



LOTOS Group  
Integrated Annual Report 2015

02

## Our strategy

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## Our strategy

In 2015, we successfully completed implementation of the LOTOS Group's Business Strategy for 2011–2015. The key objectives we had set for ourselves in that important document were met. We increased our production potential and improved operational efficiency. We also consolidated our position in the retail fuels market. All of our development-oriented activities were pursued with due regard to the ideas of sustainable development and corporate social responsibility, the key propositions of which we defined in our CSR strategy for 2012–2015.

### Profits from the strategy implementation:

- Improved competitiveness as a result of increased distillate yields, more efficient management of energy, better access to own oil reserves, and implementation of optimization projects.
- Expansion into new markets.
- Increased loyalty of customers.
- Boost to the innovative potential of our organization.
- Development and constant improvement of the risk management process.
- Maintained long-term trust of our employees.

And we will not stop here. We perceive our achievements to date as the starting point for further development and improvement of our efficiency and innovativeness. In response to serious market challenges, we implemented a new segment management model. We have also started working on our new strategy, including the perspective till 2018 and long-term perspective "2018+".

# 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

# LOTOS Group's Corporate Social Responsibility Strategy

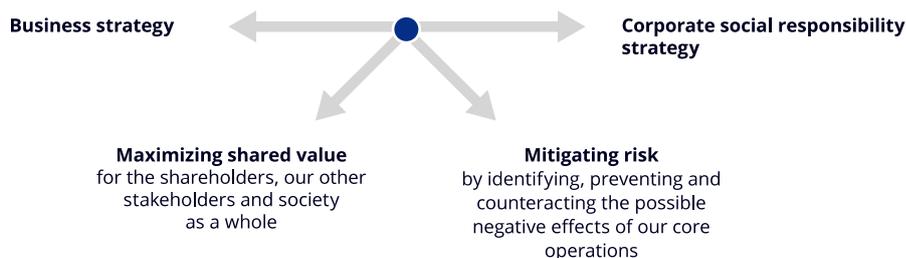
At the LOTOS Group, we approach CSR as an element of our management and improvement processes within our organization.

We believe that business should be conducted according to ethical standards, in harmony with the natural environment and social needs. This is why we have adopted a system of values which we see as a long-term pledge towards all our stakeholders.

## Development of the strategic approach:

Back in 2008, the awareness of how relevant social responsibility was to the pursuit of strategic goals prompted the Board of Grupa LOTOS to adopt the comprehensive LOTOS Group's Corporate Social Responsibility Strategy. In 2011, the document was reviewed in a process of wide-ranging consultations with our stakeholders. The outcome of the review was LOTOS Group's Corporate Social Responsibility Strategy for 2012–2015, whose overriding objective was to support the business strategy by use of the organization's resources and capabilities to generate economic and social value for the benefit of its environment.

Implementation of this objective was made possible through the use of the following mechanism:



**Our efforts in the social and business spheres, in our relations with key stakeholders and in corporate governance were aimed principally to:**

- Mitigate possible adverse impacts of our operations and the associated risks,
- Maximize chances for sustainable development over the long term,
- Ensure compliance with the law and ethical standards,
- Increase our positive contribution to social development.

The strategic approach to CSR at the LOTOS Group is manifest in each area of its business. The CSR strategy defined **13 key goals, 39 operational objectives** and **ca. 100 activities** to be undertaken each year in individual business areas.

### How was the implementation status measured?

The implementation of key goals and operational objectives and the related activities was supervised by the respective area leaders. One aspect of the concurrent focus on the business and social dimension was regular reporting to the Board of Grupa LOTOS on the progress of the CSR strategy, together with reports on the implementation of the business strategy. The measure of the CSR strategy implementation was its progress in individual areas, expressed in percentage terms.

### Implementation status:

At the **end of 2015**, the strategic objective was achieved in **90%**, and **95%** of the operational activities were completed.

