



**Directors' Report on the Operations of
Grupa LOTOS S.A.
in 2014**



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1. INFORMATION ABOUT GRUPA LOTOS S.A.

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.

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.

Apart from Grupa LOTOS S.A., the LOTOS Group currently comprises 36 other companies operating under the LOTOS name. One of these is based in Lithuania, and one in Norway. Through LOTOS Petrobaltic S.A. and LOTOS Exploration and Production Norge AS, the Group conducts exploration for and production of crude oil in the Baltic Sea and on the Norwegian Continental Shelf. The Group also has access to onshore hydrocarbon deposits in Lithuania through its subsidiary AB LOTOS Geonafta.

As at December 31st 2014, Grupa LOTOS S.A. employed 1,350 staff. Its revenue was PLN 26,243.1m. For 2014, the Company reported an operating loss of PLN 1,294.20m, and a net loss of PLN 1,285.90m.

1.1. ORGANISATION AND MANAGEMENT AT GRUPA LOTOS S.A.

A number of minor organisational changes at the Company were effected in 2014 to:

- Consolidate and optimise the areas related to the support of the procurement process as well as social and cultural matters,
- Enhance the communication process at the LOTOS Group,
- Minimise management costs,
- Improve segmental reporting,
- improve decision-making powers and accountability of corporate departments.

1.1.1. STRUCTURE OF GRUPA LOTOS S.A.

The corporate management structure of Grupa LOTOS S.A. reflects the division of competences and relations between various functions and tasks performed at the Company, and determines the reporting hierarchy of organisational units and management. As at December 31st 2014, the Company's corporate structure comprised the following units:

- 16 divisions, including 5 divisions reporting directly to the President of the Management Board and Chief Executive Officer,
- 35 offices,
- 15 departments,
- 8 complexes.

A division is a group of organisational units reporting to specific executive officers who hold decision-making powers within a certain area of the business. Organisational units are separated mainly based on their functions or business processes. The basic responsibility of an office is to support the Chief Executive Officer's or the division directors' decision-making process. Departments are responsible for performing specific functions assigned to them, and rank one level below offices in the organisational hierarchy. A complex is an operational component of the enterprise, directly performing production and technical functions.

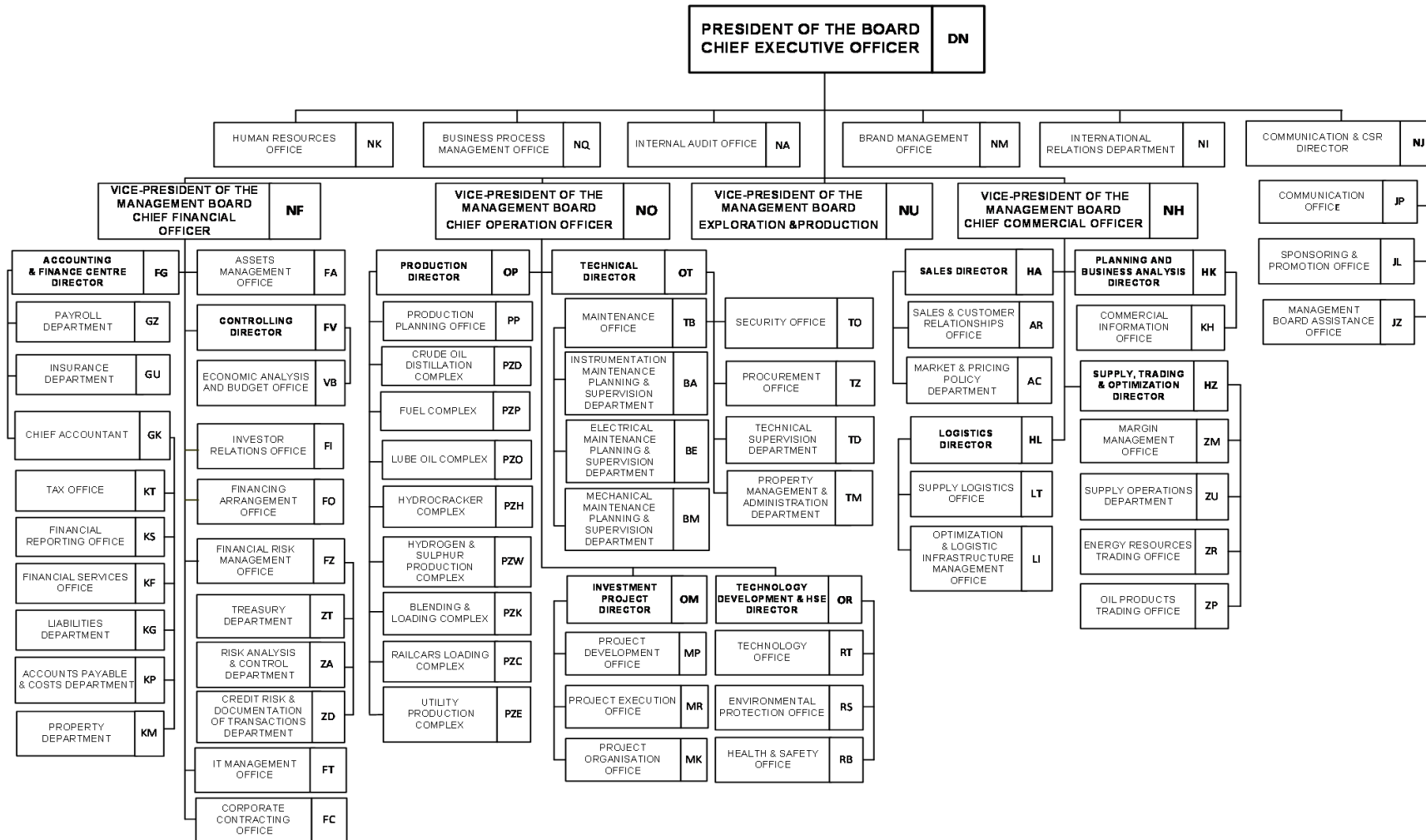
There are five divisions reporting directly to Mr Paweł Olechnowicz, President of the Management Board and Chief Executive Officer (DN): Division headed by the Chief Financial Officer, Division headed by the Chief Operation Officer, Division headed by the Chief Commercial Officer, Division headed by the Communication & CSR Director, and Division headed by the Chief Executive Officer which comprises five offices: International Relations Office (NI), Internal Audit Office (NA), Business Process Management Office (NQ), Human Resources Office (NK) and Brand Management Office (NM).

The respective areas of competence of the Vice-Presidents of the Management Board in charge of the NF Division (Mariusz Machajewski, Vice-President, Chief Financial Officer), the NO Division (Marek Sokołowski, Vice-President, Chief Operation Officer), the NH Division (Maciej Szozda, Vice-President, Chief Commercial Officer) and the NU unit (Zbigniew Paszkowicz, Vice-President, Chief Exploration and Production Officer), are presented in the corporate structure chart on page 6.

The responsibilities of the Chief Exploration and Production Officer (NU) are performed through subsidiary LOTOS Petrobaltic S.A., the parent of another group.

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

Figure 1. Corporate structure of Grupa LOTOS S.A. as at December 31st 2014



1.1.2. OWNERSHIP CHANGES AT THE LOTOS GROUP IN 2014

Changes in the Group's structure effected in 2014 are discussed below.

Table 1. Registered changes in share capital

Company	Registration date	Before	Increase	After	Comments
B8 Spółka z o.o. BALTIC S.K.A.*	Oct 7 2014	709,040,705	78,776,745	787,817,450	issue of 71,133,800 Series B ordinary registered shares (with a par value of PLN 10 per share) and issue of 7,642,945 Series C ordinary registered shares (with a par value of PLN 10 per share)
Baltic Gas Sp. z o.o.*	May 27 2014	45,000	60,000	105,000	issue of 1,200 new shares (with a par value of PLN 50 per share)
LOTOS Petrobaltic S.A.	Dec 17 2014	99,400,000	11,833,370	111,233,370	issue of 1,183,337 Series D shares (with a par value of PLN 260 per share)
Grupa LOTOS S.A.	Jan 9 2015	129,811,271	55,000,000	184,873,362	issue of 55 million Series D ordinary bearer shares (with a par value of PLN 1 per share)

* Subsidiary of LOTOS Petrobaltic S.A.

Consolidation of logistics and infrastructure assets

In 2014, the LOTOS Group continued the process of consolidating its logistics assets. As part of that process, preparations were made by Grupa LOTOS S.A. to sell the newly built fuel depot in Poznań to LOTOS Terminale S.A.

1.1.3. CHANGES IN ORGANISATIONAL OR CAPITAL LINKS BETWEEN GRUPA LOTOS S.A. AND OTHER ENTITIES
Table 2. Entities in which the Company directly holds equity interests or voting rights

Name	Registered office	Principal business activity	Ownership interest (%)	
			Dec 31 2014	Dec 31 2013
LOTOS Petrobaltic S.A. (parent of another group: LOTOS Petrobaltic Group)	Gdańsk	Acquisition of crude oil and natural gas deposits and hydrocarbon production	99.99%⁽¹⁾	99.98%
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 Asphalt 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%

Name	Registered office	Principal business activity	Ownership interest (%)	
			Dec 31 2014	Dec 31 2013
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 testing	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. (parent of another group: LOTOS Terminale Group)	Czechowice-Dziedzice	Storage and distribution of fuels	100.00%	100.00%
LOTOS Infrastruktura S.A. (parent of another group: LOTOS Infrastruktura Group)	Jasło	Storage and distribution of fuels Renting and operating of own or leased real estate	66.95% ⁽²⁾	100.00%
LOTOS Park Technologiczny Sp. z o.o. w likwidacji (in liquidation)	Jasło	Dormant	100.00%	100.00%
LOTOS Gaz S.A. w likwidacji (in liquidation)	Kraków	Dormant	100.00%	100.00%
Infrastruktura Kolejowa Sp. z o.o.	Gdańsk	Dormant	100.00%	-
AB LOTOS Geonafta (parent of another group: AB LOTOS Geonafta Group, company of the LOTOS Petrobaltic Group)	Gargždai, Lithuania	Crude oil exploration and production, drilling services, and purchase and sale of crude oil	0.00%	0.00%
LOTOS Biopaliwa Sp. z o.o. (LOTOS Terminale Group)	Czechowice-Dziedzice	Production of fatty acid methyl esters (FAME)	0.01%	0.01%
RCEkoenergia Sp. z o.o. (LOTOS Infrastruktura Group)	Czechowice-Dziedzice	Production and distribution of electricity, heat and gas	0.004% ⁽³⁾	0.01%
LOTOS Exploration & Production Norge AS (LOTOS Petrobaltic Group)	Stavanger, Norway	Oil exploration and production on the Norwegian Continental Shelf, provision of services incidental to oil and gas exploration and production	0.00%	0.00%
Investments in joint-ventures				
LOTOS – Air BP Polska Sp. z o.o.	Gdańsk	Sale of aviation fuel and logistics services	50.00%	50.00%

⁽¹⁾ Change in ownership interest following acquisition of shares in LOTOS Petrobaltic S.A. through a squeeze-out process (excluding shares held by the State Treasury). The squeeze-out of minority shareholders of LOTOS Petrobaltic S.A. was commenced in 2012 and completed in H1 2014.

⁽²⁾ Change in ownership interest following a share capital increase at LOTOS Infrastruktura S.A. carried out by LOTOS Terminale S.A. (a wholly-owned subsidiary of Grupa LOTOS S.A.). Grupa LOTOS S.A.'s pre-emptive right to acquire the new shares was waived.

⁽³⁾ Change in ownership interest following a share capital increase at RCEkoenergia Sp. z o.o. carried out by LOTOS Terminale S.A. (a wholly-owned subsidiary of Grupa LOTOS S.A.). Grupa LOTOS S.A.'s pre-emptive right to acquire the new shares was waived.

1.2. WORKFORCE OF GRUPA LOTOS S.A.

1.2.1. WORKFORCE STRUCTURE OF GRUPA LOTOS S.A.

Table 3. Grupa LOTOS S.A.'s workforce structure by job role (as at December 31st 2014)

Job type	Men	Women	Total
blue-collar jobs	503	2	505
white-collar jobs	427	418	845
Total	930	420	1,350

Table 4. Grupa LOTOS S.A.'s workforce structure by education (as at December 31st 2014)

Education	White-collar jobs	Blue-collar jobs	Total	
			Number of positions	%
PhD	8	1	9	0.7%
university-level	687	114	801	59.3%
post-secondary	32	32	64	4.7%
secondary	112	301	413	30.6%
basic vocational	5	47	52	3.9%
primary	1	10	11	0.8%
Total	845	505	1,350	100.0%

1.2.2. AGREEMENTS BETWEEN THE COMPANY AND THE MANAGEMENT STAFF; REMUNERATION, AWARDS AND 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 2014, no agreements were executed that would provide for compensation to the management staff in the event they resign or are dismissed without a good reason or in the event they resign or are dismissed as a result of the Company's takeover by another entity.

Table 5. Remuneration paid to members of the Management Board of Grupa LOTOS S.A. for 2014 (PLN '000)

Management Board members	Short-term employee benefits (salaries and wages)	Management Board – subsidiaries*	Total remuneration paid
Paweł Olechnowicz	297	1,171	1,468
Marek Sokółowski	254	641	895
Mariusz Machajewski	273	641	914
Maciej Szozda	261	641	902
Zbigniew Paszkowicz	261	552	813
Total	1,346	3,646	4,992

**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 6. Annual bonuses for Management Board members (PLN '000)

No short-term employee benefits in the form of annual bonuses for 2013 were paid to Management Board members in 2014.

Management Board members	Current liabilities under annual bonus for 2014
Paweł Olechnowicz	31.1
Marek Sokółowski	31.1
Mariusz Machajewski	31.1
Maciej Szozda	31.1
Zbigniew Paszkowicz	31.1
Total	155.5

Table 7. Remuneration paid to members of the Supervisory Board of Grupa LOTOS S.A. for 2014 (PLN '000)

Supervisory Board members	Term of office	Total remuneration paid
Wiesław Skwarko	Jan 1 – Dec 31 2014	38
Małgorzata Hirszel	Jan 1 – Dec 31 2014	38
Oskar Pawłowski	Jan 1 – Dec 31 2014	38
Michał Rumiński	Jan 1 – Dec 31 2014	38
Marcin Majeranowski	Jan 1 – Jun 30 2014	21
Agnieszka Trzaskalska	Jan 1 – Dec 31 2014	38
Magdalena Bohusz-Boguszewska	Jun 30 – Dec 31 2014	17
Total		228

As at December 31st 2014, the Company had not granted any loans or similar benefits to members of its management and supervisory staff.

As at December 31st 2014 and as at the date of release of this Directors' Report, i.e. March 6th 2015, 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 2014, Grupa LOTOS S.A. did not operate any control system for employee stock option plans.

2. OPERATIONS OF GRUPA LOTOS S.A. AND KEY BUSINESS DRIVERS

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

Grupa LOTOS S.A.'s operational priorities are set forth in its [Strategy for 2011–2015](#) and development directions until 2020. The Company's efforts are focused on improving efficiency, optimising the refining and logistics processes, and developing the hydrocarbons exploration and production segment.

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.

Grupa LOTOS S.A.'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 Company defines as consistent on-going reduction of its environmental footprint, and appreciation of its employees' intellectual potential and expertise.

UPSTREAM OPERATIONS

In 2014, 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.

The rapid decline in crude oil prices prompted optimisation of the progress of strategic projects pursued in the upstream segment.

LOTOS Petrobaltic has consistently implemented strategic projects to leverage the potential offered by the Baltic Sea. A total of 10 wells have been drilled on the B8 field, including six production and four injection boreholes, which are now equipped with wellheads and ready to begin production and water injection operations. The significant decline in crude prices affected the viability of the plan to convert the Petrobaltic rig into a production centre for the B8 field. Following a series of analyses, relevant cost assumptions were revised to restore the original viability framework of the project.

The following projects were carried out in 2014 to increase the production capacity and develop the asset portfolio:

- Intensive work on commencing commercial production from the B8 field on the Baltic Sea. B8 Sp. z o.o. Baltic spółka komandytowo-akcyjna (SPV), Polskie Inwestycje Rozwojowe S.A., Bank Gospodarstwa Krajowego, and Bank Pekao S.A. entered into a series of project finance agreements related to the financing of the development of the B8 oil field in the Baltic Sea. The Minister of the Environment issued a decision to transfer the licence for production of crude oil and associated natural gas from the B8 field located in the Polish Exclusive Economic Zone of the Baltic Sea to SPV B8. The SPV's share capital was increased through a share issue and the increase was subsequently registered by the court. LOTOS Petrobaltic made a contribution to SPV B8 in the form of (1) the right to use geological data of the B8 field, (2) assets produced by LOTOS Petrobaltic for the development of the B8 field, (3) the Petrobaltic drilling rig.

- Work on development of the B4 and B6 gas fields in partnership with CalEnergy Resources Poland. The process of selection of the development concept was completed: production wells are to be drilled using the LOTOS Petrobaltic rig. Work was underway on the front-end engineering design of the onshore and offshore installations and on securing onshore transmission capacities.
- Production of crude oil from the B3 field was continued. Pursuant to the Ministry of Environment's decision of May 23rd 2014, the term of the licence for crude oil and natural gas production from the B3 field was extended to 32 years starting from the licence issue date, i.e. until July 29th 2026.
- Production of gas and condensate from the Heimdal fields (Alta, Vale, and Skirne) was continued on the Norwegian Continental Shelf. Following completion of the overhaul of the Heimdal platform in June 2014 (Heimdal Extension Life Program, or HELP), the life of the platform was extended until 2034, as confirmed by the Petroleum Safety Authority Norway (PSA) in a relevant certificate. The Company applied for new exploration licences in the APA 2014 licensing round, and won an interest in licence 797.
- Operations within onshore licence areas in Poland LOTOS Petrobaltic and PGNiG signed an agreement on joint operations on the Górowo Iławieckie onshore licence, and carried out joint operations on the Kamień Pomorski licence.

Plans and prospects of the upstream segment

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,
 - Full appraisal of the production 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

- Continued oil production from the B3 field on the Baltic Sea,
- Development and bringing on stream the B8 oil field on the Baltic Sea,
- Expansion of activities within onshore oil and gas licence areas in Poland in cooperation with partners, including PGNiG,
- Development of 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,
- Acquisition of further production assets on the Norwegian Continental Shelf,
- Increased production from the existing producing assets in Lithuania.

Key areas of focus in the upstream business beyond 2015

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,
- 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 by developing new prospects with confirmed resources,
- Explore development opportunities in new geographies.

PROCESSING OPERATIONS

In the processing business, in 2014 the Group optimised its refining processes. The project to construct a Delayed Coking Unit with auxiliary infrastructure at the Company's refinery complex in Gdańsk (the EFRA (Effective Refining) Project) entered the final stage of preparatory work.

Strategic objectives:

- Achieve world-class standards of production and maintain strong competitive position among European refineries,
- Make optimum use of assets held and acquired as part of the growth strategy,
- Ensure safe and stable operation of the production and ancillary facilities, with the target of 98% minimum annual availability,
- Increase the distillate yield and intensify feedstock processing.

In 2014, work was continued to optimise the use of refining assets. In the refining business, the key challenge is to adjust operations to the current levels of demand and margins prevailing on the market, while keeping operating expenses in check. Given that cost of energy represents a major item in the refinery's total operating costs, it required a particularly close analysis.

The Company also took steps to further optimise operations of its key refining units. They included higher utilisation of the new crude oil distillation facility which offers better performance in terms of energy efficiency than the previous crude oil distillation unit. In 2014, a test run was performed, which confirmed that the new facility was able to process 585 tonnes of crude oil per hour, without any negative impact on product quality or mechanical integrity. This means that approximately 114% of the nominal processing capacity was reached. As a

consequence, by making maximum use of the new oil distillation facility, the Group successfully reduced energy consumption per tonne of crude oil processed by LOTOS.

Plans and prospects of the processing segment

Refinery

To fully leverage the benefits offered by the successful completion of the 10+ Programme, the LOTOS Group planned a number of investment projects. Currently, it is in the final stages of preparation for the construction of a Delayed Coking Unit (DCU) at the Gdańsk refinery, which will directly enhance processing efficiency by minimising production of unprofitable heavy fuel oil. Following the project's completion, the annual output of high-margin products will grow by 900 thousand tonnes, while the Group's output of coking coal, a new product, will be approximately 400 thousand tonnes. The DCU is planned to be brought on stream in H1 2018. The Group estimates that the launch of the DCU will add over 2 USD/bbl to its refining margin thanks to increased depth of crude processing and the resultant improved yield structure as well as synergies between the DCU unit and the upgraded and extended refinery.

By the end of 2016, the Group also intends to complete a Hydrogen Recovery Unit (HRU) to increase the output of hydrogen required to intensify the operation of hydro-conversion units, further expanding the refining margin.

In 2015, the LOTOS Group will continue to work on a concept for the application of naphtha in the manufacturing of high-margin products.

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:

- Maintain a 30% share in the domestic fuel market,
- Achieve fuel sales 15% above the refinery's fuel production capacity,
- 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,
- Develop a network of service stations and intensify the existing network's sales,
- Maintain the leading position on the Polish market for lubricating oils.

The LOTOS brand's share in the domestic fuel market (diesel oil, gasoline, light fuel oil) was 33.1% as at the end of 2014, thus exceeding the strategic target.

The Group's share in the domestic retail market (diesel oil, gasoline) grew to 9%. 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 of the marketing segment

Prospects for the Group's processing and marketing business will depend on market requirements and will be oriented towards more efficient use of the economic potential of the 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 and continuing its efforts to standardise the network and the corporate brand image.

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 sales 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** (LOTOS Oil S.A.'s consulting service designed to help industrial customers achieve optimum oil management) 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 production.

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 became operational. The Group is also looking 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 capabilities necessary for integrated margin management. In connection with the EFRA Project (i.e. construction of a Delayed Coking Unit with auxiliary infrastructure at the Gdańsk refinery) scheduled for the coming years, the Group expects a shift in its exports structure towards increased share of middle distillates. Export sales volumes of other products will depend on the volumes sold on the domestic market, and on the volumes of crude processed at the Gdańsk refinery and the processing yields.

Given the nature of investments in the fuel sector, the time required to develop and implement such projects, as well as the changing legal and economic environment, it is possible that some of the projects referred to above, which are currently in preparatory phase, will not reach the development stage. In line with the Group policy and the market practice of other fuel sector companies, more projects are analysed and prepared than actually carried out. Therefore, it cannot be ruled out that in the future the Group will decide to execute other projects, which are not listed above. The decision to implement any given project is made on a case-by-case basis, taking into consideration its profitability in the current economic, technical and legal environment, as well as the availability of financing. Furthermore, materialisation of certain risks may postpone the completion of some projects or require significant changes to their scope.

2.2. OVERVIEW OF INTERNAL AND EXTERNAL DEVELOPMENT FACTORS

External factors

- **Macroeconomic conditions in Poland and the EU** – most of the Group's revenue is generated from sales of petroleum products, including transport fuels (gasolines and diesel oil), heavy fuel oil and aviation fuel.

In 2014, Eurozone GDP grew 1.3%. At the same time, preliminary estimates put Poland's real GDP growth at 3.3%, up 1.8pp on 2013. In Poland, despite the economic growth and improved macroeconomic variables, the consumption of liquid fuels declined slightly, likely on the back of the growing grey market.

- **Petroleum product cracks** – given that most of the Group's revenue is generated from sales of petroleum products manufactured by the Group's downstream segment, the Group's refining margins and its operating performance heavily depend on **petroleum product cracks** (i.e. the difference between the quoted price of petroleum products sold by the Group and the price of Brent crude).
- **Brent-Urals differential** (i.e. the difference between the price of Brent crude and the price of Urals crude); a positive Brent-Urals differential (i.e. when the price of Urals crude is lower than the price of Brent crude) has a positive effect on the Group's performance, while a negative Brent-Urals differential (i.e. when the price of Urals crude is higher than the price of Brent crude) adversely affects the Group's performance.
- **Oil and gas prices** – the profitability of the Group's upstream operations is chiefly determined by the difference between revenue from sale of oil and gas produced by the Group, and the operating costs, tax expense related to hydrocarbon production (incurred irrespectively of sales performance), as well as cost of oil and gas transport and sale. Accordingly, a drop in oil and gas prices may reduce volumes which the Group is able to produce profitably, or may adversely affect the profitability of production from specific wells, or the profitability of ongoing or planned investment projects, making production unviable and thus forcing the Group to suspend or abandon planned investment projects, or – where abandonment is not possible – complete a project and incur a loss.

Crude oil is the key feedstock used in the Group's refining operations so fluctuations in its prices have a significant direct impact on the costs incurred by the Group in the downstream segment (as the decrease in the Group's inventories is measured by the Company with the weighted average method, oil price movements result in a difference between the current market price of oil and the cost of its processing recognised in the Group's consolidated financial statements). This method of inventory measurement defers the impact of changes in crude oil prices on the prices of finished goods. Thus, **an increase in crude oil prices on global markets has a positive effect, while a decrease adversely affects the Group's reported performance, which is known as the LIFO effect.**

The prices charged by the Group for oil and gas sold to external customers are largely a function of oil and gas prices on international markets. As a result, oil and gas price fluctuations may have a material bearing on the performance of the Group's upstream segment.

- **PLN/USD exchange rate** – exchange rate fluctuations have a significant effect on the Group's performance and financial position. This is due to the fact that while PLN is the Group's reporting currency and the functional currency of the Company and the majority of its consolidated subsidiaries, trading prices of crude oil and petroleum products are generally denominated in, or tied to, USD. In

addition, certain of the Group's other costs and revenues are denominated in EUR and other foreign currencies.

The Group has a structural long position in USD (which means it benefits from a rise in the USD/PLN exchange rate) as its cash inflows dependent on the USD exchange rate (mainly revenue from sale of petroleum products) are higher than the corresponding cash outflows in USD (mainly on purchase of crude oil). In order to reduce the Group's structural long position in USD, and consequently also currency risk, the Group's long-term credit facilities used to finance the 10+ Programme were contracted in USD.

- **Demand for and supply of petroleum products** – most of the Group's revenue is derived from the production and sale of petroleum products. Consequently, the level and structure of demand for and supply of petroleum products in the markets in which the Group operates have a material effect on the Group's performance.

The structure of demand and supply by product types is an important factor affecting the Group's revenue given the different crack spreads on petroleum products sold by the Group – i.e. relatively high crack spreads in the case of middle distillates (diesel oil, aviation fuel and light fuel oil) and light fractions (gasoline and naphtha), as opposed to negative crack spreads in the case of heavy residues (heavy fuel oil and bitumen). According to JBC, the demand for petroleum products in Europe will decrease further (in 2019 it will be lower 1.7% relative to 2014), largely as a result of a significant drop in consumption of gasolines and fuel oils, which is expected to be partially offset by an increase in consumption of LPG, aviation fuel and naphtha (with a slight upturn in diesel oil consumption). The Company believes that trends in the Polish market should mirror those prevailing in the European market. An anticipated economic recovery in Poland and across the region (growing GDP rates, falling unemployment and stabilising inflation) should stimulate demand for petroleum products, especially diesel oil and aviation fuel. At the same time, efforts to counteract the grey market in Poland, undertaken both by the government and legitimate fuel suppliers, should reduce the market's size, additionally contributing to an increase in registered demand for diesel oil. The Company expects the market of gasolines and substitute LPG to stabilise over the coming years, while the market of heating oils (light fuel oil and heavy fuel oil), which must compete with cheaper substitutes, will continue on the downward trend of the past few years. Although many European refineries have been shut down, the lower supply of petroleum products in Europe was compensated by higher exports from the US, where refining capacity expansion was accompanied by a drop in demand for petroleum products on the US market and low petroleum prices (mainly on the back of growing production of indigenous shale oil and a ban on oil exports) coupled with an increase in supplies from the Russian Federation (following an upgrade of the Russian refining system) and the Middle East (largely in connection with the construction of new export-oriented refineries).

In order to mitigate the impact of these factors on its operating results, the Group sells its products through diversified sale channels (both in Poland and abroad) while maintaining a flexible pricing policy.

Internal factors

- **Efficiency-enhancing measures** In 2014, Grupa LOTOS S.A. continued the [2013–2015 Efficiency and Growth \(E&G\)](#) Programme. The Programme is geared toward improving the Group'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 growth potential and facilitate access to new financing sources.

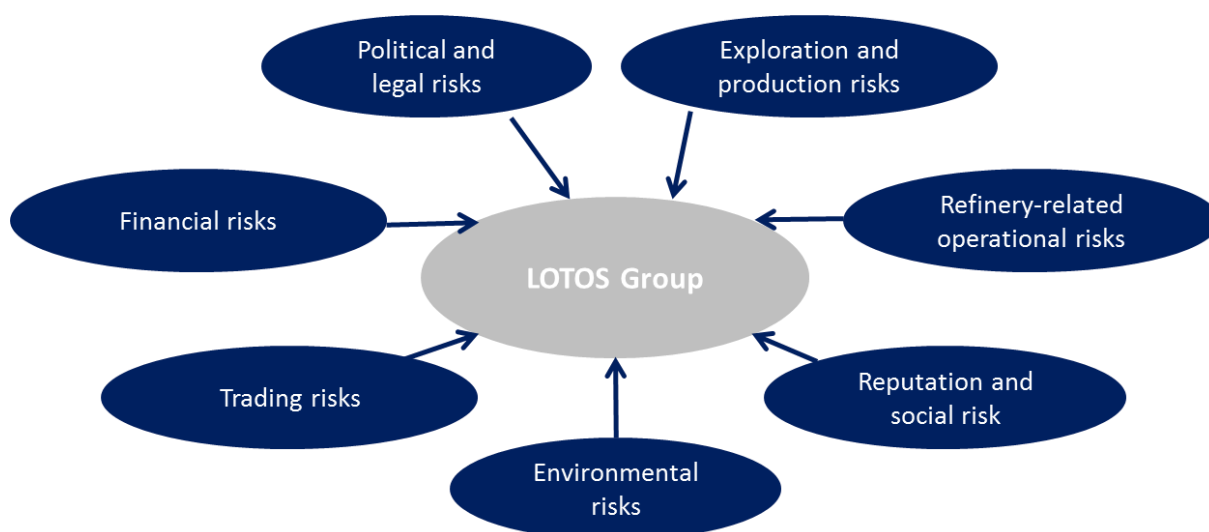
- **Investment projects in the processing segment** focus on efficient utilisation of Grupa LOTOS S.A.'s expanded refining capacities following completion of the 10+ Programme, further increase in the distillate yield, and optimum use of production capacities.
- **Strengthening of the LOTOS brand's market 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 (for more information, see Section 2.6 'Logistics'), 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

Throughout 2014, as part of the ERM (Enterprise Risk Management) system, a number of risk mitigation measures were being implemented at the LOTOS Group, reducing the probability that specific risks might materialise. In the case of risks that did materialise, pre-defined action plans were applied, mitigating their adverse consequences. In addition, new risks were defined, associated primarily with projects of crucial importance to the Group (EFRA, or Delayed Coking Unit (DCU) and B8 field development). A number of measures were also being implemented to improve the risk management tools, including risk identification, assessment and monitoring methodologies.

