Implementing the strategy

Our strategy until 2015 provides for the consolidation of the LOTOS Group's position as a strong, innovative and successfully developing entity, which plays a crucial role in ensuring Poland's energy security. We operate in compliance with the principles of social responsibility and sustainable growth. Our current priority is the dynamic growth of the hydrocarbons exploration and production segment. In 2012, we recorded a record-high crude oil throughput at our Gdańsk refinery of almost 9.7m tonnes, up 5.6% on 2011. We also saw 15.1% year-on-year growth in crude oil production, with volumes of 262,000 tonnes.

IN THIS CHAPTER

Letter from the Chairman of the Supervisory Board

Dear All,

2012 was another successful year for Grupa LOTOS.
The Company maintained and developed its tradition of growth in a difficult macroeconomic climate. The results achieved by LOTOS in 2012 are remarkable, and give grounds for optimism for the future development of the company.

Grupa LOTOS saw PLN 33.1bn income last year, a more than 13% increase on 2011. We are also extremely satisfied with the increase of our crude oil processing to a record level of 9.7m tonnes. Even more significantly, extraction of crude oil increased by over 15% to 262,000 tonnes. This is not yet the target scale, but is strong proof of a consistently realised development strategy, whose fundamental direction is in increasing our own extraction rate. This should be helped enormously by our cooperation with PGNiG.

Our high tax contributions are also worth mentioning on this occasion. Poland's state budget received almost PLN 9.5bn from Grupa LOTOS in various forms of taxation. Local, municipal, county and provincial authorities all also received sizeable contributions from the Company.

The efficiency of our installations also rose systematically, with the uptime ratio now at 99.2%. LOTOS continues to successfully modernise the refinery, despite having already concluded the 10+ Programme. Thanks to the creative concepts devised by LOTOS engineers, the MHC hydrocracking installation was also improved, and conversion efficiency increased from the projected 60% to 85%. The Company also launched production of xylene, a high-margin petrochemical semi-product, which is currently in high demand.

Dynamic development of the service station chain systematically increased Grupa LOTOS' share in the retail market, which in 2012 was 8%. As at the end of 2012, altogether 405 stations operated under LOTOS colours, including 101 LOTOS Optima stations.

The Board of Grupa LOTOS operates with remarkable efficiency, even in difficult market environments. One of its defining traits is its ability to respond promptly to changes occurring in the economic environment. In 2012, the Board introduced an efficiency and savings enhancement plan, the Optimal Expansion Programme. As a result, savings of PLN 446m were made, although the plan had only envisaged a total of PLN 257m. It is important to note that the reduction of costs did not in any way interfere with the LOTOS Group's dynamic development.

Grupa LOTOS' measured development concepts also include a new area of growth, in the agreement with Zakłady Azotowe w Tarnowie Mościcach (Azoty Tarnów). This opens new prospects for the addition of a petrochemical complex to the refinery, creating a strong, beneficial synergy between LOTOS' and Azoty's technical resources.

I consider the high quality of the the LOTOS Group's management to be of primary importance and a key factor in the evaluation of the future perspectives for the development of the company, and it is maintained at a remarkably high level - not easy when faced with the challenges of an increasingly competitive market. This involves strong ethical accents, an

understanding of the modern concept of social business responsibility, and very efficient communication with employees and the external world. Grupa LOTOS is a company based on a culture of values. Professionalism, respect, transparency and cooperation are all defined as the most important principles in the company. Taken together, they become a very strong asset of Grupa LOTOS.

With the increasingly uncertain macroeconomic situation we can be sure that the future of Grupa LOTOS is built on solid foundations. Application of the latest technology, efficient management and a strong community spirit shared by all employees opens new growth perspectives and guarantees market success.

Yours faithfully,

Wiesław Skwarko
Chairman of the Supervisory Board
Grupa LOTOS S.A.

Letter from the President of the Board

It is with a sense of pride and satisfaction that I present the Integrated Annual Report of Grupa LOTOS S.A. for the year 2012.

The economic slowdown which affected many countries across Europe began to deteriorate into a recession, and a spate of bad economic news put consumers on red alert, prompting them to significantly cut their spending on everyday essentials – including motor fuels. For 12 months, Western Europe lived in fear of imminent eurozone collapse, amid violent swings in currency exchange rates. For an enterprise importing crude oil, such swings can be detrimental. The price of crude oil remained high, hovering around USD 100/bbl, and given the strong currency volatility and flat demand for fuels, this presented an enormous challenge to the oil companies.

But in such an adverse environment, our strategy proved its worth. We were right in predicting that in a market riddled with challenges, with crude prices soaring, only those refineries with optimal plant and equipment would be well placed for success. Having completed the 10+ Programme, Grupa LOTOS is at the technological cutting edge of the European and global refining industries. Thanks to projects undertaken sufficiently in advance, 2012 allowed us to ramp up production and win market shares, while delivering robust financial performance. It was, by all means, another year in which we increased Company value and reinforced the foundations for further growth.

I am proud to admit that that inventory of our 2012 successes is a long one. We recorded PLN 33.1bn in revenue, a 13% improvement on the year before. This was generated by record high throughput volumes at the Gdańsk refinery, which processed 9.7 million tonnes of crude oil (up by 5.6% on 2011). We also saw 15.1% year-on-year growth in crude oil production, with volumes produced from our own sources running to 262,000 tonnes. Our net profit came in at PLN 923m, up 42% on 2011.

In 2012, Grupa LOTOS paid nearly PLN 9.5bn in taxes, the lion's share of which (PLN 9.37bn) went to the state budget. Our expanded refinery and growing output of fuels and other LOTOS products were also a bounty to local government (at the municipal, county and provincial levels). Last year, local government's tax receipts from Grupa LOTOS' operations totalled PLN 85.3m. There is a steady upward trend in our tax payments, which between 2009 and 2012 grew by nearly PLN 1.5bn.

Grupa LOTOS solidified its position on the retail fuel market, with LOTOS OPTIMA as the fastest growing chain in Poland. The total number of LOTOS branded stations operating in Poland at the end of 2012 was 401, including 101 sites branded as LOTOS OPTIMA. In addition to the prime quality of the fuels and oils on offer, customers of LOTOS stations highly value their friendly, helpful service, a fact confirmed by numerous customer satisfaction surveys.

The upstream business of Grupa LOTOS, integrated as LOTOS Petrobaltic, is also growing at a fairly brisk rate. LOTOS Petrobaltic has established its own group, with more than a dozen subsidiaries. They are engaged in ongoing production projects or will be used as vehicles through which Grupa LOTOS will gain access to oil reserves beneath the floor of the

Baltic Sea, on the Norwegian shelf of the North and Norwegian Seas, as well as in Lithuania. Our strategic plans set target production volumes at 1.2 million tonnes, to be achieved by 2015.

Based on the innovative ideas of the refinery's staff, the MHC unit has been enhanced to deliver a much larger output of high quality fuels than originally designed. The facility works at a conversion ratio of about 85%, significantly above the originally planned level of 60%.

We have also entered into production of xylene, a component used in making polyester. Given the rapidly increasing output of packaging materials world-wide, xylene is now in great demand on the international market.

Amongst Polish brands, the value of LOTOS has been estimated at more than PLN 1bn, a fourfold increase from 2004. The numerous awards and distinctions we have received, both in Poland and abroad, confirm that the LOTOS brand is excellently received by both the market and the general public. We have also been ranked sixth among the leading companies from Central and Eastern Europe.

In line with the LOTOS growth strategy, we will undertake activities aimed at leveraging our existing potential, while opening up new fields of expansion. To further this strategic objective, we have entered into an agreement with PGNiG on the joint exploration for and production of natural gas and crude oil, from both traditional and unconventional deposits. LOTOS Petrobaltic and CalEnergy Resources Poland will work together on the development of the B4 and B6 gas fields on the Baltic Sea, which are estimated to contain up to 4bn cubic metres of resources.

Towards the year's end, we also signed an agreement with Zakłady Azotowe w Tarnowie-Mościcach on a preliminary feasibility study for two alternative development directions: the first, by building a steam cracker and polyethylene production unit, and the second, by building an aromatics complex. These projects follow logically from the site and technical conditions, as well as the goal of utilising the refinery's semi-products to meet market demand.

At Grupa LOTOS, we attach great importance to the social implications and ethical aspects of our operations. In 2012, all our employees had a chance to contribute to LOTOS's ethical vision, which defines the system of values to be adhered to in every position at every level of the Company. The principles we singled out as the most important include professionalism, respect, transparency and cooperative spirit. Grupa LOTOS is widely acclaimed for its CSR actions, while its sponsorship of sports has come to be recognised as a paragon of modern relations between business and sports.

Despite the sheer size of our organization, Grupa LOTOS is able to act with a considerable degree of flexibility – a crucial factor in today's rapidly changing environment. We can respond quickly and implement solutions that ensure secure execution of the LOTOS Group's major growth-oriented projects, despite the challenging and volatile macroeconomic climate. A case in point is our new efficiency and savings initiative, rolled out in early 2012 as the Optimum Expansion Programme, which has delivered annual savings of PLN 220m. Another important element of our Development Strategy is the newly launched 2013-2015 Efficiency and Growth Programme, which focuses on delivering efficiency gains and putting all the companies of the LOTOS Group on track for further fast-paced growth.

Ladies and Gentlemen,

we are truly pleased with our strong performance as it reflects the soundness of our business decisions. Even so, given the low likelihood of the macroeconomic climate improving and Europe's economic growth recovering any time soon, I would like you to take careful note of last year's events, which are set to create LOTOS value in the years to come. We have entered the 2013 fiscal year 'armed' with the knowledge and experience of previous crises. Our team of qualified experts, dedicated to their work and the Company, the general understanding of our clear-cut and realistic development strategy and high quality business management, make it more than certain that Grupa LOTOS will survive the current turmoil in good shape – they guarantee that it will continue to grow, going from strength to strength in all its markets.

Best regards,

Paweł Olechnowicz
President of the Board
Chief Executive Officer
Grupa LOTOS S.A.

Business environment

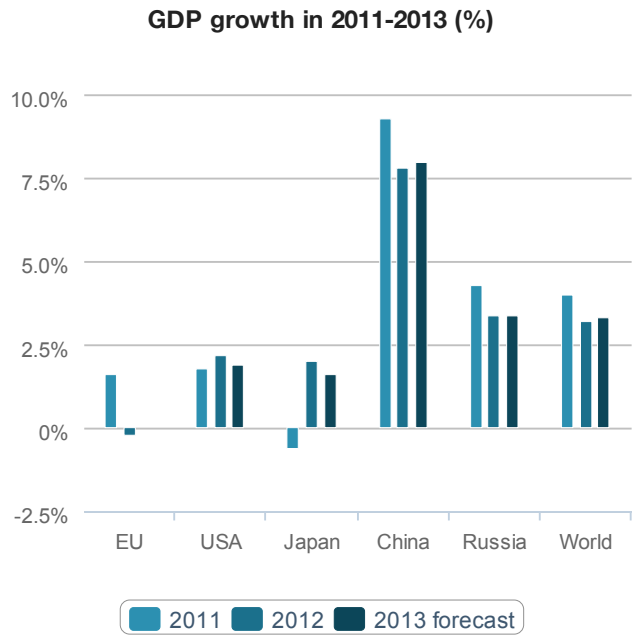
The global economic situation in 2012 was below market expectations. The largest world economies retained a slight growth, but growth rates were lower than in previous years.

In the developed nations, financial stability, production growth and declining unemployment were supported by actions introducing a more relaxed monetary policy and enhancing market liquidity. The principal source of prevailing uncertainty was that many countries found it difficult to implement balanced fiscal policies.

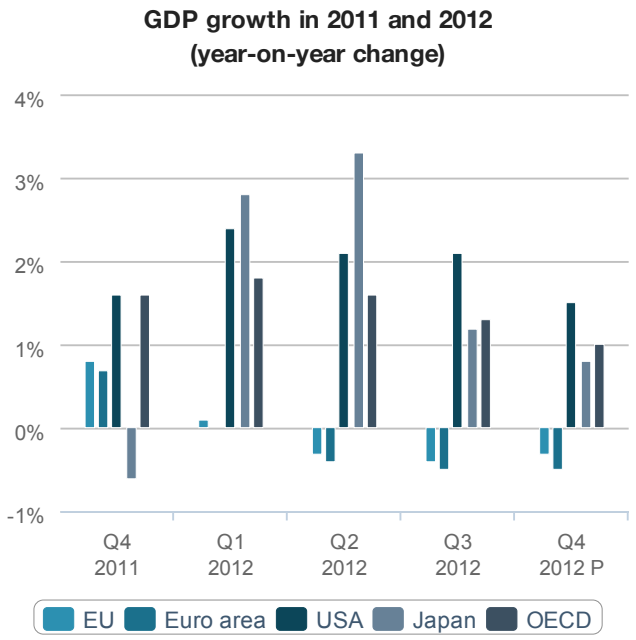
In 2012, the global economy continued to grow, but the growth rate (3.2%) was lower than expected (0.3pp below the forecast from July 2011). The forecast for 2013 has been affected by a slightly stronger downward correction (of 0.6pp), which has set the expected GDP growth rate at 3.3%.

