Directors' Report on the Operations of the LOTOS Group in 2015

This is a translation of a document originally issued in Polish.

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1. INFORMATION ON THE LOTOS GROUP

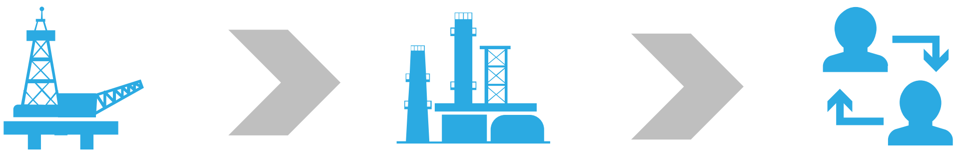
1.1. OVERVIEW OF THE LOTOS GROUP

Business

The LOTOS Group is the second largest fuel producer in Poland. It is the sole producer of hydrocarbons in Poland’s Exclusive Economic Zone of the Baltic Sea. Other areas where the Group is engaged in petroleum production include the Norwegian Continental Shelf and Lithuania (onshore). Grupa LOTOS’ refinery in Gdańsk is one of the newest and most advanced refineries in Europe in terms of applied technologies and environmental protection.

The Group’s business is organised into two segments: Upstream and Downstream.

UPSTREAM | **DOWNSTREAM**



Portfolio of assets located in three countries: Norway, Poland and Lithuania

One of Europe’s most technologically advanced refineries (complexity index of 9.5 according to Solomon study)

Poland’s 3rd largest network of 476 service stations. Wholesale of fuels and other petroleum products (bitumens and oils)

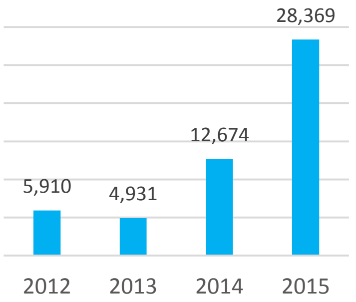
Apart from Grupa LOTOS (the parent and operator of the Gdańsk-based refinery with a nominal throughput capacity of 10.5m tonnes of crude oil per year), the LOTOS Group comprises 14 other companies operating under the LOTOS name. Two of them are based outside Poland, in Lithuania and Norway.

The Group’s operations focus on crude oil production and processing, as well as wholesale and retail sale of petroleum products such as fuels (unleaded gasoline, diesel oil and light fuel oil), heavy fuel oil, bitumens, aviation fuel, naphtha, LPG and base oils.

Development

The overriding strategic objective of the LOTOS Group is to create value for shareholders through optimised deployment of human and material resources and implementation of development programmes in exploration and production, processing and marketing. These programmes are pursued in compliance with the principles of sustainable development and corporate social responsibility.

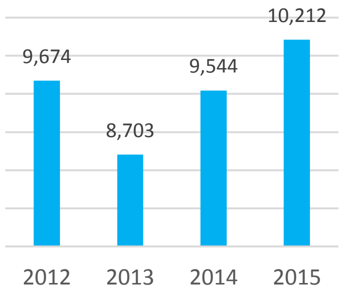
CRUDE OIL AND GAS PRODUCTION



Production of hydrocarbons at 28,369 barrels per day[1]

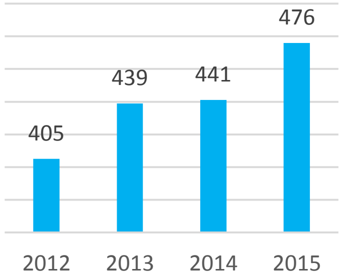
CRUDE OIL REFINING

(ths tonnes per year)



Annual oil throughput of 10,212 thousand tonnes

SERVICE STATIONS



Growing number of service stations and improvements in their standard

Key financial measures and ratios

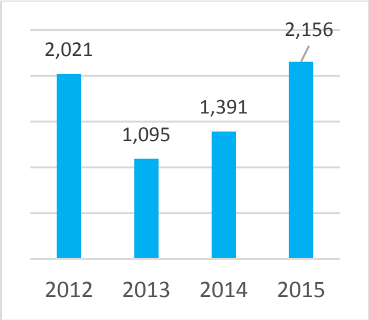
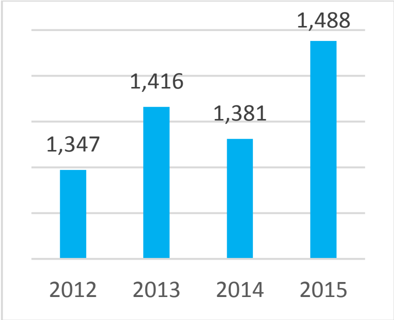
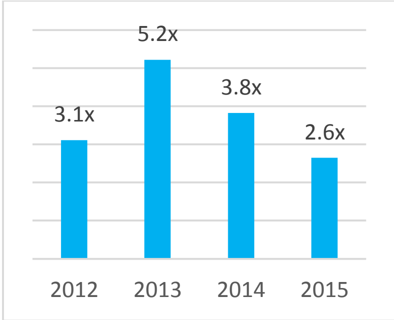
By consistently implementing its strategy aimed at maximising the integrated margin, the Group has succeeded in increasing its production potential and operating efficiency, which has contributed to its sound operating performance as measured by normalised LIFO-based EBITDA.[2]

In 2012–2015, normalised LIFO-based EBITDA **averaged PLN 1.67bn**, and in 2015 it stood at **PLN 2.16bn.**

In 2015, consolidated revenue was PLN 22,709m. Net cash from operating activities was PLN 1,488m, while its average level in 2012−2015 was PLN 1,408m. Net loss for 2015 was PLN -263.3m.

[1] *Including average daily output from the acquired Sleipner assets attributable to the LOTOS Group, as of the effective date of the acquisition (January 1st 2015)*

[2] *EBIT before depreciation and amortisation, excluding one-off items and the LIFO effect (the difference arising from the application of the Last In First Out (LIFO) method and the weighted average cost method to account for inventory flows)*

NORMALISED LIFO-BASED EBITDA (PLNm)	CASH FLOWS FROM OPERATING ACTIVITIES (PLNm)	NET DEBT [3] TO NORMALISED LIFO-BASED EBITDA
		
Fluctuations in financial performance due to changing macroeconomic environment; 2012−2015 average: PLN 1,666bn	Stable levels of cash generated from operating activities; 2012−2015 average: PLN 1,408m	Improving ability to service the existing debt

1.2. SEGMENTAL MANAGEMENT MODEL AND CORPORATE STRUCTURE

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

To perform its role, Grupa LOTOS S.A. has implemented a segmental management model. A segment is a separate area of operations managed within the LOTOS Group by a designated member of the Management Board of Grupa LOTOS S.A. Such model ensures efficiency in managing the Group and enables it to achieve cost and revenue synergies across the organisation. Segmental management provides for consistent implementation of strategy, planning and controlling, integrated operational management and maintenance of uniform corporate standards.

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

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

For management purposes, the LOTOS Group is divided into business units within the management/corporate support segment and within two equally ranking business segments covering the upstream and downstream areas of the Group's operations (as illustrated in Figure 1, page 9):

- Management segment – falls within the remit of President of the Management Board of Grupa LOTOS S.A., Head of the management segment. The segment's activities focus on increasing the LOTOS Group's value through overall management of its operations and coordination of process support functions, including human resources management, ensuring effective communication, corporate social responsibility, management of

[3] *Net debt/normalised LIFO-based EBITDA; net debt at December 31st, adjusted LTM LIFO-based EBITDA*

international relations, investor relations, brand management, management of marketing activities, corporate organisation, management of business processes and systems, and maintenance of the internal control system.

- **Exploration & production segment:** falls within the remit of the Vice-President of the Management Board of Grupa LOTOS S.A., Chief Exploration & Production Officer, Head of the exploration & production segment.

  The segment's tasks include formulation of development strategies for the LOTOS Group in oil and gas exploration and production, as well as management and supervision of these activities.

  The exploration & production segment comprises LOTOS Petrobaltic along with its subsidiaries and affiliates.

- **Refining & marketing segment:** falls within the remit of the Vice-President of the Management Board of Grupa LOTOS S.A., Chief Refining & Marketing Officer, Head of the refining & marketing segment. The refining & marketing segment's tasks include overall management of activities aimed at maximising the integrated margin, as well as coordination of efforts related to maintaining the required operability and availability of processing assets and their optimum utilization, refining production, crude oil supply, as well as trading in petroleum products and energy commodities. The segment is also responsible for the retail business (expanding the service station network) and developing trading activities.

  The refining & marketing segment comprises LOTOS Asfalt, LOTOS Infrastruktura, LOTOS Kolej, LOTOS Oil, LOTOS Paliwa, LOTOS Serwis, LOTOS Straż and LOTOS Terminale (along with its group member companies).

- **Strategy & development segment:** falls within the remit of the Vice-President of the Management Board of Grupa LOTOS S.A., Chief Strategy & Development Officer, Head of the strategy & development segment. The segment's responsibilities include developing the strategy for the LOTOS Group and monitoring its implementation, research and development, innovations, defining development and investment directions, implementation of the EFRA project, project management, corporate risk management, and coordination of activities in environmental protection, occupational health and safety and physical security.

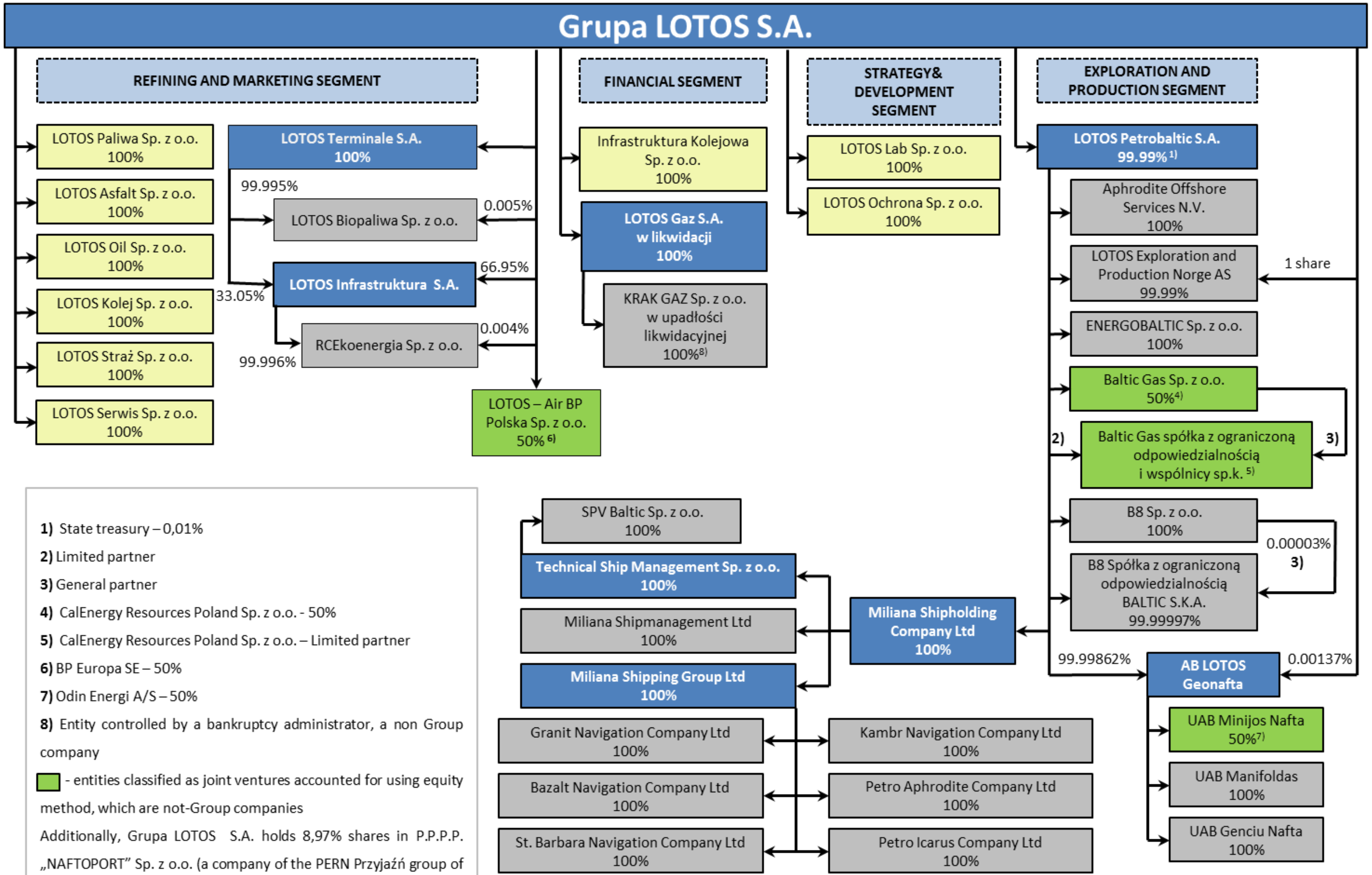
  The strategy & development segment comprises LOTOS Lab and LOTOS Ochrona.

- **Financial segment:** falls within the remit of the Vice-President of the Management Board of Grupa LOTOS S.A., Chief Financial Officer, Head of the financial segment. The segment's tasks include overall management of financial and accounting processes, including formulation of financial, fiscal and insurance strategies and monitoring of their implementation, managing the budgeting and controlling processes, development and implementation of financial risk management strategies, and overall management of assets and restructuring processes.

  The financial segment comprises Infrastruktura Kolejowa Sp. z o.o. and LOTOS Gaz w likwidacji (in liquidation), along with its subsidiary.

In 2015, significant changes were made to the corporate structure of the LOTOS Group, triggering a transformation of the structure towards business segments having a stronger focus on core business and towards enhanced integration of the management and support functions providing services to the operating structures, all to ensure effective implementation of strategic objectives, process optimisation, dynamism, greater operational flexibility, as well as strengthening of corporate functions and owner supervision.

Figure 1. Organisational structure of the LOTOS Group by segments as at December 31st 2015



1) State treasury – 0,01%
2) Limited partner
3) General partner
4) CalEnergy Resources Poland Sp. z o.o. - 50%
5) CalEnergy Resources Poland Sp. z o.o. – Limited partner
6) BP Europa SE – 50%
7) Odin Energi A/S – 50%
8) Entity controlled by a bankruptcy administrator, a non Group company

- entities classified as joint ventures accounted for using equity method, which are not-Group companies

Additionally, Grupa LOTOS S.A. holds 8,97% shares in P.P.P.P. „NAFTOPORT" Sp. z o.o. (a company of the PERN Przyjaźń group of Płock).

1.3. KEY EVENTS IN 2015

Table 1. Material events at the LOTOS Group in 2015

Period	Event
January – February	• Launch of a new railway terminal. • Launch of oil supplies from PGNiG. • Grupa LOTOS S.A. is the chief sponsor of the Polish national football team. • LOTOS Asfalt obtains the Construction Company of the Year 2014 award.
March – April	• LOTOS Lab signs an agreement to sell its Jasło and Czechowice branches to Polwax. • LOTOS Asfalt wins the Golden Laurel in the Pomeranian Quality Award competition. • Grupa Lotos S.A. tops the Responsible Companies Ranking in the category of fuels, energy sector and extractive industries. • LOTOS Terminale buys a fuel terminal in Poznań from Grupa Lotos S.A.
May – June	• The Supervisory Board passes a resolution to appoint Mr. Paweł Olechnowicz as President of the Management Board of Grupa Lotos S.A. of the ninth term. • Grupa Lotos S.A. wins the Golden CSR Leaf • LOTOS Asfalt signs credit facility agreements to finance the EFRA Project investments with a consortium of eight financial institutions. • The 450th service station in the LOTOS network (and at the same time the 175th in the LOTOS Optima segment) opens in Kalisz. • LOTOS Oil begins to market four modern synthetic motor oils for use in post-warranty maintenance inspections. • Innovation Award 2015 goes to Grupa LOTOS S.A.
July – August	• As part of the EFRA Project, LOTOS Asfalt signs a PLN 1.26bn EPC contract with Kinetics Technology (KT) of Italy for the three key project installations. • Building permit is granted for the subsea gas pipeline from the B8 field to Władysławowo. • Establishment of the LOTOS Foundation. • LOTOS Asfalt signs a coke sale agreement with Oxbow Energy Solutions of the Netherlands. • Forbes' Diamonds are awarded to LOTOS Oil. • The EFRA Project kick-off meeting with KT is held.

September October	• Construction of the hydrogen recovery unit commences. • Grupa Lotos S.A. wins the Top Secondary Listing award for its best secondary share offering in Central and Eastern Europe. • Grupa Lotos S.A. enters into an agreement with Linde AG, Engineering Division, on the construction of an oxygen generation unit. • The cornerstone is laid for the units to be built as part of the EFRA Project. • First crude is produced from the B8 field on the Baltic Sea. • LOTOS Norge signs an agreement with ExxonMobil Norway on the acquisition of a portfolio of assets in the Sleipner area on the Norwegian Continental Shelf. • Grupa Lotos S.A. and KT sign an agreement on the construction of a Hydrowax Vacuum Distillation Unit (HVDU). • Lotos Asfalt signs an agreement with Przembud Gdańsk on the construction of a power system facility as part of the EFRA Project. • Grupa Lotos S.A. is awarded the National Security Leader title. • Grupa Lotos S.A. receives the Top Quality HR Certificate. • The Minister of Economy's award is presented to LOTOS Kolej in recognition of the company's prominent achievements in railway transport. • LOTOS Oil is named Ambassador of Polish Economy in the European Brand category. • LOTOS ranks second in the Best Annual Report 2014 competition in the Corporations category. • The Super Biznes Golden Laurel in the Sports Sponsorship category goes to LOTOS.
November December	• Daily production from the B8 field exceeds that from the B3 field. • The Pearl of Polish Economy title in the Great Pearls category goes to the LOTOS Group. • LOTOS Serwis sells its Czechowice and Jasło branches to Apex Elzar. • LOTOS Kolej launches rail freight operations in Germany. • LOTOS-Air BP signs an agreement on fuel deliveries to the Olsztyn-Szymany airport. • LOTOS Norge receives the consent of Norwegian ministries for the acquisition of an asset portfolio in the Sleipner area. • The launch of production from the B8 field and the acquisition of the Sleipner assets in Norway enabled Grupa LOTOS to increase its daily output of hydrocarbons two and a half times, to 30,300 boe/d at the end of 2015, thus exceeding the production target set in the Strategy for 2011−2015 of 24,000 boe/d. • The LOTOS brand wins the Good Brand 2015 – Quality, Trust, Reputation title in the Engine Oils category. • Grupa LOTOS S.A. is once again honoured with the prestigious Well-Perceived Company title.

1.4. CORPORATE SOCIAL RESPONSIBILITY

The overriding strategic objective of Grupa LOTOS S.A. in 2015 was 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.

As declared in its mission statement, the Company strives to operate in all areas of its business in a sustainable manner, with due regard to all legal requirements and in accordance with the principles of corporate social responsibility.

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 has adopted a system of values, which it sees as a long-term pledge towards all its stakeholders.

The four primary values underlying the LOTOS Group's corporate social responsibility are:

- **TRANSPARENCY** – stands for the duty to comply with the most exacting environmental standards, commitment to ethical and fair competition, and counteracting the abuse of human rights.
- **OPENNESS** − the LOTOS Group's attitude to changes, the world's needs and people's expectations.
- **INNOVATIVENESS** − recognition and protection of the intellectual capital within the LOTOS Group, as well as the competencies of its employees.
- **RESPONSIBILITY** – the right attitude towards mankind and its future, the environment, home country and its international security.

The efforts undertaken by the LOTOS Group in the social and business spheres, in our relations with key stakeholders and in corporate governance are aimed principally to:

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

The LOTOS Group's CSR activities are focused around three key areas:

- Environmental protection and ecology− with special focus on the biodiversity of the Baltic Sea (given the seaboard location of the Gdańsk refinery), as well as other areas of outstanding natural value located in the Company's immediate vicinity,
- Road traffic safety − to which the LOTOS Group contributes through the quality of its products and comprehensive educational campaigns,
- Ensuring equal opportunities and supporting the education and development of children and young people − who are the target group of our CSR sports programmes and various other projects focusing on the support of talented youth.

In each of these areas, the LOTOS Group works with reputable and proven social partners, in keeping with its core competences and values.

FUNDACJA LOTOS

Early in June 2015, the Grupa LOTOS Management Board resolved to establish the LOTOS Foundation. Its main task is to manage the organisation's philanthropic policy. The Foundation's mission is the wide-ranging social activity to make a positive contribution to its social and natural environment. The Foundation's activities focus mainly on projects in the area of environmental protection, science, education, and social development.

Once the Foundation was established, the Special Account used to finance social initiatives through donations was closed. In 2015, the LOTOS Foundation spent more than PLN 762 thousand on donations.

The LOTOS Group's Code of Ethics, in effect since the beginning of 2013, is the cornerstone of the comprehensive Ethical Conduct Programme, designed to make business ethics the highest standard in corporate management. Apart from ethics education and communication initiatives, the Programme comprises channels for reporting violations of the Code of Ethics, and institutions − the Ethics Board and Ethics Officer − whose duty is to uphold the accepted standards of ethical conduct. Established in 2013, the Ethics Board is a collective body composed of representatives of all of the LOTOS Group's business segments. The Ethics Officer, who, like the Ethics Board, is not remunerated for this role, was first appointed in June 2014.

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 was in line with the objectives of the LOTOS Group Corporate Social Responsibility Strategy for 2012−2015.

Publicly declared support for corporate social responsibility initiatives

As a corporate citizen, in various areas of its activity the LOTOS Group endorses and follows the principles and guidelines formulated both in Poland and abroad by reputable social and industry organisations as well as public administration authorities, addressing issues related to social responsibility and sustainable development.

Grupa LOTOS S.A. has declared its support for the ten principles of United Nations Global Compact, a voluntary international corporate citizenship initiative of unprecedented reach, in which the Company's membership dates back to 2009.

THE GLOBAL COMPACT
Network Poland
WE SUPPORT

In 2014, Grupa LOTOS became a signatory of the UN Global Compact's new initiative – Call to Action on Anti-Corruption, which is a joint appeal to governments to take steps to prevent all forms of corruption.

In 2015, Grupa LOTOS joined another UN Global Compact initiative − the Baltic Programme, which stands behind the UN's efforts to restore the ecological well-being of the Baltic Sea and to effectively manage the sea's ecosystem and resources. As part of the Baltic Programme, UN Global Compact builds a platform for cooperation between, and coordinating the activities of, businesses, central and local government institutions, non-governmental organisations, and science. The initiative is a long-term programme, whose first phase is scheduled for 2015–2020.

Grupa LOTOS's commitment to sustainable development, both at the sectoral and social level, is also evidenced by its having been, since 2010, among the signatories of the Declaration on Sustainable Development in the Energy Sector in Poland.

The Company also continues its efforts under the 'Declaration of Polish Businesses for Sustainable Development', signed in 2012. It is a joint initiative undertaken by enterprises in support of the goals defined in the 'Vision of Sustainable Development of Polish Businesses until 2050'.

Since December 2008, Grupa LOTOS has been a strategic partner of the Responsible Business Forum − a non-governmental organisation which has been promoting CSR on the Polish market for 15 years.

In 2012, Grupa LOTOS was included among institutions and organisations forming a partnership for the development of the Pomerania region. The Development Initiation Forum is a multi-aspect cross-sectoral cooperation project whose objective is to initiate and run partnership programmes promoting the development of local communities. The initiative was planned as a regional one, addressed primarily to the stakeholders from the Gdańsk province. The Forum ensures equal access to the project resources – experience sharing and financing as part of the Grant Fund, which is an integral part of the Development Initiation Forum, established in 2014.

Method of CSR reporting

One of Grupa LOTOS' commitments towards its stakeholders, made in the 2008 CSR Strategy, concerned the implementation of a comprehensive system for performance reporting. Following the Guidelines for sustainability reporting, developed by Global Reporting Initiative (GRI), was chosen as the best method for preparing reports. GRI standards are recognised as the only standards which enable a comprehensive presentation of CSR matters while ensuring comparability and measurability of a given organisation's achievements in individual areas of its activity. The Company has been preparing reports in accordance with these standards since 2006. Since 2011, all the reports have been externally assured (level A+). Level A stands for the highest transparency level achieved through reporting the maximum amount of data in the three areas of the LOTOS Group's activities: financial, social and environmental.

Currently, the Company's integrated reports present three levels of information expected by its stakeholders:

- operational strategy – information providing a general context to better understand how the organisation operates,
- approach to management in individual areas – information presenting the manner in which Grupa LOTOS manages all aspects of its business and the context necessary to understand the way it operates in a particular area,
- up-to-date results and long-term plans – comparable data on the economic, environmental and social aspects of the Company’s business.

The electronic version of the reports is available on the www.raportroczny.lotos.pl website.

Information governance

For the ninth time, Grupa LOTOS was included in the RESPECT Index (Responsibility, Ecology, Sustainability, Participation, Environment, Community, Transparency) – an index of the most socially responsible WSE-listed companies. Having once more satisfied the exacting requirements of the RESPECT project, LOTOS was again among the select group of 23 names listed in the new index portfolio. Grupa LOTOS has been a constituent of the index since its inception.

The RESPECT Index is Central and Eastern Europe's first index of socially responsible companies. Indices of socially responsible companies comprise entities that operate in accordance with the best management standards in corporate and information governance and investor relations, and attach utmost importance to ESG (Environmental, Social and Governance) areas. 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.

2. STRATEGY OF THE LOTOS GROUP AND KEY DEVELOPMENT PROJECTS

2.1. IMPLEMENTATION OF THE 2011–2015 BUSINESS STRATEGY

Figure 2. The LOTOS Group value chain

In 2011-2015, Grupa LOTOS focused on its principal activities, i.e. exploration for and production of hydrocarbons, crude processing, and trading in petroleum products, while seeking to improve its marketing efficiency and optimise the refining and logistics processes. The goal of the strategy was to extend the value chain and boost product margins.

The production target of 24,000 boe/d defined in the 2011-2015 Strategy **was exceeded** thanks to, among other things, the acquisition of the Sleipner production assets (for more information, see Current Report No. 30/2015 of October 31st 2015) and launch of production from the B8 field.
The increased processing capacity and flexibility of the units constructed as part of the 10+ Programme, completed successfully in 2010, **were fully utilised in 2015**, **as a result of which 10.2 million tonnes of crude oil** were processed.
The trading segment **exceeded the target market share of 30% set in the 2011−2015 Strategy and secured a 10% share in domestic retail sales** at the end of 2015.

Mission of the LOTOS Group

Innovation-driven, sustainable development in the exploration, production and processing of hydrocarbons and marketing of high-quality products, which is conducive to creating lasting value for shareholders, ensuring customer satisfaction, enhancing and leveraging the employee potential, and which is responsible towards society and the environment and consistent with the energy security policy.

2.2. STATUS OF KEY DEVELOPMENT PROJECTS

2.2.1. EFRA

On June 26th 2015, Grupa LOTOS S.A. launched the EFRA Project together with its subsidiary LOTOS Asfalt, following approval by the Company's Supervisory Board of the terms of financing and related collateral, and a share capital increase at LOTOS Asfalt. Further steps were possible once LOTOS Asfalt, financing 79% of the Project, executed a credit facility agreement with eight financial institutions and signed the basic financing and project documentation.

The value of the EFRA Project capex totals EUR 517.8m, and the project is scheduled for completion at the beginning of Q2 2018.

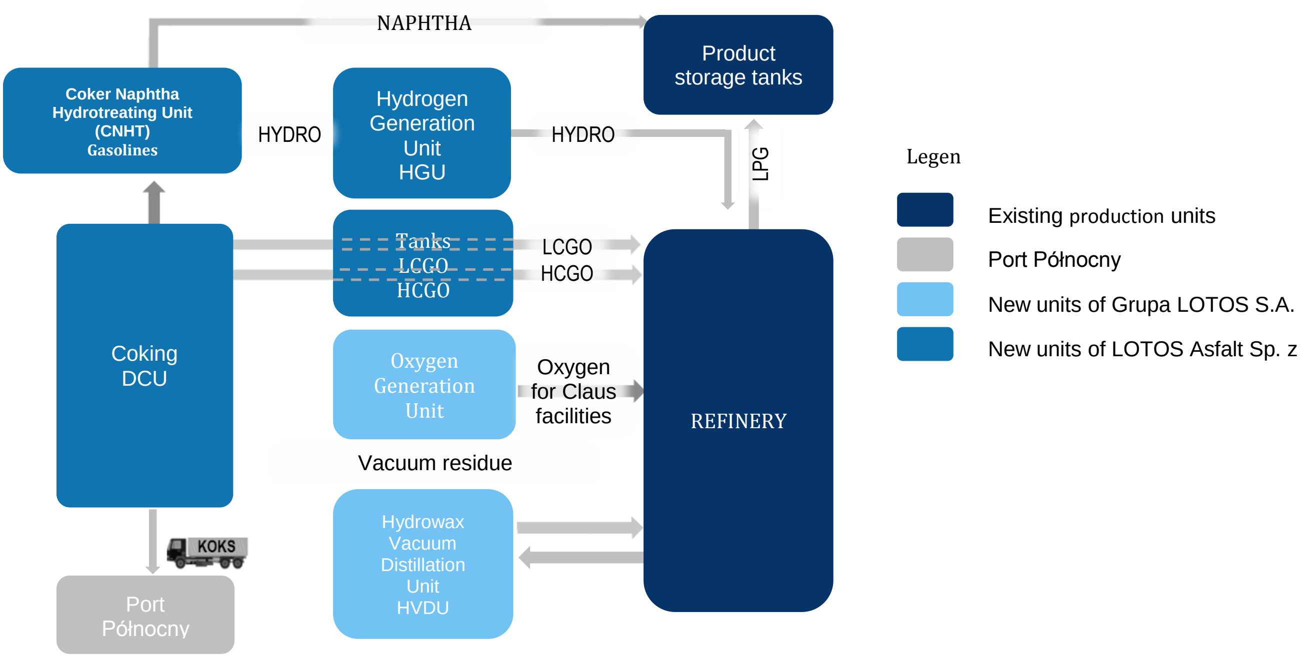
In mid July 2015, the Project entered the engineering design phase after LOTOS Asfalt and KT Kinetics Technology signed the engineering, procurement and construction (EPC) contract for turn-key delivery of the following main units: the Delayed Coking Unit (DCU), the Coker Naphtha Hydrotreating Unit (CNHT) and the Hydrogen Generation Unit (HGU). Once LOTOS Asfalt met all the conditions for disbursement of the credit facility, it became able to draw funds under the facility.

To secure a customer for the by-product from the Delayed Coking Unit (DCU), Groupa LOTOS has signed a 10-year contract with Oxbow Energy Solutions B.V. of the Netherlands to sell approximately 350,000 tonnes of coke produced as part of the EFRA Project.

By the end of 2015, EPC contracts to construct the Hydrowax Vacuum Distillation Unit (HVDU) and the Oxygen Generation Unit (OGU) as well as further contractor agreements under the engineering, procurement, and construction management contract (EPCM) for inter-unit connections and auxiliary facilities were also concluded. In addition to the design and contract execution activities, construction works (such as construction of the building to house an electrical substation and a new pipeline flyover) also commenced.

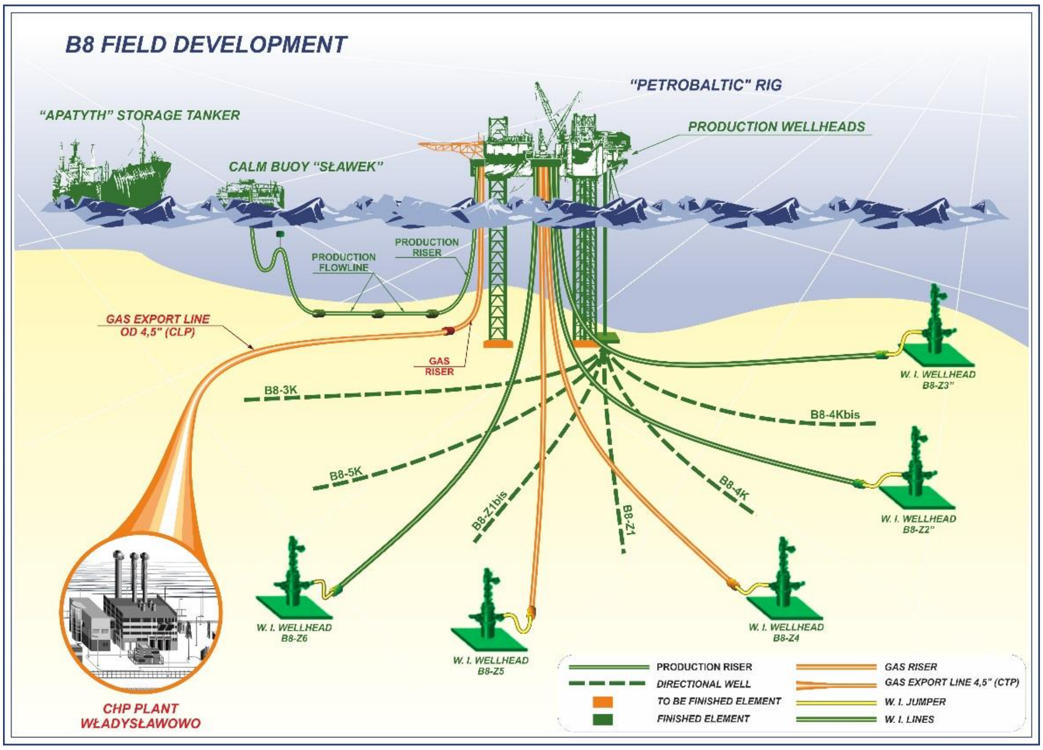
The Group was also in the process of obtaining building permits (by December 11 permits were obtained for the facilities covered by the EPCM contract for inter-unit connections and auxiliary facilities). At the end of December, the overall progress of work under the EFRA Project was 7.7%, compared with the planned 3.6%.

Figure 3. How the EFRA units work



2.2.2. B8

Under the B8 project, hydrocarbons are to be produced from a field situated in Poland's Exclusive Economic Zone on the Baltic Sea. 2P (proven and probable) reserves in the B8 field (according to the SPE classification) are estimated at approximately 3.5m tonnes of crude oil (approximately 27m barrels). B8 is the third largest oil mining facility in Poland and the oil field holding the largest recoverable oil reserves in the Polish part of the Baltic Sea.



The purpose of the project is to develop the oilfield and launch full production with the use of the converted Petrobaltic platform. From September 30th 2015, as assumed, initial production from the B8 field was launched using LOTOS Petrobaltic's drilling rig. As a result, LOTOS Petrobaltic doubled its hydrocarbon production on the Baltic Sea. Once the Petrobaltic rig is converted into the production centre on the B8 field and placed in the field and the pipeline is completed, full production from the field will be launched, amounting to approximately 5,000 bbl of crude oil daily (250,000 tonnes annually). The project is to be completed in autumn 2017.

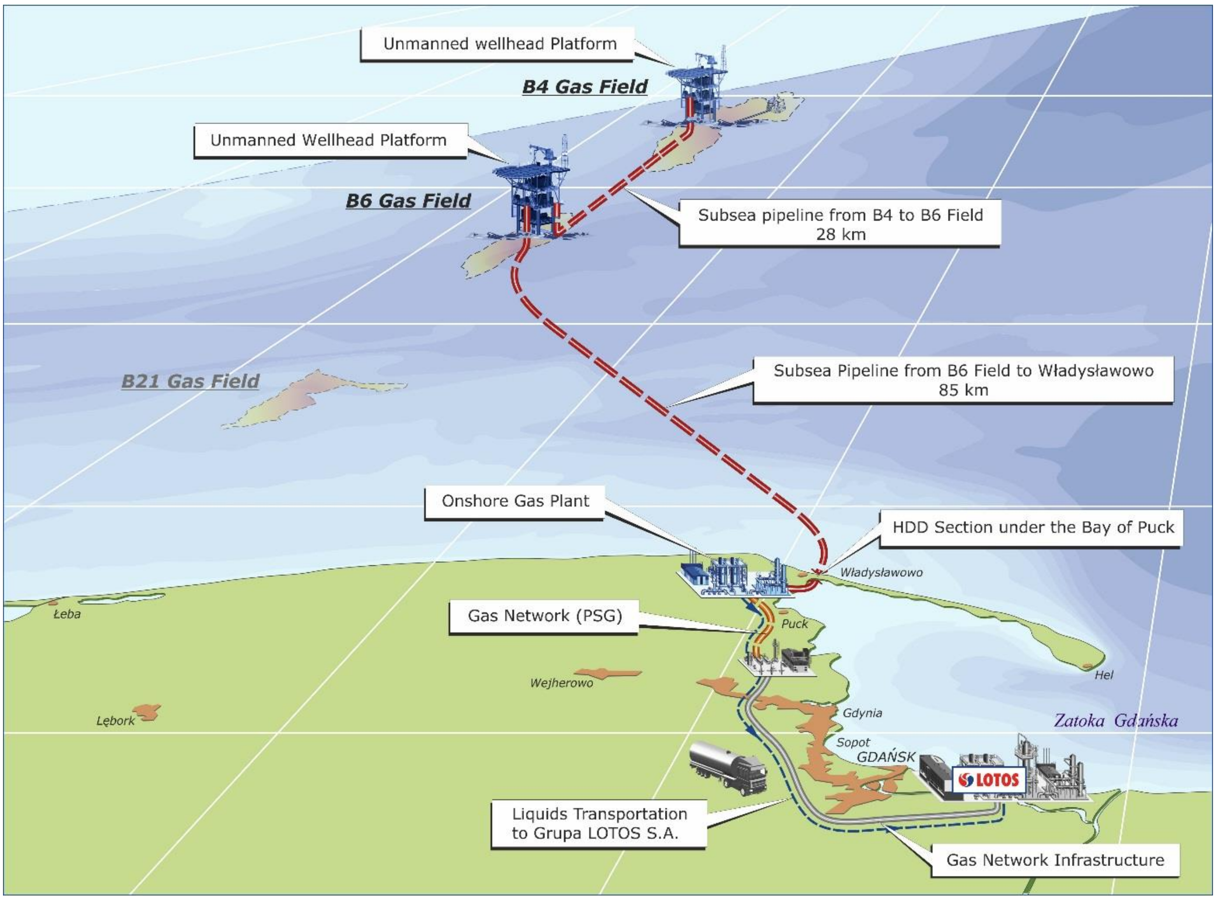
In 2015, the rig conversion project was optimised by reducing the weight of the hull, thus permitting the use of the existing legs supporting the rig. The Company obtained administrative decisions concerning the construction of a gas pipeline to Władysławowo, which will transport the gas produced along crude oil from the B8 field to Energobaltic Sp. z o.o.'s CHP plant. The conversion is the key milestone in the project execution.

Shipyard works involve mainly modification of the hull and work required to strengthen the rig's legs and bottom feet as well as performance of large assemblies. Next, after integrating the systems and equipment and their initial start-up the rig will be ready to go offshore. The end of H1 2017 is the expected deadline for the production centre to be ready and the rig transported to the B8 field, as well as for take-over of production from the LOTOS Petrobaltic drilling rig to begin.

2.2.3. B4/B6

The goal of the project is to develop and produce natural gas from the B4 and B6 fields in the Baltic Sea together with CalEnergy Resources Poland. Total natural gas resources are estimated at approximately 4.3 bcm. The produced mixture of hydrocarbons (raw gas) will be transported via underwater pipelines on shore and processed into commercial products: natural gas, LPG and condensate, to be subsequently delivered to end users.

In the reporting period, Stage 3 of the Project, involving preparation of engineering design and recommendation regarding the Final Investment Decision (FID) in Q3 2016, was underway. The goal of Stage 3 is to define the time of production launch and define the execution stage budget considering current microeconomic forecasts. The fields will be put on stream between 2018 and 2019.



2.2.4. INNOVATION AND DEVELOPMENT PROJECTS

Development projects at the LOTOS Group

The Group's research and development activities focus on the production of crude oil and its processing at the refinery. In the upstream segment, in line with the trends set by European oil companies, research and development initiatives focus on technologies for hydrocarbon exploration and optimising hydrocarbon production.

The downstream segment focuses on effective utilisation of the refinery's extended processing capacities and refinery streams, further increase in hydrocarbon conversion, and optimum use of synergies between the refining industry and the chemical, power and construction industries with a view to maximising the refining margin.

As an oil business with potential for innovation, in order to improve the competitive edge of the individual business areas, in the strategic perspective of the years 2016−2020 the LOTOS Group will run a comprehensive programme promoting employees' commitment and creativity and implement technical and technological innovations based on its own research and the research available through cooperation with third parties. The LOTOS Group seeks to increase the use of aid funding available for these purposes (including programmes financed by the National Centre for Research and Development).

Projects implemented together with higher education institutions

Grupa LOTOS S.A. is the leader of the HESTOR project designed to determine the efficiency of storing surplus electricity in the form of hydrogen obtained from electrolysis using renewable energy sources and then pumped into salt caverns for later use for power supply and technological purposes. The issues to be investigated as part of the project include hydrogen generation, transport and storage, as well as hydrogen combustion with a view to regenerating electricity to cover peak demand. The pro-environmental effect of the project will be a reduction in greenhouse gas emissions by balancing the fluctuating supplies of electricity from renewable sources. The consortium is composed of:

- Warsaw University of Technology – Consortium Partner
- Grupa LOTOS S.A. of Gdańsk – Consortium Leader
- Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A.
- Stanisław Staszic AGH University of Technology of Kraków – Consortium Partner
- Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o. – Consortium Partner
- Silesian University of Technology – Consortium Partner

Companies of the LOTOS Group, together with Energa, the Gdańsk University of Technology, University of Gdańsk, Polish Naval Academy, Gdynia Maritime University, Institute of Fluid-Flow Machinery of the Polish Academy of Sciences and Institute of Power Engineering established a consortium for submitting the smart specialisation 'Eco-efficient technologies in production, transmission, distribution and use of energy and fuels' for the Gdańsk Province. Obtaining the status of smart specialisation will facilitate the launch of innovative projects in efficient crude oil production technologies, production of state-of-the-art Group II base oils, development of technologies for obtaining high-margin petroleum products, manufacturing technologies for the second and third generation biofuels, as well as the development of state-of-the-art building materials together with technologies of their use.

Grupa LOTOS is conducting analyses to prepare a project for a competition to obtain co-financing for R&D projects executed by large enterprises, announced by the National Centre for Research and Development. The project would be a continuation of the 'Study of hydrocarbon generation, expulsion, migration and accumulation, performed with the use of technologically advanced tools and techniques for modelling petroleum processes in exploration activity and the state-of-the-art methods for analysis of rock and porous media from the Baltic Sea basin', implemented in 2014.

The research projects planned for 2016−2017 primarily concern the possibility of intensifying crude oil production from the B3 field and the use of innovative methods for processing and interpretation of seismic data obtained in recent years.

In one of the projects planned for 2015–2016, LOTOS Petrobaltic is a member of a consortium which is among the four consortia that have obtained the status of smart specialisation for the Pomerania region (the 'Off-shore and port and logistics technologies' project). 39 enterprises, 10 academic institutions and 10 business environment entities participate in the programme. The programme is organised by the Marshal Office of the Gdańsk Province.

Cooperation with higher education institutions in education, student internships and work placements

The LOTOS Group has been cooperating with higher education institutions by offering numerous internships for students of higher education institutions of the Gdańsk-Sopot-Gdynia agglomeration, as well as of the AGH University of Technology of Kraków, Kraków University of Economy, Kraków University of Technology and other. 156 student internships and 47 work placements were organised in 2015. It was for the thirteenth time that Grupa LOTOS joined a local project supporting students and graduates on the labour market, initiated by the Mayor of Gdańsk. As part of the 'Summer Holiday Work Placement' project, the Company offered 11 placements. Grupa LOTOS also offered five work placements as part of a prestigious countrywide project organised by the Ministry of State Treasury under the name of 'We build the value of Polish economy. The Company became a partner of the Kraków University of Technology for the project 'Competences − a springboard to an engineering career' (five work placements). The Human Resources Office of Grupa LOTOS also organised a meeting of LOTOS' specialists with students representing numerous student associations, including the Brevi Manu Student Scientific Association of Organisation and Management Psychology, Scientific Association of Chemistry Students of the Gdańsk University of Technology, Euro-Initiative Student Scientific Association and Scientific Association of Electrical Engineering Students of the Gdańsk University of Technology.