The Group identifies a range of diverse risks, which may affect all areas of its business. Many of them are interrelated, so the Group analyses their interactions and strives to minimise their impact. Details of the various risk groups and risk management methods are discussed further in this Report.

Figure 2. Key risks in the LOTOS Group



Political and legal risks

In 2014, the main sources of political and legal risks included the Ukrainian crisis and the plans to implement new EU legislation, especially related to tighter the EU climate policy until 2030.

The Polish regulatory framework, on the other hand, posed a lesser business risk. In 2014, Polish legislation was evolving in the direction conducive to the development of the petroleum industry (e.g. the new act on mandatory oil and fuel stocks, and regulations governing the exploration and production of hydrocarbons). In addition, a deepening of the dialogue between law makers and industry representatives (both businesses and trade organisations) helped mitigate the business risk associated with the Polish regulatory framework. Nevertheless, the Company's involvement in the legislative process, through public consultations of draft laws and government-coordinated working groups, is still very important.

Political risks

A major political risk that could affect the Company's trade flows was the escalating tension between Ukraine and Russia and the resulting EU sanctions on Moscow. The Company closely monitored the geopolitical developments and their implications. In 2014, the EU sanctions did not affect either the crude oil procurement or trade in petroleum products. The only noticeable effect, resulting from the earlier US sanctions, was that banks tended to be more cautious when intermediating in settlements with Russian entities.

Legal risks**EU's 2030 climate policy**

The solutions of January 22nd 2014 prepared by the European Commission and designed to tighten the climate policy until 2030 are extremely severe. The European Union proposes that the greenhouse gas emissions reduction ratio be doubled to 40%, the share of RES in electricity generation be raised to 27%, and the annual CO₂ emissions reduction ratio in the ETS be increased from 1.7% to 2.2%. Additionally, energy-intensive industry sectors have strong concerns that they may be included in the ETS, in which case they would face bankruptcy.

If operating costs of European enterprises go up as a result of more stringent regulations on CO₂ emissions, Europe will become an importer of fuels and chemicals from countries where such constraints do not apply.

We are already seeing a decline in EU companies' competitiveness relative to market players operating without CO₂ emissions limits. A case in point is the refining industry, currently in serious crisis (especially in the EU15 countries). Since 2009, the number of refineries in the EU has dropped from 98 to 87, and crude oil throughput may be expected to go down by almost 30% by 2020, bringing about further shutdowns.

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. The Polish administration should find ways to support not only local, but also international groups whose business goals converge with Poland's national interests. 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.

Poland's Energy Policy until 2050

In 2014, the Ministry of Economy commenced work on Poland's Energy Policy until 2050 and invited industry organisations, including CEEP (co-founded by Grupa LOTOS S.A.), to cooperate in the project. One result of this cooperation is that the draft policy includes provisions which, if maintained, will support:

- Protection of the domestic fuel market, including maintenance of the government's control of key elements of crude oil and fuel infrastructure, and ensuring that internal demand is covered with domestic production to the maximum possible extent;
- Taking further coordinated steps to curb the 'grey market' in fuel trading;
- Reducing the burden on entities operating in the crude oil sector, including possible continuation of the current changes in the mandatory stocks system;
- Extending the catalogue of biocomponents and manufacturing technologies for alternative liquid fuels, including technologies relying on co-hydrogenation.

No comprehensive legal framework for the oil sector

The oil sector in Poland is regulated under multiple legal acts, compliance with which is overseen by different departments, which hampers the industry's smooth functioning. One of important proposals put forward during the work on Poland's Energy Policy until 2050 concerns preparation of Crude Oil Law – a single legal act which would include all regulations governing operation of the oil and fuel sector in Poland.

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. Impairment or loss of reputation may be caused by circumstances outside the LOTOS Group's control (e.g. impaired reputation of the entire industry), or directly by the Group's activities (in the event of disruptions to product supplies, material deterioration of product quality, intentional misconduct or violations resulting in losses to the Group or its trading partners), or by the materialisation of various risks described in this section (e.g. failures resulting in injury or death, or contamination of the natural environment). The LOTOS Group companies are aware that loss of stakeholders' (trade partners, customers, shareholders etc.) trust may translate into a negative perception of the LOTOS Group and its operations, and thus adversely affect performance. For this reason, each risk identified at the LOTOS Group has been also assessed in terms of its effect on the reputation, and a separate map of reputation risk has been drawn up. For each major reputation risk, a mitigation plan is implemented in line with the adopted policy.
- **Social risk** is related to the LOTOS Group's operations in the context of the Group's effect on the social environment, the Group's employees, and employees of its trading partners. Open and fair communication of the projects being executed and planned is intended to make stakeholders aware of the Group's activity and is one of the tools used to mitigate potential risks. For instance, in connection with the launch of work on the EFRA project, meetings were organised with local communities to present the project objectives and consequences. Furthermore, the Group is implementing 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, periodic meetings are being held between the Group employees and members of the Management Boards of Grupa LOTOS S.A. and its subsidiaries to discuss any current issues and resolve doubts and concerns relating to the ongoing processes.
- **Misconduct risk** is construed at the LOTOS Group as the risk of an intentional act or omission which constitutes a violation of the generally applicable laws, committed to secure an unlawful gain or leading to the Company sustaining a loss (including any forms of corruption). To minimise 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 minimising its consequences. The Misconduct Prevention System is subject to an annual survey as part of an analysis of the Company's organisational maturity, and its consistently improving assessment proves the effectiveness of the solutions applied.

Exploration and production risks

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 LOTOS 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 based on the assessment of the four factors listed above (area and thickness, porosity and hydrocarbon saturation), which are assigned probability on a scale of 0% – 100%. A multiple based on these factors is a measure of the probability of success. 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), regular internal inspections of the equipment, and supervision performed by certification and administrative bodies (the Polish Register of Shipping, the Mining Authority, the Office of Technical Inspection).
- **Risks from infrastructure operation, such as the risk of oil spill, sea collision, fire or blowout** – which may cause environmental contamination, serious injury or death of an employee, downsizing or stoppage of production, as well as 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's and subcontractors' 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.

Risks related to exploration and production projects

- **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 reduced by devising an appropriate negotiation strategy at the time when the Group enters into a new partnership and while it 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 2014 in the case of licences held jointly with partners in both Norway and Poland. Projects implemented jointly with partners include the Norwegian projects: Free Gamma Delta and Fulla, as well as joint application in the APA 2014 licensing round. An example of such a project on the Baltic Sea is the partnership with CalEnergy Resources in the development of the B4/B6 gas fields. In 2014, the cooperation in all of the abovementioned projects ran smoothly, in line with the action plan prepared for each project.
- **Risk of involving capital in projects which yield unsatisfactory returns** – another risk identified in the E&P operations and execution of partnership agreements which may result in financial losses. To counteract this risk, we take care to properly define goals and acceptable conditions on which we can participate in a project, and we select our partners carefully. For each project, we define the acceptable economic viability framework and implement proper analytic tools to assess the project. We set up internal and/or external multidisciplinary teams which estimate the economic, legal, tax or technical risks (e.g. at the due diligence stage).
- **Risk of increased liabilities in relation to the YME project** – given the significance of the YME project and its impact on the Group's past performance, 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 risk associated with the removal of the MOPU, an agreement was signed with Single Buoy Moorings Inc. ("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. Of the amount transferred to the YME project escrow account, USD 81.78m was attributable to LOTOS Norge. As at the date of this Report, the estimated cost of the MOPU removal did not exceed the funds accumulated in the account. The removal activities are proceeding in line with the plan, and completion of the process is scheduled for the middle of 2015.

In 2014, the Group evaluated the quality of work performed by the operator in the YME field, helped to build an agreement between those partners that were not consortium operators in order to strengthen our position, engaged international advisers, and created the YME Task Force at LOTOS Norge to provide ongoing support to the Project Manager in performing tasks in line with the LOTOS Group strategy. 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. At the time of

preparing this Report, there was no unanimous decision of the YME consortium members as to further steps to be taken in relation to the field. As proposed by the controlling group of interest holders, a plan is to be prepared for complete liquidation of the field infrastructure, which may serve as the basis for further decisions regarding the liquidation. If made, such decisions may prevent recovery of the invested capital through the sale of interests. However, LOTOS Norge continues work on defining the possible options for the development of the YME field. The rationale for and amount of further capital expenditure on the development of the YME field are the subject of thorough analyses, assessments of the risk involved, and evaluation of the possible courses of action.

Financial risk related to the upstream business

- **Macroeconomic risk** – risks related to macroeconomic factors were crucial for the functioning of the upstream business in 2014. These included in particular a plunge in crude oil prices, resulting in deterioration of the economic parameters and profitability of investments in the upstream business, and affecting the availability and terms of external financing for such projects. Currently, funding is being raised for a new large project in the segment, i.e. development of the B8 field in the Baltic Sea. Following the adopted strategy, on August 25th 2014 the Company, Polskie Inwestycje Rozwojowe, Bank Gospodarstwa Krajowego, and Bank Pekao S.A. entered into a number of agreements concerning the project financing. The Project execution is now at the stage of analysis and work towards fulfilling the conditions precedent to the disbursement of funding. Moreover, in Q4 2014 Grupa LOTOS S.A. raised PLN 1bn through the issue of shares to finance its two key projects, including the development of the B4/B6 gas fields. Financial risks related to the operations of the LOTOS Group and applicable risk management measures are described in more detail further in this Report.

Operational risks related to the refinery

- **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. We continue to prioritise installations and equipment based on their criticality. The technologies and equipment which we use are in line with the Best Available Techniques (BAT). We have automatic emergency shutdown systems in place to prevent uncontrollable escalation of incidents, and our process units are also fitted with their own safety and fire systems. In addition, in order to raise standards for assessment of the technical condition of high-pressure installations and equipment, the Risk-Based Inspection methodology was implemented in selected areas in cooperation with the Office of Technical Inspection. Work is also under way on implementing the Risk-Based Work Selection methodology, which supports planning maintenance work on the basis of risk analyses prepared earlier for individual units. Having implemented these methodologies, we will be able to manage the LOTOS Group's infrastructure in a better and more efficient way.
- **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, for instance during OHS inspections and supplier audits, and post-inspection requirements are enforced. In addition, a number of initiatives are taken at the Group level to raise the employees' awareness of safety standards and to encourage them to observe these standards at work.

- **Risk related to legislative changes with respect to REACH.** A new Annex XIV to the Regulation on Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) has been in effect since August 21st 2014. Among substances that require authorisation, the Annex lists EDC (1,2-Dichloroethane), a solvent which is used by Grupa LOTOS S.A. This means that in order to be able to use EDC after November 22nd 2017, the Company will need an authorisation. If such authorisation is not received, the Company will not be able to perform the process in which this solvent is currently used. In order to minimise the probability of this risk materialising, Grupa LOTOS S.A. has launched an internal project to coordinate the various steps taken with a view to preparing the required documentation to apply for an authorisation to use EDC. The Company has entered into cooperation with the EDC DU consortium, an association of downstream users of the EDC solvent. Apart from that, we also plan to modernise the installations of our Oil Unit to ensure that they comply with all the mandatory technical and legal requirements enabling further use of the EDC.

Environmental risks

- **Risks related to CO2 emission allowance limits** involve an increase in prices and insufficient allocation of CO2 emission allowances, which would force the Company to incur additional costs to purchase allowances on the market to cover the deficit. 2014 was another period of intense activity for the EU Emissions Trading Scheme and its participants. In January, the European Commission published a package of documents concerning EU's strategy beyond 2020, setting forth three new objectives on Europe's way to a low-emissions economy: reduction of domestic greenhouse gas emissions by at least 40% (compared with 1990 levels), increase in the share of renewable energy to at least 27% of the EU's overall energy consumption, and improvement of energy efficiency by at least 27% relative to future energy consumption forecasts. In line with the Commission's proposal, the main instrument to achieve these objectives should be a reformed ETS, working to reduce the surplus of CO2 emission allowances built up in recent years to spur a growth in their prices. However, structural changes must be made to the ETS to put in place a permanent solution for balancing of the supply and demand. The Commission has proposed that a market stability reserve (MSR) of allowances should be built at the beginning of the next trading period in 2021, but the date of MSR's entry into force is still being debated by the European Parliament. The discussions and negotiations related to the proposed reform of the EU ETS commenced in autumn 2014 and will continue in 2015. A temporary solution consisting in postponing the auctioning of a part of CO2 allowances to stimulate an increase in their price (back-loading) was agreed in February 2014. The first auction with allowance volumes reduced as part of the back-loading mechanism was held in March last year. The back-loading and the European Commission's legislative work on the proposed reform led to an increase in the prices of EUA in 2014. The volume of free allowances allocated to Grupa LOTOS S.A. under National Allocation Plan III is not sufficient to cover the forecast emissions from the Company's existing and planned installations, which amount to an average of 1,779,653 annually in 2013–2020. In 2014, as part of the National Allocation Plan Grupa LOTOS S.A. received additional free allowances in respect of its new projects, as a result of which its average annual allowance volume until the end of the trading period reached 1,435,242. Given the changes already in effect as well as the

planned ones, Grupa LOTOS S.A. is exposed to the risk of incurring higher costs to purchase CO₂ allowances required to cover the deficit; moreover, it is uncertain whether the Company will obtain any free allowances in respect of other new projects it is planning. With a view to limiting its emissions and the need to purchase additional allowances, the Company has implemented a number of investment projects. In 2014, the last boiler in Grupa LOTOS S.A.'s CHP plant was upgraded, which means that now all the CHP plant boilers are adapted to burning natural gas. Moreover, the Company maximised the use of natural gas as a source of energy in the refinery's fuel gas network and a feedstock for production of hydrogen. The above measures enabled the Company to considerably reduce CO₂ emissions from its production units and CHP plant relative to 2013.

- **Risks related to the requirement to obtain new or amend existing permits** Grupa LOTOS S.A. is required to operate under the terms of an integrated permit obtained for installations whose operations – due to their nature or scale – may lead to significant pollution of the environment as a whole or of its individual components. In December 2014, the Company applied for amendment of its integrated permit, which was required, following extension of the infrastructure for unloading rail cars, construction of a Hydrogen Recovery Unit, changes in the types and volumes of emissions from one of the emission sources, and changes in land plot boundaries and numbers caused by new investment projects carried out on the refinery's premises. Legal regulations regarding environmental protection and the use of the environment by companies are subject to relatively frequent changes. The Act of July 21st 2014 amending the Polish Environment Protection Law implemented Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions (known as the IED Directive). In 2014, the new regulations imposed a new requirement that an application for an integrated permit or amendment of an existing integrated permit must be accompanied by a baseline report containing information on contamination of the soil and water environment with hazardous substances. In December 2014, Grupa LOTOS S.A., as the first company in the Province of Gdańsk, filed such a report as an attachment to the application for amendment of its integrated permit, and in January 2015 the Marshal Office of the Province of Gdańsk issued a decision amending the existing integrated permit. In order to reduce the risk associated with the process of obtaining any requisite permits or decisions, the required application documentation is prepared well in advance, in consideration of the risk that administrative proceedings may last longer than expected. In addition, continuous monitoring of Polish and European Community laws and regulations allows the Company to comply with any new regulations by the deadlines and to the extent specified therein.
- **Risks related to compliance with new regulations on the implementation of Best Available Techniques (BAT).** Grupa LOTOS S.A.'s installations requiring an integrated permit should meet the BAT requirements, as specified in the BAT Reference Notes (BREFs) or directly in the applicable laws and other technical specifications, technical standards etc. The BAT Reference Notes serve as recommendations, and the adaptation of installations, as well as the relevant technologies, procedures and practices to the BAT requirements is an important condition for obtaining an integrated permit. In accordance with the Industrial Emissions Directive, compliance with the so called BAT conclusions is the reference for setting integrated permit conditions and for determining the admissible emission levels. On October 9th 2014, a Commission Implementing Decision establishing BAT conclusions for the refining of crude oil and gas in accordance with the IED was published. The new requirements relating to BAT conclusions are more stringent, which will necessitate significant capital expenditure to ensure compliance. There is a risk that some Grupa LOTOS S.A.'s units or installations may not be ready to comply with the new requirements by the deadlines set out in the BAT regulations, and investment processes will need to be launched to adapt them.

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 in place a Price Risk and Trading Committee, whose main task is to supervise and support 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** – Grupa LOTOS S.A.'s revenue from sale of petroleum products is largely dependent on the difference between the price of the petroleum products and the price of crude oil. The prices may be subject to significant fluctuations in response to developments that are outside the Company's control, including mainly changes in the global and regional supply and demand, the geopolitical situation, and the related market expectations. Movements in the prices of crude oil and other feedstock used in the refinery business (including natural gas) and fluctuations in the prices of Grupa LOTOS S.A.'s petroleum products may not be correlated in time, which may cause significant volatility of the Company's refining margin. To better manage the feedstock and petroleum products price risk, in 2014 the Company implemented a new ERTM (Energy Trading and Risk Management) system – Allegro 8.0. A new feedstock and petroleum products price risk policy is expected to be approved in early 2015.
- **CO2 allowances price risk** – in 2014, Grupa LOTOS S.A. managed the entire phase III of the EU CO2 Emissions Trading Scheme covering the 2013–2020 trading period. In the previous year, year 2020 was not included in the risk management horizon given the lack of liquidity on the futures market and the instability of the underlying position. For more information on this type of risk as at December 31st 2014, see the consolidated financial statements.
- **Liquidity risk** – the risk relating to the ability to discharge all liabilities in a timely manner. It may result from a mismatch between the streams of receivables and payables or inadequate sources of financing. 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** – the Polish złoty (PLN) is the reporting and functional currency for the Company and the majority of other LOTOS Group companies, while the trading prices of crude oil and petroleum products are generally denominated in, or tied to, the US dollar (USD). Therefore, the Company has a structural long position in USD (it benefits from a rise in the USD/PLN exchange rate) as its cash inflows dependent on the USD exchange rate (mainly revenue from sale of petroleum products) are higher than

the corresponding cash outflows (e.g. on purchase of crude oil or credit facility repayment). Moreover, the US dollar was chosen by most of the Group companies as the currency for contracting and repaying long-term investment facilities. A document entitled 'The Strategy of Currency Risk Management at Grupa LOTOS S.A.' was formally adopted by the Company to manage its currency risk. The LOTOS Group also operates a so-called Group Bank that allows Group companies to enter into FX transactions with Grupa LOTOS S.A., improving the efficiency of currency risk management.

- **Interest rate risk** – Grupa LOTOS S.A. is exposed to interest rate risk, with interest rates growth translating into increased costs of servicing debt under floating-rate bank and non-bank borrowings. The risk is related primarily to the expected schedule of payments under the loans taken out to finance inventories and the 10+ Programme and the resulting amount of interest accruing at USD LIBOR.
- **Counterparty risk in financial transactions** – when entering into financial transactions with financial institutions we take into account the risk of the counterparty's default. The risk is mitigated by transacting only with creditworthy financial institutions or companies, or by executing transactions on the basis of guarantees issued by a financial institution or company with an appropriate credit rating and meeting the relevant requirements of Grupa LOTOS S.A. Credit limits in financial transactions are determined with 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.
- **Counterparty risk in trade transactions** – in the course of our trading operations we sell products and services to businesses on a deferred payment basis, which may give rise to a risk of the customer's default. The LOTOS Group operates an internal procedure whereby creditworthiness of trading partners seeking an open credit limit must be verified. Grupa LOTOS S.A. grants such limits based on assessment of partners' creditworthiness, taking into account the available data and information. 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 limited access to external financing and changes in lending terms; risk relating to debt service** – some Grupa LOTOS S.A.'s investment projects and, to a limited extent, day-to-day activities of some of the Company's subsidiaries are (or are intended to be) financed with debt. Therefore, there is a risk that Group companies may find it difficult to raise new financing or obtain financing in the required amount or on acceptable terms. This may be due to an unstable situation on financial and capital markets in Poland and abroad, more restrictive policies adopted by lenders with respect to new agreements or interpretation and performance of existing agreements, adverse economic developments in Poland or abroad, and non-performance or improper performance of contractual obligations under the financing agreements by Group companies. The ability to secure new debt financing is also limited by the Group companies' obligations related to servicing of existing debt. In addition, debt agreements impose a number of non-financial obligations and restrictions on LOTOS Group companies, related in particular to their ability to engage or refrain from engaging in certain activities or operations during the repayment period, as well as the requirement to comply with certain disclosure obligations towards the financing institutions. Any failure by a Group company to make timely payments as required under the terms of financing or to meet non-financial obligations may result in acceleration of the debt, along with debt incurred under other financial agreements or instruments. The lenders may also enforce their claims against security, including collateral established over Group companies' assets. We mitigate this risk through integrated reporting on current and planned liquidity of Group companies (including expected deficits which may require arrangement of debt or intra-Group financing). The majority of Group companies participate in a cash pooling arrangement. In addition, the financial functions at

individual Group companies monitor the obligations assumed by a given company under debt financing agreements on an ongoing basis, including obligations relating to debt service, information disclosure, maintenance of certain financial ratios and covenants as well as discharge of other obligations towards financial institutions. The LOTOS Group maintains relationships with a diversified group of creditworthy partners, and secures debt financing (or amends existing debt financing agreements) using the 'Procedure for managing debt and coordinating debt financing at the LOTOS Group,' which applies to all Group companies. The credit rating 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 LOTOS Group's ability to raise financing domestically and globally.

- **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. Frequent amendments to the tax legislation and difficulties in interpreting and applying tax laws hinder the Company's day-to-day work and smooth tax planning. They are also a source of uncertainty as to the application of tax regulations in the Company's everyday business and give rise to the risk of errors. In addition, tax laws are often interpreted and applied by tax authorities in an inconsistent manner. For fuel sector companies, excise duty is the most problematic tax, given the substantial amount of the tax liability and the complex nature of excise regulations. Excise tax legislation is very detailed, imposes a large number of diverse obligations on the taxpayers, and contains regulations which are mutually contradictory (sometimes even within the same legal act). Property tax laws also give rise to numerous interpretation uncertainties, in particular with respect to the tax base and the determination of items subject to the tax. Given the above, Group companies which operate substantial technical infrastructure equipment located on properties are exposed to the risk of disputes with tax authorities, in particular with respect to the interpretation and application of the definition of a structure under the Local Taxes and Charges Act. Where a tax risk arises from possible disparate interpretations of a law, we request the Minister of Finance to present a binding interpretation of such law. As a member of respectable organisations of employers and entrepreneurs, we also voice our opinions on proposed bills and are thus able to respond appropriately to the changing legal environment. In light of the numerous changes in interpretation of the tax laws and the introduction of new regulations, we regularly update our internal procedures to ensure compliance with legal requirements and to identify and mitigate any tax risks, particularly their effect on the Group's financial statements.

Commercial risks

- **Risk of crude supply interruptions or reduced crude supply** – as the output from its own production assets does not fully cover its processing feedstock requirements, the LOTOS Group relies on crude oil purchased from external suppliers. The Group primarily sources its oil supplies (around 92%) from Russia. Crude oil is supplied via the network of pipelines operated by PERN (the Druzhba and Pomorski pipelines) and by sea through the Naftoport oil terminal; in 2014 the Group also made its first purchase of crude oil shipped by rail. Considering the above, the key risks that may cause uncertainty in crude oil supply include the political situation in oil exporting and transit countries, as well as the availability and the working condition of transport infrastructure. The possible causes of disruptions to the Group's crude oil supplies include:
 - technical failures, including technical failures of the pipeline system used to supply crude oil to the Group, terrorist acts, acts of sabotage, riots, revolutions, war, natural disasters, adverse weather conditions and other force majeure events, and

- irregular crude oil deliveries leading to a temporary reduction in work-in-process inventory, which in turn is likely to affect the refinery's throughput volumes.

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 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),
- use of crude oil transport by rail, with new crude oil rail unloading stations built at the refinery in 2014.

An appropriate selection of crude types and supply directions is a result of continuous efforts to maximise the integrated margin.

- **Risk of movements in margins on product sales** – the principal risk factors include progressing market consolidation leading to intensified price competition on the Polish fuel market, and the rapidly changing global macroeconomic environment. In order to mitigate this risk, the Group is continuously refining its tools for monitoring variables affecting prices and margins. In retail sales, we are pursuing market diversification, including diversification into segments less prone to competition-induced margin erosion, as well as other initiatives aimed at building lasting relationships with customers.
- **Risk of decline in domestic demand** – negative trends related to macroeconomic factors (GDP, situation on the labour market, industrial production volume, etc.) may result in lower domestic demand for fuel products. Diversification of the available distribution channels, implementation of a pro-active pricing policy for price-competitive products, and optimisation of operating costs are the key elements of the strategy aimed at minimising the impact of this risk on the Group's operations.
- **Risk from grey market expansion** – in recent years, Poland has seen an increase in illegal trade, especially in diesel oil. According to estimates of the Polish Organisation of Oil Industry and Trade (POPiHN), in the first quarter of 2014, grey market transactions represented between 23% and 27% of total diesel oil sales. The growing problem of illicit fuel trading taking place outside the official tax system has an effect of depressing demand for fuels produced and sold in conformity with the law. The successful curbing of the parallel market depends on the effectiveness of government measures designed to increase the enforcement of applicable laws. A member of POPiHN, Grupa LOTOS S.A. works with other oil companies 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.

2.4. INDUSTRY OVERVIEW

2.4.1. MACROECONOMIC ENVIRONMENT

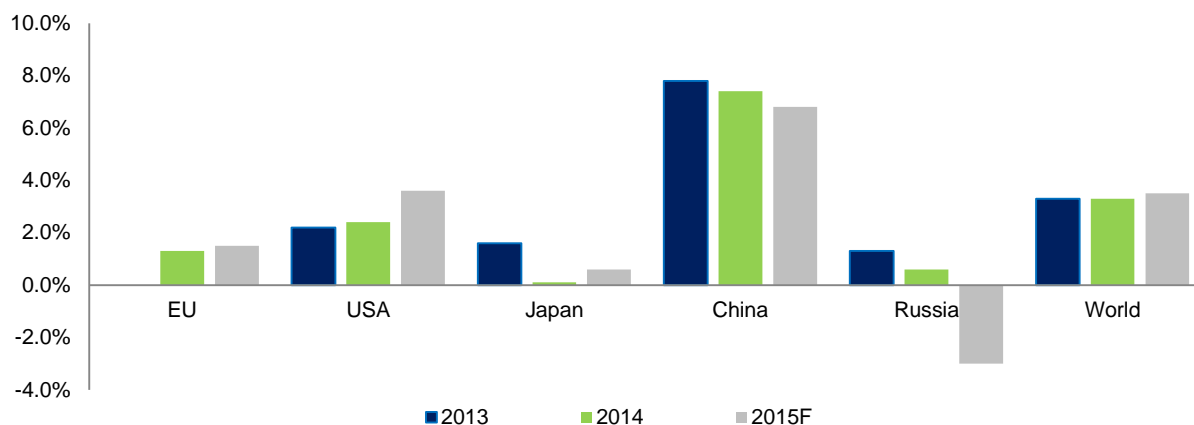
The global economic situation in 2014 was below market expectations. The world's leading economies kept expanding, but the growth rates were often lower than anticipated. The United States was a notable exception – the country's economic recovery was faster and stronger than predicted by the market. In contrast, Japan lagged behind other major economies.

Developed economies were supported by loose monetary policies and efforts to maintain market liquidity.

In 2014, global economy continued on a growth path, with the estimated growth rate (3.3%) slightly below that forecast in April last year.

In 2014, Eurozone GDP was at 1.3%, and it is expected to remain in positive territory in the coming years, with the growth rate projected at above 1%¹.

Figure 3. GDP growth rate in 2013–2015



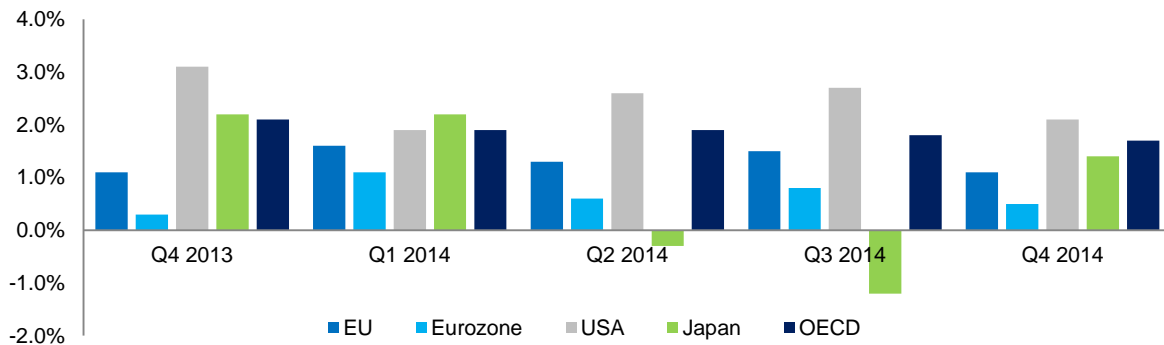
Source: In-house analysis based on IMF data (January 2015).

