



LOTOS Group  
Integrated Annual Report 2018

# 01. **THE LOTOS GROUP AND ITS ENVIRONMENT**

## Letter from the President of the Management Board

*Ladies and Gentlemen, Dear Shareholders,*

Let me present to you our Annual Report, showing the LOTOS Group's financial results for 2018. They are extremely important to us as they again confirm the sound financial condition of our company and allow us to look boldly into the future and confidently implement further ambitious growth plans.

We can proudly say that thanks to prudent asset management and the ability to maximise benefits from market opportunities we posted record operating results for another year in a row. Our adjusted LIFO-based EBITDA reached an unprecedented level of PLN 3.125bn in 2018. The company's financial position is constantly improving, as demonstrated by the solid cash flows. Operating cash flows last year amounted to PLN 2.3bn.

We are also moving ahead on our investment projects, having spent PLN 1bn last year. The debt level fell significantly, by almost 25%, to PLN 1.9bn as at the end of 2018. What is more, the ratio of net debt to adjusted LIFO-based EBITDA dropped to 0.6x. This excellent performance was reflected in the price of the company's shares on the Warsaw Stock Exchange, which came close to PLN 90 at the end of 2018. We paid dividends for the second time.

As an owner or co-owner of 36 offshore and 11 onshore licences, we extract hydrocarbons in the Polish zone of the Baltic Sea, on the Norwegian Continental Shelf, in Poland, and in Lithuania. In 2018, the 2P recoverable reserves controlled by LOTOS increased to 89.8 million barrels, and our own production reached approximately 7.5 million barrels.

Our refinery, ranked among Europe's most advanced facilities of its type, ran at full capacity last year, enabling us to break another record, with oil throughput at close to 10.8 million tonnes in 2018.

Also the macroeconomic climate looked very favourable last year, with the strong average oil price of USD 71/bbl making a positive contribution to the Group's upstream performance. Our results were also supported by the strong US dollar. In downstream, the results were particularly bolstered by middle distillate crack spreads. What significantly contributed to the segment's performance was the high model refining margin, which amounted to USD 7.41 per barrel for the whole of 2018.

The tests of our coker complex, the key EFRA Project facility, are going to be completed any day now. The project is a continuation of the Gdańsk refinery's technological development process started with the 10+ Programme. Much of the work on the EFRA Project site was carried out in 2018, including commissioning of the Hydrowax Vacuum Distillation Unit (HVDU). It contributed to the record-high crude throughput of 10.8 million tonnes achieved in 2018.

We are making progress across all segments. We are reorganising our upstream business, adjusting the commercial offering, opening new service stations, but above all we are open to new opportunities that come with alternative fuels. They are on our priority list. In autumn 2018, we commenced testing the first 12 EV charging points on the A1 and A2 motorways under the LOTOS Blue Trail project. We plan to quadruple the number of electric chargers at our stations, which means that a further 38 charging points will be built and operational by the end of 2020.

EV chargers are only the beginning. During the COP24 summit held in Katowice in December, we signed an agreement to fund hydrogen refuelling points under the Pure H2 project. We are going to launch the distribution of ultra-high purity hydrogen (99.999%), which could be used primarily as a fuel in public transport vehicles. The plans envisage the construction of a hydrogen purification unit at the Gdańsk refinery and a hydrogen sale and distribution station in the immediate vicinity of the LOTOS Group's plant, as well as two refuelling points (in Gdańsk and Warsaw). The project, worth almost EUR 10m, is to be commissioned in 2021.

One of the five pillars of our business strategy until 2022 is our commitment to developing and implementing innovations, including digital. We have signed an agreement with Microsoft to initiate joint projects and implement solutions using artificial intelligence and the latest IT technology.

With company value and the LOTOS brand reputation in mind, we have long supported sports, cultural and corporate social responsibility initiatives. In 2018, we signed a series of significant sponsorship agreements that strengthen our relations with our partners. We will be the Main Sponsor of the Polish National Football Team until 2022. Ski jumpers and cross-country skiers will receive our support for another four years. We are consistently implementing our educational and sports programmes, designed in particular for children and youth. Since August 2018, our support has also been offered to university sport clubs.