Despite the remedial action taken by its Member States, the crisis in the eurozone remains the largest threat to the global economic revival. In 2012, the eurozone recorded a negative GDP growth rate of (-) 0.6%. Concurrently, a slight pickup in economic growth of 0.3% is expected in the Member States in 2013. [1]

[1] World Economic Outlook, International Monetary Fund, April 2013.



Source: In-house analysis based on IMF data (April 2013).



Source: In-house analysis based on Eurostat, OECD, and MFW data.

The economic difficulties and threats in the developed nations are to a large extent attributable to excess government debt, and will require further support in the form of appropriate monetary policy, conservative fiscal policy, and further structural reforms to overcome.

Situation in the refining sector

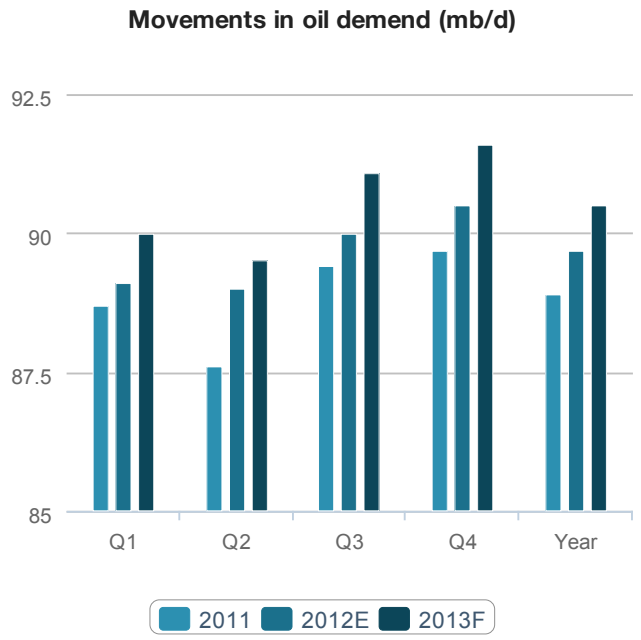
Despite adverse economic conditions, overall demand for crude oil increased (with a prevailing downward trend in consumption in the developed nations and higher consumption on the developing markets) [2], and crude prices went slightly up.

Industry organisations are estimating average demand for the commodity in 2012 at 89.2 mb/d, which is about 0.9% (0.8 mb/d) more than a year earlier. The average consumption of crude in 2013 is expected to come in at 90.1 mb/d, up 0.9%. [3] Medium-term forecasts by the International Energy Agency (IEA) predict that demand for crude will exceed 95 mb/d in 2017, meaning a compound annual growth rate (CAGR) of 1.3%.

[2] Oil Market Report, IEA, November 2012.
[3] In-house compilation based on OPEC, IEA and US EIA data.

IEA estimates indicate that the global growth is driven by rising demand for the commodity in developing countries. It is estimated that growth in non-OECD countries was 2.8% in 2012, and it is expected to remain at 2.6% (or 44.7 mb/d) in 2013. On the other hand, consumption in developing countries, which was down 1.1% in 2012, may decline by a further 0.7% (to 45.8 mb/d) in 2013. The IEA estimates indicate that these trends will prevail in the mid-term, that is, until 2017.

In 2012, crude oil consumption in Europe was estimated at 14.5 mb/d, while in 2013 it is expected that demand will drop to 14.3 mb/d. [4]



Source: In-house analysis based on IEA data (December 2012).

Factors with a heavy bearing on the upstream sector in 2012 were oil and gas prices on the global markets, and fluctuating exchange rates.

A progressive change in the global energy mix, notably the expanding share of natural gas in US power generation, increased use of alternative, renewable energy sources, and the developing shale exploration and production industry, pushed gas prices significantly down. A similar trend may also be developing in crude oil supply and demand, particularly in that unconventional oil projects are apparently on the rise.

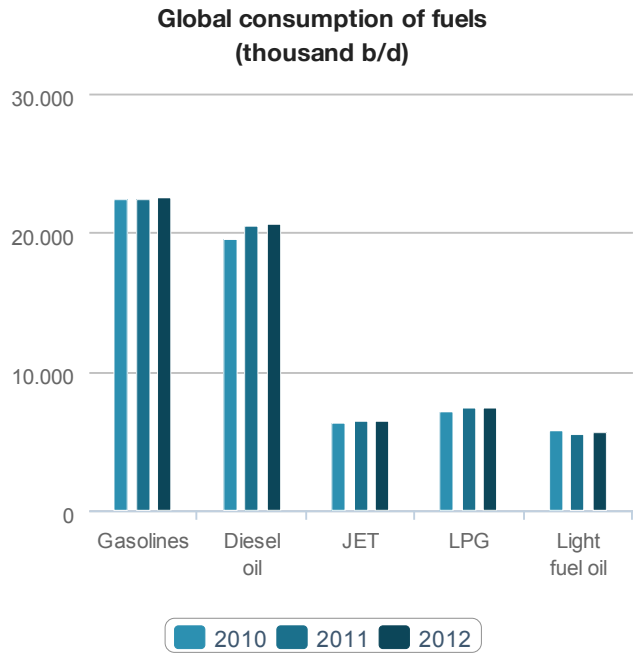
In addition, resources available at low production cost are being increasingly depleted. New deposits require a lot more capital outlay, which drives up the per-barrel price of the oil produced. At present, hydrocarbon exploration and production activity is concentrated in the US shale plays, offshore areas with deposits located at great depths, and offshore polar regions. The expected increase in production of oil and gas from said sources will require higher expenditure incurred per barrel of oil equivalent, which may find a reflection in hydrocarbon market prices.

The prices of crude oil and natural gas on the global markets will depend on how strong each of the two opposing trends become, bearing in mind the overall economic climate.

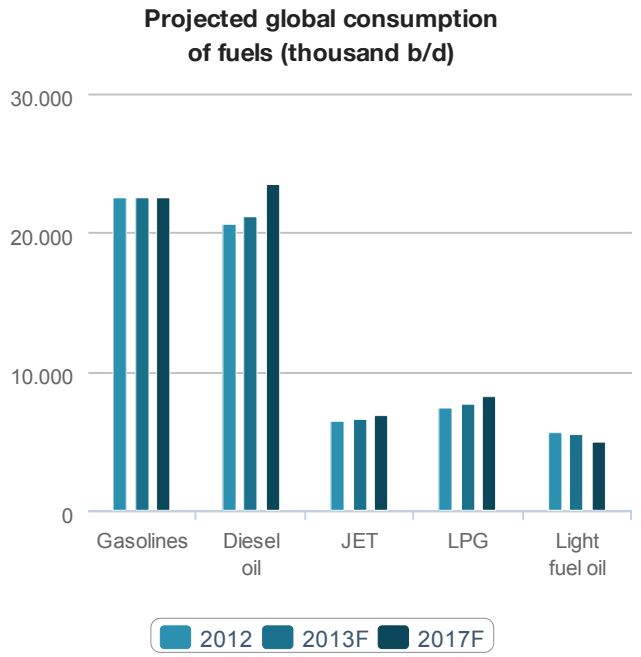
International fuel market [5]

It is estimated that the demand for oil refining products rose in 2012 by 0.7% globally, while stronger demand will be recorded in the gasolines (0.6%) and diesel oil (0.8%) segments. The estimated consumption of LPG and light fuel oil also increased (by 1.2% and 1.8%, respectively). However, the demand for JET fuel will fall slightly (-0.4%).

[4] Oil Market Report, IEA, November/December 2012.
[5] Mid-Term Oil Market Outlook 2012-2017, JBC Energy, October 2012.



Source: In-house analysis based on JBC data, October 2012.

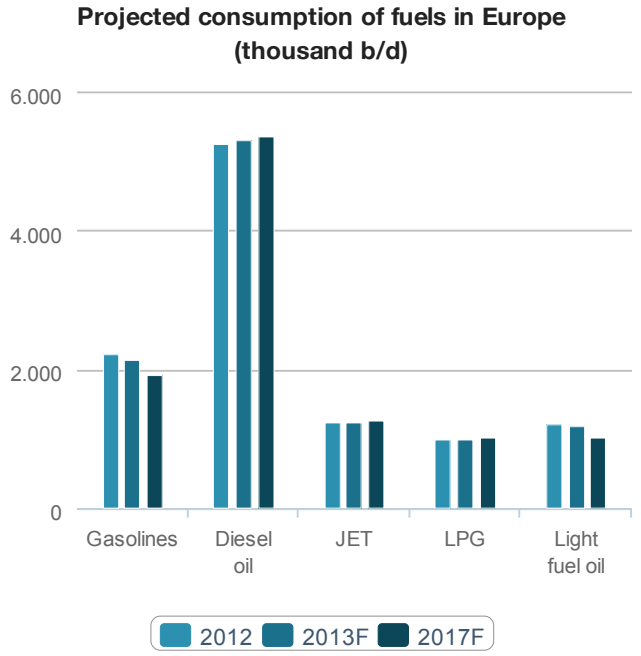


Source: In-house analysis based on JBC data, October 2012.

According to forecasts, the overall global consumption of refining products is expected to grow by over 5% until 2017. A significantly higher demand for diesel oil, LPG and JET fuel has been estimated (up by 14%, 10% and 8%, respectively, with 2012 as a point of reference). The consumption of gasoline should remain relatively unchanged, while a drop in consumption of light fuel oil (-13%) is also predicted.

Consumption of petroleum products in Europe is estimated to decline in 2013 by nearly 3%, affecting all product groups: gasolines (-4.9%), diesel oil (-1.2%), JET fuel (-2.9%), LPG (-2.7%) and light fuel oil (-2.2%). The lower consumption of petroleum products in Europe reflects the economic difficulties in the EU Member States and the eurozone.

The demand for oil refining products is forecast to fall in Europe by 3% until 2017. According to estimates, one of the reasons behind this decline will be a significant drop - of nearly 14% - in consumption of gasolines. Lower consumption is also expected on the light fuel oil market (-16%). Concurrently, a strong increase in consumption of middle distillates is expected: diesel oil by 2.1%, and JET fuel by 2.8%.



Source: In-house analysis based on JBC data, October 2012.

In the European car market, new passenger car registrations fell significantly (by 7.8%) in 2012, to 12.5m new cars, whereas in the utility vehicles segment, new registrations declined 11% to 1.6m vehicles (for January-November). In the registered new passenger cars group, increasing interest in diesel cars has been observed since 2009. The share of diesel cars in total new car registrations in Western Europe was nearly 60% (compared with 46% in 2009). [6]

[6] European Automobile Manufacturers' Association, www.acea.be

Poland – macroeconomic environment

In 2012, GDP growth in Poland slowed down. According to estimates, in real terms the GDP grew by just 2.3% over 2011, the slowest growth rate since 2009. This is chiefly attributable to weaker domestic demand and lower industry and construction output sold. Additionally, inflation was down to 3.7%.

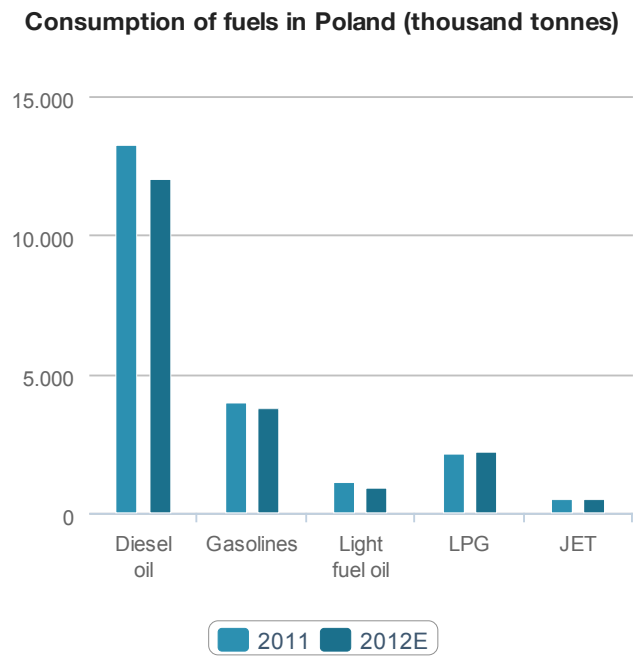
The economic slowdown in Poland in 2012 is expected to be accompanied by higher unemployment. According to market estimates, the jobless rate was 13.4% in 2012, which represents a 0.9pp rise on the previous year. In 2012, salaries and wages in the non-financial corporate sector increased by 3.4% compared with 2011, which did not translate into stronger purchasing power.

