amount of the notes, the figure included interest accrued of PLN 0.1m and a deferred arrangement fee of PLN (0.4m), which reduces the liability.

LOTOS Asfalt Sp. z o.o., another Group company, operates a short-term note issue programme under the agreement of July 27th 2010. The term of the programme is five years. In 2013, no notes were issued under the programme. As at December 2013, the Group held no liabilities under the programme.

In 2013, proceeds from the notes issued by the Group companies to investors outside the Group were PLN 203,050 thousand, including issue costs (2012: PLN 362,367 thousand). The Group did not redeem any notes in 2013.

The issue at the LOTOS Group described above was carried out by LOTOS Petrobaltic to strengthen the companies' capital position.

5. GRUPA LOTOS SHARES

5.1. GRUPA LOTOS S.A. SHARES ON THE WARSAW STOCK EXCHANGE

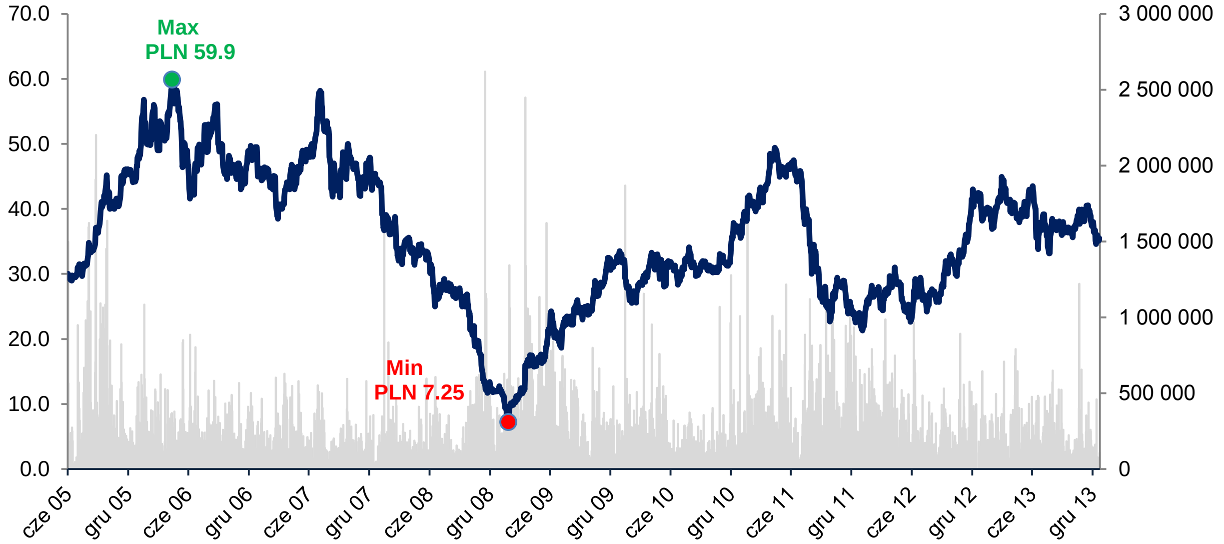
The Company shares are listed on the Warsaw Stock Exchange (WSE). The shares were floated on June 9th 2005 and are traded in PLN. The shares are traded in PLN.

ISIN	Warsaw Stock Exchange	Thomson Reuters	Bloomberg
PLLOTOS00025	LTS	LTOS.WA	LTS PW

As at December 31st 2013, the Company's share capital totalled PLN 129,873,362 and comprised 129,873,362 ordinary shares, with a par value of PLN 1 per share. Each share confers the right to one vote at the Company's General Meeting.

The Company's market capitalisation as at the end of 2013 was just over PLN 4.6bn.

Chart 52. Share price (PLN) and trading volume (number of shares) since first listing on the WSE



In 2013, Grupa LOTOS shares were included in the following indices:

Income indices

- WIG − comprises all stocks traded on the WSE Main Market which satisfy the basic eligibility criteria
- WIG-PALIWA − comprises WIG index constituents operating in the fuels sector
- WIG Poland − comprises only the shares of Polish companies traded on the WSE Main Market which satisfy the basic eligibility criteria
- RESPECT − comprises CSR-driven companies listed on the WSE Main Market

Price indices

- WIG 20 − calculated based on the value of the 20 largest and most liquid stocks traded on the WSE Main Market
- WIG 30 − calculated based on the value of the 30 largest and most liquid stocks traded on the WSE Main Market

** Income index − calculated to reflect the prices of constituent stocks as well as dividend and rights income.*
** Price index − calculated to reflect just the prices of constituent stocks, excluding dividend income.*

Grupa LOTOS share price performance vs. index performance

2013 was a good year for investors in shares, with equities emerging as the best-performing asset class, particularly in the developed markets. Stock exchange indices in the US, world's largest economy, soared by more than 30% (NASDAQ up 35% and S&P500 up approximately 30%). In Europe, the top performer was Germany's DAX, up by 26%.

The year saw only slight movements in the main WSE indices. The index of all companies listed on the Main Market, WIG, gained 8%, with the annual change in WIG-20 being negative at -7%. In September, a new index of the thirty largest and most liquid companies was launched by the WSE under the name WIG30. As at the end of the year, the index had fallen by almost 2%. Two SME indices, mWIG40 and sWIG80, rose 31% and 37% respectively, delivering the top rates of return.

By sector classification, the winning WIG-BUDOWNICTWO construction sector index gained 33%, with the WIG-PALIWA fuels sector (down 10%) arriving at the other end of the spectrum. The RESPECT corporate social responsibility index lost over 4% during 2013.

The price of the Grupa LOTOS shares followed general market trends in 2013, remained within the PLN 33.15–44.95 range, and closed for the year at PLN 35.45.

In the period under review, the number of LOTOS shares which changed hands in an average trading session was 229,877, down by 18% relative to the previous year. The total value of trading in its stock was in excess of PLN 2.2bn, representing 1% of total WSE trading, with an average of 877 trades per session.

Table 40. Grupa LOTOS shares

	2009	2010	2011	2012	2013
Free float shares (million shares)	**129.87**	**129.87**	**129.87**	**129.87**	**129.87**
Price of Grupa LOTOS shares (PLN)					
Low	7.21	25.05	22.26	21.30	**32.97**
High	32.80	37.85	49.50	43.78	**45.45**
Closing price	31.80	36.35	23.30	41.20	**35.45**
Rate of return at end of period (%)	166.11	14.31	-35.9	76.82	**-13.96**

	2009	2010	2011	2012	2013
Trade in Grupa LOTOS shares					
Trading value (PLNm)	3,642.56	3,684.33	3,299.07	2,013.15	**2,211.43**
Share in trade (%)	1.11	0.88	1.31	1.07	**1.00**
Average trading volume per session	381.938	234.464	377.048	282.163	**229,877**
Average number of trades per session	945	699	967	810	**877**

	2009	2010	2011	2012	2013
Company valuation					
Market capitalisation at end of period (PLNm)	4,130.80	4,720.80	3,026.00	5,351.00	**4,603.89**
Book value (PLNm)	6,846.20	7,513.50	7,782.40	9,066.40	**9,189.60**
EV (PLNm)	9,440.12	10,650.27	10,032.87	11,472.60	**10,311.89**
Valuation ratios					
Earnings per share (PLN)	7.44	5.23	5.03	7.14	**0.30**
P/E (x)	4.27	6.95	4.66	5.80	**118.00**
P/BV (x)	0.60	0.63	0.38	0.59	**0.50**
EV/EBITDA (x)	12.94	7.36	6.40	11.89	**12.85**

**In-house analysis based on WSE and Company data.*
** EV (Enterprise Value) − market capitalisation plus debt, non-controlling interests, and preferred shares, minus cash and cash equivalents.*
** P/E – Price/Earnings*
** P/BV – Price/Book Value*
** EV/EBITDA − Enterprise Value/EBITDA*

Chart 53. Price of Grupa LOTOS shares in 2013.

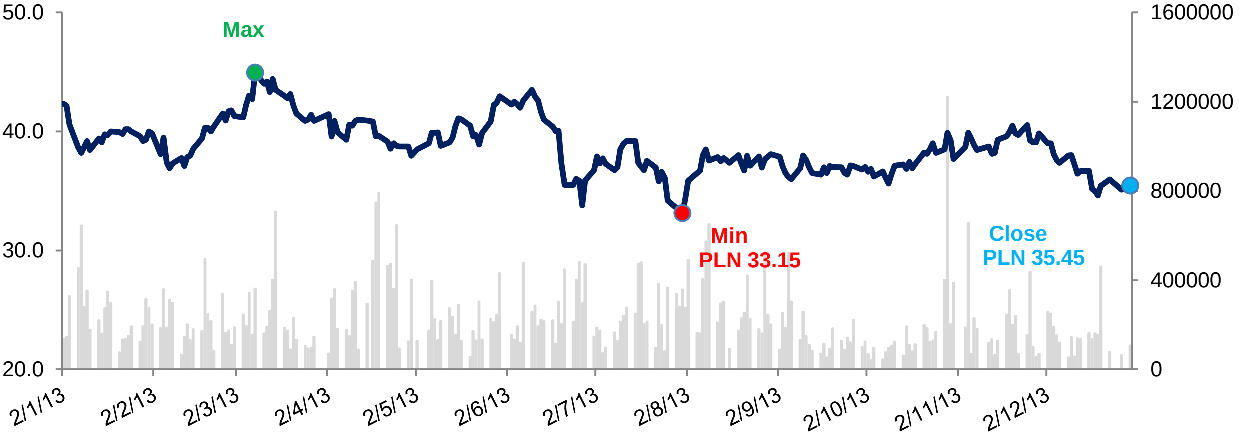


Chart 54. Effect of important events at the Company on the market price of Grupa LOTOS shares