We analyse climate change, which poses new environmental challenges. Sustainable development is important to us – we understand it as continuous improvement of efficiency while reducing negative environmental impacts. We are proud that we can speak about LOTOS as one of Europe’s “greenest” companies. Last year, we recovered as much as 96% of waste generated at our refinery, and once again reduced the emissions rate. Our energy efficiency is growing by the year.

We are well aware that there is a long way to go before you can be called the BEST. We know that we owe our great performance to the BEST, specialist, open and brave staff, whom we treat as partners. On behalf of the Management Board of Grupa LOTOS S.A., I would like to thank all LOTOS Group employees and the Supervisory Board members for their professionalism, hard work, dedication and the successes we have achieved together. I would also like to express my sincere thanks to our business and social partners as well as to our customers for the trust they place in us.

Yours faithfully,



**Mateusz A. Bonca**

President of the Management Board  
Grupa LOTOS S.A.

## Letter from the Chairwoman of the Supervisory Board

*Ladies and Gentlemen,*

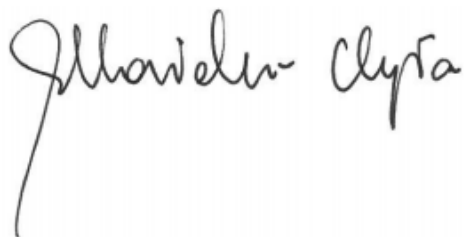
2018 was another successful year for Grupa LOTOS and the wider oil industry. Successful growth of our Company, continued support from the government and a focus on the quality of solutions and products allow us to be proud of our achievements. Consistent pursuit of our strategy has brought tangible benefits, made us very optimistic about the future and helped us continue our efforts towards the achievement of the Company's objectives.

Maximum utilisation of the refinery's capacity, record-high LIFO-based EBITDA of PLN 3.12bn, achieved despite lower refinery margins and a decrease in hydrocarbon production, as well as a significant reduction in the Company's debt, would never have been possible without the hard work of many people. The Company also paid its second dividend.

We made significant progress on our landmark EFRA project last year, which enabled us to complete the construction of the Coking Complex in 2019. We also stepped up efforts in the area of electromobility and other alternative fuels. We have contributed to enhancing innovation of the Polish industrial sector by opening twelve EV charging stations as part of the Blue Trail project and securing funding for PURE H2, an ultra-high purity hydrogen distribution project.

Grupa LOTOS is open to implementing digital innovations, state-of-the-art information technology, and artificial intelligence solutions. As part of our corporate social responsibility commitment we have been staunch supporters of sports, cultural and educational initiatives in Poland. With the natural environment in mind, we have reduced emission levels and constantly strive to cut energy consumption and foster biodiversity.

I hope that our 2019 full-year figures will be equally impressive, as our objective is continued fast growth of Grupa LOTOS. We are doing all this to be the BEST in every way.



**Beata Kozłowska-Chyła**

Chairwoman of the Supervisory Board  
Grupa LOTOS S.A.

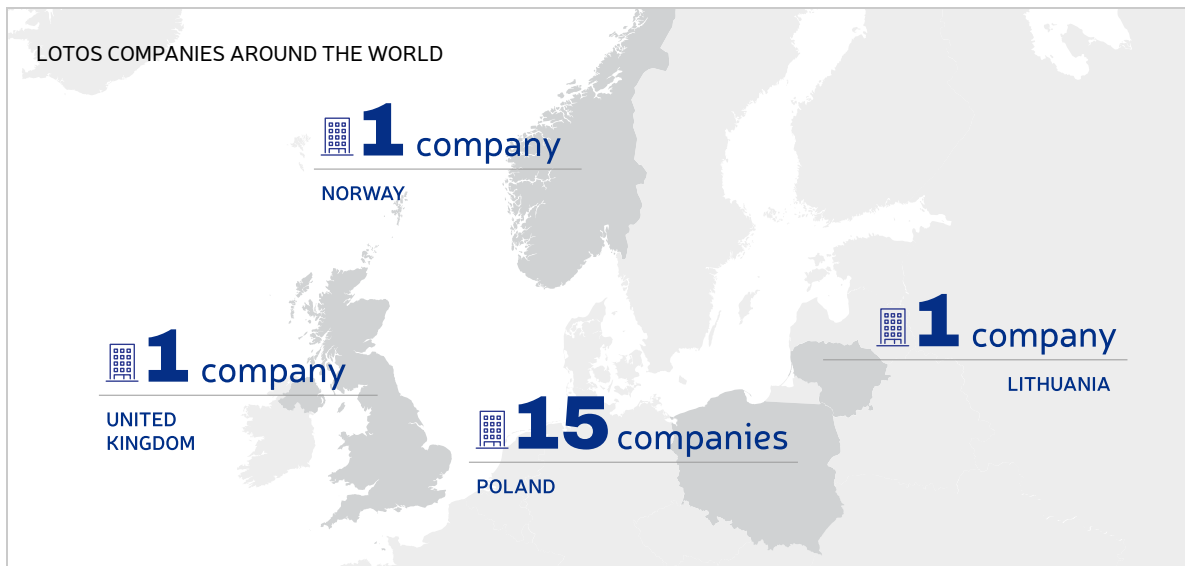
## We are driven by sustainable development