## Key goals and activities related to the implementation of the CSR strategy in 2012–2015, by area:

### Investment in human resources

Key goals	Key activities and selected indicators
<ul style="list-style-type: none"> <li>■ Ensure availability of highly qualified resources required to successfully implement our business strategy</li> <li>■ Enhance our corporate culture based on adopted values</li> </ul>	We improved the human resource management standards, perfecting HR processes, e.g. the development of LOTOS Academy, induction programme, recruitment standards, new functionalities in the self-service employee portal, i.e. HR and SAP HCM Portal.
	We conducted an employee satisfaction/engagement survey across the LOTOS Group and performed the plans of improvement activities based on their results.
	We improved the periodic employee evaluation system – 96% of our employees meet key position-specific requirements.
	We increased the number of our 50+ staff members involved in the development of their colleagues.
	Each year we organized numerous internship and traineeship programmes.
	We were actively involved in activities designed to increase the quality of secondary-school education through partnership-based cooperation with schools, universities, students' associations and research clubs.
	Each employee was given a copy of the Code of Ethics.
	We developed a training system dedicated to the LOTOS service station managers and staff.
	We developed a "Strategy for LOTOS as Employer Brand".

## Improvement of health and safety

Key goal	Key activities and selected indicators
<ul style="list-style-type: none"> <li>■ Raise the awareness and degree of involvement in improving safety among the management and employees of all ranks, as well as contractors</li> </ul>	In each year covered by the strategy, we organized the Occupational Health and Safety Day for the LOTOS Group employees.
	We organized a number of information and education campaigns and projects promoting workplace safety.
	We carried out in-house OSH training for the management, and checks of workplace safety standards at all of the LOTOS Group companies.
	We developed uniform safety standards for our contractors.

## Integration with local communities

Key goal	Key activities and selected indicators
<ul style="list-style-type: none"> <li>■ Ensure favourable attitudes among local communities and strengthen the organization's reputation as a socially conscious business by undertaking initiatives designed to provide lasting solutions to the locally relevant social and environmental issues</li> </ul>	Each year, we pursued over a dozen projects with the participation of our social partners (some of which were based on the cross-sectoral partnership model), related to road traffic safety, protection of biodiversity, and fostering equal opportunities.
	In order to improve cooperation, each year we held evaluation meetings with our social partners.
	We organized the 'Open-House Day' at the refinery for residents living in the vicinity of our plant.
	We carried out opinion surveys among people living near our plants, which included perception of the LOTOS Group as an organization with a positive influence on the quality of life of people living in the immediate neighbourhood of its plants.

## Management of natural resources in the production process

Key goal	Key activities and selected indicators
<ul style="list-style-type: none"> <li>■ Reduce the environmental risk and make constant efforts to minimize the environmental impact of the LOTOS Group's operations</li> </ul>	We did research on wildlife biodiversity in the vicinity of the Grupa LOTOS refinery in Gdańsk.
	We assessed the environmental impact of our service stations.
	Each year, as part of planning of all our investment projects, we improved energy efficiency ratios and reduced energy consumption by selected units.
	We engaged in the promotion of best practices and environmental standards.

## Ethics and corporate misconduct prevention

Key goal	Key activities and selected indicators
<ul style="list-style-type: none"> <li>Improve corporate management by ensuring ethical conduct and transparency of the business processes and protect the organization against the risk of irregularities that may threaten its operations</li> </ul>	<p>We assessed the organizational maturity with respect to the misconduct prevention system.</p> <hr/> <p>We adopted the Misconduct Prevention Policy.</p> <hr/> <p>We adopted and implemented the Code of Ethics.</p> <hr/> <p>We established the Ethics Board and appointed the Ethics Officer.</p> <hr/> <p>We set up a team responsible for the implementation of the Ethical Conduct Programme at our service stations.</p>

## Partnership with market participants

Key goals	Key activities and selected indicators
<ul style="list-style-type: none"> <li>Build lasting customer relationships through a focus on understanding customers' needs and delivering the expected product quality and safety</li> <li>Raise the awareness of LOTOS as a socially responsible brand</li> <li>Get across to capital market participants the message that corporate social responsibility is perceived by Grupa LOTOS as an essential part of its corporate management</li> </ul>	<p>In each year covered by the strategy, we carried out satisfaction surveys among the LOTOS Group customers.</p> <hr/> <p>We standardized commercial processes (including complaint handling) at the LOTOS Group, based on electronic tools.</p> <hr/> <p>We carried out a number of promotional activities addressed to the LOTOS Group employees in order to make them ambassadors of the LOTOS brand.</p> <hr/> <p>We completed the 'Helping while Refuelling' campaign – the first cause-related marketing project in the fuel industry in Poland.</p> <hr/> <p>We communicated our CSR initiatives to capital market participants.</p>