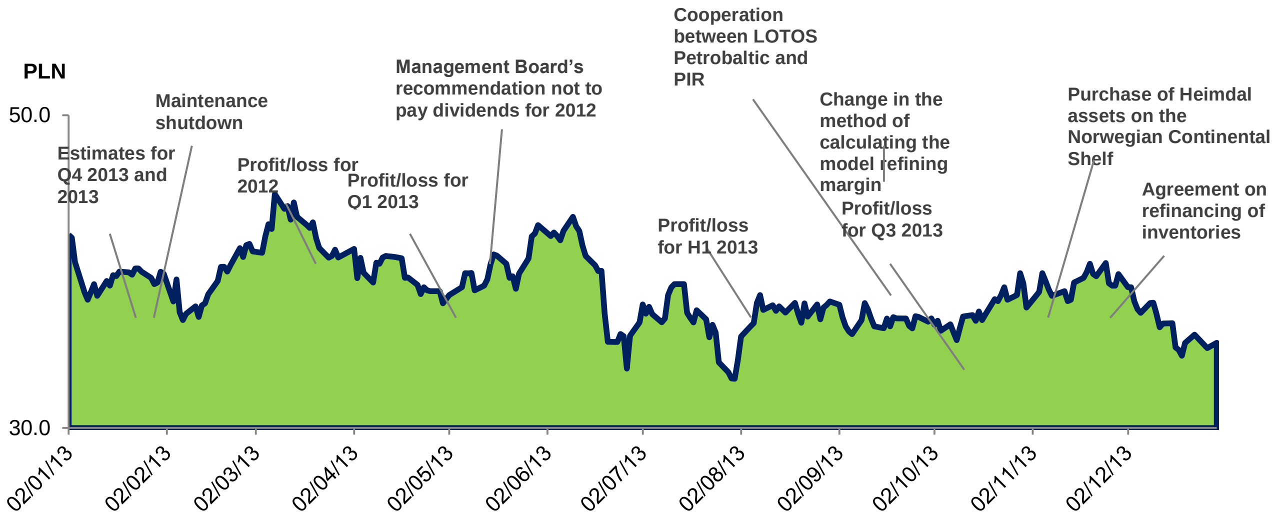
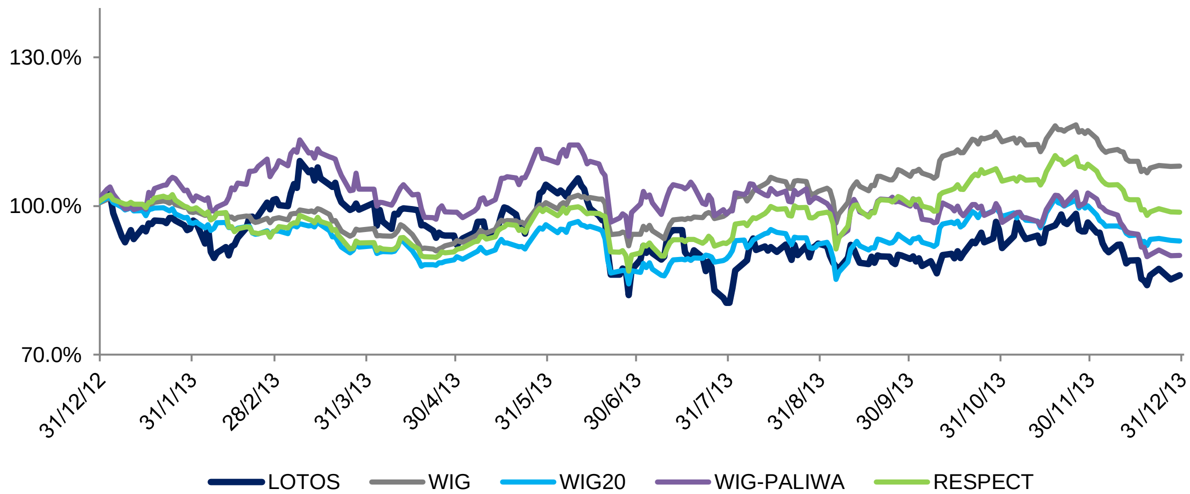


Chart 55. Grupa LOTOS share price performance vs. index performance in 2013



** Rebased (100 = closing price at December 28th 2012)*

Brokers' recommendations on Grupa LOTOS shares

Recommendations on Grupa LOTOS shares are issued by 13 investment houses (including brokerage houses and investment banks):

Table 40. Investment houses covering Grupa LOTOS

Based in Poland	Based abroad
DM mBanku	Societe Generale
DM BZ WBK	Erste Bank
DM IDM	Wood & Co.
DM PKO BP	Deutsche Bank
DM BDM	Raiffeisen Centrobank
DI Investors	
ING Securities	
Espirito Santo Investment Bank	

To the Company's knowledge, brokers issued 25 recommendations on the Company shares in 2013:

- 4 BUY recommendations
- 9 HOLD recommendations
- 3 REDUCE recommendations
- 13 SELL recommendations

Including:

- 6 recommendations were upgraded
- 10 recommendations were maintained
- 5 recommendations were downgraded.

Furthermore:

- 1 coverage initiation
- 3 coverage re-initiations

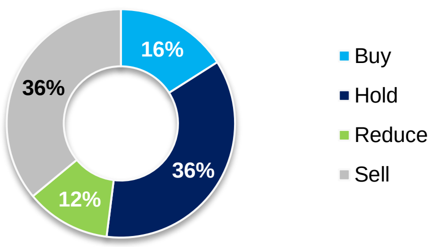
* BUY – total expected rate of return will exceed 15% in 12 months

* HOLD – total expected rate of return will be between -5% and +5% in 12 months

* REDUCE − total expected rate of return will be between -5% and -15% in 12 months

* SELL − total expected rate of return will be more than -15% in 12 months.

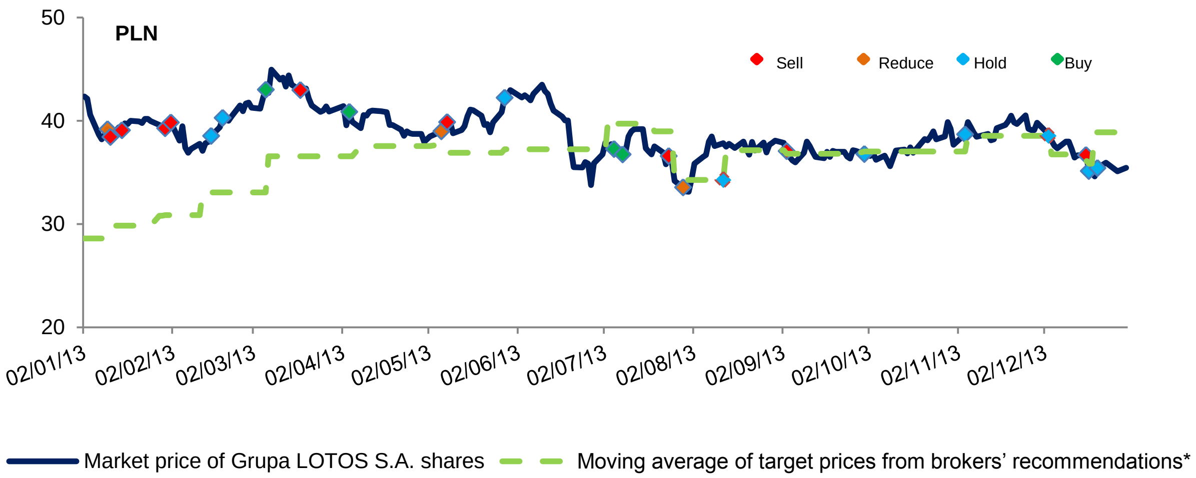
Chart 56 Structure of broker recommendations on Grupa LOTOS shares in 2013



In broker research reports, the target price of Grupa LOTOS shares ranged from PLN 29.50 to PLN 56.30, compared with PLN 19.40 to PLN 38.90 in 2012. The average target price of Grupa LOTOS shares in 2013 was PLN 37.70 (2012: PLN 26.58).

The Grupa LOTOS shares traded within the range from PLN 33.15 to PLN 44.95. At the end of 2013, the price of Grupa LOTOS shares was PLN 35.45.

Chart 57. Recommendations and moving average of target prices against the market price of the Company shares



** Simple moving average – arithmetic mean of target prices in broker recommendations for 12 months (excluding recommendation updates older than six months)*

5.2. DIVIDEND POLICY

Dividend distributions for 2011-2015 depend on the optimisation of the financing structure of the LOTOS Group. Grupa LOTOS S.A.'s financial strategy provides for distribution of up to 30% of net profit as dividend.

The Management Board of Grupa LOTOS S.A. recommended that no part of the 2012 net profit be distributed to the Company's shareholders.

On June 28th 2013, acting upon the Management Board's recommendation, the General Meeting resolved to distribute the 2012 profit as follows:

- PLN 834,931,320.89 was allocated to statutory reserve funds,
- PLN 1,500,000.00 was allocated to the Special Account designated for financing corporate social responsibility (CSR) projects.

Table 41. Dividend and dividend yield (PLN)

Financial year	Dividend	Dividend per share	Share price at year end	Dividend yield
2005	0.0	0.0	44,2	-
2006	40,932,000.0	0.4	49.3	0.7
2007	0.0	0.0	44.5	-
2008	0.0	0.0	12.0	-
2009	0.0	0.0	31.8	-
2010	0.0	0.0	36.4	-
2011	0.0	0.0	23.3	-
2012	**0.0**	**0.0**	**35.5**	**-**

** Dividend yield – dividend per share to price per share.*

Table 42. Historical dividend per share (PLN)

Financial year	Dividend per share	% of net profit	Dividend record date	Dividend payment date
2005	0.0	0.0	-	-
2006	0.4	10.1	Jun 11 2007	not later than Jul 31 2007
2007	0.0	0.0	-	-
2008	0.0	0.0	-	-
2009	0.0	0.0	-	-
2010	0.0	0.0	-	-
2011	0.0	0.0	-	-
2012	**0.0**	**0.0**	**-**	**-**

** Dividend record date – the date on which the list of shareholders entitled to receive dividend for a given financial year is determined.*
** Dividend payment date – the date on which dividend is paid to the Company's shareholders.*

5.3. ACQUISITION OF TREASURY SHARES

Grupa LOTOS S.A. did not buy back any own shares in 2013.

5.4. SHARES AND EQUITY INTERESTS HELD BY MANAGEMENT AND SUPERVISORY BOARD MEMBERS

To the best of the Company's knowledge, only the two following members of the Management Board held shares in Grupa LOTOS S.A. as at March 5th 2014.

Table 43. Aggregate number and par value of the Company shares and shares in the Company's related entities, held by management and supervisory board members

Management and Supervisory Board members	Number of Grupa LOTOS shares	Par value of shares (PLN)
Management Board, including:	9,636	9,636
Mr Marek Sokołowski	**8,636**	**8,636**
Mr Zbigniew Paszkowicz	**1,000**	**1,000**
Supervisory Board	0	0
Total	**9,636**	**9,636**

** Based on representations as at February 26th 2014.*

To the best of the Company's knowledge, as at March 5th 2014 the Management and Supervisory Board members did not hold any shares in Grupa LOTOS's related companies.

5.5. AGREEMENTS WHICH MAY GIVE RISE TO FUTURE CHANGES IN SHAREHOLDER STRUCTURE

The Management Board of Grupa LOTOS S.A. has no knowledge of any agreements which may give rise to future changes in the number of shares held by the existing shareholders and bondholders.

6. CORPORATE GOVERNANCE

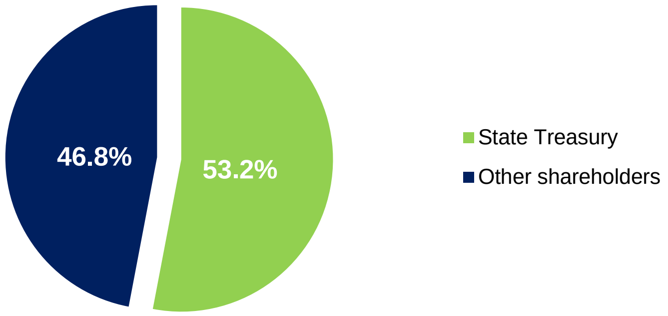
6.1. SHAREHOLDER STRUCTURE

6.1.1. SIGNIFICANT HOLDINGS OF SHARES

Changes in 2012-2013

The share capital of Grupa LOTOS S.A. did not change from the value reported in 2012 and is divided into 129,873,362 fully paid-up ordinary shares with a par value of PLN 1 per share. Each share confers the right to one vote at the General Meeting and carries the right to dividend.

Chart 58. Shareholder structure of Grupa LOTOS as at the end of 2012



On April 29th 2013, the Company was notified that – as a result of the acquisition of Grupa LOTOS shares in transactions on the Warsaw Stock Exchange, settled on April 24th 2013 – the open-end pension fund ING Otwarty Fundusz Emerytalny increased its shareholding in the Company so that it exceeded the threshold of 5% of the total voting rights at the Company's General Meeting (Current Report No. 11/2013).