Polish fuel market

Despite the previous upward trend in diesel oil consumption in Poland, growth of demand for the fuel was negative in 2012. This is believed to have been caused by the economic slowdown, and in particular by the weaker performance from the construction and transport industry than in prior years, as well as lower growth of domestic demand. The average annual retail price of diesel oil has grown rapidly over the last few years. In 2011, the growth rate was 18.1% and a year later 12.5% (according to preliminary data). As a consequence, the price per litre as at the end of 2011 soared to almost PLN 5.60, which proved to be the point beyond which consumers cut back on their diesel oil consumption. Preliminary estimates show that compared with 2011, diesel oil consumption fell 9.4% in 2012, to just above 12m tonnes.

Similarly to other European countries, the demand for gasoline declined for another consecutive year, driven by continuous price growth since 2009, weaker purchasing power and better fuel efficiency of vehicles in Poland. Another factor was the dieselisation of vehicles. For 2012, the demand for gasoline in Poland was estimated at 3.8 million tonnes. Accordingly, negative growth is projected at (-)5.1%, down 0.6pp relative to a year ago.

Given the high prices of gasoline, the less expensive LPG alternative fuel has gained popularity. More than 2.2m tonnes of LPG are estimated to have been sold in 2012, which means that, contrary to 2011, demand for the fuel is up (2.9% growth). For several years now, the demand for light fuel oil has weakened following the popularity and availability of other heating fuels in Poland. According to preliminary estimates, light fuel oil consumption in Poland in 2012 was just under 950,000 tonnes, down 13.9% on 2011.



The demand for diesel oil, gasoline, LPG and light fuel oil is estimated to drop in aggregate by approximately 7% in 2012. No significant improvement is expected in this area in 2013.

It is estimated that growth in the number of passengers served by Polish airports in 2012 accelerated compared to 2011, mainly as a result of the EURO 2012 football championship. This increase precipitated a rise in aviation fuel consumption. Preliminary data shows that in 2012, demand for aviation fuel pushed past 490,000 tonnes, which is 1.4% more than in 2011. Over the last few years, the number of passengers using Polish airports has grown, which has resulted in an average annual growth rate of JET fuel consumption of 5%..

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

Polish retail fuel market

At the end of 2012, there were about 6,700,000 service stations in Poland. [7] The year saw continued consolidation of the retail segment and optimisation of the station chain in Poland. Major moves in that direction included the acquisition by Shell of 106 Neste service stations.

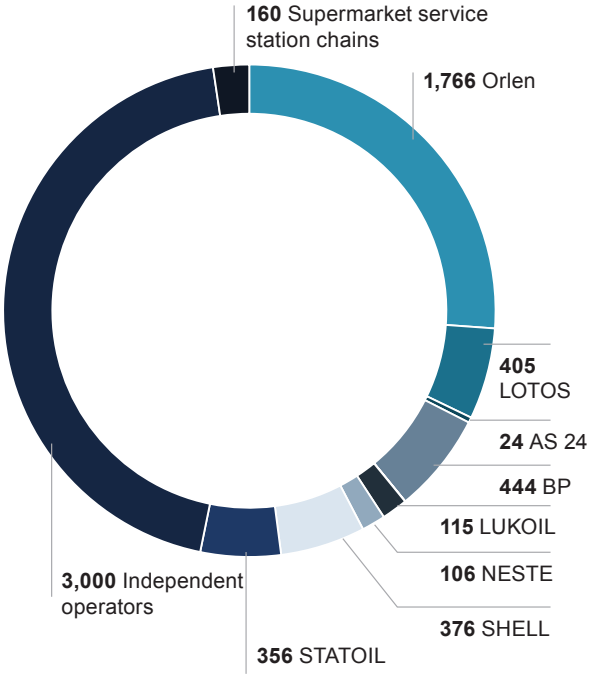
Compared with the preceding year, the number of stations owned by both Polish and international corporations increased, while concurrently there was a drop in the number of stations owned by independent operators. Among those who remained on the market, there was a marked trend to join large service station chains.

Expansion of Poland's motorway network has been accompanied by the appearance of a growing number of motorway stations. At the end of the year, there were 43 Motorway Service Areas (MSAs) in Poland. [8]

LOTOS Optima recorded a marked growth in the economy segment. At the end of 2012, there were 101 stations operating under this brand, nearly twice as many as at the end of 2011.

[7] Based on data from the Polish Organisation of Oil Industry and Trade (POPiHN).
[8] Based on data from the Polish Organisation of Oil Industry and Trade (POPiHN).

Fuel stations in Poland as at the end of 2012



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

Strategy

LOTOS Group operational priorities are set forth in the LOTOS Group strategy for 2011–2015 and development directions until 2020. In line with the strategy, most of our efforts are focused on the dynamic growth of the hydrocarbons exploration and production segment, and improvement of trading efficiency combined with optimisation of the operating area. Implementation of the strategic objectives has significantly progressed thanks to the 10+ Programme, which has increased the Gdańsk refinery's annual capacity to over 10m tonnes of crude.

Our overarching strategic objective is to create value for shareholders through optimised utilisation of human and material resources and implementation of development programmes in the areas of oil exploration and production, processing and trading. These programmes are pursued in compliance with the principles of sustainable growth, which we understand as the continuous effort to reduce our environmental footprint, and paying due regard to the intellectual capital and experience of our personnel.

In the exploration and production area, we have intensified our efforts to expand our resource base, in order to take advantage of the high margins projected for this sector in the long term.

Strategic objectives for the exploration and production business:

- Achievement in 2015 of production volumes in the range of 24,000 boe/d *(barrel of oil equivalent/day)* – equivalent to 1.2 million tonnes a year;
- Increased production of hydrocarbons in line with the priorities of Poland's energy policy until 2030;

In the operating area, we are focused on the efficient utilisation of our expanded refining capacities following the 10+ Programme, further increase of the conversion ratio and optimum use of synergies between the refining and power sectors.

Strategic operating goals:

- Achieving world-class production standards and maintaining a strong competitive position among the European refineries;
- Making optimum use of assets held and acquired as part of the growth strategy;
- Ensuring safe and stable operation of the production and ancillary facilities, as measured by the minimum annual availability of 98%;
- Further increasing the conversion ratio and intensifying feedstock processing.

The objective behind our marketing activities is to further develop our retail chain and marketing structures, based on the extended distribution network and efficient product logistics.

Strategic marketing goals:

- Maintain a 30% share in the domestic fuel market;
- Achieve fuel sales exceeding the fuel production capacities of the Grupa LOTOS refinery by 15%;
- Secure a 10% share in the domestic retail market by the end of the forecast period;
- Develop a chain of service stations and intensify sales through the existing chain;
- Maintain the leading position on the Polish lubricants market.

Implementation progress

In 2012, we continued to implement our strategy. Despite the volatile market conditions and perceived economic slowdown, the strategic objectives set at the beginning of that year did not change. The long-term perspective of our strategy permits us to flexibly respond to threats and opportunities as they arise.

The key prerequisite for the success of our strategy is intensification of our exploration and production activities. Achieving this objective by the end of 2015 will enable creation of a strong and stable oil conglomerate, with production activities contributing a significant portion of profits. In 2012, crude output was 262,300 tonnes, including 74,600 tonnes produced in Lithuania. This represents a 15.4% increase (by 35,100 tonnes) compared to the 2011 output of 227,200 tonnes. Last year, crude oil was produced from the B3 field and from the B8 field (test production) in the Baltic Sea, and from onshore fields in Lithuania. Output of associated natural gas produced from the Baltic Sea totalled 20.9m Nm3. Production levels were adversely affected by delays on the Yme project, which prevented us from producing any oil from it.

Our work toward attaining strategic goals in the upstream segment will focus on further consistent development of our operations in the Baltic Sea, on the Norwegian Continental Shelf and in Lithuania. Key tasks in the delivery of our strategy for the segment include: continued production from the B3 field, development and launching of production from the B8 field, development of new assets in the Baltic Sea and onshore, following completion of an exploration programme, acquisition of new production assets in Norway, recovery of capital invested in the Yme project, and continued production growth in Lithuania.

In the operating and marketing areas, the LOTOS Group's implementation of strategic objectives and achievement of relevant ratios in 2012 progressed in accordance with the original assumptions. The LOTOS Group's share in the domestic market for fuels (diesel oil, gasoline, light fuel oil) expanded by 0.4pp on the previous year to 34%, thus exceeding its strategic target. The LOTOS Group's share in the retail market (diesel oil, gasoline) grew to 8%. Strategic objectives here will be pursued based on further consistent roll-out of stations in the premium segment (including motorway stations) and dynamic development of the budget LOTOS Optima chain.

Development activities undertaken here are focused on increasing the LOTOS Group’s value through innovative and sustainable development with due regard to its stakeholders’ principles and values. Given the high price of oil and the volatility of the currency markets, a high share of own production relative to the refinery’s processing volumes will improve our stability and enhance profitability. We are striving to build a vertically integrated and economically efficient conglomerate. This requires a commitment to the optimal development of other segments of the business.

Prospects

The LOTOS Group's primary development directions until 2020 are consistent with those set for 2010, and include:

- Further optimisation of the management model to achieve the highest available efficiency,
- Access to proven recoverable reserves of hydrocarbons of approximately 330m boe in 2020,
- Increasing production to approximately 110,000 boe/day (equal to 5m tonnes of crude a year),
- Maintaining a 30% share in the domestic fuel market,
- Sales exceeding the fuel production capacities of Grupa LOTOS refinery by 15%,
- Getting an at least 10% share in the domestic retail market,
- Further improving the economic efficiency of crude processing, ensuring full utilisation of the LOTOS Group's assets,
- Taking steps to optimise power management processes at our refinery, by increasing its connection to other power systems.

The key tasks geared towards building our production potential after 2015 are to:

- Continue production from current fields,
- Develop the B4 and B6 gas fields in partnership with CalEnergy Resources Poland, and put the fields on stream,
- Continue exploration of our licences in order to identify prospective geological structures and subsequently develop and launch production from identified prospects,
- Expand our portfolio of exploration assets – secure new licences by filing relevant applications and participating in licensing rounds, and monitor areas covered by unconventional hydrocarbon exploration licences in Poland for opportunities to acquire shares in selected prospects,
- Maintain and enhance production potential in Lithuania – accelerate drilling in existing fields and pursue exploration activities with a view to developing new areas and evaluating their unconventional potential.

Letter from the Vice-President of the Board

Dear Stakeholders,

2012 proved to be a year of economic slowdown, fluctuations in exchange rates and varying margins on petroleum products. Yet in spite of the difficult external conditions, the EU economies being torn apart by recession and wrecked by financial liquidity problems, moderately sceptical global financial markets and political struggles in various parts of the world that caused oil prices to fluctuate, we managed to achieve a solid net profit of approximately PLN 923m.

In the four quarters of 2012 we generated consolidated sales revenue of PLN 33bn, which represents a 13% increase on the previous year. The reported operating profit of the concern is PLN 301m, whereas the operating profit (once the events distorting it are eliminated and the LIFO effect accounted for) is PLN 1.3bn - 131% higher than in 2011.

The exploration and production segment, whose development is a crucial element of our business strategy, was affected by a number of significant events. We entered into an investment contract with CalEnergy Resources on the common development of our B4 and B6 gas deposits in the Baltic Sea. In Lithuania, we took full control of the UAB Manifoldas extraction company, which belongs to the AB Geonafta Group, the purchase of which we had finalised in 2011.

2012 profit was also charged with, and therefore considerably affected by, an impairment loss of PLN 935m, with respect to the value of Grupa LOTOS' shares in the Yme project on the Norwegian Continental Shelf - the result of a significant delay in its implementation. It is also worth noting that in 2013, the operator of the deposit, Talisman Energy, and the owner the platform, SBM Offshore, concluded a contract for removal of the faulty platform from the field, which opens the possibility for us to further develop this project or sell our shares.

Another essential pillar of our strategy is the downstream segment. Throughout the year Grupa LOTOS used the processing capacity of its modern refinery at a level in excess of 92%. The operational flexibility of the refinery's installations, configured under the 10+ Programme of expansion, enabled us to adapt quickly to the market environment. Crude oil processing then reached another record level of 9.7m tonnes, which is a 6% increase on the previous year. The profit structure was improved again to the advantage of high-margin products, especially gasolines, aviation fuel and LPG. While stressing the significance of the 10+ Programme, it is also worth emphasising our financial security. In spite of the fact that the servicing of debt incurred on the financing of the 10+ Programme is still affecting the Company's finances, the modernisation has earned Grupa LOTOS a leading position among the most technologically advanced and effective European refineries. In 2012, we managed to reduce our debt considerably, which means that our net debt to assets ratio decreased to 68% from 2011's 90%.

Another important factor was the 2012 connection of the Gdańsk refinery to a natural gas power system, which is now the basis for the creation of new initiatives aimed at raising the power efficiency of the plant and the profitability of its crude oil processing.

Additionally, we have consolidated our leading sales channels and are actively searching for new ways to increase sales. In 2012, these activities saw the LOTOS brand’s share in the national fuel market increase to 34.3%.