## Energy security

Key goals	Key activities and selected indicators
<ul style="list-style-type: none"> <li>Undertake and support initiatives designed to enhance security in the energy sector at home and in other countries where Grupa LOTOS has a business presence, in a socially and environmentally responsible manner</li> </ul>	<p>We had an active role in law-making processes relating to energy sector issues in Poland and the EU.</p>

## Communicating changes and access to information

Key goals	Key activities and selected indicators
<ul style="list-style-type: none"> <li>■ Ensure timely and targeted communication with stakeholders</li> <li>■ Foster an organizational culture that rests on the foundation of open, multi-way communication, including through development of a consultation system within the LOTOS Group</li> </ul>	<p>We implemented new functional and graphical solutions in the employee intranet; we made our intranet available for employees outside the organization.</p> <hr/> <p>We developed our social media platforms, such as 'Headed for the Baltic'.</p> <hr/> <p>We implemented and developed the 'LOTOS dla Kierowcy' ('LOTOS for Motorists) and 'LOTOS Kids' mobile applications.</p>

## With responsibility towards the future

At the end of 2015, during the annual 'CSR Day' event attended by the management of the **LOTOS Group**, we commenced work on the new **Corporate Social Responsibility Strategy** based on the experience gained in the course of the strategy development process in 2011 and will take into account the changes that followed as part of the natural evolution of the LOTOS Group's CSR activity in connection with its dynamic development in 2012–2015.

### The strategy development process involved:

- Internal assessment of the degree of achievement of the objectives set for 2012–2015,
- External evaluation of the changes that the implementation of the Strategy brought in the perception of the Company's CSR commitment by its key stakeholder groups,
- Evaluation of the results of implemented initiatives based on the benefits to the organization; opinions of key external beneficiaries,
- Development of the Strategy in close cooperation with the leaders responsible for implementing strategic CSR objectives in 2012–2015 and with specialists from within the organization indicated by the leaders, as well as with representatives of the team responsible for defining the new business outlook for the LOTOS Group.

The LOTOS Group's CSR Strategy will address the **challenges defined in the Sustainable Development Goals until 2030** published by the United Nations in September 2015, the [Vision of Sustainable Development of Polish Businesses until 2050](#), and the **10 Principles of UN Global Compact**. Those objectives have already been implemented by us by e.g. long-term programmes focused on employee development at all levels, and by the social and market environment. An example of this activity can be the first cause-related marketing campaign in the fuel sector in Poland, called "[Helping while refuelling](#)". The conscious and comprehensive approach to the management of natural resources and energy security are another example of the LOTOS Group's commitment to the Sustainable Development Goals. We have constantly been reducing energy efficiency ratios and energy consumption in selected systems.

By pursuing the goals set in the Strategy, we seek to increase our contribution towards meeting the challenges defined by the UN.

### The Ten Principles of the UN Global Compact:

1. Businesses should support and respect the protection of internationally proclaimed human rights; and
2. make sure that they are not complicit in human rights abuses.
3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4. the elimination of all forms of forced and compulsory labour;
5. the effective abolition of child labour; and
6. the elimination of discrimination in respect of employment and occupation.
7. Businesses should support a precautionary approach to environmental challenges;
8. undertake initiatives to promote greater environmental responsibility; and
9. encourage the development and diffusion of environmentally friendly technologies.
10. Businesses should work against corruption in all its forms, including extortion and bribery.

The **Sustainable Development Goals** include 17 goals, 169 targets and 304 indicators to achieve by 2030, to ensure better, healthier and safer living conditions, in the social, environmental and economic spheres. In 2015, those goals replaced the previous eight millennium goals.



#### Sustainable Development Goals (SDGs), which LOTOS Group supports by taking actions:

- Goal 4 – Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
- Goal 6 – Ensure availability and sustainable management of water and sanitation for all
- Goal 7 – Ensure access to affordable, reliable, sustainable and modern energy for all
- Goal 8 – Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
- Goal 9 – Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
- Goal 10 – Reduce inequality within and among countries
- Goal 12 – Ensure sustainable consumption and production patterns
- Goal 14 – Conserve and sustainably use the oceans, seas and marine resources for sustainable development
- Goal 15 – Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
- Goal 17 – Strengthen the means of implementation and revitalize the Global Partnership for Sustainable Development

# Risk management

# Our approach to risk management

Because of the specific nature of the fuel sector, the LOTOS has a strategic approach to minimizing prospective risks likely to affect performance of our business objectives, as well as the social environment where we operate adversely. By identification, constant monitoring and strategic approach to management we reduce hazards day by day.