Table 44. Share in share Capital and total voting rights at the GM

Shareholder	Number of shares/voting rights	Par value of shares	Share in share capital/total voting rights at the GM
State Treasury	69,076,392	69,076,392	**53.2%**
ING OFE	6,893,079	6,893,079	**5.3%**
Other shareholders	53,903,891	53,903,891	**41.5%**
Total	**129,873,362**	**129,873,362**	**100.0%**

Chart 59. Shareholder structure of Grupa LOTOS in the period from April 24th 2013 to the date of release of this Director's Report (in %)

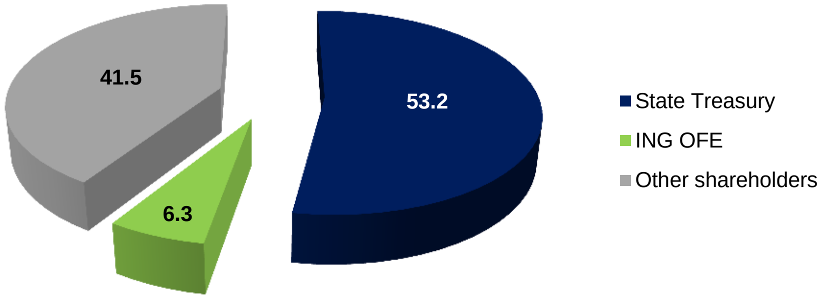


Table 45. Other pension funds in the shareholder structure of Grupa LOTOS S.A.

Pension fund	% of share capital held
Otwarty Fundusz Emerytalny PZU	3.30
Aviva Otwarty Fundusz Emerytalny	3.00
Allianz Polska Otwarty Fundusz Emerytalny	1.36
Nordea Otwarty Fundusz Emerytalny	0.59
Aegon Otwarty Fundusz Emerytalny	0.44
Axa Otwart Fundusz Emerytalny	0.39
Otwarty Fundusz Emerytalny Warta	0.30
Otwarty Fundusz Emerytalny Pocztylion	0.30
Pekao Otwarty Fundusz Emerytalny	0.26
Generali Otwarty Fundusz Emerytalny	0.26
PKO BP BANKOWY Otwarty Fundusz Emerytalny	0.12
Amplico Otwarty Fundusz Emerytalny	0.11

** Based on the investment funds' financial statements as at December 31st 2013.*

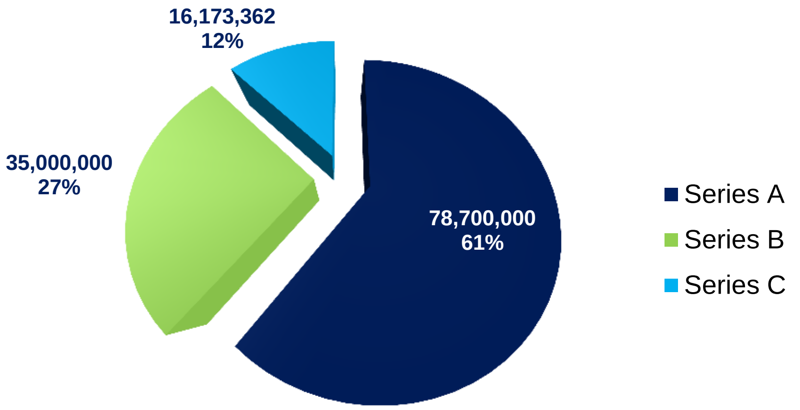
Chart 60. Geographical structure of minority interests

** Based on the identified minority interests.*

Share capital structure

The share capital of Grupa LOTOS S.A. is divided into 129,873,362 fully paid-up ordinary shares with a par value of PLN 1 per share. Each share carries the right to one vote at the GM and the right to dividend.

Chart 61. Grupa LOTOS share capital structure



In 2012−2013 and until the date of release of this Director's Report, the State Treasury has held a total of 69,076,392 ordinary bearer shares in Grupa LOTOS, representing 53.19% of its share capital and the same proportion of voting rights at its General Meeting.

In 2012, no changes occurred in the composition of the main shareholders, which means that the remaining 46.81% of share capital, that is 60,796,970 shares, was in free float.

On June 28th 2013, in Current Report No. 16/2013, the Company published a list of shareholders holding at least 5% of total voting rights at the Annual General Meeting of Grupa LOTOS S.A. held on June 28th 2013.

Table 46. Shareholders holding at least 5% of total voting rights at the Annual General Meeting of the Company held on June 28th 2013

Entity	Number of Grupa LOTOS shares held	% of total voting rights at GM	% of share capital held
State Treasury	69,076,392	78%	53.19%

Special rights and their exercise giving control of Grupa LOTOS non-commensurate with the shareholding

The Company has not issued any securities which would vest shareholders with any special control powers. As at the date of release of this Directors' Report, the Company has no information on shareholders' agreements on joint exercise of voting rights.

Limitations on the exercise of voting rights at the General Meeting of Grupa LOTOS S.A.

One share in Grupa LOTOS S.A. confers the right to one vote at its GM. However, pursuant to the Company's Articles of Association, the voting rights of Company shareholders are limited so that none of them can exercise more than 10% of total voting rights at the Company as at the day on which the General Meeting is held, with the proviso that for the purpose of determining the obligations of buyers of significant shareholdings provided for in the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies of July 29th 2005, and the Act on Insurance Activity of May 22nd 2003, such limitation of voting rights is deemed non-existent.

6.1.2. HOLDERS OF SECURITIES WHICH CONFER SPECIAL CONTROL POWERS, WITH A DESCRIPTION OF THE POWERS

Grupa LOTOS S.A. has not issued any securities which would vest shareholders with any special control powers.

6.1.3. SPECIAL RIGHTS OF THE STATE TREASURY AND THEIR EXERCISE IN COMPANIES

The Act on Special Rights Vested in the Minister Competent for the State Treasury and How Those Rights Should Be Exercised at Certain Companies or Groups of Companies Operating in the Power, Crude Oil and Gas Fuels Sectors, dated March 18th 2010 (Dz.U. No. 65, item 404) ("the Act"), introduced the institution of a special officer responsible for the protection of critical infrastructure.

In accordance with the Act, the Company's Management Board, acting in consultation with the minister competent for the State Treasury and the Head of the Government Centre for Security, has the right to appoint and remove from office a special officer responsible for critical infrastructure protection at the Company. The special officer's duties include, in particular, providing the minister competent for the State Treasury with information on the execution by the Company's governing bodies of any of the acts in law referred to above, providing the Head of the Government Centre for Security with information on critical infrastructure whenever requested, and – together with the Head of the Government Centre for Security – providing to and receiving from other entities information on any threats to the critical infrastructure.

The special officer responsible for protection of critical infrastructure is authorised to request from company governing bodies any documents or explanations regarding the issues referred to above, and, having analysed them, is required to submit the same to the minister competent for the State Treasury and the Head of the Government Centre for Security, along with the officer's written position and the grounds for it.

On July 11th 2011, Grupa LOTOS S.A. received a notification to the effect that its assets have been included in the list of assets, facilities, installations, equipment, and services comprising critical infrastructure. As a result, on August 23rd 2011 the Management Board of Grupa LOTOS S.A. appointed a special officer responsible for protection of critical infrastructure.

Under the Act, the minister competent for the State Treasury has the right to raise objections to passed resolutions, or to any other act in law performed, by the Company's Management Board with respect to any of the assets included in the single list of facilities, installations, equipment, and services comprising critical infrastructure, referred to in Art. 5b.7.1 of the Crisis Management Act of April 26th 2007, if such constitute a material threat to the operation, continuity of operation and integrity of critical infrastructure, including:

- in the power sector – infrastructure used for the purpose of generation or transmission of electricity;
- in the oil sector – infrastructure used for the purpose of production, refining, processing, storage and transmission via pipelines of crude oil and petroleum products, as well as seaports used for handling crude oil and petroleum products;

- in the gas fuels sector – infrastructure used for the purpose of production, refining, processing, storage and transmission via gas pipelines of gas fuels, as well as LNG terminals.

The minister competent for the State Treasury may also raise an objection with respect to any resolution by the Company's governing bodies providing for:

- dissolution of the Company,
- changes in the intended use or discontinuation of use of any of the Company's assets (1) included in the single list of facilities, installations, equipment, and services comprising critical infrastructure, referred to in Art. 5b.7.1 of the Polish Crisis Management Act of April 26th 2007,
- change in the Company's business profile,
- sale or lease of the Company's business or its organised part, or creation of any proprietary interest therein,
- adoption of the budget, plan of investing activities, or a long-term strategic plan,
- relocation of the Company's registered office abroad,

if the implementation of any such resolution could constitute a material threat to the operation, continuity of operation and integrity of critical infrastructure.

6.1.4. LIMITATIONS ON THE EXERCISE OF VOTING RIGHTS AT THE GENERAL MEETING

One share in Grupa LOTOS S.A. confers the right to one vote at its GM. However, pursuant to the Company's Articles of Association, the voting rights of Company shareholders are limited so that none of them can exercise more than 10% of total voting rights at the Company as at the day on which the General Meeting is held, with the proviso that for the purpose of determining the obligations of buyers of significant shareholdings provided for in the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies of July 29th 2005, and the Act on Insurance Activity of May 22nd 2003, such limitation of voting rights is deemed non-existent.

The above limitation does not apply to:

1) shareholders which as at the date of the General Meeting's resolution imposing the limitation on voting rights are holders of shares conferring more than 10% of total voting rights at the Company;

2) shareholders acting together with shareholders defined in item 1 pursuant to agreements on joint exercise of voting rights.

For the purpose of limiting the voting rights as referred to above, the voting rights of shareholders bound by a parent-subsidiary relationship shall be aggregated in the following manner:

1. A shareholder shall be any person, including a parent and a subsidiary of such person, directly or indirectly entitled to exercise voting rights at the General Meeting under any legal title, including persons who do not hold shares in the Company, in particular usufructuaries, pledgees, holders of rights under depositary receipts, as defined in the Act on Trading in Financial Instruments of July 29th 2005, as well as

persons entitled to participate in the General Meeting despite having disposed of their shareholdings after the record date.

2. A parent or a subsidiary shall be any person which:

    1) meets the relevant criteria set forth in Art. 4.1.4) of the Commercial Companies Code, or

    2) is a dominant company, a subsidiary or both a dominant company and a subsidiary within the meaning of the Act on Competition and Consumer Protection of February 16th 2007, or

    3) is a parent, ultimate parent, subsidiary, lower-tier subsidiary, jointly-controlled entity or both a parent (including an ultimate parent) and a subsidiary (including a lower-tier subsidiary and a jointly-controlled entity) within the meaning of the Accountancy Act of September 29th 1994, or

    4) exerts (in the case of a parent) or is subject to (in the case of a subsidiary) decisive influence within the meaning of the Act on the Transparency of Financial Relations between State Authorities and State-Controlled Enterprises, as well as on Financial Transparency of certain Entrepreneurs, of September 22nd 2006, or

    5) whose voting rights conferred by Company shares held directly or indirectly are aggregated with voting rights of other person or persons pursuant to the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies of July 29th 2005, in connection with the holding, disposal or acquisition of significant shareholdings in the Company.

Shareholders whose voting rights are aggregated or reduced pursuant to the rules described above, are jointly referred to as a Grouping. The aggregation of voting rights consists in adding up all voting rights held by individual shareholders comprising a Grouping. The reduction of voting rights involves decreasing the total number of voting rights at the General Meeting held by shareholders comprising a Grouping.