By the end of 2012, we had expanded the LOTOS service station chain to 405 facilities, including 101 stations under the LOTOS Optima economy brand - doubling of the number of stations in this segment since 2012. Our share in the retail market as at the end of 2012 was 8%. Because the economic situation in Europe is still unstable, the Company decided to introduce the Optimal Expansion Programme for 2012, with plans to launch a number of projects improving the overall efficiency of the concern, while still keeping an eye on the realisation of key strategic projects. By the end of 2012, the programme had realised savings of PLN 446m as a result of pro-efficiency actions, cost savings and other planned investments by the LOTOS Group.

The profit achieved in 2012 together with our stable financial situation will become a safe base for the implementation of ambitious development projects in the years to come, which will contribute to improving the competitiveness of Grupa LOTOS while also consolidating our foundations for creating better value for the Company's shareholders.

Yours faithfully,

Mariusz Machajewski
Vice-President of the Board
Chief Financial Officer
Grupa LOTOS S.A.

Stock market

Grupa LOTOS S.A. debuted on the Warsaw Stock Exchange (WSE) on June 9th 2005. Under the Issue Prospectus, 78,700,000 ordinary Series A shares with a par value of PLN 1 per share and 35,000,000 ordinary Series B shares with a par value of PLN 1 per share were introduced to public trading. Following the issue of the Series B shares, on June 28th 2005, the increase in the Company's share capital to PLN 113,700,000 was noted.

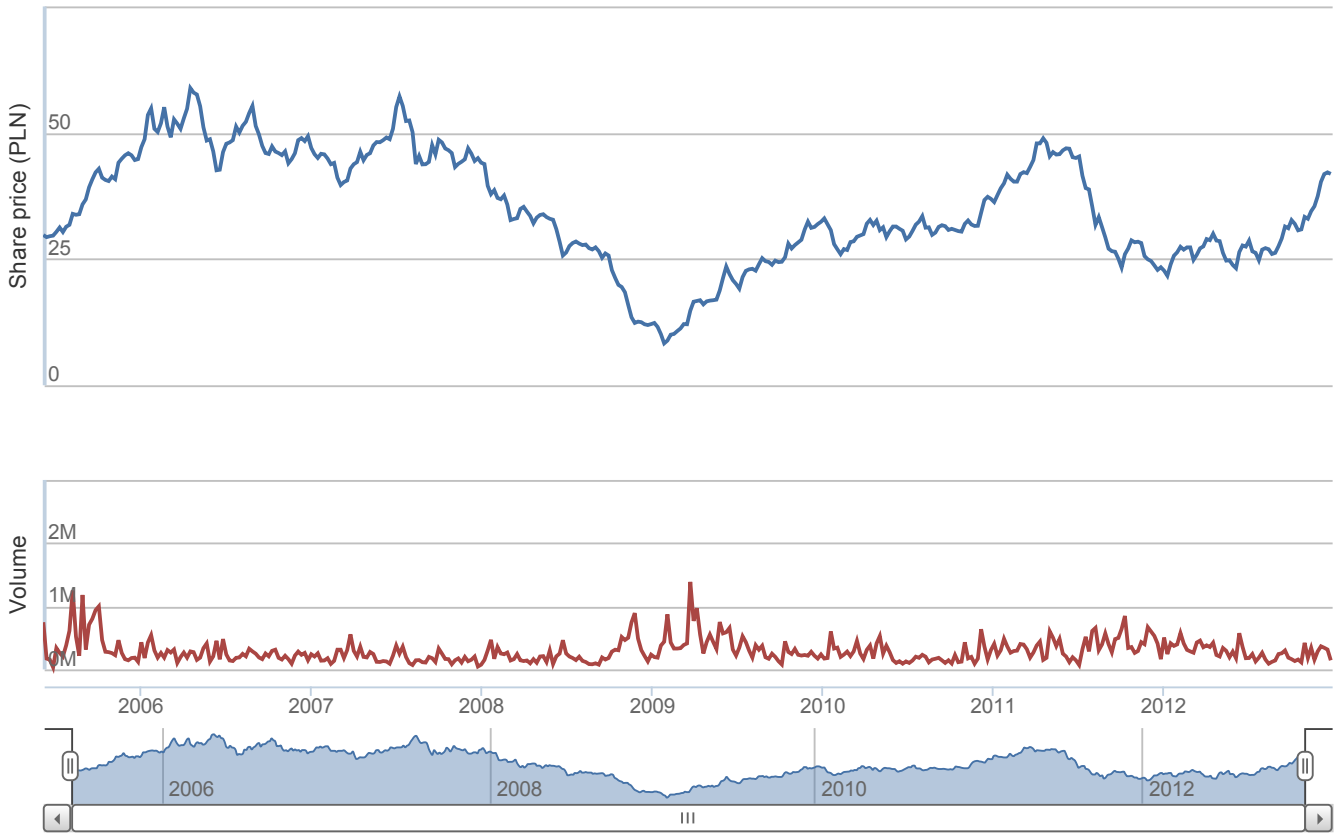
The issue price was set at PLN 29, and after trading started, the market price rose to PLN 32 - that is, by 10.34%.

Through the public offering, Grupa LOTOS raised proceeds of PLN 1,015,000,000. These were applied towards the acquisition of shares in Rafineria Czechowice S.A. (80.04% ownership interest), Rafineria Jasło S.A. (80.01%), Rafineria Nafty Glimar S.A. (91.54%) and Petrobaltic S.A. (69%), as well as to implementation of the 10+ Programme at the Company’s refinery in Gdańsk.

On July 17th 2009, another increase in Grupa LOTOS' share capital was registered, after the issue of 16,173,362 ordinary Series C shares covered by a non-cash contribution in the form of shares in LOTOS Petrobaltic, LOTOS Jasło and LOTOS Czechowice.

The current total number of Company shares is 129,873,362.

Stock price performance and trading volume since the Company's stock-exchange début



Grupa LOTOS on the stock exchange

The world's key markets closed out the year 2012 on a bullish note. London's S&P100, New York's NASDAQ Composite and France's CAC40 indices all posted gains of more than a dozen per cent, and the Warsaw Stock Exchange also saw an uptrend. The annual increase on the WIG (all-caps index of the main market) was 26.2%, while the WIG-20 rose by slightly over 20%. WIG-PALIWA (the index of fuel companies) advanced by 39.0%. Against the background of the economic deceleration in Europe, debt crisis in the eurozone and economic problems in the US, investor sentiment was improved by the decisions of bodies responsible for monetary policy (the Monetary Policy Council, European Central Bank and the US Federal Reserve).

Two major trends were observed in Grupa LOTOS stock price dynamics in 2012. In the first half of the year, there was a horizontal movement in the stock price, amid increased trading volumes. The strong price rebound in early June provided the catalyst for a strong uptrend: over the year, the price of Grupa LOTOS stock went up by 76.8%. This price reached a low on January 11st 2012 (PLN 21.33 per share) and peaked on December 11th 2012 (PLN 43.00 per share).

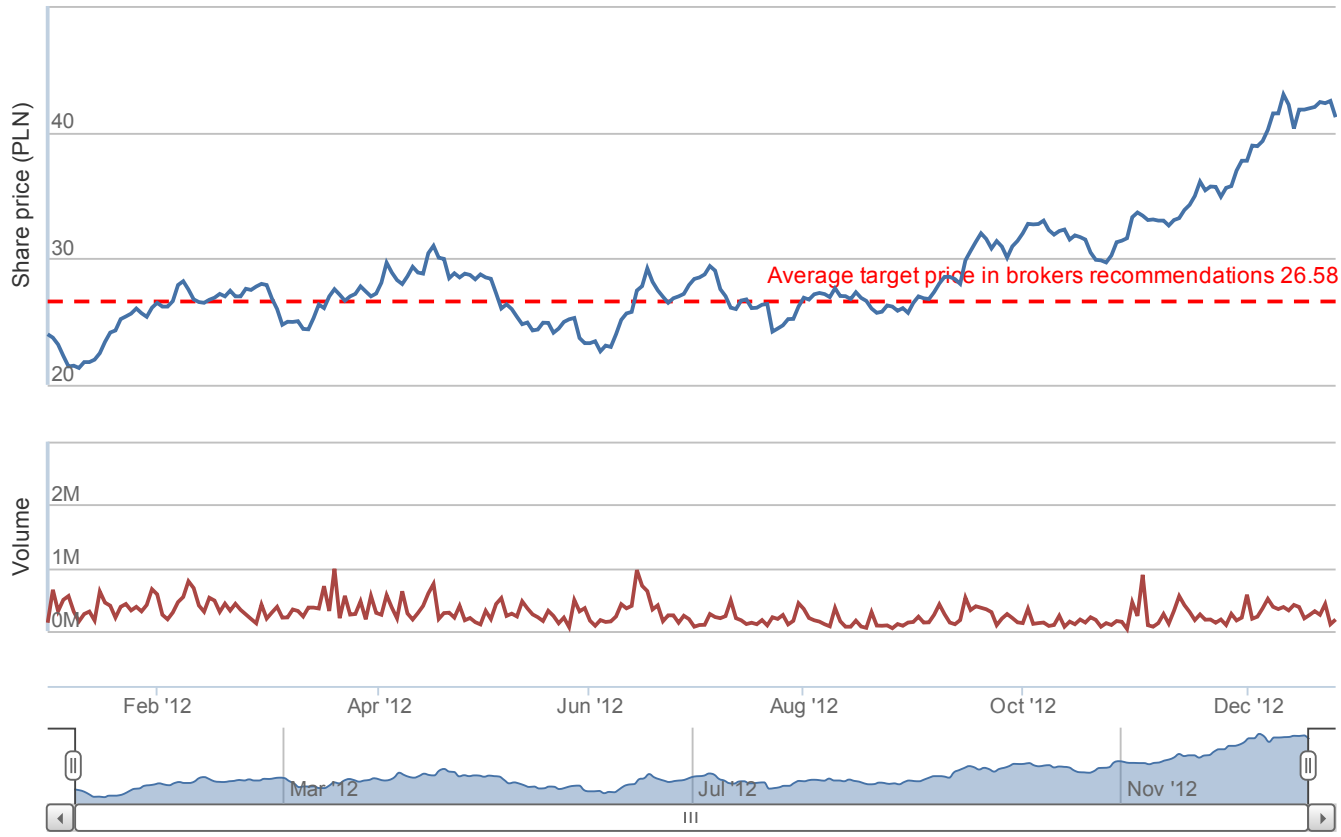
In 2012, the uptrend in Grupa LOTOS share price was stronger than in the WIG, WIG20 and WIG-PALIWA (fuel sector index) exchange indices; the price growth had significantly overtaken the market. Over 2012, the RESPECT index of socially responsible companies grew by 29.2%.

In the period under review, the number of the Company’s shares which changed hands in an average trading session was 282,163, down by 25% relative to the previous period. The total value of trading on the Company’s shares was PLN 2,013m, representing 1.07% of the total trading value on the WSE.

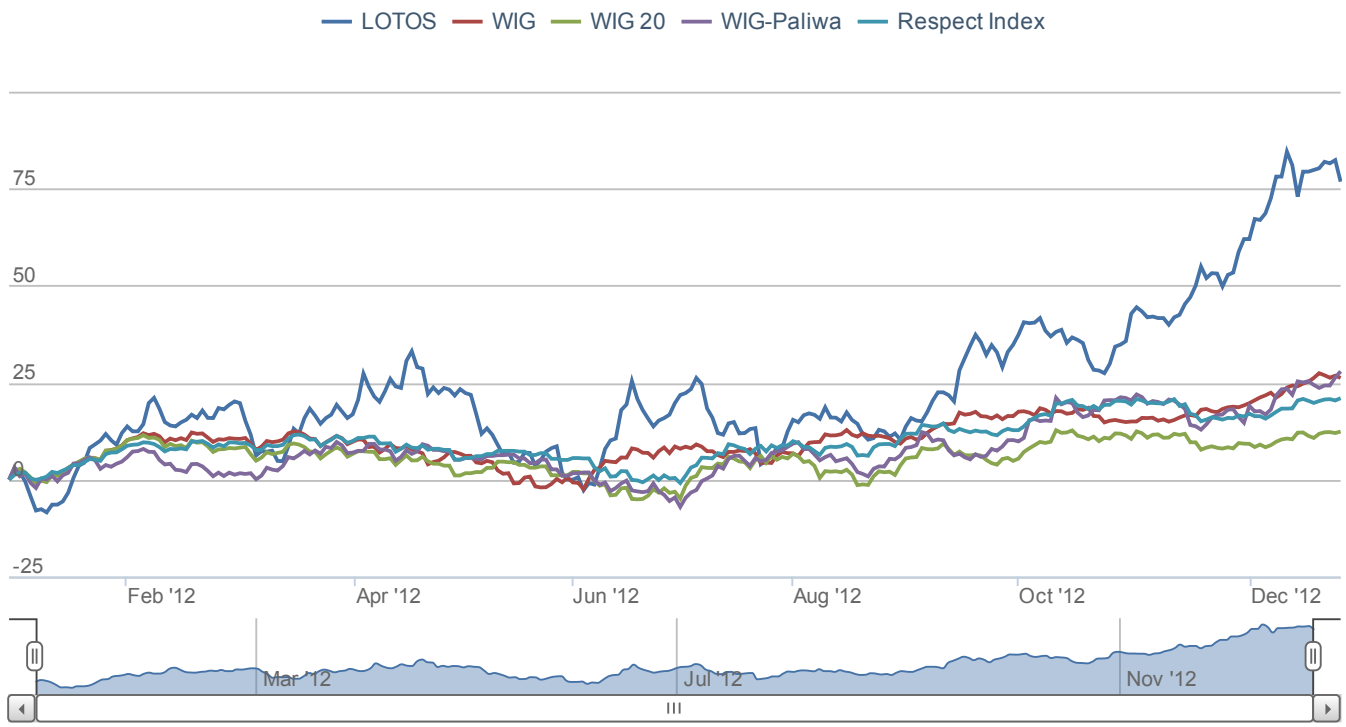
Grupa LOTOS’ market capitalisation as at the end of 2012 was PLN 5,351bn.