Developed countries may be expected to further stimulate economic growth by continuing support from monetary policy (e.g. the quantitative easing programme launched by ECB), attempts to introduce balanced fiscal policy, and further structural reforms.

However, the adopted economic policies will need to address the current crude oil market conditions (steep declines in prices in the second half of 2014) and geopolitical issues (such as the Ukraine crisis or the Islamic State in the Middle East).

¹ World Economic Outlook, IMF, January 2015.

Figure 4. GDP growth rate in 2013–2014 (year-on-year change)



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

Refining sector

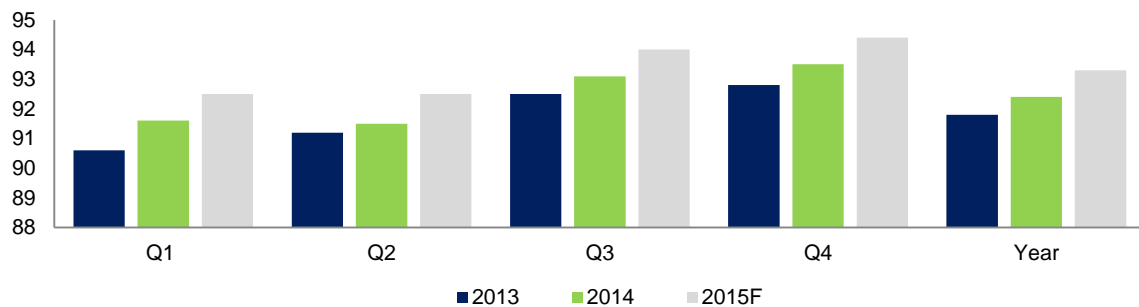
Global economic growth and lower crude oil prices led to increased global consumption of oil. This was accompanied by a continuing decline in demand in developed countries and an upward trend in consumption in developing countries.

Oil industry organisations estimate daily average demand for oil in 2014 at 91.8 mbd, up ca. 1.0% (0.9 mbd) year on year. Average daily oil consumption in 2015 is forecast at 92.8 mbd, meaning a 1.1% increase.² JBC Energy's mid-term forecasts expect the demand to rise to almost 97.8 mbd in 2019, which translates into an average annual growth rate of 1.2%.

Based on the industry estimates, global consumption continues to be driven by growing demand from developing countries. According to the estimates, it went up 2.7% in non-OECD countries in 2014 and is expected to rise 2.3% in 2015, to over 47mbd. On the other hand, consumption in developed countries is estimated to have decreased by 0.7% in 2014, with a further drop of 0.1% forecast for 2015, to over 45.6 mbd.

Crude oil consumption in Europe in 2014 is estimated at 14.3 mbd. In 2015, it should stay at 14.2 mbd³.

Figure 5. Demand for crude oil (mbd)



International fuel market⁴

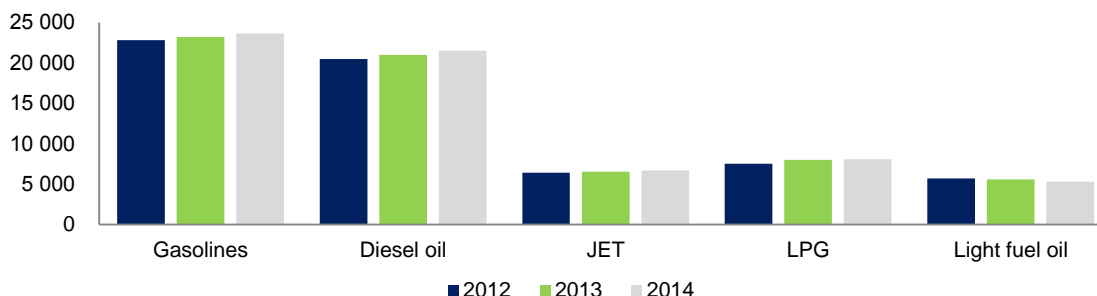
² In-house computations based on OPEC, MAE, US EIA and JBC data.

³ As above.

⁴ *Mid-Term Oil Market Outlook 2012–2017, JBC Energy, October 2012.*

It is estimated that demand for oil refining products in 2014 rose by 1.0% globally. Stronger demand was seen in the gasolines (1.8%) and diesel oil (2.5%) segments. The estimated consumption of LPG and jet fuel also increased (by 1.3% and 2.1%, respectively). However, the demand for light fuel oil fell (by -4.9%).

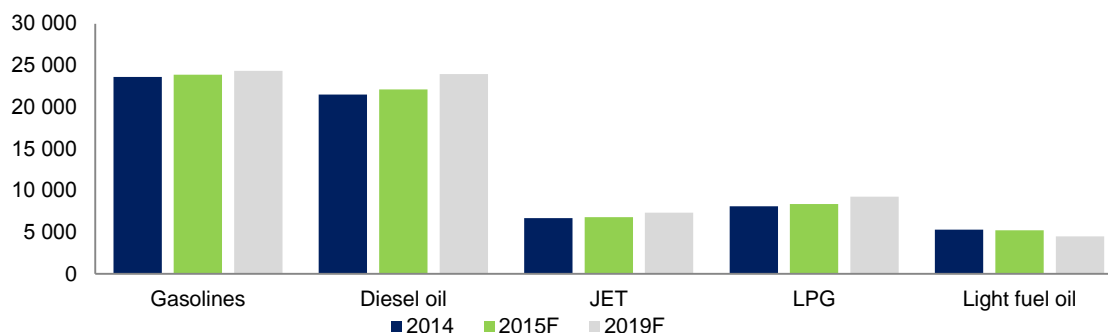
Figure 6. Global consumption of fuels (tbd)



Source: In-house analysis based on JBC data, October 2014.

According to forecasts, the overall global consumption of refinery products is expected to grow by over 5% until 2019. It is estimated that demand for LPG, diesel oil, and JET fuel will grow significantly over the 2014 consumption (up 14%, 11% and 10%, respectively). The global consumption should rise slightly (3%). Light fuel oil consumption is expected to fall by 15%.

Figure 7. Forecast global consumption of fuels (tbd)

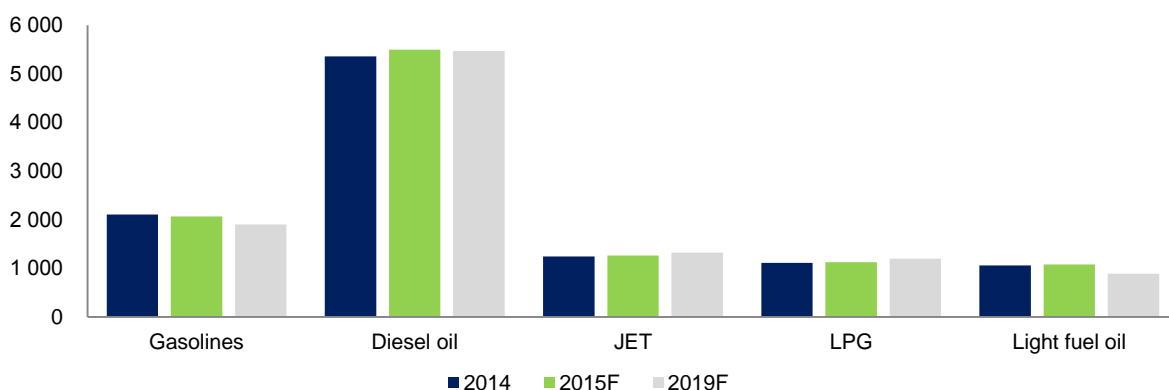


Source: In-house analysis based on JBC data, October 2014.

According to estimates, consumption of petroleum products in Europe declined in 2014 by 1.0%. However, diesel oil, JET fuel and LPG saw an increase of 1.1%, 0.8%, and 0.1%, respectively. Consumption of gasolines and light fuel oil fell by 1.8% and 10.0%. The changes in fuel consumption in Europe reflect the economic conditions in EU Member States and the Eurozone countries.

The demand for oil refining products is forecast to fall in Europe by 1.7% until 2019. According to estimates, one of the reasons behind the decline will be a significant drop in consumption of gasolines, exceeding 9%. Lower consumption is also expected to affect the light fuel oil market (-16%). Concurrently, a strong increase is expected in consumption of LPG – by 7.5%, JET fuel – by 6.1%, and diesel oil – by 2.0%.

Figure 8. Forecast consumption of fuels in Europe (tbd)



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

In the European car market, new car registrations grew by 5% in 2014, to 13m new cars. A marked improvement was also recorded in the utility vehicles segment, with new registrations up by 7% (to 1.9m new vehicles). In the group of registered new cars, there is a continued growing interest in diesel-fuelled cars. The share of such cars in total new car registrations in Western Europe was more than 53% in 2013 (compared with 46% in 2009)⁵.

Macroeconomic environment in Poland

According on preliminary estimates, Poland's real GDP grew at a rate of 3.3%, faster than in 2013 by 1.8pp.

The key factor that had a strong impact on the global and Polish petroleum markets in 2014, with significant consequences for Grupa LOTOS S.A.'s performance, was the price of crude oil, which also determined the price of petroleum products.

In Poland, despite the economic growth and improved macroeconomic variables, the consumption of liquid fuels declined.

Polish fuel market

Domestic demand for fuels is shaped by the general economic situation in Poland and the region. In the last three 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 observed in the recent years. In 2014, the Polish government's efforts involving the implementation of a stricter control regime and change in regulations, including in the energy law, coupled with falling prices in the second half of the year, limited the growth of the grey market compared with the previous years, with official diesel oil consumption at 11,288 thousand tonnes, down 0.4% year on year. The real market for diesel oil is determined by the constantly growing number of vehicles running on diesel oil (by 7% per annum on average) and continued increase in transport activity. It is estimated that diesel oil consumption is similar to that recorded in 2011, when there were approximately 1.5m diesel oil-fuelled vehicles less on the market.

Gasoline sales on the Polish market in 2014 followed the trends prevailing in other parts of Europe and continued to fall. The demand for gasoline in 2014 dropped by 1.7%, to 3,665 thousand tonnes. Weaker demand is mainly attributable to improved effectiveness of the vehicle fleet and the growing attractiveness of alternative air transport. The economic conditions, including reduced unemployment and falling fuel prices recorded in the

⁵European Automobile Manufacturers' Association, www.acea.be

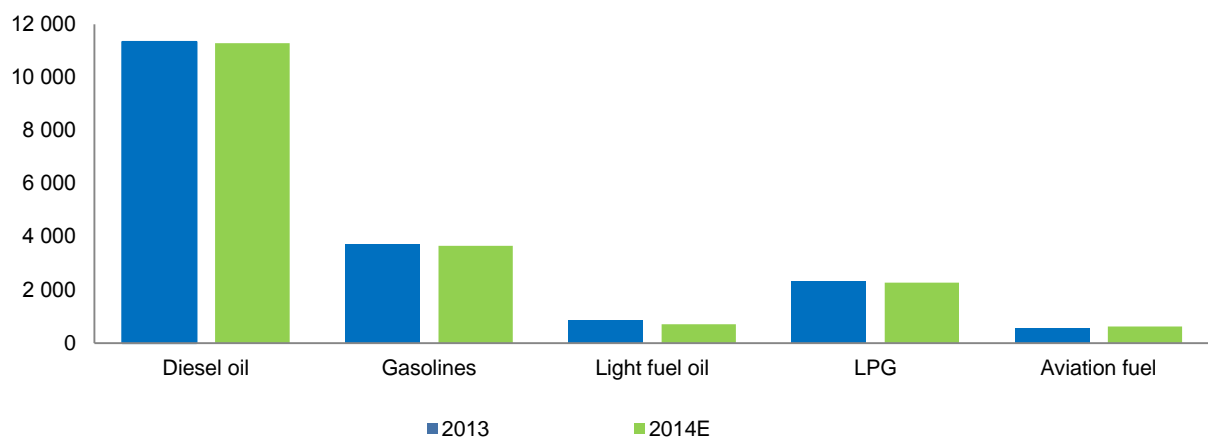
second half of the year, contributed to the fact that the decline in demand for gasoline was not as severe as in 2013.

The consumption of LPG, which serves as a substitute of gasoline, dropped in 2014 by 2%, to 2,277 thousand tonnes. The LPG market in Poland may be recognised as mature, with consumption at approximately 2,200 thousand tonnes in the last five years.

Demand for light fuel oil in 2014 continued to fall, and contracted by 15.6%, to 712 thousand tonnes. This market segment was affected by increased interest in alternative heating fuels and higher average temperatures in the heating season.

The fastest growing market was the aviation fuel market. Consumption of aviation fuel in 2014 rose 15.1%. Thanks to the growing number of airline services, expansion of new airlines and consistent increase in the number of passengers, the market is viewed as highly prospective and is expected to grow in the years to come.

Figure 9. Consumption of fuels in Poland ('000 tonnes)

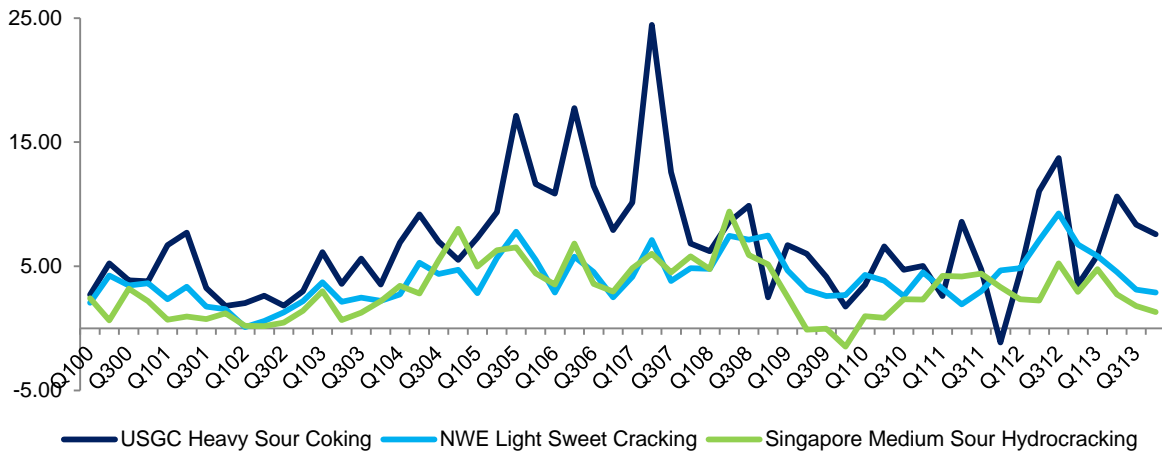


Source: In-house analysis based on Polish Organisation of Oil Industry and Trade (POPiHN) data.

2.4.2. 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 a number of 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.

Figure 10. 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.

Figure 11. Global fuel consumption and production

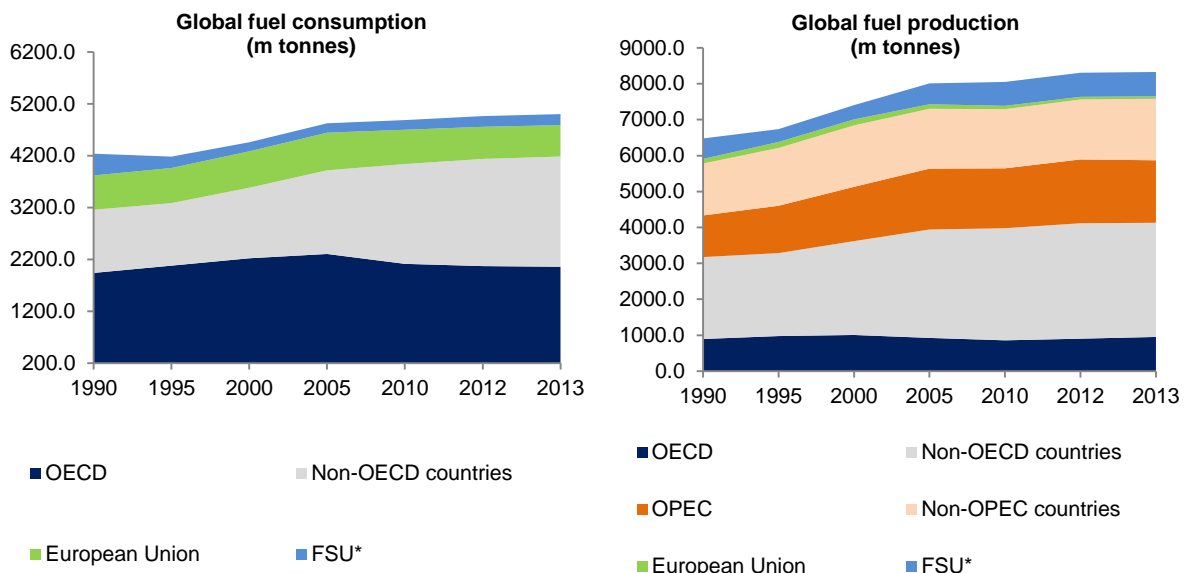
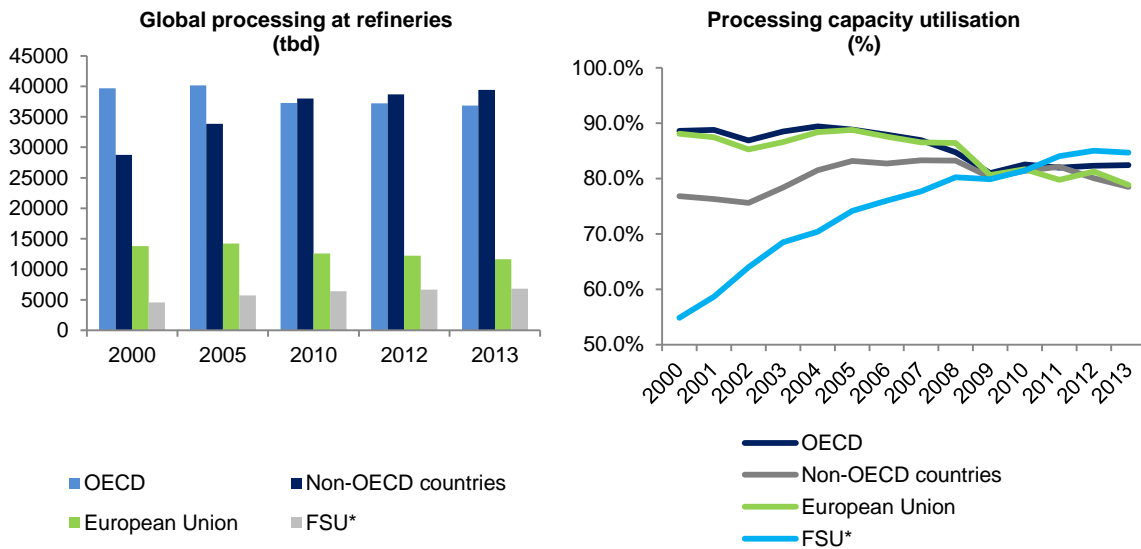


Figure 12. Global throughput and refining capacities



Source: In-house analysis based on BP data.

* FSU – Former Soviet Union.

Since 2009, several refineries with a combined processing capacity of 3.7 mbd have been shut down in the Atlantic area. However, this scaling back still seems to be insufficient, as many European refineries generate small returns, and their processing capacities are relatively low.

Small refineries with 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 8. Refinery shutdowns in Europe in 2009–2015

Year of shutdown	Refinery	Nelson Complexity Index	Capacity (tbd)	Owner	Domestic sales
2015	Collombey	N/A	72	Tamoil	Switzerland
2015	Gela	13.1	105	Eni	Italy
2014	Milford Haven	7.0	135	Murphy Oil	United Kingdom
2014	Stanlow	8.2	55	Essar Energy	United Kingdom
2014	Mantova	8.4	57	Eni	Italy
2014	Paramo	N/A	20	Unipetrol	Czech Republic
2013	Harburg	9.6	90	Shell	Germany
2013	Porto Marghera	6.8	80	Eni	Italy
2012	Coryton	12.0	172	Petroplus	United Kingdom
2012	Fawley	9.1	80	ExxonMobil	United Kingdom
2012	Kherson	3.1	138	Alliance Oil Co.	Ukraine
2012	Drogobich	3.0	78	Ukraine Oil Co.	Ukraine
2012	Petit Couronne	7.3	154	Petroplus	France
2012	Berre l'Etang	6.7	105	LyondellBasel	France
2012	Roma	7.7	85	Total ERG	Italy
2011	Arpechim	7.3	70	Petrom	Romania
2011	Petrobrazzi	7.3	6	Petrom	Romania
2011	Gonfreville	N/A	94	Total SA	France
2011	Cremona	7.5	94	Tamoil Raffnazione SPA	Italy
2011	Reichstett	5.3	85	Petroplus	France
2010	Teesside	N/A	117	Petroplus	United Kingdom
2010	Dunkirk	6.1	140	Total	France
2010	Odessa	3.9	56	LUKOIL	Ukraine
2010	Wilhelmshaven	5.0	260	Hestya Energy	Germany
2009	Antwerp	4.5	21	Petroplus	Belgium

Source: In-house analysis based on JBC data.

* Nelson Complexity Index – crude oil processing complexity ratio. It reflects the intensity of investments in the refinery, potential fixed costs, and the refinery's potential to generate value added.

2.4.3. CRUDE OIL PRICING FACTORS

The main drivers of market prices of crude oil include: (i) global and regional changes in supply and demand, expected level of future supply of and demand for oil and gas, as well as OPEC members' and other oil-producing states' capacity to achieve and maintain a given level of production and prices, (ii) uncertain geopolitical situation, actual or threatened terrorist activities or war potentially affecting supply and transport of, or demand for, hydrocarbons and petroleum products, (iii) availability and cost of construction or use of pipelines, tankers and other handling and processing infrastructure, (iv) new, existing and decommissioned refinery processing capacities and the rate of their utilisation, (v) price and availability of, and government subsidies for, alternative energy sources and new technologies, (vi) political, economic and military developments in oil-producing regions, in particular in the Middle East, Russia, Africa, Central and South America, as well as national and foreign regulations and activities of public authorities, including restrictions on imports and exports, taxes, repatriation and

nationalisation processes, (vii) global and regional economic conditions, (viii) trading activities of market participants and other entities seeking to secure access to oil and gas or hedge against trade risks, or engaging in such activities as part of their investment portfolio management, and (ix) weather conditions and natural disasters.

Figure 13. Crude oil pricing factors

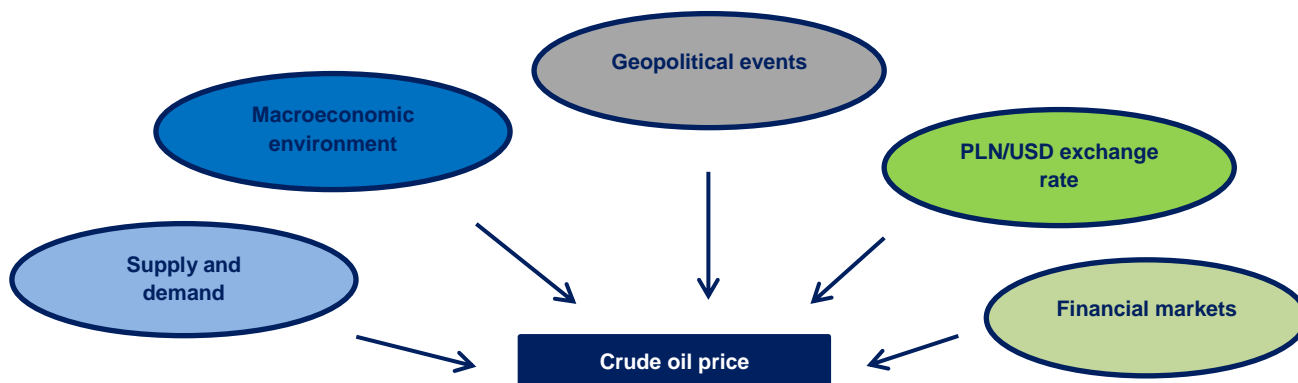
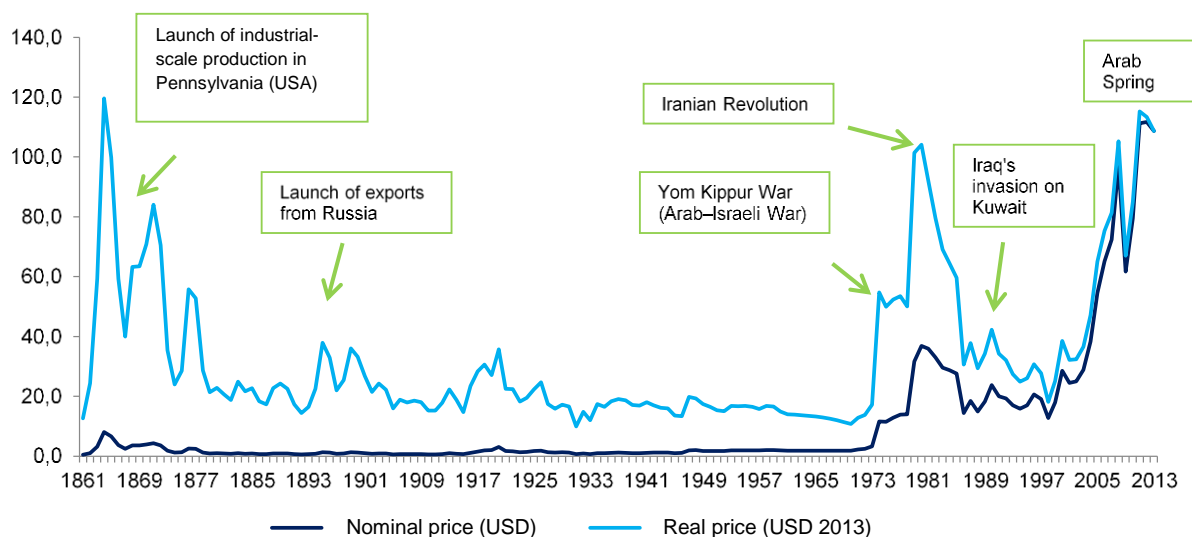


Figure 14. Oil price in 1861–2014



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 9. 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

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.

Figure 15. Urals-Brent differential

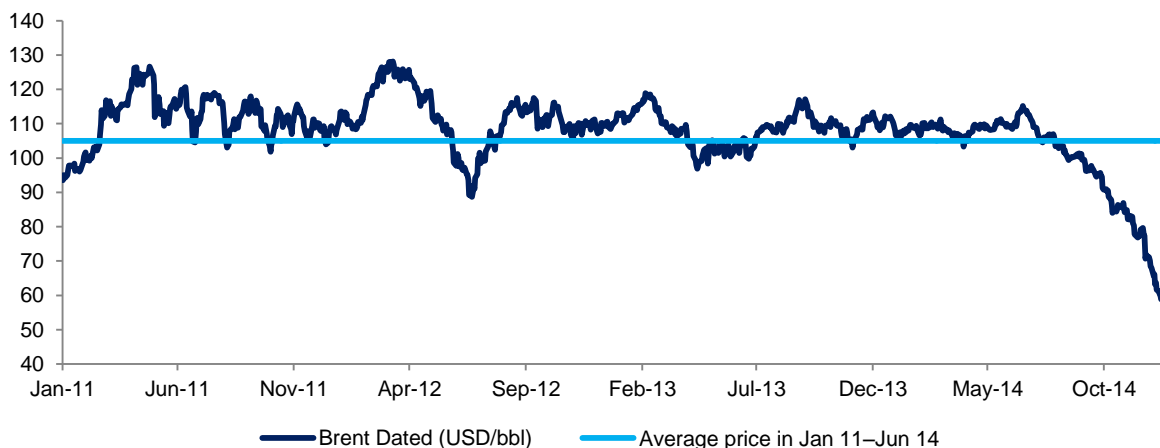


Source: In-house analysis based on Thomson Reuters data.

2.4.4. REFINING INDUSTRY IN 2014 – OVERVIEW

H2 2014 saw a plunge in oil prices: in the second half of the year they fell sharply, marking an end to an almost four-year period of high and stable prices which continued from 2011.

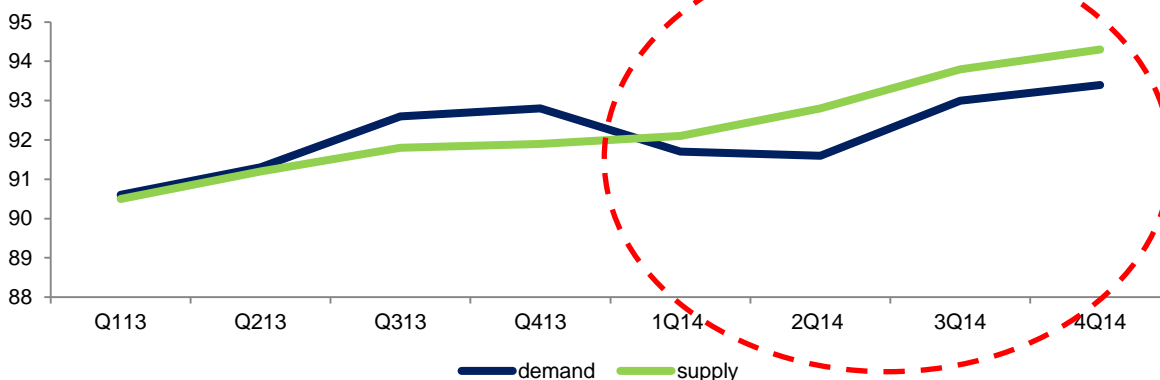
Figure 16. Oil prices in 2011–2014 (USD/bbl)



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

The price decline was chiefly driven by the structural oversupply of oil in the market (according to the International Energy Agency, the oversupply reached about 0.7m boe/d, i.e. 0.7%-0.8% of global demand), increased geopolitical risk, OPEC's abandonment of the policy of balancing global oil demand and supply, and appreciation of the US dollar.