The reduction of voting rights is made as follows:

1) the number of voting rights of the shareholder holding the highest number of voting rights in the Company from among all the shareholders comprising a Grouping is reduced by the number of voting rights in excess of 10% of the total number of voting rights in the Company held by all the shareholders in the Grouping;

2) if, despite the reduction referred to above, the total voting rights held by the shareholders comprising the Grouping exceeds 10% of total voting rights at the Company on the date the General Meeting is held, the number of voting rights held by the other shareholders in the Grouping is further reduced. Such further reduction is made in a sequence established based on the number of voting rights held by individual shareholders comprising the Grouping (from the highest to the lowest). The number of voting rights of the Grouping is further reduced until the number of voting rights held by the shareholders comprising the Grouping does not exceed 10% of the total vote at the Company;

3) if the sequence for the purpose of the reduction of voting rights cannot be established because one or more shareholders hold the same number of voting rights, the voting rights of shareholders holding the same number of voting rights are reduced proportionally, with fractional numbers rounded down to the whole number of shares. To the extent not provided for above, the rules set forth in the preceding items apply accordingly;

4) in any case, a shareholder whose voting rights have been limited retains the right to exercise at least one vote;

5) the limitation of voting rights also applies to shareholders absent from the General Meeting.

In order to determine the basis for aggregation or reduction of voting rights, each of the Company's shareholders, the Management Board, the Supervisory Board, and individual members of these bodies, as well as the Chairperson of the General Meeting, may request that a Company shareholder subject to the limitation of voting rights disclose whether it is a parent or a subsidiary of any other Company shareholder within the meaning of the Company's Articles of Association. The authority referred to in the previous sentence also includes the right to request a Company shareholder to disclose the number of voting rights held individually or jointly with other shareholders with respect to which it is a parent or a subsidiary within the meaning of the Company's Articles of Association. A person who fails to perform or improperly performs the above disclosure obligation may exercise its voting rights from a single share only, until the disclosure obligation is duly fulfilled, and any attempts to exercise its voting rights from the remaining shares are ineffective.

When in doubt, the provisions on the limitation of voting rights are interpreted in accordance with Art. 65.2 of the Civil Code.

The limitation of voting rights expires once the shareholding of a Company shareholder who as at the date of the General Meeting's resolution imposing the limitation of voting rights held shares conferring more than 10% of the total vote at the Company falls below 5% of the Company's share capital.

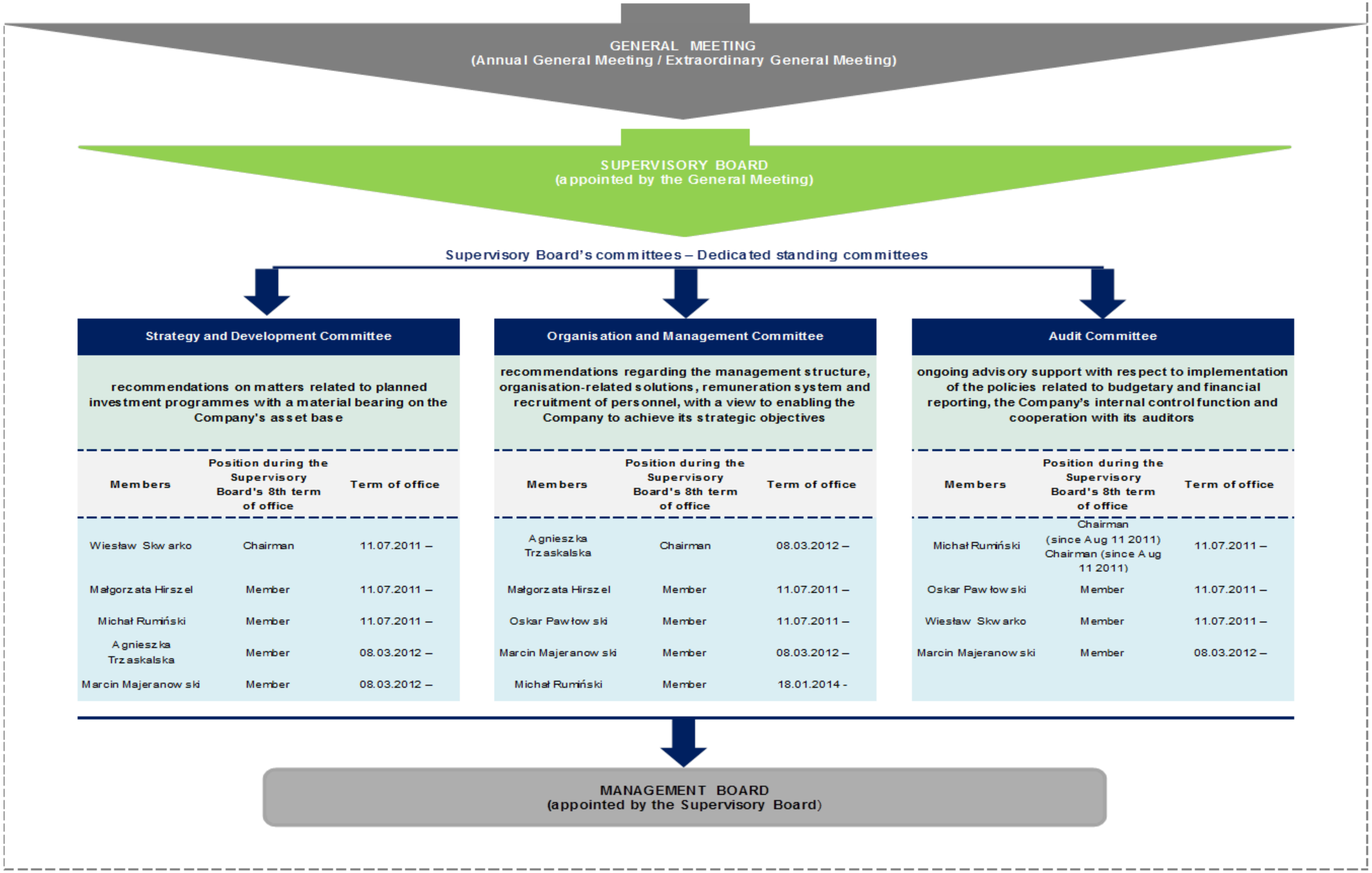
Subject to the relevant provisions of the Commercial Companies Code, a material change may be introduced in the Company's business profile without a buy-out of Company shares held by the shareholders who do not agree to such a change.

6.1.5. RESTRICTIONS ON TRANSFERABILITY OF SECURITIES

No restrictions apply to transferability of ownership rights to any shares issued by Grupa LOTOS S.A.

6.2. THE COMPANY'S GOVERNING BODIES

Chart 62. Corporate governance structure of Grupa LOTOS S.A



Strategy and Development Committee

Members	Position during the Supervisory Board's 8th term of office	Term of office
Wiesław Skwarko	Chairman	11.07.2011 –
Małgorzata Hirszel	Member	11.07.2011 –
Michał Rumiński	Member	11.07.2011 –
Agnieszka Trzaskalska	Member	08.03.2012 –
Marcin Majeranowski	Member	08.03.2012 –

Organisation and Management Committee

Members	Position during the Supervisory Board's 8th term of office	Term of office
Agnieszka Trzaskalska	Chairman	08.03.2012 –
Małgorzata Hirszel	Member	11.07.2011 –
Oskar Pawłowski	Member	11.07.2011 –
Marcin Majeranowski	Member	08.03.2012 –
Michał Rumiński	Member	18.01.2014 -

Audit Committee

Members	Position during the Supervisory Board's 8th term of office	Term of office
Michał Rumiński	Chairman (since Aug 11 2011) Chairman (since Aug 11 2011)	11.07.2011 –
Oskar Pawłowski	Member	11.07.2011 –
Wiesław Skwarko	Member	11.07.2011 –
Marcin Majeranowski	Member	08.03.2012 –

6.2.1. GENERAL MEETING OF GRUPA LOTOS S.A.

The powers and proceedings of the General Meeting (GM) of Grupa LOTOS S.A. are stipulated in detail in the Company's Articles of Association (consolidated text of December 21st 2012) and the Rules of Procedure for the General Meeting (consolidated text of August 26th 2009). Both documents are available from the Corporate Governance section of the Company's website.

General Meetings are held at the Company's registered office and are convened by the Management Board of Grupa LOTOS S.A., as provided for in the Articles of Association or in the Commercial Companies Code, by publishing an announcement on the Company's website and in the manner determined for publication of current reports, in accordance with the provisions of the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading and Public Companies.

In 2013, the Annual General Meeting (AGM) was held on June 28th. The right to convene the AGM also rests with the Supervisory Board if the Management Board fails to convene it within six months after the end of the financial year.

Extraordinary General Meetings (EGM) may be convened by the Management Board on its own initiative, by the Supervisory Board (if the Supervisory Board deems it appropriate), or by shareholders representing at least half of the Company's share capital or at least half of the total vote at the Company.

A shareholder or shareholders representing at least 1/20 of the Company's share capital may request that an EGM be convened and that certain items be placed on its agenda. If an EGM is not convened within two weeks of the submission of such a request to the Management Board, the Registry Court may authorise the requesting shareholders to convene an Extraordinary General Meeting.

A request to convene a General Meeting and include particular items on its agenda, made by parties entitled to do so, should be presented with grounds. A shareholder or shareholders representing at least 1/20 of the Company's share capital may, before a GM, submit to the Company draft resolutions for items which have been or are to be placed on the agenda of the General Meeting.

Only persons who are the Company shareholders sixteen days prior to the date of a General Meeting (i.e. on the date of registration of participation in the GM) are entitled to participate in the General Meeting. Holders of rights under registered shares or provisional certificates (*świadectwa tymczasowe*) as well as pledgees and usufructuaries holding voting rights are entitled to participate in the General Meeting, provided that they are entered in the Share Register on the registration date. A Shareholder may participate in a General Meeting and exercise voting rights in person or by proxy. The proxy is obliged to disclose to the shareholder any circumstances leading to any actual or potential conflict of interests and may vote exclusively in line with the voting instructions issued by the appointing shareholder.

Any matter to be discussed at a General Meeting is subject to prior consideration by the Supervisory Board. No resolution may be passed on matters not included in the agenda of the General Meeting, unless the Company's entire share capital is represented at the GM and no objections to the adoption of such resolution are raised by any of the persons participating in the GM, with the exception of motions to convene an Extraordinary General

Meeting and procedural motions. Resolutions of a General Meeting are adopted by an absolute majority of votes, unless the Articles of Association or Commercial Companies Code provide otherwise. Resolutions and proceedings of a General Meeting are recorded by a notary public. The minutes of the GM are signed by the Chairman of the GM and the notary public.

6.2.2. SUPERVISORY BOARD OF GRUPA LOTOS S.A.

The Supervisory Board of Grupa LOTOS S.A. operates under the Company's Articles of Association (consolidated text of December 21st 2012) and the Rules of Procedure for the Supervisory Board of Grupa LOTOS S.A. Procedures for and the scope of powers and duties of the Supervisory Board of Grupa LOTOS S.A. are stipulated in detail in the Rules of Procedure for the Supervisory Board of Grupa LOTOS S.A. (consolidated text of December 17th 2009).