Grupa LOTOS cooperates with the largest global student organisation AIESEC and the international organisation of technology students BEST. There is also the LOTOS Ambassador, actively liaising with students and promoting the Company's values among them. The Company undertakes initiatives designed to increase the quality of secondary-school education as to prepare appropriately qualified staff for its future needs. LOTOS Serwis has under its auspices the industrial automatics class at Zespół Szkół Łączności (Communication School Complex) of Gdańsk. Grupa LOTOS S.A. is party to a cooperation agreement with Centrum Kształcenia Zawodowego i Ustawicznego (Vocational and Lifelong Learning Centre) No. 2 of Gdańsk and actively participated in the Gdańsk Professionals' Week, where it promoted vocational education by, for instance, presenting various forms of the Grupa LOTOS' support for schools and job opportunities at LOTOS. Grupa LOTOS was presented with the 'Gdańsk Vocational School-Friendly Employer' award. Employees of the Human Resources Office participated in conferences devoted to vocational education and attended by representatives of the Ministry of National Education. They also co-organised the regional 'HR Executive Meeting' devoted to cooperation between businesses with schools and job openings for students completing their vocational and technical education. Grupa LOTOS' representative was also a lecturer during two seminars organised by Centrum Edukacji Nauczycielskiej (Teacher Education Centre) − 'Uncut diamond – cooperation between schools with employers'.

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

2.3.1. EXPENDITURE ON PROPERTY, PLANT AND EQUIPMENT

In 2015, the Group incurred capital expenditure of **PLN 1,420,560 thousand**, of which the most significant item was the acquisition of a portfolio of assets in the Sleipner gas field on the Norwegian Continental Shelf and the development of the B8 field (GK LOTOS Petrobaltic S.A.) and the EFRA Project. Apart from that, in 2015 the Group incurred capital expenditure on the construction of a Hydrogen Recovery Unit (HRU) and expansion and modernisation of the service station network.

Table 4. Capital expenditure of the LOTOS Group in 2015 (PLN '000)

	Capital expenditure Jan 1 2015 – Dec 31 2015
Construction and assembly work	119,086
Procurement from external suppliers – purchases	496,784
Purchase of intangible assets	209,003
Other capital expenditure	595,687
Total	**1,420,560**

Expenditure on key capex projects:

- the EFRA Project – PLN 191,488 thousand,
- acquisition of Sleipner assets – PLN 583,427 thousand,
- development of the B8 field PLN 304,332 thousand,
- hydrogen recovery unit – PLN 44,434 thousand,
- extension and modernisation of the service station chain – PLN 130,230 thousand.

2.3.2. EQUITY INVESTMENTS

In 2015, Grupa LOTOS S.A. did not make any equity investments outside of the group of related entities, described in detail in Section 6.1.2. 'Ownership changes at the LOTOS Group'.

2.3.3. 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. Grupa LOTOS S.A.'s debt is serviced on a regular basis. In 2015, the Company repaid part of its debt incurred to finance the 10+ Programme. The net debt to equity ratio rose by 9.5pp (from 64.4% to 73.9%).

The financing for the key investment project (EFRA Project) was secured through the issue of Series D shares completed in January 2015 (the issue proceeds are reserved for the project) and an investment credit facility (for more information see Current Report No. 20/2015).

Figure 4. Gearing ratio – the ratio of net debt (financial debt adjusted for free cash) to equity

2.4. ASSUMPTIONS UNDERLYING THE LOTOS GROUP'S STRATEGY FOR 2016 – 2020

The LOTOS Group's development strategy for 2016–2020 is being prepared based certain macroeconomic assumptions which reflect the Group's expectations as to the direction of changes in external environment.

Plans and prospects of the upstream segment

The LOTOS Group's upstream business focuses on smaller-scale projects characterised by low geopolitical risk, implemented in areas where the Group has competence, i.e. in Poland (mainly the Baltic Sea), Lithuania, and the Norwegian Continental Shelf.

The LOTOS Group's strategy for 2016−2020 provides for further development of the exploration and production segment with a concurrent improvement of the financial efficiency of the segment's operations.

In view of the persistently unfavourable macroeconomic environment, including unstable conditions on the commodities market and sharp decline in crude oil prices, steps to be taken with respect to the upstream segment will initially focus on improving efficiency and ensuring financial stability of the segment. During that phase we plan to focus on our key strategic projects, including the development of the B8 oil field and of the B4/B6 gas fields, as well as on recovering (based on the cash flows from the Heimdal and Sleipner fields) the capital locked in the tax asset related to the Yme field development project in Norway.

As part of the strategy-driven activities, a number of efficiency-improving initiatives are also planned, including optimisation of the operating costs (particularly important should the scenario of prolonged crisis on the market of crude oil prices materialize), discipline in project implementation, and operational excellence. These goals are to be achieved for instance through full utilization of the potential of the segment's assets, including both the hydrocarbon reserves (i.e. increasing recovery rates and extending field lives) and the technical means (i.e. optimum use of platforms, vessels).

The purpose of these strategic initiatives in 2016-2020 is to build a stable position of the upstream segment as one of the two key areas of the LOTOS Group's business. Quantitative objectives (increase in production and reserve volumes) will be a function of the adopted financial objectives.

Prospects and development plans for the downstream segment

Grupa LOTOS' state-of-the-art refining assets guarantee a high conversion ratio and cost-effective operation.

The downstream segment, thanks to the investment made to increase distillate yields, effectively uses its growing technological potential as competitive advantage. Having implemented the EFRA Project, Grupa LOTOS operates one of the most technologically advanced refineries in the world, producing very high yields of high-margin products.

The Polish retail market for petroleum products is fully saturated, and the number of service stations remains relatively stable. Margins on fuel sales are low, forcing market operators to take measures aimed at increasing non-fuel sales volumes and improving efficiency.

- In this area, the Group's operations will focus on:
  - optimising the service station chain,
  - maximising fuel sales volumes,
  - expanding the offering of non-fuel products.
- The LOTOS Group will continue to look for partners for cooperation and asset sale projects and will implement programmes to stimulate employees' commitment and creativity and put in place innovative technologies and technical solutions.
- To support its image of an innovative company and improve the competitiveness of its individual business areas, the Group intends to pursue a comprehensive programme promoting employees' commitment and creativity, as well as to implement technical and technological innovations based on its own research and available external databases.
- The initiated streamlining of the LOTOS Group's structure will continue through restructuring of the Group's non-core business companies to reduce the cost burden of auxiliary activities on core operations. The purpose of the measures that are being taken is to prepare the support and auxiliary companies for divestment, provided the interests of the LOTOS Group are appropriately protected and secured. The overall goal is to ensure the Group's focus on its core business and secure funds to finance the Group's further development.
- Another area where streamlining is needed is the efficiency of the Group's internal support function. In this respect, the objectives are to improve the business management system (including through more efficient management of the integrated margin), optimise costs through more efficient procurement management, streamline the workforce, and optimise financing through improved utilization of the LOTOS Group's assets. The Group will review its refining assets management model as well as the links and correlations between its individual areas.

Strategic time horizon beyond 2020:

1. **Hydrocarbon exploration & production:** effective production growth and development of resource base for future periods,
2. **Refining and marketing:** investments in the refinery's process assets to increase the yield of high-margin products; effective management of the refining margin through optimisation of the supply chain,
3. **Retail network:** optimisation of the service station chain and higher efficiency of the retail business,
4. **Management:** seeking excellence in business administration and management, cost optimisation and promoting a culture of innovation.

2.5. CORPORATE SOCIAL RESPONSIBILITY STRATEGY

In 2008, the Management Board of Grupa LOTOS adopted a comprehensive **Corporate Social Responsibility Strategy for the LOTOS Group until 2012**. After broad consultations with stakeholders and following analyses performed to assess the activities carried out thus far and their determinants, as well as to identify expectations, the strategy was updated for 2012−2015. The Management Board of Grupa LOTOS adopted the updated CSR Strategy with its effective term until 2015, similarly as in the case of the business strategy.

The principal goal of the LOTOS Group's CSR strategy is to support the organization in meeting the objectives provided for in its business strategy by optimum use of the organization's resources and capabilities to generate economic and social value for the benefit of the Company and its environment.

To ensure successful delivery of that goal, the social, environmental, ethical and human rights concerns included in the CSR strategy were incorporated into the LOTOS Group's core operations and business strategy.

This created a mechanism designed to:

- Maximise the building of shared value for the shareholders, other stakeholders and society as a whole,
- Identify, prevent and mitigate the possible negative effects of the Group's operations.

Implementation of the strategy is expected to:

- improve competitiveness through better forecasting and taking into account changing social expectations,
- support risk management processes,
- create new market opportunities,
- facilitate access to capital,
- build customer loyalty,
- maintain long-term employee trust,
- boost the Company's innovation potential.

The LOTOS Group's CSR strategy until 2015 defined the key objectives to be achieved in individual areas of activity. For each of these objectives, a set of targets and action plans has been developed to support the achievement of the results envisaged in the strategy.

- In the area of investment in human resources, the goal is 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, the priority is to increase the awareness and involvement in work safety improvement among the management staff, employees and contractors.

- As regards integration with the local community, the principal goal is to undertake initiatives that help to ensure lasting solutions to social and environmental issues vital to our local communities.
- The objective in the area of management of natural resources in the production process is to reduce environmental risk and constantly minimise the environmental impact of the LOTOS Group's operations.
- In terms of ethics and the prevention of misconduct, management is being improved by ensuring ethical conduct and transparency of business processes, as well as by protecting the organization against misconduct.
- The strategic goal with respect to partnership relations with the market environment is to build lasting customer relationships by focusing on understanding customers' needs and ensuring expected product quality and safety.
- As regards energy sector security, the objective is to support initiatives designed to enhance energy sector security in a socially and environmentally responsible manner.
- As regards communication, the goal is to ensure that communication with employees is timely and appropriate to their various needs and to build an organisational culture based on multi-directional, open communication, including through the development of a system of public consultations within the Group.

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

The Company's approach to CSR is long-term and comprehensive, since it has become an element of the management process. The synergy of its business and social aspects has been ensured through the development of detailed operational plans and measures of the CSR strategy performance against targets in all of its key areas. Performance against targets is supervised by leaders of particular areas, reporting to the Management Board of Grupa LOTOS. For the purpose of performance reporting, a method of monitoring the implementation of the CSR strategy, similar to that used to analyse the results of the business strategy, has been developed. The CSR practices, similarly to practices in other key management areas, are additionally assessed for maturity, and evaluated by the management on a regular basis during the annual 'CSR Day'.

2015 was the fourth and at the same time the last year of implementation of the LOTOS Group's Corporate Social Responsibility Strategy for 2012−2015. Starting from 2012, the Group measured the level of implementation of the strategic objective, the key objectives and the actions in the individual areas of its CSR Strategy. Based on such analyses, semi-annual reports on the level of implementation of the Group's CSR Strategy objectives, constituting part of the Group's report on the implementation of its Business Strategy, were prepared.

At the end of 2015, work on a new CSR strategy for the Group commenced. The following key stages of the strategy implementation process were identified:

- 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 organisation; 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 organisation indicated by the leaders, as well as with representatives of the team responsible for defining the new business outlook for the LOTOS Group.
- Submission of the draft Strategy for internal and external social consultations, in accordance with best practices in this respect

The project will be carried out based on the experience gained in the course of the work performed in 2011 and taking into consideration 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

For more information on the LOTOS Group's CSR initiatives, go to www.odpowiedzialny.lotos.pl.

3. OPERATIONS OF THE LOTOS GROUP

3.1. MACROECONOMIC ENVIRONMENT (EXTERNAL GROWTH FACTORS)

Macroeconomic conditions in Poland and the EU

Most of the LOTOS Group's revenue is generated from production and sale of petroleum products, including transport fuels (gasolines and diesel oil), heavy and light fuel oil, aviation fuel, bitumens and lubricating oils.

Macroeconomic factors – such as decrease in real GDP growth and in the level of investment in Poland, shrinking industrial output, and rising unemployment – adversely affect demand for petroleum products, which in turn results in downward pressure on prices of petroleum products and refining margins.

In 2015, 2014 and 2013, domestic sales accounted for, respectively 59%, 62% and 67% of the Group's revenue, while export sales, mainly to the Northern and Western European countries, accounted for the remaining 41%, 38% and 33%. Thus, macroeconomic conditions in Poland and the European Union have a material bearing on the LOTOS Group's performance.

Level and structure of demand for and supply of petroleum products

Most of the LOTOS 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 type is an important driver of 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 ([4]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). Another important factor with a bearing on the Group's revenue is demand (and its geographical structure) for individual petroleum products sold by the Group.

In recent years, a considerable surplus of gasolines was observed in Europe (according to JBC, in 2014,[5] the surplus of gasolines on the European market reached 1.1 million barrels per day), accompanied by a shortage of diesel oil. This considerable gasoline oversupply made European refineries set to obtain higher yields of gasoline (or light oil fractions in general) sell this part of their output on non-European markets. Thanks to higher demand for gasoline in North America in 2015, the larger supply of this product did not cause the gasoline crack spread to narrow. However, in previous years exports to non-European markets, characterised by increasingly high competitiveness (particularly due to growing exports and falling imports of petroleum products from and to the US), led to the shut-down or substantial reduction of refining capacity of some European refineries.

According to BP[6], in 2014 the global consumption of petroleum products went up 0.8%, to 92.1 million bbl/day, from 91.2 million bbl/day in 2014 (the increase in 2014 was 2.1% y/y). However, simultaneously, mainly due to unfavourable macroeconomic conditions in some EU member states, the total 2014 consumption of petroleum products in Europe dropped 1.3%, to 14.7 million bbl/day, from 14.9 million bbl/day in 2013 (down 0.8% yoy). The

[4] *Crack spread is the difference between the price of crude oil and the price of petroleum products extracted from it.*
[5] *JBC Energy Assesment – Europe Oil Products*
[6] *BP Statistical Review of World Energy June 2015*

decline, chiefly attributable to lower demand for fuel oils, gasolines and diesel oil, whose sales fell by 8%, 1% and 1%, respectively, was partly offset by higher demand for naphtha (up 4%).

According to JBC, the demand for petroleum products in Europe will decrease further (in 2020 it will be lower 1% 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 on the Polish market should mirror those prevailing in Europe. 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 Russia (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 performance, the LOTOS Group sells products through diversified channels, both in Poland and abroad.

Crack spreads and Brent-Urals differential

Most of the LOTOS Group's revenue is derived from sale of petroleum products. Refining margins and, consequently, operating performance are chiefly driven by:

- *crack spreads on petroleum products* (i.e. the difference between the price of petroleum products and the price of Brent crude) as the price formulae in the petroleum product sale contracts are, as a rule, based on petroleum product prices quoted on international markets, and the price of oil purchased and processed into petroleum products is based on the price of Brent crude;

- *the Brent-Urals differential (spread)* (i.e. the difference between the price of Brent crude and the price of Urals crude) − Urals crude (also known as REBCO) is the key raw material used in refining operations, while petroleum product cracks are based on the price of Brent 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 financial 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 financial performance; and

- *exchange rates* − while PLN is the reporting currency and 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, the US dollar.

In 2015, crack spreads were highly volatile. They are materially affected by factors beyond the Company's control, such as macroeconomic and geopolitical environment in general, changes in European and global demand for and supply of petroleum products and crude oil, or general conditions on European and global financial markets.

In 2015, the Brent-Urals differential ranged between -0.7 USD/bbl and -3.7 USD/bbl, which resulted, on the one hand, from geopolitical factors stifling demand for crude oil similar to Urals (such as the embargo on the Iranian crude, decline in oil production in Libya).

To offset the adverse changes in refining margins caused by the above factors, which are beyond the Company's control, a delayed coking unit with auxiliary infrastructure (the EFRA Project) is being constructed at the Gdańsk refinery. The Company expects that the completion of the EFRA Project, scheduled for mid 2018, will improve the refining margin by ca. USD 2/bbl, primarily as a result of a decrease in the share of heavy petroleum products with a negative crack spread in the total output in favour of more profitable petroleum products, such as diesel oil.

Regulatory environment

A significant part of the Group's business is subject to extensive regulations imposed by the jurisdictions in which it operates, including Poland and Lithuania in particular, and the European Union and Norway in general.

The LOTOS Group's operations are largely influenced by numerous regulations, including in particular the Polish Geology and Mining Law, EU regulations and international conventions, such as those relating to environmental protection and climate change. Through the introduction of new requirements and more stringent standards, those regulations often require the Group to incur additional capital expenditure and/or result in higher operating expenses. In addition, the Company expects that, similarly to previous years, in the future the Group's performance will continue to be affected by tax regulations and the interpretations and recommendations issued by public administration authorities, as well as by individual administrative decisions which have been or will be issued by such authorities with respect to the Group's business.

The Group's results of operations in 2015 were, among other factors, influenced by the following regulatory matters: (i) changes in the technical requirements with respect to service stations, which required the Group to modernise some of its service stations; and (ii) the obligation to achieve more stringent NIT levels for bio-components.

The Company expects that in the near future the Group's performance will be affected by regulatory factors such as: (i) planned regulatory changes in the taxation of the extraction of hydrocarbons; (ii) further tightening of environmental protection regulations; (iii) increase in mandatory collateral relating to the risk of environmental damage, and (iv) amendments to regulations imposing obligation to maintain a stock of crude oil and certain petroleum products.

Crude oil and gas prices

The prices charged 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 upstream segment.

The profitability of upstream operations is chiefly determined by the difference between revenue from sale of produced oil and gas and the operating costs, tax expense related to hydrocarbon production, as well as cost of oil and gas transport and sale. Accordingly, a drop in oil and gas prices may reduce volumes which can be produced profitably, or may adversely affect the profitability of production from specific wells, or the profitability of ongoing or planned investment projects, making production unviable.

Crude oil and gas prices are volatile and depend on a number of various factors, which makes predicting their future price changes a very difficult task. The drivers 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.

Given that crude oil is the key feedstock used in the LOTOS Group's refining operations, 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 consolidated financial statements) (the LIFO effect).

Determinants of price per barrel of crude oil in 2016

- Major crude oil price changes over the last eighteen months add to uncertainty of expectations concerning commodity prices in the upstream industry in 2016. Among factors most often perceived as the main drivers of price per barrel, the most significant include: lifting the crude oil export ban by the United States
- the potential agreement within OPEC to limit production of crude oil (with Russia potentially joining this agreement)
- the future of shale oil production given the considerable drop in commercial viability
- the end of sanctions imposed on Iran and the impact of future Iranian crude oil exports on global supply
- the growth rate of demand for fuels, particularly in the context of maintaining the growth of gasoline consumption in the US.
- the oversupply of crude oil and finished products, filling global storages and tankers floating at sea to capacity (if the surplus persists, it may effectively block any potential price rebound).

3.2. UPSTREAM SEGMENT

3.2.1. LEGAL ENVIRONMENT FOR EXPLORATION AND PRODUCTION ACTIVITIES IN POLAND

Exploration and production activities in the territory of Poland are conducted under a licence granted by the Minister of Environment under the Geological and Mining Law of June 9th 2011, as amended. The solutions contained in the Law are consistent with Directive 94/22/EC of the European Parliament and of the Council on the conditions for granting and using authorizations for the prospection, exploration and production of hydrocarbons.

As at December 31st 2015, the following licences were valid:[7]

- 117 licences for exploration for and/or appraisal of conventional and unconventional hydrocarbon deposits (2014: 146 licences),
- 234 licences for production of hydrocarbons from conventional sources (2014: 236 licences).

Table 6. Entities holding the largest number of licences for exploration for and/or appraisal of conventional and unconventional sources of hydrocarbons

Shareholder	Number of licences
PGNIG S.A.	62
Orlen Upstream Sp. z o.o.*	14
ShaleTech Energy Sp. z o.o.	7
LOTOS Petrobaltic S.A.	**6**

** Together with the licences granted to FX Energy*

Table 7. Entities holding the largest number of licences for production of hydrocarbons from conventional sources

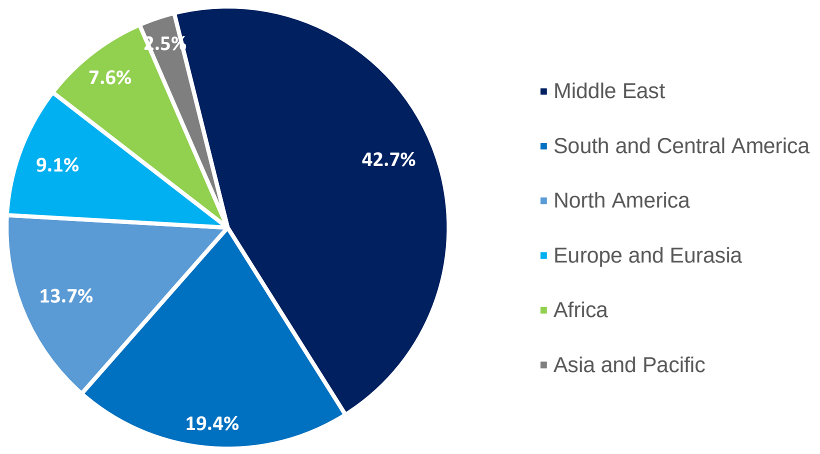
Shareholder	Number of licences
PGNIG S.A.	225
LOTOS Petrobaltic S.A.	**4**
ZOK Sp. z o.o.	2

7 Source: The Ministry of Environment, the list of licences for the exploration for, appraisal and production of hydrocarbon deposits in Poland.

3.2.2. MARKET ENVIRONMENT AND TRENDS IN THE EXPLORATION AND PRODUCTION INDUSTRY

According to the 'BP statistical review 2015', at the end of 2015 47.7% of crude oil reserves were in the Middle East: mainly Saudi Arabia (15.7% of global reserves), Iran (9.3%) and Kuwait (6.0%).

Figure 5. Global recoverable reserves of crude oil

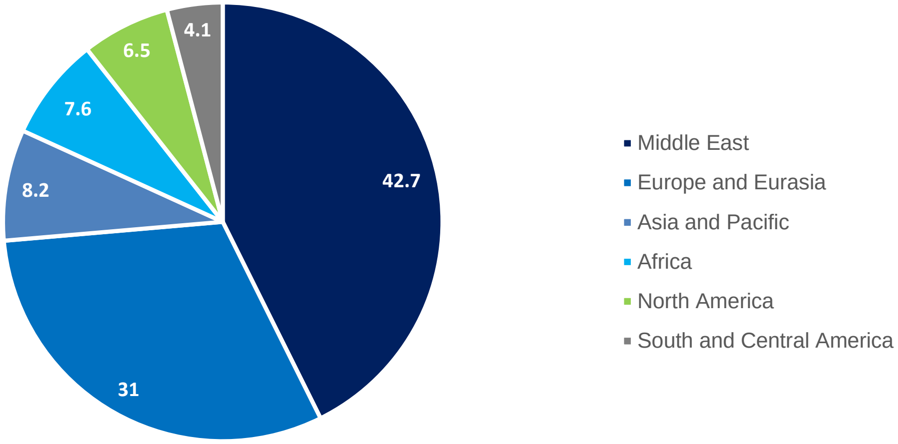


Source: BP statistical review, 2015.

In terms of crude oil reserves, the second largest region is the South and Central America (19.4% of global reserves), with the dominant position of Venezuela (17.5% of global reserves). The highest reserves to production ratio (R/P) is recorded for Venezuela (almost 120), followed by Kuwait (89), the United Arab Emirates (72) and Saudi Arabia (63). Norway's reserves stand at 6.5bn barrels (0.4% of global reserves), with the R/P ratio at 9.5.

Global reserves of natural gas amount to 187 trillion cubic metres. In terms of the quantity of reserves, the Middle East ranks first among world regions, with 42.7% of global reserves, including primarily Iran (18.2%) and Qatar (13.1%). Next are Russia (17.4% of global reserves), Turkmenistan (9.3%) and the United States (5.2%). The highest reserves to production ratios (R/P) are recorded for Azerbaijan (68.8), Russia (56.4) and Algeria (54.1). However, this ranking may change after the economic sanctions imposed on gas production in Iran in response to its nuclear programme are lifted. Norway's natural gas reserves total 1.9 trillion cubic metres (1% of global reserves) and its R/P ratio is 17.7.

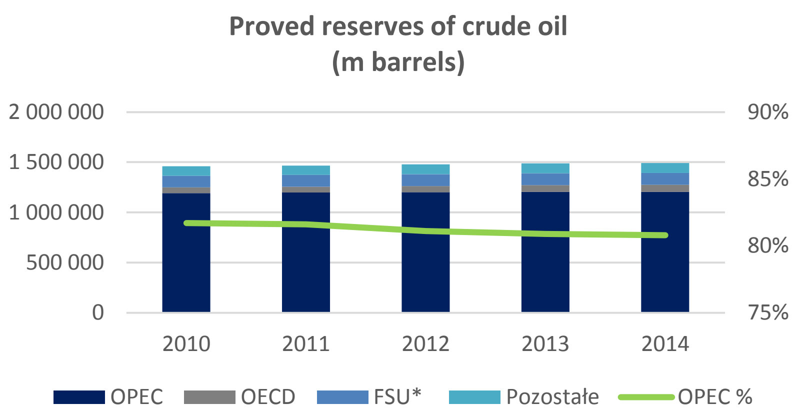
Figure 6. Global recoverable reserves of natural gas



Source: BP statistical review, 2015.

According to OPEC, global crude oil reserves increased by 0.2% as at the end of 2014, to 1,492,880m barrels.

Figure 7. Proven global crude oil reserves

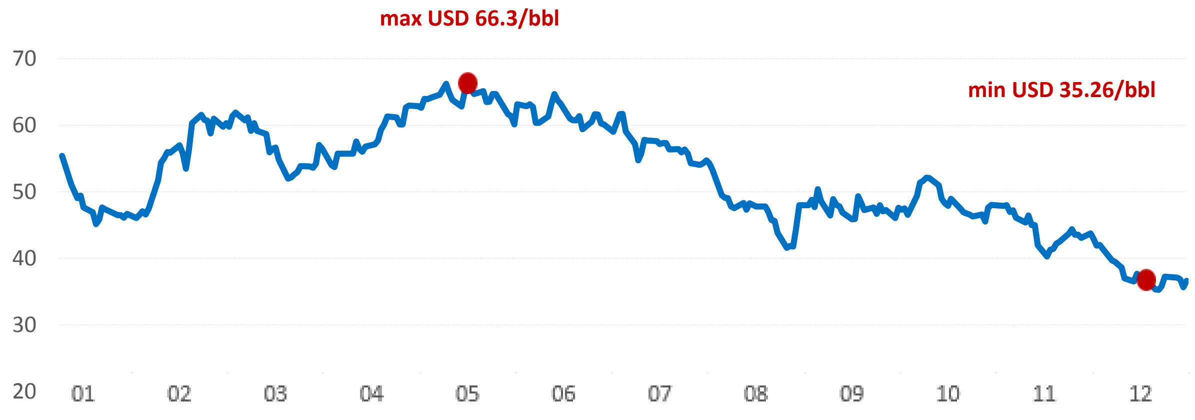


*Source: OPEC, Annual Statistical Bulletin, 2015, * FSU − Former Soviet Union.*

Throughout 2015, Saudi Arabia fought to maintain its shares in the oil market. The position of the largest crude oil producer among OPEC countries was threatened by US producers, which increased daily production to over 10 million barrels. On the other hand, in July 2015 Iran concluded an agreement with the six world powers (UK, US, France, China, Russia and Germany). Under the agreement, Iran agreed to abandon its nuclear programme in exchange for the gradual lift of international economic and financial sanctions, which will in particular enable Iran to increase its production and exports of hydrocarbons.

Based on the changes in Brent prices, 2015 can be divided into two periods. Between January and May 2015, the prices rebounded from below USD 50/bbl to the maximum of USD 66.3/bbl on May 13th 2015. In June 2015, the oil price hit a downturn and fell to as low as USD 35.26/bbl on December 22nd 2015.

Figure 8. Brent crude price in 2015 (USD/bbl)



Source: EIA.gov, Europe Brent Spot Price FOB, 2015.

Oil producers were forced to adapt to the persistently low prices of oil. The adaptation measures focused chiefly on scaling down any planned investment projects and reducing operating expenses. It is estimated that capital expenditure was cut by approximately 20−30% in 2015. Scaling down of the planned projects is expected to translate into lower crude oil supply in the coming years.

3.2.3. COMPETITION IN THE EXPLORATION AND PRODUCTION BUSINESS

As upstream margins plunged relative to those generated downstream, companies significantly reduced their exploration and production activity, which is demanding both financially (high capital expenditure) and in terms of access to the market (licence requirements). Over a short span of time, business activity by competitive companies faltered, particularly with respect to deposit development. Given the persistently low oil prices, there is no risk of crude oil and natural gas being substituted by other energy sources in a short or medium term. The bargaining power of suppliers of drilling materials and services as well as underwater and advisory services dwindled in the wake of lower capital expenditure. Consequently, the prices of such services and materials went down.

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

Baltic Sea, Polish Economic Zone

All exploration, exploration and appraisal, and production licences in the Polish zone of the Baltic Sea are held by LOTOS Petrobaltic S.A. (or companies in which it holds equity interests). The upstream segment operates in six exploration and appraisal licence areas and four hydrocarbon production licence areas.

Onshore operations in Poland

The onshore licence market in Poland is dominated by PGNiG, which holds the largest number of production licences (225 as at December 31st 2015) and licences for exploration and appraisal of conventional hydrocarbons (62 as at December 31st 2015). PGNIG's production amounted to 4.63 billion cubic metres of natural gas and approximately 1.43 million tonnes of crude oil and condensate in 2015.

Onshore operations in Lithuania

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

Norwegian Continental Shelf

Given the high hydrocarbon reserves and production volumes, the Norwegian Continental Shelf is a promising area for the upstream industry, represented here by about 60 international companies, including Statoil, Petoro, Total, Shell, Conoco, Exxon, Eni and BP, which jointly account for over 80% of the NCS's producing reserves. Besides those oil majors, about 20 small and mid caps, such as OMV, Lundin, BG Group, Wintershall, Det Norske, Noreco, Lukoil, Engie, Centrica, PGNiG, BayernGas and the LOTOS Group conduct production activities on the NCS. An important role is also played by small, independent exploration companies which are not engaged in hydrocarbon production on the NCS but which actively participate in discovering new reserves that are suitable for development. Given the structure and number of players, this market is highly competitive, but thanks to the Norwegian government's policy regarding the rules of participation in licensing rounds and the principle of cooperation as part of joint ventures created by multiple licence partners, it offers opportunities for gaining access to attractive projects and taking advantage of the experienced industry partners' knowledge.

LOTOS Group − opportunities and threats in the upstream segment

Strengths and opportunities:

- High production growth rate in the industry,
- Leader in the Baltic region,
- Constant development of experience and operator competence,
- Execution of investment projects in geographical regions characterised by relatively low political and financial risks,
- Cooperation with strong, experienced partners
- Withdrawal of certain players from the hydrocarbon exploration and production market as an opportunity to acquire attractive assets,
- Possibility of acquiring new production assets with lower risk and lower capital employed after a drop in assets value brought about by decreasing crude oil prices,
- Drop in project execution costs (due to lower prices of drilling services), higher availability of drilling platforms (due to a lower utilisation ratio).

Threats:

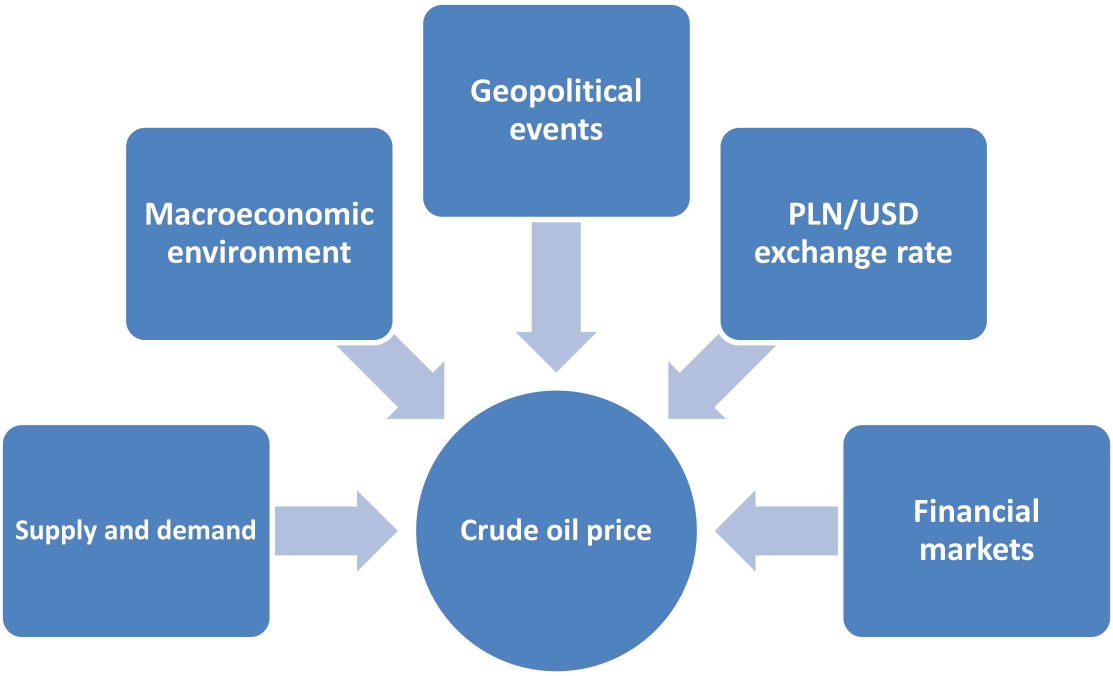
- Tough macroeconomic environment at the time of making key decisions concerning strategic projects,

- Growing exploration costs caused by having to explore and develop more difficult deposits,
- Lower availability of funding sources.

Crude oil pricing factors

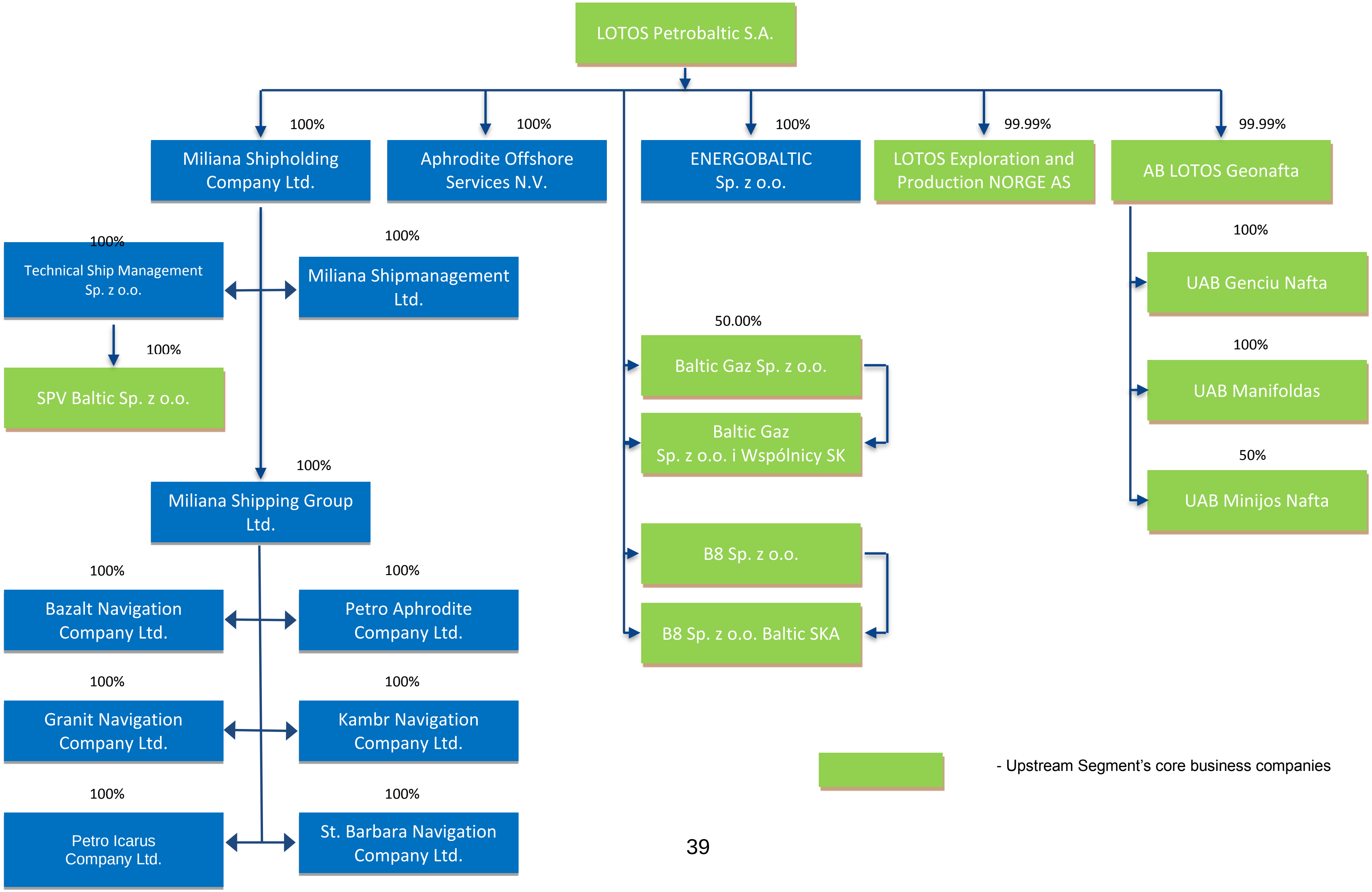
- Global and regional changes in supply and demand, expected level of future oil and gas supply and demand, as well as OPEC members' and other oil-producing states' ability to achieve and maintain a given level of production and prices,
- Uncertain geopolitical situation, terrorist activities or war potentially affecting supply and transport of, or demand for, hydrocarbons and petroleum products, or a threat of such activities,
- Availability and cost of construction or use of pipelines, tankers and other handling and processing infrastructure,
- New, existing and decommissioned refinery processing capacities and the degree of their utilisation,
- Price and availability of, and government subsidies for, alternative energy sources and new technologies,
- 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,
- 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
- Weather conditions and natural disasters.

Figure 9. Crude oil pricing factors



3.2.4. EXPLORATION AND PRODUCTION ACTIVITIES BY GEOGRAPHICAL REGION

Figure 10. Structure of the LOTOS Petrobaltic Group



Poland – Baltic Sea

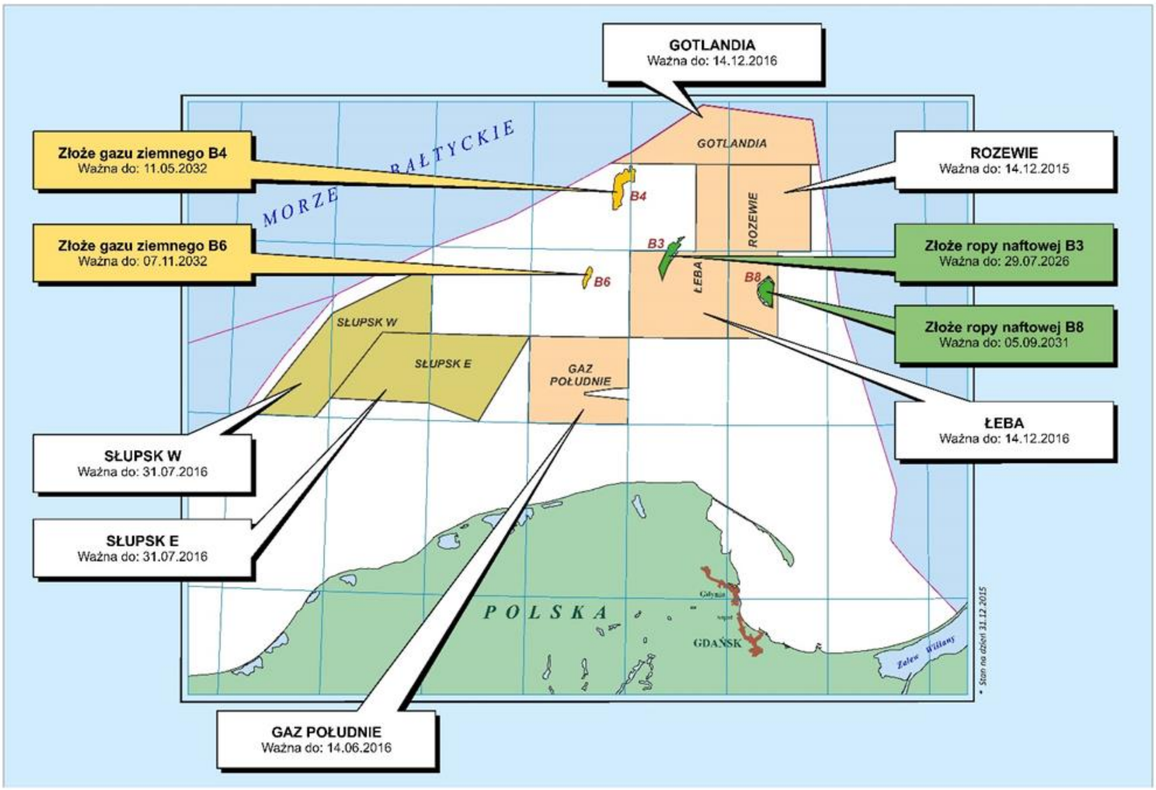
LOTOS Petrobaltic holds six licences for the exploration for and/or appraisal of crude oil and natural gas deposits in the following areas of the Polish economic zone of the Baltic Sea: Gotland, Łeba, Rozewie (proceedings for converting the licence into a licence for exploration for and appraisal of mineral deposits are pending), as well as Gaz Południe, Słupsk W, and Słupsk E.

As at December 31st 2015, the total area covered by the exploration and appraisal licences was over 6.2 thousand square kilometres, and that covered by production licences − 147.84 square kilometres.

The LOTOS Petrobaltic Group holds four licences for production of hydrocarbons in the Baltic Sea, including:

- Production licence for the B-3 field; the licence, valid until 2026, allows extraction of crude oil and associated natural gas in an area located around 73 km north off Cape Rozewie. Production from the field started in 1992.
- Production licence for the B-8 field (held by an SPV, B8 Sp. z o.o. BALTIC Sp.k.); the licence, valid until 2031, allows extraction of crude oil and associated natural gas in an area located approximately 70 km north of Jastarnia. The field is undergoing development and initial production of hydrocarbons has commenced.
- B4 and B6 production licences (held by subsidiary Baltic Gas Sp. z o.o. i Wspólnicy Sp.k. in which 50% of shares are held by the Company and the remaining 50% of shares are held by CalEnergy Resources), valid until 2032, allow extraction of natural gas north of Łeba. Preparations are underway to develop the fields in partnership with CalEnergy Resources Poland Sp. z o.o. Under a cooperation agreement, a 100% interest in the licence is held by Baltic Gas Sp. z o.o. i Wspólnicy Sp.k.

Figure 11. LOTOS Group's licences in Poland as at December 31st 2015



In 2015, in the Baltic Sea, LOTOS Petrobaltic S.A. conducted production in the B3 field and launched initial production in the B8 field. Total production of crude oil from the Baltic Sea fields was 162.4 thousand tonnes, while production of the associated natural gas was reported at 18.3mcm.