Figure 17. Global demand and supply (million barrels per day)

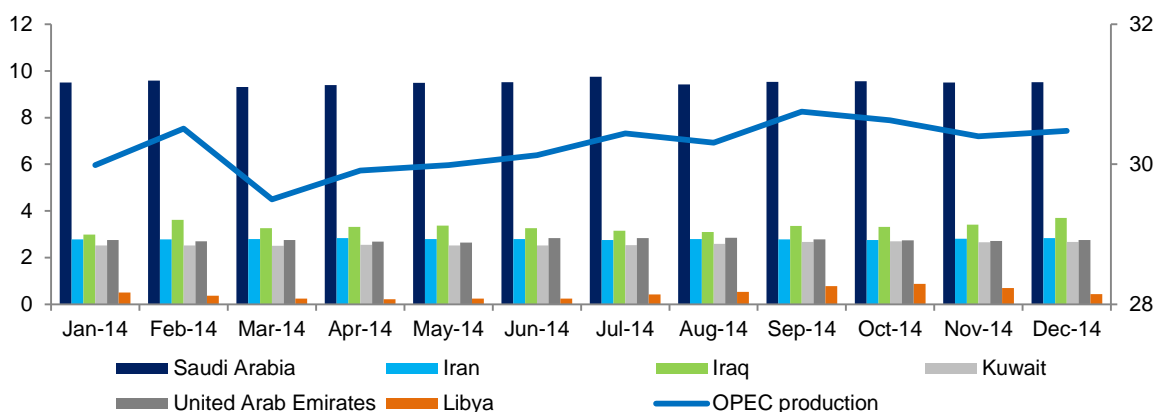


Source: In-house analysis based on International Energy Agency data, www.iea.org.

As major producers in the global oil market, OPEC countries used their spare production capacities to adjust the supply of crude and stabilise its price in the desired price range (100–110 USD/bbl in 2011–2014). Thus far methodical in its interventions, on November 27th the OPEC made a sudden face-about and decided to protect their market share by maintaining their production at 30 million barrels per day. Libya, despite its internal conflict, increased its output in the third quarter of 2014 by 0.5 million barrels per day, or 0.5% of global oil production. In Iraq, despite the activity of ISIS, oil production in 2014 was not disturbed and remained steady at 3.3 million barrels per day, the highest level since 1979 (when it stood at 3.5m bbl/d). OPEC's share in global oil supply contracted, which was partly attributable to higher oil production from unconventional deposits in the United

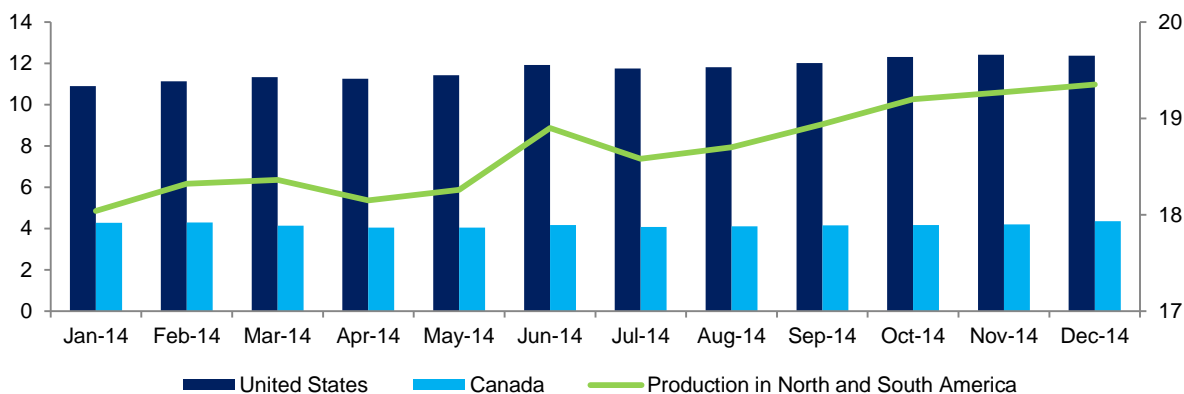
States and production of biofuels. In 2014, US output of shale oil rose by 0.9 million barrels per day (ca. 1% of global oil supply).

Figure 18. Oil output by the largest OPEC producers in 2014 (million barrels per day)



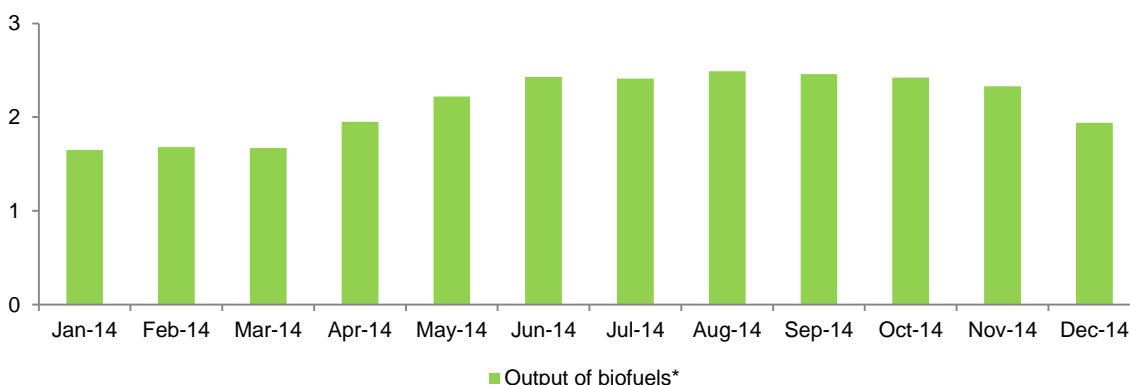
Source: In-house analysis based on International Energy Agency data, www.iea.org.

Figure 19. Oil output by the United States and Canada in 2014 (million barrels per day)



Source: In-house analysis based on International Energy Agency data, www.iea.org.

Figure 20. Global output of biofuels in 2014 (million barrels per day)



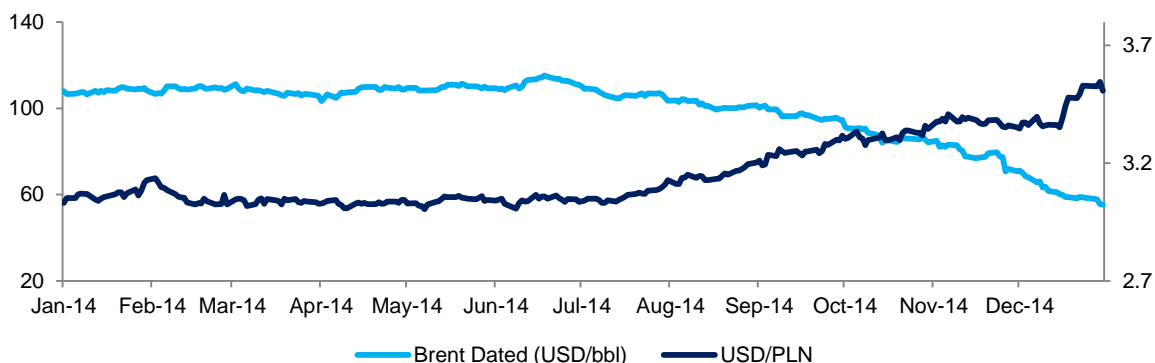
Source: In-house analysis based on International Energy Agency data, www.iea.org.

* Biofuels output – total global production of biofuels, including ethanol from the US and Brazil.

Despite concerns related to the geopolitical risk, the markets were surprised by a series of oil supply increases, especially in the United States, while demand for oil fell, partly reflecting weaker growth in the global economy. Oil price decline coincided with the strengthening of the US currency.

In the second half of 2014, the US dollar appreciated by 10% relative to other major currencies. Typically, appreciation of the US currency (which is the currency of international commodity transactions) is negatively correlated with the price of crude oil since demand may weaken in those countries which experience erosion of the purchasing power of their currencies.

Figure 21. USD/PLN exchange rate vs. crude oil price



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

In the second half of 2014, it became evident that the conflicts in the Middle East and Eastern Europe had no significant effect on the supply of crude oil. The sanctions imposed on Russia after June 2014 as a consequence of the Russian-Ukrainian conflict had marginal impact on the European crude oil market.

Between 1984 and 2013, there were five episodes when oil price plunged by 30% or more over a period of six months, all coinciding with major changes in the global economy and in the crude oil market:

- 1985–1986: growth of supply and changes in OPEC's policy,
- 1990–1991 and 2001: recession in the United States,
- 1997–1998: Asian financial crisis,
- 2007–2009: global financial crisis.

The price decline seen in 2014 is similar to the 1985/1986 oil price slump in two major aspects. The first is related to the emergence of new sources of oil (nowadays these are unconventional hydrocarbon reserves such as oil sands or shale oil, but also biofuels; in the 80s the new sources were oil production in Alaska, in the North Sea and in the Gulf of Mexico). The second aspect is that both oil price declines were accompanied by OPEC's discontinuation of the supply management policy. Saudi Arabia changed its policy in December 1985 in order to increase its market share, as a consequence of which oil price dropped by 61%, from 24.68 USD/bbl to 9.62 USD/bbl between January and July 1986. After this episode, oil prices remained low for over 15 years.

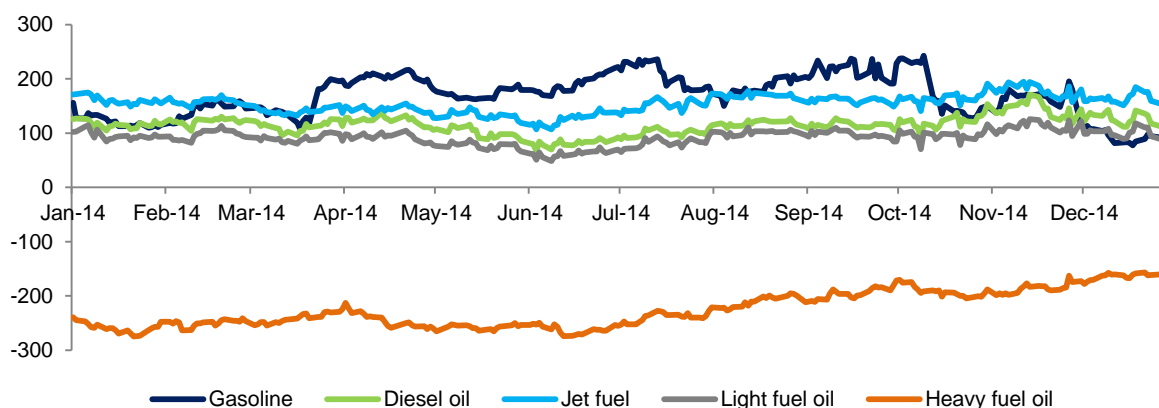
The first half of 2014 was characterised by a continued negative trend in refining margins seen across the world. In the second half of 2014, however, refining margins improved (as a result of the oil price decline). The processing capacity utilisation rate in the fuel sector remained high, as there were few maintenance shutdowns.

The crack margins on petroleum products were as follows:

- Gasoline – low: 77.16 USD/t (December 18th 2014), high: 242.86 USD/t (October 10th 2014) – annual change: -68.26% or -165.70 USD/t,

- Diesel oil – low: 67.29 USD/t (June 4th 2014), high: 171.33 USD/t (November 14th 2014); annual change: +6.31%, or +7.94 USD/t,
- JET fuel – low: 106.79 USD/t (June 4th 2014), high: 194.97 USD/t (November 12th 2014); annual change: +82.57%, or +88.18 USD/t,
- Light fuel oil – low: 48.79 USD/t (June 9th 2014), high: 125.83 USD/t (November 14th 2014); annual change: +142.11%, or +72.18 USD/t,
- Heavy fuel oil – low: -274.92 USD/t (January 22nd 2014), high: -152.82 USD/t (December 30th 2014); annual change: +43.12%, or +78.92 USD/t.

Figure 22. 2014 crack margins (USD/t)



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

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

The Group's plant with the annual processing capacity of approximately 10.5m tonnes of crude oil is one of the most advanced and youngest refineries in Europe. This has been confirmed by a number of distinctions: the World Refining Association named it the CEE Refinery of the Year in 2008, and in the Solomon Associates' ranking comparing the energy efficiency of refineries all over the world it was recognised as the most energy efficient refinery in Central and Southern Europe in 2012. Moreover, in 2013 the Company won the award of the World Refining Association for "outstanding contribution to the industry", leaving behind numerous competitors, including PKN Orlen, Lukoil, INA and Unipetrol. The criteria included performance, growth and market reputation.

To a large extent, the refinery owes its technological advancement to the Group's 10+ Programme completed in 2011, the largest industrial investment project of the last decade in Poland in terms of capital expenditure (EUR 1.43bn). The upgrade and extension of the refinery under the 10+ Programme resulted in increased yields of high-margin products per barrel of crude processed (including an increase in annual yield of fuels from 4m tonnes to 7.8m tonnes) relative to peers in the region, and enabled Grupa LOTOS S.A. to process more technologically demanding types of crude.

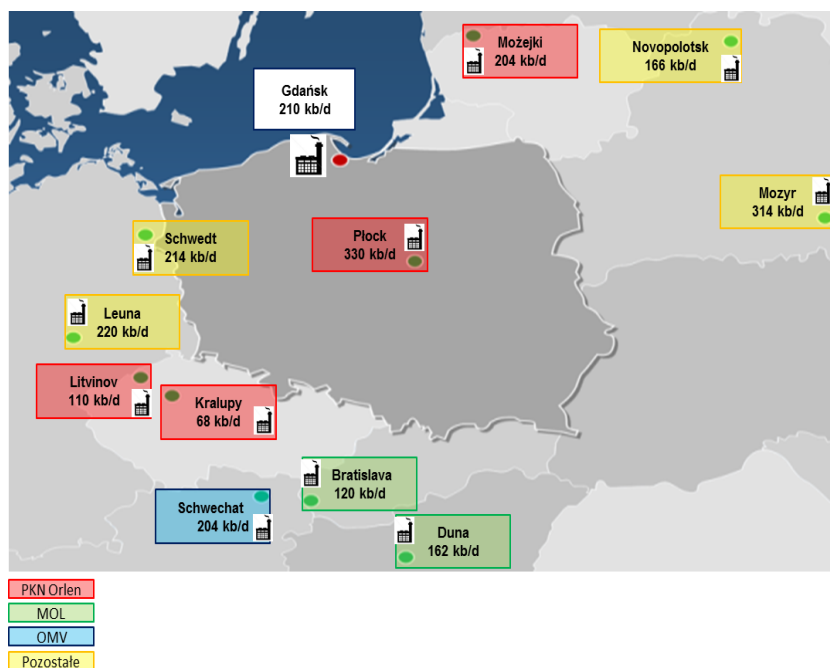
The very good technological condition of the refinery is further confirmed by its Nelson Complexity Index (crude oil processing complexity ratio). Based on the Company's estimates, it is the highest in Poland and among the highest in Europe. The ratio reflects the intensity of investments in the refinery, potential fixed costs, and the refinery's potential to generate value added. The Nelson Complexity Index for the Gdańsk refinery is 10. A rating of 10 or more is reported only for highly technologically advanced facilities, including the Slovnaft refinery in Bratislava, Slovakia (11.5), and the MOL refinery in Duna, Hungary (10.6). To compare, based on the PKN Orlen Strategy for 2014–2017 dated July 23rd 2014, PKN Orlen has the Nelson Complexity Index of 9.5.

The Gdańsk refinery also records a high distillate rate (due to a large share of fuels in the product mix) and focuses on medium distillates, which enables the Company to successfully adjust its output to the domestic demand structure and exports opportunities. The technological configuration of the refinery combined with its favourable location enable it to flexibly process various types of crude, and thus vary the production volumes for particular finished product groups in line with changes in the domestic demand structure and export opportunities.

The refinery's location is a source of major competitive advantage in the region in terms of logistics (access to feedstock and product sales channels). The location close to the handling terminal gives the Company direct access to international markets, enabling it to export its petroleum products primarily to Scandinavia, north-western Europe and Baltic states. It also supports optimisation of sales channels and efficient purchases of various types of crude oil.

The refinery also benefits from a unique combination of supply channels, guaranteeing it simultaneous access to feedstock supplies by road (from Russia) and via PERN's pipeline network, as well as by sea, from numerous countries and the Group's own fields. With access to two supply channels, the Company is able to use different supply sources and respond flexibly to changes in petroleum product and crude oil prices, and can effectively diversify the types of crude processed at the refinery without being limited to the Russian REBCO, which also has the effect of increasing its price negotiation power in respect of Russian oil.

Figure 23. Grupa LOTOS 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 of **model refining margin** confirms the high efficiency of the technological configuration of the Grupa LOTOS S.A.'s 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 – its value is determined as the sum of Dtd Brent price and the Urals vs. Brent spread.

Further information on the model refining margin is available at:

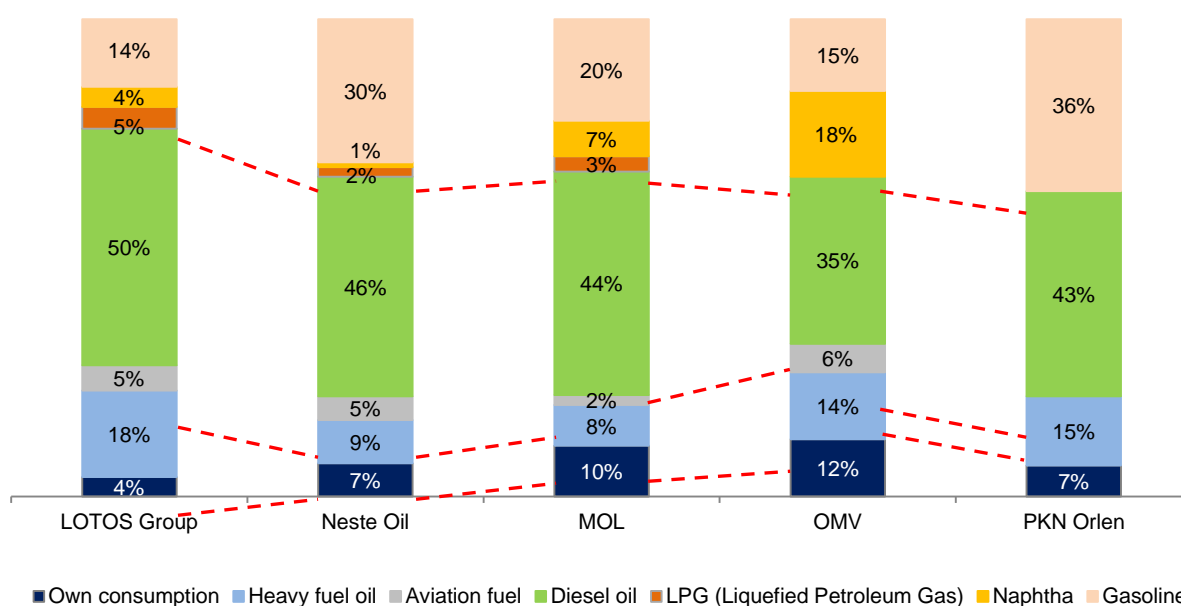
http://inwestor.lotos.pl/1439/strefa_inwestora/modelowa_marza_rafineryjna

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).

The chart below presents differences between the product slates of refineries operating in Central Europe.

Figure 24. Yield structure of refineries operated by local competitors of Grupa LOTOS



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

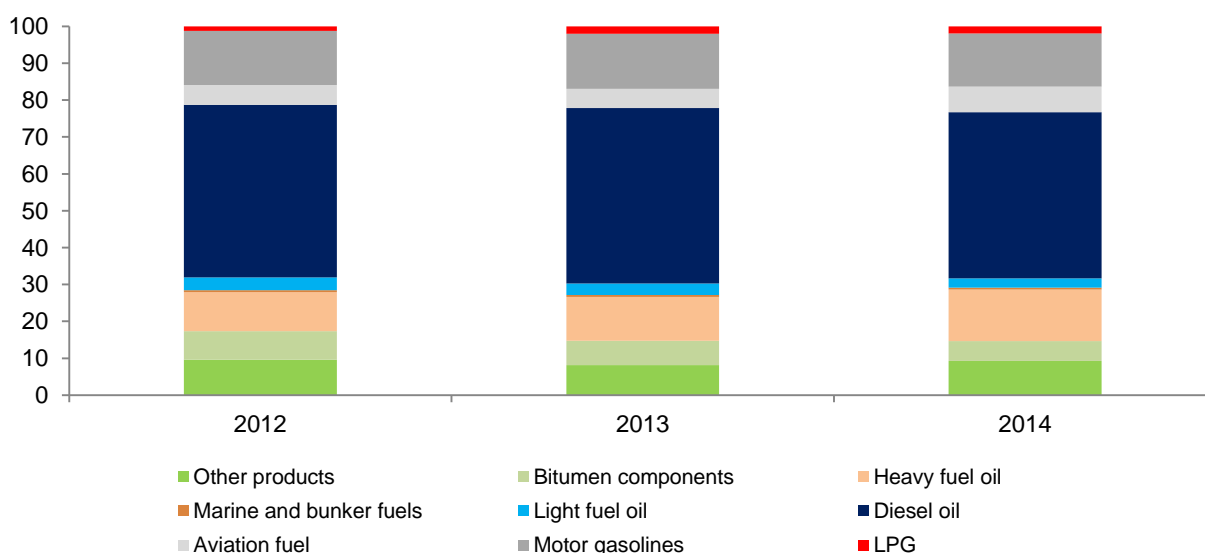
Crude processing and product slate

As in previous years, the **main type of crude processed** was Russian **REBCO**, whose share in the total volume was close to 92.5% and was higher than in previous years. The increase was largely attributable to the Urals/Brent differential remaining at favourable levels for the most part of 2014.

Crude oil imported by sea, including approx. 180 thousand tonnes of Rozewie crude supplied by LOTOS Petrobaltic, accounted for the balance of the crude feed. The choice of crudes for processing was motivated by the production optimisation process, aimed at taking advantage of opportunities for increasing the refinery's processing margins.

The structure of finished goods was driven by pricing levels on the market and demand for individual products. Production of aviation fuel, a product whose prices were particularly favourable in 2014, increased visibly relative to previous years, while less bitumen was manufactured due to declining domestic demand. As a result, the refinery had to sell most of its heavy fuel oil stocks.

Figure 26. Finished goods (%)



2.5. KEY PRODUCTS, MERCHANDISE AND SERVICES



The key groups of products obtained from crude oil processing at the refinery are:

- Fuels (unleaded gasoline, diesel oil and light fuel oil),
- Heavy fuel oil,
- Bitumens,
- Aviation fuel,

- Naphtha,
- Propane-butane LPG,
- Base oils.

Fuels

Unleaded gasoline is used in spark-ignition engines. The Company's unleaded gasolines include premium gasoline – LOTOS DYNAMIC 98, containing antioxidants and washing additives which support better cleaning of the engine, lengthen its useful life and economise fuel consumption. The fuel is dedicated solely to LOTOS service stations.

Diesel oil is used in compression-ignition engines. This product group includes premium diesel oil – LOTOS DYNAMIC DIESEL, which owing to the use of friction-reducing components offers more power efficiency of the engine and guarantees start-up at -32°C. The fuel is dedicated solely to LOTOS service stations. Diesel oil has the largest share in sales on the Polish fuel wholesale market.

Light fuel oil is designed for use in heating equipment. With a low sulfur content and unique additives, the product shows great performance in terms of oxidation resistance, anti-corrosive action, maintaining cleanness of nozzles, and reduction of emissions of noxious combustion products.

Heavy fuel oil

Heavy fuel oil may be used for three purposes: as fuel for power generation, bunker fuel, and feedstock for further processing, including in coking units.

Bitumens

In the bitumens product group, the key product is road bitumen used in construction and maintenance of roads, airports and other hard surfaces. Apart from the road construction industry, bitumens are also used in the manufacturing of construction materials with waterproofing properties (bitumen roofing papers, bitumen roof shingles, adhesives), with industrial bitumens being the most popular component.

Aviation fuel

Aviation fuel is designed for use in jet engines.

Naphtha

Naphtha is used as a raw material in the petrochemical industry and in production of motor gasolines. The entire naphtha output is exported.

Propane-butane LPG

Propane-butane LPG may be used as a fuel for engines equipped with an LPG system, as a fuel for heating equipment, gas tanks and as a feedstock for petrochemical processes.

Base oils

The key products include the so called Group I base oils, which are used as feedstock for production of lubricant oils, including motor and industrial oils.

The primary motor oil product lines include: (i) LOTOS Quazar – premium synthetic oils for cars (distributed only in authorised service centres), (ii) LOTOS Thermal Control – mineral, semisynthetic and synthetic oils dedicated for cars, and (iii) LOTOS Turdus – mineral, semisynthetic and synthetic oils dedicated for HGVs.

The key product lines of industrial oils are Hydromil, Transmil and Remiz, which make up a full category of hydraulic, turbine and machine oils, as well as industrial lubricants.

Other major 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.
- Xylene fraction is a product launched in 2012, obtained through reformat 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.

Table 10. Grupa LOTOS S.A.'s revenue by products, merchandise and services

	in the period Jan 1–Dec 31 2014		in the period Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Gasolines	4,557,091	17.4%	4,927,995	18.5%
Naphtha	750,974	2.9%	824,241	3.1%
Reformate	28,689	0.1%	-	-
Diesel oil	13,163,501	50.2%	13,921,391	52.0%
Light fuel oil	736,883	2.8%	928,000	3.5%
Heavy fuel oil	2,297,781	8.8%	1,962,997	7.4%
Aviation fuel	2,044,246	7.8%	1,467,215	5.5%
Bunker fuel	121,379	0.5%	139,361	0.5%
Bitumen production components	712,311	2.7%	927,697	3.5%
Base oils	712,307	2.7%	610,817	2.3%
Liquid gas	451,071	1.7%	398,124	1.5%
Xylene fraction	302,294	1.2%	277,635	1.0%
Other refinery products, merchandise and materials	230,770	0.9%	189,208	0.7%
Total petroleum products, merchandise and materials	26,109,295	99.5%	26,574,681	99.5%
Other merchandise and materials	8,047	0.0%	9,701	0.0%
Services	125,764	0.5%	125,249	0.5%
Effect of cash flow hedge accounting	(7,992)	0.0%	(12,452)	0.0%
Total	26,243,106	100.0%	26,697,179	100.0%

Table 11. Grupa LOTOS S.A.'s sales volumes by products, merchandise and services

	in the period		in the period		change (2014/2013)
	Jan 1–Dec 31 2014		Jan 1–Dec 31 2013		
	thousand tonnes	% share	thousand tonnes	% share	%
Gasolines	1,523	15.2%	1,515	16.4%	0.5%
Naphtha	286	2.8%	286	3.1%	0.0%
Reformate	13	0.1%	0	0%	0.0%
Diesel oils	4,582	45.6%	4,380	47.3%	4.6%
Bunker fuel	45	0.4%	47	0.5%	-4.3%
Light fuel oil	257	2.6%	293	3.2%	-12.5%
Heavy fuel oil	1,397	13.9%	1,055	11.4%	32.5%
JET A-1 fuel	692	6.9%	451	4.9%	53.5%
Base oils	247	2.5%	221	2.4%	11.9%
Bitumen components	514	5.1%	591	6.4%	-13.1%
LPG	197	2.0%	179	1.9%	10.4%
Other	289	2.9%	237	2.6%	22.2%
Total petroleum products, merchandise and materials	10,041	100%	9,254	100%	8.5%

In 2014, Grupa LOTOS sold 10,041 thousand tonnes of its products, up 8.5% year on year, recording a similar level of sales as in 2012. The most significant increase was posted in the case of heavy fuel oil (32.5%), diesel oil (4.6%) and JET fuel (53.5%). A considerable drop in sales was seen in light fuel oil (-12.5%) and bitumen components (-13.1%), which was directly attributable to weaker domestic demand for the products.

Like in the previous years, in 2014 diesel oil had the largest share in the total sales volume. In 2014, the sales volume of diesel oil was 4,582 thousand tonnes, accounting for 45.6% of total sales. The second largest item in the structure of the Company's sales were gasolines, whose share in total sales volume was 15.2%. The sales volume of gasolines in 2014 was 1,523 thousand tonnes, having grown year on year by 0.5%. The last item with a more than 10% share in the Company's total sales volume was heavy fuel oil, whose share in total sales was 13.9%. The volume of sales in this product group was 1,397 thousand tonnes in 2014, 32.5% up on 2013, which was directly attributable to an increase in crude oil throughput and lower demand for bitumens.