The Supervisory Board may comprise five to nine members, appointed for a joint three-year term of office by the General Meeting in a secret ballot, by an absolute majority of votes, from an unlimited number of candidates. The number of Supervisory Board members is determined by the General Meeting. The Chairperson of the Supervisory Board is appointed by the General Meeting, while the Deputy Chairperson and the Secretary are elected by the Supervisory Board from among its other members. A Supervisory Board member or the entire Board may be removed at any time prior to expiry of their term of office. As long as it remains a shareholder in the Company, the State Treasury is entitled to directly appoint and remove one member of the Supervisory Board.

SUPERVISORY BOARD MEMBERS	POSITION	ON THE SUPERVISORY BOARD (8TH TERM)	CARRIER PATH AND POWERS
 **Wiesław Skwarko**	Chairperson	Jun 27 2011−	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-21
 **Marcin Majeranowski**	Deputy Chairperson	Feb 29 2012−	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-53
 **Oskar Pawłowski**	Secretary	Jun 27 2011−	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-54

 Małgorzata Hirszel	Member	Jun 27 2011–	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-55
 Agnieszka Trzaskalska	Member	Feb 29 2012–	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-56
 Michał Rumiński	Member	Jun 27 2011–	http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-57

The Supervisory Board exercises ongoing supervision of the Company's business, across all areas of its operations. It performs its duties collectively, but may set up ad hoc or standing committees to supervise specific areas of the Company's activities or investigate specific issues. Standing committees of the Supervisory Board include the Audit Committee, Strategy and Development Committee, and Organisation and Management Committee.

Delegation of specific duties to individual Supervisory Board members

The Supervisory Board may delegate its members to individually perform certain tasks or functions. By virtue of its decision of October 24th 2012 (Resolution No. 58/VIII/2012), the Supervisory Board delegated Mr Oskar Pawłowski to independently perform supervision of the legal aspects of the Company's continued participation in the consortium developing the YME field and the dispute with the field's operator. Considering that the tasks delegated by the Supervisory Board in this respect had been completed, and given the ongoing restructuring of the Company's North Sea projects, the Supervisory Board, by virtue of its decision of May 23rd 2013, maintained Mr Oskar Pawłowski's delegation to independent supervision of the restructuring of the Norwegian assets of the LOTOS Group's Exploration & Production Segment.

By virtue of Resolution No. 66/VIII/2013 of January 11th 2013, Mr Marcin Majeranowski was delegated to independently supervise the execution of the LOTOS Group's capital reconstruction programme and the implementation of its schedule.

6.2.3. MANAGEMENT BOARD OF GRUPA LOTOS S.A. AND POWERS OF INDIVIDUAL MEMBERS

The Management Board of Grupa LOTOS S.A. operates pursuant to the following documents available on the Company's website in the Corporate Governance section: the Company's Articles of Association and the Rules of Procedure for the Management Board (adopted by virtue of Management Board Resolution No. 6/VI/2007 dated January 23rd 2007 and approved by virtue of Supervisory Board Resolution No. 70/VI/2007 dated January 29th 2007).

The Management Board represents Grupa LOTOS S.A. before third parties and manages its corporate affairs. Moreover, the individual members of the Management Board perform duties in line with the division of powers and responsibilities resulting from their operational functions within the Company. Each member of the Management Board is also authorised to represent the Company in all judicial and non-judicial business relating to the Company's operations, excluding matters reserved for the General Meeting or Supervisory Board under the Commercial Companies Code or the Company's Articles of Association, as well as matters falling outside the scope of ordinary management of the business where they require the Management Board's prior resolution and matters within the powers of another member of the Management Board.

From January 1st 2013 to December 31st 2013 and as at the date of release of these financial statements, the Company's Management Board in its eighth term of office consisted of the following persons:

Management Board: composition and powers

Paweł Olechnowicz

President of the Management Board, CEO

Appointment to the Management Board:

Mr Olechnowicz has held the position of President of the Management Board of Grupa LOTOS since March 12th 2002, when he was appointed by the Supervisory Board to the Management Board of the 4th term.

Then, in 2003, 2006, 2009 and 2012 he was re-appointed President the Management Board by the Company's Supervisory Board.

Since September 2007, he has served as Chairman of the Board of Directors of LOTOS Exploration and Production Norge AS and since April 2011 - Chairman of the Board of Directors of AB LOTOS Geonafta.

Responsibilities: overall management of the LOTOS Group's operations

Qualifications, professional experience and achievements:

Graduated from Kraków University of Technology (the Faculty of Technology and Mechanisation of Foundry Engineering), completed a post-graduate course in Organization, Economics and Industrial Management at Gdańsk University of Technology, MBA INSEAD, Fontainebleau, and attended a number of courses in management, both in Poland and abroad. In 1977, he started his professional career at Zakłady Mechaniczne Zamech of Elbląg (from 1990 – ABB Zamech Sp. z o.o.). In 1990-1996, he was President of the Management Board and Director General of ABB Zamech Ltd. and concurrently, between 1994 and 1996, he was Vice-President of ABB Polska. Subsequently, for two years Mr Olechnowicz worked at the headquarters of ABB Ltd. Zurich, Switzerland, as Vice- President for Central and Eastern Europe. In 1999-2000, Mr Olechnowicz was Vice-President and Deputy Director General of ZML Kęty S.A., and from 2001, managed his own consultancy firm, Paweł Olechnowicz-Consulting. He was one of the founders, in 2010, of Central Europe Energy Partners (CEEP), an expert organisation representing the interests of the energy sector at large. He chaired its Board of Directors. After taking the position of President of the Management Board of Grupa LOTOS in March 2002, Mr Olechnowicz started the dynamic process of modernising the Company's structures and developing its production and marketing potential. He initiated the programme of building the LOTOS Group as a manufacturing and marketing organisation; caused the change of name to Grupa LOTOS S.A. (June 2003); commenced the technical upgrading of the Gdańsk refinery; caused business consolidation with the Czechowice and Jasło refineries located in southern Poland, as well as the integration of Petrobaltic into the Group; managed implementation of the ISO-based Integrated Management System; floated Grupa LOTOS shares on the Warsaw Stock Exchange (June 2005), and used the IPO proceeds to carry out the 10+ Programme (completed in 2011); led the implementation of a set of anti-crisis measures involving a cost-cutting programme developed jointly by the Company's management and staff (2009), and the Optimal Expansion Programme, an efficiency and savings enhancement plan (2012). He is also implementing the objectives of the 'Efficiency and Growth in 2013-2015' programme, designed to ensure the development and reorganisation of the LOTOS Group, as part of which Grupa LOTOS S.A., Grupa Azoty S.A. and Polskie Inwestycje Rozwojowe are implementing a petrochemical project.

http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-12

Mariusz Machajewski

Vice-President of the Management Board, Chief Financial Officer

Appointment to the Management Board: Mr Machajewski has held the position of Vice-President of the Management Board since June 19th 2006, when he was appointed by the Supervisory Board to the 6th term Management Board. He was reappointed by the Supervisory Board as Vice-President in 2009 and 2012.
Since 2006 he has sat on the Supervisory Board of LOTOS Paliwa Sp. z o.o. as Deputy Chairman, and since 2010 on the Supervisory Board of RCEkoenergia Sp. z o.o., where he serves as Chairman.
Since 2013, he has been a member of the Supervisory Board of the Association of Stock Exchange Issuers.

Responsibilities: Overall management of finance and accounting, and overall supervision of Grupa LOTOS S.A.'s assets and restructuring processes, with responsibility for these areas; oversight of issues and activities related to defining corporate guidelines and uniform procedures for contract execution, contractor selection and assessment, and IT and telecommunications system development.

Qualifications, professional experience and achievements:
Mr Machajewski is a graduate of the Faculty of Economics at Gdańsk University, and has also attended a number of courses in management and economics in Poland and abroad.
From 1994 to 1997 he worked at Stocznia Gdynia S.A. (Gdynia Shipyard). In 1997, he joined Rafineria Gdańska S.A. (currently Grupa LOTOS S.A.), and in 1999, he was placed in charge of the Company's controlling functions. Since mid-2002, he has held the position of Chief Financial Officer, and also served as the Company's commercial proxy from April 2005 to June 2006. Appointed to the Management Board in June 2006. He played an active role in the Company's internal restructuring, which included establishment of the Finance and Accounting Centre in 2005, chiefly providing accounting support to Grupa LOTOS S.A. and its subsidiaries. He was also involved in the preparation of the Company for its listing on the Warsaw Stock Exchange on June 9th 2005. More recently, he led the process of preparing the funding concept for the 10+ Programme and putting it into place – the credit facility agreement executed in June 2008 for the 10+ Programme was the largest in Company history. It was declared Transaction of the Year in the European oil industry, and named Best Finance Project of the Year by a number of high-profile specialist titles. Mr Machajewski was also responsible for preparing and monitoring the implementation of the 'Package of Anti-Crisis Measures' cost cutting programme (2009), as well as the 'Optimal Expansion Programme' savings and efficiency initiative (2012). As part of his supervision of the current restructuring processes, Mr Machajewski is in charge of implementating the 'Efficiency and Growth 2013-2015' capital restructuring and development programme for the LOTOS Group for 2013-1015, and also provides corporate oversight of the Group's subsidiaries.
http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-15

Zbigniew Paszkowicz

Vice-President of the Management Board, Chief Exploration and Production Officer

Appointment to the Management Board:

Mr Paszkowicz has held the position of Vice-President of the Management Board of Grupa LOTOS S.A. since June 28th 2012, when he was appointed by the Supervisory Board to the Management Board of the 8th term.

In October 2012, he was appointed President of the Management Board of LOTOS Petrobaltic S.A. and since January 2013 has served on the Board of Directors of LOTOS E&P Norge AS.

Responsibilities: management of the exploration and production segment of the LOTOS Group, including supervision of the segment's companies

Qualifications, professional experience and achievements:

In 1989, Mr Paszkowicz completed mechanics studies at the Ship-building Institute of the Gdańsk University of Technology. Graduate of Ecole Nationale Superieure du Petrole et des Moteurs, where in 1991 he obtained engineer's diploma at the Faculty of Petroleum and Internal Combustion Engines.

His career with Grupa LOTOS S.A. (formerly Rafineria Gdańska S.A.) commenced in 1992, initially as a specialist in the Maintenance Planning and Preparation Department. In 2002-2004, he was head of the Plant Engineering Unit, in charge of reorganisation of overhaul services and maintenance of refinery operation based on advanced prevention methods.

In 2004, he was appointed Technical Director of Grupa LOTOS S.A. and was directly responsible for the preparation and execution of the Spring 2005 maintenance shutdown, during which the plant's annual processing capacity was increased from 4.5m to 6m tonnes of crude oil. In 2006, he was appointed Head of Refinery Expansion, in charge of execution of the 10+ Programme, the largest industrial project of the last decade in Poland. After completion of the Programme, in April 2011 he took the position of Deputy CEO of Grupa LOTOS S.A., and his responsibilities included monitoring of implementation of the Company's Strategy; supervision of support functions for the Company's governing bodies; development of corporate guidelines and uniform contracting procedures; development of IT and telecommunication systems, and security and physical protection.