The LOTOS Group is one of the largest business players in the Polish market and the second largest fuel producer in Poland. We operate in the crude oil and natural gas production and processing business and sell quality petroleum products. We also provide highly specialised logistics services and servicing support.

Our activities are determined by sustainable development. The refinery in Gdańsk is one of the youngest and most advanced refineries in Europe in terms of technology and environmental protection. We have been introducing into our offering alternative fuels, such as hydrogen and LNG, and we are an active player in electromobility, steadily consolidating our position as the leader of innovation in this segment.

Our Group comprises Grupa LOTOS S.A. (the Parent), production, trading and service companies, and a foundation.

Grupa LOTOS S.A.'s headquarters are located at ul. Elbląska 135 in Gdańsk.



## ORGANISATIONAL STRUCTURE AND AREAS OF COMPETENCE OF THE INDIVIDUAL LOTOS GROUP COMPANIES

wholesale and retail sale of fuels and light fuel oil, management of the LOTOS service station network (495 stations)

production and sale of lubricating oils and lubricants, and sale of base oils

production and sale of bitumens

acquisition of crude oil and natural gas reserves, production of hydrocarbons

production operations in the Norwegian Continental Shelf

a holding company implementing the segment's growth plans based on subsidiaries

storage and distribution of fuels, renting and operating of own or leased real estate

storage and distribution of fuels

railway logistics support for the entire Group

laboratory analysis

security services – protection of people and property

fire service activities

crude oil exploration and production, drilling services, and purchase and sale of crude oil in onshore areas of Lithuania

maintenance of mechanical and electric operations and controlling devices, overhaul and repair services



