

# Business strategy of the LOTOS Group

The overriding strategic objective adopted by the LOTOS Group in its Business Strategy for 2011–2015 was to create value for shareholders through optimized deployment of human and material resources and implementation of development programmes in the following areas:

- exploration and production,
- crude processing,
- marketing.

As at the end of 2015, we accomplished as many as 10 out of the 11 strategic objectives formulated in the LOTOS Group's Business Strategy for 2011–2015. They included all development-related objectives for the areas that we consider to be of key importance.

Area	Strategic objective	The accomplishment of the objective
<b>Management segment</b>	Achieve growth of the LOTOS brand equity in 2011–2015, understood as the effect of synergies between image and strength among key target groups for the brand. A measure of success of our efforts in this area was the level of the aggregated LOTOS brand equity index as at the end of 2015, which stood at 140 pts.	
	Implement the CSR strategy to support achievement of the business strategy objectives.	
<b>Upstream segment</b>	Increase hydrocarbon production to 1.2 million toe in 2015, equivalent to 24 thousand boe per day. As a result of the measures we implemented, as at the end of 2015 daily production capacity on an annualized basis amounted to 30.3 thousand boe per day.	
<b>Marketing segment</b>	Maintain at least 30% share of the domestic fuel market.	
	Achieve 10% share of the domestic retail fuel market by the end of 2015.	
	Increase sales to a level exceeding by 15% the fuel production capacities of the Grupa LOTOS refinery.	
	Maintain leading position in the Polish lubricating oils market.	

## Refining segment

Maintain high competitiveness of Grupa LOTOS' refinery.



Achieve best production standards in the refining industry with respect to energy management, use of the natural environment, and accident rates.



Ensure safety of the technological processes at Grupa LOTOS.



Increase depth of conversion and distillate yields.



objective accomplished



objective unaccomplished

At the end of 2015, the only item where our performance was slightly below the target was sales volume exceeding by 15% the fuel production capacities of the Grupa LOTOS refinery. We achieved 95% of the target volume, which followed from the Company's deliberate decisions. As margin levels towards the end of the period covered by the strategy no longer supported a further increase in production and sales volumes, the Company responded by adapting to the new macroeconomic environment.

The previous year was an important milestone on the LOTOS Group's growth path. We exceeded key strategic targets set for 2011–2015 in the upstream segment and the wholesale and retail fuel markets in Poland. 2016 opens a new chapter of growth for LOTOS, where our key goals will be to further enhance Poland's security in the energy sector, help with the industrialization of the national economy, and deliver substantial growth in company value.

Our hydrocarbon production rose to 28.4 thousand boe/d. The wholesale and retail fuel market shares we achieved at the end of 2015 were 31.1% and 10.5%, respectively.

Once completed, the deep oil conversion complex built under the EFRA Project will deliver numerous benefits, including an around USD 2/bbl increase in the refining margin. It will also enable LOTOS to produce an additional 900 thousand tonnes of fuels a year, mainly diesel oil, which will be placed on the Polish market. The work on the project launched last year is scheduled for completion in 2018.

## Solid performance despite external pressures

The strong decline in crude prices (nearly 47% year on year) and the downward trend in the prices of petroleum products had an adverse effect on the results reported by the LOTOS Group. Last year, it booked PLN 22.7bn in consolidated revenue, with a net loss of PLN 263m.

The reported net loss was primarily driven by finance costs, including foreign exchange losses of close to PLN 345m, arising from the stronger USD/PLN exchange rate in 2015 at the end of the period, (+11.1% year on year), which affected the valuation of outstanding bank loans denominated in the US dollar.

In the reporting period the LOTOS Group generated PLN 1,488m in cash flows from operating activities (2014: PLN 1,381m) – a visible proof of its stable financial condition.

## **Major increase in hydrocarbon production – Sleipner and B8**

2015 saw LOTOS Petrobaltic's combined production in Poland, Norway and Lithuania rise to an all-time high of 28.4 thousand boe/d. Despite the depressed oil and natural gas prices, LOTOS Petrobaltic Group increased the volume of hydrocarbons produced from its assets, which included output from the recently purchased interests in the Sleipner gas field in Norway and initial production from the B8 field in the Baltic Sea.

B8 is now the largest oil extraction facility in the Polish economic zone of the Baltic Sea, with production potential estimated at 3.5m tonnes of crude. LOTOS Petrobaltic will produce up to 5 thousand boe/d from the B8 field once target production levels are reached.

Upstream EBITDA totalled PLN 185m in 2015, compared with a loss of PLN 280m the year before.

## **Record throughput, rising sales**

In 2015, the Grupa LOTOS refinery in Gdańsk processed a record volume of 10.2m tonnes of crude (2014: 9.5 million tonnes). The refinery's annual capacity utilization rate was 97%.

In 2015, in the production and sale sector, LOTOS sold a total of 10.9 million tonnes of products, which is approximately 8.1% more than in 2014. The rise in output and sales was an effect of refining margins remaining very strong for the most part of 2015.

## **Clean EBITDA at record highs for LOTOS service stations**

As at the end of 2015, the LOTOS retail chain comprised 476 stations. A total of 35 new service stations, including 25 sites in the LOTOS Optima economy segment, were added during the year. The financial performance of the LOTOS network was improved by successful optimization efforts, with clean 2015 EBITDA in the retail sector reaching PLN 112m, compared with PLN 95m in 2014 and PLN 44m in 2013.

## **New goals for new times**

**We started working on the new business structure including the new perspective. We have worked intensely on the short-term strategy up to 2018 and on the strategic development directions after 2018.**

**The key assumptions made for the strategy include:**

- Company's return to dividend distribution and retained capacities to distribute it in long term
- Stable and efficient development of complementary activity sectors
- Continued policy of optimising integrated margin
- Poland's security in the energy sector with economic advantages of material source diversification

**In the short term (by 2018), we plan:**

- To identify the strategic growth directions and plan development initiatives
- To analyse the current assets in terms of their long-term ability to generate value for the Group
- To include EFRA system into the process line, to achieve full production capacities of B8 field and complete the analyse of B4/B6 gas field profitability
- To start the projects related to organisational and saving improvements gradually
- To strengthen the innovative culture in line with the reindustrialization policy of Poland

**In the 2018+ perspective we assume:**

- Implementation of further development projects, retaining the ability to distribute dividends
- Ongoing optimization of the target operating, capital and legal infrastructure