Throughout 2015, as part of the Enterprise Risk Management (ERM) system, we undertook a number of risk mitigation measures reducing the probability that specific risks may materialize. In the case of risks that did materialize, we applied the action plans prepared in advance, successfully limiting their adverse effects. We also defined new risks, mainly associated with projects of crucial importance to the LOTOS Group (such as [EFRA](#) or [B8 field](#) development). A number of measures were also being implemented to improve the risk management tools and risk identification, assessment and monitoring methodologies.

At the LOTOS Group, we identify a range of risks in all areas of our business. Many of them are interrelated, so we analyse their interactions and take steps to minimize their impact.

## Key risk groups for the LOTOS Group



Risks are identified in reference to the strategic and operational objectives pursued by the organization. Risk assessment is performed based on a defined and approved risk matrix, and includes analysis of the likelihood of the risk materialization and possible financial and reputational consequences, where the latter are understood as damage to reputation, environment or people's health. All identified risks are monitored, and those considered as material are subject to more stringent control requirements.

## Key elements of risk and opportunity management at the LOTOS Group



- **Risk identification** – risks are identified in reference to the strategic and operational objectives pursued by the organization.
- **Risk assessment** – risks are assessed in the annual and long-term perspectives in terms of their potential consequences for the LOTOS Group’s financial standing and reputation (including adverse impact on the LOTOS Group’s image, the environment and people’s health).
- **Risk analysis** – for each risk, we define the current management procedure as well as monitoring and protection measures, and if a risk is deemed material, detailed risk management charts are prepared. The charts specify how a given risk should be mitigated and what actions to take should it materialize. Key risk indicators (KRI) are defined, by means of which the risk and the level of exposure can be monitored in accordance with established guidelines. Risk owners are responsible for the above elements of risk analysis.
- **Risk reviews** – all identified risks are periodically reviewed and updated, twice as year as a minimum.
- **Process reporting** – appropriate standards have been implemented for communicating and reporting the results at each stage of the process.

## Roles in the risk management process:

- The Supervisory Board – monitors the effectiveness of the risk management system.
- The Board of Grupa LOTOS – makes key ERM decisions and approves risk maps.
- Segment heads – are responsible for overall monitoring and supervision of risk management in their segments.
- Enterprise Risk Management Committee – recommends ERM-related actions and monitors their progress. The Committee consists of representatives of each segment.
- Enterprise Risk Coordinator – coordinates and supports risk management activities within the LOTOS Group.
- Risk owners – manage individual risks, defining the course of action with respect to each risk and monitoring its levels.
- The LOTOS Group employees – implement risk mitigation activities and identify new risks.
- Internal Audit Office and Business Process Management Office – carry out audits at LOTOS Group companies to review the implemented controls and evaluate their effectiveness, identify and assess threats to the organization's operations, carry out annual evaluations of the risk management system's effectiveness as part of the organizational maturity assessment, and assess individual risk management procedures.

Enterprise risk management activities at the LOTOS Group are supported by a dedicated IT tool, the ERM Portal. The ERM Portal is used to record risks and risk assessment results and prepare risk maps, to monitor current risk indicators and the progress of planned actions, as well as for reporting purposes. Audit results are also recorded in the ERM Portal where the audit involves a review of the risk management procedures.

## How is the system's effectiveness evaluated?

The ERM system's effectiveness is evaluated every year, as part of our [organizational maturity assessment](#), the conclusions and recommendations of which are used to further improve the system. A final assessment score is expressed as a percentage and reflects:

- The degree to which the system designed at the Company conforms with best practices and standards for a given area, and
- Conformity of the system's operation in practice with the system's design.

In the period from 2011 (when the system was launched at the organization) to 2015, the assessment score rose to 96%. Risk is inherent in Grupa LOTOS' business. The risk management system, being a strategic business process at the organization, is subject to constant improvement.