He also provided support to the CEO within his remit. In January 2012, he was appointed Chairman of the Supervisory Board of LOTOS Petrobaltic. In June 2012, he was appointed Vice-President of Grupa LOTOS S.A., and since October 2012 he has also served as President of the Management Board of LOTOS Petrobaltic S.A. His primary area of focus is development of the exploration and production operations. Since June 2012, he has been directly involved in development of the strategy for and successful completion of negotiations (with Talisman of Canada, licence operator) on removal of a defective rig from the Yme field and recovery of invested funds (March 2013). He also monitored the acquisition of an interest in the Heimdal field, which is the hub for processing and distribution of natural gas extracted from the Norwegian Continental Shelf (November 2013). Mr Paszkowicz supervises intensive appraisal work on hydrocarbon deposits in the Baltic Sea to enable full use of the potential and resources available in the Polish economic zone. Currently, he is supervising the final phase of development of the B8 field, involving in particular conversion of the 'Petrobaltic' drilling rig into a production rig, and construction of underground production infrastructure. As part of strategy implementation, early March 2014 is to see start of drilling work by the newly acquired 'LOTOS Petrobaltic' rig, which will be transported to the Baltic Sea in the second half of February 2014.

http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-16

Marek Sokołowki

Vice-President of the Management Board, Chief Operations Officer

Appointment to the Management Board:

Mr Sokołowski has held the position of Vice-President of the Management Board of Grupa LOTOS since April 19th 2002, when he was appointed by the Supervisory Board to the Management Board of the 6th term. Then, in 2003, 2006, 2009 and 2012 he was re-appointed Vice-President the Management Board by the Company's Supervisory Board.

From establishment of LOTOS Kolej in 2002 to 2009, he was Chairman of the company's Supervisory Board. Since May 2005 he has served as Chairman of the Supervisory Board of LOTOS Terminale S.A. (formerly LOTOS Czechowice S.A.) and since December 2010 - as Chairman of the Supervisory Board of LOTOS Biopaliwa Sp. z o.o.

Responsibilities: management of production, technical, and technology development units; investments related to technical and technological development; supervision of the processing business in the LOTOS Group

Qualifications, professional experience and achievements:

Mr Sokołowski graduated from Gdańsk University of Technology (Faculty of Electrical Engineering), completed a post-graduate course in industrial investments and a number of management courses in Poland and abroad.

He has worked at Grupa LOTOS S.A. (formerly Rafineria Gdańska S.A.) since 1973. In 1990, Mr Sokołowski was appointed to the Management Board and took the position of Technical Director, in charge of plant engineering and execution of investment projects. At the end of 1994 and beginning of 1995, he participated in the development of the 'Technical Development Programme for Rafineria Gdańska S.A. until 2000', designed to increase the refinery's annual crude processing capacity from 3m to 4.5m tonnes, and to construct conversion installations, including the hydrocracking unit. From 1996, he managed execution of the Programme until its completion at the end of 1999. In mid-2000, he resigned from the Management Board and until April 2002 held the position of Chief of Technical Services; also served as the Company's commercial proxy. In April 2002, he was appointed Vice-President of the Management Board of Grupa LOTOS S.A. In 2004-2011, he was responsible for refinery expansion as part of the 10+ Programme (formerly the Comprehensive Technical Development Programme), officially launched in August 2007 by laying the cornerstone for the diesel oil hydrodesulfurization (HDS) unit.

Once completed, the 10+ Programme considerably increased the refinery's crude processing capacity, depth of crude processing, and feedstock flexibility. Completion of the 10+ Programme placed Grupa LOTOS S.A. in the elite group of the most advanced refineries in Europe. In recent years, he initiated the Operational Excellence Programme and a project involving connection of the refinery to the gas distribution network. Currently, he is engaged in development of the petrochemical complex as part of the joint effort of Grupa LOTOS S.A., Grupa Azoty S.A. and Polskie Inwestycje Rozwojowe S.A.

http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-14

Maciej Szozda

Vice-President of the Management Board, Chief Commercial Officer

Appointment to the Management Board:

Mr Szozda has held the position of Vice-President of the Management Board of Grupa LOTOS since July 1st 2009, when he was appointed by the Supervisory Board to the Management Board of the 7th term. Then, in 2012 he was re-appointed Vice-President the Management Board by the Company's Supervisory Board. Since August 2009, he has chaired the Supervisory Board of LOTOS Paliwa Sp. z o.o., and since December 2010 he has served as deputy chairman of the Supervisory Board of LOTOS Biopaliwa Sp. z o.o.

Responsibilities: overall management of and responsibility for marketing, procurement and distribution processes at the LOTOS Group. He is also charged with oversight of companies allocated to the LOTOS Group's marketing segment.

Qualifications, professional experience and achievements:

Maciej Szozda graduated from the Warsaw School of Economics (Faculty of Trade). In 1980, he began work at PHZ Labimex. In 1983-1984, he was Managing Director at KMW Engineering. Then, until 1986, he worked in the United States as contract manager. In 1986, he joined Przedsiębiorstwo Zagraniczne Ipaco, where he held the position of Director, and in 1987-1989 he was Export Manager for Sinexim Gmbh of West Berlin. From 1989, he operated as a sole trader, working for Easey Garments UK Ltd. (Easy Jeans) as Head of its Representative Office for Poland and the CIS countries. In 2002, he joined PKN Orlen S.A., where he served (in chronological order) as Director of the Retail Network Planning and Development Office, Director of the Retail Network Development Office – Europe, and Retail Sales Executive Director. From October 2008 to February 2009, Mr Szozda was Member of the Supervisory Board of Orlen Deutschland AG. From 2007 to March 2009, he served as Member and then President of the Management Board of AB VENTUS NAFTA of Vilnius, a company of the ORLEN Group.

He joined Grupa LOTOS S.A. in 2009. He supervises efforts aimed at increasing the Group's share in the fuel market through development of the service station network, and continued improvement of the stations' efficiency, involving implementation of uniform operating standards. The network development is also a result of capital expenditure on Motorway Service Areas, which have been built since October 2009 at various motorway sections in Poland. Their current number is 14. LOTOS Dynamic fuels, marketed across the network, became available in all larger Polish towns in December 2009, and won the first place in the fifth edition of the 'Laur Konsumenta 2009' programme in the Premium Fuel category. Mr Szozda implemented the concept of OPTIMA budget service stations, where basic fuels are available at attractive prices. In 2011, 50 OPTIMA stations were opened, and thus Company beat the national record for the number of stations opened within one year by adding as many as 63 new locations to its network. All those efforts helped LOTOS stations win the prestigious Crystal Emblem of European Trusted Brands (2012). Mr Szozda's other responsibilities include efforts to maintain LOTOS' leading position on the domestic lubricants market; continuous improvement of other products' market shares; and development of aviation fuel sales, which in 2013 resulted in the formation of a joint venture LOTOS Air BP Polska.

http://inwestor.lotos.pl/en/1142/corporate_governance/organizational_structure#person-13

For more information on the professional experience of the Management Board's members, visit the Company's website.

The following matters require resolutions by the Management Board:

1. Setting of the organisational rules of the Company, including organisation of the Company's business,
2. Planning of the annual budget for the Company,
3. Approval of the LOTOS Group strategy,
4. Setting of the rules of procedure for the Company's business as required under law,
5. Company equity investments and implementation of all projects related to capital expenditure on property, plant and equipment (excluding replacement projects) with a value of up to PLN 100,000,
6. Exercise of the Company's voting rights at its subsidiaries' General Meetings with regard to:
   - Appointment and removal of members of the Management and Supervisory Boards,
   - Coverage of loss,
   - Share capital increase or reduction,
   - Mergers with other companies or company transformations,
   - Sale or lease of the Company's business and/or encumbrance with usufruct rights.
7. Appointment and removal of those Management and Supervisory Board members who are appointed and removed directly by Grupa LOTOS S.A.,
8. Establishment of companies under commercial law,
9. Acquisition and disposal of shares in limited-liability companies,
10. Acquisition and disposal of shares, except where the shares are acquired or disposed of in public trading in securities, unless such acquisition or disposal results in gaining or losing the status of the parent,
11. Acquisition and disposal of property, perpetual usufruct rights or an interest in property,
12. Establishment and joining of partnerships, organisations or ventures which involve unlimited liability enforceable against the Company's assets,
13. Preparation of:
   - the Company's financial statements for the previous financial year, in accordance with the Polish Accountancy Act, with the Directors' Report on the Company's operations for the previous financial year, consolidated financial statements, and the Directors' Report on the LOTOS Group's operations for the previous financial year,
14. Convening of annual and extraordinary General Meetings in due time, on its own initiative, with a written motion of the Supervisory Board or at the request of a shareholder or shareholders representing at least one-tenth of the share capital, as well as in other cases as provided for in the Commercial Companies Code,
15. Setting of GM agendas,
16. Matters falling outside the scope of ordinary management of the enterprise,
17. Matters which have been objected to by at least one of the members of the Management Board,

18. Matters which must be resolved by way of Management Board resolutions if so required by the President of the Management Board or at least half of the members of the Management Board, and which fall within the scope of responsibilities of particular members of the Management Board,
19. Granting of powers of proxy.

Pursuant to the provisions of the Commercial Companies Code and the Company's Articles of Association, the Management Board, having obtained the Supervisory Board's opinion, is authorised to move to the GM for issuance of new shares or buyback of existing shares. Further, if authorised accordingly by the relevant provisions of the Company's Articles of Association and the GM's resolution, the Management Board may, by way of a resolution(s) decide to issue new shares within the authorised share capital defined by the General Meeting.

Ordinary matters of the Company, not requiring a Management Board resolution, are carried out by the President independently and by individual members of the Management Board in line with the division of powers and responsibilities defined under the Organisational Rules of Grupa LOTOS S.A.

Moreover, the President of the Management Board conducts and supervises the Company's corporate matters in the scope of:

- Convening and presiding over meetings of the Management Board,
- Maintaining the Management Board's documentation, files and meeting minutes,
- Performing obligations under commercial law and matters relating to the register of entrepreneurs,
- Ensuring that necessary services are rendered to the Company's governing bodies and that minutes of proceedings are prepared,
- Representing the Management Board before the Company's other governing bodies, subject to the provisions of
- the Commercial Companies Code and the Company's Articles of Association.

Rules of procedure for the Management Board, including procedures for calling meetings, passing and archiving resolutions, as well as the powers and duties of individual Board members are set forth in

the Rules of Procedure for the Management Board of Grupa LOTOS S.A.

Rules governing appointment and removal of management staff

In accordance with the Articles of Association of Grupa LOTOS S.A., the Management Board may consist of three to seven members. The Supervisory Board appoints and determines the number of Members of the Management Board. Members of the Management Board are appointed by the Supervisory Board following a qualification procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 on qualification procedures for members of management boards of certain commercial-law companies (Dz. U. No. 55, item 476), taking into consideration "The Best Practices to be Followed in the Selection of Candidates to Governing Bodies of Companies of Key Importance to the State Treasury," defined by the Minister of the State Treasury.

Management Board members are appointed for a joint term of three years. The President, Vice-Presidents and Members of the Management Board, as well as the entire Management Board, may at any time be removed from office or suspended from duty by the Supervisory Board if there is a valid reason for doing so. Each Member's mandate expires no later than on the date of the General Meeting which approves the financial statements for the previous full financial year. Supervisory Board resolutions to appoint or remove a Management Board Member or the entire Management Board from office require that at least two thirds of Supervisory Board Members are present and voting. A Management Board Member's mandate also expires upon their resignation from office.

6.2.4. RULES FOR AMENDING THE ARTICLES OF ASSOCIATION OF GRUPA LOTOS S.A.

An amendment to the Articles of Association requires that a relevant resolution be passed by the General Meeting by an absolute majority of votes, save for amendments to Article 10.1 of the Articles of Association, which require that four fifths of the total vote be cast in favour of the amending resolution and at least half of the Company's share capital be represented at the General Meeting.