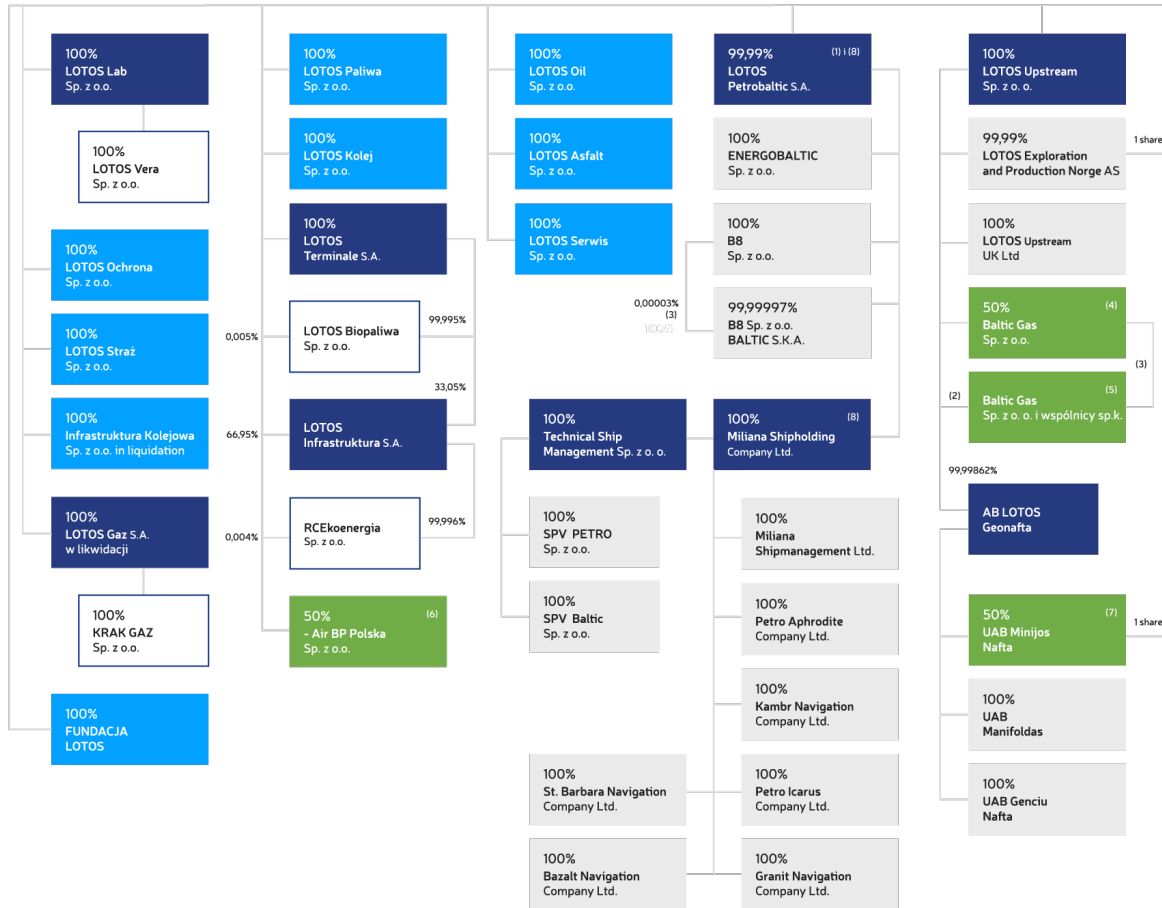
sales up 16% in 2018

implementation of a gas reserves development project

manufacture of cars

FULL ORGANISATIONAL STRUCTURE OF THE LOTOS GROUP

GRUPA LOTOS S.A.



(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) In merger process (merger plan accepted on 19.12.2017)

Entities classified as joint ventures accounted for using the equity method, which are non-Group companies

Additionally, Group 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)

## Modern and efficient oil production and refining processes

In our principal business activities, we focus on three areas:

- hydrocarbon exploration and production,
- crude oil refining, and
- trading in petroleum products.

To improve our trading efficiency, we are constantly optimising our refining and logistics processes.

### OUR OPERATIONS ARE DIVIDED INTO TWO SEGMENTS:



#### EXPLOTRATION AND PRODUCTION

acquisition and production of crude oil and natural gas, and the related auxiliary, transport and servicing activities,