## Implementation costs of hedging strategies

The costs of hedging strategies depend on the materiality of the risk and the potential benefits derived from hedging. Whenever possible, risk is reduced to a level considered economically acceptable. Furthermore, when preparing risk analyses or action plans, potential costs are among the factors considered in making the final decision. This approach enables us to deploy the financial resources required for risk management in the most efficient manner possible.

## What are other manifestations of our precautionary approach?

- The [Code of Ethics](#): sets the standards of conduct in line with the LOTOS Group values.
- Agreements: include appropriate provisions governing cooperation with partners.
- Environmental protection and OHS standards: ensure the highest standard of people's and process safety.
- Project management: ensures proper project implementation and budget control.
- Controlling: supervision over the current budgets.

# Key risk groups for the LOTOS Group and key risks identified within individual groups

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## Risk groups

## Key risks

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### Political and legal risks

- Tensions between Ukraine and Russia and the resulting EU sanctions on Moscow.
- Plans to implement new EU legislation, especially related to tighter EU climate policy until 2030. 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 CO<sub>2</sub> emissions reduction ratio in the ETS be increased from 1.7% to 2.2%.
- Lack of comprehensive legal framework for the oil sector.

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### Reputational and social risks

- Events that may affect the perception of LOTOS and the LOTOS brand value. Factors beyond the Company's control include impairment of the reputation of our industry. Factors directly related to the Company's activities include delays in product supplies, deterioration of product quality, and industrial accidents.
  - [Risk of misconduct](#) — related e.g. to all corrupt practices.
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## Exploration and production risks

- Risks from estimating hydrocarbon resources and reserves discovered by exploration wells.
- Risk of drilling a dry well (without hydrocarbon flow).
- Risk of failure of production equipment and facilities due to their limited durability or improper operation.
- 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.
- Risk of limited control of joint ventures as such projects involve at least two partners.
- Macroeconomic risk – in 2015 relating mainly to 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.
- [Risk of increased liabilities in relation to the YME project.](#)

## Refinery-related operational risks

- Technical risks related to possible occurrence of serious industrial accidents or irreparable damage to infrastructure.
- Work safety risk – relates to potential occurrence of accidents and other threats involving exposure of employees to dangerous and onerous factors.
- Risk related to legislative changes with respect to REACH (Regulation of the European Parliament and of the Council concerning safe use of chemical substances, which is to be achieved through registration and evaluation, and in some cases through introduction of permits and restrictions on trade).

## Environmental risks

- Risks related to CO<sub>2</sub> emission allowance limits – include the risk of an increase in prices and insufficient allocation of CO<sub>2</sub> emission allowances, which may necessitate additional costs to be incurred to purchase allowances on the market to cover the deficit.
- Risks related to the need to obtain new or amend existing permits.
- Risks related to compliance with new regulations on the implementation of Best Available Techniques (BAT).

## Financial risks

- Commodity and petroleum product price risk – operating results are largely dependent on the difference between the price of petroleum products and the price of crude oil. CO<sub>2</sub> allowances price risk – in 2015, Grupa LOTOS managed the risk associated with entire phase III of the EU CO<sub>2</sub> Emissions Trading Scheme covering the 2013–2020 trading period ([for more details, see the consolidated financial statements for 2015](#)).
- Liquidity risk – the risk relating to the ability to discharge all liabilities in a timely manner. It may result from a mismatch between streams of receivables and payables or inadequate sources of funding.
- 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).
- Interest rate risk – Grupa LOTOS is exposed to interest rate risk, with interest rates growth translating into increased costs of servicing debt under floating-rate borrowings.
- Counterparty risk in trade transactions – in the course of trading operations, products and services are sold to businesses on a deferred payment basis, which may give rise to a risk of the customer's default.
- Risk of limited access to or change in the terms of external financing – some of the investment projects pursued by Grupa LOTOS and its subsidiaries as well as their day-to-day operations are or may be financed with borrowings.
- Risk of adverse changes in tax regulations, interpretations or court rulings – this risk may result in higher tax burden (excise duty, property tax, CIT), and give rise to tax risk in transactions where such risk was previously non-existent.