As at the end of 2015, LOTOS Petrobaltic S.A.'s 2P reserves of crude oil in the Baltic Sea were 4.815m tonnes, whereas its 2P reserves of natural gas totalled 0.51 bcm.

Poland – onshore operations

In 2012, LOTOS Petrobaltic launched onshore operations in Poland in partnership with PGNiG. In 2013, the companies signed an agreement for joint operations within the Kamień Pomorski licence area, in the north west of Poland, and in 2014 − an agreement for joint operations within the Górowo Iławeckie licence area in the north east of Poland. Exploration and appraisal work is under way in both licence areas.

Lithuania

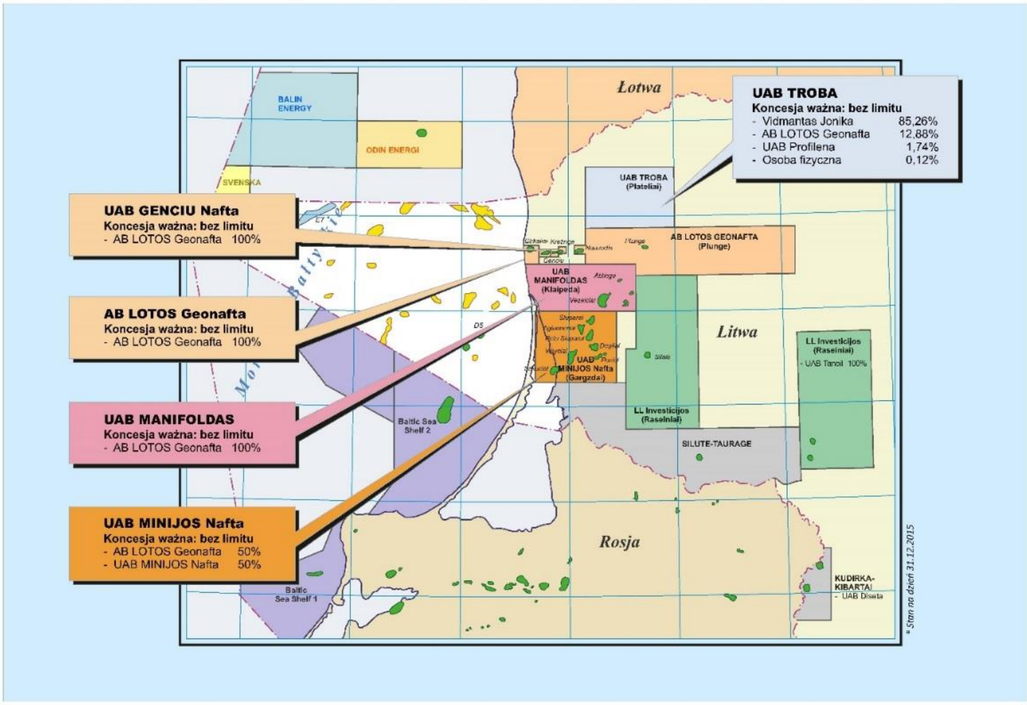
Lithuania is the market where AB LOTOS Geonafta, controlled by LOTOS Petrobaltic, operates.

The AB LOTOS Geonafta Group comprises:

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

The LOTOS Geonafta Group is engaged in crude oil exploration and production and provides drilling services in Lithuania. It also trades in crude oil.

Figure 12. LOTOS Group's licences in Lithuania as at December 31st 2015



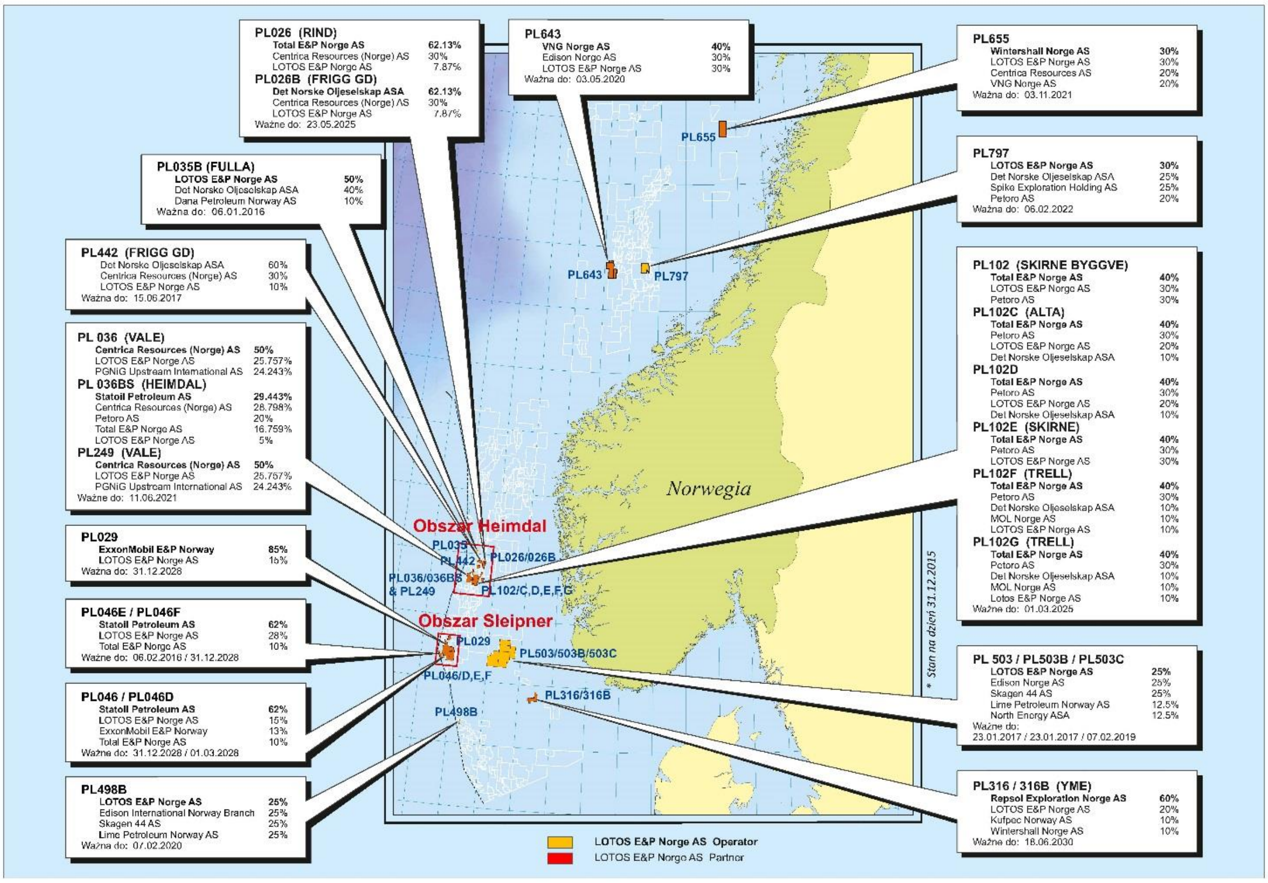
In aggregate, as at the end of 2015 AB Geonafta Group companies conducted hydrocarbon production from 14 fields. The Group produced 63.4 thousand tonnes of crude oil in 2015.

As at the end of 2015, the LOTOS Geonafta Group's 2P reserves of crude oil were 0.93m tonnes.

Norway

LOTOS Exploration & Production Norge AS of Stavanger, Norway, is the subsidiary responsible for the development of operations on the Norwegian Continental Shelf. Following acquisition of Sleipner production assets, LOTOS E&A Norge holds interests in 27 oil exploration and production licences in the Norwegian Continental Shelf, including: PL 498B, PL 503, PL 503B, PL 503C, PL 643, PL 655, PL 442 FRIGG GD, PL 797, PL 316/PL 316B YME, PL 249 VALE, PL 026 RIND, PL 026B, PL 035B FULLA, PL 036 VALE, PL 036BS HEIMDAL, PL 102 SKIRNE BYGGVE, PL 102C ALTA, PL 102D, PL 102E SKIRNE, PL 102F TRELL, PL 102G TRELL, PL029 Sleipner Vest, PL046 Sleipner Vest/ Sleipner Øst, PL046 D SleipnerØst, PL046E Utgard (AlfaSentral) and PL046F Utgard (AlfaSentral). The company is the operator under five licences: PL 498B, PL 503, PL 503B, PL 503C and PL 035B.

Figure 13 LOTOS Group's licences in Norway as at December 31st 2015



In 2015, LOTOS E&A Norge's production from the Norwegian Continental Shelf amounted to 89.1 thousand tonnes of crude and 288.9 bcm of gas.

As at December 31st 2015, LOTOS A Norge's crude oil and natural gas reserves classified as 2P were 0.982m tonnes and 2.246bcm, respectively.

LOTOS Group's oil and gas reserves

The LOTOS Group's operations in the exploration and production segment are carried on through LOTOS Petrobaltic S.A., in which Grupa LOTOS S.A. holds a 99.98% equity interest. LOTOS Petrobaltic S.A. is engaged in exploration and production in the following countries:

- Poland – LOTOS Petrobaltic S.A and its subsidiaries B8 Sp z o.o. (100%), B8 Sp. z o.o Baltic SKA (99.50%), Baltic Gas Sp. z o.o. i Wspólnicy s.k., Baltic Gas Sp. z o.o. (50%),
- Lithuania – AB LOTOS Geonafta and its subsidiaries UAB Minjos Nafta (50%), UAB Manifoldas (100%), UAB Genciu Nafta (100%),
- Norway – LOTOS Exploration and Production Norge AS (99.99%).

Table 8 Crude oil and natural gas reserves classified as 2P* as at December 31st 2015

Volume (m boe**)	Domestic sales	Crude oil	Natural gas	Total crude oil and natural gas
	Poland	37.381	3.200	**40.581**
	Norway	4.990	14.125	**19.115**
	Lithuania	7.138	0	**7.138**

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

Table 9 LOTOS Petrobaltic Group's production and sales of crude oil and gas in 2015

Sale	Domestic sales	Volume ('000 boe)
Total crude oil and natural gas	Poland	**1,396.0**
	Norway	**2,378**
	Lithuania	**366.71**

Production	Domestic sales	Volume ('000 boe/d)
Total crude oil and natural gas	Poland	**3.76**
	Norway*	**23.27**
	Lithuania	**1.33**

***Including average daily output of 16.5 thousand boe/d from the purchased Sleipner assets attributable to the LOTOS Group, as of the effective date of the purchase transaction (January 1st 2015).*

Key products, merchandise and services

The LOTOS Petrobaltic Group's core business is hydrocarbon exploration, production and sale conducted by three companies: LOTOS Petrobaltic S.A., LOTOS E&P NORGE AS and AB LOTOS Geonafta. In 2015, crude oil and natural gas were produced from deposits located in Poland (mainly crude oil and small quantities of associated gas), Lithuania (crude oil) and Norway (gas and condensate, i.e. light crude, predominantly natural gas).

Energobaltic Sp z o.o. is engaged in processing the gas produced from the Baltic fields, generation of heat and electricity, and production of LPG and natural gas condensate.

Miliana Shipping Company Ltd. manages the fleet of specialist ships on a service basis.

3.2.5. IMPORTANT EVENTS IN THE UPSTREAM SEGMENT IN 2015

Poland

In 2015, the upstream segment pursued the objectives specified in the LOTOS Group Strategy for 2011−2015. The launch of initial production from the B8 field in the Baltic Sea and the acquisition of the Sleipner assets enabled the LOTOS Group to increase its daily output of hydrocarbons two and a half times, to 30,300 boe/d at the end of 2015, thus exceeding the strategic objective (24,000 boe/d at the end of 2015).

The upstream segment companies focused on maintaining their financial stability given the unfavourable macroeconomic conditions affecting the industry. The segment sought to secure financial liquidity through cost cutting measures, optimisation of capital expenditure and debt restructuring. Its operating activities focused on the execution of key strategic projects:

- as part of continued production from the B3 field: workover of two production wells was completed.
- In line with the assumptions, in September 2015 initial production from the B8 field was launched, with the use of LOTOS Petrobaltic's drilling platform. Following the conversion of the Petrobaltic platform into a production centre, its deployment on the field and construction of a gas pipeline to Władysławowo, production takeover by the production centre will take place in H2 2017. In view of the macroeconomic environment in 2015, the scope of the project to convert the Petrobaltic's drilling platform was optimised, construction plans and specifications were approved, a building permit for the sub-sea gas pipeline connecting the B8 field with Władysławowo and a planning permit for the onshore section of the pipeline were obtained.
- Preparations to develop the B4 and B6 gas fields in partnership with CalEnergy Resources Poland were underway.

  Phase 3 of the project, involving engineering design work and preparation of a recommendation for the Final Investment Decision in Q3 2016, was in progress. A detailed timetable for the development of the B4 and B6 fields, including the start date of gas production, will be precisely defined based on the results of engineering design work. The fields will be put on stream between 2018 and 2019.
- In cooperation with PGNIG, exploration activities in the Górowo Iławieckie and Kamień Pomorski onshore licence areas were continued. The acquired seismic data was interpreted. The results will serve a basis for defining the plan and scope of further work in the licence areas.

Norway

- On December 30th 2015, LOTOS Norge finalised the **acquisition of the Sleipner assets** located in the central part of the North Sea. The transaction covered interests in five licences including four production fields and the Alfa Sentral field, discovered and scheduled for development. Statoil is the operator of all those licences, and the other consortium partners are Exxon and Total. Towards the end of 2015, the production level attributable to LOTOS Norge's interest in the Sleipner assets exceeded 16,000 thousand boe/d. The expected average volume of hydrocarbon production attributable to LOTOS Norge's interest is estimated at approximately 9,500 boe/d in 2016−2018. In terms of size, the Sleipner area is the second largest gas hub in the North Sea, of strategic importance for gas exports from Norway to the Continental Europe and the United Kingdom (40% of gas exports is distributed from the area). The base purchase price of the Sleipner assets was USD 160m and the Norwegian "pro & contra" mechanism allowed for a cashless settlement of the transaction with the use of LOTOS Norge's tax shield.

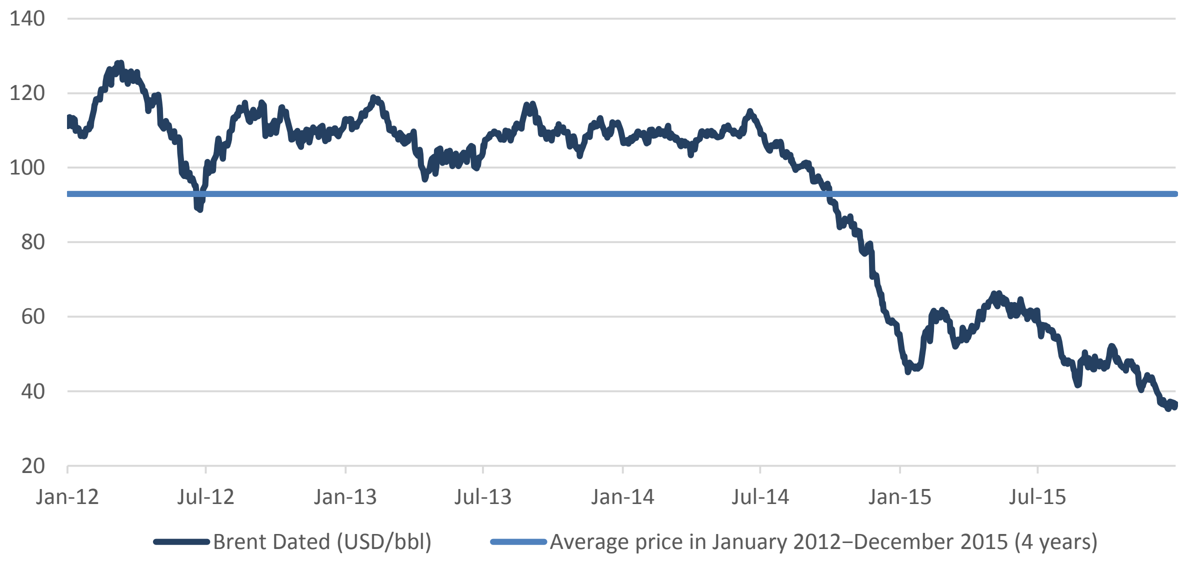
- In June 2015, the Norwegian Ministry of Petroleum and Energy (MPE) approved the request not to submit a Revised Development Plan, made by the operator of the **Yme project** licence, Repsol of Spain (which took over the interest of the former operator, Talisman Energy). The partners are implementing the project to abandon the Yme field, planned for 2016–2020, and work together to limit the scope and costs of field abandonment. The Abandonment Plan is scheduled for submission to the MPE for approval at the end of 2016. In January 2016, Repsol, the field operator, and Okea signed an agreement for the sale of a 60% interest in the Yme field. The agreement provides for conditions precedent: removal of the Mobile Offshore Production Unit (MOPU) and obtaining of an updated YME field development plan approved by the Norwegian authorities. Okea is interested in continuing the work on the development of the YME field. LOTOS is analysing the situation on an ongoing basis to arrive at the best solution for the Yme project.

3.3. DOWNSTREAM SEGMENT – CRUDE OIL REFINING

3.3.1. GLOBAL REFINING MARKET ENVIRONMENT AND INDUSTRY TRENDS

Crude prices collapsed in the second half of 2015. In April, a barrel of oil cost USD 60 compared with USD 36 in December, a decline of 40%.

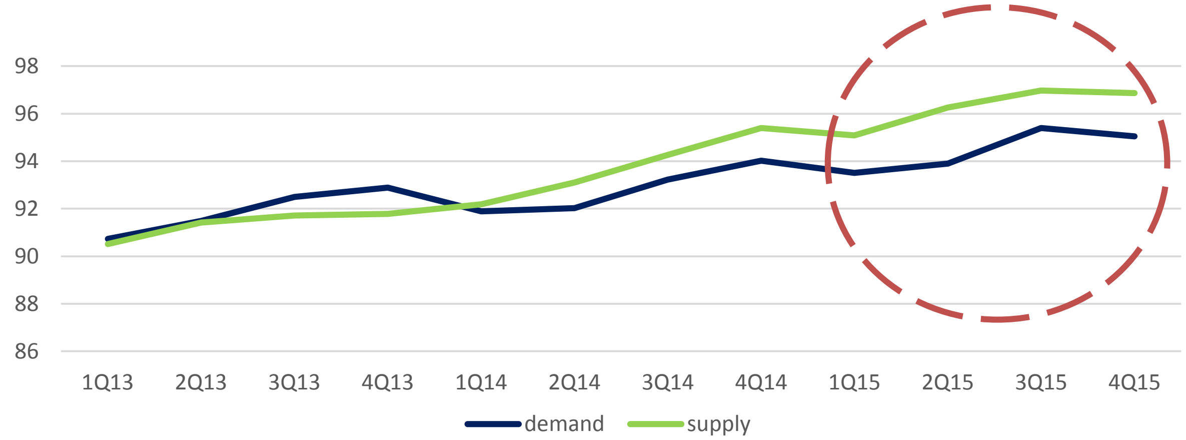
Figure 14. Oil prices in 2011−2015 (USD/bbl)



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 US Energy Information Administration, the oversupply reached about 2m boe/d, representing almost 2% 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.

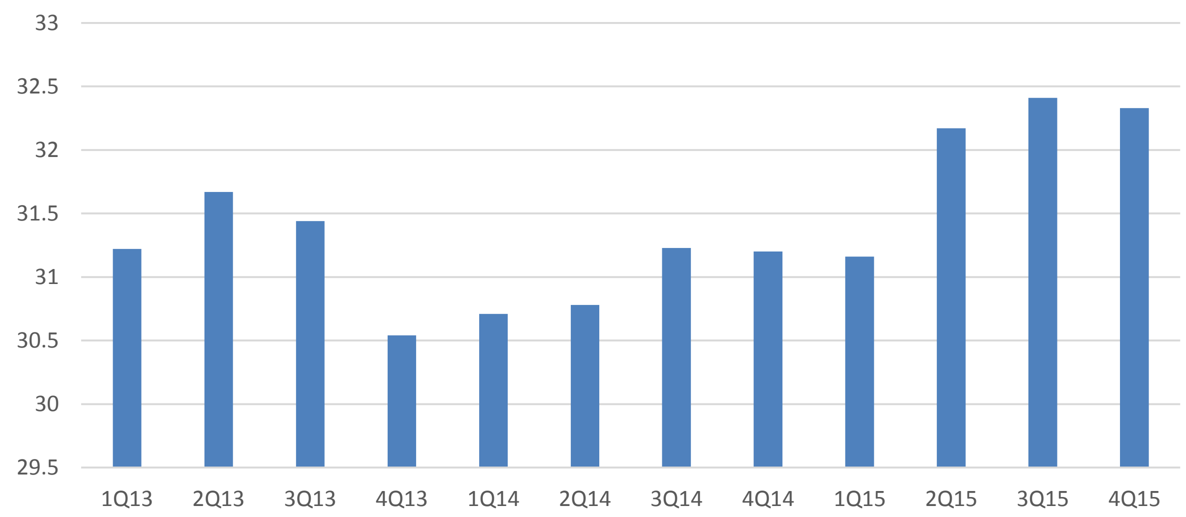
Figure 15. Global demand and supply (million boe/d)



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

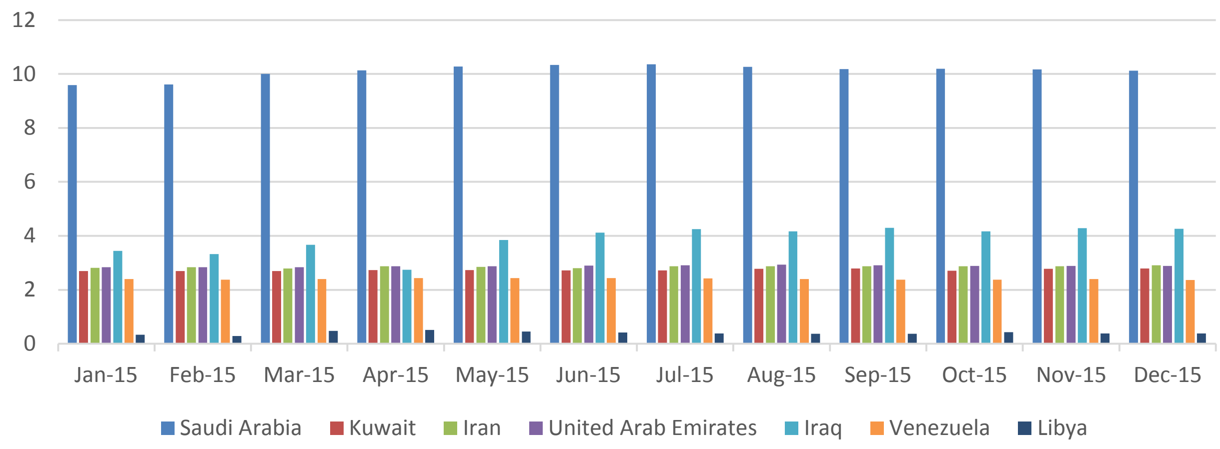
As major producers in the global oil market, OPEC countries used their spare production capacities to adjust the supply of crude and stabilise its price in the desired price range in 2011−2014. On November 27th 2014, the OPEC decided to protect their market share by maintaining their production at 30 million boe/d. The cartel kept the target unchanged throughout 2015, with two member countries, Saudi Arabia and Iraq, having actually increased their output. Saudi Arabia stepped up production by over 6%, to 10.12 million boe/d, while Iraq, despite the ongoing Islamic ISIS incursion, ramped up output to 3.98 million boe/d, the highest level since 1979 (3.5 million boe/d).

Figure 16. OPEC crude oil production in 2013−2015 (boe/d)



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

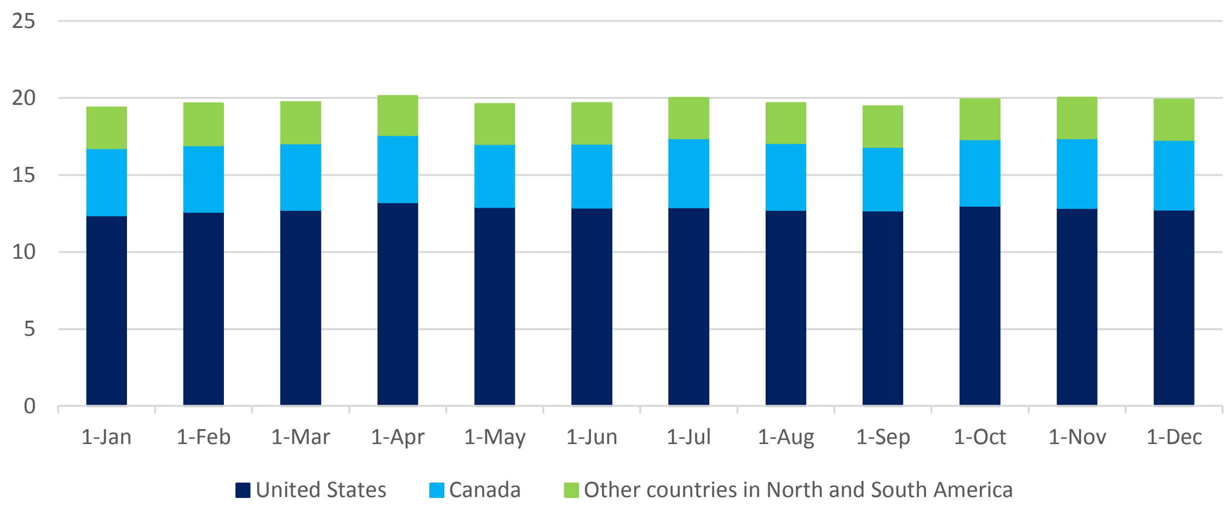
Figure 17. Oil output by the largest OPEC producers in 2015 (million boe/d)



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

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 in the second half of 2015, partly reflecting weaker growth in the global economy. 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. The lifting of sanctions against Iran announced in July 2015 and expectations that this would increase the global oil supply delivered another blow to oil prices.

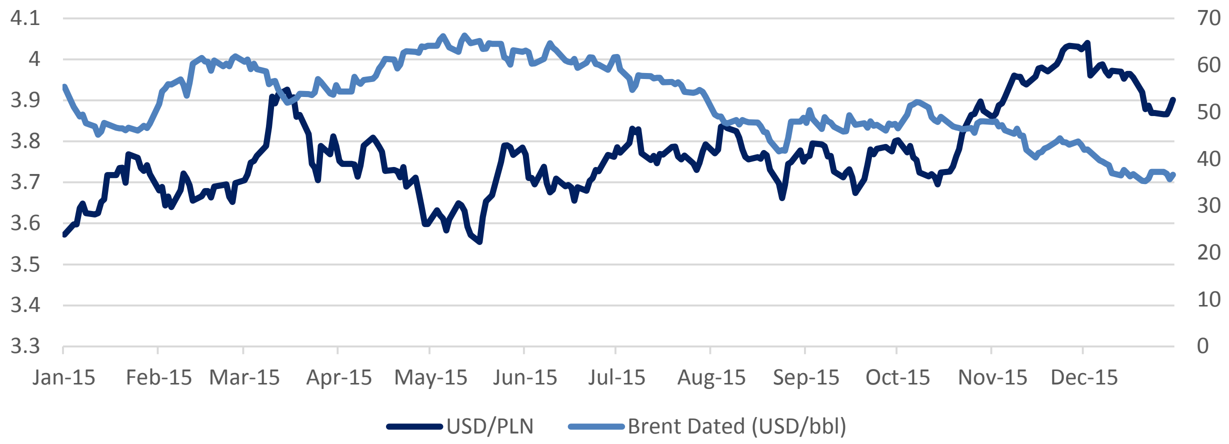
Figure 18. Oil output by the Unites States and Canada in 2015 (million boe/d)



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

In the second half of 2015, the US dollar appreciated 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 19. USD/PLN exchange rate vs. Brent Dated crude oil price

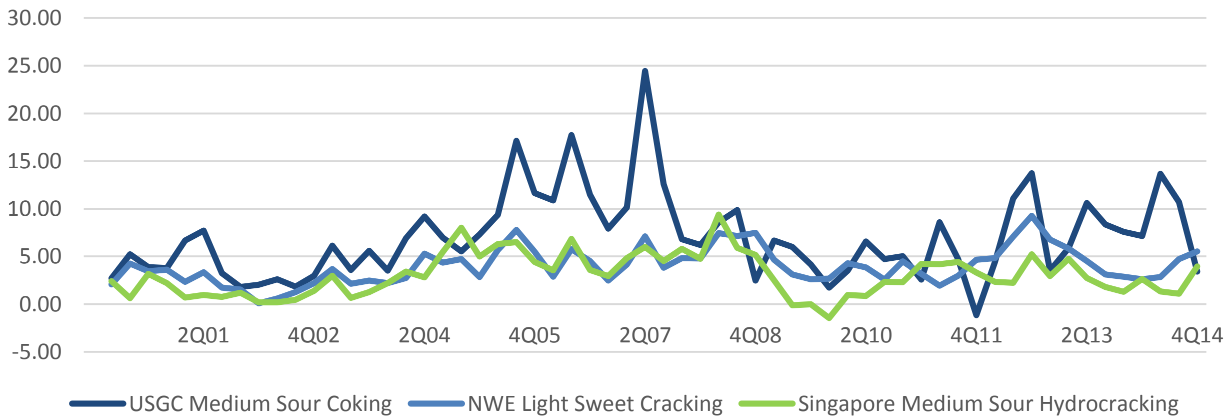


Source: In-house analysis based on Thomson Reuters data.

The price decline observed since 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.

2015 was a good year for fuel producers, who benefited from low oil prices, averaging approximately USD 52/bbl for the year (down 47% on 2014), and strong crack spreads on refined products. Refiners around the world, including Poland, sought to maximise throughput to deliver the highest possible margins.

Figure 20. Refining margins globally (USD/bbl)

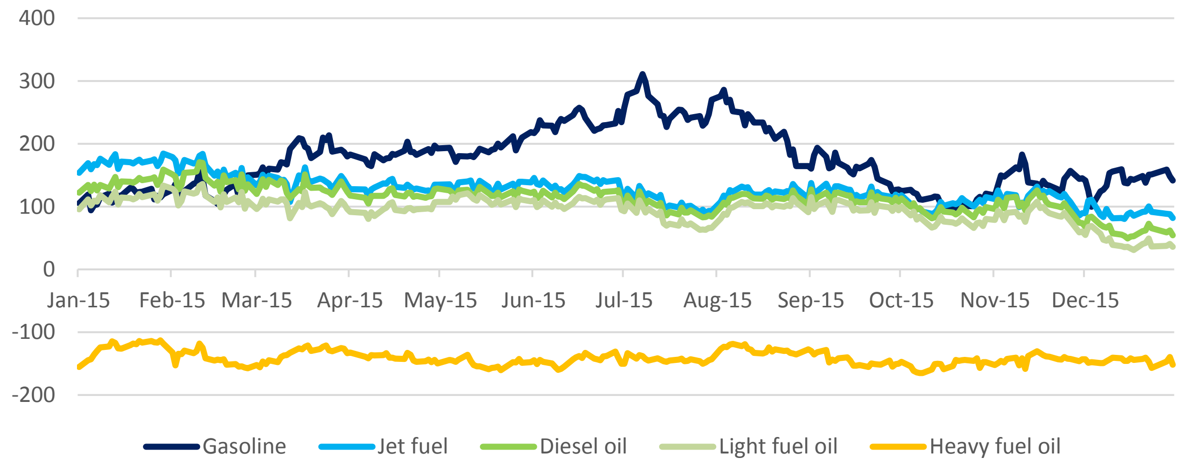


Source: In-house analysis based on BP data. The presented refining margins are benchmark margins for three major global refining centres: US Gulf Coast (USGC), North-West Europe (NWE – Rotterdam) and Singapore.

The crack margins on petroleum products were as follows:

- Gasoline – low: USD 94.19/t (January 6th 2015), high: USD 311.29/t (July 8th 2015) – annual change: +230.49% or USD 217.10/t
- Jet fuel – low: USD 80.36/t (December 15th 2015), high: USD 184.69/t (January 30th 2015) – annual change: -56.49% or USD -104.33/t
- Diesel oil – low: USD 49.43/t (December 30th 2015), high: USD 170.91/t (February 5th 2015) – annual change: -71.08% or USD -121.48/t
- Light fuel oil (LOO) – low: USD 30.70/t (December 7th 2015), high: USD 136.01/t (January 15th 2015) – annual change: -77.43% or USD -105.31/t.
- Heavy fuel oil (COO) – low: USD -165.08/t (October 28th 2015), high: USD -113.814/t (February 9th 2015) – annual change: -45.9% or USD -51.94/t.

Figure 21. 2015 crack margins (USD/t)



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

Figure 22. Global fuel consumption (million tonnes)

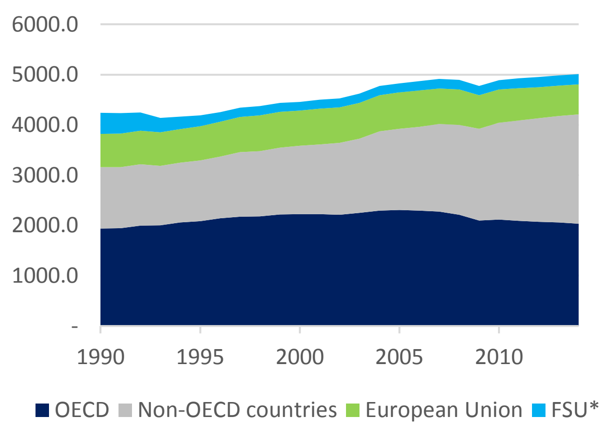
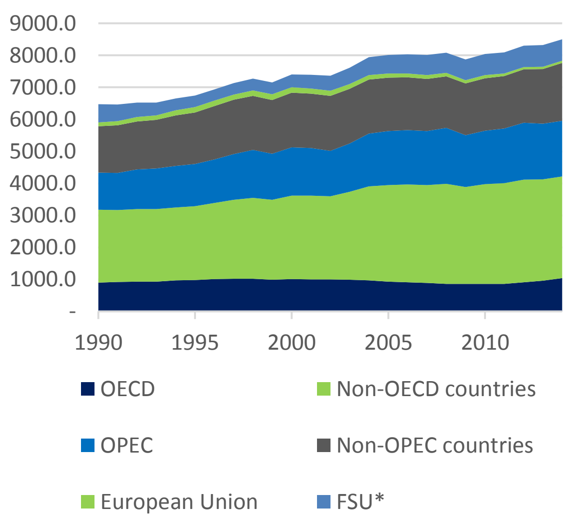


Figure 23. Global fuel production (million tonnes)



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

Figure 24. Global processing at refineries utilisation (thousand boe/d)

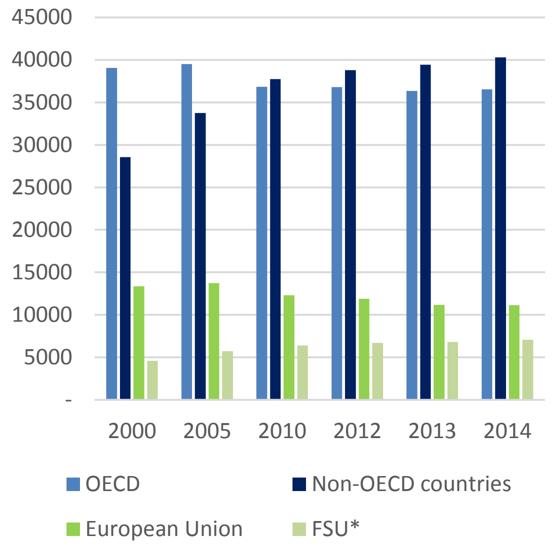
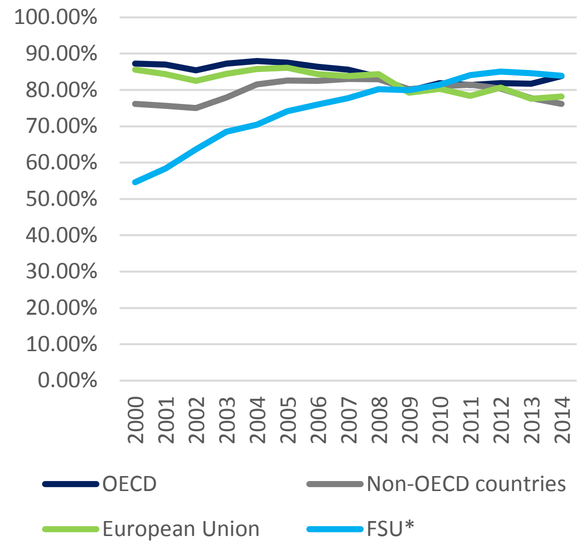


Figure 25. Processing capacity (%)



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.

Table 10. 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

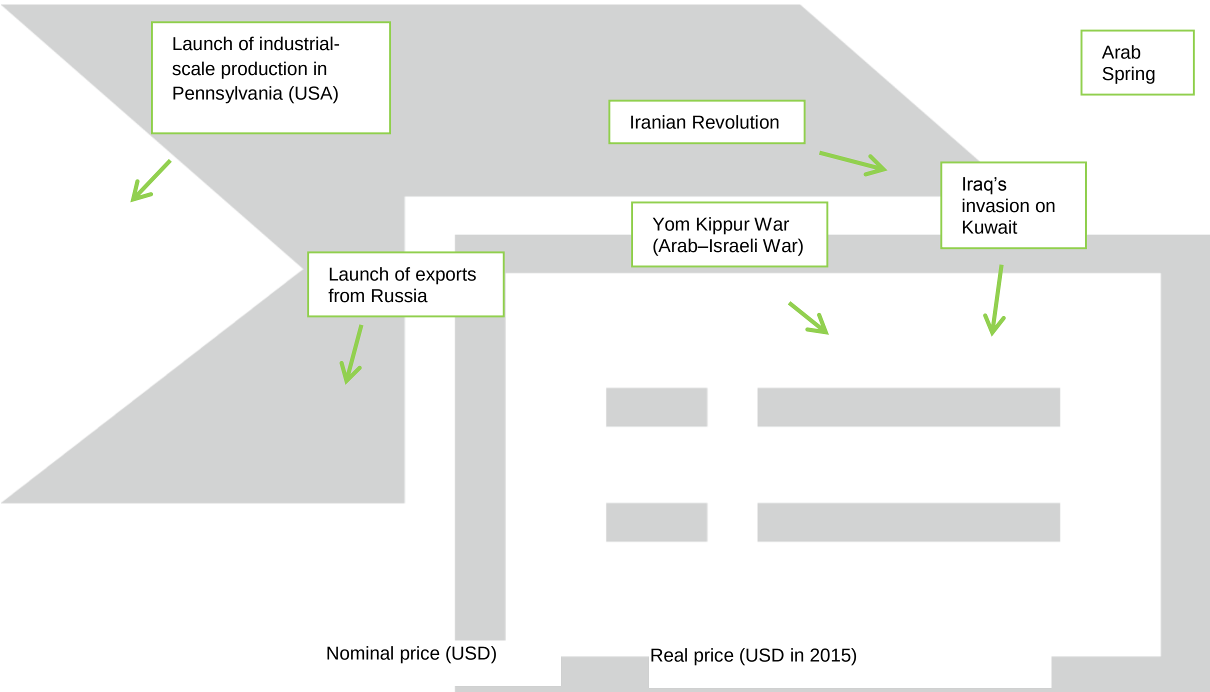
Year of shutdown	Refinery	Nelson Complexity Index	Capacity (tbd)	Owner	Domestic sales
2011	Arpechim	7.3	70	Petrom	Romania
2011	Petrobrazi	7.3	6	Petrom	Romania
2011	Gonfreville	N/A	94	Total SA	France
2011	Cremona	7.5	94	Tamoil Raffnazione SPA	Italy
2011	Reichstett	5.3	85	Petroplus	France
2010	Teesside	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.*

3.3.2. FACTORS DRIVING PETROLEUM PRODUCT PRICES

Figure 26. Oil price in 1861–2015



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 11. Characteristics of crude oils

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

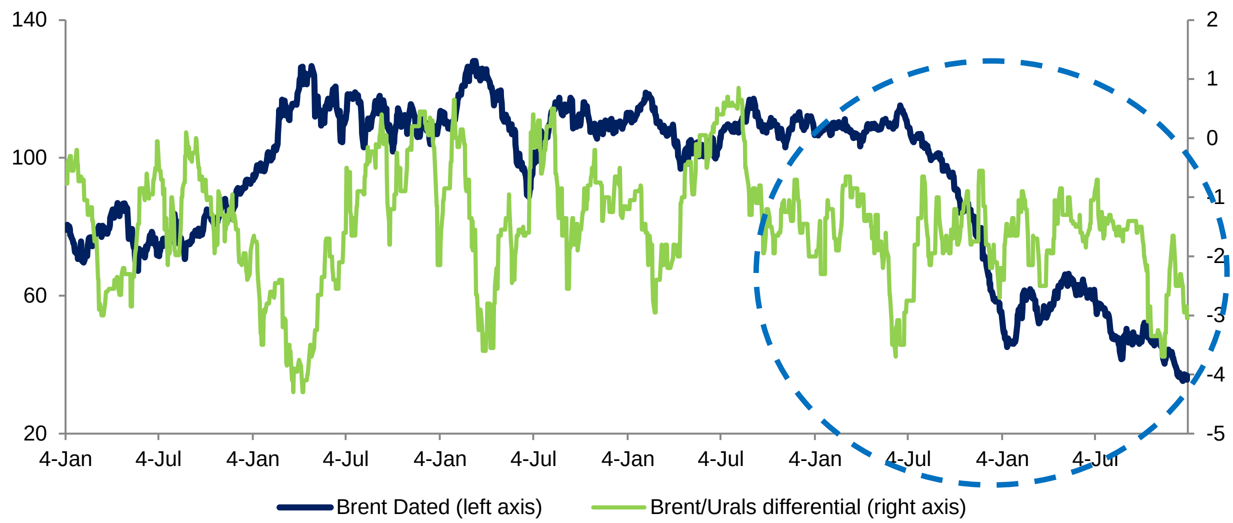
Table 12. Fractional content (wt %)

	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 27. Brent-Urals differential and Brent Dated crude prices (USD/bbl)



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

3.3.3. GRUPA LOTOS S.A.'S GDAŃSK REFINERY IN A REGIONAL CONTEXT

Grupa LOTOS S.A.'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.

A natural continuation of the wider effort to technologically modernise the refinery, supplementing the crude oil processing chain created under the 10+ Programme, is the EFRA Project.

EFRA stands for 'efektywna rafinacja' in Polish (effective refining). It is a project carried out by LOTOS to ensure more advanced and deeper conversion of crude oil at the Delayed Coking Unit. With the project units, the heavy residues from the refinery could be processed into high-margin products, including diesel oil and jet fuel, while production of low-margin products, such as bitumens and heavy fuel oil, could be reduced.

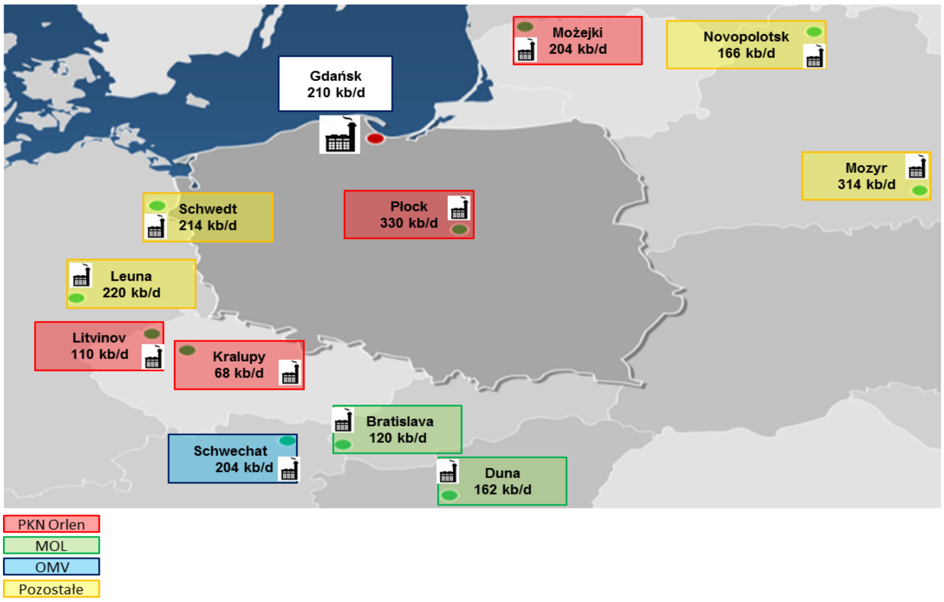
The very good technological condition of the refinery is further confirmed by its Nelson Complexity Index (crude oil processing complexity ratio). Based on the Company's estimates, it is the highest in Poland and among the highest in Europe. The ratio reflects the intensity of investments in the refinery, 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 28. Gdańsk refinery vs. local competitors



Source: In-house analysis; daily production capacity in thousands boe/d.