At the end of 2012, the closing price was PLN 41.20 per Company’s share. The rate of return for the year was 76.82%.

Grupa LOTOS' stock price performance and trading volume in 2012



Grupa LOTOS price performance vs. market indices in 2012



All-year low and high closing prices of Grupa LOTOS shares and closing prices on the WSE

End of year, December 31			
	Low (PLN)	High (PLN)	Closing price (PLN)
2009	7.21	32.80	31.80

2010	25.05	37.85	36.35
2011	22.26	49.50	23.30
2012	21.30	43.78	41.20

Source: In-house analysis based on WSE data.

Months, 2012

Month	Low (PLN)	High (PLN)	Closing price (PLN)
January	21.30	26.37	26.10
February	25.72	28.98	28.00
March	24.36	28.19	27.23
April	27.33	31.90	28.35
May	23.30	28.92	23.30
June	22.66	29.57	27.90
July	24.02	29.49	26.19
August	25.55	27.65	26.48
September	26.60	32.00	31.40
October	29.50	33.98	33.65
November	32.27	38.55	37.75
December	37.81	43.78	41.20

Source: In-house analysis based on WSE data.

Rate of return

End of year, December 31st

Year	Rate of return at end of period (%)	Rate of return from beginning of year (%)
2009	166.11	166.11
2010	14.31	14.31
2011	-35.90	-35.90
2012	76.82	76.82

Source: In-house analysis based on WSE data.

Months, 2012

Month	Rate of return at end of period (%)	Rate of return from beginning of year (%)
January	12.02	12.02
February	10.28	20.17
March	-2.02	16.87
April	4.11	21.67
May	-17.81	0.00
June	17.67	19.74
July	-6.13	12.40
August	5.00	13.65
September	18.58	34.76
October	7.17	44.42
November	12.18	62.02
December	9.14	76.82

Source: In-house analysis based on WSE data.

Volume

According to data furnished by the WSE, the total value of trading on Company's shares - that is, the aggregate value of all transactions on Grupa LOTOS securities concluded in 2012 - was PLN 2,013.15m. 54.10% of Company's shares were traded in 2012. The average daily trading volume was 282,000 shares per session.

As at the end of the year

Year	Trading value (PLN m)	Share in trade on the WSE (%)	Turnover rate (%) *	Average trading volume per session
2009	3,642.56	1.11	173.00	381,938
2010	3,684.33	0.88	53.40	234,464
2011	3,299.07	1.31	73.10	377,048
2012	2,013.15	1.07	54.10	282,163

Source: In-house analysis based on WSE data.

* Turnover rate – the ratio of annualised trade for a current period to market capitalisation at end of period.

Months, 2012

Month	Trading value (PLN m)	Share in trade (%)	Turnover rate (%)	Average trading volume per session

January	189.46	1.06	6.10	379,430
February	225.38	1.25	6.40	397,127
March	214.68	1.11	6.20	368,315
April	187.20	1.48	5.00	338,203
May	150.55	1.05	4.60	281,384
June	170.11	1.10	5.00	321,139
July	116.84	0.74	3.40	201,949
August	82.41	0.57	2.40	140,576
September	148.96	0.99	3.90	252,139
October	116.61	0.73	2.80	158,500
November	193.81	1.29	4.30	266,366
December	217.14	1.50	4.10	310,169

Source: In-house analysis based on WSE data.

Stock market ratios

End of year, December 31st

Year	Number of shares	Capitalisation at year end (PLN m)	Book value (PLN m)	Earnings per share (PLN)	P/E **	P/BV **
2009	129.87	4,130	6,489.76	7.44	4.60	0.61
2010	129.87	4,721	7,266.09	5.23	7.00	0.63
2011	129.87	3,026	7,829.99	5.03	4.63	0.38
2012	129.87	5,351				

Source: In-house analysis based on WSE and Company data.

** Based on the year-end price.

Dividend Policy

Distributions of dividend for the years covered by the current strategy, i.e. for 2011–2015, are subject to the optimisation of LOTOS Group financing. Grupa LOTOS' financial strategy provides for distribution of up to 30% of net profit as dividend.

The Company’s Board recommended that no part of the 2011 net profit be distributed among the Company’s shareholders.

On June 28th 2012, acting upon the Board's recommendation, the General Meeting resolved to distribute the 2011 profit as follows:

- PLN 306,169,935.90 was transferred to statutory reserve funds,
- PLN 1,500,000.00 was transferred to the Special Account designated for financing corporate social responsibility (CSR) projects.

Dividend and dividend yield

Financial year	Dividend per share (PLN)	Dividend per share (PLN)	Share price at the year end (PLN)	Dividend yield* (%)
2005	0.00	0.00	44.20	
2006	40,932,000.00	0.36	49.30	0.73
2007	0.00	0.00	44.50	
2008	0.00	0.00	11.95	
2009	0.00	0.00	31.80	
2010	0.00	0.00	36.35	
2011	0.00	0.00	23.30	

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

Historical dividend per share

Financial year	Dividend per share (PLN)	% of net profit	Dividend record date*	Dividend payment date**
2005	0.00	0.00		
2006	0.36	10.06	June 11 2007	not later than July 31 2007
2007	0.00	0.00		
2008	0.00	0.00		
2009	0.00	0.00		
2010	0.00	0.00		
2011	0.00	0.00		

* Dividend record date – date on which the list of shareholders entitled to receive dividend for a given financial year is determined.
** Dividend payment date – date on which dividend is paid to the Company's shareholders.

Brokers' recommendations

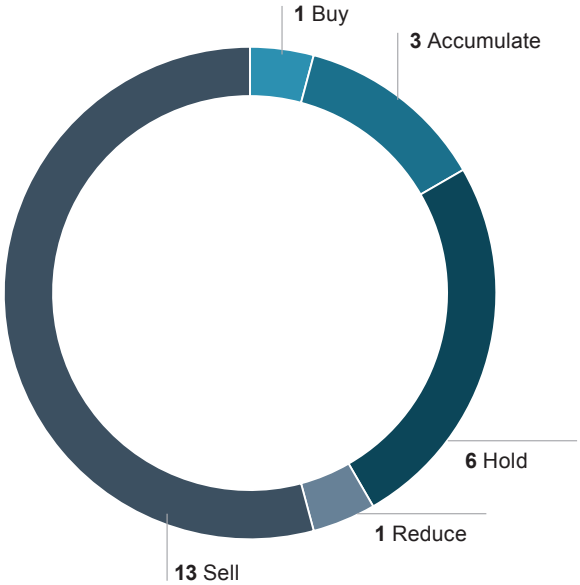
According to the Company's knowledge, in 2012 brokers issued 24 recommendations (including also updates to recommendations), as follows:

- 1 recommendation "Buy",
- 3 recommendations "Accumulate",
- 6 recommendations "Hold",
- 1 recommendation "Reduce",
- 13 recommendations "Sell".

According to the brokers, the target price of Grupa LOTOS shares fluctuated from PLN 19.40 to PLN 38.90. The average price of Grupa LOTOS shares was PLN 26.58 in 2012.

The market value of Grupa LOTOS shares fluctuated from PLN 21.30 to PLN 43.78. At the end of 2012, the price stood at PLN 41.20.

Structure of brokers' recommendations for Grupa LOTOS shares



Grupa LOTOS in the RESPECT Index

Since November 19th 2009, Grupa LOTOS has been continuously included in the index of WSE-listed socially responsible companies – the RESPECT Index (*Responsibility, Ecology, Sustainability, Participation, Environment, Community, Transparency*). The index comprises businesses managed in a sustainable and responsible manner, offering highly attractive investment opportunities.

In 2012, the Company twice (every six months) underwent external review for compliance with the index's criteria. Following the preliminary classification of companies against the free-float criterion, this further evaluation covers corporate governance, information governance and investor relations practices, as well as practices in the area of environmental protection, social responsibility, and employee and customer relations.

On January 24th 2013, Grupa LOTOS was selected for inclusion in the RESPECT Index for the sixth time. The index currently consists of 20 listed names.

The RESPECT Index is an income index, taking into account income from dividends and pre-emptive rights. The interests of the companies listed as part of the index (their weights) represent their number of free float shares less the number of shares introduced to trading. The numbers are rounded to the nearest thousand. The shares of major index companies are limited to 25% when the index includes fewer than 20 companies, and to 10% when it exceeds 20. The index is calculated continuously at one-minute intervals. The index's opening value is published after session opening, when the companies' stock prices enable valuation of at least 65% of the index's portfolio during the session. Its closing value is broadcast once the session has been closed.

Exploration and production

The LOTOS Group views further development of the exploration and production segment as a priority. The LOTOS Group's development directions until 2020 provide for:

- Increased production of hydrocarbons to approximately 100,000 boe/day (equal to 5m tonnes of crude a year),
- Access to proven recoverable reserves of hydrocarbons of approximately 330m boe in 2020.

Strategic objectives for the exploration and production business are achieved through:

- Continued operations in the Baltic Sea, in Lithuania, on the Norwegian Continental Shelf and in the North Sea,
- Acquisition of hydrocarbon deposits with a low or moderate risk profile,
- In the short term, projects in their final stage of development and/or in the production phase; in the long term, growth projects and acquisition of new licences,
- Looking for growth opportunities in market niches beyond the oil majors' interests,
- Acquisition of new licences as part of the development of the onshore and offshore exploration and production business, including in the area of unconventional hydrocarbon exploration.

Management approach

Grupa LOTOS is engaged in exploration and production in Poland, Lithuania, and Norway through its subsidiary, LOTOS Petrobaltic S.A.

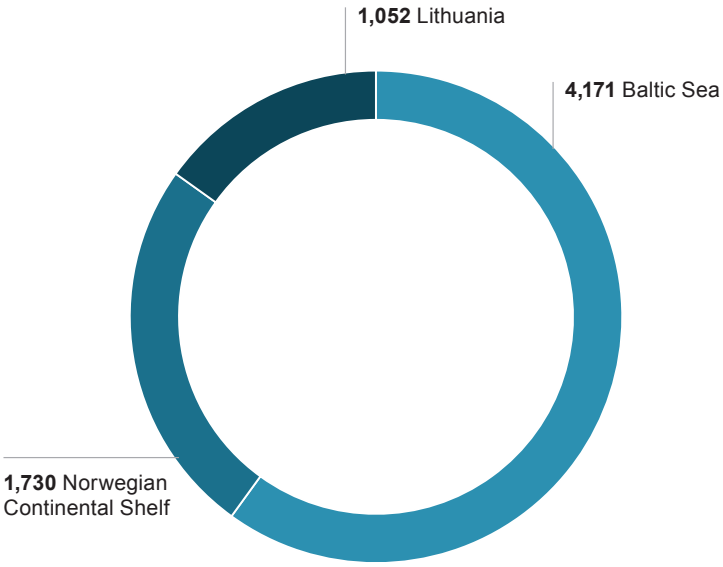
LOTOS Petrobaltic is directly responsible for operating activities at home. In Lithuania, it conducts operations through AB LOTOS Geonafta of Gargždai and its subsidiaries, while Norwegian operations are carried out by LOTOS Exploration and Production Norge AS of Stavanger. The LOTOS Petrobaltic Group includes also two companies conducting support activities: Grupa Miliana and Energobaltic Sp z o.o.

Grupa Miliana renders sea transport services, using six company-owned vessels: a tanker, two surveillance ships, two tugboats and a research vessel. Additionally, Grupa Miliana charters third-party vessels, such as tankers and tug/supply vessels.