## Trading risks

- Risk of crude supply interruptions or shortages – 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.
- Risk of changes 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.
- 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.
- Risk of grey market expansion – in recent years, Poland has seen an increase in illegal trade in fuels, especially in diesel oil. In 2015, the grey market was about 18% of diesel oil consumption in Poland, and in 2014 it was about 20%.

In addition, in 2015 the LOTOS Group identified two new enterprise risks:

■ **Risk of potential environmental damage caused in the course of upstream operations**

The risk was identified in connection with expansion of production activities in the Baltic Sea and the growing hydrocarbon output. Following a relevant assessment and analysis, the risk was classified as moderate, i.e. with a low likelihood of occurrence but with potentially severe financial and reputational consequences. We have defined a detailed risk management process for this risk and put in place appropriate controls along with methods and schedules of their review.

■ **Risk of financial losses that may be incurred as a result of trading activities in the event of potential participation in a carousel fraud**

The risk was included in the risk register following receipt of a decision by the Director of the Tax Audit Office in Bydgoszcz concerning failure to exercise due care in fuels trading. Grupa LOTOS as a direct seller of fuels has always exercised due care in selecting its partners in fuels trading business and drafting trade contracts. The identification of the risk prompted a systemic review of internal procedures and protocols. As a result, the counterparty selection and trading contract execution processes were optimized across the LOTOS Group. The improvements will prevent similar incidents from happening in the future and will contribute to curtailing the black market in fuels in Poland.

# Opportunities and strengths of the LOTOS Group

In 2015, like other oil companies, we faced a number of challenges and threats:

- Markedly lower prices of crude oil and gas,
- Uncertain market situation,
- Stagnant demand for petroleum products in Europe,
- Growing competition from the Middle East, the US, and Russia.

Value growth and positive long-term financial results can be achieved through our competitive advantages, such as:

- Large technological potential of the refinery, high distillate yields and complexity,
- Diversification of crude supplies and growing access to own sources of crude oil,
- Developed own sales channel – a service station chain that allows the LOTOS Group to increase its share in the retail market,
- Growing retail demand for fuels,
- Consistent pursuit of development strategy,
- Coastal location of the refinery facilitating imports of crude and exports of petroleum products,
- Optimum and full use of assets,
- Generating cash flows along the value chain,
- Positive image of the LOTOS Group as a socially conscious organization and a leader of sustainable development in Poland.

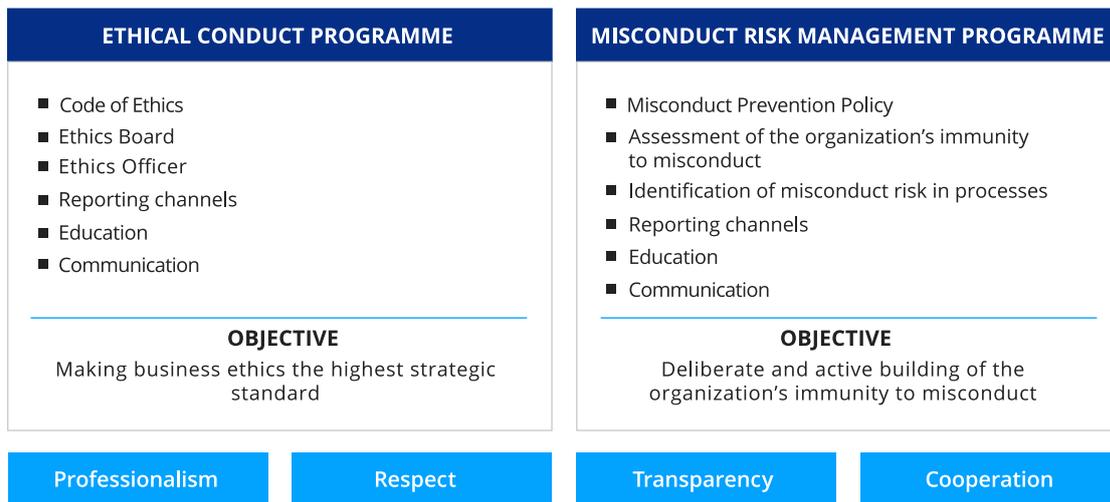
More information on risks and opportunities, and on how we manage them, see the [Directors' Report](#) Groupy on the operations of the LOTOS Group in 2015

# **Values, ethics and misconduct prevention**

# Our commitment to professionalism and transparency

In order to maintain the highest ethical standards and to actively prevent any potential misconduct, the LOTOS Group has adopted a consistent approach to ethics and misconduct management to ensure we operate with due regard to generally accepted social standards. The approach adopted by the LOTOS Group rests on the following two pillars:

- Active operation of the **Ethical Conduct Programme** at the LOTOS Group, addressed and applied in practice to both employees and external parties and constituting the foundation of the organizational and management culture.
- Improvement of business process safety within the organization through **comprehensive management of the misconduct risk** under a misconduct prevention system.