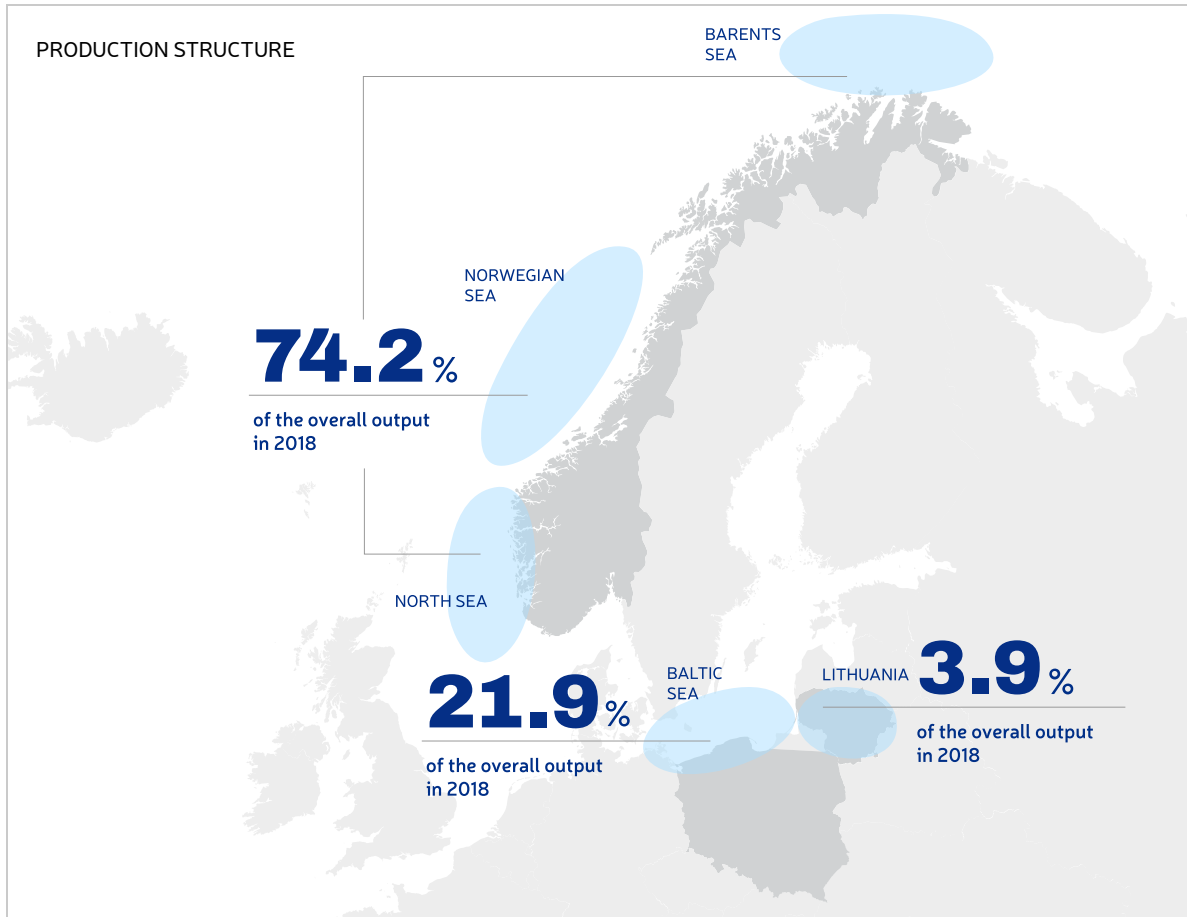
#### REFINING AND MARKETING

petroleum processing and manufacture of refined petroleum products, wholesale and retail sale of petroleum products, and the related auxiliary, transport and servicing activities.

### Exploration and production

We are the only company engaged in hydrocarbon production in Poland's Exclusive Economic Zone of the Baltic Sea. As regards our foreign operations, we produce hydrocarbons on the Norwegian Continental Shelf and in Lithuania.





**4.5** kboepd  
 LOTOS Group's average daily output in Poland in 2018  


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 22% of the segment's total volume

**15.2** kboepd  
 LOTOS Group's average daily output in Norway in 2018  


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 74% of the segment's total volume

**0.79** kboepd  
 LOTOS Group's average daily output in Lithuania  


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 4% of the segment's total volume

**10.8** million tonnes

Gdańsk refinery's refining throughput in 2018

the highest throughput in the refinery's history

**20.4** kboepd

LOTOS Group's average daily output in 2018

**89.8** mboe

LOTOS Group's total oil and gas reserves as at the end of 2018

including 78% crude oil and 22% natural gas

## EXPLORATION & PRODUCTION SEGMENT

### Poland

Baltic Sea



Reserves 2P  
**49.6** mboe



Production  
**4.5** kboepd

### Lithuania

Onshore



Reserves 2P  
**2.9** mboe



Production  
**0.8** kboepd

### Norway

Norwegian Continental Shelf



Reserves 2P  
**37.3** mboe



Production  
**15.2** kboepd

### Exploration & Production segment



Reserves 2P  
**89.8** mboe



Production  
**20.4** kboepd

## Crude processing

Our refinery is among the most advanced and youngest in Europe, and boasts a throughput capacity of approximately 10.5 million tonnes of oil per year. In 2018, we broke our own record by processing as much as 10.8 million tonnes of crude oil, mainly Urals (73.1%). Our oil refining products are sold in Poland and abroad, through wholesale and retail channels (the latter being our own service station chain).