Table 12. Grupa LOTOS S.A.'s sales by products and markets

		in the period		in the period		Change 2014/2013
		Jan 1–Dec 31 2014		Jan 1–Dec 31 2013		
		thousand tonnes	% share	thousand tonnes	% share	%
Domestic sales	Gasolines	1,099	10.9%	975	10.5%	12.8%
	Diesel oils	3,856	38.4%	3,959	42.8%	-2.6%
	Bunker fuel	45	0.5%	47	0.5%	-4.3%
	Light fuel oil	257	2.6%	293	3.2%	-12.5%
	Heavy fuel oil	22	0.2%	38	0.4%	-42.6%
	JET A-1 fuel	160	1.6%	84	0.9%	90.3%
	Lubricants	0	0.0%	0	0.0%	0.0%
	Base oils	149	1.5%	146	1.6%	2.0%
	Bitumen components	514	5.1%	591	6.4%	-13.1%

	in the period		in the period		Change
	Jan 1–Dec 31 2014		Jan 1–Dec 31 2013		2014/2013
	thousand tonnes	% share	thousand tonnes	% share	%
LPG	158	1.6%	156	1.7%	1.5%
Other	202	2.0%	158	1.7%	28.4%
Total domestic sales	6,462	64,4%	6,448	69,7%	0.2%
Export sales					
Gasolines	424	4.2%	540	5.8%	-21.6%
Naphtha	285	2.8%	286	3.1%	-0.1%
Reformate	13	0.1%	0	0.0%	0%
Diesel oils	726	7.2%	421	4.5%	72.6%
Bunker fuel	0	0.0%	0	0.0%	0.0%
Heavy fuel oil	1,375	13.7%	1,016	11.0%	35.3%
JET A-1 fuel	532	5.3%	366	4.0%	45.1%
Base oils	98	1.0%	75	0.8%	31.3%
LPG	39	0.4%	23	0.2%	71.4%
Other	87	0.9%	79	0.9%	9.9%
Total export sales	3,579	35,6%	2,806	30,3%	27.5%
Total	10,041	100%	9,254	100.0%	8.5%

In 2014, Grupa LOTOS S.A.'s sales volumes grew by 787 thousand tonnes (up 8.5% year on year). The increase was recorded both in domestic sales (0.2%) and exports (27.5%).

Stronger domestic sales resulted mainly from improved retail sale and wholesale of gasolines (up 12.8%, to 1,099 thousand tonnes) as well as growth in aviation fuel sales (almost two-fold increase, to 160 thousand tonnes), primarily through direct sale to customers at airports. Lower sales were posted in the case of diesel oil (down 2.6%, to 3,856 thousand tonnes) and light fuel oil (down 12.5%, to 257 thousand tonnes), which was related to such factors as weaker registered demand for the products. The decline in domestic diesel oil sales stemmed both from the grey market (whose size in 2014 is estimated at 20% of total diesel oil consumption in Poland), as well as changes in the purchasing preferences of the Company's key customers (growing demand for gasolines, falling demand for diesel oil).

The year-on year growth in exports was driven by the continued high level of refining margins in 2014, which was conducive to maximising production, and the base effect – in 2013 exports were strongly affected by a maintenance shutdown. Grupa LOTOS S.A. recorded an increase in export sales of diesel oil (up 72.6%, to 726 thousand tonnes), heavy fuel oil (up 35.3%, to 1,375 thousand tonnes), and aviation fuel (up 45.1%, to 532 thousand tonnes). The increased export volumes were associated with production optimisation as supply was adapted to match the refining margins and the domestic market's poor absorption capacity.

Table 13. Grupa LOTOS S.A.'s net revenue by markets

	in the period		in the period	
	Jan 1–Dec 31 2014		Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Domestic sales:	17,832,184	67.9%	19,264,209	72.2%
- <i>products and services</i>	17,466,243	66.5%	18,033,031	67.6%
- <i>merchandise and materials</i>	365,941	1.4%	1,231,178	4.6%
Export sales:	8,410,922	32.1%	7,432,970	27.8%
- <i>products and services</i>	8,334,450	31.8%	7,432,747	27.8%
- <i>merchandise and materials</i>	76,472	0.3%	223	0.0%
Total	26,243,106	100.0%	26,697,179	100.0%

Grupa LOTOS S.A.'s key customers

In 2014, Grupa LOTOS S.A.'s largest customer whose share in the Company's total revenue exceeded 10% was LOTOS Paliwa Sp. z o.o. (wholly owned by Grupa LOTOS S.A.), with a share of 37.54%. Other major customers with a more than 10% share in total sales in 2014 included Statoil Group and Shell Group companies (14.08% and 13.60%, respectively).

In 2013, Grupa LOTOS S.A.'s largest customers with a more than 10% per share in total revenue were LOTOS Paliwa Sp. z o.o. (41.24%) and Shell Group companies (11.66%).

To the best of the Company's knowledge, as at the date of release of this Directors' Report there were no formal links between Grupa LOTOS S.A. and the Statoil and Shell Group companies, except for trade contracts.

Trading and optimisation

Crude oil supply

In 2014, Grupa LOTOS S.A. purchased 9.43m tonnes of crude oil, 93% of which was Russian 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.

Petroleum product exports

In 2014, Grupa LOTOS S.A. exported 3,579 thousand tonnes of petroleum products worth PLN 8,411 thousand, up 27% year on year. The increase was chiefly attributable to the base effect, as exports in 2013 had been limited owing to a maintenance shutdown. Revenue from export sales improved by 12% year on year, mainly on the back of lower petroleum product prices and exchange rates.

The largest buyers of exported petroleum products were international trading companies, such as Mercuria Energy Trading and the Vitol Group, and integrated fuel companies from northern and western Europe, including Statoil ASA, Neste Oil, BP Oil and Shell.

In 2014, the markets for Grupa LOTOS S.A.'s exports were as follows:

- Naphtha – integrated fuel and petrochemical companies in Germany, and the Amsterdam-Rotterdam-Antwerp (ARA) oil hub,
- Motor gasolines – the Amsterdam-Rotterdam-Antwerp (ARA) oil hub and Sweden,

- Aviation fuel – Scandinavian and Baltic Sea countries, and the Czech Republic, where the products were transported by land,
- Diesel oil – Germany, United Kingdom and France,
- Heavy fuel oil – storage depots of global trading companies in Estonia, Denmark and the Netherlands (for further sale outside of Europe).

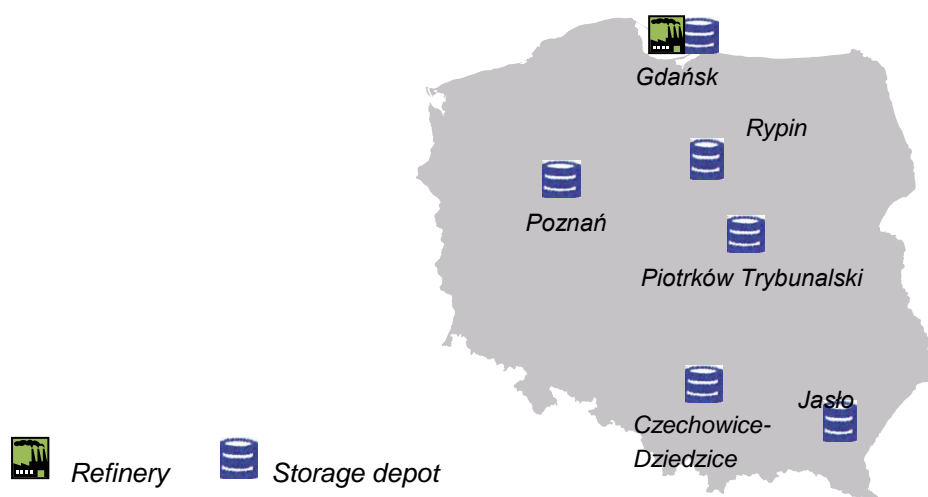
The vast majority of exported products were transported by sea, mostly under CIF (Cost, Insurance and Freight (named port of destination)) INCOTERMS 2000, through PPPP Naftoport's liquid fuel handling terminal.

Optimisation of processing and marketing operations

Decisions on crude oil purchases and product sales (in Poland or on foreign markets) are a part of the integrated margin optimisation process. The volumes and structure of processed oil types and the resulting volumes and structure of exported products depend on optimisation decisions made on an ongoing basis and reflecting the current market conditions.

2.6. LOGISTICS

Figure 27. Location of the LOTOS Group's refinery and storage depots



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 LOTOS Group in 2014 was the launch of the fuel depot in Poznań after 12 months of upgrade work, and the introduction of self-service fuel collection at all fuel depots of Grupa LOTOS S.A.
The structure of mandatory stocks was optimised to ensure minimum cost of their maintenance, with revenue from the provision of stock ticket service, based on the Company's crude oil processing capacities, taken into account.
- A comprehensive LPG delivery system was developed in 2015 as part of preparations for retail and semi-wholesale sales of LPG by Grupa LOTOS S.A.

- Efforts were being made to secure financing 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 S.A.'s own wharf.
- **Freight transport by sea** is a vital element of the LOTOS Group's logistics chain. The Company enjoys considerable advantages thanks 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. 2014 was yet another record year for Grupa LOTOS S.A. 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 Company's history exceeded 370.
- **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 handle 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 assume the responsibility for transport in sea freight shipment operations, seeking 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 Company to reduce the frequency of ship detention and optimise the related costs.

Table 14. Grupa LOTOS S.A.'s purchases of raw materials, merchandise and petroleum materials by region

	in the period Jan 1–Dec 31 2014		in the period Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Domestic purchases	2 453 967	10.4%	3 451 288	13.6%
Foreign purchases	21 051 645	89.6%	22 014 500	86.4%
Total purchases	23 505 612	100.0%	25 465 788	100.0%

Table 15. Grupa LOTOS S.A.'s structure of purchases

	in the period Jan 1–Dec 31 2014		in the period Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Raw materials	23,272,743	93.0%	24,195,297	89.5%
Merchandise	350,388	1.4%	1,267,588	4.7%
Services	1,207,241	4.8%	1,148,828	4.3%
Materials	71,359	0.3%	239,237	0.9%
Other purchases*	126,274	0.5%	173,483	0.6%
Total	25,028,004	100.0%	27,024,433	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 16. Grupa LOTOS S.A.'s structure of purchases – petroleum products for resale

	in the period Jan 1–Dec 31 2014		in the period Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Diesel oils	63,259	18.0%	751,410	59.3%
Gasolines	270,680	77.3%	516,178	40.7%
Other	16,448	4.7%	-	0.0%
Total	350,388	100.0%	1,267,588	100.0%

Table 17. Grupa LOTOS S.A.'s structure of purchases – raw materials, semi-finished products, chemicals and petroleum materials

	in the period Jan 1–Dec 31 2014		in the period Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Crude oil	20,692,295	89.4%	21,630,970	89.4%
Diesel oil	551	0.0%	400	0.0%
MTBE/ETBE gasoline components	286,581	1.2%	283,190	1.2%
FAME	985,532	4.3%	1,187,569	4.9%
Gasolines	314	0.0%	35,893	0.1%

	in the period		in the period	
	Jan 1–Dec 31 2014		Jan 1–Dec 31 2013	
	PLN '000	% share	PLN '000	% share
Heavy fuel oil	352	0.0%	14,885	0.1%
Ethyl alcohol	152,048	0.7%	130,694	0.5%
Additives	28,061	0.1%	29,381	0.1%
Gasoil	150,330	0.6%	185,405	0.8%
Diesel oil components	95,367	0.4%	-	0.0%
Natural gas	752,725	3.3%	691,259	2.9%
Other	11,069	0.0%	8,554	0.0%
Total	23,155,225	100.0%	24,198,200	100.0%

Grupa LOTOS S.A.'s key suppliers

The key suppliers of Grupa LOTOS S.A. whose supplies accounted for more than 10% of the Company's total revenue in 2014 were: VITOL SA of Switzerland, Rosneft Oil Company of Russia and Tatneft Europe AG of Switzerland. Their shares in Grupa LOTOS S.A.'s purchases were 24.38%, 21.29% and 20.08%, respectively.

In 2013, Grupa LOTOS S.A.'s key suppliers whose supplies exceeded 10% of the Company's total revenue were Mercuria Energy Trading of Switzerland and UK-based Petraco Oil Company Ltd, with a share of 35.18% and 22.05%, respectively, in Grupa LOTOS S.A.'s purchases.

To the best of the Company's knowledge, as at the date of release of this Directors' Report there were no formal links between Grupa LOTOS S.A. and any of the suppliers listed above, except for trade contracts.

2.7. ENVIRONMENTAL PROTECTION

Grupa LOTOS S.A. was the first company in the Gdańsk Province to fulfil one of the new obligations on protection of soil and underground water, imposed on the operators of IPPC installations by the Industrial Emissions Directive (Directive 2010/75/EU of the European Parliament and of the Council of November 14th 2010) and by new Polish legislation – Act of July 21st 2014 amending the Environment Protection Law and certain other acts. The IED Directive and the aforementioned Polish legislation imposed a new requirement that an application for an integrated permit or amendment of an existing integrated permit must be accompanied by a baseline report containing information on contamination of the soil and water environment with hazardous substances. In December 2014, the Company applied for amendment of the integrated permit regulating its operations and submitted a baseline report, as an integral part of the application, to the Marshall Office. As of the effective date of the new requirement, no integrated permit may be issued if the baseline report is not provided. The Company's integrated permit needed to be updated following extension of the infrastructure for unloading rail cars, construction of a Hydrogen Recovery Unit, changes in the types and volumes of emissions from one of the emission sources, and changes in land plot boundaries and numbers caused by new investment projects carried out on the refinery's premises. In January 2015, the Marshall Office issued a decision amending the existing integrated permit.

In 2014, the last boiler in Grupa LOTOS S.A.'s CHP plant was upgraded, which means that now all the CHP plant boilers are adapted to burning natural gas. Thanks to these measures, the Company was able to considerably reduce emissions from its production units and CHP plant and cut carbon emissions, expressed in kg CO₂/CWT (complexity weighted tonne), relative to previous years.

Figure 28. Emissions of main pollutants from Grupa LOTOS S.A.'s CHP plant to the air as percent of permitted values (Mg)

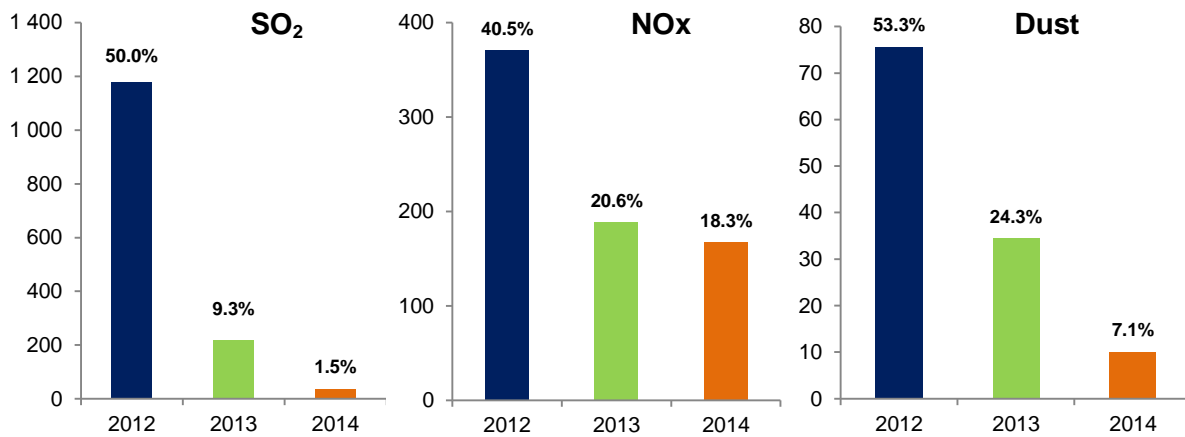


Figure 29. Emissions of main pollutants from Grupa LOTOS S.A.'s refinery units to the air as percent of permitted values

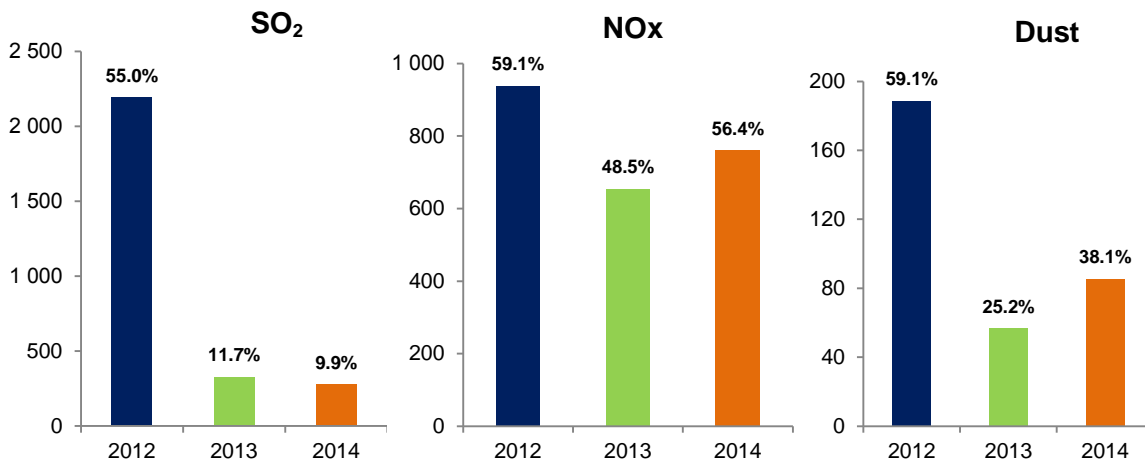
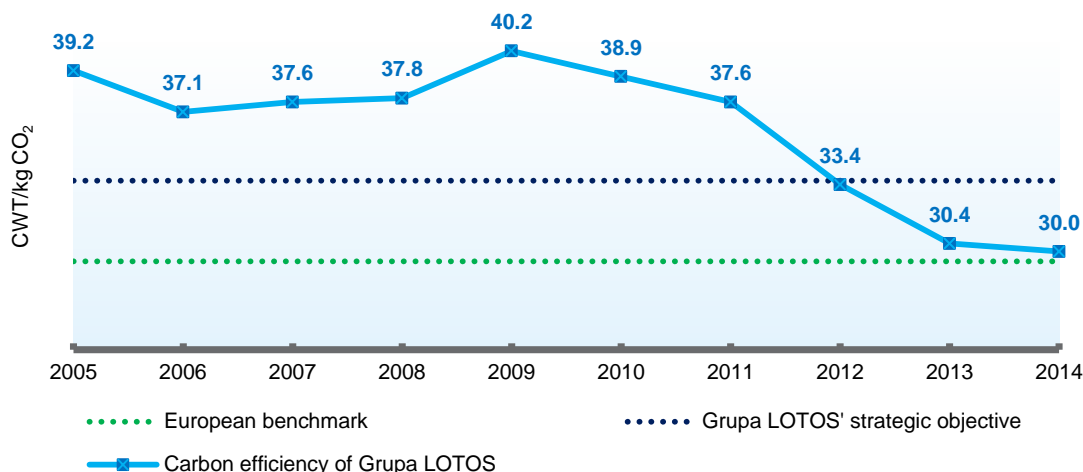


Figure 30. CO₂ emissions from Grupa LOTOS S.A.'s units in 2005–2014 (CWT/kg CO₂)



Grupa LOTOS S.A. voluntarily carried out a comprehensive environmental survey in the areas of its activities and in the areas that may be directly affected by its activities. The survey covered: the refinery (2.5 sq. km.), areas surrounding the refinery (approximately 12.1 sq. km.), and the area of the Company's retention reservoir in Przejazdowo (2.4 sq. km., 2.5 km from the boundaries of the complex). The product of the survey was a report detailing all the identified fungi, lichen, plant and animal species, with a particular focus on species or natural habitats protected by Polish and EU laws. The environmental survey, performed voluntarily and on such a large-scale, was one of the first such projects to be completed in Poland.

2.8. RESEARCH AND DEVELOPMENT

In 2014, research and development activities of the LOTOS Group were focused, inter alia, on the development of the production technology for Group 2 oil bases. In 2014, a number of laboratory research projects were carried out to optimise the production technology for the type 350N oil. A research project was also launched to obtain high-purity organic solvents based on crude oil processing distillates. The above research projects are being continued in 2015.

In 2014, Grupa LOTOS S.A. and a number of other parties entered into an agreement on the HESTOR project. The project was submitted by a research and industry consortium to the GEKON (Generator of Ecological Concepts) programme and was qualified to receive co-financing from the National Centre for Research and Development (NCBiR). The consortium includes Grupa LOTOS S.A. and GAZ SYSTEM S.A. as industry partners as well as AGH University of Science and Technology of Kraków, Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o., the Silesian University of Technology and the Warsaw University of Technology as research partners. The purpose of the HESTOR project is to assess the viability of storing hydrogen generated using renewable energy sources (RES) in salt caverns and its further use for power-generation or industrial process purposes. An important task will be to perform an economic viability analysis of the project.

The project provides for the production of hydrogen through electrolysis of water with the use of surplus electricity generated by wind farms and solar power plants (RES).

Hydrogen produced in that way and stored in salt caverns would be used (thereby enhancing energy efficiency) in:

- Refinery technological processes – reducing the need to produce hydrogen from natural gas, and streamlining and optimising the hydrogen and natural gas management processes;
- Power generation – as a fuel for gas turbines during electricity peak demand times.

As regards road bitumen production technologies, research work was focused on finding new applications for innovative bitumen products and confirming their usefulness in making durable and environmentally friendly bitumen surfaces. In particular, research work covered the following products and their planned applications:

- Rubber-modified bitumens – recommended for low-noise and durable bitumen surfaces;
- Highly-modified bitumens – specialised products dedicated to surfaces with very high fatigue-resistance requirements and very high traffic loads and to the so-called 'long-life' surfaces;
- WMA bitumens – products with a wide scope of applications, including the construction of hot-rolled road surfaces, construction of hot-rolled road surfaces in adverse climate conditions (longer construction work season), construction of road surfaces using bitumen granulate from recycled bitumen surfaces.

In 2014, development work was also carried out on oil products manufactured by LOTOS Oil. The most important lubricant-related R&D activities in 2014 included:

- Development of production technologies for new motor oils for cars, applications for approvals – implementation in the first quarter of 2015,
- Extension of 72 approvals for lubricants,
- Obtaining of 5 approvals for new oils.

2.9. MATERIAL EVENTS IN 2014

Table 18. Material events at the LOTOS Group in 2014

Period	Event
January – February	<ul style="list-style-type: none"> LOTOS – Air BP Polska begins operations at the Katowice Pyrzowice International Airport as a supplier of aviation fuels 'at the wing-tip' The presence of crude oil on the PL 102F licence held by LOTOS Norge is confirmed A newly purchased drilling rig 'LOTOS Petrobaltic' is delivered
March – April	<ul style="list-style-type: none"> Three of the four boilers at Grupa LOTOS S.A.'s CHP plant are fired by natural gas which replaced heavy fuel oil containing sulfur (sulfur and dust emissions from the CHP plant have dropped to close to zero) LOTOS Serwis and the Polish Shipping Register sign a letter of intent providing for collaboration between the two companies
May – June	<ul style="list-style-type: none"> LOTOS Norge and PGNiG Upstream International sign a letter of intent for collaboration in projects on the Norwegian Continental Shelf An agreement on intermodal rail transport services is signed between LOTOS Kolej and PCC Intermodal LOTOS Petrobaltic receives the Minister of the Environment's decision extending the licence for the production of crude oil and associated natural gas from the B3 field by 10 years Fuel distribution operations are launched at Grupa LOTOS S.A.'s upgraded fuel depot in Poznań (located near a A2 motorway junction)
July – August	<ul style="list-style-type: none"> Grupa LOTOS S.A. and AMCS Corporation sign a contract for the construction of a Hydrogen Recovery Unit (HRU); work on the project is scheduled to start in spring 2015 LOTOS Petrobaltic, Polskie Inwestycje Rozwojowe, Bank Gospodarstwa Krajowego and Bank Pekao S.A. sign agreements for the financing of development of the B8 field in the Baltic Sea
September – October	<ul style="list-style-type: none"> LOTOS Petrobaltic signs a contract for the conversion of its drilling rig into a production unit; the consortium of the project's contractors consists of companies controlled by Polska Grupa Zbrojeniowa S.A. (Energomontaż – Północ Gdynia and Stocznia Remontowa NAUTA) and a domestically-owned shipyard, Crist
November – December	<ul style="list-style-type: none"> Successful share offering of Grupa LOTOS bringing nearly PLN 1bn in proceeds to be used to finance investment projects under the 'Efficiency and Growth 2013-2015' programme – the largest public offering on the WSE in 2014 LOTOS service stations join the Large Family Card (Karta Dużej Rodziny) programme

Exploration and production segment

- Intensive work was performed on commencing commercial production from the **B8 field** on the Baltic Sea. B8 Sp. z o.o., Baltic spółka komandytowo-akcyjna, Polskie Inwestycje Rozwojowe S.A., Bank Gospodarstwa Krajowego, and Bank Pekao S.A. entered into a series of project finance agreements related to the financing of the development of the B8 oil field in the Baltic Sea. The Minister of the

Environment issued a decision to transfer the licence for production of crude oil and associated natural gas from the B8 field.

- Work on development of the **B4 and B6 gas fields in partnership with CalEnergy Resources Poland**. The process of selection of the development concept was completed: production wells are to be drilled using the LOTOS Petrobaltic rig. Work was underway on the front-end engineering design of the onshore and offshore installations and on securing onshore transmission capacities.
- Production of crude oil from the **B3 field** was continued. Pursuant to the Ministry of Environment's decision of May 23rd 2014, the term of the licence for crude oil and natural gas production from the B3 field was extended to 32 years starting from the licence issue date, i.e. until July 29th 2026.
- Production of gas and condensate from the Heimdal fields (Alta, Vale, and Skirne) was continued on the Norwegian Continental Shelf. Following completion of the overhaul of the Heimdal platform in June 2014 (Heimdal Extension Life Program or HELP), the life of the platform was extended until 2034.
- Operations within onshore licence areas in Poland LOTOS Petrobaltic and PGNiG signed an agreement on joint operations on the Górowo Iławieckie onshore licence, and carried out joint operations on the Kamień Pomorski licence.

Downstream segment

- Towards the end of 2014, the LOTOS Group entered the final stages of preparation for the construction of a Delayed Coking Unit (DCU) at the Gdańsk refinery, which will directly enhance processing efficiency by minimising production of unprofitable heavy fuel oil. Following the project's completion, the annual output of high-margin products will grow by 900 thousand tonnes, while the Group's output of coking coal, a new product, will be approximately 400 thousand tonnes.
- In 2014, Grupa LOTOS S.A. worked on a project to construct a Hydrogen Recovery Unit (HRU), to be completed by the end of 2016. The HRU is designed to increase the output of hydrogen required to intensify the operation of hydro-conversion units, further expanding the refining margin.
- In June 2014, the LOTOS Group completed and placed in service a fuel depot in Poznań, Poland's most advanced facility of its kind. Designed to increase the depot's fuel capacities at least four times, the project was in line with the LOTOS Group's consistent efforts to offer competitive customer service quality and strengthen its position in the Poznań Province, which is one of the most important markets for the Group in Poland.

Issue of Series D shares

In 2014, Grupa LOTOS S.A. issued Series D ordinary bearer shares in a public offering. The purpose of the offering was to raise funds to finance investment projects (presented in the order corresponding to the priority of issue objectives):

- Construction of a Delayed Coking Unit with auxiliary infrastructure (EFRA Project, previously: DCU Project) by LOTOS Asphalt in cooperation with Grupa LOTOS S.A. The new unit is to be constructed at the refinery, close to the Company's existing facilities, and is designed to intensify the processing of crude oil and improve the Company's refining margin by some USD 2/bbl.
Grupa LOTOS S.A. estimates the total cost of the EFRA Project, including costs to service the Project's financing during the construction stage and costs to maintain reserve deposits required by the banks, at approximately PLN 2,343m. For that purpose the Company intends to apply approximately PLN 530-

650m raised from the issue of Series D shares; the remaining part of expenditure on the Project of PLN 1,693-1,813m is to be financed with own funds and debt (investment facility to be contracted by LOTOS Asphalt). Grupa LOTOS S.A. expects that the part of share issue proceeds earmarked for LOTOS Asphalt will be transferred in the form of a contribution to LOTOS Asphalt's share capital. The Group intends to use the funds by the end of 2017.

- Continued cooperation between LOTOS Petrobaltic and CalEnergy Resources Poland Sp. z o.o. in the development of the B4 and B6 gas fields located in the Polish Exclusive Economic Zone of the Baltic Sea with a view to launching commercial production of gas from the fields in late 2017 or early 2018. Three appraisal wells were drilled in the B4 gas field, and two in the B6 gas field. As part of preparations for the development of the fields, 3D seismic surveys were carried out in 2013, and in the first half of 2014 the field development concept was selected, providing for drilling of production wells using the LOTOS Petrobaltic rig. The front end engineering design (FEED) was developed. During its preparation, a phased launch of production from the fields (B6 and B4) was analysed. It is expected that the FEED will be completed and the final investment decision will be made in late Q1 2015 or early Q2 2015. If a decision is made to proceed with the project, the development of the fields will be carried out in 2015–2018 and will include: construction and installation of a production platform on the B6 field and a satellite platform on the B4 field, drilling of production wells, construction of an underwater gas pipeline to Władysławowo and an onshore separator of liquids (LPG, condensate) on the premises of the Energobaltic CHP Plant in Władysławowo. Additionally, gas from the CHP Plant in Władysławowo would be fed to the transmission network operated by GAZ-SYSTEM S.A. For that purpose, the Group intends to execute an agreement with the local gas network operator and construct an approximately 40km long onshore gas pipeline. Implementation of the B4 and B6 field development project will involve obtaining the required administrative permits, including amendments to the B4 and B6 licences to reflect the current development plan, as well as environmental decisions and building permits. Also, it will be necessary to execute relevant agreements for the purpose of commercial production from the fields, including agreements on the use of land and infrastructure of the Energobaltic CHP Plant, agreements concerning gas transmission between Władysławowo and customers, as well as agreements for offtake of gas, gas condensate and LPG. The Group estimates that the total capital expenditure of LOTOS Petrobaltic will amount to approximately PLN 800m. The Group intends to apply for that purpose approximately PLN 350-470m raised from the issue of Series D shares; the remaining part of the expenditure on the project, of PLN 330-450m, is to be financed by the Group with its own funds and debt (bank borrowings). Grupa LOTOS S.A. expects that the proceeds from the issue of Series D shares will be transferred to LOTOS Petrobaltic in the form of a loan or contribution to the subsidiary's share capital. LOTOS Petrobaltic will then make those funds available to Group companies involved in the project based on the financing structure to be agreed in the course of project execution. The Group intends to use the funds by the end of 2017.