# Ethics and integrity

At the LOTOS Group, we are aware of the need to follow a code of ethics and clear-cut standards of behaviour both in social and workplace environments. Adherence to ethical standards improves the comfort and quality of our work, regardless of what responsibilities we hold or what place we occupy within the organization, which also plays an important role in shaping long-term and trust-based business relations, including commercial ones.

## Adherence to ethical standards + economic efficiency = value for the LOTOS Group shareholders

The LOTOS Group's Code of Ethics has been in place since 2013. This document is of key importance to us for the following reasons:

- It is a set of principles and standards of conduct rooted in the organization's ethical values.
- It is intended to govern behaviour within the organization, as well as external relations with key stakeholder groups, capital market participants, customers and trading partners, local communities and competitors.

We make every effort to communicate the LOTOS Group's ethical standards within and outside of our organization. All our existing and newly hired supervisory and management staff as well as employees and trading partners of the LOTOS Group are required to confirm with their signatures that they have read and are familiar with the Code of Ethics. The LOTOS Group's Code of Ethics has been translated into English and Lithuanian. Additionally, we organize training for all new hires, and the Ethics Officer holds regular meetings with the employees.

Number of downloads of the Code of Ethics in the Polish language version	2013	2014	2015
www.lotos.pl	1,107	889	2,804
Intranet	370	125	159

The full version of the LOTOS Group's Code of Ethics is available on our [website](#).

## Ethical Conduct Programme – objectives and implementation

The LOTOS Group's Code of Ethics is the cornerstone of our comprehensive Ethical Conduct Programme, designed to make business ethics the highest point of reference in the management of our organization.

As part of the Ethical Conduct Programme, in addition to ethics education, communication initiatives and channels for reporting violations of the Code of Ethics, an important role is played by the Ethics Officer, whose duty is to ensure that the accepted standards of ethical conduct are always upheld. The Ethics Officer was first appointed in 2014. Persons in this role perform their duties without remuneration.

## The voice of employees is heard:

Each employee of the LOTOS Group has access to the Ethics Officer. The management staff members have a special role to play in improving the organization's ethical culture: they support the employees by setting a good example to follow, and by discussing with them any doubts concerning ethical issues.

### The Ethics Office can be contacted by:

- A meeting, upon earlier phone contact (phone no. 505 050 218) at the time convenient for the interested party;
- A telephone conversation or recording the message (phone no. +48 58 308 80 70);
- An e-mail sent to [liniaetyki@grupalotos.pl](mailto:liniaetyki@grupalotos.pl);
- Filling in a Request form at [www.lotos.pl](http://www.lotos.pl) and in LOTOSTRADA, ETHICS PROGRAMME subservice;
- Sending communication by traditional mail.

## We listen to what others have to say:

The LOTOS Group's stakeholders may report any suspected or actual breaches of the Code of Ethics to the persons responsible for their prevention using dedicated channels of communication with the LOTOS Group's Ethics Officer. Relevant form is available on our website:

### [More information](#)

## Excellent ethical conduct and how to achieve it – as exemplified by LOTOS Paliwa

In 2015, LOTOS Paliwa set up the Ethical Conduct Programme Team responsible for the Programme's operation throughout the LOTOS service station network, which marked the end of a two-year phase of implementation of ethical standards at the LOTOS stations. The Team promotes the knowledge of the values, standards and rules of conduct defined in the Code of Ethics. One of the communication tools used to that end is the Dynamiczni quarterly, addressed to individuals working for the service stations. In addition to news on recent developments at the service stations, the quarterly also discusses the rules to be followed in their business. It also features articles presenting interpretation of the provisions of the Code of Ethics so that they are fully observed in day-to-day operations.