The LOTOS Group's trading activities in 2018 were carried out by Grupa LOTOS and its subsidiaries: LOTOS Paliwa, LOTOS Oil, LOTOS Asfalt, and LOTOS-Air BP.

**10.8 MT – Gdańsk refinery's refining throughput in 2018 – the highest throughput in the refinery's history, achieved through maximum production capacity utilisation.**

Our operations are highly efficient – the new technologies we use in our production processes enable us to obtain up to 95% of pure fuel from one barrel of oil. The waste generated in the refining process (5% of an oil barrel) is used to produce bitumen, which we sell to our trading partners.

## Products and services – versatile and green offering

Our operations span 86 markets. We sell our products mainly in Poland and other European countries, including Germany, the Netherlands, Belgium, Sweden, Denmark, the United Kingdom, France, Estonia and the Czech Republic.

Under the LOTOS brand, we offer a vast range of products and services, including high-quality motor fuels (sold, among other outlets, at the 495 LOTOS service stations conveniently located all over Poland, including at 20 Motorway Service Areas), a wide range of lubricating oils (for automotive and industrial applications), various types of road and industrial bitumens, JET A1 specialty aviation fuel, as well as many services provided under the LOTOS brand, such as logistics and security services.

### PRODUCTS OBTAINED FROM CRUDE PROCESSING



fuels (unleaded gasoline, diesel oil, and light fuel oil)



heavy fuel oil



bitumens



aviation fuel



naphtha



liquefied petroleum gas (LPG)



base oils

## Our offering

The LOTOS Group offers a wide range of products and services, including:

- high-quality fuels (including aviation and marine fuels);
- a broad selection of superior performance oils for automotive, agricultural, industrial and marine applications;
- paving-grade bitumens, MODBIT modified bitumens (including MODBIT HIMA highly-modified bitumens), WMA bitumens (for the production of aggregate-bitumen mixtures), and industrial bitumens;
- rail transport services;
- and much more.

## OUR BRANDS

**Dynamic**

**cafe púńkt**

**navigator** 

**LOTOS**  
**QUAZAR**

**LOTOS**  
**TURDUS**

**AGROL**

## LOTOS SERVICE STATIONS

**495**

the number of LOTOS service stations at the end of 2018  
up by **two** stations compared with 2017 – including **306** CODO stations and **189** DOFO stations

**14** CODO stations

the number of upgraded service stations operating under the LOTOS brand in 2018

# 18%

the increase in store sales in 2018 vs 2017

# 17%

store margin growth in 2018 thanks to cost optimisation

We make every effort to gradually make our stations increasingly eco-friendly.

At the end of November 2018, we launched 12 electric vehicle charging points. Located along the A1 and A2 motorways between Warsaw and Gdańsk, the points form the Blue Trail.

Soon, Grupa LOTOS will also become the first producer of purified hydrogen in Poland and will build two hydrogen filling stations. Last year, a decision was made to grant EU funding for Grupa LOTOS' Pure H2 project to construct hydrogen purification and dispensing units.

Also LOTOS Lab and LOTOS Kolej have undertaken projects aimed at upgrading their operations to make them more friendly to the environment. By 2022, the companies are to build two prototypes of shunting locomotives with advanced hybrid drive systems.



Map presenting location of LOTOS service stations

Health and safety of our customers are extremely important to us. We make every effort to ensure that our operations and products are safe at each stage of the value chain. LOTOS Lab, a part of the Group for 16 years now, thoroughly tests all the semi-finished products, products, components and additives we use to manufacture our fuels, oils and bitumens, as well as the water used to produce energy and the wastewater we generate.

Information on the health and environmental impacts of our products, as well as on the content of chemicals and chemical preparations in those products, is provided in the Product Information or the Product Safety Data Sheet. Such information also includes instructions on what to do in case of fire or discharge of the product into the environment and how to handle waste.

## People as top priority

People have always been at the centre of LOTOS’s business. Our stakeholders play a part in how we generate not only economic, but also social and environmental value. In decision making, we always take into account their benefit and seek to build good and lasting relations with them.