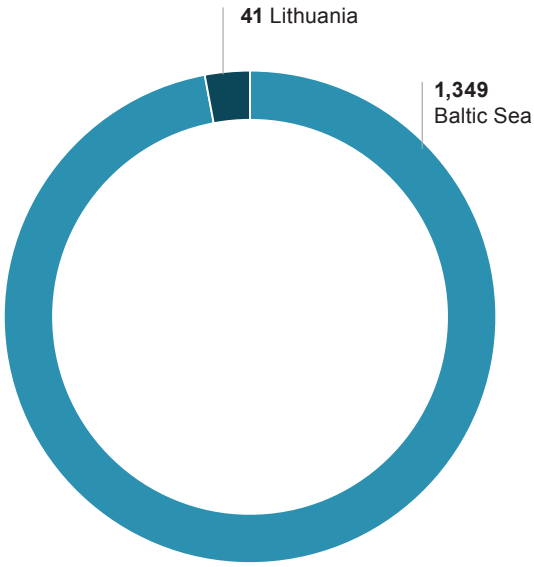
Energobaltic was established to manage associated gas generated in the process of oil production from fields located in the Baltic Sea. The company, which has its registered office in Władysławowo, is involved in the production of electricity, heat, LPG and natural gas condensate, using waste gas from an offshore oil production facility (the B3 field).

As at December 31st 2012, crude oil reserves and resources held by the LOTOS Petrobaltic Group amounted to 6.95 million tonnes, or 53.2m bbl (reserves classified as 2P), and 1.39 million tonnes or 10.6m bbl (resources classified as 2C), whereas its natural gas reserves and resources were 0.48 billion cubic metres (2P) and 6.46 billion cubic metres (2C).

Crude oil reserves classified as 2P (thousand tonnes)



Crude oil reserves classified as 2C (thousand tonnes)



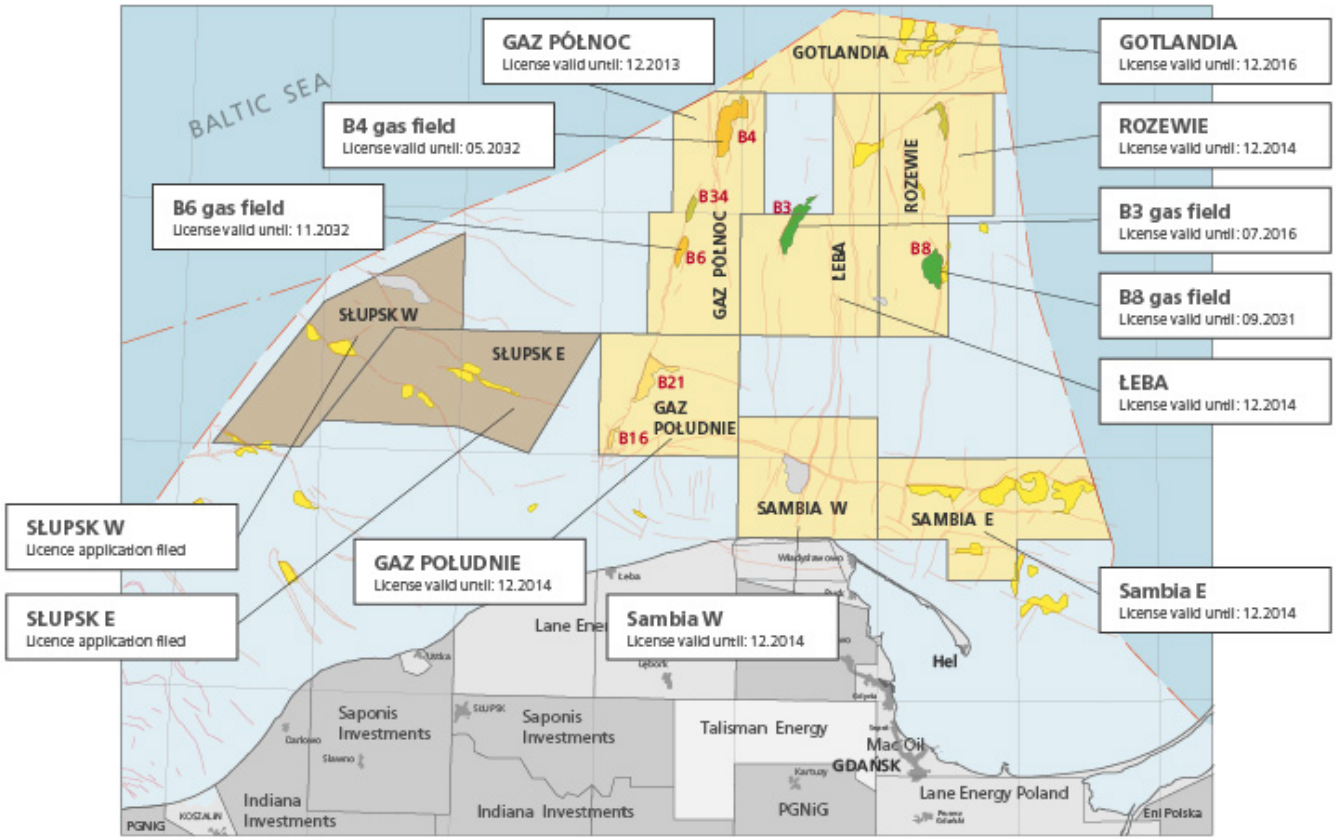
Upstream business in Poland – Baltic Sea

LOTOS Petrobaltic holds seven licences for exploration and appraisal of mineral deposits in the Polish economic zone of the Baltic Sea. These are the Gotlandia, Łeba, Rozewie, Gaz Północ, Gaz Południe, Sambia E and Sambia W exploration licences, covering a total area of more than 7,000 km2. Two applications for exploration licences for the Słupsk E and Słupsk W areas are currently awaiting decisions from the Ministry of Environment.

LOTOS Petrobaltic holds four hydrocarbon production licences:

- For the B3 field: a field of crude oil and associated natural gas located around 73 km north of Cape Rozewie; in production since 1992. An option to extend the period of oil production beyond 2016 is currently being analysed.
- For the B8 field: crude oil and associated natural gas, located around 70 km north of Jastarnia (B8). The B8 licence is valid until 2031. The field is currently being developed.
- For the B4 and B6 natural gas fields: valid until 2032. Preparations are underway for development of the fields in partnership with CalEnergy Resources Poland, as part of a cooperation agreement signed in 2012.

As at December 31st 2012, LOTOS Petrobaltic's crude oil reserves and resources in the Baltic Sea amounted to 4.17 million tonnes, or 32.3m bbl (reserves classified as 2P) and 1.35 million tonnes or 10.4m bbl (resources classified as 2C), whereas its natural gas reserves and resources were 0.48 billion cubic metres (2P) and 6.46 billion cubic metres (2C).

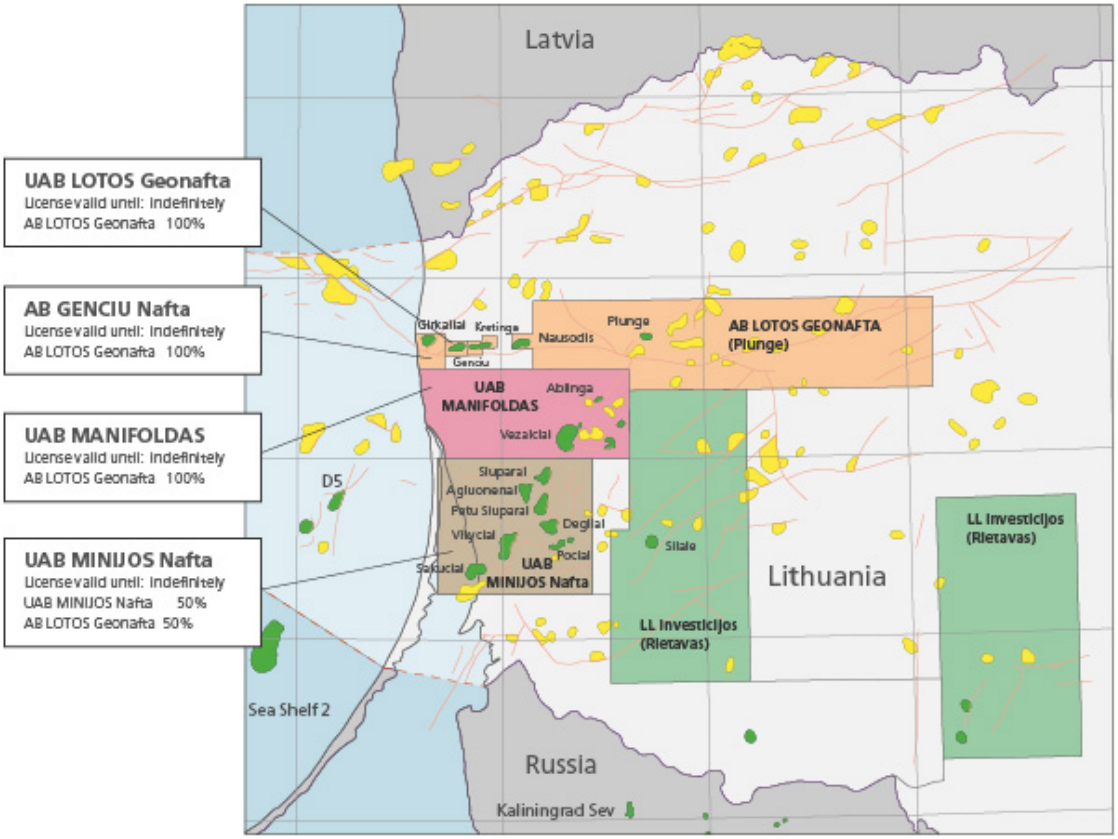


In the Baltic Sea in 2012, LOTOS Petrobaltic produced from the B3 field and, as part of production tests, from the B8 field. In the reporting period, total production from the fields in the Baltic Sea reached 187,700 tonnes of crude oil and 20.9 million Nm3 of natural gas.

Upstream business in Lithuania

In Lithuania, LOTOS Petrobaltic operates through its wholly-owned subsidiary, AB LOTOS Geonafta. The AB LOTOS Geonafta Group comprises UAB Genciu Nafta, UAB Manifoldas and UAB Minijos Nafta.

The AB LOTOS Geonafta Group's core business consists in the exploration for and production of crude oil, and the provision of drilling services in Lithuania. The company is also engaged in crude oil trading. The AB LOTOS Geonafta Group produces from 15 oil fields.



As at December 31st 2012, crude oil reserves classified as 2P held by the AB LOTOS Geonafta Group amounted to 1.1 million tonnes (8.1 mn bbl).

The AB LOTOS Geonafta Group's crude oil production totalled 74,600 tonnes in 2012. The Lithuanian companies aim to achieve a total annual crude oil output of approximately 100,000 tonnes in 2015.

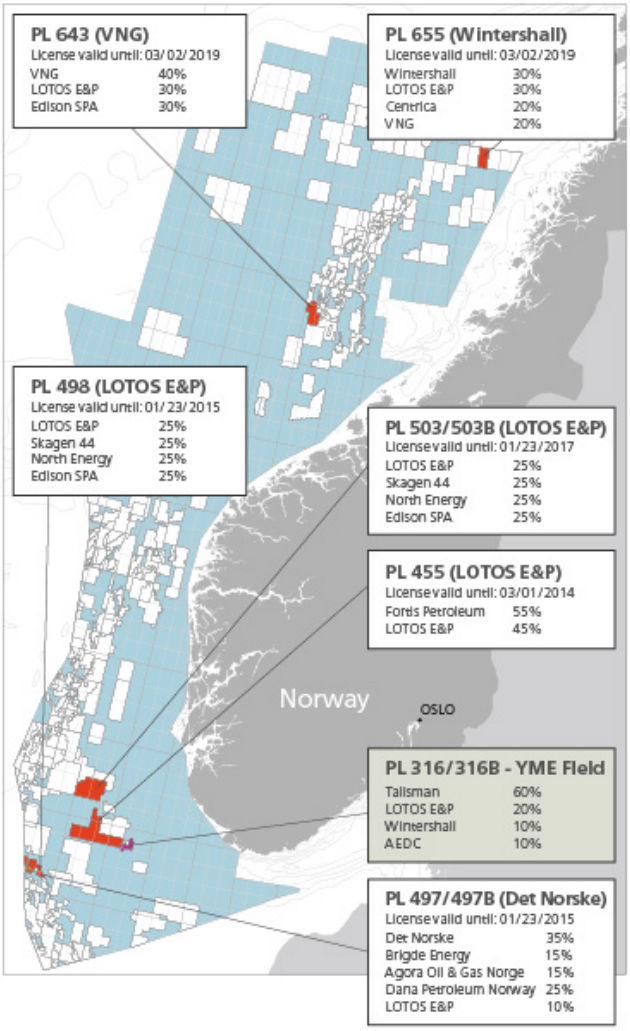
Upstream business in Norway – Norwegian Continental Shelf

LOTOS Exploration & Production Norge (LOTOS Norge) is the subsidiary responsible for the development of operations on the Norwegian Continental Shelf. LOTOS Norge presently has interests in seven licences for exploration for and production of crude oil: (PL 643, PL 503/503B, PL 498, PL 497/497B, PL 655, PL 455, PL 316/316B), acting as the operator for three of them (PL 503/503B, PL 498 and PL 455).