## What else did we do?

We organized the 'Monday with Ethics' competition for the LOTOS Group employees, which aimed to demonstrate that the provisions of the Code of Ethics should be a reference for decisions made in the course of our professional duties.

# Misconduct Prevention Policy of the LOTOS Group

Our approach to managing the risk of misconduct is defined in the Misconduct Prevention Policy of the LOTOS Group, adopted in 2012. Besides the Code of Ethics, the Policy is the primary source of rules and standards for misconduct prevention in our organization. The adoption of the two documents was in line with the objectives of the LOTOS Group Corporate Social Responsibility Strategy for 2012–2015.

## We are vigilant:

In 2015, the Board of Grupa LOTOS adopted the revised third edition of the Misconduct Prevention Policy – Zero Tolerance for Misconduct, under which each employee is required to immediately report any suspected instance of misconduct to the Head of the Internal Audit Office:

- directly or through their superior,
- by calling: +48 58 308 87 87,
- by email to: [audyt@grupalotos.pl](mailto:audyt@grupalotos.pl),
- by completing a form available on
- <http://www.lotos.pl> or in the Ethical Conduct Programme sub-service on LOTOSTRADA,
- by post, in a letter addressed to the Internal Audit Office.

## Cautious = more knowledgeable

Educating employees is the key to preventing misconduct. In September 2015, we began to regularly send emails with educational content to our employees. The initiative, continued in 2016, aimed at raising the employees' awareness of the risk of misconduct and its prevention. It was also an opportunity for us to distribute the Misconduct Prevention Policy to the LOTOS Group employees. Moreover, each email informed the employees of their obligation to report any instances of suspected misconduct through the channels set out in the Policy.



**627**  
employees

of LOTOS Group took part in training devoted to misconduct prevention (some employees attended more than one training session)



**1,896**  
hours of training

devoted to misconduct prevention

Titles of emails in 2015	Date sent	Number of emails sent
<i>Together we create an early warning system (Misconduct Prevention Policy attached to the email)</i>	<i>September 7th 2015</i>	1,812
<i>Together we protect our organization's intellectual property</i>	<i>November 26th 2015</i>	1,733

## 'NO' to misconduct

We are committed to increasing the degree of immunity to misconduct within the LOTOS Group, which means:

- Being aware of real and perceived misconduct threats arising in the course of our operations,
- Putting in place and using solutions that are best adapted to the scale and nature of the risk, and that are geared towards preventing, detecting and responding to such threats.

The purpose of these efforts is to secure the LOTOS Group's ability to:

- Mitigate the risk of misconduct,
- Reduce the harmful effects of misconduct,
- Gather resources which will accelerate the organization's return to pre-misconduct state.

## The threats we face

At the LOTOS Group, we have identified the risk of misconduct as one of the enterprise risks. We understand misconduct as an intentional act or omission which constitutes violation of the law or a breach of our organization's internal regulations, committed to secure an unlawful gain or causing a LOTOS Group company to sustain a loss. Misconduct includes any type of corrupt practices.

In 2015, we developed a map of misconduct risk, which shows that at the LOTOS Group companies – with a few exceptions – exposure to the risk is concentrated in the following areas:

- Investment project preparation and execution,
- Sales,
- Logistics,
- Procurement and inventory management.

Misconduct risk was assessed based on the following criteria:

- Significance of the area to the implementation of strategic objectives by a given company.
- A misconduct review or investigation carried out in a given area.
- Significance of the areas depending on misconduct risk exposure in defined categories.
- Level of misconduct risk as perceived by the management, based on survey findings.

## What else did we do?

- We published dedicated educational materials in the LOTOSFERA monthly for the LOTOS Group employees.
- We developed e-learning materials to be used by our new hires.
- We completed operational work on pilot reviews of misconduct categories related to unlawfully claimed remuneration and employee benefits, data and intellectual property theft as well as computer crime.

No instance of corruption was reported at the LOTOS Group in 2015.

At the LOTOS Group we seek to actively counteract computer crime. In 2015, we commenced a training programme under the name 'Security Awareness', devoted to the security of IT system users. The eight training sessions were attended by 468 LOTOS Group employees, including 344 management staff.

**100%**  
 of the LOTOS Group  
 companies were  
 assessed in 2015 in  
 terms of the risk of  
 misconduct