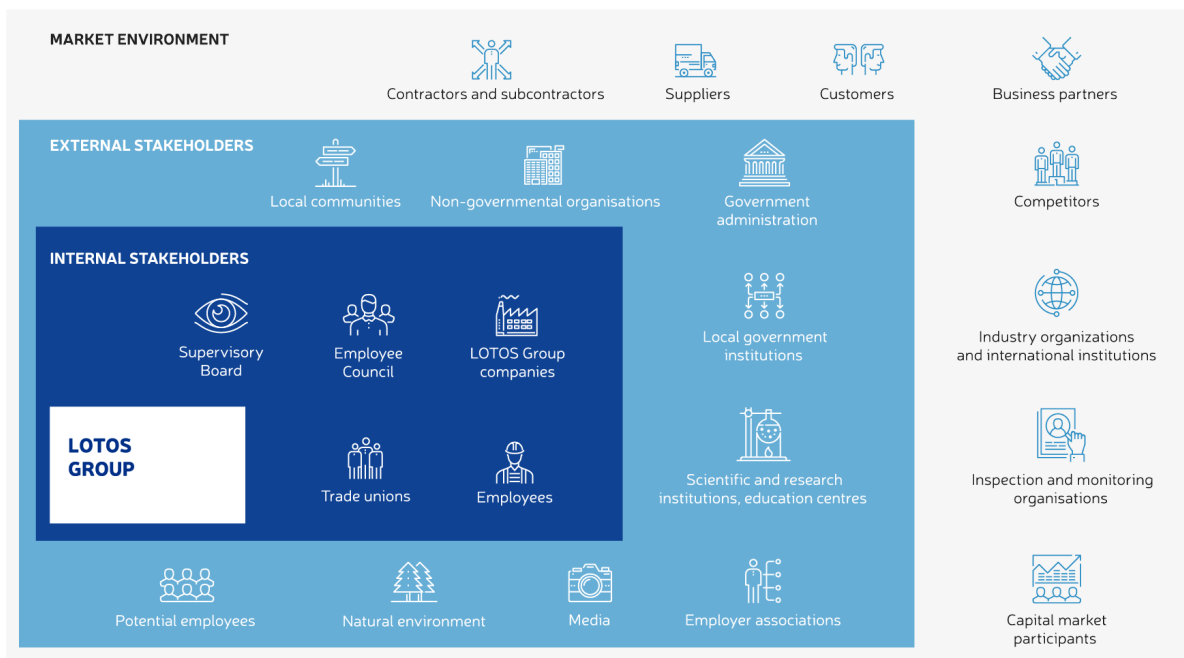
Our relations within the organisation, as well as relations with trading partners and customers are marked by particular care for safety and respect for dignity. This applies both to persons who represent LOTOS on everyday basis and those with whom our company interacts in its operations and communication activities.

We aim to engage in a dialogue with both our social and market stakeholders. The form and frequency of the dialogue vary depending on the stakeholder group. We aspire to improve the quality of our relations and ensure mutual benefits.

### OUR KEY EFFORTS IN THIS AREA INCLUDE:

- ➔ regular surveys to gauge the level of satisfaction among our customers and trading partners,
- ➔ regular exchange of information with capital market participants through our Investor Relations site and road shows,
- ➔ maintaining contact with regulatory, inspection/audit, and monitoring bodies on an as-needed basis,
- ➔ dialogue with employees during day-to-day work and through trade unions, and regular job satisfaction surveys.

### LOTOS'S STAKEHOLDER MAP



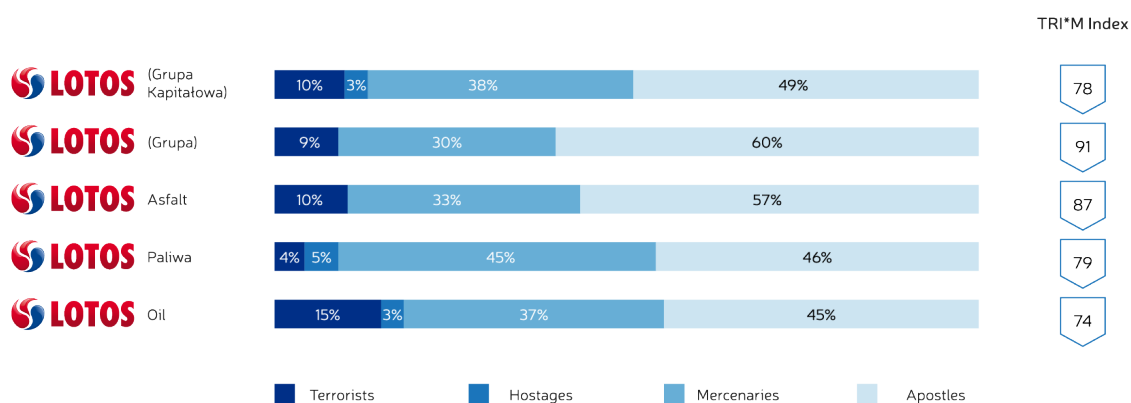
## Customers have a high opinion of LOTOS