LOTOS Norge's assets include a 20% interest in licence PL 316/316B, under which the YME field is being developed by a consortium which includes Talisman Energy, a Canadian company, as the operator. A number of problems have been encountered in the course of the development process that have prevented the start of production from the Yme field. In 2012, after identification of cracks in the supports of the platform legs and due to the failure by SBM, the platform’s owner and supplier, to provide relevant safety certificates, the operator evacuated the platform's staff and suspended work. Currently, Grupa LOTOS activities in the YME project are focused on securing the Company's strategic interests and recovering the capital invested so far in the project.

In the area covered by the remaining six licences, exploration work is in progress to evaluate their potential and identify any in-place resources. LOTOS Norge also participated in the APA licensing rounds organised by the Norwegian Ministry of Petroleum and Energy.

As at December 31st 2012, crude oil reserves classified as 2P held by LOTOS Norge amounted to 1.73 million tonnes (12.9 mln bbl). Due to the delays in the execution of the YME project, there has been no production from the Norwegian Continental Shelf as yet.



Achievements

Major achievements in the hydrocarbon exploration and production business in 2012 included:

Poland

Baltic Sea

- Oil production from the B3 field continued,
- Development of the B8 oil field continued. This included drilling of two injection wells and running of a test production,
- An investment agreement was executed with CalEnergy Resources Poland, for joint development of and production from the B4 and B6 gas fields,
- Analyses and exploration work were conducted to examine the possibility of developing new areas.

Onshore:

- An agreement was signed with PGNiG on cooperation in exploration for and production of conventional and unconventional oil and gas, as well as commercial cooperation on PGNiG's onshore licences.

Lithuania

- LOTOS Petrobaltic purchased the remaining 50% interest in UAB Manifoldas, gaining full control of the company,
- Six production wells were drilled,
- The unconventional potential of the Lithuanian licences was analysed.

Norway

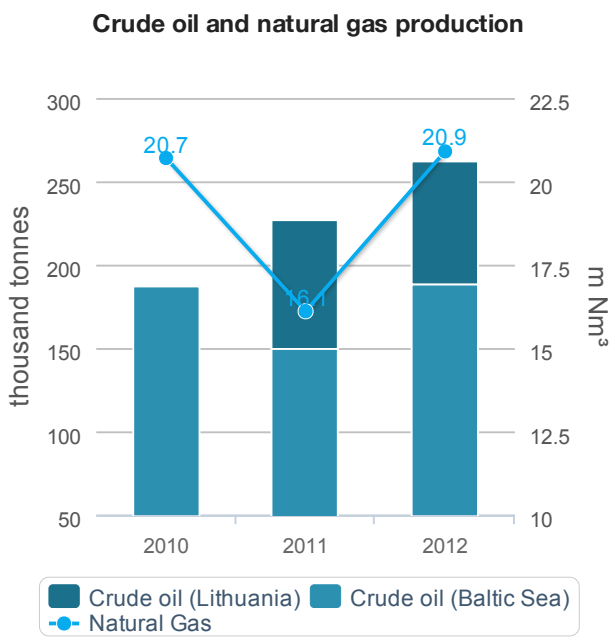
- Steps were taken to recover capital invested so far in the YME project,
- Steps were taken to acquire interests in a production field on the Norwegian Continental Shelf,
- Two exploration wells were drilled on the PL 497 and PL 498 licences,
- Two exploration licences (PL 643 and PL 655) were awarded in licensing round APA 2011.

In 2012, the crude output of the LOTOS Petrobaltic Group totalled 262,300 tonnes, including:

- 187,700 tonnes produced in Poland,
- 74,600 tonnes produced in Lithuania.

Natural gas output in 2012 totalled 20.9m Nm^3.

In the upstream segment, ongoing efforts are being made to identify new oil and gas prospects. Current exploration activities, including seismic surveys and exploration drilling, are being carried out to confirm the presence of hydrocarbons prior to further field development.



Exploration activities under way on the Baltic Sea are focused on evaluating the resource potential of the Gotland, Łeba, Sambia E and Sambia W licence areas, and the possibility of developing the prospects there. Preparations are also being made for the drilling of an exploration well on the Rozewie licence.

In 2012, two exploration wells were drilled in the Norwegian Continental Shelf, neither of which provided a flow of hydrocarbons. Other exploration work being carried out in Norway is focused on the acquisition of seismic data.

In Lithuania, planned exploration activities include the drilling of exploration wells under licences held by UAB Manifoldas, conduct of an extensive seismic acquisition programme, analysis of the possibility of intensifying production by carbon dioxide injection, and continued evaluation of unconventional resources.

Development plans

In 2012, we entered into two material agreements that will support implementation of our strategy in the area of crude oil exploration and production in the near future.

Cooperation with PGNiG

In September 2012, we initiated cooperation with PGNiG in the area of exploration for and production of crude oil and natural gas from conventional and unconventional deposits, as well as trading activities. The agreement's objective is intensification of exploration work in Poland. After analysis of the production potential of seven of PGNiG's licenses, four of the licence areas, situated in the Gdańsk and Szczecin Provinces, were identified for further exploration. The next phase of our work together will involve development of an action plan for the selected licences and assessment of the projects' economic viability. The action plan will define the extent of necessary seismic surveys and exploration and production drilling to be made with a view to discovering and proving the reserves, and pursuing joint development of the conventional and unconventional hydrocarbon fields.

Agreement with CalEnergy Resources

In October 2012, LOTOS Petrobaltic and CalEnergy Resources Poland entered into a joint operation agreement with respect to the B4 and B6 gas fields. Their projects will be executed through a special purpose vehicle, to which a license will be contributed. LOTOS Petrobaltic and CalEnergy Resources will share profits and costs in the SPV on a 51:49 basis (51% for LOTOS Petrobaltic and 49% for CalEnergy Resources). Under the preparatory work schedule, acquisition of seismics and selection of a preliminary field development concept are scheduled for 2013–2014. Upon completion, the partners will be able to make a final investment decision concerning development of the fields. The project will also enable LOTOS Petrobaltic to pursue exploration and development work on other resources, which may potentially be combined with the B4 and B6 fields.

Plans for 2013 provide for the following exploration and production operations:

Poland

Baltic Sea

- Continued development of the B8 crude oil field: drilling of two production wells, financing arrangement process, preparation of technical designs and execution of contracts,
- Ensuring the safety of further oil production from the B3 field: repair of the PG-1 unmanned drilling rig and re-start of production from the PG-1 node,
- Preparation of the B4 and B6 gas fields for their development in cooperation with CalEnergy Resources: seismics acquisition work on the Gaz Południe and Gaz Północ licences, which cover the B4 and B6 gas fields, in order to modify and refine the field development concept,

- Development of the B28S site: drilling of an exploratory well to prove the presence of hydrocarbons and, if the well is drilled with positive results, commencement of the site's development,
- Continued exploration work to identify structures with the potential for discovery of hydrocarbons in other licence areas.

Onshore:

- Cooperation with PGNiG on exploration and production of conventional and unconventional natural gas and crude oil.

Norway

- Securing the LOTOS Group's strategic interests in the YME project and taking steps to recover the capital invested in the project,
- Efforts aimed at acquiring a producing field as part of the strategy for increasing oil production, which provides the optimal scenario for recovering funds tied up in the Yme project.

Lithuania

- Increasing and maintaining crude oil production at approximately 100,000 tonnes a year,
- Continuation of drilling projects (drilling of five new production wells) and continuation of exploration work, also for unconventional resources.

Operating activity

In line with the LOTOS Group's strategic objectives, we are committed to maintaining the highly competitive position of the Grupa LOTOS' refinery in Gdańsk. In 2012, we met the targets of our policy for improving the efficiency of the refinery's production process, whose chief elements were:

- connection, successful start-up and continuous utilisation of natural gas for the production of hydrogen gas and steam in the CHP plant, and as fuel for process furnaces,
- hydrowax use,
- efficient use of the ROSE unit and MHC hydrocracking to process heavy vacuum residue,
- an increase in the conversion rate at the MHC unit, and
- the launch of xylene production at the newly constructed unit.

In 2013, we plan to execute further projects designed to enhance the efficiency of our production processes, one of which will consist in improving the technical condition of all the refinery's production units as part of the Spring 2013 periodic overhaul. We also intend to complete implementation of the Energy Management System.

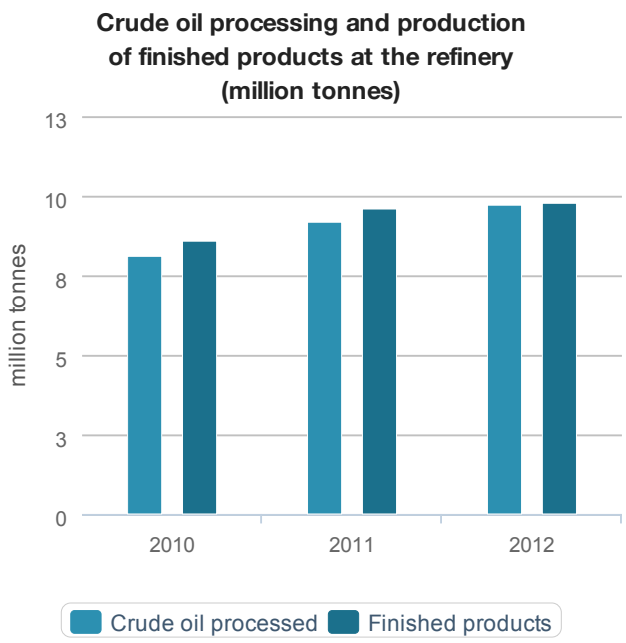
Management approach

The LOTOS Group’s operating activity is centred on refining operations and supplying the market with high quality products, maximising the LOTOS Group's production capacities and minimising its adverse environmental impact.

The LOTOS Group’s operating segment comprises the operations of the Gdańsk refinery and subsidiaries involved in production or support functions. These include LOTOS Czechowice, LOTOS Jasło, LOTOS Serwis, LOTOS Lab and LOTOS Straż. The Grupa LOTOS refinery is the largest of the LOTOS Group’s production plants.

Achievements

2012 was another record year for the Grupa LOTOS refinery. The Gdańsk refinery processed 9.67m tonnes of crude, the highest in the refinery's history and equal to an average annual utilisation rate of its installed capacities slightly exceeding 92%. Utilisation was adjusted during the year to reflect the prevailing market conditions. Throughput was increased in periods with high refining margins, for example in September and October 2012, when the utilisation rate exceeded 100%.



Source: Grupa LOTOS in-house data.

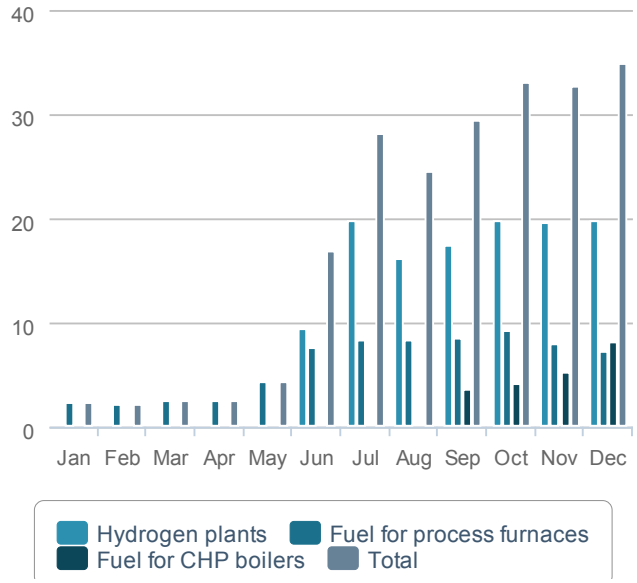
As in previous years, the main type of crude processed was Russian REBCO. Its share in the total volume was approx. 90.2%, which remained relatively flat in 2011. Crude oil imported by sea, including approx. 180,000 tonnes of Rozewie crude supplied by LOTOS Petrobaltic, accounted for the balance of the crude used. The selection of crudes for processing was based on output optimisation, using emerging opportunities to increase the refinery's processing margin.

Apart from crude oil, other production inputs included fuel components and feedstock purchased for further processing, as well as enhancing additives. This last category consists of biofuels (ethanol, ETBE and FAME), which are added to fuels to achieve the National Indicative Target. In 2012, the long-awaited change in quality requirements applicable to liquid fuels finally came into force. On February 7th 2012, quality requirements for liquid fuels were changed by virtue of the Minister of Economy's regulation, whereby the permitted content of fatty acid methyl esters (FAME) in diesel oil was increased from 5% to 7%. As a result, on February 14th 2012, the first batch of diesel oil with a 7% FAME content (B7) was produced at the refinery. This change made it possible to attain the National Indicative Target in 2012 with minimum sales of 100 per cent biodiesel (B100).