Research and development

- In 2014, a number of laboratory research projects were carried out to optimise the production technology for the type 350N oil. A research project was also launched to obtain high-purity organic solvents based on crude oil processing distillates. The above research projects are being continued in 2015.
- In 2014, Grupa LOTOS S.A. and a number of other parties entered into an agreement on the HESTOR project. The project was submitted by a research and industry consortium to the GEKON (Generator of Ecological Concepts) programme and was qualified to receive co-financing from the National Centre for Research and Development (NCBiR). The purpose of the HESTOR project is to assess the viability of storing hydrogen generated using renewable energy sources (RES) in salt caverns and its further use for power-generation or industrial process purposes.
- In 2014, development work was also carried out on oil products manufactured by LOTOS Oil. The most important lubricant-related R&D activities in 2014 included:
 - Development of production technologies for new motor oils for cars, applications for approvals – implementation in the first quarter of 2015,
 - Extension of 72 approvals for lubricants,
 - Obtaining of 5 approvals for new oils.

2.10. MATERIAL AGREEMENTS AND COURT PROCEEDINGS IN 2014
2.10.1. AGREEMENTS SIGNIFICANT FOR GRUPA LOTOS S.A.'S OPERATIONS EXECUTED IN 2014
Table 19. Agreements significant for Grupa LOTOS S.A.'s operations

No.	Counterparty	Date	Subject matter	Estimated value, VAT exclusive (PLN)	More information	Link
1	Statoil Group	Jan 28 2014	Sale of fuels	933m ¹	Current Report No. 1/2014	http://inwestor.lotos.pl/1185/p,194,i,762/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_spolkami_grupy_kapitalowej_statoil
2	LOTOS Kolej	Feb 10 2014	Railway transport services	3,000m	Current Report No. 2/2014	http://inwestor.lotos.pl/1185/p,194,i,763/raporty_i_dane/raporty_biezace/zawarcie_umowy_znaczacej_pomiedzy_lotos_kolej_sp_z_oo_a_grupa_lotos_sa
3	Mercuria Energy Trading S.A.	Mar 26 2014	Crude oil supplies	758m ¹	Current Report No. 3/2014	http://inwestor.lotos.pl/1185/p,194,i,765/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_mercuria_energy_trading_sa
4	The Shell Group	Apr 10 2014	Sale of fuels	794m ¹	Current Report No. 9/2014	http://inwestor.lotos.pl/1185/p,194,i,766/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_spolkami_grupy_kapitalowej_shell
5	TOTAL Group	Apr 15 2014	Sale of fuels	787m ¹	Current Report No. 6/2014	http://inwestor.lotos.pl/1185/p,194,i,768/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_spolkami_grupy_kapitalowej_total
6	Mercuria Energy Trading S.A.	Jun 5 2014	Crude oil supplies	924m ¹	Current Report No. 9/2014	http://inwestor.lotos.pl/1185/p,194,i,773/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_mercuria_energy_trading_sa
7	PIR, BGK and Pekao SA	Aug 25 2014	Financing of the B8 project	1,800m	Current Report No. 17/2014	http://inwestor.lotos.pl/1185/p,194,i,790/raporty_i_dane/raporty_biezace/zawarcie_umow_dotyczacych_finansowania_zagospodarowania_zloza_b8
8	Statoil ASA	Sep 3 2014	Sale of fuels	753m ¹	Current Report No. 18/2014	http://inwestor.lotos.pl/1185/p,194,i,791/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_statoil_asa
9	Ministry of State Treasury	Oct 15 2014	Assistance in the form of non-public aid	530m	Current Report No. 21/2014	http://inwestor.lotos.pl/1185/p,194,i,795/raporty_i_dane/raporty_biezace/zawarcie_przez_grupe_lotos_sa_oraz_ministra_skarbu_panstwa_umowy_w_sprawie_udzielenia_wsparcia_niebedacego_pomoca_publiczna

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No.	Counterparty	Date	Subject matter	Estimated value, VAT exclusive (PLN)	More information	Link
10	Bank syndicate	Oct 29 2014	Inventory refinancing facility	1,328m	Current Report No. 24/2014	http://inwestor.lotos.pl/1185/p.194,i.798/raporty_i_dane/raporty_biezace/przedluzenie_umowy_kredytowej_na_refinansowanie_zapasow_grupy_lotos_sa
11	Mercuria Energy Trading S.A.	Oct 31 2014	Crude oil supplies	802m ¹	Current Report No. 27/2014	http://inwestor.lotos.pl/1185/p.194,i.802/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_mercuria_energy_trading_sa
12	Bank syndicate	Nov 13 2014	Share issue underwriting agreement	Not applicable	Current Report No. 30/2014	http://inwestor.lotos.pl/1185/p.194,i.806/raporty_i_dane/raporty_biezace/zawarcie_umowy_gwarantowania_emisji_przez_grupe_lotos_sa
13	Mercuria Energy Trading S.A.	Nov 28 2014	Sale of heavy fuel oil	780m ¹	Current Report No. 39/2014	http://inwestor.lotos.pl/1185/p.194,i.816/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_mercuria_energy_trading_sa
14	Shell International Trading and Shipping LTD	Dec 1 2014	Sales of diesel oil	691m ¹	Current Report No. 40/2014	http://inwestor.lotos.pl/1185/p.194,i.817/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_shell_international_trading_and_shipping ltd
15	VITOL Group	Dec 16 2014	Crude oil supplies	4,300m	Current Report No. 46/2014	http://inwestor.lotos.pl/1185/p.194,i.823/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_vitol
16	LUKOIL	Dec 23 2014	Sale of fuels	742m ¹	Current Report No. 47/2014	http://inwestor.lotos.pl/1185/p.194,i.824/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_lukoil
17	STATOIL Fuel & Retail	Dec 23 2014	Crude oil supplies	3,710m	Current Report No. 48/2014	http://inwestor.lotos.pl/1185/p.194,i.825/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_statoil_fuel_retail
18	The Shell Group	Dec 30 2014	Sale of fuels	2,390m ¹	Current Report No. 49/2014	http://inwestor.lotos.pl/1185/p.194,i.826/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_shell
19	BP Group	Dec 30 2014	Sale of fuels	1,400m ¹	Current Report No. 50/2014	http://inwestor.lotos.pl/1185/p.194,i.827/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_spolkami_grupy_kapitalowej_bp

1) Total value of agreements with the counterparty since the release of the previous current report or within 12 months preceding the agreement date (execution of the agreement results in reaching or exceeding the threshold value for a significant agreement).

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

In the year ended December 31st 2014, no related-party transactions were concluded on non-arms' length terms.

2.10.3. AGREEMENT WITH QUALIFIED AUDITOR OF FINANCIAL STATEMENTS

Based on a resolution passed by the Grupa LOTOS Supervisory Board on October 31st 2012, Ernst & Young Audyt Polska spółka z ograniczoną odpowiedzialnością sp. k., 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 Audyt Polska spółka z ograniczoną odpowiedzialnością sp. k. of Warsaw executed a contract which provides, inter alia, for:

- Review of the separate and consolidated half-year financial statements for 2013–2015,
- Audit of the separate and consolidated full-year financial statements for 2013–2015.

Table 20. Total fees for audit, review and verification procedures (PLN '000)

	2014	2013
Audit of separate and consolidated full-year financial statements of Grupa LOTOS S.A. ⁽¹⁾	204	215
Assurance services ⁽¹⁾	1 596	371
Tax advisory services	-	-
Other services ⁽²⁾	23	10
Total	1 823	596

⁽¹⁾ Fees for the audit, review and verification of the financial statements, as well as for other services provided by Ernst & Young Audit Sp. z o.o. under the service contract of July 30th 2013 regarding the review of the separate and consolidated financial statements for the first six months of 2013, 2014 and 2015 and for the audit of the separate and consolidated financial statements in 2013–2015.

⁽²⁾ Fees paid for auditor training services.

2.10.4. COURT, ARBITRATION OR ADMINISTRATIVE PROCEEDINGS

In 2014 no court, arbitration or administrative proceedings were pending concerning Grupa LOTOS S.A.'s or its subsidiaries' liabilities or debts whose value pertaining to 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.

3. FINANCIAL STANDING OF GRUPA LOTOS S.A.

3.1. GRUPA LOTOS S.A.'S PERFORMANCE IN 2014

3.1.1. STATEMENT OF COMPREHENSIVE INCOME

In 2014, Grupa LOTOS S.A. posted PLN 26,243.1m in net revenue (down 1.7% on 2013). The decline was caused mainly by falling prices of petroleum products on global markets. The Company's average unit selling price was PLN 2,614/t in 2014 (down PLN 271/t or 9.4% on 2013).

Table 21. Annualised macroeconomic figures

USD/bbl	2014	2013	2014 / 2013
DATED Brent FOB prices	98.98	108.62	-8.9%
Urals-Brent differential	1.73	0.96	80.2%
Model refining margin	6.08	5.7	6.6%

Crack margins (USD/t)	2014	2013	2014 / 2013
Gasoline	168.48	162.21	3.9%
Naphtha	84.38	76.65	10.1%
Diesel oil (10 ppm)	114.50	120.88	-5.3%
Light fuel oil	91.99	101.70	-9.5%
Aviation fuel	154.31	164.36	-6.1%
Heavy fuel oil	-224.88	-233.80	3.8%

USD/PLN	2014	2013	2014 / 2013
PLN/USD exchange rate at end of period	3.51	3.01	16.6%
Average PLN/USD exchange rate	3.15	3.16	-0.3%

Source: Thomson Reuters and the National Bank of Poland.

The total volume of petroleum products, merchandise and materials sold by the Company in 2014 was 10,041.3 thousand tonnes (up 8.5% on 2013). The share of domestic sales in the total sales volume fell by 5.1pp.

In 2014, cost of sales was PLN 26,660.4m (up 1.7% on 2013). The PLN 445.7m increase in cost of sales, coupled with a PLN 454.1m decrease in revenue, translated into a PLN 417.3m gross loss in 2014. The average unit cost of sales was PLN 2,655/t (down PLN 178/t or 6.3% on 2013) and was by PLN 41/t higher than the average net selling price.

The 8.6% increase in distribution costs in 2014 was mainly attributable to an 8.5% growth in sales volume. The Company's administrative expenses decreased by 8.5% in 2014.

The Company reported a negative net result on other operating activities of PLN 3.9m in 2014 (2013: other income, net of PLN 3.9m). The figure reflects recognition and reversal of impairment losses on receivables in the amount of PLN 3.7m (see Notes 9.4, 9.5 and 17.1 to the financial statements of Grupa LOTOS S.A. for 2014).

In 2014, Grupa LOTOS S.A. posted an operating loss of PLN 1,294.2m, owing largely to a plunge in prices in H2 2014 and its effect on the measurement of inventories and cost of sales. After remeasurement of inventories of raw materials, products, semi-finished products and merchandise held at the year end, performed to reflect the current prices, Grupa LOTOS S.A.'s 2014 operating result went down by PLN 614.9m. On January 2nd 2014, the price of Dtd Brent crude was USD 107.94/bbl, and continued on a slightly upward trend in H1 2014 until the maximum of USD 115.19/bbl was reached on June 19th 2014. In H2 2014 the price dipped to USD 55.27/bbl on December 31st 2014. The continuing downward trend in the prices of crude oil and petroleum products had an adverse effect on the Company's performance (its inventories are measured with the weighted average method) and brought the result down by PLN 496.9m.

The decline in crude oil prices in H2 2014 was accompanied by the strengthening of the US dollar against the Polish zloty, resulting in foreign exchange losses increasing cost of sales, which pushed the operating result down by PLN 65.1m.

Table 22. Statement of comprehensive income of Grupa LOTOS S.A. (PLNm)

	2014	2013	2014-2013	2014/2013
Revenue	26,243.1	26,697.2	-454.1	-1.7%
Cost of sales	-26,660.4	-26,214.7	-445.7	1.7%
Gross profit/loss	-417.3	482.5	-899.8	-
Distribution costs	-667.3	-614.3	-53.0	8.6%
Administrative expenses	-205.7	-224.9	19.2	-8.5%
Other income	6.2	12.1	-5.9	-48.8%
Other expenses	-10.1	-8.2	-1.9	23.2%
Operating profit/(loss)	-1,294.2	-352.8	-941.4	-
Finance income	169.6	412.1	-242.5	-58.8%
Finance costs	-421.3	-144.5	-276.8	191.6%
Gain on disposal of investments	0.0	7.7	-7.7	-100.0%
Pre-tax profit/loss	-1,545.9	-77.5	-1,468.4	-
Income tax expense	260.0	62.7	197.3	314.7%
Net profit (loss)	-1,285.9	-14.8	-1,271.1	-

Key factors that contributed to a loss on financing activities of PLN 251.7m:

- Dividends received in 2014 of PLN +151.7m,
- Foreign exchange losses on remeasurement of borrowings of PLN -99.6m,
- Net loss on measurement and settlement of market risk hedging derivative instruments of PLN -180.0m,
- Offset interest on debt, interest income, fees and commissions of PLN -105.9m.

(See Notes 9.6 and 9.7 to the financial statements of Grupa LOTOS S.A. for 2014).

Grupa LOTOS S.A. applied 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. In the period January 1st–December 31st 2014, foreign exchange losses of PLN -584.7m were charged to cash-flow hedging reserve.

In 2014, Grupa LOTOS S.A. reported a net loss on measurement and settlement of market risk hedging transactions of PLN -180.0.

Net loss on settlement and measurement of derivative instruments comprising forwards and a currency swap hedging the foreign exchange risk was PLN -129.2m. Net loss on measurement and settlement of transactions hedging petroleum product prices was PLN -30.8m and net loss on IRS transactions hedging interest rates was PLN -22.9m. Net gain on settlement of futures hedging the risk of changes in prices of CO2 emission allowances stood at PLN 2.9m.

The net profit on financing activities of PLN 267.6m posted in 2013 was chiefly attributable to: dividend received (PLN +269.2m), foreign exchange gains (PLN +25.5m), net gain on measurement and settlement of financial instruments (PLN +101.7m), net loss on offsetting interest on debt, interest income, and fees and commissions (PLN -125.7m).

The net loss on financing activities posted in 2014 (PLN -251.7m) decreased further the pre-tax profit/loss, and deferred tax of PLN +260.1m reduced the loss to the net value of PLN -1,285.9m (see Note 10.1 to the financial statements of Grupa LOTOS S.A. for 2014).

3.1.2. STATEMENT OF FINANCIAL POSITION

Table 23. Assets (PLNm)

	Dec 31 2014	Dec 31 2013	Change	%
Total assets	14,339.8	15,559.4	-1,219.6	-7.8%
Total non-current assets	8,045.8	8,037.3	8.5	0.1%
Property, plant and equipment	6,299.4	6,572.7	-273.3	-4.2%
Intangible assets	120.4	114.4	6.0	5.2%
Shares	1,220.5	910.7	309.8	34.0%
Deferred tax assets	165.0	0.0	165.0	-
Other non-current assets	240.5	439.5	-199.0	-45.3%
Total current assets	6,245.0	7,522.1	-1,277.1	-17.0%
Inventories	3,573.9	5,544.5	-1,970.6	-35.5%
Trade receivables	1,248.8	1,584.7	-335.9	-21.2%
Current tax assets	0.5	10.3	-9.8	-95.1%
Derivative financial instruments	11.2	74.0	-62.8	-84.9%
Other current assets	1,170.9	84.6	1,086.3	1,284.0%
Cash and cash equivalents	239.7	224.0	15.7	7.0%
Assets held for sale	49.0	0.0	49.0	-

As at December 31st 2014, the Company's total assets were PLN 14,399.8m.

Key factors that contributed to a decrease (PLN -1.219,6m) in assets:

- PLN 273.3m decrease in property, plant and equipment, chiefly attributable to depreciation charges (see Note 13 to the financial statements of Grupa LOTOS S.A. for 2014),
- PLN 1,970.6m decrease in inventories, mostly mandatory stocks, whose value was down owing to lower prices of petroleum products and crude oil, which translated into inventory write-downs of PLN 614.9m, and lower volumes of mandatory stocks (see Note 18 to the financial statements of Grupa LOTOS S.A. for 2014),
- PLN 335.9m decrease in trade receivables, largely on the back of lower prices of petroleum products on global markets, which drove down the average net selling price in December 2014 relative to December 2013 (see Note 17 to the financial statements of Grupa LOTOS S.A. for 2014),
- PLN 1,086.3m increase in other current assets, mainly attributable to PLN 996.9m of proceeds from Grupa LOTOS S.A. share issue, deposited in a separate bank account of the Polish National Depository for Securities (see Note 17 to the financial statements of Grupa LOTOS S.A. for 2014),
- PLN 309.8m increase in shares, due mainly to the acquisition by Grupa LOTOS S.A. of 1,183,337 new shares, with a value of PLN 260 per share, following a share capital increase at LOTOS Petrobaltic S.A. with a total value of PLN 307.7m (see Note 16 to the financial statements of Grupa LOTOS S.A. for 2014).

Table 24. Financial position – equity and liabilities (PLNm)

	Dec 31 2014	Dec 31 2013	Change	%
Equity and liabilities	14,339.8	15,559.4	-1,219.6	-7.8%
Total equity	6,346.8	7,135.6	-788.8	-11.1%
Share capital	184.9	129.9	55.0	42.3%
Share premium	2,229.6	1,311.3	918.3	70.0%
Cash flow hedging reserve	-412.5	61.0	-473.5	-
Retained earnings	4,344.8	5,633.4	-1,288.6	-22.9%
Total non-current liabilities	3,743.6	3,851.8	-108.2	-2.8%
Bank borrowings	3,613.7	3,538.8	74.9	2.1%
Derivative financial instruments	62.6	52.9	9.7	18.3%
Deferred tax liability	0.0	206.8	-206.8	-100.0%
Employee benefit obligations	67.3	53.3	14.0	26.3%
Total current liabilities	4,249.4	4,572.0	-322.6	-7.1%
Bank borrowings	1,661.8	1,327.5	334.3	25.2%
Derivative financial instruments	146.0	28.3	117.7	415.9%
Trade payables	1,664.9	2,436.6	-771.7	-31.7%
Employee benefit obligations	26.7	33.6	-6.9	-20.5%
Other liabilities and provisions	750.0	746.0	4.0	0.5%

Grupa LOTOS S.A.'s equity was PLN 6,346.8m as at the end of 2014, following a PLN 788.8m decrease on 2013, largely caused by a PLN 1,285.9 net loss and PLN 473.5m foreign exchange losses on measurement of cash flow hedges net of the tax effect taken to the cash flow hedging reserve. At the same time, after the issue of 55m Series D ordinary bearer shares, the share premium account increased by PLN 918.3m (see Notes 20, 21, 22 and 23 to the financial statements of Grupa LOTOS S.A. for 2014).

The share of equity in total equity and liabilities fell from 45.9% in 2013 to 44.3% in 2014.

Key factors that contributed to a decrease (PLN 430.8m) in liabilities:

- PLN 771.7m decrease in trade payables, primarily as a result of a year-on-year decline in prices and volumes of crude oil purchases made in December 2014 (see Note 27 to the financial statements of Grupa LOTOS S.A. for 2014),
- PLN 409.2m increase in liabilities under borrowings, attributable chiefly to measurement of the borrowings at higher exchange rates and increased use of the credit facility for refinancing and financing of inventories (see Note 24 to the financial statements of Grupa LOTOS S.A. for 2014),
- No deferred tax liabilities, given that the Company recorded a net loss.

As at December 31st 2014, the Company's financial debt was PLN 5,275.5m (up PLN 409.2m on December 31st 2013). The ratio of financial debt (adjusted for free cash) to equity was 79.3% (up 14.3pp on December 31st 2013).

3.1.3. STATEMENT OF CASH FLOWS
Table 25: Cash flows (PLNm)

	2014	2013	Change
Cash flows from operating activities	561.3	733.6	-172.3
Cash flows from investing activities	-137.3	51.0	-188.3
Cash flows from financing activities	-392.8	-597.9	205.1
Change in net cash	31.6	186.1	-154.5
Cash and cash equivalents at beginning of period	-220.2	-406.3	186.1
Cash and cash equivalents at end of period	-188.6	-220.2	31.6

As at December 31st 2014, the Company's cash balance, including current account overdrafts, was PLN -188.6m (see Note 19 to the financial statements of Grupa LOTOS S.A. for 2014). In 2014, net cash flows were PLN 31.6m (down PLN 154.5m on 2013).

The Company generated PLN 561.3m of positive cash flows from operating activities (down 172.3m on 2013), mainly due to a decrease in inventories and lower trade receivables.

In 2014, net cash from investing activities was negative at PLN -137.3m and mainly included dividends received and expenditure on purchase of property, plant and equipment and loans advanced to related parties.

Negative cash flows from financing activities of PLN -392.8m were mainly caused by the negative balance of proceeds from borrowings and outflows on principal and interest payments. The item does not account for

restricted cash representing proceeds from the issue of Series D shares in Grupa LOTOS S.A., deposited in a separate bank account of the Polish National Depository for Securities.

3.1.4. NON-RECURRING FACTORS AND EVENTS WITH A MATERIAL EFFECT ON THE FINANCIAL PERFORMANCE OF GRUPA LOTOS S.A. IN 2014

The only material non-recurring factor with a bearing on Grupa LOTOS S.A.'s performance in 2014 was inventory write-downs recognised as at the end of the year to account for the difference between production costs and net realisable values caused by a decline in crude oil and petroleum product prices.

3.1.5. EXPLANATION OF DIFFERENCES BETWEEN ACTUAL FINANCIAL PERFORMANCE AND PREVIOUSLY PUBLISHED FORECASTS

Grupa LOTOS S.A. did not publish any separate performance forecasts for 2014.

3.2. REPRESENTATIONS OF THE MANAGEMENT BOARD

3.2.1. REPRESENTATION ON THE ANNUAL FINANCIAL STATEMENTS AND THE DIRECTORS' REPORT ON THE OPERATIONS OF GRUPA LOTOS S.A.

The Management Board of LOTOS S.A., composed of:

Paweł Olechnowicz – President of the Management Board, Chief Executive Officer

Mariusz Machajewski – Vice-President of the Management Board, Chief Financial Officer

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

Marek Sokołowski – Vice-President of the Management Board, Chief Operations Officer

Maciej Szozda – Vice-President of the Management Board, Chief Commercial Officer

hereby represents that, to the best of its knowledge, the annual financial statements of Grupa LOTOS S.A. for 2014 and the comparative data were prepared in compliance with the applicable accounting standards and give a true, clear and fair view of Grupa LOTOS S.A.'s assets, financial standing and financial performance.

Furthermore, the Management Board of Grupa LOTOS S.A. represents that the Directors' Report on the operations of Grupa LOTOS S.A. in 2014 gives a true view of the Company's development, achievements and position, and includes a description of key risks and threats.

3.2.2. REPRESENTATION ON APPOINTMENT OF THE QUALIFIED AUDITOR OF FINANCIAL STATEMENTS

The Management Board of Grupa LOTOS S.A. represents that the qualified auditor of the financial statements of Grupa LOTOS S.A. for 2014 was appointed in accordance with the applicable laws, and that the auditing firm and the qualified auditors who performed the audit met the conditions necessary to issue an impartial and independent auditor's opinion in accordance with the applicable regulations and professional standards.

3.3. CAPITAL EXPENDITURE

In 2014, Grupa LOTOS S.A. pursued its investment plans in line with the current business strategy, which prioritises the Exploration and Production Segment. The key objectives of Grupa LOTOS S.A.'s projects were to maintain the highly competitive market position, as well as safety and reliability standards at the Gdańsk refinery.

3.3.1. EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT

In 2014, the Company incurred capital expenditure of PLN 134,572 thousand, mainly in connection with the extension of the fuel depot in Poznań and construction of a Hydrogen Recovery Unit (HRU).

Table 26: Capital expenditure on property, plant and equipment incurred by Grupa LOTOS S.A. in 2014 (PLN '000)

	Capital expenditure Jan 1–Dec 31 2014
Construction and assembly work	43,450
Procurement from external suppliers – purchases	61,515
Purchase of intangible assets	6,739
Other capital expenditure	22,868
Total	134,572

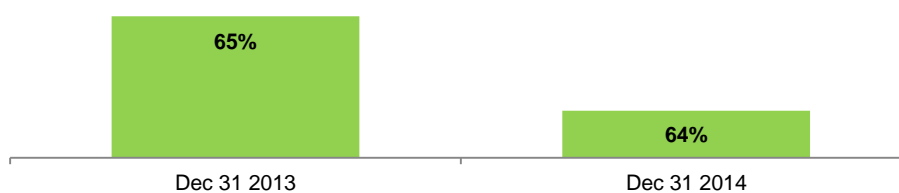
3.3.2. EQUITY INVESTMENTS

In 2014, 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'.

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

In 2014, 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. The net debt to equity ratio decreased in 2014 by 1pp (from 65% to 64%).

Figure 31. Gearing ratio – the ratio of net debt (financial debt adjusted for free cash) to equity



3.4. FINANCING SOURCES

3.4.1. CREDIT FACILITY AGREEMENTS AND LOANS ADVANCED IN 2014

Table 32. Bank borrowings of Grupa LOTOS S.A. as at December 31st 2014:

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)		current portion	non-current portion		
	PLN	Currency	PLN	Currency	PLN	Currency				
	('000)	('000)	('000)	('000)	('000)	('000)				
Bank Syndicate (1)*	-	USD 400,000	1,052,449	USD 300,082	-	-	Dec 20 2015	-	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)**	-	USD 1,125,000	326,387	USD 93,191	2,647,872	USD 752,479	Oct 15 2015	Jan 15 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)***	-	USD 425,000	126,645	USD 36,812	965,802	USD 272,299	Oct 15 2015	Jan 15 2021	fixed interest rate	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 (4)****	USD 200,000 or equivalent		299.654	-	-	-	Overdraft facility	-	interest based on 3M LIBOR for USD funds, 3M WIBOR for PLN funds and 3M EURIBOR for EUR funds + bank margin for each currency (identical with the Credit Facility A margin). Interest payable every three months on Jan 15, Apr 15, Jul 15, or Oct 15.	
			121.517	USD 34,648	-	-				
			7.038	EUR 1,651	-	-				
Funds in bank deposits securing payment of interest and principal*****			(271.919)	USD (77,532)	-	-				
TOTAL			299,653	-	-	-				
			1,355,080	USD 387,201	3,613,674	USD 1,024,778				

Directors' Report on the operations of Grupa LOTOS S.A. in 2014

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)		current portion	non-current portion		
	PLN	Currency	PLN	Currency	PLN	Currency				
	('000)	('000)	('000)	('000)	('000)	('000)				
			7,038	EUR 1,651	-	-				
			1,661,771		3,613,674					

(1) Disclosed taking into consideration amortised cost measurement, including arrangement fees.

(2) *Bank Syndicate (1): Pekao S.A., mBank S.A., ING Bank Śląski S.A., Société Générale S.A., Bank Handlowy w Warszawie S.A., Bank Zachodni WBK S.A.

(3) **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 (dawniej 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., Sumitomo Mitsui Banking Corporation Europe Ltd.,

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

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

(6) ***** As at December 31st 2014, 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 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). Accumulation of funds for the repayment of credit facilities is expressly provided for in the documentation relating to the investment facilities obtained to finance the 10+ Programme, as well as the inventory financing and refinancing facility. The Company is required to set aside and maintain funds for repayment of principal instalments and interest due over the next six months. The purpose of adopting the net-basis presentation approach is to reflect the expected future cash flows from settlement of two or more financial instruments.

Table 33. Loans advanced to subsidiaries in the year ended December 31st 2014

Related entity	Agreement date	Principal as per loan agreement PLN thousand	Maturity date	Security	Interest terms
LOTOS Petrobaltic S.A.	Jan 23 2014	100,000	Dec 31 2017	blank promissory note with a 'protest waived' clause and promissory note declaration	interest payable at a variable annual rate based on 6M WIBOR plus margin
LOTOS Gaz S.A. w likwidacji (in liquidation)	Feb 28 2014	80	Dec 31 2014	blank promissory note with a 'protest waived' clause and promissory note declaration	interest payable at a fixed annual rate based on 3M WIBOR plus margin

On November 28th 2014, Grupa LOTOS S.A. and LOTOS Petrobaltic S.A. signed a set-off agreement, whereby amounts due to Grupa LOTOS S.A. under loans advanced to LOTOS Petrobaltic S.A. between 2012 and 2014, in the aggregate amount of PLN 307,698 thousand (the principal and interest accrued until November 28th 2014) were offset against the amounts due to LOTOS Petrobaltic S.A. in connection with the acquisition of LOTOS Petrobaltic S.A. shares by Grupa LOTOS S.A. (see Note 16.1.1 to the separate financial statements of Grupa LOTOS S.A. for 2014). Following the set-off, PLN 307,668 thousand of the amounts due to Grupa LOTOS S.A. under the loans was cancelled. The balance of PLN 30 thousand was paid by LOTOS Petrobaltic S.A. As at December 31st 2014, Grupa LOTOS S.A. carried no receivables under loans to LOTOS Petrobaltic S.A.

3.4.2. CONTINGENT LIABILITIES OR OTHER SECURITY

Since August 20th 2014, the Company has had a PLN 240,000 thousand own blank promissory note deposited at the Customs Office in Gdańsk as lump-sum security for excise duty of PLN 800,000 thousand. The security expiry date is August 19th 2015. As at December 31st 2014, the Company had another PLN 240,000 thousand own promissory note deposited with the Head of the Customs Office in Gdańsk. The promissory note will be returned to the Company upon formal settlement of the previous lump-sum security for excise duty of PLN 800,000 thousand, which was valid from August 20th 2013 to September 19th 2014.