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 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 Brent Dated price and the Urals/Brent spread.

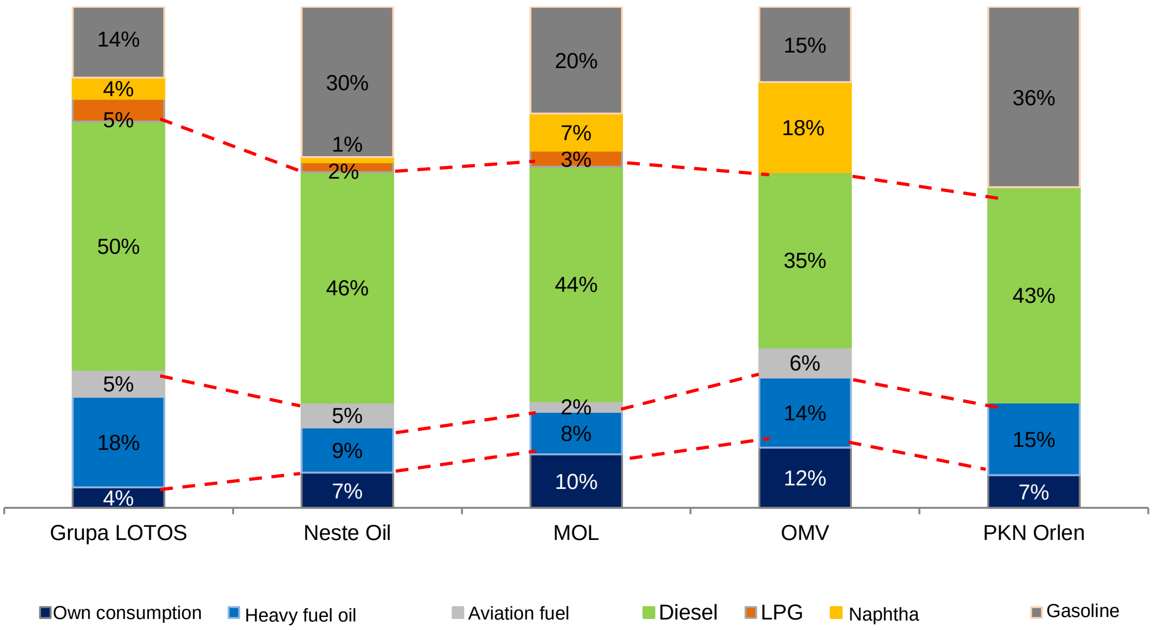
Further information on the model refining margin is available at:

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).

Figure 29. Yield structure of refineries operated by local competitors of Grupa LOTOS S.A.



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

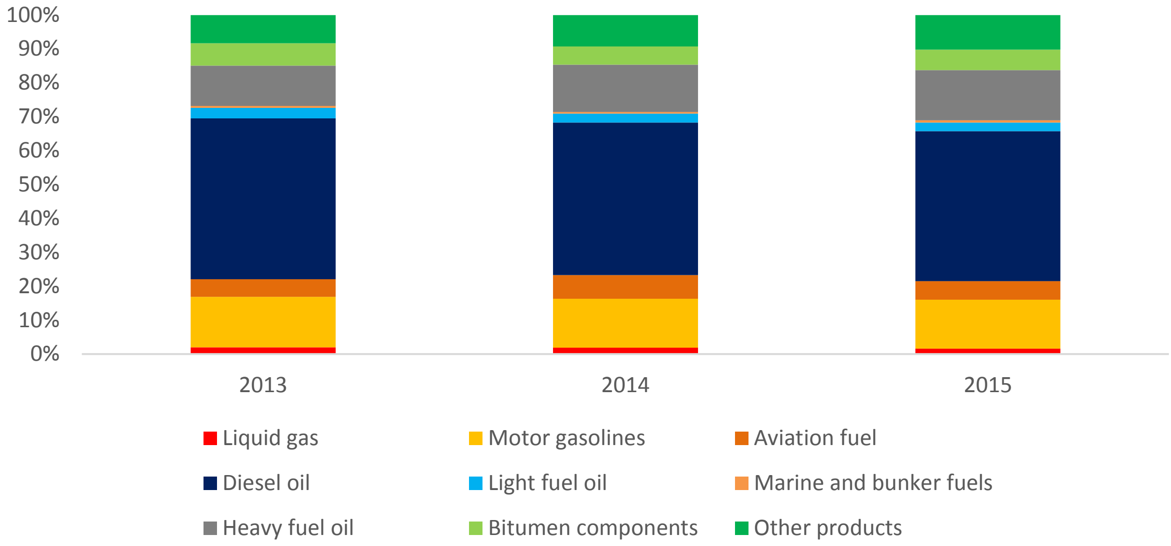
Crude processing and product slate

As in previous years, the main type of crude processed was Russian REBCO. Its share in the total volume was close to 76.6%, which was significantly lower than in previous years. The shrinking share of REBCO crude is an effect of favourable conditions on the oil market.

Crude oil from other sources, including approximately 220 thousand tonnes of crude supplied by the LOTOS Petrobaltic Group, 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.

In 2015, the refinery processed 10.2 million tonnes of crude, the highest throughput in Grupa LOTOS S.A.'s history. The structure of finished goods was driven by pricing levels on the market and demand for individual products.

Figure 30. Finished goods (%)



3.3.4. 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 Group's unleaded gasolines include premium gasoline – LOTOS DYNAMIC 98, containing antioxidants and washing additives which ensure 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 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 reformate splitting. It is used as feedstock in plastics production. The xylene separation will further diversify the LOTOS Group's product portfolio and reduce the share of aromatic hydrocarbons in the range of gasoline components produced by the Gdańsk refinery. This will contribute to greater technological flexibility of the refinery, while allowing it to sell some of the components on the fuel or petrochemical market.

3.3.5. KEY THREATS AND OPPORTUNITIES

The situation in the downstream segment will be influenced by macroeconomic factors (the prospect of continued economic slowdown in China; further strengthening of the US dollar; economic growth rate in the eurozone, etc.) and geopolitical developments (fighting ISIS, Iraq-Iran tensions, etc.).

Key threats include rising competition from Middle East refineries. It is expected that their key sales market in Europe will be the Mediterranean region, but this will nevertheless have an impact on the fuel supply-demand balance in Europe. Another possible threat is crack spreads (particularly on middle distillates like light fuel oil and diesel oil) falling and staying low.

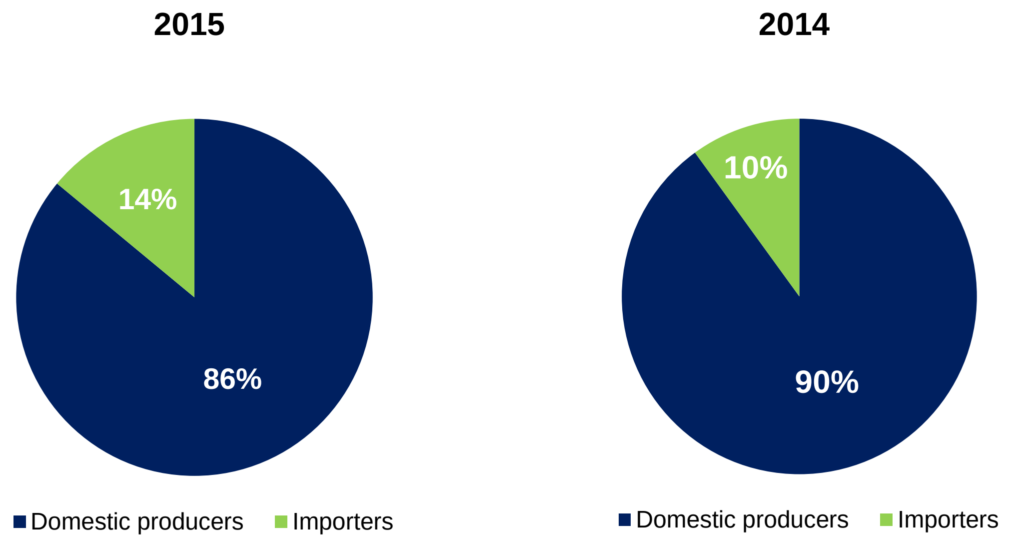
Opportunities include strong retail demand for fuels. Rising consumption of gasoline by retail customers is likely to be supported by low retail prices (resulting from low feedstock prices). European oil companies shutting down small and obsolete refineries in an effort to optimise their assets also presents an opportunity for the downstream segment.

3.4. DOWNSTREAM – WHOLESALE AND RETAIL SALE

3.4.1. DOMESTIC FUEL MARKET OVERVIEW

Poland's fuel market is supplied from two sources: **domestic producers** (PKN Orlen S.A. and Grupa LOTOS S.A.) and **importers**. In 2015, the **share of importers rose 4pp** year on year.

Figure 31. Estimated structure of domestic market supplies



It is important to note that 2015 was very different from previous years in terms of fuel consumption in Poland. After three years of declines caused by a rampant grey market, official fuel consumption picked up in 2015, rising 7.1% (1.36 mcm), to 20.6 mcm, with domestic production at 20.4 mcm. Low prices offered by independent importers (not associated in the Polish Oil Industry and Trade Organisation or POPIHN) forced domestic producers, unable to compete on the home market, to sell their fuels abroad, with exports rising 46% year on year, to 2.76 mcm. At the same time, imports by independent importers grew 69%, to 1.86 mcm. The shift was observed in all three product categories: gasolines, diesel oil and light fuel oil. On the whole, Poland was a net exporter of fuels in 2015.

A 10% year-on-year growth in production was driven solely by a favourable market environment, as refining margins, remaining strong for the most part of 2015, prompted refiners to maximise throughput. Crack spreads were wide enough to make production step-up profitable even assuming that part of the output would need to be sold abroad.

The increase in consumption is not to be taken as a sign that the problem of grey market has been solved – the grey market share of total fuel sales in Poland is estimated at around 13% (2014: 16%). The 2015 rise in consumption was partly an effect of the shrinking grey market, but its main driver was low retail fuel prices, which fell tracking oil prices and fed through into increased consumption. It is important to note that, according to official statistics, in Q1−Q3 2015 imports of diesel oil to Poland went up 37%, with a 9% growth of domestic consumption, which proves that competition on the domestic fuel market is rising.

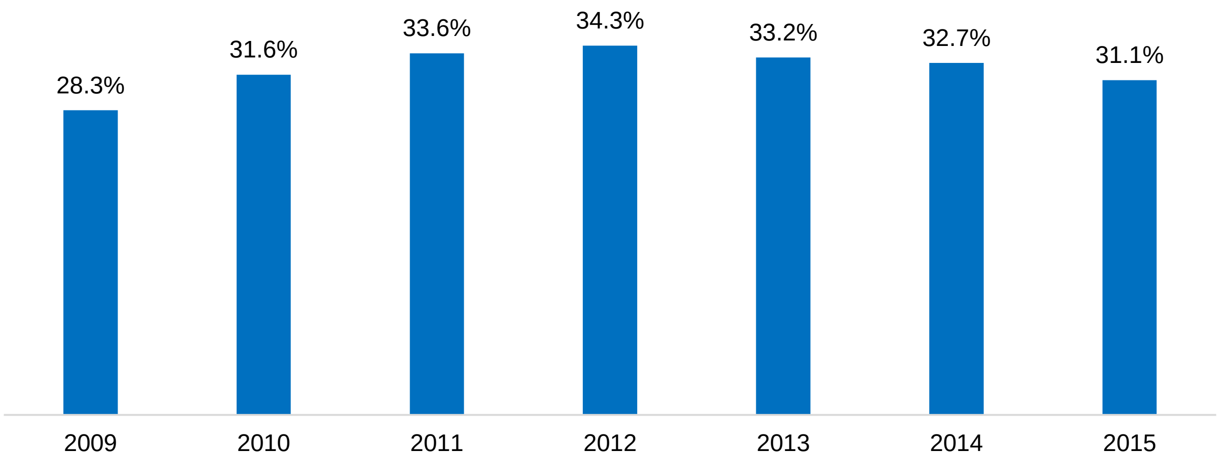
3.4.2. DISTRIBUTION CHANNELS, MARKET POSITION, AND FUEL AND NON-FUEL PRODUCT SALES

The LOTOS Group's marketing activities in 2015 were carried out by Grupa LOTOS and its subsidiaries: LOTOS Paliwa, LOTOS Oil, LOTOS Asfalt, and LOTOS-Air BP Polska. Grupa LOTOS conducted its marketing business domestically (sales to foreign companies) and through export sales, by sea and by land, while its subsidiaries' production and sales were targeted at the fuel, lubrication oil and bitumen industries.

The LOTOS Group offers fuels on the domestic retail market exclusively through LOTOS Paliwa. On the wholesale market, the LOTOS Group operates both through Grupa LOTOS S.A. (supplying fuel to international corporations and key customers, e.g. under contracts with the Material Reserves Agency and the Military Property Agency) and LOTOS Paliwa (transactions with wholesale customers and independent operators).

In 2015, the LOTOS Group secured a 31.2% share in the domestic fuel market, exceeding the target set in the 2015 Strategy by 1.2pp.

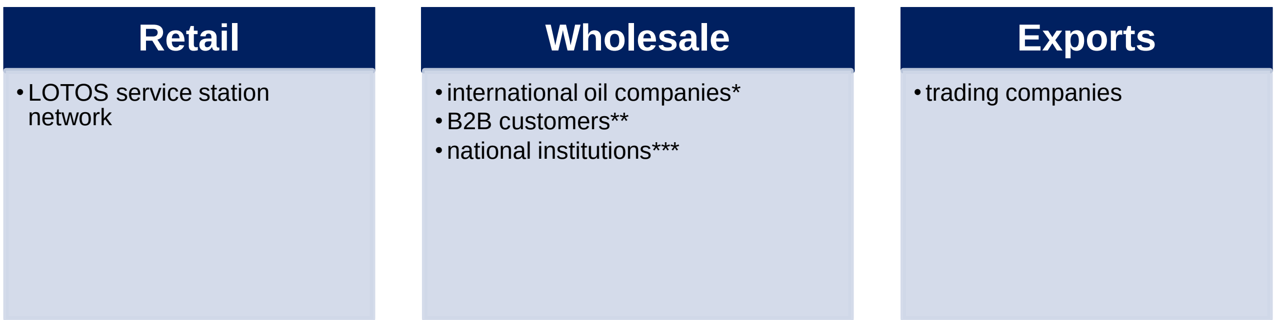
Figure 32. LOTOS Group's share in the domestic fuels market



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

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

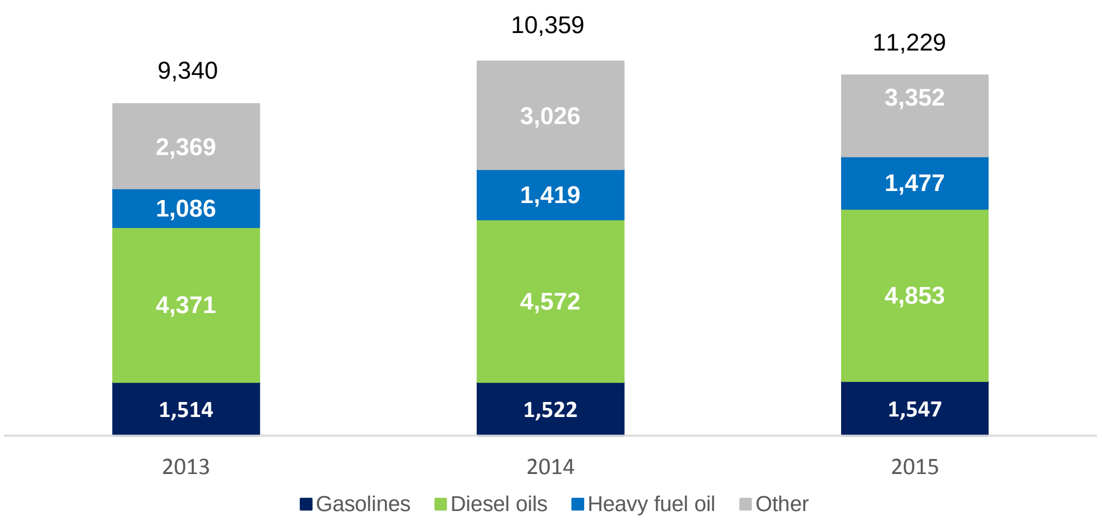
Figure 33. Downstream distribution channels



** international oil companies present on the Polish market, including Statoil, Shell, BP, and Lukoil,*
*** independent operators with own service stations and conducting wholesale operations on local markets,*
**** as part of nationwide tenders.*

The volume of products sold by the LOTOS Group in the downstream segment in 2015 was **10,924 thousand tonnes, 8.1% up year on year.** The rise in output and sales was an effect of refining margins remaining very strong for the most part of 2015. Figure 34 also shows the upstream segment's sales in the sales structure.

Figure 34. LOTOS Group's sales by key products (in thousand toe[8])



Detailed product categories are presented in Table 13. Oil and natural gas sales are presented separately (as part of production belonging to the upstream business).

Table 13. LOTOS Group's sales by products, merchandise and services ('000 t)

	in the period Jan 1 2015 – Dec 31 2015		in the period Jan 1 2014 – Dec 31 2014		2015 vs. 2014 change
	thousand tonnes	% share	thousand tonnes	% share	%
Gasolines	1,547	**14.2%**	1,522	**15.1%**	**1.6%**
Naphtha	508	**4.6%**	286	**2.8%**	**77.8%**
Reformate	13	**0.1%**	13	**0.1%**	**2.6%**
Diesel oils	4,853	**44.4%**	4,572	**45.2%**	**6.1%**
Bunker fuel	66	**0.6%**	39	**0.4%**	**69.7%**
Light fuel oil	251	**2.3%**	256	**2.5%**	**-2.1%**
Heavy products*	2,099	**19.2%**	1,959	**19.3%**	**4.1%**
JET A-1 fuel	556	**5.1%**	692	**6.8%**	**-19.6%**
Lubricants	60	**0.6%**	67	**0.7%**	**-10.8%**
Base oils	202	**1.8%**	182	**1.8%**	**11.0%**
LPG	238	**2.2%**	239	**2.4%**	**-0.5%**
Crude oil for resale	243	**2.2%**	-	**0.0%**	**0.0%**
Other	290.2	**2.7%**	280.4	**2.8%**	**3.5%**
Downstream segment's total petroleum products, merchandise and materials	**10,924**	**100.0%**	**10,106**	**100.0%**	**8.1%**
Natural gas (toe)	**223**	**-**	**186**	**-**	**20%**
Crude oil (upstream)	**82**	**-**	**67**	**-**	**23%**

*Source: In-house analysis; *heavy fuel oil and bitumens*

[8] *Tons of oil equivalent*

The largest increase in sales was reported for naphtha (up 77.8%) and bunker fuel (up 69.7%), which, however, are non-key products representing only a small proportion of total annual sales. The largest drop in sales was reported for aviation fuel (down 19.6%), which was an effect of shifting the development focus from wholesale towards more profitable retail channels.

In 2015, Grupa LOTOS S.A. sold 243 thousand tonnes of crude oil to the Material Reserves Agency under an awarded contract.

Like in the previous years, diesel oil had the largest share in the total sales volume. **In 2015, the sales volume of diesel oil was 4,853 thousand tonnes**, accounting for 44.1% of total sales. The second largest item in the structure of the LOTOS Group's sales were gasolines, whose share in total sales volume was 14.1%. The **sales volume of gasolines in 2015 was 1,547 thousand tonnes**, having grown year on year by 1.6%. The last item with a more than 10% share in the LOTOS Group's total sales volume was heavy fuel oil, whose share in total sales was 13.4%. The volume of sales in this product group was 1,477 thousand tonnes in 2015, 4.1% up on 2014.

Table 14. LOTOS Group's revenue by products, merchandise and services (PLN '000)

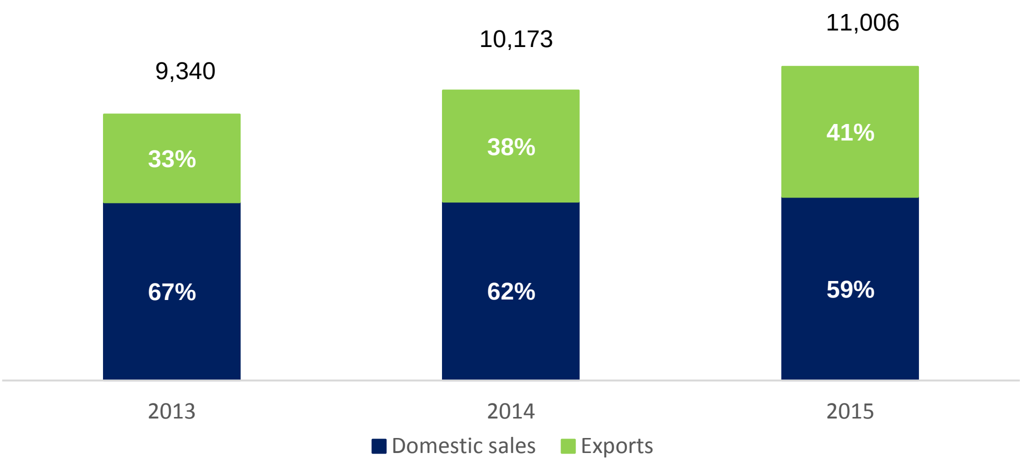
	in the period Jan 1 2015 -	period Dec 31 2015	in the Jan 1 2014 -	period Dec 31 2014
	PLN '000	**% share**	**PLN '000**	**% share**
Gasolines	3,649,735	*16.1%*	4,660,642	*16.4%*
Naphtha	880,530	*3.9%*	750,974	*2.6%*
Reformate	25,163	*0.1%*	28,689	*0.1%*
Diesel oils	11,163,813	*49.2%*	13,608,087	*47.7%*
Bunker fuel	129,511	*0.6%*	108,467	*0.4%*
Light fuel oil	565,411	*2.5%*	757,506	*2.7%*
Heavy products*	2,143,640	*9.4%*	3,405,523	*11.9%*
Aviation fuel	1,170,250	*5.1%*	2,044,246	*7.2%*
Lubricants	286,666	*1.3%*	345,702	*1.2%*
Base oils	519,654	*2.3%*	580,307	*2.0%*
LPG	444,376	*2.0%*	629,750	*2.2%*
Crude oil for resale	254,234	*1.1%*	-	*0.0%*
Crude oil as a product	133,781	*0.6%*	156,103	*0.5%*
Natural gas	230,560	*1.0%*	218,843	*0.8%*
Other refinery products, merchandise and materials	456,983	*2.0%*	553,505	*1.9%*
Other products, merchandise and materials	358,480	*1.6%*	330,286	*1.2%*
Services	379,103	*1.6%*	331,249	*1.2%*
Effect of cash flow hedge accounting	(82,448)	*-0.4%*	(7,992)	*0.0%*
Total	**22,709,442**	***100.0%***	**28,501,887**	***100.0%***

*Source: In-house analysis; *heavy fuel oil + bitumen.*

3.4.3. DOMESTIC SALES, EXPORTS, TRADING AND OPTIMISATION

In 2015, the LOTOS Group's downstream segment sold 6,446 thousand tonnes of products in Poland (2014: 6,282 thousand tonnes; 2013: 6,257 thousand tonnes) and exported 4,560 thousand tonnes (2014: 3,891 thousand tonnes; 2013: 3,082 thousand tonnes).

Figure 35. Downstream segment's domestic sales and exports in 2013−2015 (thousand tonnes)



Source: In-house analysis.

Detailed product categories broken down by domestic sales and exports are presented in Table 15. Oil and natural gas sales are presented separately (as part of production belonging to the upstream business).

Table 15. LOTOS Group's sales of products by domestic sales and exports

		in the period Jan 1 2015-Dec 31 2015		in the period Jan 1 2014-Dec 31 2014		Change 2014/2013
		thousand tonnes	% share	thousand tonnes	% share	%
Domestic sales	Gasolines	1,004	**9.2%**	1,098	**10.9%**	**-9%**
	Diesel oils	3,951	**36.2%**	3,846	**38.1%**	**3%**
	Bunker fuel	66	**0.6%**	39	**0.4%**	**70%**
	Light fuel oil	251	**2.3%**	256	**2.5%**	**-2%**
	Heavy fuel oil	385	**3.6%**	462	**4.5%**	**-58%**
	JET A-1 fuel	94	**0.9%**	160	**1.6%**	**-42%**
	Lubricants	43	**0.4%**	50	**0.5%**	**-15%**
	Base oils	5	**0.0%**	6	**0.1%**	**-13%**
	LPG	219	**2.0%**	200	**2.0%**	**9%**
	Crude oil	243	**2.2%**	-	**0.0%**	**0%**
	Other	185.69	**1.7%**	164	**1.6%**	**13%**
Total domestic sales		**6 446**	**59.0%**	**6,282**	**62.2%**	**3%**
Export sales	Gasolines	542	**5.0%**	424	**4.2%**	**28%**
	Naphtha	508	**4.6%**	286	**2.8%**	**78%**
	Reformate	13	**0.1%**	13	**0.1%**	**3%**
	Diesel oils	902	**8.3%**	726	**7.2%**	**24%**
	Heavy fuel oil	1,714	**15.7%**	1,496	**14.8%**	**6%**
	JET A-1 fuel	462	**4.2%**	532	**5.3%**	**-13%**
	Lubricants	18	**0.2%**	18	**0.2%**	**0%**

	Base oils	196	**1.8%**	175	**1.7%**	**12%**
	LPG	19	**0.2%**	39	**0.4%**	**-51%**
	Other	105	**1.0%**	116	**1.1%**	**-10%**
Total export sales		**4,478**	**41.0%**	**3,824**	**37.8%**	**17%**
Total		**10,924**	**100.0%**	**10,106**	**100.0%**	**8%**
Export sales (toe)	**Natural gas (toe)**	**223**	**-**	**186**	**-**	**20%**
Export sales (tonnes)	**Crude oil (upstream)**	**82**	**-**	**67**	**-**	**23%**

Source: In-house analysis.

In 2015, the LOTOS Group sold 6,446 thousand tonnes of products in Poland (2014: 6,282 thousand tonnes) and exported 4,478 thousand tonnes (2014: 3,824 thousand tonnes).

Domestic sales were up mainly on rising volumes of diesel oil sold through wholesale and retail channels (up 105 thousand tonnes), higher sales of bunker fuel (up 27 thousand tonnes), following from changes in the fuel sulfur requirements in the Sulphur Emission Control Area, and increased sales of LPG (up 19 thousand tonnes).

A drop in sales volumes was mainly seen in the case of gasolines (down 94 thousand tonnes), this being an effect of changes in the contracting structure, and aviation fuel (down 67 thousand tonnes), which resulted from shifting the development focus from wholesale towards more profitable retail channels.

Exports rose 17% year on year as strong refining margins during 2015 made step-up in production profitable even assuming that part of the output would be sold abroad at prices lower than domestic prices.

Table 16. LOTOS Group's net revenue by markets

	in the period Jan 1 2015 - Dec 31 2015		in the period Jan 1 2014 - Dec 31 2014	
	PLN '000	**% share**	**PLN '000**	**% share**
Domestic sales:	17,177,340	***75.6%***	19,031,740	***66.8%***
- products and services	15,923,398	***70.1%***	18,327,441	***64.3%***
- merchandise and materials	1,253,942	***5.5%***	704,299	***2.5%***
Export sales:	5,532,102	***24.4%***	9,470,147	***33.2%***
- products and services	5,325,296	***23.4%***	9,052,344	***31.8%***
- merchandise and materials	206,806	***0.9%***	417,803	***1.5%***
Total	**22,709,442**	***100.0%***	**28,501,887**	***100.0%***

LOTOS Group's key customers

With a share of 10.04%, Statoil Group companies were the LOTOS Group's only customers whose share in the Group's total revenue exceeded 10% in 2015.

In 2014, Statoil Group and Shell Group companies were the LOTOS Group's main customers whose shares in the Group's total revenue exceeded 10%. Their joint shares in total revenue were 12.96% and 12.52%, respectively.

To the best of the Company's knowledge, as at the issue date 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

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.

Taking advantage of the favourable conditions on crude oil futures markets (experiencing contango, where futures prices are higher than spot prices) in Q1 2015, Grupa LOTOS S.A. increased its crude oil stocks and concluded transactions hedging the purchase and selling prices of crude oil in order to secure the profit resulting from the structure of the futures market.

Crude oil supply

In 2015, Grupa LOTOS S.A. purchased 10.81m tonnes of crude oil, 77% of which was Russian crude. Other crudes, including oil produced in Poland by LOTOS Petrobaltic S.A. and Lithuanian oil supplied by AB LOTOS Geonafta, accounted for the balance of the crude used.

Petroleum product exports

The key export customers for LOTOS' exported petroleum products were integrated oil companies, including BP Oil, TOTAL, Statoil and Shell, international trading companies, including Vitol, Mercuria and Glencore, and independent wholesalers and retailers, including Argos (Netherlands), NEOT (Finland and Sweden) and Greenenergy (United Kingdom).

In 2015, the markets for Grupa LOTOS S.A.'s exports were as follows:

- Naphtha – integrated fuel and petrochemical companies in Germany and Scandinavia and the Amsterdam-Rotterdam-Antwerp (ARA) oil hub,
- Motor gasolines – the Amsterdam-Rotterdam-Antwerp (ARA) oil hub, Sweden, and United Kingdom
- Aviation fuel – Scandinavian and Baltic Sea countries, and the Czech Republic, where the products were transported by land,
- Diesel oil – Germany, United Kingdom and Czech Republic,
- Heavy fuel oil – storage depots of global trading companies in Estonia, Denmark, Sweden 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.

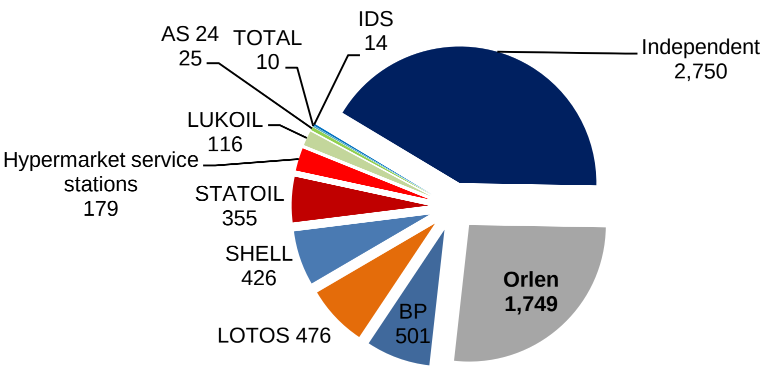
3.4.4. OVERVIEW OF THE RETAIL BUSINESS

According to the Polish Organisation of Oil Industry and Trade (POPiHN), over 6.6 thousand service stations operated on the Polish fuel market in 2015. As in the previous years, more than one third of the stations belonged to domestic companies, 22% were owned by international corporations, while 42% operated independently. The chains owned by oil companies were developed by opening both CODO and DOFO stations. In 2015, the LOTOS Group added 35 sites to its retail network, retaining the position of the third-largest and the fastest-growing service station chain in Poland.

In 2015, the number of Orlen's service stations operating under the Bliska brand decreased by a significant 66 locations, some of which were rebranded as Orlen stations. Concurrently, the independent service station network expanded by around 50 new sites, with most of the increase attributable to service stations operating under the brand of a single operator. Higher service station numbers were also reported by most foreign oil companies and supermarket chains.

Expansion of Poland's motorway network has been accompanied by the appearance of a growing number of motorway service stations. At the end of the year, there were 78 Motorway Service Areas (MSAs) in Poland, including 18 under the LOTOS brand.

Figure 36. Service stations in Poland at the end of 2015

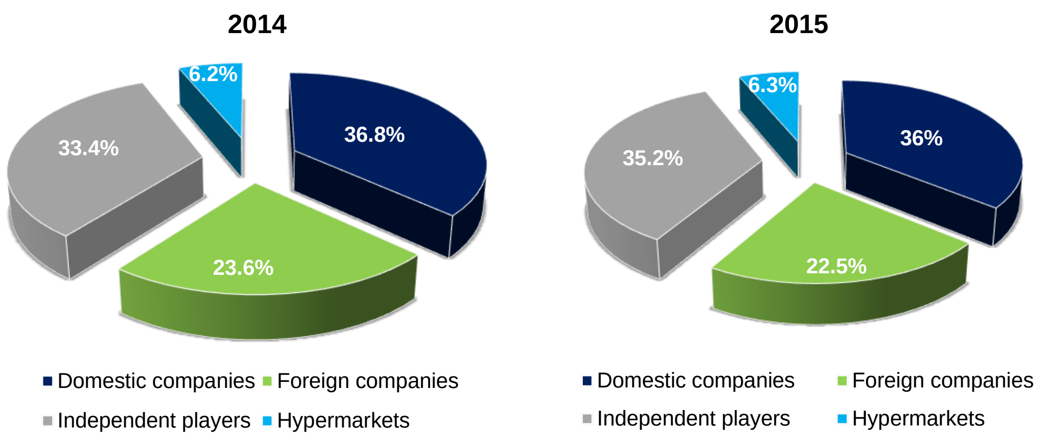


Source: Polish Organisation of Oil Industry and Trade (POPiHN).

Competition

In 2015, the share of domestic oil companies in the retail market fell due to PKN Orlen service station optimisation measures implemented by PKN Orlen (down from 36.8% in 2014 to 36% in 2015). Despite a new entry into the market (the new entrant being Total with a chain of ten service stations operated in 2015) and expansion of service station networks owned by international companies, the latter's share in the retail market was also down, from 23.6% in 2014 to 22.5% in 2015. In contrast, independent operators increased their market share by almost 2pp.

Figure 37. Liquid fuels retail sales structure in 2015 and 2014



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

3.4.5. LOTOS GROUP'S POSITION ON THE DOMESTIC RETAIL MARKET AND OVERVIEW OF THE LOTOS SERVICE STATION NETWORK

Grupa LOTOS sells fuels to retail customers through a chain of service stations organised into **Economy (LOTOS Optima)** and **Premium (LOTOS)** segments.

Dynamic expansion of the LOTOS service station network and improved sales efficiency enabled the Group to increase its market share in 2015 to an average of 9.4% (compared with 8.9% in 2014). In December 2015, the Group **met its 2015 strategic target, securing a 10.5% market share.**

In 2015, the Premium and Optima chains were further standardised and enlarged by adding new locations, both CODO stations and DOFO stations operated under franchise agreements.

In 2015, new LOTOS stations opened, including 21 CODO stations (with one MSA[9] in the village of Komorów) and 14 DOFO stations.

Another two stations are under construction (including MSA Krzyżanów Wschód on the A1 motorway), which are scheduled to be launched in 2016. To meet the strategic objective to expand the network of company-owned MSA service stations, the Company participates in contract award procedures organised by the General Directorate for National Roads and Motorways (GDDKiA) and/or Licence Holders to select licensees for the MSAs built by new sections of motorways and expressways.

The optimisation measures implemented in the past few years have led to closing down a number of unattractive locations and all DODO stations, which helped improve business efficiency across the LOTOS network.

As at December 31st 2015, 476 stations operated under the LOTOS and LOTOS Optima brands.

[9] *MSA – Motorway Service Area; a service station located by a motorway or expressway*

Figure 38. MSA service station networks (as at December 31st 2015)

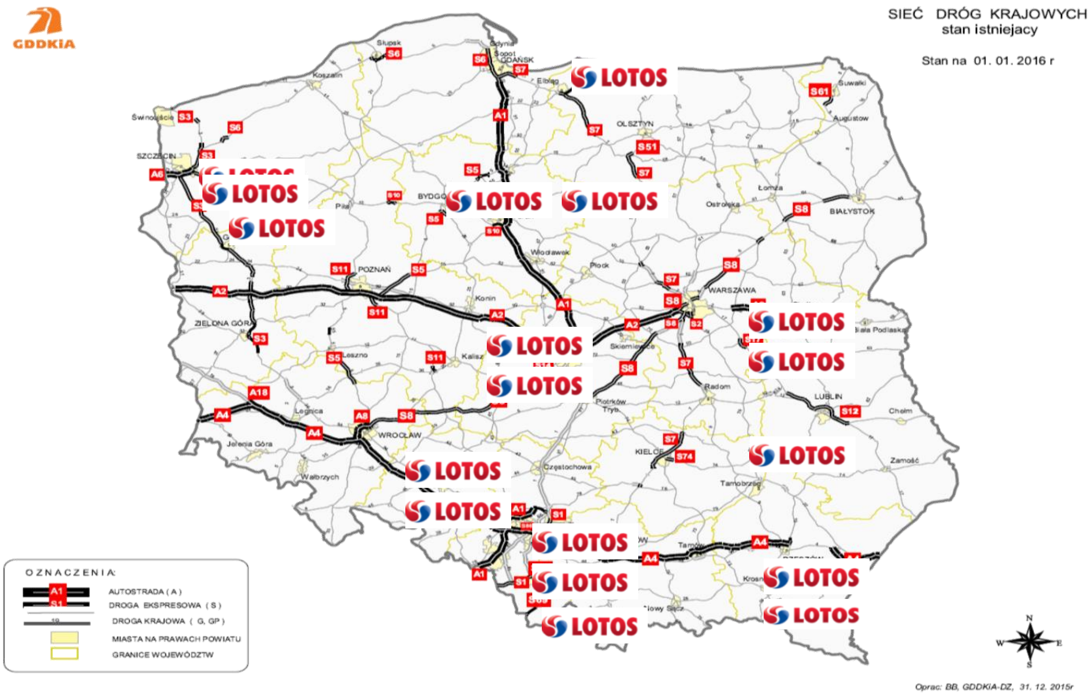


Figure 39. Expansion of LOTOS service station network by segment in 2010–2015 (number of stations as at December 31st)

LOTOS PREMIUM

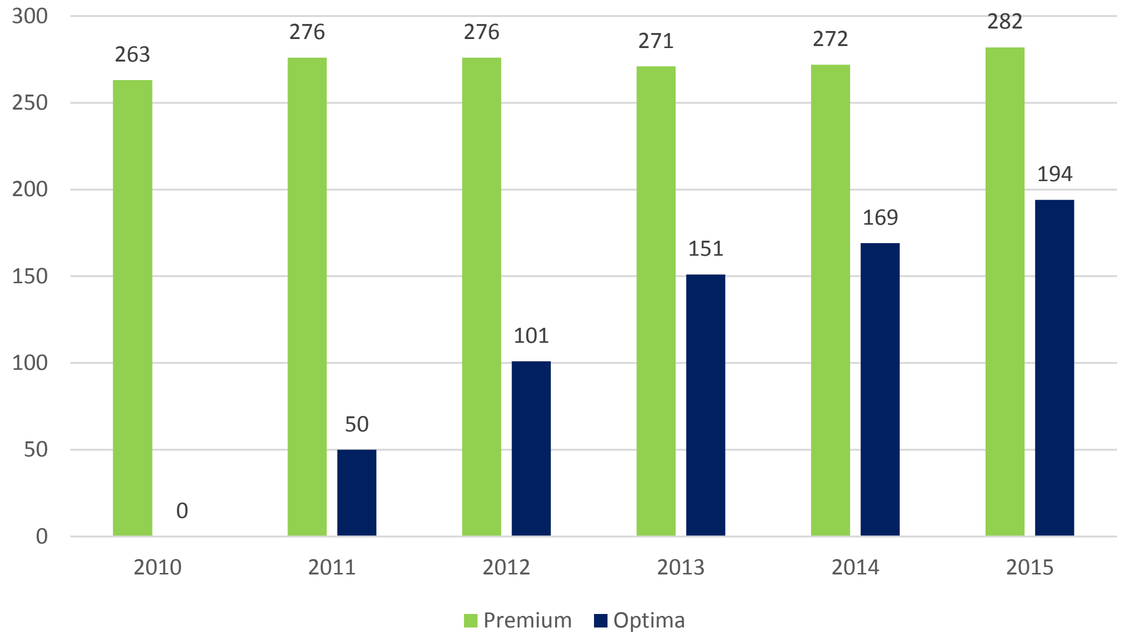
282 stations

- **151 CODO** stations
- **18 MSA** stations
- **113 DOFO** stations

LOTOS Optima

194 stations

- **121 CODO** stations
- **73 DOFO** stations



Source: In-house analysis.

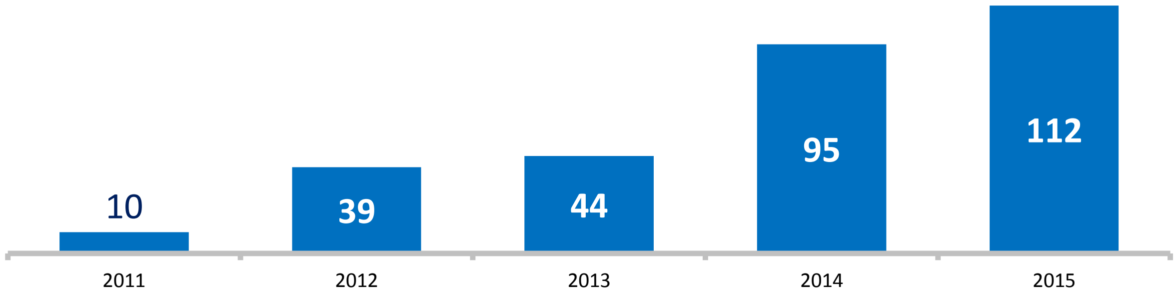
The structural optimisation measures described above were implemented in parallel with enhancements to the services offered at the stations, which included:

- Continued work on standardisation of the Premium and Optima networks,
- Launch of cooperation with an external partner – SUBWAY corporate franchise: extension of the food and beverage offering,
- Pilot extension of the coffee offering in partnership with the popular COSTA coffee shop chain,
- Completion of the process to introduce the DYNAMIC fuels at OPTIMA service stations,
- Development and implementation of a strategy for the development and management of car wash services at LOTOS service stations,
- Development and implementation of a warehouse management system for the CAFE PUNKT food and beverage products,
- Extension of the LOTOS Biznes offering, including by securing an anchor customer (RABEN) and intensification of the SME channel (LOTOS Biznes Gotówka),
- Extension of the food and beverage offering by introducing a lunch menu at the MSA service stations and broadening the product range,
- Improvement of customer service quality, as confirmed through the 'mystery shopper' exercises – L4L score improved by 2% (90%−92%).

Successful optimisation efforts improved the performance of the LOTOS retail network. **Operating profit before depreciation and amortisation excluding non-cash impairment losses** (normalised EBITDA) **amounted to PLN 112m in 2015**, up by 18% year on year and 1,079% compared to 2010.

The LOTOS retail network, built through organic growth and based on a well thought out concept, proves that market success brings tangible benefits to shareholders.

Figure 40. Adjusted retail segment EBITDA in 2011–2015 (PLNm)



Source: In-house analysis.