Our customers' opinions and expectations are a vital source of information and inspiration for our further business growth, which is why we monitor customer feedback on a regular basis. In 2018, the LOTOS Group's business customer satisfaction index stood at 78, remaining flat on the previous edition and indicating a high level of customer satisfaction. To compare, the average satisfaction level for all industries in Poland is 69.

LOTOS Asphalt is the LOTOS Group company that can boast the largest increase in customer satisfaction levels, which have been on the rise since 2016. Grupa LOTOS's business customer satisfaction index rose by 1 point, to impressive 91 points. On the other hand, LOTOS Oil recorded a decline in customer satisfaction levels.

Respondents are satisfied with our products: 91% would recommend them and 89% would choose them again. Compared with 2017, minor changes in the LOTOS Group's customer base can be seen. The share of satisfied and loyal customers decreased slightly (by 1 pp) and the percentage of disloyal and dissatisfied customers slightly increased (by 1 pp). At present, almost half of our customers (49%) are the Apostles, i.e. the most loyal and satisfied group of customers, who are emotionally attached to the brand and disseminate positive opinions about it.

### TYPES OF CUSTOMERS - BREAKDOWN BY COMPANY





## Membership of industry associations and CSR

We are a member of many Polish and international organisations, some of which bring together specialised fuel, energy, and chemical sector entities. We have also joined business organisations working towards Poland's economic growth and those promoting the principles of corporate social responsibility.



In 2018 we were a member of such organisations as the Polish Chamber of Chemical Industry (PIPIC), Central Europe Energy Partners, Fuels Europe, the Polish Organisation of Oil Industry and Trade, United Nations Global Compact (the world's largest corporate sustainability initiative), and the Promeranian Employers (Pracodawcy Pomorza) organisation.

Since 2008, the LOTOS Group has been the strategic partner of the Responsible Business Forum, a non-governmental organisation which for over a decade now has been involved in disseminating knowledge about and promoting the concept of corporate social responsibility in Poland.



A complete list of industry organisations we hold membership of

## Awards and distinctions

We are glad that our commitment to corporate social responsibility benefits many entities and is highly evaluated by experts, as confirmed by the string of awards and distinctions conferred on LOTOS. We especially value those received for our efforts and commitment to the areas which are of key importance to the development of CSR practices.

The awards and distinctions are a token of appreciation and confirmation of our ability to foster relations with employees, investors, and business partners, to improve workplace safety, protect the natural environment, and to engage in social outreach initiatives.

### AWARDS AND DISTINCTIONS FOR THE LOTOS GROUP IN 2018



**12th time in the RESPECT Index for the LOTOS Group**

In December 2018, the LOTOS Group was included for the 12th time in the RESPECT Index of the most socially responsible companies listed on the Warsaw Stock Exchange.



**FTSE4Good**

**LOTOS Group shares for the first time included in FTSE4Good, London Stock Exchange's index of ethical investment stocks.**



**ranking odpowiedzialnych firm**

**2nd place in the 'Fuels, Energy, Production' category in the 12th edition of the Socially Responsible Companies Ranking.**



ranking  
odpowiedzialnych  
firm

**6th place overall in the 12th edition  
of the Socially Responsible  
Companies Ranking.**



**Silver CSR Leaf for the LOTOS  
Group**

– an award for companies which  
undertake regular efforts to conform  
to the stringent ISO 26000 CSR  
standard on a daily basis.