3.4.3. FINANCIAL RESOURCES MANAGEMENT

In 2014, Grupa LOTOS S.A. was able to meet all of its liabilities towards third parties. In the period from January 1st to December 31st 2014, the Company used investment credit facilities and working capital overdraft facilities. As at December 31st 2014, the Company had PLN 324.7m in funds available under working capital facilities. The amount outstanding under overdraft facilities as at December 31st 2014 was PLN 428.2m (see Note 19 to the financial statements of Grupa LOTOS S.A. for 2014).

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.

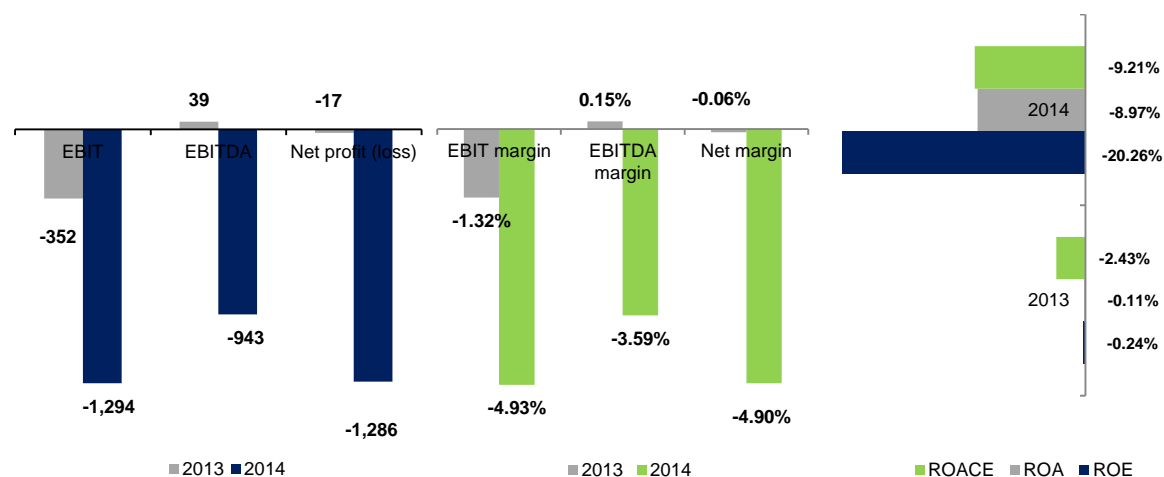
In connection with the refinancing facility, the Company is also required to meet a financial covenant of maintaining the Loan to Pledged Inventory Value ratio of no more than specified in the facility agreement.

As at December 31st 2014 and December 31st 2013, the covenants were complied with.

A brief assessment of Grupa LOTOS S.A.'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 %)



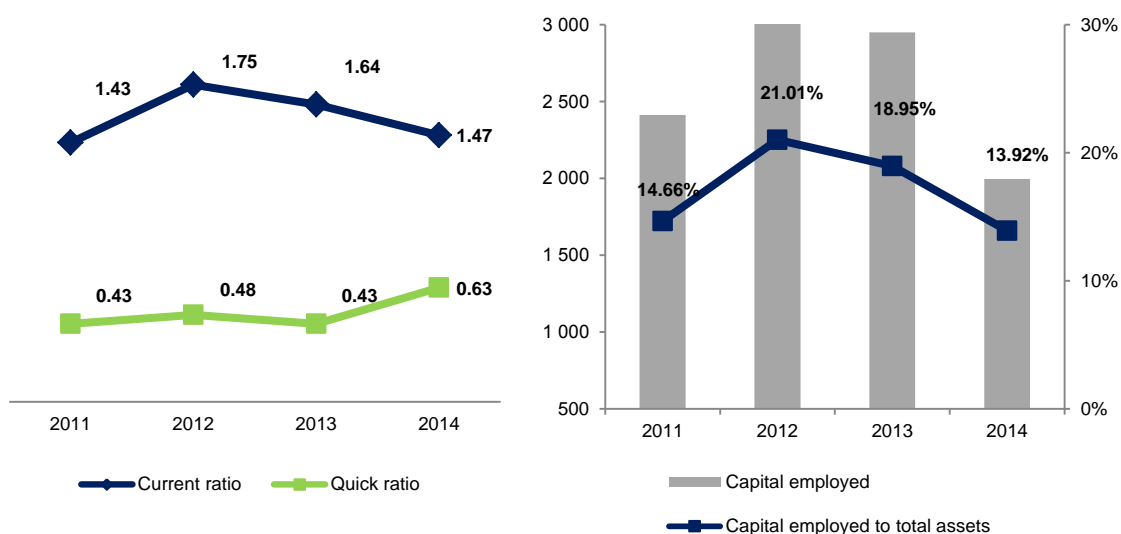
- Negative profitability ratios due to operating loss and net loss.

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 %)

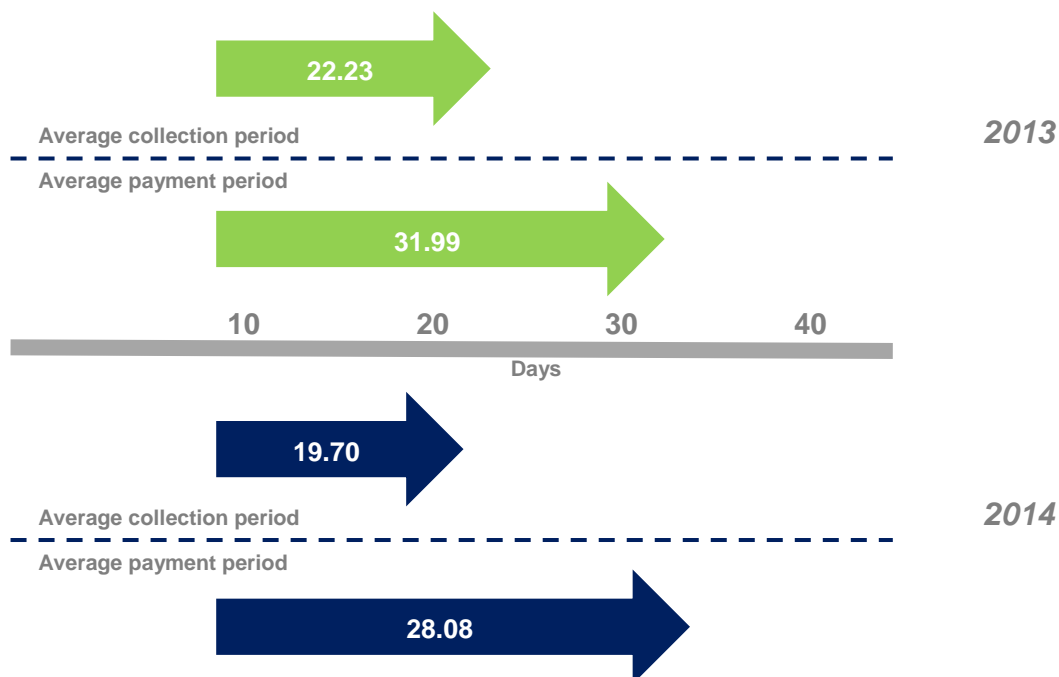


- Current ratio (1.47) lower year on year (down 10.7%), following a stronger decrease in current assets (down 17.0%) than in current liabilities (down 7.1%); quick ratio (0.63) higher year on year (up 45.3%) due to a significant decrease in inventories (down 35.5%).
- PLN 954.5m decrease in capital employed, following a stronger decrease in current assets (down PLN 1,277.1m) than in current liabilities (down PLN 322.6m), and decrease of the share of capital employed in total assets.

Liquidity ratio formulas

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

Collection and payment periods
(days)

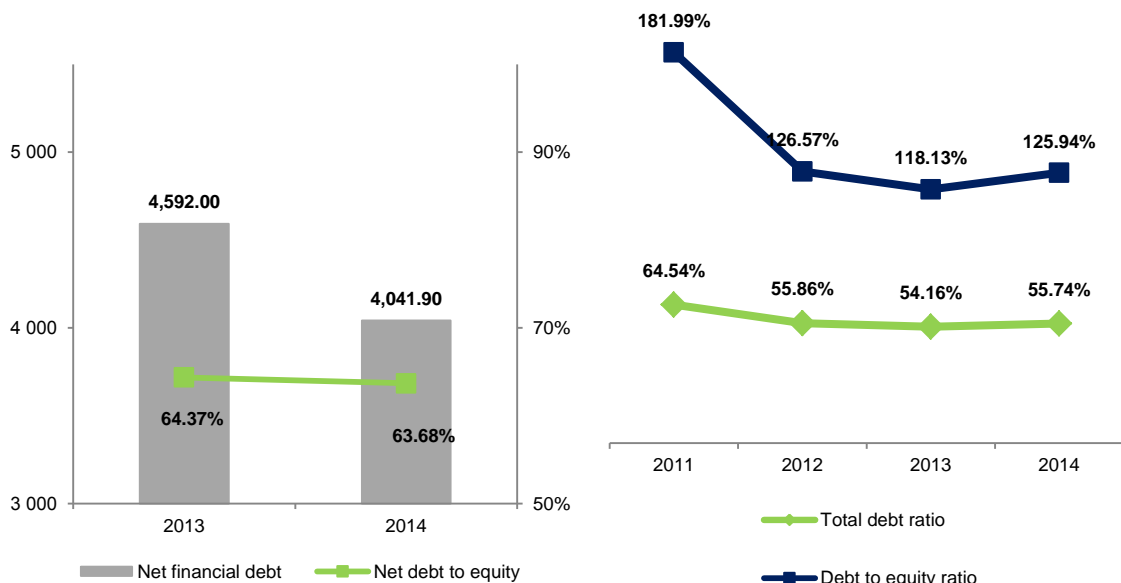


- Average collection period in 2014 shorter than in 2013 (down 2.6 days), as average trade receivables fell more (down 12.9%) than revenue (down 1.7%); average payment period shorter by 7.2 days as average trade payables fell (down 18.8%) while cost of sales increased (up 1.7%).

Collection and payment period formulas	
Average collection period (days)	average trade receivables to net sales times 365 days in the period
Average payment period (days)	average trade payables to cost of sales times 365 days in the period

Capital structure and debt ratios

(PLNm or %)



- Increase in the share of liabilities in the financing of assets by 1.6pp, as liabilities decreased less (down 5.1%) than assets (down 7.8%).
- Decrease in net debt to equity ratio (financial leverage) by 0.7pp, as net financial debt decreased (down 12.9%, while equity fell (down 11.1%).
- Increase in debt to equity ratio by 7.9pp, as equity fell more (down 11.1%) than liabilities (down 5.1%).

Capital structure and debt ratio formulas

Total debt ratio	total liabilities to total assets (at period end)
Net financial debt	long-term and short-term borrowings less cash (at period end)
Net debt to equity ratio (financial leverage)	net financial debt to equity (at period end)
Debt to equity ratio	total liabilities to equity (at period end)

3.4.4. USE OF SHARE ISSUE PROCEEDS TO IMPLEMENT THE ISSUE OBJECTIVES

In 2014, Grupa LOTOS S.A. issued Series D ordinary bearer shares in a public offering. The purpose of the offering was to raise funds to finance investment projects (presented in the order corresponding to the priority of issue objectives):

- Construction of a Delayed Coking Unit with auxiliary infrastructure (EFRA Project, previously: DCU Project) by LOTOS Asphalt in cooperation with Grupa LOTOS S.A. The new unit is to be constructed at the refinery, close to the Company's existing facilities, and is designed to intensify the processing of crude oil and improve the Company's refining margin by some USD 2/bbl.
Grupa LOTOS S.A. estimates the total cost of the EFRA Project, including costs to service the Project's financing during the construction stage and costs to maintain reserve deposits required by the banks, at approximately PLN 2,343m. For that purpose the Company intends to apply approximately PLN 530-650m raised from the issue of Series D shares; the remaining part of expenditure on the Project of PLN 1,693-1,813m is to be financed with own funds and debt (investment facility to be contracted by LOTOS Asphalt). Grupa LOTOS S.A. expects that the part of share issue proceeds earmarked for LOTOS Asphalt will be transferred in the form of a contribution to LOTOS Asphalt's share capital. The Group intends to use the funds by the end of 2017.
- Continued cooperation between LOTOS Petrobaltic and CalEnergy Resources Poland Sp. z o.o. in the development of the B4 and B6 gas fields located in the Polish Exclusive Economic Zone of the Baltic Sea with a view to launching commercial production of gas from the fields in late 2017 or early 2018. Three appraisal wells were drilled in the B4 gas field, and two in the B6 gas field. As part of preparations for the development of the fields, 3D seismic surveys were carried out in 2013, and in the first half of 2014 the field development concept was selected, providing for drilling of production wells using the LOTOS Petrobaltic rig. The front end engineering design (FEED) was developed. During its preparation, a phased launch of production from the fields (B6 and B4) was analysed. It is expected that the FEED will be completed and the final investment decision will be made in late Q1 2015 or early Q2 2015. If a decision is made to proceed with the project, the development of the fields will be carried out in 2015-2018 and will include: construction and installation of a production platform on the B6 field and a satellite platform on the B4 field, drilling of production wells, construction of an underwater gas pipeline to Władysławowo and an onshore separator of liquids (LPG, condensate) on the premises of the Energobaltic CHP Plant in Władysławowo. Additionally, gas from the CHP Plant in Władysławowo would be fed to the transmission network operated by GAZ-SYSTEM S.A. For that purpose, the Group intends to execute an agreement with the local gas network operator and construct an approximately 40km long onshore gas pipeline. Implementation of the B4 and B6 field development project will involve obtaining the required administrative permits, including amendments to the B4 and B6 licences to reflect the current development plan, as well as environmental decisions and building permits. Also, it will be necessary to execute relevant agreements for the purpose of commercial production from the fields, including agreements on the use of land and infrastructure of the Energobaltic CHP Plant, agreements concerning gas transmission between Władysławowo and customers, as well as agreements for offtake of gas, gas condensate and LPG. The Group estimates that the total capital expenditure of LOTOS Petrobaltic will amount to approximately PLN 800m. The Group intends to apply for that purpose approximately PLN 350-470m raised from the issue of Series D shares; the remaining part of the expenditure on the project, of PLN 330-450m, is to be financed by the Group with its own funds and debt

(bank borrowings). Grupa LOTOS S.A. expects that the proceeds from the issue of Series D shares will be transferred to LOTOS Petrobaltic in the form of a loan or contribution to the subsidiary's share capital. LOTOS Petrobaltic will then make those funds available to Group companies involved in the project based on the financing structure to be agreed in the course of project execution. The Group intends to use the funds by the end of 2017.

4. GRUPA LOTOS SHARES

4.1. GRUPA LOTOS 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. and are traded in PLN.

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

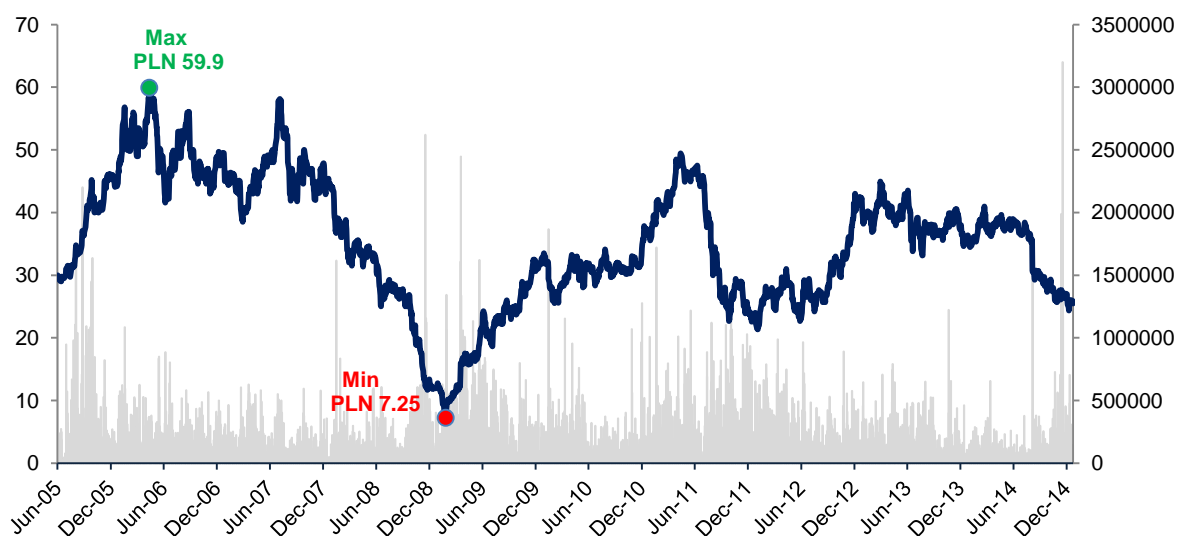
As at December 31st 2014, the Company's share capital totalled PLN 129,873,362 and comprised 129,873,362 shares, with a par value of PLN 1 per share, including:

- i. 78,700,000 Series A ordinary bearer shares,
- ii. 35,000,000 Series B ordinary bearer shares,
- ii. 16,173,362 Series C ordinary bearer shares.

Each share confers the right to one vote at the Company's General Meeting.

The Company's market capitalisation as at the end of 2014 was just over PLN 3.3bn.

Figure 34. Share price (PLN) and trading volume (number of shares) since first listing on the WSE



In 2014, 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

2014 was a successful year for investors trading on stock markets in the U.S. and South Asia. Key stock exchange indices in the U.S. climbed by over 10%, with S&P 500 and Nasdaq up by 11.4% and 13.4%, respectively. These high rates of return were driven by positive signals from the American economy. However, the highest rates of return in 2014 were brought by equities listed on the Chinese Shanghai Stock Exchange, where the Shanghai Composite Index rose by 52.9%, also on the back of positive information from the Chinese market.

At the same time, global capital shifted away from emerging markets, whose sluggish economic growth, growing political risk, and weaker local currencies discouraged investments (China being the sole exception). Given the geographical location of Poland in the vicinity of Russia and Ukraine and lower liquidity of the stock exchange market, the year saw only slight movements in the WSE indices.

The index of all companies listed on the Main Market, WIG, gained 0.3%, and the annual change in WIG-20 was negative at -3.5%. The lowest rate of return was delivered by the WIG250 small-cap index, which was down 16.8%.

Looking at stock performance by sector, the best-performing WIG-ENERGIA power sector index gained 23.5%, with the WIG-PALIWA fuels sector index up 5.2%. The RESPECT corporate social responsibility index increased by over 4.4% during 2014.

The price of Grupa LOTOS shares followed general market trends in H1 2014, but later fell sharply following the announcement of a planned issue of new Series D shares. Throughout the year Grupa LOTOS shares traded within the PLN 24.05–40.96 range, and closed the year at PLN 25.50.

In 2014, the number of LOTOS shares changing hands in a trading session was 203,839, down 11% year on year. The total value of trading in the stock was in excess of PLN 1.6bn, representing 0.7% of total WSE trading, with an average of 851 trades per session.

Table 27. Grupa LOTOS shares

	2009	2010	2011	2012	2013	2014
Free float shares (million shares)	129.87	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	24.05
High	32.80	37.85	49.50	43.78	45.45	40.96
Closing price	31.80	36.35	23.30	41.20	35.45	25.50
Rate of return at end of period (%)	166.11	14.31	-35.9	76.82	-13.96	-28.07

	2009	2010	2011	2012	2013	2014
Trade in Grupa LOTOS shares						
Trading value (PLNm)	3,642.56	3,684.33	3,299.07	2,013.15	2,211.43	1,588.52
Share in trade (%)	1.11	0.88	1.31	1.07	1.00	0.77
Average trading volume per session	381,938	234,464	377,048	282,163	229,877	203,839
Average number of trades per session	945	699	967	810	877	851

	2009	2010	2011	2012	2013	2014
Company valuation						
Market capitalisation at end of period (PLNm)	4,130.80	4,720.80	3,026.00	5,351.00	4,603.89	3,311.69
Book value (PLNm)	6,846.20	7,513.50	7,782.40	9,062.40	9,189.60	8,258.50
EV (PLNm)	9,440.12	10,650.27	10,032.87	11,472.60	10,311.89	9,627.39
Valuation ratios						
Earnings per share (PLN)	7.44	5.23	5.03	7.11	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	0.40
EV/EBITDA (x)	12.32	7.06	5.70	11.58	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.

Figure 35. Price of Grupa LOTOS shares in 2014



Figure 36. Effect of important events at the Company on the market price of Grupa LOTOS shares

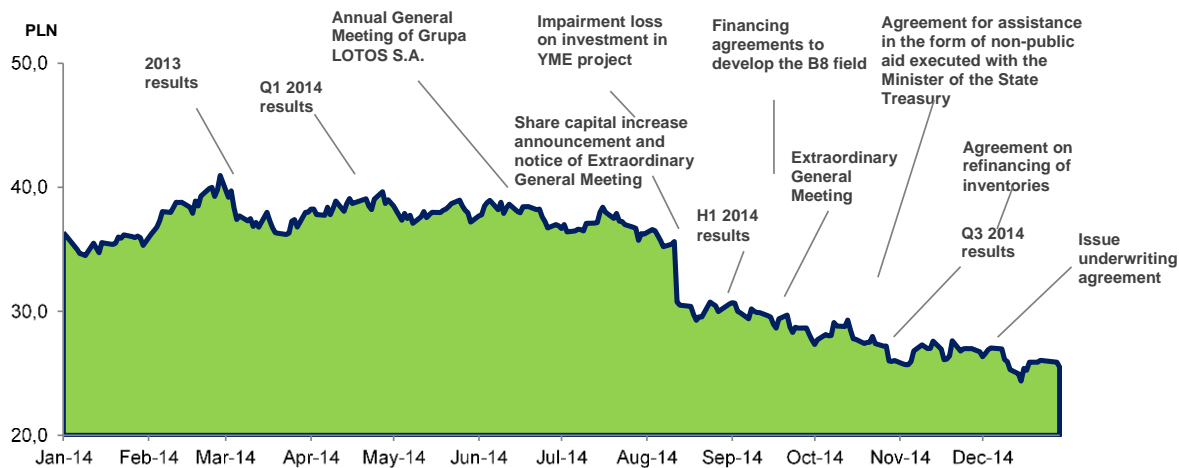
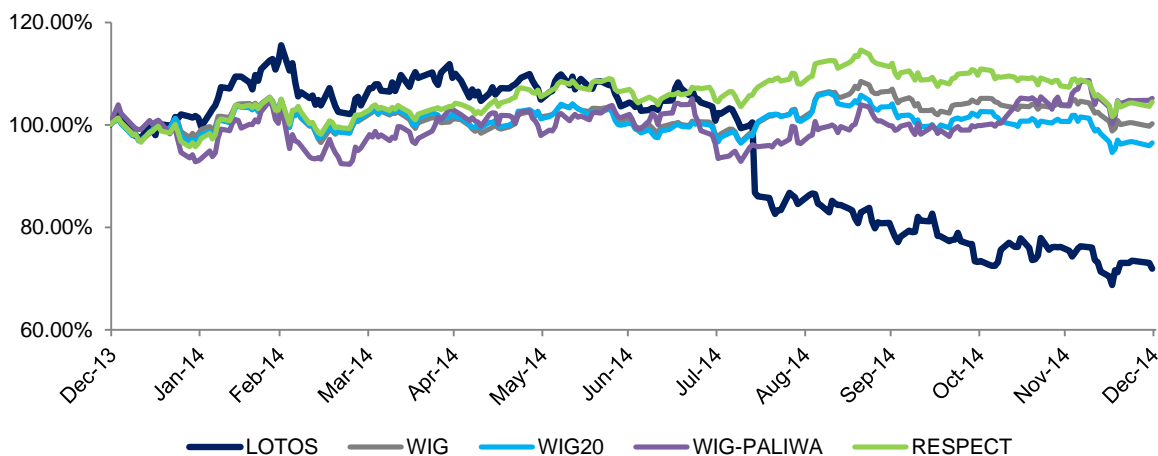


Figure 37. Grupa LOTOS share price performance vs. index performance in 2014



* Rebased (100 = closing price at December 30th 2013)

Brokers' recommendations on Grupa LOTOS shares

Recommendations on Grupa LOTOS shares are issued by 16 investment houses (including brokerage houses and investment banks):

Table 28: Recommendations on Grupa LOTOS shares issued by investment houses

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

To the Company's knowledge, brokers issued 18 recommendations on the Company shares in 2014:

- 9 BUY recommendations
- 6 HOLD recommendations
- 1 REDUCE recommendation
- 1 SELL recommendation
- 1 NEUTRAL recommendation.

Plus:

- 2 coverage initiations.

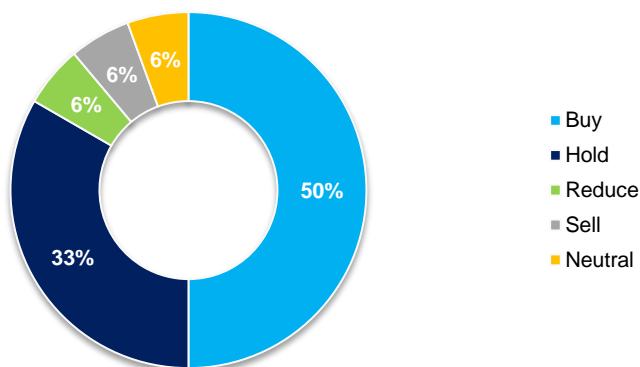
* BUY – total expected rate of return will exceed 15% in 12 months.

* 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.

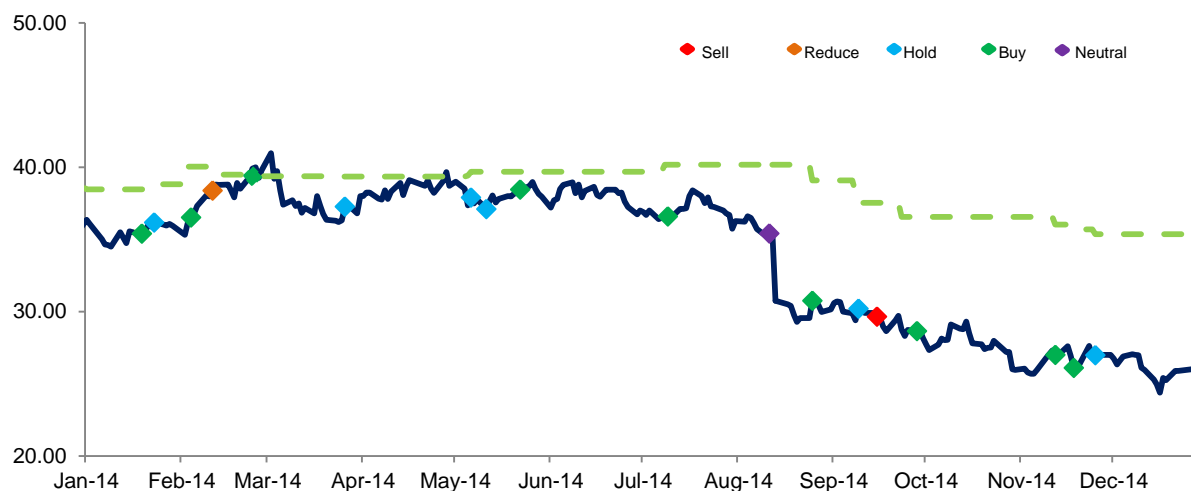
Figure 38. Structure of broker recommendations on Grupa LOTOS shares in 2014



The target price of Grupa LOTOS shares in brokers' research reports fluctuated from PLN 25.80 to PLN 54.07, compared with PLN 29.50 to PLN 56.30 in 2013. The average target price in 2014 was PLN 37.90 (2013: PLN 37.70).

Grupa LOTOS shares traded within the range from PLN 24.05 to PLN 40.96. The year-end closing price in 2014 was PLN 25.50.

Figure 39. 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).

4.2. 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. proposed to fully cover the 2013 net loss of PLN 14,774,128.10 from the Company's statutory reserve funds.

Taking into consideration the Management Board's proposal, on June 30th 2014, the General Meeting resolved to fully cover Grupa LOTOS S.A.'s 2013 net loss of PLN 14,774,128.10 from the Company's statutory reserve funds.

Table 29: 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	41.2	-
2013	0.0	0.0	35.5	-

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

Table 30. Historical dividend per share

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	-	-
2013	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.

4.3. ACQUISITION OF TREASURY SHARES

Grupa LOTOS S.A. did not buy back any own shares in 2014.

4.4. 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 6th 2015.

Table 31. 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 23rd 2015.

To the best of the Company's knowledge, as at March 6th 2015 the Management and Supervisory Board members did not hold any shares in Grupa LOTOS S.A.'s related companies.

4.5. AGREEMENTS WHICH MAY GIVE RISE TO FUTURE CHANGES IN SHAREHOLDING 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.

5. CORPORATE GOVERNANCE

5.1. SHAREHOLDING STRUCTURE

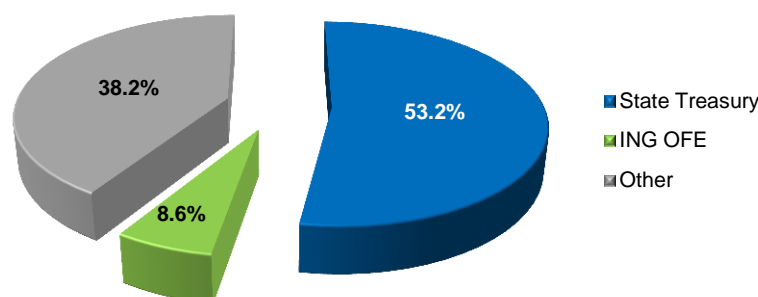
5.1.1. SIGNIFICANT HOLDINGS OF SHARES

Changes in 2013–2014

The share capital of Grupa LOTOS S.A. did not change relative to 2013 and comprised 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. 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 total voting rights at the Company's General Meeting ([Current Report No. 11/2013](#)).