3.5. LOGISTICS

3.5.1 UPSTREAM SEGMENT'S LOGISTICS

Baltic Sea

Crude oil and associated natural gas are produced from the B3 field using the Baltic Beta rig and the PG-1 unmanned drilling rig. All produced crude oil is transported by tankers and sold to Grupa LOTOS. Natural gas is transported via a subsea pipeline with a length of over 80 km to the CHP plant in Władysławowo, owned by Energobaltic Sp. z o.o. (wholly-owned subsidiary of LOTOS Petrobaltic).

Crude oil from the B8 field is initially produced using the LOTOS Petrobaltic drilling platform. All produced crude oil is transported by tankers and sold to Grupa LOTOS. The objective is to ultimately produce crude oil using the Petrobaltic drilling platform after it is converted into a production centre. Natural gas is to be transported to the Energobaltic CHP plant in Władysławowo.

Sea logistics services in the Baltic Sea region are provided by the Miliana Shipholding Company Ltd. Group companies. The services consist in the receipt and storage of crude oil in the production areas, transport of crude from the field to the port, and rescue assistance services for offshore rigs.

Lithuania

Crude oil from the Lithuanian fields is produced using onshore production infrastructure. Produced crude oil is transported to a marine terminal in Liepāja (Latvia). The oil is then transported to Gdańsk on a tanker ship and sold to Grupa LOTOS. The only exception is the oil produced by the subsidiary UAB Minijos Nafta (50% of its shares are held by LOTOS Geonafta), which is sold to the Orlen Lietuva refinery. All associated natural gas is flared.

Norway

Through its subsidiary LOTOS E&P NORGE AS, the LOTOS Petrobaltic Group holds interests in licences covering the production infrastructure in the Heimdal and Sleipner fields, including: the Heimdal gas and condensate processing and export hub (5% interest, with Statoil Petroleum AS as the operator) and the Sleipner gas and condensate processing and export hub (15% interest, with Statoil Petroleum AS as the operator).

Gas produced from the Heimdal and the Sleipner fields is injected into the Gassled pipeline system, and then delivered to various off-take points in the UK and continental Europe (the Netherlands, Germany).

Condensate from the Heimdal field is injected into the Forties Pipeline System (FPS), and then delivered to an off-take point at the Kinneil Terminal/Hound Point in Scotland, where it is processed into final products, i.e. Forties Blend crude oil and gas fractions.

Condensate from the Sleipner field is transported via a pipeline to an off-take point at Karsto (Norway), where it is processed into final products, i.e. Gudrun Blend light crude and liquid fractions (NGL).

3.5.2 DOWNSTREAM SEGMENT'S LOGISTICS

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

In 2015, cooperation with TRIOS Sp. z o.o., operator of the fuel depot in Łętownia was commenced, distribution of the IZ-40 arctic fuel from LOTOS Terminale fuel terminals in Jasło and Czechowice was launched, and logistics support for retail sale and semi-wholesale of LPG was transferred from LOTOS Paliwa to Grupa LOTOS S.A. As part of other secondary logistics activities, the adopted model of cooperation with LOTOS Paliwa Sp. z o.o. and transport companies was maintained, allowing Grupa LOTOS S.A. appropriate flexibility in customer service (e.g. in fuel supplies to hypermarket service stations with fixed costs curbed to the minimum).

In 2015, with a view to improving its logistics assets' efficiency, the LOTOS Group continued the consolidation of its fuel terminals. On April 1st 2015, the fuel terminal in Poznań was transferred (sold) to LOTOS Terminale S.A.

In 2015, the LOTOS Group implemented a business intelligence tool for end-to-end analysis of fuel volume discrepancies arising during supply to service stations. The solution significantly enhanced the integrity of the fuel loss control system in the LOTOS Group's logistics chain.

The structure of mandatory stocks was optimised to ensure that the cost of their maintenance was minimised. At the same time, Grupa LOTOS S.A. derived additional revenue from the provision of logistics services also to companies outside the LOTOS Group, including fuel turnover and sale of the stock ticket service consisting in maintaining, on behalf of customers, mandatory stocks of fuels in the existing processing potential of crude oil stored as Grupa LOTOS S.A.'s mandatory stock.

The scope of the project to construct a marine cargo terminal on the Martwa Wisła river, in the immediate vicinity of the Gdańsk refinery, was regularly reviewed in the context of the planned volume and structure of Grupa LOTOS' products following the completion of the EFRA project. Concurrently, the logistics services market was being monitored to identify any alternative solutions related to low-tonnage sea cargo handling.

Sea transport

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 Grupa LOTOS' main mode of exporting petroleum products and also accounts for a significant portion of deliveries of raw materials and components. 2015 was yet another record year for Grupa LOTOS both in terms of the volume of cargo handled at sea ports (over 8.5 tonnes of crude oil, petroleum products and fuel components) and the number of tankers handled at the ports, which for the first time in the Company's history exceeded 400.

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 to respond quickly and flexibly to changing market conditions. Apart from the Naftoport fuel depot, Grupa LOTOS also uses the maritime bulk terminal in Gdynia and the Siarkopol terminal in Gdańsk to handle smaller cargoes.

Grupa LOTOS 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 future, crude oil produced from the reserves under the North Sea.

Grupa LOTOS seeks to assume the responsibility for transport in sea freight operations to control the transport process along as much of the supply chain as possible, from affreightment 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.

In 2015, Grupa LOTOS developed its sea transport organisation services for the LOTOS Petrobaltic Group, involving the chartering of tankers for collection of crude oil from vessels operating on the B-3 and B-8 fields. In 2015, six operations involving on-field oil transshipment to tankers chartered by Grupa LOTOS and delivery of the oil to Naftoport were performed. Grupa LOTOS also intermediated in the conclusion of a time charter contract for the Apatyth tanker, serving as a storage vessel on the B-8 field.

Rail transport

Rail transport of products from the refinery in Gdańsk is a mainstay of the Group's production security. Comprehensive services in the area of rail logistics are provided by LOTOS Kolej, a company specialising in such services.
In 2015, LOTOS Kolej provided the following railway services:

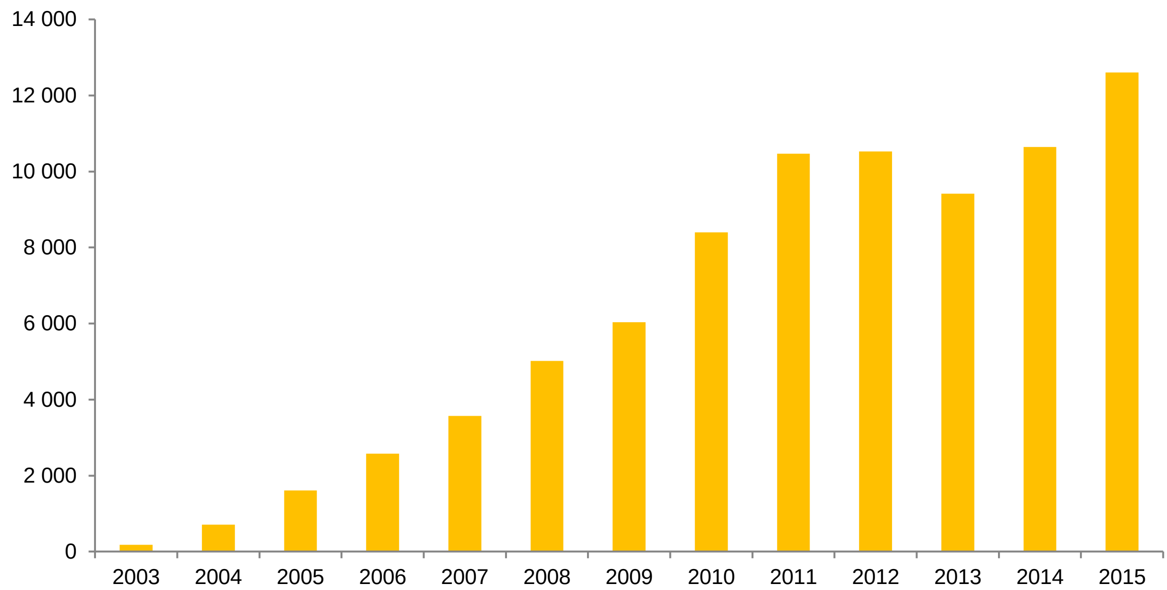
- rail transport all over the country,
- freight transport services in Germany (from November),
- transport in entire drafts of cars or separate cars,
- maintenance of rolling stock,

- eco-friendly cleaning of rail tank cars,
- carrying goods by rail abroad – forwarding services,
- management of railway sidings for the LOTOS Group and maintenance of railway infrastructure – in December 2014, a change of the business model for cooperation between Grupa LOTOS and LOTOS Kolej in railway siding management was initiated. The process was completed in the first half of 2015. As a result, Grupa LOTOS became responsible for the provision of the above services in accordance with the requirements applicable to the railway siding user, as set out in the Rail Transport Act of March 28th 2003.

In 2015, LOTOS Kolej transported over 12.6m tonnes of cargo. The company continues to cooperate with customers from outside the LOTOS Group in the area of both domestic and international transport. A noteworthy event in Q3 2015 was the conclusion of an agreement with Rentrans International Spedition (a subsidiary of OT Logistics), under which LOTOS Kolej will provide freight services in rail transport. The agreement, with an estimated value of approximately PLN 250m, remains in effect until June 30th 2020.

Under a five-year agreement signed by Polskie Górnictwo Naftowe i Gazownictwo S.A. and Grupa LOTOS S.A., since January 2015 LOTOS Kolej has delivered crude oil from PGNiG's railway terminals located at the PGNiG Zielona Góra Branch to the Grupa LOTOS S.A.'s refinery. The agreement provides for supplying to Grupa LOTOS approximately 275,000 tonnes of crude per year. In addition, LOTOS Kolej has taken over comprehensive shunting services at the PGNiG railway sidings in Barnówko (Szczecin Province) and Wierzbno (Zielona Góra Province). The company also transports sulfur produced at Lubiatów to the production plant of Grupa Azoty Zakłady Chemiczne Police.

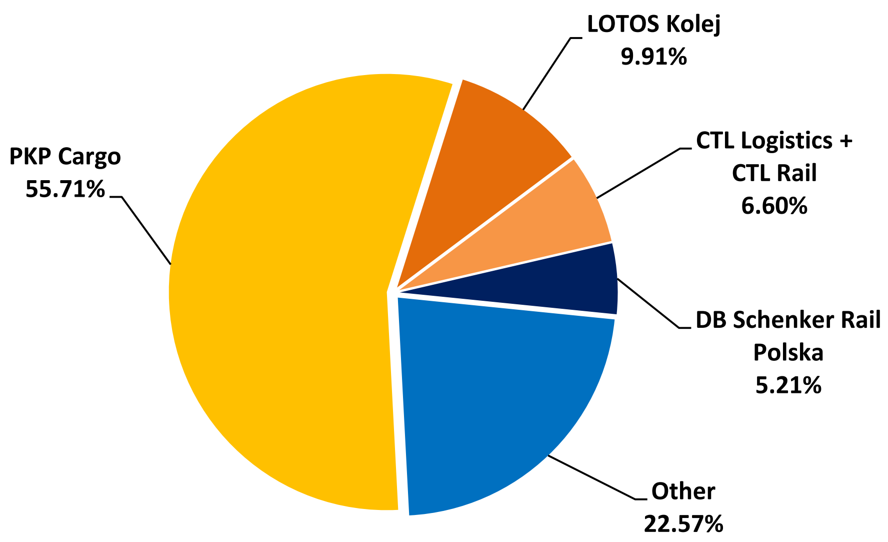
Figure 41. LOTOS Kolej rail transport operations in 2003−2015 ('000 tonnes)



Source: In-house analysis of the LOTOS Group.

In 2015, LOTOS Kolej increased its share in the Polish rail freight market from 8.87% to 9.91% (in terms of tonne-kilometres, based on the Railway Transport Authority's data for the period January−November 2015), thus maintaining the second position among rail cargo carriers. The company also increased its share in the intermodal transport segment (from 19.17% to 22.78%, in terms of tonne-kilometres, according to the Railway Transport Authority's data for the period January−September 2014).

Figure 42. LOTOS Kolej's share in the domestic market of rail cargo transport in 2015 (tonne-kilometres)



Source: In-house analysis of the LOTOS Group based on data from the Railway Transport Authority (Urząd Transportu Kolejowego), January 2016.

In 2015, LOTOS Kolej obtained Part B of the Safety Certificate for Germany, and launched transport activities in this country. German market is the European Union's largest transport market, with a high share of railway transport (over 20%). Given the size and stability of its economy, Germany is also the market with the largest potential. Previously, the company carried cargo only across the border to the first German station, where the rail freight was taken over by a subcontractor. Since 2015, the company has been able to individually perform freight transport services in Germany and thus compete with other carriers providing international railway transport services and strengthen the relationship with its existing customers who need fast transport between Poland and Germany.

LOTOS Kolej provides freight transport services using mainly electric locomotives. In 2015, the company and NEWAG S.A. signed a contract for the delivery of five GRIFFIN E4DCU-DP four-axle locomotives. These are 5.6 MW electric locomotives equipped with a 350 kW DUAL POWER diesel module. The contract provides for the lease of the locomotives and their maintenance for a period of seven years with an extension option. All the locomotives will be delivered to LOTOS Kolej in 2017. Under the contract, other electric locomotives manufactured by NEWAG S.A. may be delivered to LOTOS Kolej at a later date.

Table 17. LOTOS Group's purchases of raw materials, merchandise and petroleum materials by region

	in the period Jan 1 2015- Dec 31 2015		in the period Jan 1 2014- Dec 31 2014	
	PLN '000	% share	PLN '000	% share
Domestic purchases	2,535,701	**14.9%**	2,373,748	**10.2%**
Foreign purchases	14,492,912	**85.1%**	20,985,220	**89.8%**
Total	**17,028,613**	**100.0%**	23,358,969	**100.0%**

Table 18. LOTOS Group's structure of purchases

	in the period Jan 1 2015- Dec 31 2015		in the period Jan 1 2014- Dec 31 2014	
	PLN '000	share (%)	PLN '000	share (%)
Raw materials	16,561,018	***85.1%***	22,779,833	***89.0%***
Merchandise	925,258	***4.8%***	900,121	***3.5%***
Services	1,717,567	***8.8%***	1,721,156	***6.7%***
Materials	258,001	***1.3%***	213,051	***0.8%***
Total	**19,461,844**	***100.0%***	**25,614,161**	***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 19. LOTOS Group's structure of purchases – petroleum products for resale

	in the period Jan 1 2015- Dec 31 2015		in the period Jan 1 2014- Dec 31 2014	
	PLN '000	% share	PLN '000	% share
Liquid gas	713	***0.1%***	134,470	***19.7%***
Gasolines	131,134	***22.4%***	272,808	***40.0%***
Diesel oils	448,154	***76.7%***	226,517	***33.2%***
Other	4,274	***0.0%***	47,959	***7.1%***
Total	584,274	***100.0%***	681,754	***100.0%***

Table 20. LOTOS Group's structure of purchases – raw materials, semi-finished products, chemicals and petroleum materials

	in the period Jan 1 2015- Dec 31 2015		in the period Jan 1 2014- Dec 31 2014	
	PLN '000	% share	PLN '000	% share
Crude oil	14,446,921	*87.9%*	20,178,856	*89.0%*
Diesel oil	8,025	*0.0%*	7,119	*0.0%*
MTBE/ETBE gasoline components	213,505	*1.3%*	286,581	*1.3%*
FAME	582,474	*3.5%*	579,054	*2.6%*
Gasolines	86	*0.0%*	139	*0.0%*
Heavy fuel oil	0	*0.0%*	352	*0.0%*
Ethyl alcohol	109,253	*0.7%*	152,048	*0.7%*
Additives	98,834	*0.6%*	98,914	*0.4%*
Gasoil	20,493	*0.1%*	150,330	*0.7%*
Diesel oil components	32,723	*0.2%*	95,367	*0.4%*
Natural gas	573,270	*3.5%*	752,725	*3.3%*
Bitumens, bitumen components and additives	31,999	*0.2%*	41,810	*0.2%*
Feedstock for FAME production	319,607	*1.9%*	321,833	*1.4%*
Other	7,149	*0.0%*	12,087	*0.0%*
Total	**16,444,339**	***100.0%***	22,677,215	***100.0%***

LOTOS Group's key suppliers

The key suppliers of the LOTOS Group whose supplies accounted for more than 10% of the Group's total revenue in 2015 were: VITOL SA of Switzerland, Rosneft Oil Company of Russia and Tatneft Europe AG of Switzerland, with a share of 24.6%, 17.34% and 14.94%, respectively, in the LOTOS Group's purchases.

In 2014, the key suppliers of the LOTOS Group whose supplies accounted for more than 10% of the Group's total revenue were VITOL SA of Switzerland, Rosneft Oil Company of Russia and Tatneft Europe AG of Switzerland, with the shares of 23.02%, 20.10% and 18.96%, respectively.

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

4. FINANCIAL STANDING OF THE LOTOS GROUP

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

4.1.1. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

EBIT

In 2015, the LOTOS Group posted PLN 22,709.4m in revenue (down 20.3% on 2014), driven mainly by lower prices of crude oil and petroleum products on global markets. Average net revenue per tonne/(toe) of volume sold in 2015 was PLN 2,022 (down PLN 729, or 26.5%, on 2014).

Table 21. Annualised macroeconomic figures

USD/bbl	2015	2014	2013	2015 / 2014
DATED Brent FOB prices	**52.28**	98.98	108.62	**-47.2%**
Urals-Brent spread	**1.83**	1.73	0.96	**5.8%**
Model refining margin	**7.77**	6.08	5.70	**27.8%**

Margin USD/t	2015	2014	2013	2015 / 2014
Gasoline	**173.64**	168.48	162.21	**3.1%**
Naphtha	**64.33**	84.38	76.65	**-23.8%**
Diesel oil (10 ppm)	**113.36**	114.50	120.88	**-1.0%**
Light fuel oil	**94.60**	91.99	101.70	**2.8%**
Aviation fuel	**127.73**	154.31	164.36	**-17.2%**
Heavy fuel oil	**-141.16**	-224.88	-233.80	**37.2%**

Currency (USD/PLN)	2015	2014	2013	2015 / 2014
PLN/USD exchange rate at end of period	**3.90**	3.51	3.01	**11.1%**
Average PLN/USD exchange rate	**3.77**	3.15	3.16	**19.7%**

The volume of products, merchandise and petroleum materials sold in 2015 by the LOTOS Group was up approximately 8.4% on 2014. The most significant increase was reported for diesel oils and gasolines. Additionally, 243.0 tonnes of crude oil purchased for resale from the Material Reserves Agency were sold in 2015.

Table 22. Financial highlights of the LOTOS Group (PLNm)

	2015	2014	2013	2015-2014	2015/2014
Revenue	**22,709.4**	28,501.9	28,559.2	-5,792.5	**-20.3%**
Cost of sales	**-20,249.0**	-27,466.6	-26,878.9	7,217.6	**-26.3%**
Gross profit	**2,460.4**	**1,035.3**	**1,680.3**	**1,425.1**	**137.7%**
Distribution costs	**-1,284.9**	-1,162.1	-1,106.2	-122.8	**10.6%**
Administrative expenses	**-459.1**	-447.0	-429.2	-12.1	**2.7%**
Other income	**48.3**	26.7	30.9	21.6	**80.9%**
Other expenses	**-341.3**	-845.9	-22.7	504.6	**-59.7%**
Loss of control of subsidiary	**0.0**	0.0	13.5	0.0	-
Operating profit/(loss)	**423.4**	**-1,393.0**	**166.6**	**1,816.4**	**-**
LIFO-based EBIT	**702.1**	**-430.9**	**543.2**	**1,133.0**	**-**

In 2015, cost of sales of the LOTOS Group stood at PLN 20,249.0m (down 26.3% on 2014). In the same period, the estimated unit cost of sales was PLN 1,803/t (down PLN 849/t or 32.0% on 2014). The unit sales margin in 2015 came at PLN 219/t (up 119.0% on 2014). The LOTOS Group's consolidated gross profit for 2015 was PLN 2,460.4m (up PLN 1,425.1m on 2014).

Distribution costs grew by PLN 122.8m (10.6% on 2014), chiefly on the back of 8.4% higher sales volumes and higher average annual USD/PLN exchange rate (up 19.7% on 2014).

In 2015, the Group reported net other expenses of PLN 293.0m, including chiefly:

- impairment losses of approximately PLN 69m on Lithuanian assets, related to the AB LOTOS Geonafta Group's deposits,
- net value of decommissioned intangible assets classified as exploration and evaluation assets – Heimdal licence (PL362, PL035B, PL503) – of approximately PLN 15m,
- approximately PLN 10m revaluation of the provision for decommissioning of the MOPU in LOTOS Norge,
- impairment loss on the Sambia E area - approximately PLN 12m,
- approximately PLN 4m write-down of the value of vessels used at the Petrobaltic Group,
- PLN 8m impairment loss on service stations,
- approximately PLN 41m expenditure write-off and costs related to the B8 project,
- and PLN 161m VAT expense (pursuant to the decision of the Tax Audit Office, see Note 9.4 to the consolidated financial statements for 2015).

The Group's operating profit for 2015, totalling PLN 423.4m, includes:

- PLN 449.0m operating profit in the downstream segment.
- PLN -57.3m operating loss in the upstream segment,

(see Note 8 to the consolidated financial statements for 2015).

The amount of the 2015 operating profit was affected by PLN 450.9m inventory write-downs recognised in 2014 and the related lower cost of products sold in H1 2015. At the same time, as a result of a plunge in prices in H2 2015 and a remeasurement of inventories of raw materials, products, semi-finished products and merchandise held at the end of 2015, performed to reflect current prices, the operating result went down by PLN 264.2m. On January 2nd 2015, the price of Dtd Brent crude was USD 51.74/bbl, and continued on a slightly upward trend in H1 2015 until the maximum of USD 66.33/bbl was reached on May 13th 2015. In H2 2015, the prices started falling again to hit the lowest level of USD 35.26/bbl on December 22nd 2015. The continuing downward trend in the prices of crude oil and petroleum products had an adverse effect on the consolidated performance of the Group, whose inventories and change in inventories are measured with the weighted average method, and brought the result down by an additional PLN 465.7m.

Operating segments

Table 23. Upstream segment's key financial data (PLNm)

	2015	2014	2013	2015-2014	2015/2014
Revenue	**698.9**	906.3	585.8	-207.4	**-22.9%**
Operating profit/(loss)	**-57.3**	**-624.1**	**174.0**	**566.8**	**-**
Amortisation	**242.9**	344.1	133.6	-101.2	**-29.4%**
EBITDA	**185.6**	**-280.0**	**307.6**	**465.6**	**-**

The decrease in the upstream segment's revenue in 2015 (down 22.9% on 2014) was driven primarily by falling prices of crude oil and petroleum products on global markets, offset by higher crude oil and natural gas sales volumes and a higher average annual USD/PLN exchange rate.

Weighing down on the upstream segment's operating result were non-recurring items with a value of approximately PLN 151m, including:

- impairment losses on the Lithuanian assets (PLN 69m),
- impairment loss on the Sambia E licence area (PLN 12m),
- liquidation of intangible assets in Norway - Heimdal licences (PLN 15m).
- revaluation of the provision for decommissioning of the MOPU in LOTOS Norge (PLN 10m),
- expenditure write-off and costs related to the B8 project (PLN 41m).
- approximately PLN 4m write-down of the value of vessels used at the Petrobaltic Group.

(See Notes 13 and 15 to the consolidated financial statements for 2015)

Table 24. Downstream segment's key financial data (PLNm)

	2015	2014	2013	2015-2014	2015/2014
Revenue	**22,369.1**	28,157.9	28,587.3	-5,788.8	**-20.6%**
Operating profit/(loss)	**449.0**	**-774.5**	**13.9**	**1,223.5**	**-**
Amortisation	**466.3**	459.5	500.8	6.8	**1.5%**
EBITDA	**915.3**	**-315.0**	**514.7**	**1,230.3**	**-**

The lower revenue posted by the downstream segment in 2015 relative to 2014 is mostly due to a 26.5% fall in average selling prices caused by lower prices of petroleum products on global markets, offset by a higher USD/PLN exchange rate.

In 2015, the Group posted operating profit of PLN -499.0m in the downstream segment. It is due to, among other things, the PLN 450.9m inventory write-downs recognised in 2014 and the related lower cost of products sold in H1 2015. At the same time, as a result of a plunge in crude oil and petroleum products prices in H2 2015, remeasurement of inventories of raw materials, products, semi-finished products and merchandise held at the end of 2015, performed to reflect the current prices, the operating result went down by PLN 264.2m (inventory write-down in 2015).

Net profit/(loss)

Table 25. Net profit/(loss) of the LOTOS Group (PLNm)

	2015	2014	2013	2015-2014	2015/2014
Operating profit/(loss)	**423.4**	**-1,393.0**	**166.6**	**1,816.4**	**-130.4%**
Finance income	**100.6**	21.7	135.2	78.9	**363.6%**
Finance costs	**-688.2**	-728.0	-342.3	39.8	**-5.5%**
Share in net profit/loss of equity-accounted joint ventures	**-31.1**	-24.4	-18.2	-6.7	-
Pre-tax profit/(loss)	**-195.3**	**-2,123.7**	**-58.7**	**1,928.4**	**-**
Income tax expense	**-68.0**	657.3	98.1	-725.3	-
Net profit/(loss)	**-263.3**	**-1,466.4**	**39.4**	**1,203.1**	**-**

The Group posted a loss on financing activities of PLN -587.6m chiefly as a result of:

- Net foreign exchange losses (relating mainly to the measurement of borrowings and foreign-currency transactions in bank accounts) of PLN -344.9m (2014: loss of PLN -307.0m),
- Negative net balance of interest on debt, interest income and commission fees of PLN -284.4m, including interest on VAT arrears for 2010-2011 of PLN 77.9m (2014: PLN -200.7m),
- Net gain on measurement and settlement of market risk hedging derivative instruments of PLN +78.8m (2013: loss of PLN 197.9m).

(See Notes 9.5 and 9.6 to the consolidated financial statements for 2015)

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 2015, foreign exchange losses of PLN -356.0m were charged to cash-flow hedging reserve.

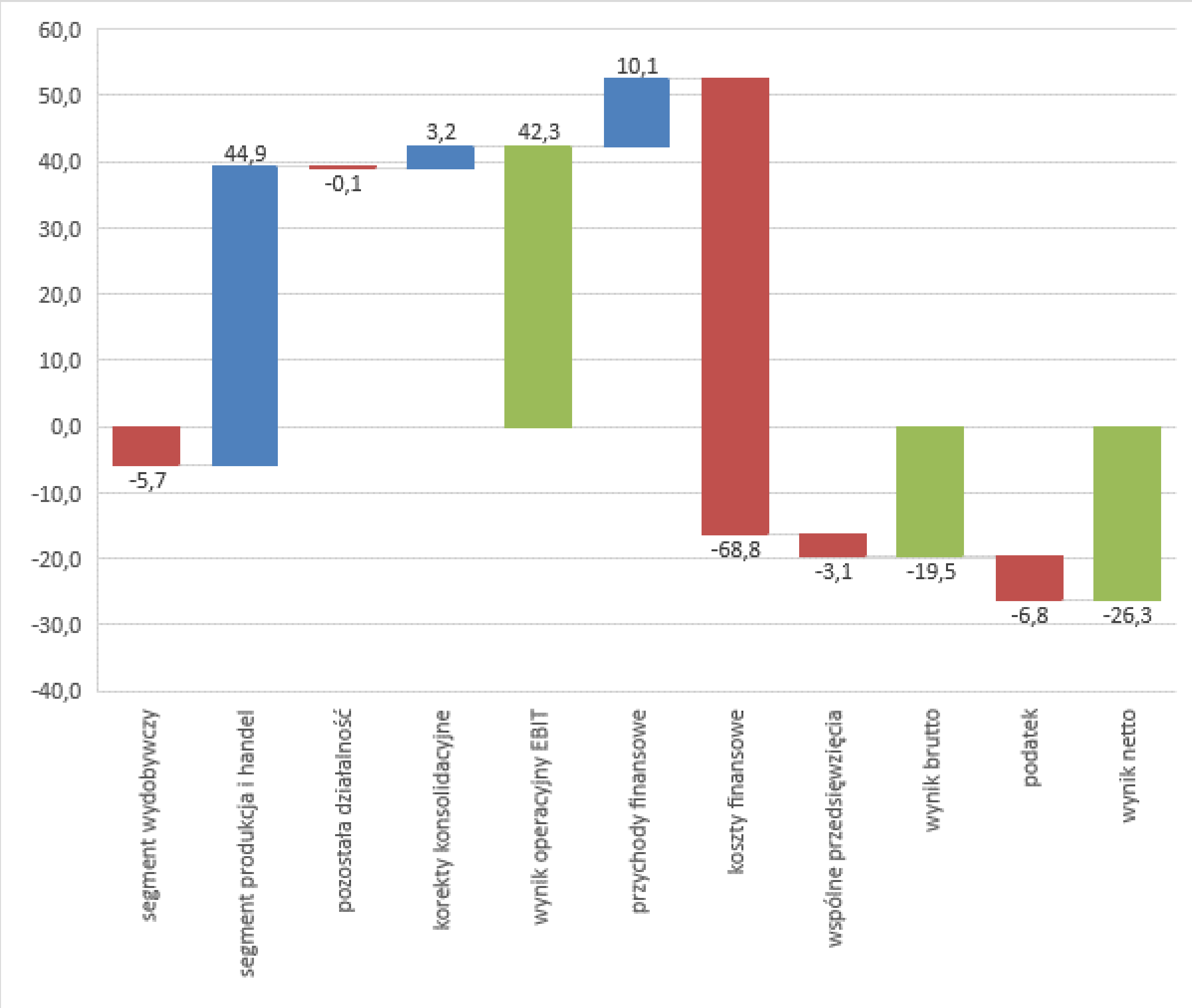
In 2015, the net loss on measurement and settlement of market risk hedging transactions at the LOTOS Group was PLN +78.8m and included:

- net gain on settlement and measurement of transactions hedging petroleum products prices of PLN +148.9m,
- Net loss on settlement and measurement of derivative instruments hedging the foreign exchange risk of PLN -57.9m,
- Net loss on settlement and measurement of interest rate hedging IRS transactions of PLN -19.4m,
- Net gain on settlement of futures hedging the risk of changes in prices of CO_2 emission allowances of PLN 7.2m.

Corporate income tax increased the pre-tax loss by PLN 68.0m (see Note 10.1 to the consolidated financial statements for 2015).

In 2014, the LOTOS Group posted net loss of PLN -263.3m.

Figure 43. Consolidated financial performance of the LOTOS Group (PLNm)



4.1.2. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Table 26. Financial position – Assets (PLNm)

	Dec 31 2015	Dec 31 2014	Dec 31 2013	change in 2015	%
Assets (PLNm)	**19,169.3**	**18,947.2**	**20,284.8**	***222.1***	**1.2%**
Non-current assets	**12,437.7**	**11,781.9**	**11,979.9**	***655.8***	**5.6%**
Property, plant and equipment	**10,568.4**	9,481.9	10,009.1	*1,086.5*	**11.5%**
Goodwill	**46.7**	46.7	46.7	*0.0*	**0.0%**
Other intangible assets	**617.7**	557.5	658.8	*60.2*	**10.8%**
Equity-accounted joint ventures	**70.7**	99.6	129.8	*-28.9*	**-**
Deferred tax assets	**924.5**	1,488.9	924.5	*-564.4*	**-37.9%**
Derivative financial instruments	**8.7**	-	-	*8.7*	**-**
Other non-current assets	**201.0**	107.3	211.0	*93.7*	**87.3%**
Current assets	**6,723.2**	**7,154.9**	**8,304.1**	***-431.7***	**-6.0%**
Inventories	**3,235.8**	3,917.1	5,728.9	*-681.3*	**-17.4%**
Trade receivables	**1,550.9**	1,406.5	1,591.7	*144.4*	**10.3%**
Current tax assets	**12.0**	59.1	76.7	*-47.2*	**-79.9%**
Derivative financial instruments	**208.5**	4.4	73.9	*204.1*	**4638.6%**
Other current assets	**925.8**	1,419.6	337.1	*-563.3*	**-39.7%**
Cash and cash equivalents	**856.3**	348.2	495.8	*511.5*	**146.9%**
Assets held for sale	**8.4**	**10.4**	**0.8**	***-2.0***	**-19.2%**

As at December 31st 2015, the LOTOS Group carried total assets of PLN 19,169.3m (up PLN 222.1m on December 31st 2014).

Key changes in assets:

- PLN 1,086.5m increase in property, plant and equipment attributable chiefly to the acquisition of the Sleipner assets (see Note 13 to the consolidated financial statements for 2015),
- PLN 564.4m decrease in deferred tax assets, including PLN 558.0m on accounting for the acquisition of the Sleipner assets (see Note 10.3 to the consolidated financial statements for 2015),
- PLN 681.3m decrease in inventories, including in mandatory stocks (down PLN -362.2m), attributable to lower prices of petroleum product and crude oil inventories as at the end of 2015 relative to the end of 2014 (see Note 19 to the consolidated financial statements for 2015),
- PLN 563.3m decrease in other current assets, chiefly related to PLN 996.9m of proceeds from Grupa LOTOS S.A. share issue, deposited in a separate bank account of the Central Securities Depository of Poland in 2014 and partially used in 2015 (see Note 18 to the consolidated financial statements for 2015),
- PLN 511.5m increase in cash and cash equivalents (see Note 20 to the consolidated financial statements for 2015),
- PLN 204.1m increase in positive fair value of financial instruments.

Table 27. Financial position – equity and liabilities (PLNm)

	Dec 31 2015	Dec 31 2014	Dec 31 2013	change in 2015	%
Equity and liabilities (PLNm)	**19,169.3**	**18,947.2**	**20,284.8**	***221.2***	1.2%
Equity	**7,712.2**	**8,258.5**	**9,189.6**	***-546.3***	**-6.6%**
Share capital	**184.9**	184.9	129.9	*0.0*	**0.0%**
Share premium	**2,228.3**	2,229.6	1,311.3	*-1.3*	**-0.1%**
Cash flow hedging reserve	**-700.9**	-412.5	61.0	*-288.4*	**69.9%**
Retained earnings	**5,928.5**	6,191.0	7,666.8	*-262.5*	**-4.2%**
Translation differences	**71.3**	65.3	20.3	*6.0*	**9.2%**
Non-controlling interests	**0.1**	0.2	0.3	*-0.1*	**-50.0%**
Non-current liabilities	**6,031.2**	**5,456.7**	**5,682.0**	***574.5***	**10.5%**
Borrowings, other debt instruments and finance lease liabilities	**4,454.5**	4,495.6	4,496.2	*-41.1*	**-0.9%**
Derivative financial instruments	**54.3**	62.6	52.9	*-8.3*	**-13.3%**
Deferred tax liabilities	**47.6**	55.5	275.8	*-7.9*	**-14.2%**
Employee benefit obligations	**182.2**	185.4	151.4	*-3.2*	**-1.7%**
Other liabilities and provisions	**1,292.6**	657.6	705.7	*635.0*	**96.6%**
Current liabilities	**5,425.9**	5,222.9	5,413.2	*203.0*	**3.9%**
Borrowings, other debt instruments and finance lease liabilities	**2,544.8**	2,168.1	1,715.2	*376.7*	**17.4%**
Derivative financial instruments	**110.8**	135.9	21.3	*-25.1*	**-18.5%**
Trade payables	**1,232.5**	1,692.8	2,395.2	*-460.3*	**-27.2%**
Current tax payables	**11.8**	4.7	8.8	*7.1*	**151.1%**
Employee benefit obligations	**122.2**	84.1	104.0	*38.1*	**45.3%**
Other liabilities and provisions	**1,403.8**	1,137.3	1,168.7	*266.5*	**23.4%**
Liabilities directly associated with assets held for sale	**0.0**	9.1	0.0	*-9.1*	**-**

The PLN -546.3m decrease in the LOTOS Group's equity relative to December 31st 2014, to PLN 7,712.2m as at the end of 2015, was mainly a result of:

- PLN 262.5m decrease in retained earnings, attributable to the net loss posted in 2015 (see Note 24 to the consolidated financial statements for 2015),
- PLN 288.4m foreign exchange losses on measurement of cash flow hedges adjusted for the tax effect and charged to reserve capital (see Note 23 to the consolidated financial statements for 2015),

The share of share capital in total equity and liabilities decreased by 3.4pp yoy, to 40.2%.

In 2015, non-current liabilities increased by PLN 574.5m, mainly in connection with an increase in other provisions and liabilities resulting from the LOTOS Norge provision for decommissioning and reclamation costs of the oil and gas extraction facilities, associated with the Sleipner fields (see Note 30 to the consolidated financial statements for 2015).

Year on year, current liabilities as at December 31st 2015 were up PLN 203.0m, mainly due to:

- PLN 376.7m increase in current borrowings, chiefly at the Parent and in the upstream segment, attributable to remeasurement of the borrowings at higher USD/PLN exchange rates (see Note 27 to the consolidated financial statements for 2015),
- PLN 266.5m rise in other liabilities and provisions, including mainly liabilities to the state budget, chiefly related to:
  - a new deadline for settling VAT on imported oil delivered through pipelines in connection with the Authorised Economic Operator (AEO) certificate (later deadline for VAT settlement),
  - an increase in excise duty, fuel charge and stock charge liabilities,
- PLN 460.3m decrease in trade payables, primarily as a result of a year-on-year decline in prices and volumes of crude oil purchases made in November and December 2015 (see Note 30 to the consolidated financial statements for 2015),

As at December 31st 2015, the LOTOS Group's financial debt totalled PLN 6,999.3m, up PLN 335.6m on December 31st 2014. The increase was chiefly related to a higher USD exchange rate (up PLN 0.39/USD on December 31st 2014.) The ratio of financial debt (adjusted for free cash), including cash earmarked to pursue the objectives of the issue of Series D shares, to equity was 73.9% (up 9.5pp on December 31st 2014.)

4.1.3. CONSOLIDATED STATEMENT OF CASH FLOWS

Table 28. Cash flows (PLNm)

	2015	2014	Change
Cash flows from operating activities	**1,488.1**	1,380.5	107.6
Cash flows from investing activities	**-1,162.0**	-958.3	-203.7
Cash flows from financing activities	**114.7**	-597.3	712.0
Change in net cash	**444.8**	-163.6	608.4
Cash and cash equivalents at beginning of period	**-166.7**	-3.1	-163.6
Cash and cash equivalents at end of period	**278.1**	-166.7	444.8

As at December 31st 2015, the LOTOS Group's cash balance (including current account overdrafts) was PLN 278.1m. In 2015, net cash flows caused an increase of PLN 444.8m in cash and cash equivalents (see Note 20 to the consolidated financial statements for 2015.)

The LOTOS Group generated positive cash flows of PLN 1,488.1m from operating activities (up PLN 107.6m on 2014), primarily due to adjustment of net loss for a decrease in inventories, depreciation/amortisation expense, net loss on investing activities, and foreign exchange losses.

Cash flows from investing activities of PLN -1,162.0m primarily involved PLN 757.9m expenditure on acquisition of property, plant and equipment and other intangible assets (mainly in the upstream segment) and PLN 433.4m of cash earmarked for the implementation of the EFRA project.

The PLN 115.0m net cash flows generated by financing activities comprised mostly the PLN 114.7m cash proceeds from the issue of Grupa LOTOS S.A. Series D shares, negative balance (PLN -604.3m) of proceeds from borrowings and expenditure on borrowings fees, interest and repayment, and a loss of PLN -222.2 on the settlement of financial instruments.

4.1.4. OFF-BALANCE SHEET ITEMS BY ENTITY, TYPE AND VALUE

Material contingent liabilities

- On June 24th 2015, the Head of the Customs Office in Gdańsk returned to Grupa LOTOS S.A. a promissory note with a promissory note declaration for up to PLN 240,000 thousand, which had served as lump-sum security for excise duty of PLN 800,000 thousand effective in the period from August 20th 2013 to August 19th 2014 (see Note 32.2 to the financial statements for 2014), following formal settlement of the security.

- On July 17th 2015, the Company deposited two promissory notes issued by the Company for up to PLN 40,000 thousand and PLN 200,000 thousand, respectively, with the Head of the Customs Office in Gdańsk. The promissory notes were deposited as lump-sum security for future excise duty liabilities of PLN 800,000 thousand, will remain valid until August 19th 2017. A PLN 240,000 thousand promissory note deposited as security for excise duty and valid until August 19th 2015 was returned to the Company on September 30th 2015.

- On September 30th 2015, the Head of the Customs Office in Gdańsk returned to Grupa LOTOS S.A. the PLN 240,000 thousand promissory note with a promissory note declaration, which had served as lump-sum security for excise duty of PLN 800,000 thousand, effective in the period from August 20th 2014 to August 19th 2015 (see Note 32.2 to the financial statements for 2014), following formal settlement of the security.

- An unconditional and irrevocable guarantee issued by LOTOS Petrobaltic S.A. for the benefit of the government of Norway on June 17th 2008, concerning the activities of LOTOS Exploration and Production Norge AS related to its exploration and production operations on the Norwegian Continental Shelf, was effective as at December 31st 2015 and December 31st 2014. In the guarantee, LOTOS Petrobaltic S.A. undertook to assume any financial liabilities which may arise in connection with the operations of LOTOS Exploration and Production Norge AS on the Norwegian Continental Shelf, consisting in exploration for and extraction of the natural resources from the sea bottom, including their storage and transport using means of transport other than ships.

Moreover, contingent liabilities include future investment commitments presented by the Group in Notes 13.3 and 15.3 to the consolidated financial statements.

4.1.5. NON-RECURRING FACTORS AND EVENTS AFFECTING FINANCIAL PERFORMANCE

The key factors and non-recurring events affecting the Group's operating performance in 2015 were as follows:

- Inventory write-down adjusting the carrying amount of inventory to the net realisable value in accordance with IAS 2 (PLN -264m),
- Impairment losses of approximately PLN 69m on Lithuanian assets, related to the AB LOTOS Geonafta Group's deposits,
- net value of decommissioned intangible assets classified as exploration and evaluation assets – Heimdal licence (PL362, PL035B, PL503) – of approximately PLN 15m,
- approximately PLN 10m revaluation of the provision for decommissioning of the MOPU in LOTOS Norge,
- impairment loss on the Sambia E area - approximately PLN 12m,
- approximately PLN 4m write-down of the value of vessels used at the Petrobaltic Group,
- PLN 8m impairment loss on service stations,
- approximately PLN 41m expenditure write-off and costs related to the B8 project,
- and PLN 161m VAT expense (pursuant to the decision of the Tax Audit Office, see Note 9.4 to the consolidated financial statements for 2015).

4.1.6. EXPLANATION OF DIFFERENCES BETWEEN ACTUAL FINANCIAL PERFORMANCE AND PREVIOUSLY PUBLISHED FORECASTS FOR 2015

The LOTOS Group did not publish any performance forecasts for 2015.