After the General Meeting passes a resolution on amending the Company's Articles of Association, the Management Board of Grupa LOTOS S.A. notifies a registry court of the amendments. The amendments come into force upon their registration by the court.

A consolidated text of the Articles of Association incorporating the amendments is then produced by the Supervisory Board, provided that the Board receives relevant authorisation from the General Meeting.

6.3. CORPORATE GOVERNANCE PRINCIPLES APPLICABLE AT GRUPA LOTOS S.A. IN 2013

Observance of Best Practices at the LOTOS Group

Best Practices are principles designed to establish high standards of corporate governance, which thus help bring corporate supervision into line with EU standards.

Grupa LOTOS S.A. cares for its investor relations and makes every effort to ensure they are based on equality and developed in a manner satisfactory to both sides.

The key objectives of corporate governance at the LOTOS Group are as follows:

- transparency of operations,
- trust in relations with Stakeholders,
- building of shareholder value.

In 2005-2007, the Best Practices for Public Companies 2005 document, which was modified by general practice, discussions and the European Commission's recommendations, was used as a guide to corporate governance principles by companies wishing to nurture their long-term relationships with shareholders. At its stock market debut in June 2005, Grupa LOTOS S.A. adhered to most of the recommendations set out in this document. Then, since 2008, it has followed the Code of Best Practice for WSE Listed Companies, and its versions as amended by WSE's Supervisory Board in its Resolutions of October 19th 2011 and November 21st 2011, the latest of which has been in force since the beginning of 2013.

In line with disclosure requirements, the Company reports on instances of incidental or permanent non-compliance with corporate governance rules. The reports are published through the Electronic Information Base (EBI), similarly to current reports, and released in two languages on the Company's investor relations website.

Non-mandatory corporate governance principles observed by the Company based on recommendations of the Code of Best Practice for WSE Listed Companies

The LOTOS Group understands that corporate governance strengthens its credibility as an entity listed on the WSE's regulated market, and thus its competitive position on the market. Therefore, the Group has a significant interest in implementing and complying with best practices. The Group takes steps to provide unambiguous and reliable communication to capital market participants.

Grupa LOTOS S.A. and its subsidiaries make every effort to ensure that their information policy is effective and supports the objectives of corporate governance principles, i.e. transparency of the Company's operations as a listed company, trust in stakeholder relations, and consistency in creating value for shareholders.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 1

The Company's information policy and relations with the capital market

The LOTOS Group is keen to ensure that its relations with investors and stakeholders are forged and fostered based on equality and dialogue, in a manner satisfactory to both parties. The Group analyses and gradually introduces new communication tools, and continually improves the content and form of its reporting.

Grupa LOTOS S.A.'s Investor Relations (IR) Team makes every effort to present to investors a precise, reliable and transparent picture of the Company's operations and financial standing, taking into account the principles of commitment, availability and equal treatment of all investors.

The Company uses a broad range of IR tools to communicate with investors, including mailing, newsletters, webcasts, participation in conferences for institutional and individual shareholders and brokers, conference calls, one-on-one meetings, open-house days for analysts and investors, and participation in the RESPECT index.

In 2013, the Investor Relations team supported the Company's Management Board in organising meetings with investors and maintaining regular contact with capital market participants. After every release of an interim report of the LOTOS Group, a meeting was held between financial analysts and Mr Mariusz Machajewski, Member of the Management Board, Chief Financial Officer.

On November 27th 2013, the International Capital Markets Day was held in Gdańsk, focused primarily on the performance of the LOTOS Group's strategy. The investor presentation used by the Management Board during the meeting with equity market representatives is available at the Company's website.

As part of its relations with individual shareholders, the Company collaborates with the Polish Association of Retail Investors. In 2013, Grupa LOTOS S.A. attended the 17th Wall Street Conference of retail investors, organised by the Polish Association of Retail Investors in Karpacz on June 7th-9th 2013.

The Grupa LOTOS S.A. investor relations website is dedicated to market participants and Company stakeholders. This bilingual (Polish-English) service is updated on an ongoing basis to provide foreign investors and analysts with equal access to information. The website contains information and tools grouped in four thematic blocks:

1. LOTOS Group - this section of the LOTOS website presents the Group, its strategy, share capital structure and CSR activities.
2. Reports and Key Data - this section organises financial and non-financial information (includes an easily downloadable excel file databook), as well as the Group's current and periodic reports published via the Warsaw Stock Exchange.

3. Investors – this section contains information on the method of calculating the model refining margin of Grupa LOTOS S.A. and its quarterly updated values, information on the Company's dividend policy and dividend payouts, investor tools (calculator, historical LOTOS stock prices). It also groups downloadable files, i.e. periodic reports, strategy and efficiency improvement presentations, and the issue prospectus. This section also lists of equity analysts covering the Company and their most recent recommendations for the LOTOS securities traded on the WSE. The corporate events calendar (quarterly reports, General Meeting dates, open-house days, and other events which, in shareholders' opinion, might impact the price of the Company shares) is published in the 'Investor's Calendar' tab.
4. Corporate Governance – this section contains information concerning the Company's compliance with the requirements of the Best Practice for WSE Listed Companies. It also provides information on the composition, powers and rules of procedure of the Management Board, Supervisory Board and General Meeting of Grupa LOTOS S.A., and contains the Company's constitutional documents.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 2 - deleted

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 3

The Company makes every effort to ensure that shareholders can exercise their right to participate in a General Meeting. The Articles of Association allow the Management Board to decide to carry out real-time broadcast of the General Meeting and Grupa LOTOS S.A. is analysing whether to do so in the future.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 4

This recommendation does not apply to the Company.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 5

Remuneration of the Management Board and Supervisory Board members is subject to limitations and conditions prescribed under the Act on Remunerating Persons Who Manage Certain Legal Entities of March 3rd 2000 (Compensation Cap Act) (Dz.U. of 2000 No 26, item 306, as amended).

On November 13th 2009, the Supervisory Board – acting within the powers vested in it by the Company's Articles of Association and the Act of March 3rd 2000 – decided that Vice-Presidents of the Company's Management Board would receive remuneration equal to six-fold the average monthly salary in the non-financial corporate sector, net of bonuses paid from profit in the fourth quarter of the preceding year, as announced by the President of the Central Statistics Office (GUS). Concurring with the proposal of the Supervisory Board, contained in Resolution No. 63/VII/2009 of November 13th 2009, on December 17th 2009 the Extraordinary General Meeting determined the same remuneration policy for President of the Management Board, while repealing the General Meeting's resolution of August 18th 2000, which had until then defined the rules of remuneration for members of the Management Board.

In 2000, the Extraordinary General Meeting determined the remuneration policy for the members of the Supervisory Board. Pursuant to the policy, Supervisory Board members receive monthly remuneration equal to the average monthly salary in the non-financial corporate sector net of bonuses paid from profit in the fourth quarter of the preceding year, as announced by the President of GUS.

In line with the amended Compensation Cap Act, in 2013 the members of the Supervisory and Management Boards were entitled to receive individual monthly remuneration in an amount determined on the basis of the average monthly remuneration in the non-financial corporate sector (net of bonuses paid out from profit) in the fourth quarter of 2009.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, items 6 and 7

To the Company's knowledge, Members of the Supervisory Board adhere to the recommendations set out in the Code of Best Practice on their engagement in performance of duties and acting in the interest of the Company.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 8

The Company seeks to ensure equal relations with and fair treatment of its shareholders with regard to transactions and agreements made by the Company with the shareholders and their related entities.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 9

The Company ensures that women and men have equal access to management and supervisory functions, and therefore has no policy that would favour or discriminate against either of the sexes.

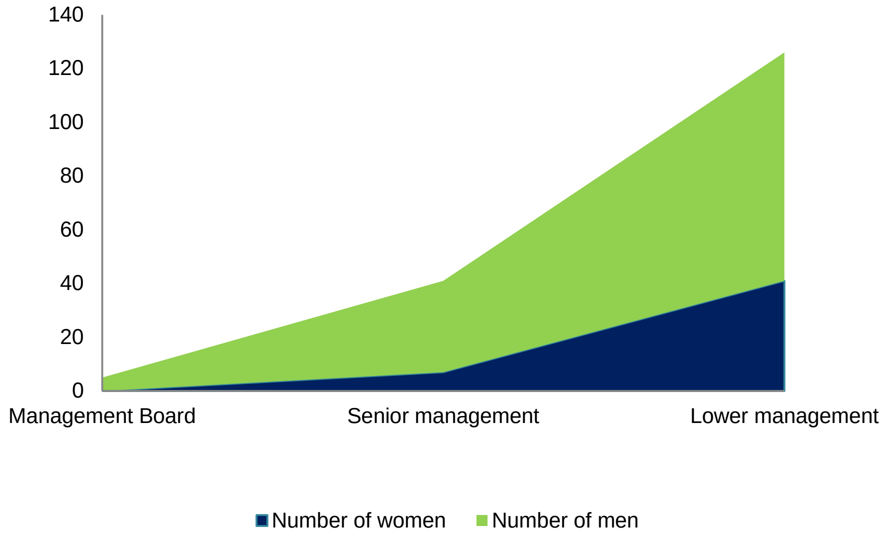
Table 48. Number of women and men on the Supervisory Board

	Number of women	Number of men
Jan 1–Jan 27 2012	1	5
Jan 27–Feb 29 2012	1	4
Feb 29–Dec 31 2012	2	4
Jan 1–Dec 31 2013	2	4

Table 49. Number of women and men on the Management Board and other management positions at Grupa LOTOS S.A.

	Number of women	Number of men
Management Board	0	5
Senior management	7	34
Lower management	41	85
Total	**48**	**123**

Chart 63. Management personnel by sex (as at December 31st 2013)



Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 10

Supporting various forms of artistic and cultural expression, sporting activities and education as an element of Company strategy

The overriding strategic objective of Grupa LOTOS S.A. until 2015 is to create value for shareholders through optimised deployment of human and material resources and implementation of development programmes in key areas of the Company's operations, i.e. in exploration and production, refining and marketing.

Ethical values and corporate social responsibility strategy

The LOTOS Group's strategy incorporates social, environmental, ethical and human rights concerns into the Group's core operations and business strategy.

In 2008, the Management Board of Grupa LOTOS S.A. adopted a comprehensive Corporate Social Responsibility Strategy for Grupa LOTOS S.A. until 2012, which − after broad consultations with stakeholders and following analyses performed to assess the activities carried out thus far, their determinants, as well as to identify expectations − was updated in May 2012 for the 2012-2015 period. The strategic objectives identified by the Company were as follows:

In the area of investment in human resources − to ensure the availability of highly qualified staff required to successfully implement the business strategy and enhance the corporate culture based on adopted values.

As regards health and safety improvement − to increase the awareness and involvement in work safety improvement among the management staff, employees and contractors.

With respect to integration with local communities − to ensure favourable attitudes among local communities and strengthen the Company’s image as a socially committed business, by undertaking initiatives to provide lasting solutions to social and environmental issues.

In the area of management of natural resources in the production process − to reduce environmental risk and seek to continually minimise the environmental impact of the Group’s operations.

In terms of ethics and the prevention of misconduct − to improve management by ensuring ethical conduct and the transparency of business processes, as well as by protecting the organisation against misconduct.

With respect to partnership relations with the market environment − to build lasting customer relationships by focusing on understanding customers' needs and ensuring the expected product quality and safety.

As regards energy sector security − to support initiatives designed to enhance energy sector security in a socially and environmentally responsible manner.