ING OFE announced that as at December 31st 2014 it held 8.57% of total voting rights at the Company's General Meeting.

Figure 57. Shareholding structure of Grupa LOTOS as at December 31st 2014



* Based on the investment funds' annual assets structures as at December 31st 2014 (Polish Press Agency).

On January 9th 2015, the District Court for Gdańsk-Północ in Gdańsk, 7th Commercial Division of the National Court Register, registered an increase in the share capital of Grupa LOTOS S.A. from PLN 129,873,362 to PLN 184,873,362, effected through the issue of 55,000,000 Series D ordinary bearer shares with a par value of PLN 1 per share, pursuant to Resolution No. 2 of the Extraordinary General Meeting of September 8th 2014 on increasing the Company's share capital by way of issue of new shares, public offering of new shares, setting the record date for determining the pre-emptive rights to new shares for November 18th 2014, conversion into book-entry form and seeking admission of pre-emptive rights, allotment certificates and new shares to trading on the regulated market of the Warsaw Stock Exchange, amending the Company's Articles of Association and authorising the Supervisory Board to prepare a consolidated text of the Company's Articles of Association.

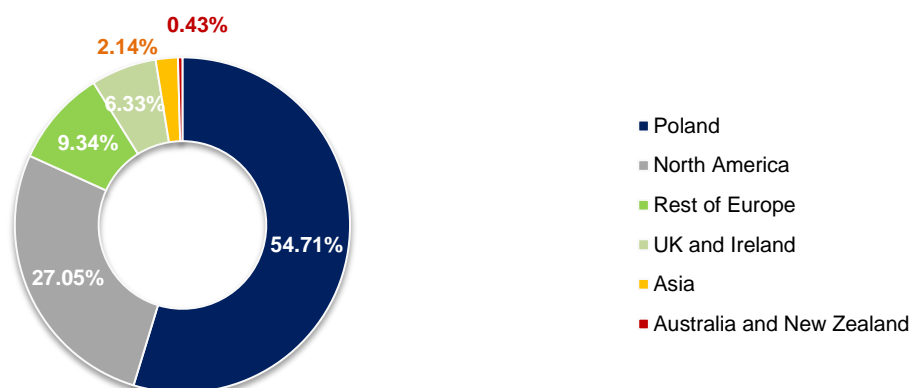
Table 41. Share capital and voting rights at the General Meeting held by significant shareholders of Grupa LOTOS as at December 31st 2014

Shareholder	Share in share capital/total voting rights at the GM
State Treasury	53.2%
ING OFE	8.6%
Other	38.2%
Total	100.0%

Table 42. Pension funds in the shareholding structure of Grupa LOTOS S.A. as at December 31st 2014*

Pension fund	Value of holding in Grupa LOTOS S.A.	% of share capital held	% change in shareholding, 2014 vs. 2013
ING Otwarty Fundusz Emerytalny	283,724,493.22	8.57	2.27
Otwarty Fundusz Emerytalny PZU	165,394,080.72	4.99	1.69
Aviva Otwarty Fundusz Emerytalny	101,801,309.00	3.07	0.10
Allianz Polska Otwarty Fundusz Emerytalny	55,019,716.00	1.66	0.30
Axa Otwarty Fundusz Emerytalny	23,544,641.00	0.71	0.32
Nordea Otwarty Fundusz Emerytalny	19,473,008.00	0.59	0.00
PKO BP BANKOWY Otwarty Fundusz Emerytalny	9,909,455.05	0.30	0.18
Otwarty Fundusz Emerytalny Pocztylion	9,880,723.82	0.30	0.00
Pekao Otwarty Fundusz Emerytalny	9,581,135.00	0.29	0.03
Generali Otwarty Fundusz Emerytalny	2,425,700.00	0.07	-0.19
Amplico Otwarty Fundusz Emerytalny	2,036,509.00	0.06	-0.05
Aegon Otwarty Fundusz Emerytalny	0.00	0.00	-0.44

* Based on the investment funds' annual assets structures as at December 31st 2014 (Polish Press Agency).

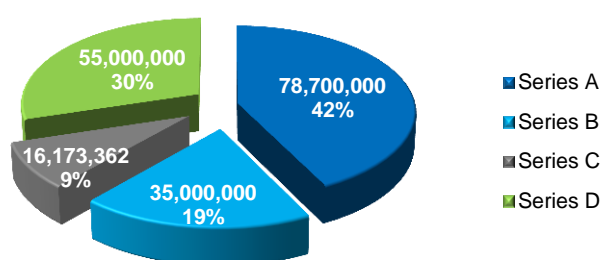
Figure 43. Geographical distribution of non-controlling interests


* Based on the identified non-controlling interests.

Share capital structure

The share capital of Grupa LOTOS S.A. comprises 184,873,362 fully paid-up ordinary shares with a par value of PLN 1 per share. Each share carries the right to one vote at the General Meeting of Shareholders and the right to dividend.

Figure 44. Grupa LOTOS share capital structure



In 2013–2014 and as at the date of release of this Directors' Report, ordinary bearer shares in Grupa LOTOS held by the State Treasury represented 53.19% of the Company's share capital and the same proportion of voting rights at its General Meeting.

In 2014, no changes occurred in the composition of the main shareholders, which means that the remaining 46.81% of the share capital was in free float.

On June 30th 2014, in Current Report No. [12/2014](#), the Company published a list of shareholders holding 5% or more of total voting rights at the Annual General Meeting of Grupa LOTOS S.A. held on June 30th 2014.

Table 32. Shareholders holding 5% or more of total voting rights at the Annual General Meeting of the Company held on June 30th 2014

Shareholder	Number of Grupa LOTOS shares held	% of total voting rights at GM	% of share capital held
State Treasury	69,076,392	79.06%	53.19%
ING OFE	8,000,000	9.16%	6.16%

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

The Company has not issued any securities conferring special control powers. As at the date of release of this Directors' Report, the Company has no information on any shareholder 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 date of the General Meeting, with the proviso that for the purpose of determining the obligations of buyers of major holdings of shares 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 (for more information, see Section 5.1.4).

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

Grupa LOTOS S.A. has not issued any securities conferring special control powers.

5.1.3. 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 investment 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.

5.1.4. 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 date of the General Meeting, with the proviso that for the purpose of determining the obligations of buyers of major holdings of shares 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 are aggregated in the following manner:

1. A shareholder is 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 is any person which:
 - 1) meets the relevant criteria set forth in Art. 4.1.4) of the Commercial Companies Code, or
 - 2) is a parent, a subsidiary or both a parent 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 total voting rights at the Company falls below 5% of the Company's share capital.

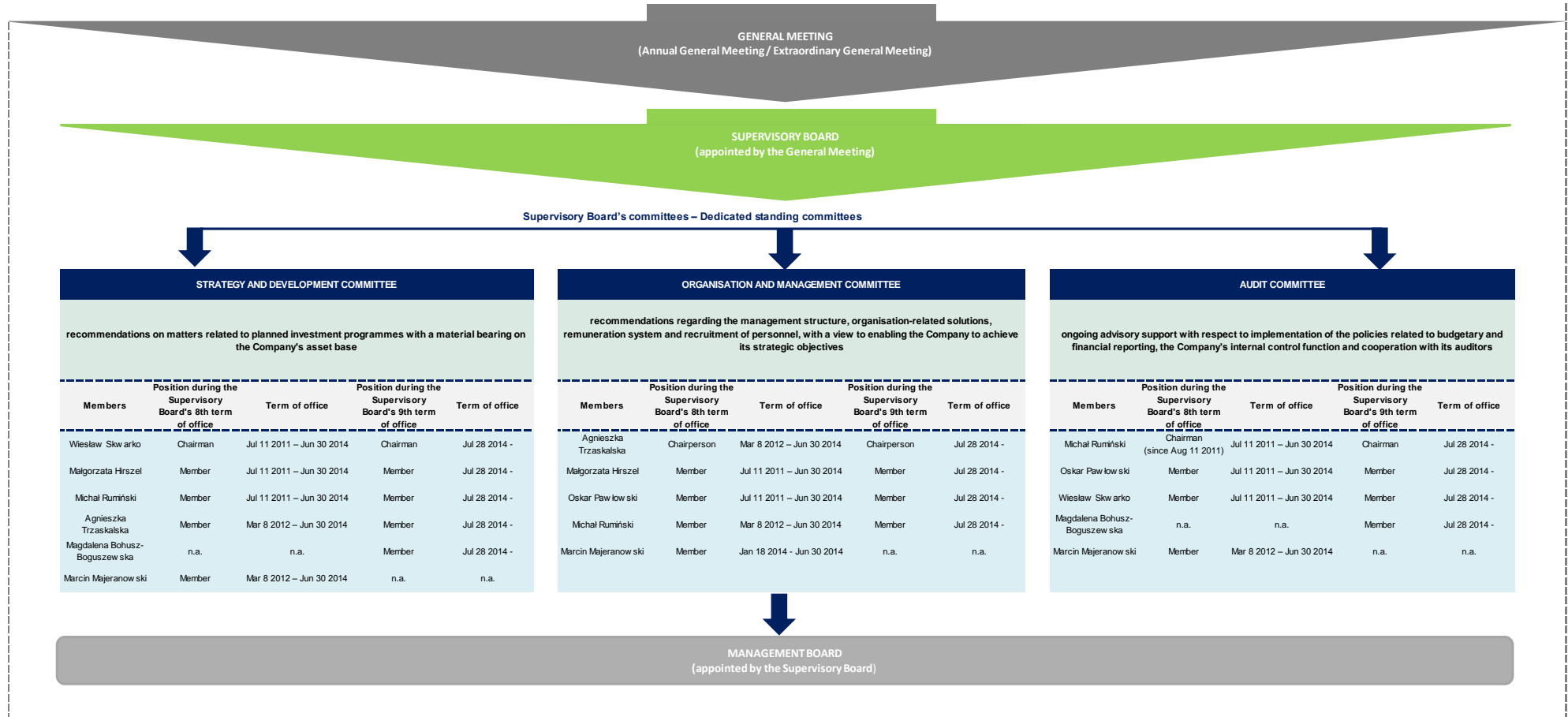
Subject to the relevant provisions of the Commercial Companies Code, a material change may be introduced in the Company's business profile without a buy-out of Company shares held by the shareholders who do not agree to such a change.

5.1.5. RESTRICTIONS ON TRANSFERABILITY OF SECURITIES

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

5.2. CORPORATE GOVERNANCE STRUCTURE OF GRUPA LOTOS S.A.

Figure 45. Corporate governance structure of Grupa LOTOS S.A. as at December 31st 2014



5.1.1. 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 February 23rd 2015) 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 2014 the Company's Annual General Meeting was held on June 30th, and was convened by the Management Board.

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 total voting rights 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.

In 2014, the Company's Extraordinary General Meeting was held twice, on September 8th and on November 25th, and was in each case convened by the Company's Management Board.

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 (*świadcetwa 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.

5.1.2. 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. (consolidated text of December 17th 2009) (link: http://inwestor.lotos.pl/226/lad_korporacyjny/dokumenty_spolki). 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. Any or all Supervisory Board members 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.




Following the expiry of the 8th term of office of the Supervisory Board, on June 30th 2014 the Annual General Meeting of Grupa LOTOS S.A., acting in accordance with Article 11.1 of the Company's Articles of Association and Resolution No. 21, set the number of Supervisory Board members of the 9th term of office at seven. In accordance with Articles 385.1 and 385.2 of the Commercial Companies Code as well as Articles 9.4 and 11.2 of the Articles of Association, the following persons were appointed as members of the Supervisory Board: Wiesław Skwarko (appointed as Chairperson of the Supervisory Board), Agnieszka Trzaskalska, Oskar Pawłowski, Małgorzata Hirszel, Magdalena Bohusz-Boguszewska, and Michał Rumiński.

Pursuant to Article 11.2 of the Articles of Association, as long as it remains a shareholder in the Company, the State Treasury, represented by the Minister of State Treasury, is entitled to directly appoint and remove one member of the Supervisory Board. As at the date of release of this Report, the State Treasury had not exercised this right.

The Supervisory Board of the ninth joint term of office was established at its first meeting on July 28th 2014. Ms Agnieszka Trzaskalska was appointed as Deputy Chairperson of the Supervisory Board (Resolution No. 1/IX/2014), and Mr Oskar Pawłowski was appointed as Secretary of the Supervisory Board (Resolution No. 2/IX/2014).




During the meeting, the Supervisory Board agreed on the composition of its standing committees, as presented in Figure 62. above.

Table 33. Composition of the Supervisory Board of Grupa LOTOS S.A. (8th term)

SUPERVISORY BOARD MEMBERS (8TH TERM)	POSITION	ON THE SUPERVISORY BOARD (8TH TERM)	CAREER PATH AND POWERS
 Wiesław Skwarko	Chairman	Jun 27 2011 - Jun 30 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-21
 Marcin Majeranowski	Deputy Chairman	Feb 29 2012 - Jun 30 2014	
 Oskar Pawłowski	Secretary	Jun 27 2011 - Jun 30 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-54

	Member	Jun 27 2011– Jun 30 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-55
<p>Małgorzata Hirszel</p>			
	Member	Feb 29 2012 - Jun 30 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-56
<p>Agnieszka Trzaskalska</p>			
	Member	Jun 27 2011 - Jun 30 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-57
<p>Michał Rumiński</p>			

Table 34. Composition of the Supervisory Board of Grupa LOTOS S.A. (9th term)

SUPERVISORY BOARD MEMBERS (9TH TERM)	POSITION	ON THE SUPERVISORY BOARD (9TH TERM)	CAREER PATH AND POWERS
 Wiesław Skwarko	Chairman	Jun 30 2014 –	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-21
 Agnieszka Trzaskalska	Member Deputy Chairwoman	Jun 30 2014 – Jul 28 2014 Jul 28 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-56
 Oskar Pawłowski	Member Secretary	Jun 30 2014 – Jul 28 2014 Jul 28 2014	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-54

 <p>Małgorzata Hirszel</p>	<p>Member Jun 30 2014 – http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-55</p>
 <p>Magdalena Bohusz-Boguszewska</p>	<p>Member Jun 30 2014 – http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-66</p>
 <p>Michał Rumiński</p>	<p>Member Jun 30 2014 – http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-57</p>

The Supervisory Board of Grupa LOTOS S.A. 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.

Mr Marcin Majeranowski – delegated by virtue of Supervisory Board Resolution No. 66/VIII/2013 of January 11th 2013 to independently supervise the execution of the LOTOS Group's capital restructuring programme and the implementation of its schedule. As the eighth term of office of the Supervisory Board expired and the Annual General Meeting of June 30th 2014 did not appoint Mr Marcin Majeranowski for the next 9th joint term of office, his powers of delegation expired.

Mr Oskar Pawłowski – delegated by virtue of Supervisory Board Resolution No. 98/VIII/2013 of May 23rd 2013 to independently supervise the restructuring of the Norwegian assets of the LOTOS Group's Exploration & Production Segment. The Supervisory Board of the ninth joint term of office, by virtue of its decision of July 28th 2014 (Resolution No. 6/IX/2014), maintained Mr Pawłowski's powers of delegation to supervise the restructuring of the Norwegian assets.

Ms Magdalena Bohusz-Boguszewska – delegated by virtue of Supervisory Board Resolution No. 10/IX/2014 of August 22nd 2014 to independently exercise detailed and ongoing supervision of the Project involving the construction of a Delayed Coking Unit (DCU) and auxiliary installations, including the process of negotiation and selection of main contractors and arrangement of financing.

5.1.3. 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: (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 documents are available from the [the Company's Articles of Association and the Rules of Procedure for the Management Board Corporate Governance](#) section of the Company's website.

The Management Board represents Grupa LOTOS S.A. before third parties and manages its corporate affairs. 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 this Report, the Grupa LOTOS S.A. Management Board of the eighth term of office consisted of the following persons:

Management Board: composition and powers

**Paweł
Olechnowicz**

President of the Management Board, CEO**Term of service on 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 fourth 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: He is in charge of, and takes responsibility for, the overall management and direction 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, holds an MBA from INSEAD in Fontainebleau, and attended a number of courses in management, both in Poland and abroad.

In 1977, Mr. Olechnowicz began his professional career in Zakłady Mechaniczne Zamech of Elbląg (renamed ABB Zamech Sp. z o.o. in 1990). In 1990–1996, he was President of the Management Board and Director General of ABB Zamech Ltd.; concurrently, in 1994–1996, also served as 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 of Central Europe Energy Partners (CEEP), an expert organisation established in 2010 in Brussels to represent the interests of energy companies from Central and Eastern Europe. He serves as Chairman of the Board of Directors of CEEP.

After taking the position of President of the Management Board of Grupa LOTOS S.A., Mr Olechnowicz began the dynamic process of modernising the Company's structures and developing its production and marketing potential. He was responsible for the Company's business consolidation with Petrobaltic, an exploration and production company, and the Czechowice-Dziedzice and Jasło refineries. He also floated Grupa LOTOS shares on the Warsaw Stock Exchange (June 9th 2005) and used the IPO proceeds (approximately PLN 1bn) to carry out the 10+ Programme which involved construction of state-of-the-art liquid fuel production installations at the Gdańsk refinery and increased its throughput capacity from 6 to 10.5 million tonnes. The +10 Programme, carried out in 2007–2011 and valued at nearly EUR 1.5bn, was one of the largest investment projects to be implemented in Poland in the last 25 years. Mr Olechnowicz led the implementation of the cost-cutting Package of Anti-Crisis Measures developed jointly by the Company's management and staff (2009), as well as the efficiency-enhancement and cost-cutting Optimal Expansion Programme (2012). In late 2014 and early 2015, Mr Olechnowicz as President of Grupa LOTOS S.A. led a successful follow-up issue of the Company shares. The Company raised approximately PLN 1bn from the issue and plans to use the proceeds to finance investment projects under the 'Efficiency and Growth 2013–2015' programme. These include mainly the construction of a Delayed Coking Unit (DCU) and auxiliary installations as part of the EFRA Project, and development of the B4/B6 gas fields in the Baltic Sea. In 2014, at the 'Nafta i Chemia' conference devoted to the oil and chemical industries, President of Grupa LOTOS S.A. Paweł Olechnowicz was awarded the 'Man of the Decade' title.

http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-12



**Mariusz
Machajewski**

Vice-President of the Management Board, Chief Financial Officer

Term of service on the Management Board: Mr Machajewski has held the position of Vice-President of the Management Board of Grupa LOTOS S.A. since June 19th 2006, when he was appointed by the Supervisory Board to the Management Board of the sixth term. In 2009 and 2012 he was re-appointed Vice-President of the Board by the Company's Supervisory Board.

Since 2006, he has served as Deputy Chairman of the Supervisory Board of LOTOS Paliwa Sp. z o.o., and since 2010 – as Chairman of the Supervisory Board of RCEkoenergia Sp. z o.o.

Mr Machajewski has also been member of the Supervisory Board of Stowarzyszenie Emitentów Giełdowych (Polish Association of Listed Companies) since 2013.

Responsibilities: He is mainly in charge of, and takes responsibility for, the overall management of the Company's economic, financial and accounting activities, as well as all matters related to its asset base and restructuring processes. In addition, he also exercises supervision over matters related to the formulation of corporate guidelines and standardisation of procedures related to the conclusion of agreements, selection and evaluation of trading partners, as well as development of IT systems and telecommunication services.

Qualifications, professional experience and achievements:

Mr Machajewski is a graduate of the Faculty of Economics at Gdańsk University. He also attended a number of courses in management and economics in Poland and abroad.

In 1994–1997, he worked at Stocznia Gdynia S.A. (Gdynia Shipyard). In 1997, he joined Grupa LOTOS S.A. (formerly Rafineria Gdańska S.A.), where he was placed in charge of the Company's controlling functions in 1999. Since mid-2002, he has held the position of Chief Financial Officer. From April 2005 to June 2006, he also served as the Company's commercial proxy.

Appointed to the Management Board in June 2006. He was involved in the Company's internal restructuring, which led to the creation (in 2005) of the Finance and Accounting Centre, a body primarily intended to provide accounting services to Grupa LOTOS S.A. and its subsidiaries. He assisted in preparations before the floatation of Grupa LOTOS shares on the Warsaw Stock Exchange on June 9th 2005. Mr Machajewski played an instrumental role in formulating and arranging the financing framework for the 10+ Programme. The credit facility executed in June 2008 to finance the 10+ Programme was the largest transaction in the Company's history. It was declared transaction of the year in the European oil industry and named the Best Financing Project of the year by a number of prestigious specialist journals. Mr Machajewski prepared and oversaw the implementation of the cost-cutting Package of Anti-Crisis Measures (2009) and the efficiency-enhancement and cost-cutting Optimal Expansion Programme (2012). In charge of restructuring processes, he is responsible for the implementation of the LOTOS Group's development and capital restructuring programme: 'Efficiency and Growth 2013–2015', and oversees the exercise of corporate supervision at subsidiary companies. He supervised the processes of share capital increase at the Company carried out in 2014 and development of the framework for arranging financing for the ongoing 'EFRA – Effective Refining' Project,

http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-15



Zbigniew
Paszkowicz

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

Term of service on 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 eighth 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: He is in charge of, and takes responsibility for, the overall management of the Group's exploration and production segment. As part of this role, he is charged with the oversight of companies in that segment.

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 Supérieure du Pétrole 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. He supervised the final phase of development of the B8 field, involving in particular conversion of the Petrobaltic drilling rig into a production platform, and construction of subsea production infrastructure. As part of strategy implementation, in March 2014, the then newly acquired LOTOS Petrobaltic' rig was transported to the Baltic Sea.

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



**Marek
Sokołowski**

Vice-President of the Management Board, Chief Operations Officer

Term of service on the Management Board:

Mr Sokołowski has served as Vice-President of the Management Board of Grupa LOTOS S.A. since April 19th 2002, as member of the Management Boards of the fourth, fifth, sixth, seventh and eighth term.

Between 2002 and 2009, he was the Chairman of the Supervisory Board of LOTOS Kolej Sp. z o.o. 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. Until April 2002 Mr Sokołowski held the position of Chief of Technical Services, concurrently serving 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 hydrodesulfurisation (HDS) unit.

Once all the new installations built as part of the 10+ Programme came on stream, the refinery's crude processing capacity, depth of crude processing, and feedstock flexibility improved considerably. Completion of the 10+ Programme placed Grupa LOTOS S.A. in the elite group of the most advanced refineries in Europe. In recent years, Marek Sokołowski has been the promoter of the idea of enhancing the refinery's energy security by connecting it to mains gas network. Another of his initiatives was organisational changes as part of the Operational Excellence Programme, whose implementation resulted in the Gdańsk refinery being evaluated by international auditors (Solomon Inc.) as one of the most efficient refineries in Europe. Currently, Mr Sokołowski is involved in efforts aimed at building a new unit under the 'EFRA – Effective Refining' project, the purpose of which is to achieve a significant improvement in refining margin thanks to an increased crude distillate yield. Mr Sokołowski has been a member of the Board of the Polish Chamber of Chemical Industry.

http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-14



Maciej
Szozda

Vice-President of the Management Board, Chief Commercial Officer

Term of service on the Management Board:

Mr Szozda has served as Vice-President of the Management Board of Grupa LOTOS S.A. since July 1st 2009, as member of the Management Boards of the seventh and eighth terms.

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 Easy 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 as (in chronological order) 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 a member of the Supervisory Board of Orlen Deutschland AG. From 2007 to March 2009, he served as a 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 17. 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, the Company beat the national record for the number of stations opened within one year by adding as many as 68 new locations to its network. Between 2009 and 2015, the number of stations in the network doubled. In 2012, LOTOS stations won the prestigious Crystal Emblem of European Trusted Brands. 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/1137/lad_korporacyjny/struktura_organizacyjna#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 its 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, and 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 the Management Board's own initiative, upon 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

[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 duties by the Supervisory Board if there is a good 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 any or all members of the Management Board 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.

The Management Board's current eight term of office ends in 2015.

5.1.4. 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 votes 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 the 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 Supervisory Board receives relevant authorisation from the General Meeting.

The process of increasing the Company's share capital carried out in 2014 involved amendment to the Company's Articles of Association. In its Resolution No. 2, the Extraordinary General Meeting held on September 8th authorised the Management Board to determine the final wording of Art. 4.1 of the Company's Articles of Association concerning the amount of share capital, and to file a relevant application for registration of the amendment with the registry court. The share capital increase and the amendment to the Company's Articles of Association were registered by the court on January 9th 2015.

Concurrently, the Extraordinary General Meeting authorised the Company's Supervisory Board to prepare a consolidated text of the Company's Articles of Association incorporating the amendments made under the Resolution, a process that is still pending as at the date of release of this Report.

5.2. CORPORATE GOVERNANCE PRINCIPLES APPLICABLE AT GRUPA LOTOS S.A. IN 2014

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 in 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 2014, the Investor Relations Team supported the Company's Management Board in organising meetings with investors and maintaining regular contact with capital market participants.

In the second half of the year, the Investor Relations Team coordinated work on the Series D shares issue project.

As part of its relations with individual shareholders, the Company collaborates with the Polish Association of Retail Investors. In 2014, Grupa LOTOS S.A. attended the 18th Wall Street Conference of retail investors, organised by the Polish Association of Retail Investors in Karpacz on June 6th-8th 2014.

[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 contains downloadable files, i.e. periodic reports, strategy and efficiency improvement presentations, and the issue prospectus. This section also lists 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 2014 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 in relation to 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.

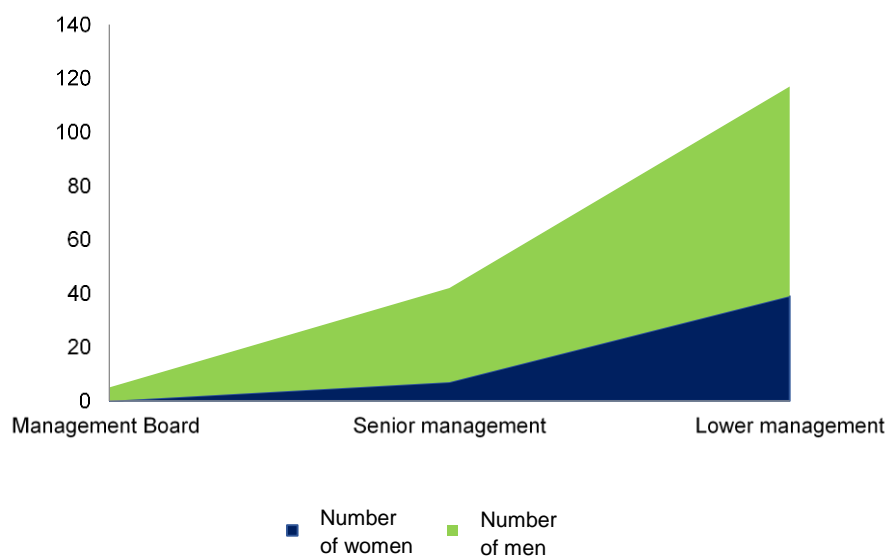
Table 35. Number of women and men on the Supervisory Board

	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
Jan 1–Jun 30 2014	2	4
Jun 30–Dec 31 2014	3	3

Table 36. Number of women and men on the Management Board and in other management positions at Grupa LOTOS S.A., as at December 31st 2014

	Number of women	Number of men
Management Board	0	5
Senior management	7	35
Lower management	39	78
Total	46	118

Figure 46. Management personnel by sex (as at December 31st 2014)



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 designed 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.

Figure 47. 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 objectives of the LOTOS Group Corporate Social Responsibility Strategy for 2012–2015. The system of fundamental CSR values is aligned with key LOTOS brand values which rest on three pillars:

Table 37. Key groups of stakeholders under the LOTOS Group's Corporate Social Responsibility Strategy

Group I	Group II	Group III
INTERNAL STAKEHOLDERS	EXTERNAL STAKEHOLDERS	MARKET ENVIRONMENT
Employees	Local communities	Contractors and subcontractors
Group companies	Non-governmental organisations	Suppliers
Works Council	Local government institutions	Customers
	Government administration	Trading partners
	Scientific and research institutions, education centres	Competitive companies
	Employer associations	Industry organisations and international institutions
	The media	Organisations responsible for inspecting, monitoring, certifications
	Natural environment	Participants of the capital market

Table 38. 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
<p>Creating values beneficial to the social environment</p> <p>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.</p>	<p>Creating values beneficial to the natural environment</p> <p>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.</p>	<p>Creating values beneficial to the business</p> <p>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.</p>

Table 39. Areas of strategic focus under the Corporate Social Responsibility Strategy

Investment in human resources	Management of natural resources in the production process	Ethics and corporate misconduct prevention
Improvement of health and safety		Partnership with market participants
Integration with local communities		Security of energy sector

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 a consistent 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 the LOTOS Group'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 18th 2014, Grupa LOTOS S.A. was included in the RESPECT Index for the eighth time. The index currently lists 23 companies.

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: financial report and social 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 2012–2014

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, acting under Par. 29.3 of the WSE Rules, releases 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.

In 2014, the Company did not publish any reports on instances of non-compliance with obligatory corporate governance rules.

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.

Consolidated financial statements are prepared in accordance with 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., Norway-based LOTOS Exploration and Production Norge AS, LOTOS Asphalt Sp. z o.o., LOTOS Oil S.A., LOTOS Paliwa Sp. z o.o., LOTOS Kolej Sp. z o.o., LOTOS Serwis Sp. z o.o., Lithuania-based AB LOTOS Geonafta and its subsidiaries, APHRODITE Offshore Services N.V., MILIANA Shipholding Company Ltd. and its subsidiaries, and SPV Baltic Sp. z o.o. and B8 Spółka z ograniczoną odpowiedzialnością BALTIC S.K.A. 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.