4.2. FINANCING SOURCES

4.2.1. BORROWINGS INCURRED AND LOANS ADVANCED IN 2014

Table 29. LOTOS Group's bank borrowings as at December 31st 2015:

Bank name; form of incorporation	Amount as per agreement		Outstanding amount (current portion)		Outstanding amount (non-current portion)		Repayment date of the current portion	Repayment date of the non-current portion	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)				
Bank Syndicate (1)	-	USD 400,000	1,170,728	USD 300,102	-	-	Dec 20 2016	-	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	394,718	USD 100,883	2,561,915	USD 654,733	Oct 15 2016	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	152,108	USD 38,595	939,765	USD 238,265	Oct 15 2016	Jan 15 2021	fixed interest rate	
Bank Syndicate (4)	USD 200,000 or equivalent		420,882	-	-	-	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	
			129,967	USD 33,316	-	-				

Bank name; form of incorporation	Amount as per agreement		Outstanding amount (current portion)		Outstanding amount (non-current portion)		Repayment date of the		Financial terms (interest rate, interest payment schedule, etc.)	Type of security
	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	current portion	non-current portion		
			9,620	EUR 2,257	-	-			Facility A margin). Interest payable every three months on Jan 15, Apr 15, Jul 15, or Oct 15.	
Bank Syndicate (5)	**150,000**	**-**	16,685	-	108,333	-	Dec 31 2016	Jun 30 2023	1M WIBOR + bank margin	mortgages
Bank PEKAO S.A.	**20,000**	**-**	4,042	-	8,083	-	Dec 31 2016	Dec 31 2018	1M WIBOR + bank margin	mortgages
PKO BP S.A.	**20,000**	**-**	4,042	-	8,083	-	Dec 31 2016	Dec 31 2018	1M WIBOR + bank margin	mortgages
Bank PEKAO S.A.	**100,000**		21,159	-	-	-	Overdraft facility	-	1M WIBOR + bank margin	representation on voluntary submission to enforcement, power of attorney over bank account,
Provincial Fund for Environmental Protection and Water Management in Gdańsk	**5,000**	**-**	1,000	-	1,250	-	Nov 30 2016	Nov 30 2017	0.8 of the promissory note rediscount rate	blank promissory note, assignment of claims
Provincial Fund for Environmental Protection and Water Management in Gdańsk	**6,900**	**-**	651	-	5,597	-	Nov 30 2016	Jul 31 2024	0.8 of the promissory note rediscount rate	blank promissory note, assignment of claims
PKO BP S.A.	**-**	**USD 80,000**	42,936	USD 11,000	132,711	USD 34,000	Jun 30 2016	Dec 31 2018	1M LIBOR + bank margin	pledge, guarantee
PKO BP S.A.	**-**	**USD 105,000**	62,454	USD 16,000	171,744	USD 44,000	Jun 30 2016	Dec 31 2018	1M LIBOR + bank margin	pledge, guarantee
Nordea Bank Litwa	**-**	**USD 117,033**	35,936	USD 9,250	48,514	USD 12,500	Jun 30 2016	Jun 30 2019	1M LIBOR + bank margin	mortgages, registered pledge over inventories, registered pledge over bank accounts, assignment of rights under sale agreements, pledge over shares in subsidiaries

Bank name; form of incorporation	Amount as per agreement		Outstanding amount (current portion)		Outstanding amount (non-current portion)		Repayment date of the current portion	Repayment date of the non-current portion	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)				
PKO BP S.A.	**100,000**		9,528	-	74,120	-	Dec 31 2016	Jan 31 2021	1M WIBOR + bank margin	pledge over a drilling rig, pledge over assets, pledge over shares, pledge over bank accounts, assignment of rights under insurance agreements, assignment of rights under agreement on services involving the drilling rig, representation on voluntary submission to enforcement, promissory note
Agencja Rozwoju Przemysłu S.A.	**100,000**		9,528	-	74,120	-	Dec 31 2016	Jan 31 2021	1M WIBOR + bank margin	pledge over a drilling rig, pledge over assets, pledge over shares, pledge over bank accounts, assignment of rights under insurance agreements, assignment of rights under agreement on services involving the drilling rig, representation on voluntary submission to enforcement, promissory note
Bank Syndicate (7)	**100,000**		10,003	-	82,500	-	Dec 31 2016	Mar 31 2025	3M WIBOR + bank margin	mortgages
Consortium of financial institutions (8)	**300,000**		110,015	-	-	-	Jan 21 2016	Dec 31 2024	1M WIBOR + bank margin	ceiling mortgage; registered pledges over inventories, all assets and rights, receivables; power of attorney over bank accounts; representation on voluntary submission to enforcement; assignment of rights under project agreements, insurance policies, trade contracts; pledge over the shares of the Parent in LOTOS Asfalt Sp. z o.o.; assignment of rights under conditional loan agreement between the Parent and LOTOS Asfalt Sp. z o.o.
			1,931	USD 495	18,823	USD 4,818				

Bank name; form of incorporation	Amount as per agreement		Outstanding amount (current portion)		Outstanding amount (non-current portion)		Repayment date of the current portion	Repayment date of the non-current portion	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)				
Bank Millennium S.A.	**50,900**		5,090	-	42,417	-	Dec 31 2016	Apr 30 2025	3M WIBOR + bank margin	mortgages, registered pledges over property, plant and equipment, assignment of receivables and assignment of rights under insurance policies.
Funds in bank deposits securing payment of interest and principal*			(317,818)	USD (81,469)	-	-				
TOTAL			**612,626**	**-**	**404,502**	**-**				
			1,672,960	**USD 428,172**	**3,873,472**	**USD 988,316**				
			9,620	**EUR 2,257**	**-**	**-**				
			2,295,206		**4,277,974**					

Bank margins on the borrowings are within the range of 0.30pp. – 4.00pp.

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

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 (previously 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.,

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

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

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

Bank Syndicate (6): Nordea Bank Finland Plc. Lithuania Branch, PKO BP S.A.,

Bank Syndicate (7): Pekao S.A., mBank S.A.,

Consortium of financial institutions (8): Bank Gospodarstwa Krajowego, Bank Millennium S.A., Pekao S.A., Bank Zachodni WBK S.A., PKO BP S.A., Powszechny Zakład Ubezpieczeń S.A., Powszechny Zakład Ubezpieczeń na Życie S.A. and Société Générale S.A.

*As at December 31st 2015, Grupa LOTOS S.A. offset a financial asset (cash reserved for repayment of the facilities) against a financial liability under the facilities and, in accordance with IAS 32 Financial Instruments: Presentation, it disclosed the relevant net amount in the statement of financial position (the Company holds a valid legal title to set off the amounts and intends to realise the asset and settle the liability simultaneously). 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 30. LOTOS Group's intra-Group borrowings as at December 31st 2015:

Lender	Borrower	Amount as per agreement		Outstanding amount		Repayment date	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
		PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)			
LOTOS Terminale S.A.	RCEkoenergia Sp.z o.o.	**5,900**	**-**	1,888	-	Dec 31 2017	3M WIBOR + margin	blank promissory note, ceiling mortgage
LOTOS Petrobaltic S.A.	ENERGOBALTIC Sp. z o.o.	**9,927**	**-**	4,977	-	Dec 31 2017	1M WIBOR + margin	blank promissory note with a 'protest waived' clause and promissory note declaration
LOTOS Petrobaltic S.A.	LOTOS E&P Norge AS	**832,522**	**USD 273,200**	631,520	USD 161,882	Dec 31 2017	6M LIBOR + margin	blank promissory note with a 'protest waived' clause and promissory note declaration
LOTOS Petrobaltic S.A.	LOTOS E&P Norge AS		**NOK 26,163**	20,978	NOK 47,343	Dec 31 2017		
LOTOS Petrobaltic S.A.	AB LOTOS Geonafta	**29,334**	**EUR 7,050**	19,404	EUR 4,553	Jul 14 2016	6M EURIBOR + margin	blank promissory note with a 'protest waived' clause and promissory note declaration
LOTOS Petrobaltic S.A.	SPV Baltic Sp. z o.o.	**46,323**	**-**	49,485	-	Jan 31 2022	6M WIBOR + margin	blank promissory note
LOTOS Petrobaltic S.A.	SPV Baltic Sp. z o.o.	**42,662,**	**USD 14,000**	58,965	USD 15,115	Jan 31 2022	6M LIBOR + margin	blank promissory note
LOTOS Petrobaltic S.A.	B8 Sp. Z o.0. SKA	**8,600**	**-**	7,934	-	Dec 31 2016	3M WIBOR + margin	blank promissory note
AB Lotos Geonafta	LOTOS Norge AS	**78,022**	**USD 20,000**	91,797	USD 23,536	Dec 31 2017	3M LIBOR + margin	promissory note
Aphrodite Offshore N.V.	LOTOS Petrobaltic S.A.	**4,203**	**USD 1,250**	5,084	USD 1,303	Dec 31 2016	3M LIBOR + margin	blank promissory note with a 'protest waived' clause and promissory note declaration

Lender	Borrower	Amount as per agreement		Outstanding amount		Repayment date	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
		PLN ('000)	Currency ('000)	PLN ('000)	Currency ('000)			
LOTOS Norge AS	LOTOS Petrobaltic S.A.	**38,695**	**USD 10,000**	39,026	USD 10,004	Dec 31 2017	6M LIBOR + margin	blank promissory note with a 'protest waived' clause and promissory note declaration
Kambr Navigation Company Limited	Miliana Shipmanagement Limited	**820**	**USD 210**	410	USD 105	Dec 31 2017	1M LIBOR + margin	None
Petro Icarus Company Limited	Miliana Shipmanagement Limited	**4,272**	**USD 1,095**	2,152	USD 552	Dec 31 2017	1M LIBOR + margin	None
Granit Navigation Company Limited	Miliana Shipmanagement Limited	**683**	**USD 175**	249	USD 64	Dec 31 2017	1M LIBOR + margin	None
Bazalt Navigation Company Limited	Miliana Shipmanagement Limited	**624**	**USD 160**	73	USD 19	Dec 31 2017	1M LIBOR + margin	None
St. Barbara Navigation Company Limited	Miliana Shipmanagement Limited	**1,716**	**USD 440**	878	USD 225	Dec 31 2017	1M LIBOR + margin	None
Granit Navigation Company Limited	Miliana Shipmanagement Limited	**2,146**	**USD 550**	925	USD 237	Dec 31 2017	1M LIBOR + margin	None
Petro Icarus Company Limited	Miliana Shipmanagement Limited	**11,703**	**USD 3,000**	5,416	USD 1,388	Dec 31 2017	1M LIBOR + margin	None
Kambr Navigation Company Limited	Miliana Shipmanagement Limited	**2,341**	**USD 600**	982	USD 252	Dec 31 2017	1M LIBOR + margin	None
St. Barbara Navigation Company Limited	Miliana Shipmanagement Limited	**4,681**	**USD 1,200**	1,116	USD 286	Dec 31 2017	1M LIBOR + margin	None

Lender	Borrower	Amount as per agreement		Outstanding amount		Repayment date	Financial terms (interest rate, interest payment schedule, etc.)	Type of security
		PLN	Currency	PLN	Currency			
		('000)	('000)	('000)	('000)			
Bazalt Navigation Company Limited	Miliana Shipmanagement Limited	**1,951**	**USD 500**	464	USD 119	Dec 31 2017	1M LIBOR + margin	None
			TOTAL	**64,284**	**-**			
				839,057	**USD 215,087**			
				19,404	**EUR 4,553**			
				20,978	**NOK 47,343**			
				943,723				

4.2.2. FINANCIAL RESOURCES MANAGEMENT

In 2015, the LOTOS Group was able to meet all of its liabilities towards third parties. In the period from January 1st to December 31st 2015, the LOTOS Group used investment and working capital overdraft facilities. As at December 31st 2015, the LOTOS Group had PLN 505.3m in funds available under working capital facilities. The amount outstanding under overdraft facilities as at December 31st 2015 was PLN 581.6m (see Note 20 to the consolidated financial statements for 2015).

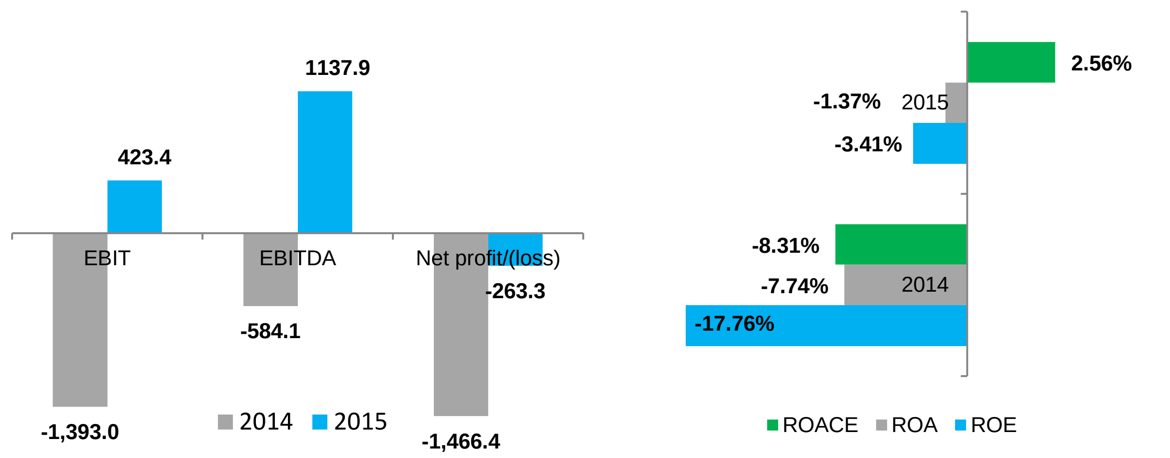
In connection with the credit facilities incurred to finance the 10+ Programme and the facility for the refinancing of inventories, Grupa LOTOS S.A. is required to maintain the Tangible Consolidated Net Worth ratio of no less than specified in the facility agreements.
In connection with the refinancing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

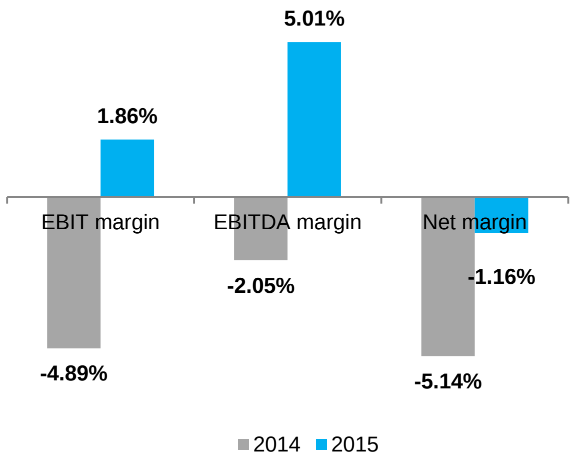
As at December 31st 2015 and December 31st 2014, the covenants were complied with.

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

Profitability ratios

(PLNm or %)



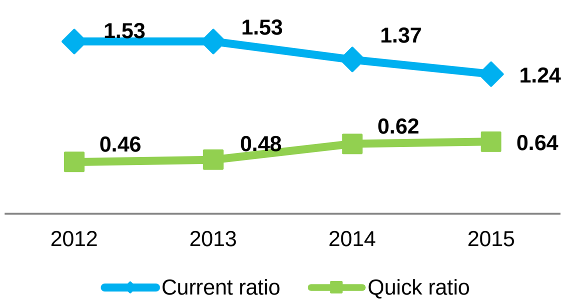


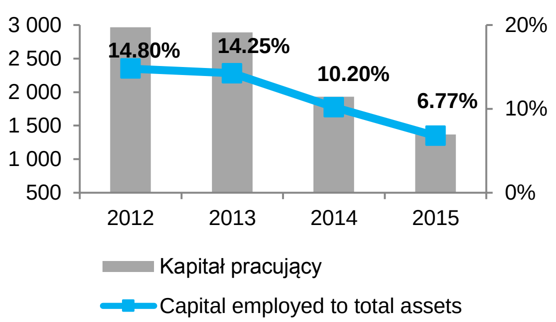
- Improved profitability ratios:
  - higher EBIT margin and EBITDA margin, driven by operating profit
  - improved net margin and rates of return on lower net loss

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 %)





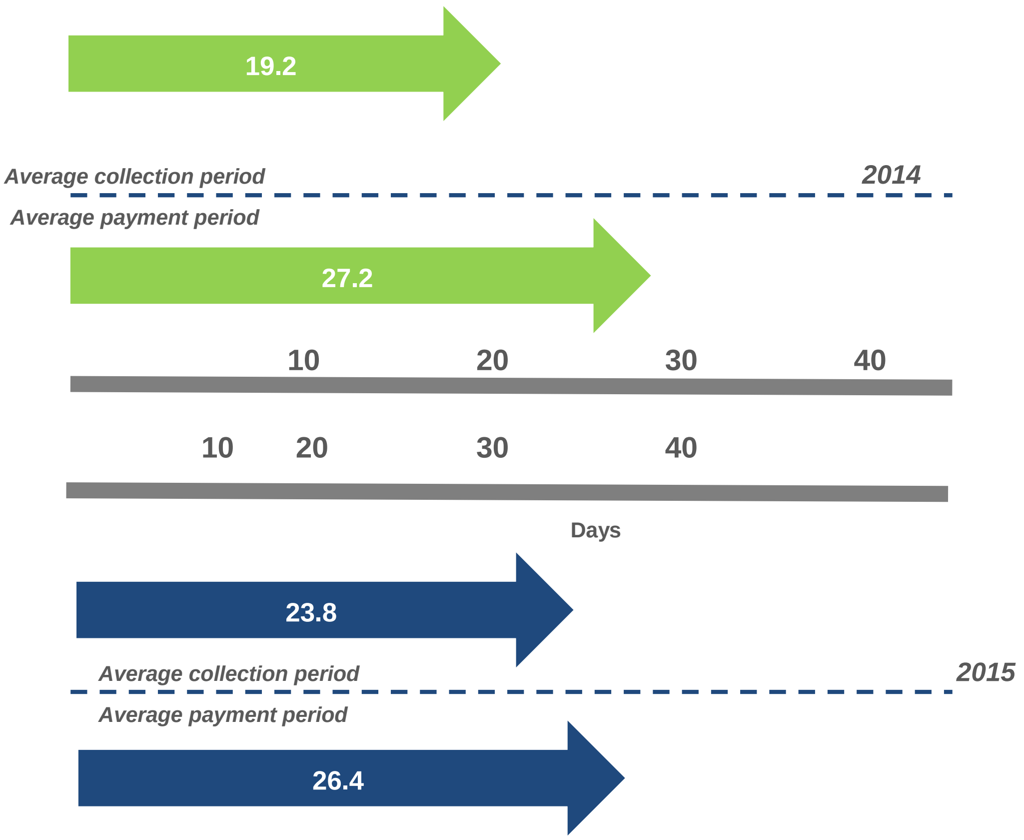
- Current ratio (1.24) lower year on year (down 9.5%), as current assets fell (6.0%) and current liabilities rose (3.9%)

- Quick ratio (0.64) similar as in 2014 (0.62)
- PLN634.7m decrease in capital employed, following decrease in current assets (down PLN -431.7m), increase in current liabilities (up PLN 203.0m), 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)

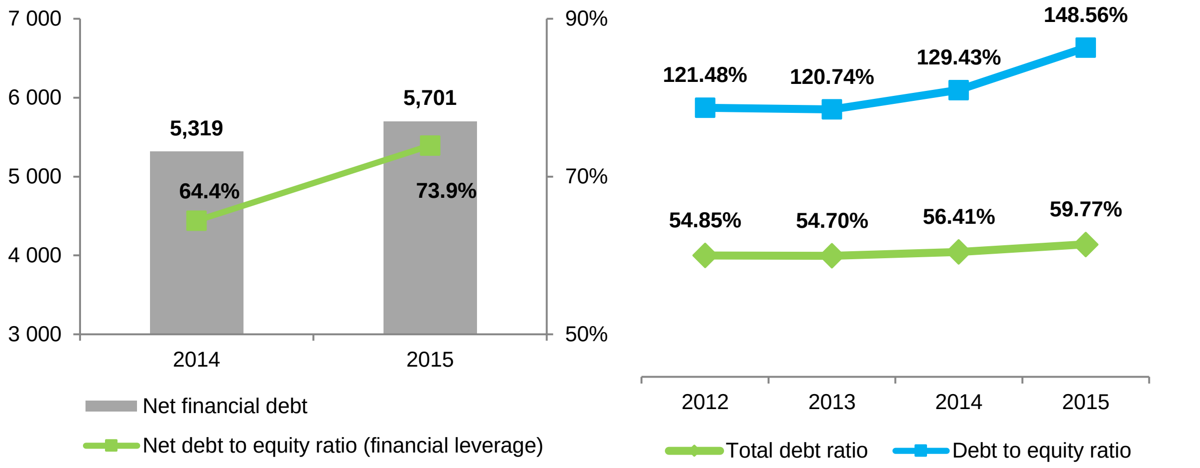


- The average collection period in 2015 was 23.8 days (up 4.6 days compared with 2014) as revenue fell significantly (down 20.3%) and average trade receivables changed only slightly (down 1.4%).
- The average payment period was shorter by 0.8 days as average trade payables and cost of sales decreased by 28.4% and 26.3%, respectively.

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 3.4pp as liabilities and assets increased by 7.2% and 1.2%, respectively.
- Increase in net debt to equity ratio (financial leverage) by 9.5pp as net financial debt grew (up 7.2%), while equity fell (down 6.6%).
- Increase in debt to equity ratio by 19.1pp, as equity fell (down 6.6%), while liabilities grew (7.2%).

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, other debt instruments, and finance lease liabilities less cash and cash proceeds from the issue of shares (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)

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

In 2015, the LOTOS Group continued to pursue its investment projects using proceeds from the public offering of Series D ordinary bearer shares. For more details about the projects, see Section 2.2 on page 18.

4.3. REPRESENTAION OF THE MANAGEMENT BOARD

4.3.1. REPRESENTATION ON THE FULL-YEAR FINANCIAL STATEMENTS AND THE DIRECTORS' REPORT ON THE OPERATIONS OF THE LOTOS GROUP

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

represent that, to the best of their knowledge, the full-year consolidated financial statements of the LOTOS Group for 2015 and the comparative data were prepared in compliance with the applicable accounting standards and give a true, clear and fair view of the LOTOS Group'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 the LOTOS Group in 2015 gives a true view of the Group's development, achievements and position, and includes a description of key risks and threats.

4.3.2. 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 consolidated financial statements of the LOTOS Group for 2015 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. Information on the rules of auditor change is published by the LOTOS Group in the 'Investor relations' section on its website.

4.4. POLICIES APPLIED IN THE PREPARATION OF FULL-YEAR CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements of the LOTOS Group ("consolidated financial statements", "financial statements") have been prepared in accordance with the International Financial Reporting Standards ("IFRS") endorsed by the European Union and in effect as at December 31st 2015. Given the ongoing process of implementation of the IFRSs in the European Union and the scope of the Group's business, as far as the accounting policies applied by the Group are concerned, there is no difference between the IFRSs which have come into force and the IFRSs endorsed by the European Union for 2015, save for the principles which have been modified or introduced as a result of applying new IFRS regulations for annual periods beginning on or after January 1st 2015.

The following new standards, amendments to the existing standards and interpretations which have been endorsed by the European Union (the "EU") are effective in periods beginning on or after January 1st 2015 and have been applied by the Company:

- Amendments introduced as part of the Improvements to IFRSs 2011-2013 cycle, published on December 12th 2013 (effective for annual periods beginning on or after July 1st 2014) − in the EU effective for annual periods beginning on or after January 1st 2015,
- IFRIC 21 Levies, published on May 20th 2013 (applicable to annual periods beginning on or after January 1st 2014 – in the EU effective for annual periods beginning on or after June 17th 2014).

These amendments and interpretations of IFRSs have no material effect on the Group's financial statements.

The consolidated financial statements have been prepared on the assumption that the Group companies will continue as a going concern in the foreseeable future. As at the date of approval of the financial statements, no circumstances were identified which would indicate any threat to the Group companies' continuing as a going concern.

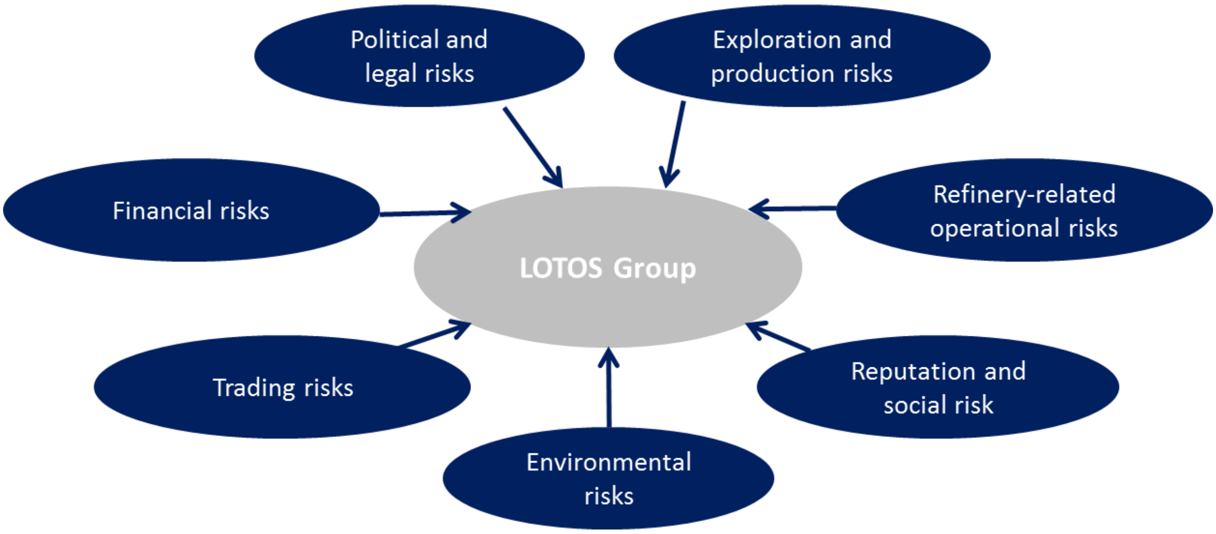
The Parent's functional currency and the presentation currency of the consolidated financial statements is the Polish złoty ("złoty", "zł", "PLN"). The consolidated financial statements were prepared in thousands of złoty and, unless indicated otherwise, all amounts are stated in thousands of złoty.

5. LOTOS GROUP'S BUSINESS RISKS

Throughout 2015, 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 (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 Section.

Figure 44. Key risks in the LOTOS Group



Political and legal risks

In 2015, the Ukrainian crisis and the plans to implement new EU legislation, especially the tighter EU climate policy until 2030, continued to be the main sources of political and legal risks.

The Polish regulatory framework, on the other hand, posed a lesser business risk. In 2015, Polish legislation was evolving in the direction favourable to the development of the petroleum industry. Changes supporting the industry's growth included entry into force of amendments to the Act on Mandatory Oil and Fuel Stocks (envisaging partial takeover of mandatory stocks by the Material Reserves Agency, shortening of the period of stocks maintenance by distributors, including by Grupa LOTOS S.A., and introduction of a stocks charge payable to the Material Reserves Agency), amendments to the Act on Illegal Fuel Trading (reduction of the grey market) increasing the VAT deposit to PLN 10m, and regulations governing hydrocarbon exploration and production. 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 risk − 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 2015, 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 CO_2 emissions reduction ratio in the ETS be increased from 1.7% to 2.2%.
  We are already seeing a decline in EU companies' competitiveness relative to market players operating without CO_2 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.
  If operating costs of European enterprises go up as a result of more stringent regulations on CO_2 emissions, Europe will become an importer of fuels and chemicals from countries where such constraints do not apply.
  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 2015, the Ministry of Economy continued its 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.
- **Absence of comprehensive legislation for the oil sector −**The oil sector in Poland is regulated by 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 Grupa LOTOS S.A.'s control (e.g. impaired reputation of the entire industry), or directly by Grupa LOTOS S.A.'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 LOTOS Group's 2013−2015 Efficiency and Development Programme was nearing completion; the programme's aim was to increase efficiency and support continued dynamic development of the entire LOTOS Group. 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 were 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 geological parameters and formation properties affecting the volume of resources, Grupa LOTOS S.A. provides three estimate cases for reserves (1P/2P/3P) and for prospective resources (P10/P50/P90), in accordance with the SPE 2007 international classification framework. This risk means that it is possible that an exploration or appraisal well, designed and drilled on the basis of performed geological and seismic surveys, does not confirm the presence the originally assumed volume of reserves, or that successive appraisal wells drilled to test a discovery yield results requiring a reduction of the estimated reserves volume due to unfavourable variation in formation properties. One of the methods of ongoing evaluation of reserves and resources and management of the risk of their erroneous evaluation is to analyse the distribution of formation properties determining the reserves volume, such as the area and thickness of the productive horizon, as well as its porosity and hydrocarbon saturation. To evaluate these parameters, the LOTOS Petrobaltic Group has appointed an Exploration Committee, whose members include heads of the hydrocarbon exploration areas. Before making a decision to start drilling, the Committee assesses the assumptions made with regard to the target area geology and properties of the potential productive formation. Also, after a new well has been drilled or any events with implications for the estimated volume of reserves have occurred, the Committee analyses the reasons for their occurrence.

- **Risk of drilling a dry well (without hydrocarbon flow)** – in assessing the chance of success in discovering a hydrocarbon accumulation, we use the PoS (probability of success) ratio. The PoS ratio is calculated by reference to four pre-conditions which must be met for a natural accumulation of hydrocarbons to form (the presence of a reservoir and a trap, and whether hydrocarbons have been generated and have migrated and accumulated in the prospect). These factors are assigned a probability of occurrence between 0 and 100%, and their product defines the probability of success in discovering a new deposit. This risk is managed by performing comprehensive geological analyses for exploration and appraisal wells, and reservoir engineering analyses for producing wells. The PoS ratio is evaluated by the LOTOS Petrobaltic Group's Exploration Committee on a quarterly basis.

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, there is a risk that a project may not be implemented in accordance with the LOTOS Group's expectations. This risk is mitigated primarily by defining the boundary conditions for participation in a project and analysing the project partners (with respect to the objective they are pursuing by becoming involved in the project, their financial standing or market image, etc.). For a jointly implemented project to be successful, the partners' common interests must be defined already in the course of the negotiations preceding the execution of the agreement between the parties. As part of negotiations, the LOTOS Group's interests are secured primarily through appropriate definition of the terms of cooperation, to be later further clarified by precise contractual provisions. At project implementation stage, it is indispensable to appropriately communicate with the partners and ensure task supervision, in particular through regular monitoring of compliance with contractual provisions/issuing opinions, approval of budgets and schedules, appointment of internal or/and external committees, recommendations of decisions to relevant governing bodies. As part of day-to-day risk management, in 2015 the above activities were performed to mitigate risk related to the following joint projects: development of the B/B6 gas fields in the Baltic Sea in cooperation with CalEnergy Resources Poland, cooperation with PGNiG in onshore licence areas in Poland, and projects implemented with partners in licence areas in Norway. In 2015, the cooperation in all of the above projects ran in line with the action plan prepared for each project.

- **Risk of investing capital in projects which yield unsatisfactory returns** – another risk involved in exploration and production, related to investing capital in an unsuccessful project leading to financial losses. To mitigate this risk, it is fundamental to define the boundary parameters for the project and make a comprehensive analysis of the project using appropriate analytical tools. Internal and/or external multidisciplinary teams are set up (working together as part of a due diligence process) to perform an economic analysis of the project and evaluate the risk. The entire process is conducted based on internal regulations and its particular stages are subject to reviews performed to obtain approvals from competent decision-making bodies of the LOTOS Group. By performing the activities defined as indispensable to mitigate the discussed risk, the Group succeeded in completing the acquisition of the Heimdal and Sleipner assets in December 2013 and December 2015, respectively.
- **Risk of increased liabilities in relation to the YME project** – given the significance of the YME project and its past impact on the consolidated performance, it is under the Group's special supervision, with a number of measures implemented to mitigate the attendant risks. Currently, work is under way to abandon the Yme field. To this end, two sub-projects have been identified, including removal of the MOPU (Mobile Offshore Production Unit) from the field and abandonment of the field. 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. As at the date of this Report, the estimated cost of the MOPU removal did not exceed the funds accumulated in the account. Following the Norwegian Ministry of Petroleum and Energy's (MPE) decision, issued on June 30th 2015, to exempt the partners from the obligation to submit the Revised Development Plan for the field, in the middle of the year Talisman, the Yme licence operator, was acquired by the Spanish oil and gas company REPSOL, which took over as the licence operator. The licence partners are pursuing a project to abandon the Yme field, scheduled for 2016-2020. The partners' objective is to minimise the scope of the field abandonment operation and its costs. The Abandonment Plan is to be presented to the MPE for approval at the end of 2016. The plan will define the methods and scope of decommissioning of the field's infrastructure, along with detailed schedules and costs of the operation. Removal of the MOPU is planned for mid-2016. The costs incurred on the Yme project are building a tax shield that the Group benefits from thanks to the production assets it holds (interests in the Heimdal and Sleipner fields). In parallel to the Yme field abandonment project, Grupa LOTOS has been looking for opportunities to exit the project early.

Financial risk related to the upstream business

- **Macroeconomic risk** − risks related to macroeconomic factors were crucial for the functioning of the upstream business in 2015. 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, LOTOS Petrobaltic is taking further optimisation/adaptation measures to maintain the liquidity of the upstream segment while continuing its key projects (B8, B4 and B6). The upstream segment has implemented a policy to keep its costs below 35 USD/bbl and has been consistently striving to further improve its operating efficiency to flexibly adapt to the changing macroeconomic environment by fostering business and organisational awareness and using incentive tools and systems. In the course of the work on the 2016 budget, scenarios envisaging cost reductions and investment project downscaling, along with securing additional financing in the event oil prices reach USD 35/30/25/20 per barrel, will be developed.

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 Grupa LOTOS S.A. 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 Grupa LOTOS S.A.'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 EDCAC consortium, an association of downstream users of the EDC solvent. Apart from that, the Company plans to modernise the Oil Unit installations and implement environmental monitoring and personal protection measures programmes to ensure that all mandatory technical and legal requirements enabling further use of the EDC are met.

Environmental risks

- **Risks related to CO_2 emission allowance limits involve an increase in prices and insufficient allocation of CO_2 emission allowances, which would force the Company to incur additional costs to purchase allowances on the market to cover the deficit.** The measures that have been implemented by the European Commission, affecting the operation of the EU ETS (Emissions Trading Scheme), will not remain without consequences for the price of allowances. The MSR (market stability reserve) mechanism, introduced into the EU law in 2015, which will materially affect the number of allowances available on the market and, consequently, also their price, is to be put in place in 2019 instead of 2021 as originally proposed. As a result of the finally adopted solution, rules of trading in the EU ETS will change materially in the course of a trading period (currently the third trading period – 2013-2020) rather than from the beginning of the next trading period. According to Polish politicians and business circles, this is inconsistent with the definition of the EU ETS as a free market system, a feature that was supposed to be one of the cornerstones for its effective operation. Poland's objections were formulated in a complaint filed by Poland on January 4th 2016 with the Court of Justice of the European Union calling for voiding of the decision of the European Parliament and of the Council concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme. Given the complexity of the case, it is expected that the court may even take a year to issue a judgment. 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 additional 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 CO_2 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.
- **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 (IPPC installations). 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 view of this risk, in connection with the EFRA project, in 2015 the procedure of amending the integrated permits of Grupa LOTOS and LOTOS Asfalt was commenced. 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. 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). The amendment extended the list of IPPC installations. With the coming into force of the amended laws also the wastewater treatment plant serving the Gdańsk-based refinery operated by Grupa LOTOS S.A. became an installation requiring an integrated permit and had to obtain such permit by July 1st 2015. The

application was filed with the Marshal Office of the Gdańsk Province in April, and the decision that added the wastewater treatment plant as the third IPPC installation to Grupa LOTOS S.A.'s integrated permit was obtained in June 2015.

- **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 very stringent, necessitating significant capital expenditure to ensure compliance. In 2015, the Marshal Office of the Gdańsk Province, acting in compliance with the new laws, declared that the installations of Grupa LOTOS S.A.'s refinery meet all the requirements of the BAT Conclusions. The Company was only obligated to supplement its integrated permit with provisions concerning BAT-related monitoring.

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:

- **Commodity and petroleum product price risk** – operating results are 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 LOTOS Group's refining margin. In 2015, the Company adopted a new policy for managing its commodity and petroleum product price risk. The new policy introduced a classification of transaction portfolios, described how risk was understood, defined the permitted financial instruments and transaction limits as well as transaction execution standards. The Company uses ETRM– Allegro 8.0 software to support its price and trading risk management process.

- **CO_2 allowances price risk** − in 2014, Grupa LOTOS S.A. managed the risk associated with the entire phase III of the EU CO_2 Emissions Trading Scheme covering the 2013−2020 trading period. For more information on this type of risk as at December 31st 2015, 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 the LOTOS 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 Group 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. In 2015, the Company adopted a new currency risk management policy in which the central risk metric is Cash-Flow-at-Risk (CFaR), computed based on the CorporateMetrics™ methodology, with the CFaR value limit and the maximum hedge ratio being the key limits. In addition, the LOTOS Group operates a group bank which allows the Group companies to enter into FX transactions with Grupa LOTOS S.A., improving the efficiency of currency risk management.
- **Interest rate risk** – 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 the risk of the counterparty's default is taken into account. 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 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. The LOTOS Group has in place an appropriate procedure for checking the creditworthiness of trading partners and granting them trade credit limits. 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 or change in the terms of external financing** - some of the investment projects pursued by Grupa LOTOS S.A. and its subsidiaries as well as their day-to-day operations are or may be financed with borrowings (e.g. the external financing for the EFRA Project, raised in 2015).

Therefore, there is a risk that Group companies may find it difficult to raise new external 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 financing agreements by the LOTOS 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 the 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. In the event of such failure, the lenders could enforce their claims against security, including collateral established over Group companies' assets.

This risk is mitigated through integrated ongoing monitoring of 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 debt service obligations assumed by a given company under financing agreements on an ongoing basis, including the obligations relating to maintenance of certain financial ratios and covenants as well as discharge of all other obligations towards financial institutions.

The LOTOS Group also maintains relationships with a properly 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 institutions providing financing for the LOTOS Group are also monitored in a continuous and comprehensive manner, 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 Grupa LOTOS S.A.'s day-to-day work and smooth tax planning for the LOTOS Group. 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, the LOTOS 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, the Company also voices its opinions on proposed bills and is 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, internal procedures are regularly updated 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 77%) from Russia. Crude oil is supplied via the network of pipelines operated by PERN (the Druzhba and Pomorski pipelines), by sea through the Naftoport oil terminal, and by rail. 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, 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),
    - regular use of crude oil transport by rail (the rail tankers may be unloaded at the rail unloading stations at the refinery).

  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. Key elements of the strategy aimed at minimising the impact of this risk on the Group's operations include diversification of distribution channels, active pricing policy for price-competitive products, and optimisation of operating costs. Domestic demand in 2015 did not shrink relative to 2014, opposite to the trend seen in 2012-2014, when demand was falling.

- **Risk of grey market expansion −** in recent years, Poland has seen an increase in illegal trade, especially in diesel oil, though the data for 2015 (though incomplete) points to a reversal of this unfavourable trend. According to estimates by the Polish Organisation of Oil Industry and Trade (POPiHN), in the first three quarters of 2015 the grey market accounted for about 13% of the entire fuel trading market (diesel oil, gasoline, light fuel oil), down by about 3pp year on year. In 2012-2014, the growing problem of illicit fuel trading taking place outside the official tax system had 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.

6. ORGANISATION AND MANAGEMENT AT THE LOTOS GROUP

6.1. OWNERSHIP LINKS AND MANAGEMENT RULES

6.1.1. GRUPA LOTOS S.A. DIVISIONS

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

6.1.2. OWNERSHIP CHANGES AT THE LOTOS GROUP

Below are discussed changes in the Group's structure in 2015.

Table 31. Registered changes in share capital

Shareholder	Registration date	Before	Increase	After	Comments
LOTOS Exploration and Production Norge AS *	Jan 22 2015	NOK 1,083,718,441	NOK 650,000,000	NOK 1,733,718,441	issue of 650 million Series B shares with a par value of NOK 1 per share; the new shares were subscribed and paid for with cash by LOTOS Petrobaltic S.A.
Infrastruktura Kolejowa Sp. z o.o.	Mar 04 2015	PLN 5,000	PLN 37,400	PLN 42,400	issue of 748 new shares with a par value of PLN 500 per share; increase through takeover of assets of LOTOS Kolej Sp. z o.o. (related to the division of LOTOS Kolej through a spin-off under Art. 529.1.4. of the Commercial Companies Code); the new shares were subscribed for by Grupa LOTOS S.A.
B8 Sp. z o.o. *	Apr 13 2015	PLN 105,000	PLN 100,000	PLN 205,000	issue of 2,000 new shares with a par value of PLN 50 per share; the new shares were subscribed for by LOTOS Petrobaltic S.A.
AB Genciu Nafta **	Apr 17 2015	EUR 2,900	EUR 100	EUR 3,000	conversion of the share capital from LTL to EUR (1 share = LTL 10 → 1 share = EUR 2.90; number of shares = 1,000) and share capital increase financed with the company's own funds, carried out through an increase of the par value of the shares by EUR 0.10, i.e. from EUR 2.90 to EUR 3 per share;
UAB Manifoldas **	Apr 17 2015	EUR 292,496	EUR 10,504	EUR 303,000	conversion of the share capital from LTL to EUR (1 share = LTL 100 → 1 share = EUR 28.96; number of shares = 10,100) and share capital increase financed with the company's own

					funds, carried out through an increase of the par value of the shares by EUR 1.04, i.e. from EUR 28.96 to EUR 30 per share;
AB LOTOS Geonafta *	Jun 22 2015	EUR 63,336.87	EUR 9,464.13	EUR 72,801	conversion of the share capital from LTL to EUR (1 share = LTL 3 → 1 share = EUR 0.87; number of shares = 72,801) and share capital increase financed with the company's own funds, carried out through an increase of the par value of the shares by EUR 0.13, i.e. from EUR 0.87 to EUR 1 per share;
Baltic Gas Sp. z o.o. ***	Jul 03 2015	PLN 105,000	PLN 40,000	PLN 145,000	issue of 800 new shares with a par value of PLN 50 per share; 400 new shares, with an aggregate par value of PLN 20,000, were subscribed for by LOTOS Petrobaltic S.A. in exchange for a cash contribution of PLN 20,000; the rest of the new shares were subscribed for by the other shareholder, CalEnergy Resources Poland Sp. z o.o.
LOTOS Asfalt Sp. z o.o.	Jul 9 2015	PLN 20,000,000	PLN 11,515,000	PLN 31,515,000	issue of 2,303 new shares with a par value of PLN 5,000 per share and the issue price of PLN 195,400; the new shares were subscribed and paid for with cash by Grupa LOTOS S.A.
LOTOS Exploration and Production Norge AS *	Aug 10 2015	NOK 1,733,718.44	NOK 500,000,000	NOK 2,233,718,441	issue of 500 million new Series B shares with a par value of NOK 1 per share; the new shares were subscribed by LOTOS Petrobaltic S.A. (offset against loans advanced)

** Subsidiary of LOTOS Petrobaltic S.A.*

*** Subsidiary of AB LOTOS Geonafta*

**** Jointly controlled by LOTOS Petrobaltic S.A.*

Consolidation of logistics and infrastructure assets

In 2015, the LOTOS Group continued the process of consolidating its logistics assets. As part of that process, on April 1st 2015 Grupa LOTOS S.A. sold an organised part of business in the form of the newly built fuel terminal in Poznań to LOTOS Terminale S.A.

Sale of the southern branches of LOTOS Lab Sp. z o.o.

On March 31st 2015, agreements on the sale of branches of LOTOS Lab Sp. z o.o. (organised parts of business in the form of the Jasło branch and the Czechowice-Dziedzice branch) to Polwax S.A. of Jasło were executed.

Sale of the southern branches of LOTOS Serwis Sp. z o.o.

On November 3rd 2015, LOTOS Serwis Sp. z o.o. sold two organised parts of business, in the form of the Jasło branch and the Czechowice-Dziedzice branch, to REM Serwis Jasło Sp. z o.o. of Jasło and REM Serwis Czechowice-Dziedzice Sp. z o.o. of Czechowice-Dziedzice, respectively, wholly-owned subsidiaries of Apex-Elzar Sp. z o.o. of Włocławek.

Division of LOTOS Kolej Sp. z o.o.