As regards communication − to ensure that communication with employees is timely and appropriate to their various needs and to build organisational culture based on multi-directional, open communication, including through the development of a system of public consultations within the Group.

Chart 54. Corporate values

The LOTOS Group believes that business should be conducted according to ethical standards, in harmony with the natural environment and social need. This is why the Group proclaims its corporate values, which it sees as a long-term pledge towards all its stakeholders. The four principal values to be fostered by the Group include:

1. **Cleanliness** − the LOTOS Group's care to ensure compliance with the most exacting environmental standards, commitment to ethical and fair competition, and counteracting corruption and human rights abuses.
2. **Openness** − the LOTOS Group's attitude to changes, the world's needs and people's expectations,
3. **Innovativeness** − recognition and protection of the intellectual capital within the LOTOS Group, as well as the competencies of its employees,
4. As a fuel company and owner of a refinery, the LOTOS Group is also aware of its special **responsibility** towards future generations, humanity in general, the natural environment, and also Poland, particularly the security of its position globally.

On January 1st 2013, the **LOTOS Group Code of Ethics** was introduced, which superseded the existing documents which had governed the conduct of the Group's employees and managers from the middle of the past decade. The document is intended to govern behaviour within the organisation, as well as external relations with capital market participants, customers and trading partners, local communities and competitors. It is the key element of a larger project to implement a comprehensive Ethical Conduct Programme.

A crucial element of the standards applicable at the Group is the **Misconduct Prevention Policy,** which was adopted in 2012. The adoption of the two documents is in line with the key objectives of the LOTOS Group Corporate

Social Responsibility Strategy for the years 2012-2015. The system of fundamental CSR values is aligned with the key LOTOS brand values which rest on three pillars:

Table 50. Key groups of stakeholders under the LOTOS Group's Corporate Social Responsibility Strategy

Group I	Group II	Group III
INTERNAL ENVIRONMENT	**SOCIAL ENVIRONMENT**	**MARKET ENVIRONMENT**
Employees	Local communities	Contractors and subcontractors
Group companies	Organizacje pozarządowe	Suppliers
Trade unions	NGOs	Customers
Employee Council	Local government institutions	Trade partners
		Competitors
	Government administration	Trade partners
	Science and research institutes, and educational centres	Industry organisations and international institutions
	Employer organizations	Industry organisations and Regulatory and monitoring organisations, certification bodies
	Media	Regulatory and monitoring organisations, certification bodies
	Natural environment	Capital market participants

Table 51. Foundations of the LOTOS Group's Corporate Social Responsibility Strategy for 2012-2015

FOUNDATIONS OF THE LOTOS GROUP'S CORPORATE SOCIAL RESPONSIBILITY STRATEGY		
I	II	III
SOCIAL RESPONSIBILITY	**ENVIRONMENTAL RESPONSIBILITY**	**BUSINESS RESPONSIBILITY**
Creating values beneficial to the social environment The Company's activity is characterised by respect for intellectual capital and diversity, and compliance with human rights standards, including freedom of speech and freedom of association. The Company plays an active role in creating new jobs and enhancing the quality of human capital in the regions where it operates. LOTOS acts to prevent social exclusion and other social issues in the areas of its competencies.	**Creating values beneficial to the natural environment** The Company constantly strives to limit its negative environmental impact by adhering to high standards applicable in hydrocarbon production and processing, as well as by complying with stringent environmental standards in production, transport and marketing of oil and petroleum products. In its upstream operations, the Company employs the best available techniques and rules of conduct, continuously monitoring latest technological developments. It also seeks to identify and develop opportunities for obtaining energy from renewable sources.	**Creating values beneficial to the business** LOTOS places great importance on the reliable and accountable management of our relations with our environment, in line with ethical principles and rules of transparency and partnership. These principles underlie the pursuit of profits and long-term value creation in the Company's business. The Company's accountability also manifests itself in activities pursued to enhance energy security in Poland and on Grupa LOTOS' other home markets, such activities being undertaken in a socially and environmentally responsible manner. The Company offers stable fuel supplies to the Polish market, and engages in exploration and production of hydrocarbons from both conventional and unconventional sources.

Table 52. Areas of strategic focus under the Corporate Social Responsibility Strategy

Investment in human resources Improvement of health and safety Integration with local communities	Management of natural resources in the production process	Ethics and prevention of business misconduct Market partnerships Energy sector security

On its website, the Company reports in detail on its engagement in supporting various forms of artistic and cultural expression, sporting activities and education through initiatives aimed at bridging social gaps, as well as social and environmental programmes.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 11

Information governance

Grupa LOTOS's Communications Team, assisted by the Investor Relations Team, is responsible for maintaining coherent and transparent communication policy at the LOTOS Group by cultivating continued relations with the media. The manner of operation and responsibilities of the office are defined in Grupa LOTOS's procedures and are subject to periodical review and assessment.

Since November 19th 2009, Grupa LOTOS S.A. has been a constituent of the WSE's RESPECT (Responsibility, Ecology, Sustainability, Participation, Environment, Community, Transparency) index of socially responsible companies, which demonstrates the Company's adherence to high reporting standards.

The RESPECT Index is Central and Eastern Europe's first index of socially responsible companies.

The Index was created to highlight companies managed in a responsible and sustainable manner. The RESPECT Index portfolio is updated based on regular reviews of companies' compliance with the applied criteria. The index comprises solely listed companies that operate in accordance with the best management standards in corporate and information governance, as well as investor relations, and that act responsibly on environmental, social, and labour issues.

The RESPECT Index also takes into account the criteria of profitability related to dividend payments and pre-emptive rights, which provide insight into the economic standing of the companies included in the Index.

On December 17th 2013, Grupa LOTOS was included in the RESPECT Index for the seventh time. The index currently lists 22 companies.

In 2013, Grupa LOTOS S.A. won first place for 'The Best Annual Report 2012' and 'The Best Annual Report on the Internet' in a contest organised by the Accounting and Tax Institute.

The LOTOS Group develops and introduces best practices in such areas as environmental protection, health and safety at work, and security of management systems, beyond the requirements of Polish law.

Grupa LOTOS S.A. is the first oil company in Poland to secure the Integrated Management System certificate and adopt the Global Compact Principles, which are a financial, social and environmental reporting model compliant with the recommendations issued by the United Nations Global Compact.

GRI-compliant Integrated Annual Reports published

In addition to the annual report published in line with the Minister of Finance's Regulation on current and periodic information to be published by issuers of securities, dated February 19th 2009, for the fifth time the Company is preparing the electronic version of its integrated report. It contains two consolidated reports: a financial report and a non-financial report. The former has been prepared in accordance with the International Financial Reporting Standards (IFRS), and the latter – with the Global Reporting Initiative's Sustainable Reporting Framework. The Global Reporting Initiative (GRI) is an independent institution whose mission is to develop and promote Sustainability Reporting Guidelines.

By applying the GRI guidelines, a company undertakes to publish comprehensive reports on its economic, environmental and social activities. The reports prepared by Grupa LOTOS S.A. are compliant with the currently effective, third generation GRI guidelines, and cover the highest number of GRI standard disclosures (A+ Application Level). In fact, LOTOS is one of the few companies in Poland that demonstrate such a high level of transparency in the disclosure of non-financial information.

Code of Best Practice for WSE Listed Companies, Chapter I Recommendations, item 12

The Company will consider allowing the shareholders to exercise their voting rights at the General Meeting using electronic means of communication.

Obligatory corporate governance principles observed by Grupa LOTOS S.A.

Code of Best Practice for WSE Listed Companies, Sections II–IV

The Best Practices section of the Company's website contains information on corporate governance at Grupa LOTOS S.A.: Company's and Group's annual Statements of Compliance with corporate governance principles, reports released via the EBI system, and information about the proportion of men and women on the Management and Supervisory Boards.

Since 2007, the Management Board has been publishing Statements of compliance with corporate governance principles, listing instances of the Company's non-compliance, along with relevant explanations.

Reports on compliance with corporate governance principles in 2012-2013

In 2012, Grupa LOTOS S.A. complied with most of the obligatory corporate governance principles set forth in the Code of Best Practice for WSE Listed Companies. In line with the comply-or-explain principle, which provides that public companies should either comply with corporate governance rules or explain any instances of incidental or permanent non-compliance, Grupa LOTOS S.A., acting under Par. 29.3 of the WSE Rules, released non-compliance reports via the EBI system, similarly to current reports.

On January 27th 2012, the Company reported a single instance of non-compliance with Rule 5 of Section III of the Code of Best Practice for WSE Listed Companies, as a result of the resignation on that day of Rafał Wardziński from his position as member of the Grupa LOTOS Supervisory Board.(EBI Report No. 1/2012 of January 27th 2012).

In 2013, the Company reported non-compliance with Rules 10.1 and 10.2 of Section IV of the Code of Best Practice for WSE Listed Companies, on enabling shareholders to participate in the General Meetings by means of electronic communication (EBI Report No. 1/2013 of May 31st 2013). Further, the Company does not provide real-time broadcast of General Meetings and does not publish the recordings of the proceedings of General Meetings, in audio or video format, on its website, although recommended to do so by Section II.1.9a of the Code.

The Company explained that its Articles of Association do not provide for the possibility of participating in General Meetings by means of electronic communication. The Company does not plan to make audio or video recordings of the proceedings of its General Meetings or to publish such recordings on its website, as it believes that its current methods of documenting the proceedings of the General Meeting ensure transparency of the Company's activities and protect the rights of all its shareholders. Grupa LOTOS S.A. publishes passed GM resolutions in the form of current reports and announcements posted on its website.

Pursuant to Article 8 of the Company’s Articles of Association, the Management Board is authorised to make the decision, if any, to broadcast the proceedings of the General Meeting in real time. The Company will examine the possibility of complying with the rules specified above in the future.

Internal audit and risk management systems used in preparing financial statements

In line with the Minister of Finance's Regulation on current and periodic information to be published by issuers of securities, dated February 19th 2009, the Management Board is responsible for the internal audit function and its effective application in the financial reporting process.

Financial statements are prepared, approved and released to the public in line with an internal procedure, whereunder oversight of the financial reporting process lies within the remit of the Head of the Finance and Accounting Centre’s Office and the person responsible for keeping the Company’s accounting books (Chief Accountant). Responsibility for preparing the consolidated and separate financial statements lies with the Financial Reporting Office of Grupa LOTOS S.A.

The basis for the preparation of consolidated financial statements are the International Financial Reporting Standards (IFRS), based on the financial statements of Grupa LOTOS S.A. and of the entities controlled by Grupa LOTOS S.A.

Grupa LOTOS S.A., LOTOS Petrobaltic S.A., LOTOS Exploration and Production Norge AS, LOTOS Asfalt Sp. z o.o., LOTOS Oil S.A., LOTOS Paliwa Sp. z o.o., LOTOS Kolej Sp. z o.o., LOTOS Tank Sp. z o.o., and LOTOS Serwis Sp. z o.o. maintain their accounts in accordance with the accounting policies prescribed by the IFRS. The other Group companies maintain their accounting books in accordance with the accounting standards defined in the Polish Accountancy Act of September 29th 1994 and the accounting policies and standards applicable at their foreign locations. Consolidated financial statements include adjustments which are absent from the accounting books of the Group’s entities applying accounting standards other than IFRS, and which have been introduced to ensure consistency of the entities’ financial information with the IFRS.

In order to ensure accounting uniformity, the accounting policies effective at the Company were implemented across the LOTOS Group companies for application in preparing their consolidation packages.