On February 16th 2015 (LOTOS Kolej Sp. z o.o.) and on March 4th 2015 (Infrastruktura Kolejowa Sp. z o.o.), a division of LOTOS Kolej Sp. z o.o. made through a spin-off under Art. 529.1.4. of the Commercial Companies Code, i.e. through the transfer of a part of the company's assets comprising an organised part of its business − Debt Collection Office − to Infrastruktura Kolejowa Sp. z o.o., was entered in the register of entrepreneurs of the National Court Register. The division was made in accordance with Art. 542.4 of the Commercial Companies Code from the LOTOS Kolej Sp. z o.o.'s equity components other than the share capital, without reducing LOTOS Kolej Sp. z o.o.'s share capital. In connection with the division of LOTOS Kolej Sp. z o.o., the share capital of Infrastruktura Kolejowa Sp. z o.o. (the acquirer) was increased. All shares in the increased share capital of Infrastruktura Kolejowa Sp. z o.o. were acquired by Grupa LOTOS S.A., which retained all the shares held previously.

Pledge over 100% of shares in LOTOS Asfalt Sp. z o.o.

On November 2nd 2015, a registered pledge over 100% of shares in LOTOS Asfalt Sp. z o.o. was entered in the Pledge Register maintained by the District Court for Gdańsk-Północ in Gdańsk, 9th Commercial Division of the Pledge Register. The registered pledge was created to secure the repayment of liabilities under a credit facility agreement executed to acquire a part of funds necessary to finance the EFRA Project. The credit facility agreement was concluded between LOTOS Asfalt Sp. z o.o. and a syndicate of financial institutions comprising Bank Gospodarstwa Krajowego, Bank Millennium S.A., Bank Polska Kasa Opieki S.A. (coordinating the financing of the EFRA Project), Bank Zachodni WBK S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Powszechny Zakład Ubezpieczeń S.A., Powszechny Zakład Ubezpieczeń na Życie S.A., and Société Générale. Grupa LOTOS S.A.'s share in the share capital and total voting rights at the Pledgor's General Meeting is 100%.

On November 3rd 2015, two registered pledges over 100% of shares in LOTOS Asfalt Sp. z o.o. were entered in the Pledge Register maintained by the District Court for Gdańsk-Północ in Gdańsk, 9th Commercial Division of the Pledge Register. The registered pledges were created to secure the repayment of liabilities under a credit facility agreement executed to acquire a part of funds necessary to finance the EFRA (Effective Refining) Project, and potential liabilities under hedging transactions to be executed in connection with the EFRA Project pursuant to the credit facility agreement. The credit facility agreement was concluded between LOTOS Asfalt Sp. z o.o. and a syndicate of financial institutions comprising Bank Gospodarstwa Krajowego, Bank Millennium S.A., Bank Polska Kasa Opieki S.A. (coordinating the financing of the EFRA Project), Bank Zachodni WBK S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Powszechny Zakład Ubezpieczeń S.A., Powszechny Zakład Ubezpieczeń na Życie S.A., and Société Générale. The Company's share in the share capital and total voting rights at the Pledgor's General Meeting is 100%.

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

The LOTOS Group comprises Grupa LOTOS S.A. (the Parent) and a number of production, service and trading companies which are direct or indirect subsidiaries of Grupa LOTOS S.A. The Group also holds shares in equity-accounted joint ventures.

Contact data and brief description of the principal business activity of these entities, as well as the Group's ownership interests and the applied consolidation method are presented below.

Table 32. Companies of the LOTOS Group

Name	Registered office	Principal business activity	Group's ownership interest	
			Dec 31 2015	Dec 31 2014
Parent				
Downstream segment				
Grupa LOTOS S.A.	Gdańsk	Production and processing of refined petroleum products (mainly fuels) and their wholesale	Not applicable	Not applicable
Direct fully-consolidated subsidiaries				
Upstream segment				
LOTOS Petrobaltic S.A. (parent of another group: LOTOS Petrobaltic Group)	Gdańsk	Acquisition of crude oil and natural gas deposits, extraction of hydrocarbons	**99.99%**	**99.99%**
Downstream segment				
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 Sp. z o.o.[(1)]	Gdańsk	Production and sale of lubricating oils and lubricants, and sale of base oils	**100.00%**	100.00%
LOTOS Asfalt Sp. z o.o.	Gdańsk	Production and sale of bitumens	**100.00%**	100.00%
LOTOS Kolej Sp. z o.o.	Gdańsk	Railway transport	**100.00%**	100.00%
LOTOS Serwis Sp. z o.o.	Gdańsk	Maintenance of mechanical and electric operations and controlling devices, overhaul and repair services	**100.00%**	100.00%
LOTOS LAB Sp. z o.o.	Gdańsk	Laboratory 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	**100%**	100.00%
Other				
LOTOS Gaz S.A. (in liquidation)	Kraków	Dormant	**100,00%**	100.00%

Name	Registered office	Principal business activity	Group's ownership interest	
			Dec 31 2015	Dec 31 2014
LOTOS Park Technologiczny Sp. z o.o. w likwidacji (in liquidation) (2)	Jasło	Dormant	-	100.00%
Non-consolidated direct subsidiaries				
Infrastruktura Kolejowa Sp. z o.o.	Gdańsk	Dormant	**100%**	**100%**
Indirect fully-consolidated subsidiaries				
Downstream segment				
LOTOS Infrastruktura Group				
RCEkoenergia Sp. z o.o.	Czechowice-Dziedzice	Production and distribution of electricity, heat and gas	**100%**	100.00%
LOTOS Terminale Group				
LOTOS Biopaliwa Sp. z o.o.	Czechowice-Dziedzice	Production of fatty acid methyl esters (FAME)	**100%**	100.00%
Upstream segment				
LOTOS Petrobaltic Group				
LOTOS Exploration and Production Norge AS	Norway, Stavanger	Oil and gas exploration and production on the Norwegian Continental Shelf, provision of services incidental to oil and gas exploration and production	**99.99%**	99.99%
Aphrodite Offshore Services N.V.	Curaçao	Dormant	**99.99%**	99.99%
B8 Sp. z o.o.	Gdańsk	Support activities for extraction and quarrying operations	**99.99%**	99.99%
B8 Spółka z ograniczoną odpowiedzialnością BALTIC S.K.A.	Gdańsk	Exploration and production of crude oil and natural gas	**99.99%**	99.99%
Miliana Shipholding Company Ltd. (parent of another group: Miliana Shipholding Group)	Nicosia, Cyprus	Storage and transport of crude oil, other sea transport services	**99.99%**	99.99%
Technical Ship Management Sp. z o.o. (parent of another group: Technical Ship Management Group)	Gdańsk	Sea transport support activities. ship operation advisory services	**99.99%**	99.99%
SPV Baltic Sp. z o.o.	Gdańsk	Provision of sea transport and related services	**99.99%**	99.99%
Miliana Shipmanagement Ltd.	Nicosia, Cyprus	Provision of sea transport and related services	**99.99%**	99.99%
Miliana Shipping Group Ltd. (parent of another group: Miliana Shipping Group)	Nicosia, Cyprus	Management of own assets	**99.99%**	99.99%
Bazalt Navigation Company Ltd.	Nicosia. Cyprus	Ship chartering	**99.99%**	99.99%

Name		Registered office	Principal business activity	Group's ownership interest	
				Dec 31 2015	Dec 31 2014
	Granit Navigation Company Ltd.	Nicosia, Cyprus	Ship chartering	**99.99%**	99,99%
	Kambr Navigation Company Ltd.	Nicosia, Cyprus	Ship chartering	**99.99%**	99,99%
	St. Barbara Navigation Company Ltd.	Nicosia, Cyprus	Ship chartering	**99.99%**	99,99%
	Petro Icarus Company Ltd.	Nicosia, Cyprus	Ship chartering	**99.99%**	99,99%
	Petro Aphrodite Company Ltd.	Nicosia, Cyprus	Ship chartering	**99.99%**	99,99%
AB LOTOS Geonafta (parent of another group: AB LOTOS Geonafta Group)		Lithuania, Gargždai	Crude oil exploration and production, drilling services, and purchase and sale of crude oil	**99,99%**	99,99%
	UAB Genciu Nafta	Lithuania, Gargždai	Crude oil exploration and production	**99,99%**	99.99%
	UAB Manifoldas	Lithuania, Gargždai	Crude oil exploration and production	**99,99%**	99.99%
Other					
LOTOS Petrobaltic Group					
ENERGOBALTIC Sp. z o.o.		Władysławowo	Production of electricity, heat, LPG and natural gas condensate	**99.99%**	99.99%
Equity-accounted joint ventures					
● LOTOS - Air BP Polska Sp. z o.o. [(3)]		Gdańsk	Sale of aviation fuel and logistics services	**50.00%**	50.00%
LOTOS Petrobaltic Group					
Baltic Gas Sp. z o.o.[(4)]		Gdańsk	Oil and gas production (support activities for oil and gas production)	**49.99%**	49.99%
Baltic Gas spółka z ograniczoną odpowiedzialnością i wspólnicy sp.k.		Gdańsk	Crude oil and gas production	**43.96[5)]**	62.40%
AB LOTOS Geonafta Group					
	UAB Minijos Nafta	Lithuania, Gargždai	Crude oil exploration and production	**49.99%**	49.99%

[(1)] On April 1st 2015, Lotos Oil Sp. z o.o. was entered in the Register of Entrepreneurs of the National Court Register maintained by the District Court for Gdańsk-Północ in Gdańsk, 7th Commercial Division of the National Court Register, and a change of the company's legal form from joint stock company (S.A.) to a limited liability company (Sp. z o.o.) was registered.

[(2)] On March 12th 2015, LOTOS Park Technologiczny Sp. z o.o. w likwidacji (in liquidation) was deleted from the Register of Entrepreneurs of the National Court Register maintained by the District Court of Rzeszów, 12th Commercial Division of the National Court Register.

(3) Joint venture agreement between Grupa LOTOS S.A. and BP Europe SE on joint operations related to supply of aviation fuel through LOTOS - Air BP Polska Sp. z o.o.

(4) A special purpose vehicle established in connection with the cooperation between LOTOS Petrobaltic S.A. and CalEnergy Resources Poland Sp. z o.o. on development of the B-4 and B-6 fields.

(5) In 2015, the change in the Group's ownership interest in Baltic Gas spółka z ograniczoną odpowiedzialnością i wspólnicy sp. k. was attributable to cash contributions made by limited partners of the company:

- LOTOS Petrobaltic S.A. − PLN 3,877 thousand;
- CalEnergy Resources Poland Sp. z o.o. − PLN 40,176 thousand.

In 2015, the agreed contributions were increased in the following manner:

- On September 1st 2015, an increase in the contribution agreed to be made by the Company, that is the contribution to be made by the limited partner LOTOS Petrobaltic, from PLN 52,647,500 to PLN 53,627,500, i.e. by PLN 980,000, through a cash contribution of PLN 980,000, was entered in the Register of Entrepreneurs of the National Court Register maintained by the District Court for Gdańsk - Północ in Gdańsk, 7th Commercial Division of the National Court Register;
- On November 18th 2015, the following increases in the agreed contributions were entered in the Register of Entrepreneurs of the National Court Register maintained by the District Court for Gdańsk - Północ in Gdańsk, 7th Commercial Division of the National Court Register :
  a) increase of the agreed contribution of the limited partner LOTOS Petrobaltic S.A. from PLN 53,627,500 to PLN 81,869,711, i.e. by PLN 28,242,211, through a cash contribution of PLN 28,242,211;
  b) increase of the agreed contribution of CalEnergy Resources Poland sp. z o. o. from PLN 66,070,580 to PLN 98,933,89, i.e. by PLN 32,863,317, through a cash contribution of PLN 32,863,317;

As a result, the ownership interests in the company, measured as a percentage of the amount of contributions made by individual partners to total contributions as at December 31st 2015, were as follows:

- Baltic Gas Sp. z o.o. (general partner) (0.001%);
- LOTOS Petrobaltic S.A. (limited partner) (43.968%);
- CalEnergy (limited partner) (56.031%).

For IFRS purposes, Baltic Gas Sp. z o.o. i wspólnicy sp.k. and Baltic Gas Sp. z o.o. are entities jointly controlled by the Group (equity-accounted joint venture under IFRS 11).

6.1.4. CHANGES IN THE KEY MANAGEMENT POLICIES OF GRUPA LOTOS S.A. AND THE LOTOS GROUP − ASSESSMENT OF ORGANISATIONAL MATURITY

Assessment of organizational maturity

Given the growing expectations of its external environment, Grupa LOTOS S.A. decided to take steps to further assure its stakeholders of the maturity of the solutions adopted by Grupa LOTOS S.A. in the following areas:

- internal control,
- risk management,
- compliance,
- misconduct prevention,
- corporate governance.

In its CSR Report, based on the Global Reporting Initiative (GRI) methodology, Grupa LOTOS S.A. assured that it would inform its owners, investors, and business partners of the effective mechanisms in the above systems.

In order to facilitate an assessment of the systems, a model was developed for Grupa LOTOS S.A. based on GRC (Governance, Risk Management, and Compliance) best business practice established by the Open Compliance & Ethics Group and other sources, such as the corporate governance rules in the Code of Best Practice for WSE Listed Companies, as well as the Deloitte methodology for fraud risk management.

In the model, a uniform approach is taken to reviewing and evaluating the individual systems. It is also possible to formulate a combined score for all the systems, to be viewed as the degree of the Company's organisational maturity. The model is composed of sections corresponding to the individual systems.

2015 was the sixth year when such an assessment was made. The first, pilot, maturity assessment took place in 2010, and the one made in 2015 was the last according to the model. In 2016, the Company plans to develop a new Organisational Maturity Assessment Model for the entire LOTOS Group.

Assessment of the internal control system covered solutions that constitute a framework for the internal control environment as well as solutions embedded in the 23 individual defined processes in the Company. The assessment carried out in 2015 was comprehensive in nature.

Assessment of the risk management system focused on correct definition and operation of the system's framework and on accurate risk identification and assessment.

Assessment of the compliance system focuses on solutions whose aim is to ensure compliance with external regulations by correct identification of external regulations relevant to the Company's business and by familiarising the employees with the regulations. However, compliance with internal regulations is also taken into account.

Assessment of the misconduct prevention system is focused on solutions preventing misconduct (e.g. by developing and fostering appropriate attitudes and behaviours, or following appropriate HR policy) and on the process of misconduct risk identification and assessment.

Issues relating to effective management of the Company (e.g. monitoring and control, corporate culture) are important elements of the assessment of the corporate governance system.

For the purposes of the review and assessment, organizational maturity is defined as the level of professionalism of key organizational solutions, processes and activities, as well as their consistency with the best operating and management practices, which underpin the organization's potential to *achieve success in terms of protection and creation of value for its stakeholders*.

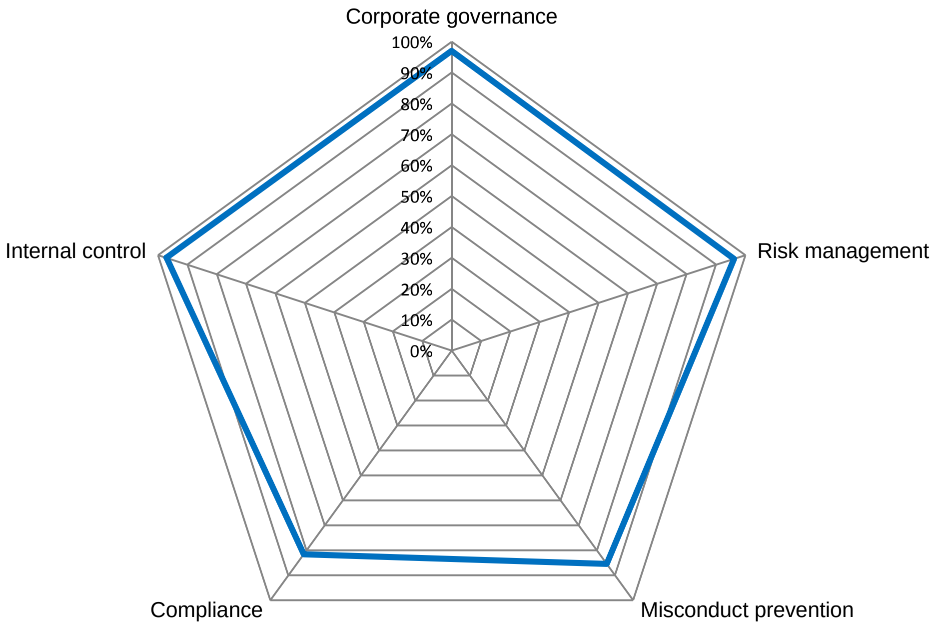
Such organizational maturity depends on the company's systems and their constituent solutions which are crucial to the creation of value for stakeholders, relevant to the protection of company value, and key to its ability to operate on a day-to-day basis without any disruptions and in compliance with the law.

Assessment of the organisational maturity of Grupa LOTOS S.A. covers five systems deemed the critical elements of the backbone supporting the entire organisation. The assessment combines the results of the systems' 'planned' score and 'compliance with planned' score.

Table 33. Summary of organisational maturity assessment of Grupa LOTOS S.A.

Systems constituting organisational maturity of the Company	'Planned' score	'Compliance with planned' score	Total score	
Internal control system	99%	97%	**97%**	**VERY HIGH**
Risk management system	97%	99%	**96%**	**VERY HIGH**
Compliance system	86%	96%	**82%**	**HIGH**
Misconduct prevention system	87%	98%	**85%**	**HIGH**
Corporate governance	98%	99%	**97%**	**VERY HIGH**
Maturity assessment − combined score	**93%**	**98%**	**91%**	**HIGH**

Figure 45 Total score of systems contributing to Grupa LOTOS S.A.'s organisational maturity



The above combined results of the assessment of the Company's organizational maturity indicate that Grupa LOTOS is an organization oriented towards professionalism and adoption of the best operating and management practices.

The results also indicate that Grupa LOTOS S.A. makes a significant effort to protect the Company's value, as evidenced by the well-developed internal control system and corporate governance solutions, as well as by the implementation of the misconduct prevention system in 2012. Grupa LOTOS S.A. also focuses on being able to operate without disruptions and in compliance with the law. All these efforts are generally reflected in the current complexity and development level of the systems.

To sum up, the relatively high score achieved by Grupa LOTOS S.A. in the organizational maturity assessment was largely the result of steps taken in the last few years and in 2015 to secure the Company's value and operations, demonstrated by the effective internal control system as well as solutions supporting corporate governance, compliance and identification of key risks for the Company business.

The score was also boosted by the implementation and operation of the misconduct prevention system, which plays a vital role in supporting the measures taken to protect the Company's value (including against threats which traditional internal control or compliance systems are not prepared to deal with).

6.2. WORKFORCE OF THE LOTOS GROUP

6.2.1. THE LOTOS GROUP WORKFORCE STRUCTURE

Table 34. The LOTOS Group workforce structure by job role

Company	Workforce as at December 31st 2015	
	Blue-collar jobs	White-collar jobs
Grupa LOTOS S.A.	501	863
LOTOS Paliwa Sp. z o.o.	0	273
LOTOS Kolej Sp. z o.o.	684	282
LOTOS Oil S.A.	108	196
LOTOS LAB Sp. z o.o.	76	38
LOTOS Serwis Sp. z o.o.	320	162
LOTOS Straż Sp. z o.o.	75	14
LOTOS Asfalt Sp. z o.o.	82	118
LOTOS Gaz S.A.	0	1
LOTOS Ochrona Sp. z o.o.	138	23
LOTOS Park Technologiczny Sp. z o.o.	0	0
LOTOS Air BP Polska Sp. z o.o.	32	17
LOTOS Infrastruktura S.A.	40	34
LOTOS Terminale S.A.	70	55
RC Ekoenergia Sp. z o.o.	48	31
LOTOS Biopaliwa Sp. z o.o.	24	14
LOTOS Petrobaltic S.A.	148	247
ENERGOBALTIC Sp. z o.o.	3	29
LOTOS E&P Norge AS	0	27
AB LOTOS Geonafta	42	15
Miliana Shipping Ltd	0	1
Technical Ship Management	0	9
SPV Baltic Spółka z o.o.	7	3
	2,398	**2,452**
Total		**4,850**

Figure 46. The LOTOS Group workforce structure by key companies (as at December 31st 2015)

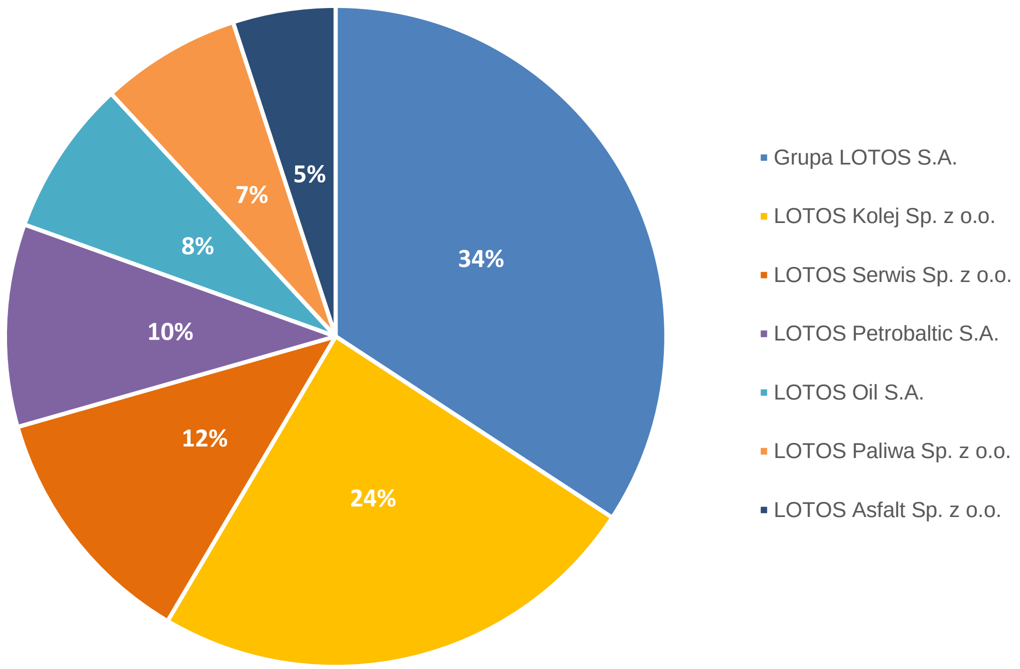


Table 35. The LOTOS Group workforce structure by sex (as at December 31st 2015)

Job type	Men	Women	Total
blue-collar jobs	2,265	133	2,398
white-collar jobs	1,465	987	2,452
Total	**3,730**	**1,120**	**4,850**

Table 36. LOTOS Group's workforce in 2009−2015

Workforce	Dec 31 2009	Dec 31 2010	Dec 31 2011	Dec 31 2012	Dec 31 2013	Dec 31 2014	Dec 31 2015
Grupa LOTOS S.A.	1,305	1,310	1,329	1,349	1,345	1,350	**1,364**
LOTOS Group	4,949	5,010	5,168	5,015	4,983	5,106	**4,850**

6.2.2. REMUNERATION POLICY – REMUNERATION SYSTEM, TERMS OF REMUNERATING MANAGEMENT BOARD MEMBERS, CHANGES IN REMUNERATION POLICY

The Management Board of Grupa LOTOS S.A.

The five members of the Management Board of Grupa LOTOS S.A. are employed under indefinite-term employment contracts and the terms of their remuneration are regulated by the Act on Remunerating Persons Who Manage Certain Legal Entities, dated April 10th 2000 (Compensation Cap Act). The Act stipulates that the monthly salary cannot exceed the sixfold average monthly pay in the business sector excluding annual bonuses from profit in the fourth quarter of the previous year, as published by the Central Statistics Office. Pursuant to certain acts complementing the budget act, which have been in force since 2011, in 2015 the monthly remuneration of Members of the Management Board of Grupa LOTOS S.A. was computed based on the average monthly pay in the business sector excluding annual bonuses from profit in Q4 2010 /PLN 3,454.58/. Therefore, the monthly base pay of Members of the Management Board of Grupa LOTOS S.A. was PLN 20,727.48, i.e. sixfold of the average monthly pay in the business sector. Furthermore, pursuant to Art. 10 of the Compensation Cap Act, Members of the Management Board of Grupa LOTOS S.A. may be awarded an annual bonus of not more than threefold their average monthly remuneration in the preceding year.
In 2015, no annual bonus was paid to the Members of the Management Board of Grupa LOTOS S.A.

Staff A (senior management)

Employees classified to Staff A of the LOTOS Group work under employment contracts. The main component of salaries is base pay. Staff A employees are also eligible to receive an annual bonus, the amount of which is defined individually in the employment contract and ranges from 30% to 50% of the annual salary. The annual bonus is only awarded if the LOTOS Group achieves selected economic parameters and subject to achievement of individual tasks set for the given employee in the given year. Employees classified as Staff A are also eligible to receive a length-of-service award in accordance with the applicable collective bargaining agreement (first after 15 years of service, subsequent every five years). Staff A employment contracts also guarantee severance pay amounting to four or six months' salary.

6.2.3. 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 2015, 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 37. Remuneration paid to members of the Management Board of Grupa LOTOS S.A. for 2015 (PLN '000)

Management Board members	Short-term employee benefits (salaries and wages)	Management Board – subsidiaries*	Total remuneration paid
Paweł Olechnowicz	236	1,173	1,409
Marek Sokołowski	233	641	874
Mariusz Machajewski	237	641	878
Maciej Szozda	240	641	881
Zbigniew Paszkowicz	237	533	770
Total	**1,183**	**3,631**	**4,812**

**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*

***figures do not sum up due to rounding*

Table 38. Provision for annual bonuses for Management Board members (PLN '000)

Management Board members	Current liabilities annual bonus for 2015
Paweł Olechnowicz	62,182.44
Marek Sokołowski	62,182.44
Mariusz Machajewski	62,182.44
Maciej Szozda	62,182.44
Zbigniew Paszkowicz	62,182.44
Total	**310,912.20**

No short-term employee benefits in the form of annual bonuses for 2014 were paid to Management Board members in 2015.

Table 39. Remuneration paid to members of the Supervisory Board of Grupa LOTOS S.A. for 2015 (PLN '000)

Supervisory Board members	Term of office	Total remuneration paid
Wiesław Skwarko	Jan 1 – Dec 31 2015	41
Małgorzata Hirszel	Jan 1 – Dec 31 2015	42
Oskar Pawłowski	Jan 1 – Dec 31 2015	41
Michał Rumiński	Jan 1 – Dec 31 2015	41
Agnieszka Trzaskalska	Jan 1 – Dec 31 2015	42
Magdalena Bohusz-Boguszewska	Jan 1 – 30.06.2015	25
Katarzyna Witkowska	Jun 30 – Dec 31 2015	18
Robert Pietryszyn	Dec 23 – Dec 31 2015	0
Total		**252***

**figures do not sum up due to rounding*

As at December 31st 2015, the Company had not granted any loans or similar benefits to members of its management and supervisory staff.

As at December 31st 2015 and as at the issue date of this Directors' Report, i.e. March 3rd 2015, members of the Grupa LOTOS Supervisory Board did not serve on management or supervisory boards of Grupa LOTOS S.A.'s subsidiaries.

6.2.4. CONTROL SYSTEMS FOR EMPLOYEE STOCK OPTION PLANS

In 2015, the LOTOS Group did not operate any employee stock option plan.

6.3. ENVIRONMENTAL PROTECTION

The Act on Amendment of the Environmental Protection Law and Certain Other Acts published in 2014, implementing the requirements of the EU Directive on industrial emissions (Industrial Emissions Directive, IED) to Polish law, imposed several requirements on installations requiring an integrated permit (installations subject to IPPC). Grupa LOTOS S.A. met the requirement concerning preparation of a baseline report still in 2014.

Another requirement to be met are the conclusions on the application of the best available techniques (BAT Conclusions). BAT Conclusions for the refining sector were issued still in 2014, in the form of a decision of the European Commission. They describe the best available techniques reducing the environmental impact of each technological process carried out at refineries. In accordance with the law, operators of installations subject to IPPC in the European Union are obliged to implement the solutions specified in the document (or equivalent solutions) within four years from the publication of BAT Conclusions, i.e. by October 2018 in the case of refineries. Authorities issuing integrated permits are required to take into account the BAT Conclusions in the process of issuing the permit.

In April 2015, in accordance with applicable laws, the Marshal Office of the Gdańsk Province reviewed the integrated permit held by Grupa LOTOS S.A. Based on the review, the Company was requested in writing to supplement its integrated permit within a year with a description of how it monitors certain aspects of environmental impact of its installation specified in BAT Conclusions. Grupa LOTOS S.A. had already met other requirements of the BAT

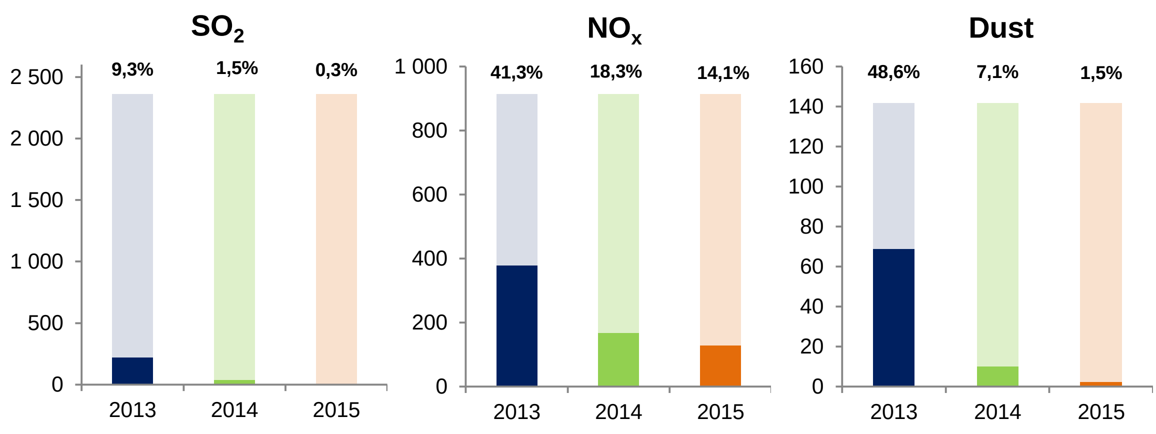
Conclusions. The request to amend the permit, containing the description referred to above, will be submitted within the deadline set by the Office.

Another change significant to the operations of Grupa LOTOS S.A., implemented under the amended Environment Protection Law, was the extension of the list of installations subject to IPPC. In line with the new regulations, an integrated permit should be obtained before July 1st 2015 also for the wastewater treatment plant at the Gdańsk refinery. A relevant request was submitted in April, and the required decision, under which the wastewater treatment plant was included as the third installation subject to IPPC in the integrated permit held by Grupa LOTOS S.A., was received in June 2015.

The year 2015 was the last effective year of the LOTOS Group's Corporate Social Responsibility Strategy for 2012-2015. One of the objectives of the strategy was to achieve in 2015 an average annual carbon (CO_2) intensity level at Grupa LOTOS S.A.'s Gdańsk refinery, expressed in kg CO_2/CWT, below 90% of the level recorded in 2011. Thanks to connection of the refinery to the gas grid in 2012 and use of natural gas as the fuel in the CHP plant and as feedstock for hydrogen generation, as well as several other upgrades, the average carbon intensity level at Grupa LOTOS S.A. was cut to 29.8 kg CO_2/CWT, which is 79% of the 2011 figure.

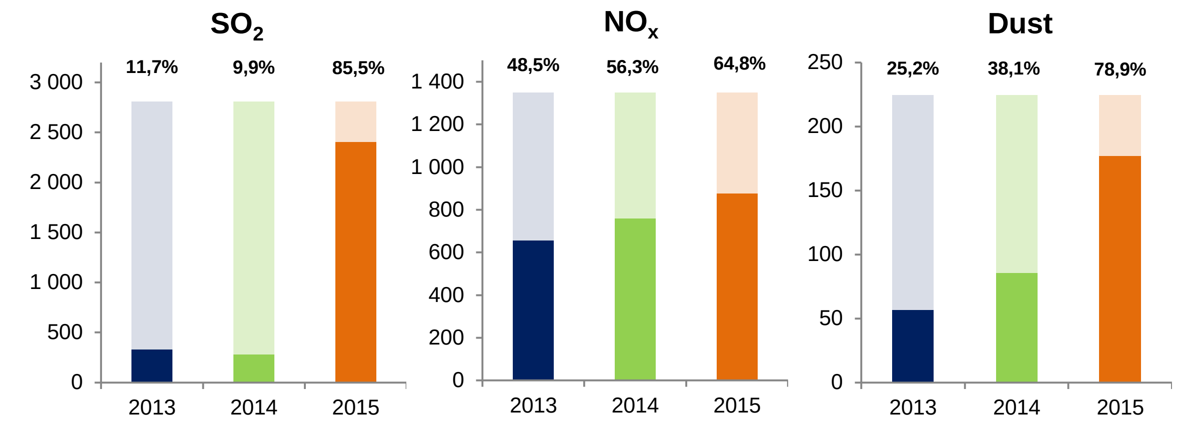
The environmental impact of Grupa LOTOS S.A.'s refinery in Gdańsk in 2015 was largely affected by falling oil prices and the resultant decrease in prices of finished goods. In the new price environment, the unit cost of energy generated from the refinery's finished goods turned out to be lower than the unit cost of energy generated from natural gas. This was an opportunity to reduce operating expenses and improve the Company's competitive edge. The larger share of finished goods in the energy and feedstock mix at Grupa LOTOS S.A.'s refinery in Gdańsk had a noticeable impact on sulfur dioxide (SO_2) and particulate emissions from the Company's installation. At one of the hydrogen generation units, the Company returned to using LPG as a feedstock on a temporary basis. This situation is expected to continue as long as the prices of finished goods remain low or until the unit cost of energy generated from natural gas is reduced. The share of heavier fractions of finished goods, their quality, as well as the amount of pollutant emissions were within the permitted levels set out in the integrated permit.

Figure 47. Emissions of main pollutants from Grupa LOTOS S.A.'s CHP plant to the air as percent of permitted values



SO_2 – sulfur dioxide; NO_x – nitrogen oxides

Figure 48. Emissions of main pollutants from Grupa LOTOS S.A.'s refinery units to the air as percent of permitted values



SO_2 – sulfur dioxide; NO_x – nitrogen oxides

6.4. MATERIAL AGREEMENTS AND COURT PROCEEDINGS IN 2015

6.4.1. AGREEMENTS SIGNIFICANT TO THE LOTOS GROUP'S OPERATIONS EXECUTED IN 2015

Table 40. Agreements significant to the LOTOS Group's operations in 2015

No.	Counterparty	Date	Subject matter	Estimated value, VAT exclusive (PLN)	More information	Link
1	Petraco Oil Company Ltd.	29.01.2015	Crude oil supplies	688m[1]	Current Report No. 5/2015	http://inwestor.lotos.pl/1185/p,194,i,832/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_spolkami_grupy_petraco
2	TOTAL Group	11.03.2015	Crude oil supplies	692m[1]	Current Report No. 8/2015	http://inwestor.lotos.pl/1185/p,194,i,836/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_total
3	Vitol S.A.	22.04.2015	Sale of fuel oil	720m[1]	Current Report No. 9/2015	http://inwestor.lotos.pl/1185/p,194,i,837/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_vitol_sa
4	CEPRO, a.s.	19.05.2015	Sale of diesel oil	697m[1]	Current Report No. 12/2015	http://inwestor.lotos.pl/1185/p,194,i,842/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_cepro_as
5	Mercuria Energy Trading S.A.	29.05.2015	Crude oil supplies	691m[1]	Current Report No. 15/2015	http://inwestor.lotos.pl/1185/p,194,i,847/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_mercuria_energy_trading_sa
6	Bank syndicate	30.06.2015	Financing of the EFRA Project	1,926m	Current Report No. 20/2015	http://inwestor.lotos.pl/1185/p,194,i,852/raporty_i_dane/raporty_biezace/zawarcie_umowy_na_finansowanie_projektu_efra
7	Kinetics Technology S.p.A., Maire Tecnimont Group	14.07.2015	Technical design, supply and construction of main units under the EFRA Project	1,260m	Current Report No. 24/2013	http://inwestor.lotos.pl/1185/p,194,i,856/raporty_i_dane/raporty_biezace/zawarcie_kontraktu_na_projektowanie_techniczne_dostawy_i_budowe_glownych_instalacji_programu_efra__umowa_znaczaca
8	Oxbow Energy	21.08.2015	Sale of coke	1,050m	Current Report No. 26/2015	http://inwestor.lotos.pl/1185/p,194,i,859/raporty_i_dane/raporty_biezace/zawarcie_umowy_sprzedazy_koksu

No.	Counterparty	Date	Subject matter	Estimated value, VAT exclusive (PLN)	More information	Link
	Solutions B.V.					
9	ExxonMobil Exploration, Production Norway AS	31.10.2015	Acquisition of significant assets	620m	Current Report No. 30/2015	http://inwestor.lotos.pl/1185/p,194,i,864/raporty_i_dane/raporty_biezace/nabycie_aktywow_o_znacznej_wartosci_przez_lotos_exploration_and_production_norge_na_norweskim_szelfie_kontynentalnym
10	Bank syndicate	18.11.2015	Inventory refinancing facility	1,592m	Current Report No. 33/2015	http://inwestor.lotos.pl/1185/p,194,i,867/raporty_i_dane/raporty_biezace/przedluzenie_umowy_kredytowej_na_refinansowanie_zapasow_grupy_lotos_sa
11	STATOIL Fuel & Retail	23.12.2015	Sale of fuels	3,161m[1]	Current Report No. 37/2015	http://inwestor.lotos.pl/1185/p,194,i,871/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_statoil
12	The Shell Group	23.12.2015	Sale of fuels	1,716m[1]	Current Report No. 39/2015	http://inwestor.lotos.pl/1185/p,194,i,873/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_shell
13	BP Group	30.12.2015	Sale of fuels	1,910m[1]	Current Report No. 42/2015	http://inwestor.lotos.pl/1185/p,194,i,876/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_kapitalowa_bp
14	The Vitol Group	31. 12.2015	Crude oil supplies	2,300m[1]	Current Report No. 44/2015	http://inwestor.lotos.pl/1185/p,194,i,878/raporty_i_dane/raporty_biezace/zawarcie_umow_o_wartosci_znaczacej_pomiedzy_grupa_lotos_sa_a_grupa_vitol

1) Total value of agreements with the counterparty since the issue 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).

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

In the year ended December 31st 2015, no related-party transactions were concluded on non-arms' length terms.

6.4.3. AGREEMENT WITH QUALIFIED AUDITOR OF FINANCIAL STATEMENTS

Based on the resolution passed by the Grupa LOTOS Supervisory Board on October 31st 2012, Ernst &Young Audit Sp. z o.o., entered in the register of entities qualified to audit financial statements maintained by the National Board of Chartered Auditors under entry No. 130, was selected as the qualified auditor to audit the Company's financial statements for 2013, 2014 and 2015.
On July 30th 2013, Grupa LOTOS S.A. and Ernst & Young Audit Sp. z o.o. of Warsaw executed a service contract, which provides, inter alia, for:

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

Table 41. Total fees for audit, review and verification procedures (PLN '000)

	2015	**2014**
Audit of the full-year separate and consolidated financial statements of selected companies of the LOTOS Group*	**1,575**	1,475
Assurance services	**799**	1,746
Tax advisory services	**316**	599
Other services**	**113**	26
Total	**2,802**	3,846

*** Remuneration for the audit of accounts of selected LOTOS Group companies is paid under separate agreements between the auditor and each of the selected LOTOS Group companies.*
*** fees paid for auditor training services.*

6.4.4. COURT, ARBITRATION OR ADMINISTRATIVE PROCEEDINGS

In 2015 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.

7. GRUPA LOTOS SHARES

7.1. GRUPA LOTOS SHARES ON THE WARSAW STOCK EXCHANGE

The Company shares are listed on the Warsaw Stock Exchange (GPW). 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 2015, the Grupa LOTOS share capital totalled PLN 184,873,362 and comprised 184,873,362 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,
iii. 16,173,362 Series C ordinary bearer shares,
iv. 55,000,000 Series D 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 2015 was approximately PLN 5bn.

Figure 49. Share price (PLN) and trading volume (number of shares) since first listing on the WSE

In 2015, Grupa LOTOS S.A. shares were constituents of the following indices:

Return 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 30 − calculated based on the value of the 30 largest and most liquid stocks traded on the WSE Main Market
- mWIG40 − calculated based on the value of the 40 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 S.A. share price performance vs. index performance

2015 turned out to be a good year for investors on the US market. After a strong downward trend in August, the main US indices managed to recover: the S&P 500 closed 2015 with a small loss of 0.7% and Nasdaq went up 5.9%. The Shanghai Composite index went up 57.2% in the first half of 2015. The local negative economic signals and data caused the index to fall in the middle of the year. Shanghai Composite eventually closed the year up 9%.

At the same time, global capital shifted away from emerging markets, whose slower economic growth, growing political risk, and the slowdown in Chinese economy discouraged investments. Polish indices closed the year with significant losses.

The index of all companies listed on the Main Market, WIG, dropped 9.6%, with the annual change in WIG-20 being negative at -19.7%.

Looking at stock performance by sector, WIG-PALIWA gained 32.2% while WIG-ENERGETYKA went down by 31.38% The RESPECT corporate social responsibility index lost over 15.1% during 2015.

Grupa LOTOS S.A. shares outperformed the market in 2015. Their price remained within the PLN 23.83–33.15 range and closed the year at PLN 27.00.

In 2015, the average number of LOTOS shares changing hands during one trading session was 314,239, up 54% year on year. The total value of trading in the stock was in excess of PLN 2bn, representing 1.1% of total WSE trading, with an average of 1,534 trades per session.

Grupa LOTOS shares

	2009	2010	2011	2012	2013	2014	2015
Free float shares (million shares)	**129.87**	**129.87**	**129.87**	**129.87**	**129.87**	**129.87**	**184.87**
Price of Grupa LOTOS shares (PLN)							
Low	7.21	25.05	22.26	21.30	32.97	24.05	**23.83**
High	32.80	37.85	49.50	43.78	45.45	40.96	**33.15**
Closing price	31.80	36.35	23.30	41.20	35.45	25.50	**27**
Rate of return at end of period (%)	166.11	14.31	-35.9	76.82	-13.96	-28.07	**4.40**

	2009	2010	2011	2012	2013	2014	2015
Trade in Grupa LOTOS shares							
Trading value (PLNm)	3,642.56	3,684.33	3,299.07	2,013.15	2,211.43	1588.52	**2,227.56**
Share in trade (%)	1.11	0.88	1.31	1.07	1.00	0.77	**1.10**
Average trading volume per session	381,938	234,464	377,048	282,163	229,877	203,839	**314,239**
Average number of trades per session	945	699	967	810	877	851	**1,534**

	2009	2010	2011	2012	2013	2014	2015
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	**4,991.58**
Book value (PLNm)	6,846.20	7,513.50	7,782.40	9,066.40	9,189.60	8,258.50	**7,712.20**
EV (PLNm)	9,513.72	10,679.70	10,232.00	11,642.30	10,319.79	9,627.39	**11,131.3**
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	**0.65**
EV/EBITDA (x)	12.32	7.06	5.70	11.58	12.85	-	**10.22**

**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.*

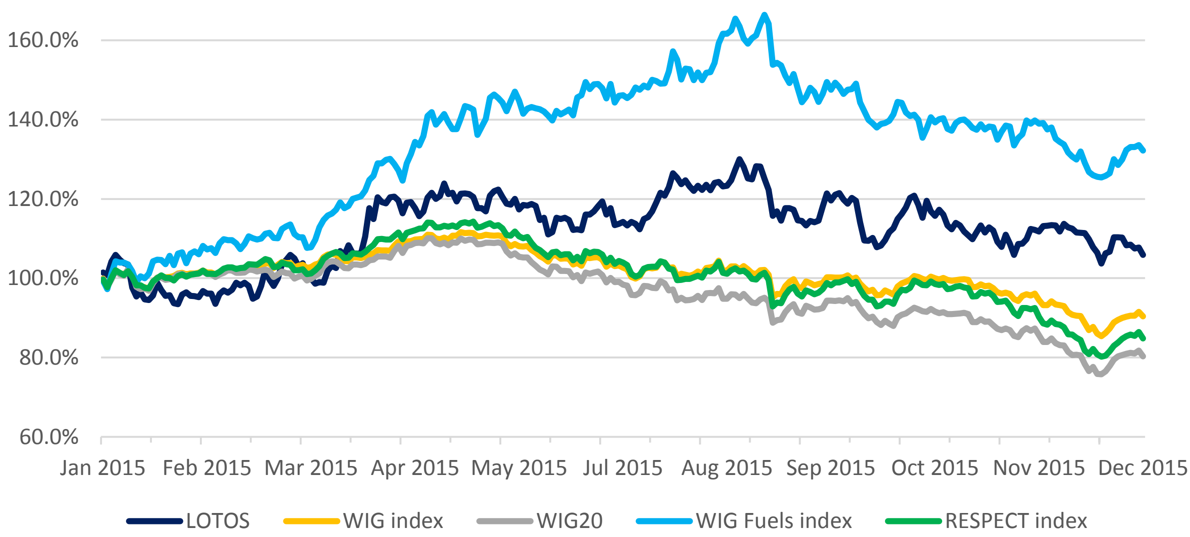
** P/E – Price/Earnings*

** P/BV – Price/Book Value*

** EV/EBITDA − Enterprise Value/EBITDA*

Figure 50. Price of Grupa LOTOS shares in 2015

Figure 51. Grupa LOTOS share price performance vs. index performance in 2015



* Rebased (100 = closing price at December 30th 2014)

Brokers' recommendations on Grupa LOTOS shares

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

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 20 recommendations on the Company shares in 2015:

- 5 BUY recommendations
- 5 ACCUMULATE recommendations
- 6 HOLD recommendations
- 1 REDUCE recommendation
- 3 SELL recommendations

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

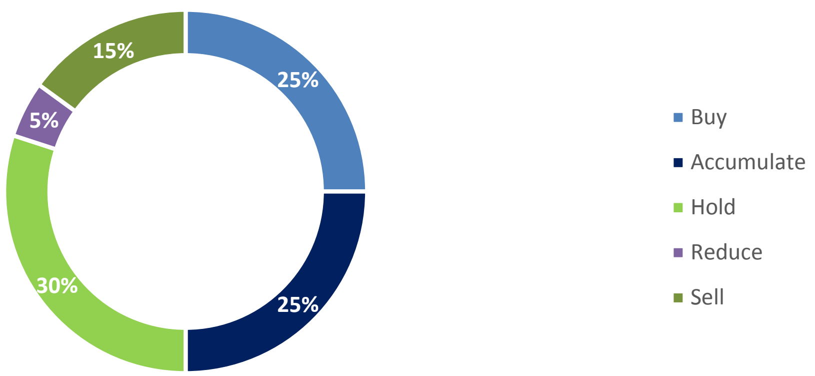
*ACCUMULATE - total expected rate of return will be between 5% and 15% in 12 months.

* 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.

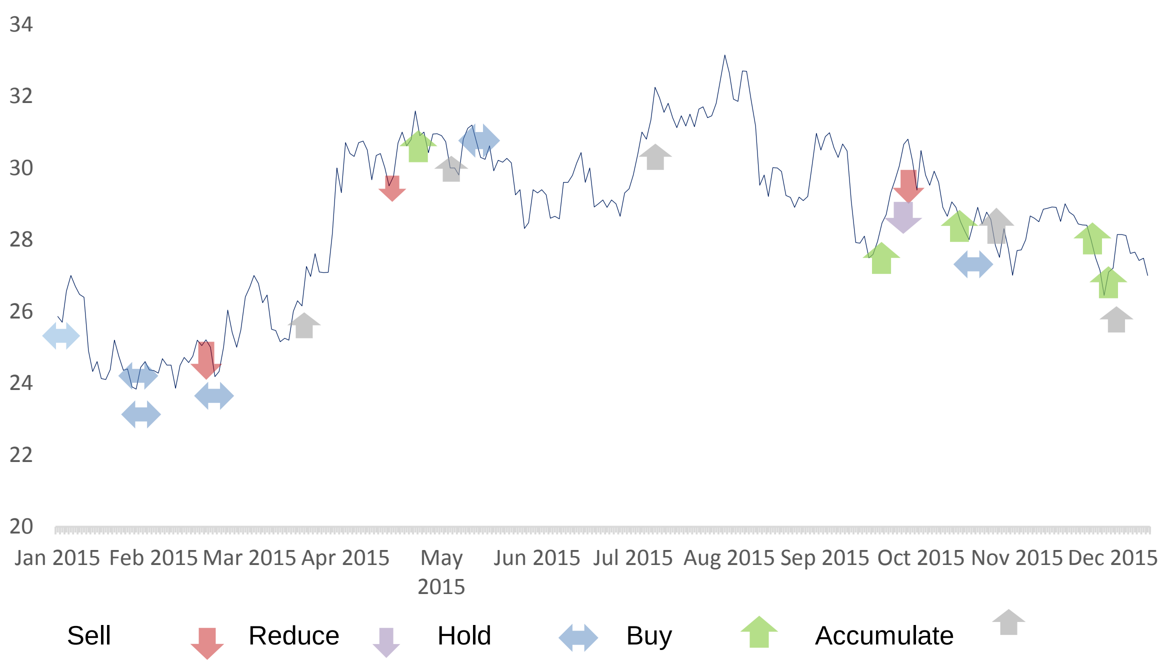
Figure 52. Structure of broker recommendations on Grupa LOTOS shares in 2015



The target price of Grupa LOTOS shares in brokers' research reports fluctuated from PLN 22.90 to PLN 33.50, compared with PLN 25.80 to PLN 54.07 in 2014. The average target price in 2015 was PLN 30.47 (2014: PLN 37.90).

Grupa LOTOS shares traded within the range from PLN 23.83 to PLN 33.15. The closing price on the last day of 2015 was PLN 27.00.

Figure 53. 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)*

7.1 DIVIDEND POLICY

Distributions from profit for 2011−2015 depended 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 cover the PLN 1,285,909,803.46 net loss for 2014 from future years' profits.

Taking into consideration the Management Board's proposal, on June 1st 2015 the General Meeting resolved to cover Grupa LOTOS S.A.'s net loss of PLN 1,285,909,803.46 for 2014 from future years' profits.

Table 42. 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	-
2014	**0.0**	**0.0**	**27**	**-**

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

Table 43. Historical dividend per share (PLN)

Financial year	Dividend per share	% of net profit	Dividend record date	Dividend payment date
2005	0.0	0.0	-	-
2006	0.4	10.1	Jun 11 2007	not later than Jul 31 2007
2007	0.0	0.0	-	-
2008	0.0	0.0	-	-
2009	0.0	0.0	-	-
2010	0.0	0.0	-	-
2011	0.0	0.0	-	-
2012	0.0	0.0	-	-
2013	0.0	0.0	-	-
2014	**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.*

7.2 ACQUISITION OF TREASURY SHARES

Grupa LOTOS S.A. did not buy back any own shares in 2015.

7.3 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 February 26th 2016.

Table 44. 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 S.A. shares	Par value of shares (PLN)
Management Board, including:	9,636	9,636
Mr Marek Sokołowski	**8,636**	**8,636**
Mr Zbigniew Paszkowicz	**1,000**	**1,000**
Supervisory Board	0	0
Total	**9,636**	**9,636**

** Based on representations as at February 26th 2016.*

To the best of the Company's knowledge, as at February 26th 2016 the Management and Supervisory Board members did not hold any shares in Grupa LOTOS S.A.'s related companies.

7.4 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.

8. CORPORATE GOVERNANCE

8.1. SHAREHOLDING STRUCTURE

8.1.1. SIGNIFICANT HOLDINGS OF SHARES

By January 9th 2015, the share capital of Grupa LOTOS S.A. did not change relative to 2014 and comprised 129,873,362 fully paid-up ordinary shares with a par value of PLN 1 per share. Each Company share confers the right to one vote at the General Meeting and carries the right to dividend.

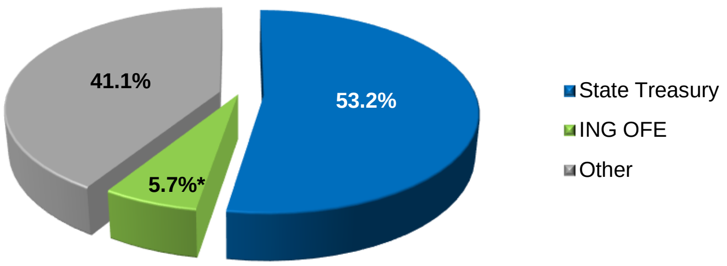
On January 9th 2015, the District Court for Gdańsk-Północ in Gdańsk, 7th Commercial Division of the National Court Register, registered an increase in the share capital of Grupa LOTOS S.A. from PLN 129,873,362 to PLN 184,873,362, effected through the issue of 55,000,000 Series D ordinary bearer shares 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. The total issue cost of Series D shares was PLN 23,538 thousand (VAT-exclusive), and included the cost of preparing, conducting and marketing the Offering: PLN 15,197 thousand (remuneration paid to the Offering Managers for their services provided in connection with the Offering, including placement and underwriting of the Offering), and the cost of preparing the prospectus, including the cost of advisory services: PLN 8,341 thousand.

The average cost of the subscription per new share was PLN 0.43.

The above costs were charged to equity, reducing the share premium.

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 and then Nationale Nederlanden OFE (formerly ING OFE) announced that as at December 31st 2015 it held 5.73% of total voting rights at the Company's General Meeting.

Figure 54. Shareholding structure of Grupa LOTOS S.A. as at December 31st 2015



** Based on the investment funds' annual asset structures as at December 31st 2015 (Polish Press Agency).*

Table 45. Share capital and voting rights at the General Meeting held by significant shareholders of Grupa LOTOS as at December 31st 2015

Shareholder	Share in share capital/total voting rights at the GM
State Treasury	**53.2%**
Nationale Nederlanden OFE	**5.7%**
Other	**41.1%**
Total	**100.0%**

Table 46. Pension funds in the shareholding structure of Grupa LOTOS S.A. as at December 31st 2015*

Pension fund	Value of holding in Grupa LOTOS S.A.	% of share capital held	% change in shareholding, 2015 vs. 2014
NN Otwarty Fundusz Emerytalny	289,056,877.97	**5.73%**	**-2.84%**
Otwarty Fundusz Emerytalny PZU	252,071,054.21	**4.99%**	**0.00%**
Aviva Otwarty Fundusz Emerytalny	169,037,730.21	**3.35%**	**0.28%**
Nordea Otwarty Fundusz Emerytalny	48,386,000.92	**0.96%**	**0.37%**
Allianz Polska Otwarty Fundusz Emerytalny	41,360,940.38	**0.82%**	**-0.84%**
Axa Otwarty Fundusz Emerytalny	24,834,512.36	**0.49%**	**-0.22%**
Generali Otwarty Fundusz Emerytalny	19,753,623.41	**0.39%**	**0.32%**
Pekao Otwarty Fundusz Emerytalny	16,421,120.66	**0.33%**	**0.04%**
Aegon Otwarty Fundusz Emerytalny	16,256,796.39	**0.32%**	**0.32%**

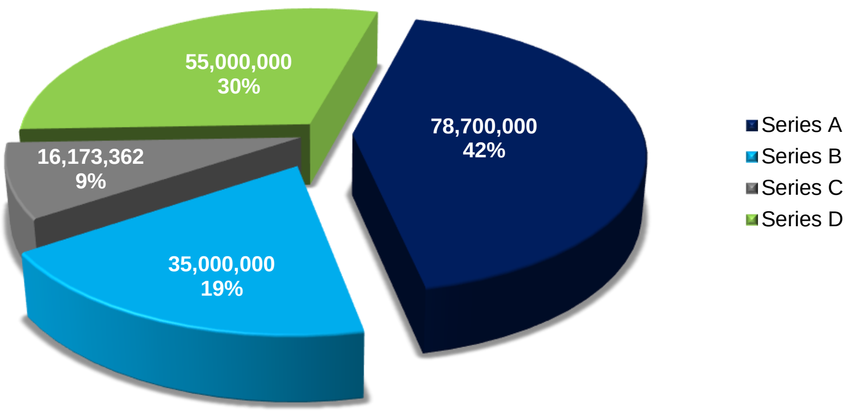
PKO BP BANKOWY Otwarty Fundusz Emerytalny	15,719,963.72	**0.31%**	**0.01%**
Otwarty Fundusz Emerytalny Pocztylion	10,528,387.34	**0.21%**	**-0.09%**
Amplico Otwarty Fundusz Emerytalny	0	**0.00%**	**-0.06%**

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

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 55. Grupa LOTOS share capital structure



In 2015 and as at the issue date 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 2015, there were no changes in large holdings of Grupa LOTOS shares, which means that the remaining 46.81% of the share capital was free float

On July 1st 2015, in Current Report No. 23/2015, 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 2015.

Table 47. Shareholders holding 5% or more of total voting rights at the Annual General Meeting of the Company held on June 30th 2015

Shareholder	Number of Grupa LOTOS shares held	% of total voting rights at GM	% of share capital held
State Treasury	98,329,515	75.82%	53.19%
ING OFE	11,740,000	9.05%	6.35%
OFE PZU Złota Jesień	9,100,000	7.02%	4.92%

In 2016, Grupa LOTOS S.A. published a list of shareholders holding 5% or more of total voting rights at the Extraordinary General Meeting of the Company convened for January 27th 2016.

Table 48. Shareholders holding at least 5% of total voting rights at the Extraordinary General Meeting of the Company held on January 27th 2016

Shareholder	Number of Grupa LOTOS shares held	% of total voting rights at GM	% of share capital held
State Treasury	98,329,515	75.84%	53.19%
ING OFE	10,584,287	8.16%	5.73%
OFE PZU Złota Jesień	9,100,000	7.02%	4.92%

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

The Company has not issued any securities conferring special control powers. As at the issue date of this Directors' Report, the Company has no information on any shareholder agreements on joint exercise of voting rights (for more information, see Section 5.1.4).

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

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

8.1.2. 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.

8.1.3. 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.

8.1.4. 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.

8.1.5. RESTRICTIONS ON TRANSFERABILITY OF SECURITIES

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

8.2. THE COMPANY'S GOVERNING BODIES

Figure 56. Corporate governance structure of Grupa LOTOS S.A. as at December 31st 2015

GENERAL MEETING
(Annual General Meeting / Extraordinary General Meeting)

SUPERVISORY BOARD
(appointed by the General Meeting)

STRATEGY AND DEVELOPMENT COMMITTEE

recommendations on matters related to planned investment programmes with a material bearing on the Company's asset base

Members	Position during the Supervisory Board's 9th term of office	Term of office
Wiesław Skwarko	Chairman	Jul 28 2014 - Jan 27 2016
Małgorzata Hirszel	Member	Jul 28 2014 - Jan 27 2016
Michał Rumiński	Member	Jul 28 2014 - Jan 27 2016
Agnieszka Trzaskalska	Member	Jul 28 2014 - Jan 27 2016
Magdalena Bohusz-Boguszewska	Member	Jul 28 2014 - Jun 30 2015
Katarzyna Witkowska	Member	Jul 31 2015 - Jan 27 2016
Robert Pietryszyn	Chairman	Feb 24 2016 -
Katarzyna Witkowska	Member	Feb 24 2016 -
Cezary Krasodomski	Member	Feb 24 2016 -
Dariusz Figura	Member	Feb 24 2016 -

ORGANISATION AND MANAGEMENT COMMITTEE

recommendations regarding the management structure, organisation-related solutions, remuneration system and recruitment of personnel, with a view to enabling the Company to achieve its strategic objectives

Members	Position during the Supervisory Board's 9th term of office	Term of office
Agnieszka Trzaskalska	Chairperson	Jul 28 2014 - Jan 27 2016
Małgorzata Hirszel	Member	Jul 28 2014 - Jan 27 2016
Oskar Pawłowski	Member	Jul 28 2014 - Jan 27 2016
Michał Rumiński	Member	Jul 28 2014 - Jan 27 2016
Katarzyna Witkowska	Member	Jul 31 2015 - Jan 27 2016
Robert Pietryszyn	Chairman	Feb 24 2016 -
Katarzyna Lewandowska	Member	Feb 24 2016 -
Maria Sierpińska	Member	Feb 24 2016 -
Cezary Krasodomski	Member	Feb 24 2016 -

AUDIT COMMITTEE

ongoing advisory support with respect to implementation of the policies related to budgetary and financial reporting, the Company's internal control function and cooperation with its auditors

Members	Position during the Supervisory Board's 9th term of office	Term of office
Michał Rumiński	Chairman	Jul 28 2014 - Jan 27 2016
Oskar Pawłowski	Member	Jul 28 2014 - Jan 27 2016
Wiesław Skwarko	Member	Jul 28 2014 - Jan 27 2016
Magdalena Bohusz-Boguszewska	Member	Jul 28 2014 - Jun 30 2015
Agnieszka Trzaskalska	Member	Jul 31 2015 - Jan 27 2016
Maria Sierpińska	Chairperson	Feb 24 2016 -
Katarzyna Witkowska	Member	Feb 24 2016 -
Katarzyna Lewandowska	Member	Feb 24 2016 -
Dariusz Figura	Member	Feb 24 2016 -

MANAGEMENT BOARD
(appointed by the Supervisory Board)

8.2.1. GENERAL MEETING OF GRUPA LOTOS S.A.

The powers and proceedings of the General Meeting (GM) of Grupa LOTOS S.A. are stipulated in detail in the Company's Articles of Association (consolidated text of 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 2015, the Annual General Meeting was convened for June 1st 2015. At the request of the State Treasury (the main shareholder of Grupa LOTOS S.A.) the General Meeting was adjourned. The main shareholder justified the request stating that it needed time for further analysis regarding the agenda item relating to changes in the composition of the Grupa LOTOS Supervisory Board. The Annual General Meeting resumed its proceedings on June 30th 2015 at the Company's registered office.

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.

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.

In 2015, no Extraordinary General Meeting was held.

At the request of the State Treasury, a shareholder, submitted on December 22nd 2015, on December 29th 2015 the Company's Management Board convened an Extraordinary General Meeting, which was held on January 27th 2016.

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

Any matter to be discussed at a General Meeting is subject to prior consideration by the Supervisory Board. No resolution may be passed on matters not included in the agenda of the General Meeting, unless the Company's entire share capital is represented at the GM and no objections to the adoption of such resolution are raised by any of the persons participating in the GM, with the exception of motions to convene an Extraordinary General Meeting and procedural motions. Resolutions of a General Meeting are adopted by an absolute majority of votes, unless the Articles of Association or Commercial Companies Code provide otherwise. Resolutions and proceedings of a General Meeting are recorded by a notary public. The minutes of the GM are signed by the Chairman of the GM and the notary public.

8.2.2. SUPERVISORY BOARD OF GRUPA LOTOS S.A.

The Supervisory Board of Grupa LOTOS S.A. operates under the Company's Articles of Association (consolidated text of February 23rd 2015) 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.

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.

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 ninth 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. The composition of the Supervisory Board did not change until June 30th 2015.

In exercise of its powers, acting in accordance with Art. 385.1 of the Commercial Companies Code and Art. 9.4 and Art. 11.2 of the Company's Articles of Association, the Annual General Meeting convened for June 1st 2015, which resumed its proceedings on June 30th 2015 after an adjournment, removed Ms Magdalena Bohusz-Boguszewska from the Supervisory Board by Resolution No. 21. Concurrently, by Resolution No. 22 the Annual General Meeting appointed Ms Katarzyna Iskra (currently Katarzyna Witkowska – surname changed on July 27th 2015) as Member of the Supervisory Board.

Pursuant to Article 11.2 of the Articles of Association, as long as it holds Company shares, the State Treasury, represented by the Minister of State Treasury, is entitled to directly appoint and remove one member of the Supervisory Board. The shareholder exercised its right and on December 23rd 2015 appointed Mr Robert Pietryszyn as a Supervisory Board member.

Following these changes, the composition of the Supervisory Board as at December 31st 2015 was as follows: Mr Wiesław Skwarko, Ms Agnieszka Trzaskalska, Mr Oskar Pawłowski, Ms Małgorzata Hirszel, Ms Katarzyna Witkowska, Mr Michał Rumiński and Mr Robert Pietryszyn.

The State Treasury, the Company's shareholder, represented by the Minister of the State Treasury, in exercise of its rights set out in Art. 11.2 of the Company's Articles of Association, on January 26th 2016 removed Mr Robert Pietryszyn from the Supervisory Board.

The Extraordinary General Meeting of the Company held on January 27th 2016, convened at the request of the State Treasury, acting pursuant to Art. 385.1 of the Commercial Companies Code and Art. 9.4 of the Company's Articles of Association, changed the composition of the Grupa LOTOS Supervisory Board of the ninth term of office by Resolutions No. 3–12. Concurrently, in line with Section 6.5 of the Rules of Procedure for the General Meeting, by Resolution No. 2 the General Meeting resolved not to adopt a resolution to set the number of Supervisory Board members, leaving it unchanged at seven.

On January 27th 2016, the Extraordinary General Meeting of Grupa LOTOS S.A. removed the following persons from the Supervisory Board: Mr Wiesław Skwarko – Chairman, Ms Agnieszka Trzaskalska – Deputy Chairperson, Mr Oskar Pawłowski – Secretary, Ms Małgorzata Hirszel and Mr Michał Rumiński, and appointed the following persons to the Supervisory Board: Mr Robert Pietryszyn, as the Chairman, Ms Katarzyna Lewandowska, Mr Dariusz Figura, Mr Cezary Krasodomski and Ms Maria Sierpińska.

Following the General Meeting's decision, as of January 27th 2016 the Supervisory Board of Grupa LOTOS S.A. of the ninth term of office is composed of Mr Robert Pietryszyn, Mr Dariusz Figura, Mr Cezary Krasodomski, Ms Katarzyna Lewandowska, Ms Maria Sierpińska and Ms Katarzyna Witkowska.

By the issue date of this report, the State Treasury, represented by the Minister of the State Treasury, did not re-exercise its right set forth in Art. 11.2 of the Articles of Association, under which it may directly appoint and remove one member of the Supervisory Board.

On February 24th 2016, the Supervisory Board of the ninth joint term of office held the first meeting in its new composition and appointed Ms Katarzyna Lewandowska as Deputy Chairwoman of the Board (Resolution No. 68/IX/2016), and Mr Cezary Krasodomski as Secretary of the Board (Resolution No. 69/IX/2016) During the meeting, the Supervisory Board also determined the composition of the Supervisory Board's standing committees, which had not operated from January 27th 2016, when the General Meeting resolved to change the composition of the Supervisory Board (for more information, see Table 45).

Table 49. Composition of the Supervisory Board of Grupa LOTOS S.A. of the ninth term.

SUPERVISORY BOARD MEMBERS	POSITION	ON THE SUPERVISORY BOARD OF THE 9TH TERM	CAREER PATH AND POWERS
 Wiesław Skwarko	Chairman	Jun 30 2014– Jan 27 2016	-
 Agnieszka Trzaskalska	Member Deputy Chairwoman	Jun 30 2014– Jul 28 2014 Jul 28 2014– Jan 27 2016	-
 Oskar Pawłowski	Member Secretary	Jun 30 2014– Jul 28 2014 Jul 28 2014– Jan 27 2016	-
 Małgorzata Hirszel	Member	Jun 30 2014– Jan 27 2016	-
 Magdalena Bohusz-Boguszewska	Member	Jun 30 2014 – Jun 30 2015	-

 **Michał Rumiński**	Member	Jun 30 2014– Jan 27 2016	-
 **Katarzyna Witkowska**	Member	Jun 30 2015–	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-75
 **Robert Pietryszyn**	Member Chairman	Dec 23 2015 – Jan 26 2016 Jan 27 2016–	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-79
 **Dariusz Figura**	Member	Jan 27 2016–	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-80
 **Cezary Krasodomski**	Member Secretary	Jan 27 2016– Feb 24 2016 Feb 24 2016	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-78

 **Katarzyna Lewandowska**	Member Deputy Chairwoman	Jan 27 2016– Feb 24 2016 Feb 24 2016	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-81
 **Maria Sierpińska**	Member	Jan 27 2016−	http://inwestor.lotos.pl/1137/lad_korporacyjny/struktura_organizacyjna#person-82

Delegation of specific duties to individual Supervisory Board members

The Supervisory Board may delegate its members to individually perform certain tasks or functions.

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. Mr Oskar Pawłowski's delegation expired on January 27th 2016 upon his removal from the Grupa LOTOS Supervisory Board.

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. Ms Magdalena Bohusz-Boguszewska's delegation expired on June 30th 2015 upon her removal from the Grupa LOTOS Supervisory Board.

Ms Katarzyna Witkowska – delegated by virtue of Supervisory Board Resolution No. 66/IX/2015 of December 18th 2015 to independently exercise detailed and ongoing supervision of the EFRA – Effective Refining Project.

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

The Management Board of Grupa LOTOS S.A. operates pursuant to the following documents: the Company's Articles of Association and the Rules of Procedure for the Management Board (adopted by virtue of Management Board Resolution No. 2/IX/2015 dated July 6th 2015 and approved by virtue of Supervisory Board Resolution No. 56/IX/2015 dated July 31st 2015). The documents are available in the 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.

The composition of Grupa LOTOS S.A.'s Management Board in 2015 was as follows:

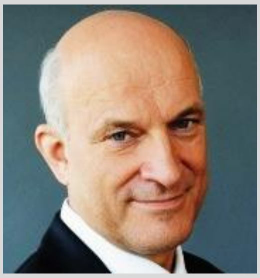
From January 1st 2015 until the end of the 8th term of office (June 28th 2015), the Management Board was composed of:

- 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

In connection with the expiry of the Management Board's eighth term of office, as part of a recruitment procedure the Supervisory Board appointed five Management Board members for the ninth joint term of office that began on June 29th 2015. Concurrently, the Supervisory Board decided to change the powers and responsibilities of members of the Company's Management Board.

As a result, from June 29th 2015 to December 31st 2015 and as at the issue date of this Report the composition of the Management Board was as follows:

Management Board: composition and powers



President of the Management Board
Term of service on the Management Board of Grupa LOTOS S.A.: since March 12th 2002, as President of the Management Boards of the fourth, fifth, sixth, seventh, eighth and ninth term.

Paweł Olechnowicz

Qualifications, professional experience and achievements

He is in charge of, and takes responsibility for, the overall management and direction of the LOTOS Group's operations. Since September 2007, on the Board of Directors of LOTOS Exploration and Production Norge AS and since April 2011 on the Board of Directors of LOTOS Geonafta – in both cases as the Chairman. A graduate of the Kraków University of Science and Technology (the Faculty of Technology and Mechanisation of Foundry Engineering), completed a post-graduate course in Organization, Economics and Industrial Management at the Gdańsk University of Technology, MBA INSEAD, 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 CEO 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. in 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.

Vice-President of the Management Board and Chief Financial Officer Term of service on the Management Board of Grupa LOTOS S.A.: since June 19th 2006, as Vice-President of the Management Boards of the sixth, seventh, eighth and ninth term.

Mariusz Machajewski

Qualifications, professional experience and achievements

As Vice-President of the Management Board and Chief Financial Officer, he manages and supervises the financial area. 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. 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 participated in preparations to Grupa LOTOS' debut 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 was responsible for the Company's share capital increase carried out in 2014 and for arranging financing for the ongoing 'EFRA − Effective Refining' Project,

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

Zbigniew Paszkowicz

Qualifications, professional experience and achievements

As Vice-President of the Management Board, Chief Exploration and Production Officer, he manages and supervises the Company's operations in the areas of hydrocarbon exploration, development of hydrocarbon reserves and production of hydrocarbons

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.

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

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

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

He also provided support to the CEO within his remit and in January 2012 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 platform 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. As part of the Group's strategic projects, in March 2014 the then new LOTOS Petrobaltic rig was transported into the Baltic Sea. Mr Paszkowicz supervised the capex programme to develop the B8 field, involving in particular the conversion of the Petrobaltic rig from a drilling rig into a production platform, as well as the construction of the subsea production infrastructure. In 2015, he monitored the acquisition of an interest in the Sleipner production field on the Norwegian Continental Shelf, an important hub for processing and distribution of natural gas extracted from the Norwegian Continental Shelf.

Vice-President of the Management Board, Chief Strategy and Development Officer Since April 19th 2002, Vice-President of the Management Boards of the fourth, fifth, sixth, seventh, eighth and ninth term.

Marek Sokołowski

Qualifications, professional experience and achievements

As Vice-President of the Management Board, Chief Strategy and Development Officer, he manages and supervises the development

and implementation of the Company's strategy, strategic development projects, and Company's security in the area of environmental protection, product safety, occupational health & safety, and IT.

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.

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 engaged, among other efforts, in the execution of the EFRA project, the purpose of which is to achieve significant improvements in refining margins by increasing the crude distillate yield Mr Sokołowski has been a member of the Board of the Polish Chamber of Chemical Industry.

Maciej Szozda

Vice-President of the Management Board, Chief Refining and Marketing Officer Since July 1st 2009, Vice-President of the Management Boards of Grupa LOTOS S.A. of the seventh, eighth and ninth terms.

Qualifications, professional experience and achievements

As the Vice-President of the Management Board, Chief Refining and Marketing Officer, he directs and supervises the Company's operations in the downstream area.

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.

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.

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) adoption or amendment of the Rules of Procedure for the Management Board,

2) adoption or amendment of the Organisational Rules for the Company, including the Company's organisational structure,

3) adoption of any rules or regulations which are required for the Company by law,

4) granting of a power of proxy (in which case a resolution passed unanimously by all Management Board members shall be required),

5) adoption of the Company's annual budget,

6) adoption of the Strategy for the LOTOS Group,

7) adoption of the Company's financial statements for the previous financial year, prepared in accordance with the International Financial Reporting Standards, along with the Directors' Report on the Company's operations in the previous financial year (not later than within three months of the reporting date),

8) adoption of the consolidated financial statements for the previous financial year, prepared in accordance with the International Financial Reporting Standards, along with the Directors' Report on the LOTOS Group's operations in the previous financial year (not later than within three months of the reporting date),

9) convening of annual and extraordinary General Meetings on the Management Board's own initiative or at the request of a shareholder or shareholders representing at least one-twentieth of the share capital, as well as in other cases provided for in the Commercial Companies Code (in due time),

10) determining a General Meeting's agenda,

11) any equity investments or projects involving capital expenditures made by the Company, including assumption of related liabilities, if such investments or projects entail expenses or charges exceeding PLN 100,000 (VAT exclusive),

12) exercise of the Company's voting rights at its subsidiaries' General Meetings with regard to:

a) appointment and removal of members of the Management and Supervisory Boards,

b) coverage of loss,

c) share capital increase or reduction,

d) mergers with other companies or company transformations,

e) sale or lease of the company's business and/or its encumbrance with usufruct rights, appointment or removal of those management and supervisory board members who are appointed and removed directly by Grupa LOTOS S.A.,

13) formation of companies under commercial law and foreign companies,

14) acquisition and disposal of shares and interests in companies,

15) 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,

16) acquisition or disposal of property, perpetual usufruct rights or an interest

in property,

17) establishment and joining of partnerships, organisations or ventures which involve unlimited liability enforceable against the Company's assets,

18) any matters which require the Supervisory Board's and General Meeting's resolution,

19) matters falling outside the scope of day-to-day management of the business,

20) matters which have been objected to by at least one of the Management Board members,

21) matters which must be resolved by way of the Management Board's resolution if so required by the President of the Management Board or at least half of the Management Board members, and which fall within the scope of responsibilities of individual members of the Management Board.

Ordinary matters of the Company, not requiring the Management Board's resolution, shall be carried out by the President independently and by individual Management Board members in line with the division of powers and responsibilities defined under the Organisational Rules of Grupa LOTOS S.A., pursuant to which:

- the President of the Management Board directs and supervises the Company's operations in the management area,
- the Vice-President of the Management Board, Chief Exploration and Production Officer, directs and supervises the Company's operations in the areas of hydrocarbon exploration, development of hydrocarbon reserves and production of hydrocarbons,
- the Vice-President of the Management Board, Chief Financial Officer, directs and supervises the Company's operations in the financial area,
- the Vice-President of the Management Board, Chief Refining and Marketing Officer, directs and supervises the Company's operations in the downstream area,
- the Vice-President of the Management Board, Chief Strategy and Development Officer, directs and supervises the Company's operations with respect to development and implementation of the Company's strategies, development projects, and aspects related to the Company's security.

Moreover, in line with the adopted division of responsibilities, the President of the Management Board conducts and supervises the following corporate matters:

- 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

Pursuant to the provisions of 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.

In 2015, the eighth joint term of office of the Management Board of Grupa LOTOS S.A. expired. The current, ninth term expires in 2018.

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

An amendment to the Articles of Association requires that a relevant resolution be passed by the General Meeting by an absolute majority of votes, save for amendments to Article 10.1 of the Articles of Association, which require that four fifths of 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 the consolidated text of the Company's Articles of Association incorporating the amendments made under the Resolution, which took place on February 23rd 2015.

8.3. CORPORATE GOVERNANCE PRINCIPLES APPLICABLE AT GRUPA LOTOS S.A. IN 2015

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. Since its IPO in June 2005, Grupa LOTOS S.A. has complied with most of the guidance provided in this document. As of the beginning of 2008, the Company followed the Code of Best Practice for WSE Listed Companies, and then its versions as amended by WSE's Supervisory Board in its Resolutions of October 19th 2011 and November 21st 2012. As of January 1st 2016, the Company has complied with the revised Code of Best Practice for WSE Listed Companies 2016.

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.

Obligatory corporate governance principles observed by Grupa LOTOS S.A. in 2015

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 and the new Code of Best Practice for WSE Listed Companies 2016

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 and 2015, the Company did not publish any reports on instances of non-compliance with obligatory corporate governance rules.

As of January 1st 2016, the Company complies with the revised Code of Best Practice for WSE Listed Companies 2016.

On January 4th 2016, in the Investor Relations section of its website Grupa LOTOS S.A. published a list of Best Practices it applies or which it intends to comply with in 2016, including information on three exceptions together with grounds for non-compliance:

"The Company publishes:

I.Z.1.16. information about the planned transmission of a general meeting not later than seven days before the date of the general meeting: **not applied.**

Commentary: The Company has never broadcast any of its General Meetings, but it may do so in the future.

I.Z.1.20. an audio or video recording of a general meeting: **not applied.**

Commentary: The Company has never made an audio or video recording of its General Meeting.
In the Company's opinion, the form of documentation of its General Meetings has ensured
transparency and protection of shareholder rights. Moreover, the information on resolutions passed by the Company
is disclosed in current reports and published on the www.lotos.pl website.
The Company does not rule out documenting its General Meetings in the form of audio or video recordings in the future.

IV.Z.2. If justified by the structure of shareholders, companies should ensure publicly available
real-time broadcasts of general meetings: **Not applied.**

Commentary: The Company believes there is no threat attributable to the Company's not ensuring publicly available real-time broadcasts of its General Meetings given that its Shareholders have the right to attend General Meetings in person or by proxy. Additionally, General Meetings are held at the Company's registered office in Gdańsk, which facilitates attendance by Shareholders or their proxies. The Company complies with the disclosure requirements imposed by legal regulations and promptly, within 24 hours of the close of a General Meeting, issues current reports with information on resolutions passed, ballot results and objections raised, and also publishes such information on its corporate website. Furthermore, the Company publishes questions posed by, and answers given to, Shareholders during General Meetings. This appears sufficient to ensure Shareholders' participation in General Meetings."

Non-mandatory corporate governance principles observed by the Company in 2015 based on recommendations of the Code of Best Practice for WSE Listed Companies

The LOTOS Group understands that corporate governance is a means to enhancing 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. In 2015 and earlier, Grupa LOTOS S.A. and its subsidiaries made 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 2015, the Investor Relations team supported the Company's Management Board in organising meetings with investors and maintaining regular contact with capital market participants.

As part of its relations with individual shareholders, the Company collaborates with the Polish Association of Retail Investors.

In 2015, Grupa LOTOS S.A. attended the 19th Wall Street Conference of retail investors, organised by the Polish Association of Retail Investors in Karpacz on May 29th–31st 2015. In cooperation with the Polish Association of Retail Investors, an online chat with Mr Mariusz Machajewski, Vice-President of the Management Board, Chief Financial Officer, was held to allow retail investors to discuss the Group's 2014 results.

The Grupa LOTOS 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 monthly updated values, macroeconomic data including prices of petroleum commodities and products in the global markets, as well as information on the Company's dividend policy and dividend payouts, investor tools (calculator, historical LOTOS stock prices). It also groups downloadable files, i.e. periodic reports, strategy and efficiency improvement presentations, and the issue prospectus. This section also lists 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 2015 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.

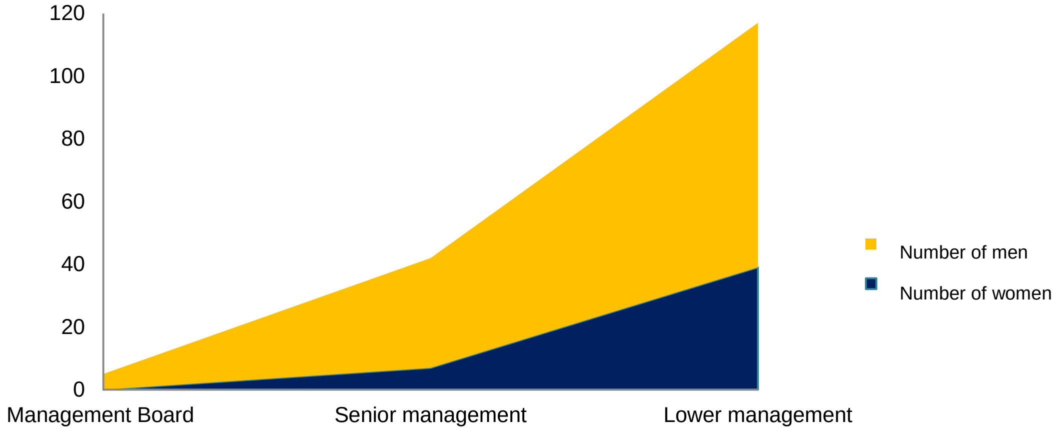
Table 50. Number of women and men on the Supervisory Board

	Number of women	Number of men
01.01.2012 - 27.01.2012	1	5
27.01.2012 - 29.02.2012	1	4
29.02.2012 - 31.12.2012	2	4
01.01.2013 - 31.12.2013	2	4
01.01.2014– 30.06.2014	**2**	**4**
30.06.2014 – 31.12.2014	**3**	**3**
01.01.2015– 30.06.2015	**3**	**3**
30.06.2015 – 23.12.2015	**3**	**3**
23.12.2015 – 31.12.2015	**3**	**4**
31.12.2015 – 26.01.2016	**3**	**4**
26.01.2016 – 27.01.2016	**3**	**3**
27.01.2016 -	**3**	**3**

Table 51. Number of women and men on the Management Board and in other management positions at Grupa LOTOS S.A. as at December 31st 2015

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

Figure 61. Management personnel by sex (as at December 31st 2015)



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.

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 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.

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.A'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 Grupa LOTOS' procedures and are subject to periodic assessment.

For more information on the information policy, business ethics, publication of the integrated report and the Company's inclusion in the RESPECT Index, see Section 1.5 – Corporate Social Responsibility.

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.

Sponsorship policy

In accordance with the adopted sponsorship rules, Grupa LOTOS and its subsidiaries act as sponsors mainly in Poland, in those administrative districts and provinces where their offices are located and where LOTOS Group companies conduct their business. Sponsorship activities are consistent with the LOTOS Brand Communication Strategy and the LOTOS Group's Corporate Social Responsibility Strategy.

In 2015, sports sponsorship activities were conducted mainly by Grupa LOTOS S.A. and involved support for nationwide projects and for motor sports. Grupa LOTOS S.A. continued to sponsor professional and amateur sports, as well as periodic sports events during which the LOTOS brand has been promoted for several years. A range of initiatives addressed to children and youth were also supported.

As part of cultural sponsorship activities, Grupa LOTOS primarily engaged in the organisation of the most important events in a given region and those demonstrating a significant potential for promoting and building the image of the LOTOS brand. Additional criteria for the selection of cultural projects included their social dimension and artistic quality. A number of key projects implemented in previous years were continued. Nationwide (sponsorship of the national team) and industry-related (motor sports) projects were also undertaken.

In 2015, Grupa LOTOS S.A.'s spending on sponsorship and CSR- related activities amounted to approximately PLN 52.4m and included in particular:

sports sponsorship

- sports projects combined with social themes addressed to children and youth, such as the 'White and Green Future with LOTOS' project implemented in partnership with the Lechia Gdańsk Football Academy, and the 'In Search for the Champion's Successors' project, implemented together with the Polish Skiing Association, as well as
- motor sports projects, including support for Robert Kubica in WRC events and for Kajetan Kajetanowicz in European Rally Championship, Chief Sponsor of the Polish national football team, Official Partner of Robert Kubica (rallies), LOTOS Rally Team, Poland's General Skiing Sponsor, sponsor of Lechia Gdańsk (football), LOTOS Trefl Gdańsk (volleyball) and Trefl Sopot (basketball),
- training children and youth as part of the National Ski Jumping Development Programme or the Lechia Gdańsk Football Academy,
- sponsoring of PRC (rallies) and Rally Poland (WRC),
- sponsoring of Tour de Pologne (bicycle racing),
- sponsoring of golf tours: PGA Polska and LOTOS Polish Open.

culture sponsorship

Criteria for the selection of cultural projects as part of which the LOTOS brand is promoted include, next to the location of the event, its social dimension, artistic quality and contribution to promoting the LOTOS brand and the region in which the event is held.

The key cultural projects implemented in 2015 included:

- Collaboration with the Baltic Opera and the Baltic Sea Cultural Centre in Gdańsk as a Strategic Partner,

- Solidarity of Arts Festival,
- LOTOS Jazz Festival – Bielska Zadymka Jazzowa,
- Culture Orchestra,
- Dwa Teatry (Two Theatres) – a festival organised by Polish Radio and Television,
- Siesta Festival.

In 2015, CSR activities focused on three key areas:

- environmental protection and ecology, with special focus on conservation of the environment and natural values of the Baltic Sea, and nature protection of areas directly adjacent to the plants operated by the LOTOS Group,
- road traffic safety,
- levelling out social discrepancies and supporting educational projects, in particular those addressed to children and youth.

As part of environmental protection programmes, a range of initiatives were undertaken to raise environmental awareness and promote pro-environmental behaviour. These included the 'Protect the Wildlife of the Sobieszewo Island' programme, the 'LOTOS Protects the Baltic Sea Wildlife' programme, the Maritime Education Programme, the International Baltic Clean-Up Campaign, and educational communication on the 'Headed for the Baltic' website.

As part of its road traffic safety initiatives, the Company continued the 'LOTOS Safety Belt Champions' project, which in 2014, being in its pilot phase, was implemented in the Gdańsk Province only. The programme is designed to promote the awareness of car passenger safety rules, correct fastening of seat belts, and proper ways of transporting children to reduce the number of passenger injuries in road accidents.

In addition, in 2015 the 'Talent with LOTOS' programme, designed to support the education of talented students in the regions in which the LOTOS Group operates, was continued. Also social initiatives and activities addressed to the Company's immediate environment were continued with a view to building a positive image and good relations with local communities (the initiatives included support for the Great Orchestra of Christmas Charity, Children's Day, Santa Claus gift-giving events).

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 of Grupa LOTOS S.A. 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 Grupa LOTOS' 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 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 Asfalt 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.