Another significant event in our refining operations was the commissioning of a high pressure gas pipeline, constructed in partnership with Polskie Górnictwo Naftowe i Gazownictwo and Pomorska Spółka Gazownictwa. Prior to this, the Gdańsk refinery had very limited access to natural gas. Connection of the pipeline, along with pressure reduction stations, enabled the refinery to considerably increase consumption of this environmentally-friendly and cost-efficient fuel. Natural gas is used at the Grupa LOTOS refinery as fuel in process furnaces, the Company's CHP plant boilers, and as feedstock for hydrogen production. In the production of hydrogen, it replaces the previously used fuel oil and liquid gas. As a result, the carbon footprint of our refining operations was substantially reduced.

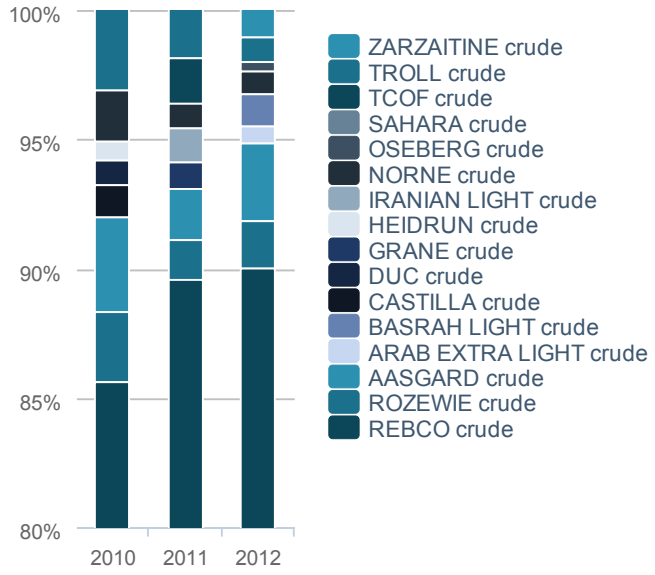
In 2012, the refinery's monthly gas consumption had increased from 2,500 tonnes to approximately 35,000 tonnes. By the end of the year, two out of four boilers in the CHP plant had been switched to gas. Following modernisation of the other two boilers, natural gas consumption will increase even further.

Natural gas consumption in 2012 (thousand tonnes)



Source: Grupa LOTOS in-house data.

Throughput by types of crudes (% by weight)

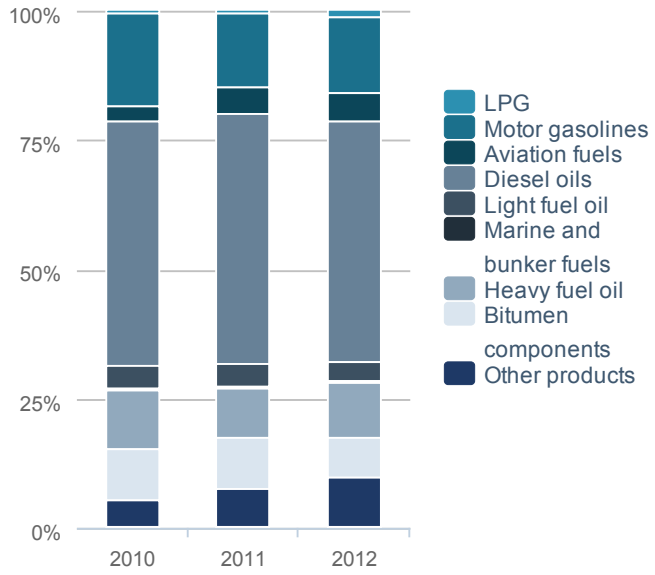


Source: Grupa LOTOS in-house data.

In terms of product portfolio diversification, the May 2012 launch of the xylene separation unit at the Grupa LOTOS refinery was also a major event. The unit relies on reformate as feedstock (the high-octane value components used in the manufacture of gasolines). From the reformate, the xylene fraction is recovered – hydrocarbons used in the petrochemical industry. This helps reduce the number of motor gasoline components, which tend to be less in demand in Poland and Europe, while obtaining a valuable non-fuel raw material. In 2012, the xylene separation unit produced some 28,000 tonnes of xylene fraction.

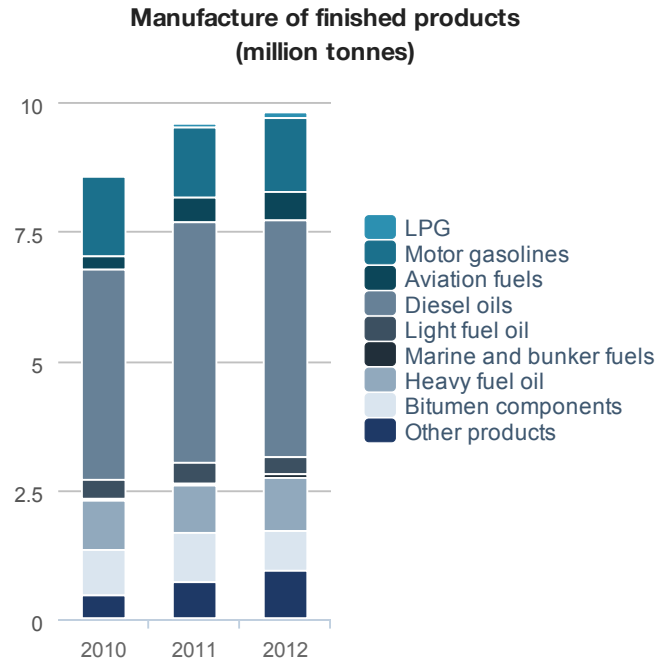
The total output of finished products in 2012 was approximately 9.8m tonnes. As usual, diesel oils accounted for the largest share in total sales (nearly 47%).

Finished products by weight

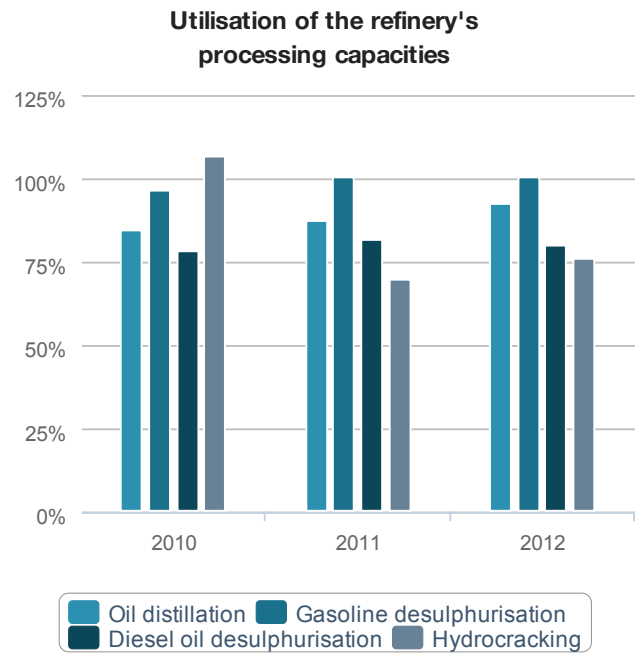


Source: Grupa LOTOS in-house data.

Utilisation of the refinery's installed capacity was primarily dependant on the optimum crude processing volumes in the period, as well as the potential of the processed crudes. The higher volumes of crude processed and the lower production of bitumen components led to increased load on the hydrocracking units. Thanks to the unique process system in place at the unit for vacuum residue deasphalting, the Gdańsk refinery is capable of earning an additional margin on the processing of vacuum residue into fuel.



Source: Grupa LOTOS in-house data.



Source: Grupa LOTOS in-house data.

Maintenance

As regards maintenance and overhaul management, our major achievement in 2012 was maintaining the main and ancillary process units' availability at above 99.2%, placing Grupa LOTOS among the best performing refineries in Europe according to the Solomon Report. This strong service factor helped us deliver on production plans.

The safe, stable operation of the main and ancillary processing units was achieved with professional technical and process support, consistent improvement of personnel qualifications, introduction of modern workplace organisation and information flow methods, use of project management techniques in our modernisation and overhaul projects, and development of technical failure prevention strategies. Overhaul and maintenance costs for all these tasks were fully optimised through leveraging of the potential of the LOTOS Group's subsidiaries.

In 2012, we also launched our technical risk management programme. Working with the Office of Technical Inspection we ran a pilot test of the RBI (Risk Based Inspection) methodology – used for planning inspections by analysing identified risks – on the CCR reforming unit and the atmospheric distillation unit. Implementation work continues on other units.

Grupa LOTOS' refinery is one of the newest and most advanced production plants in Europe. Its excellent condition is chiefly attributable to the 10+ Programme, which was completed in 2011. Even though the refinery has been in operation for nearly 40 years, the average in-service life of its installed units is approximately 11 years.

Capital expenditure

Two of the most important projects completed by Grupa LOTOS in 2012 were:

- The connection of the refinery to a natural gas supply (introducing natural gas as a fuel in the process furnaces and as feedstock in hydrogen production). This project has delivered substantial economic and environmental benefits - we are now able to place three times as much LPG on the market and significantly reduce the refinery's environmental footprint;
- The construction of a xylene separation unit, which enabled us to market a new product, xylenes, which may be used as intermediate petrochemical feedstocks (in polyester production), or as paint and varnish thinners. This project

helped us reduce the content of harmful aromatics in the gasolines we produce, minimising the operating costs associated with the requirement to meet norm limits on aromatics content in gasolines.

Research and development

Following changes in the law, in 2012 Grupa LOTOS developed and launched a new type of diesel oil with a FAME content of up to 7%.

The Company's R&D activities also focused on developing technologies for producing and optimising processes at the oils unit. Key R&D achievements in 2012 included:

- R&D work on production of high viscosity Group II base oils of >10 cSt at 100 ^{0}C, from paraffin fraction;
- Development, production and sale of a low viscosity Group II base oil of <5.6 cSt at 100 ^{0}C, for use as feedstock in the production of enhanced-quality engine oils;
- Development, production and sale of Group I base oils using a new intermediate product - paraffin fraction. This improved oil efficiency, which helped enhance the energy profile and utilisation rates of the oils unit. Group I+ base oils have low sulphur content, a better evaporation rate as tested by the Noack method, higher content of saturated hydrocarbons, and a very high viscosity index (99–110);
- Development, production and sale of low-sulphur light paraffin wax using the new paraffin fraction product. Low-sulphur paraffin wax is used to manufacture various types of paraffin and paraffin products;
- Production and sale of Base Oil SAE 10 LS and Base Oil SAE 30 LS with sulphur residue below 0.5% m/m, to be used as feedstock for production of higher quality engine oils.

In road bitumen production technologies:

- R&D work continued on designing a production technology for environmentally friendly bitumen binders with scrap rubber added, for use with road mineral-bitumen compounds. The final stage of the research was completed in 2012, involving validation of product properties in final application; test sections were laid using rubber-modified bitumen MODBIT 45/80-55 CR. The thermostability and rheological properties of the bitumen binder in the new mineral-bitumen compounds were confirmed, and the product will be brought to market in 2013,

In 2012, development work also focused on oil products produced by LOTOS Oil. The most important lubricant-related R&D activities included:

- Completion of research on passenger car oils containing our own base oils, for compliance with the ACEA (European Automobile Manufacturers Association) 2010 sequences. Approvals will be secured in 2013;
- Completion of research into ways of improving the quality of oils for trucks, also based on our own base oils. Approvals will be secured in 2013;
- Completion of research on 4T motorcycle oils for compliance with JASO (*Japanese Automobile Standards Organization*) standards. Licences will be secured in 2013;
- Launch of new engine oils for trucks (Turdus Powertec 3000,Turdus Powertec 5100);
- Extension of 44 Approvals for lubricants,
- Obtaining of 21 Approvals for new oils.

Development plans

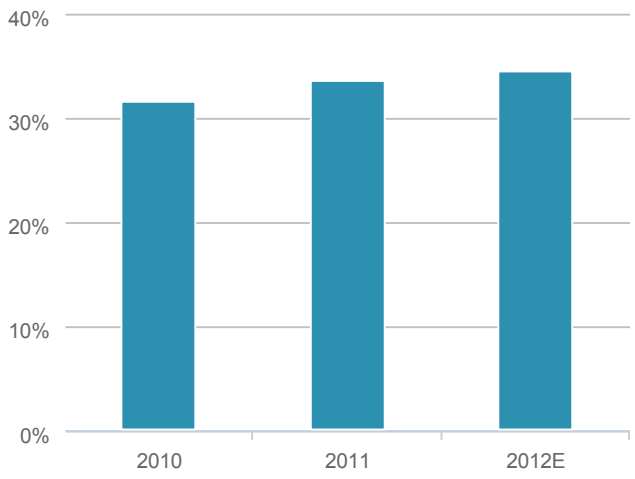
Our plan of action is to implement the strategic objective of increasing the conversion ratio and intensifying crude processing, provided that in 2012 the front-end engineering design phase is begun for the complex of refining units which would be processing the heavy residue from crude oil processing into high-value products. Towards the end of 2011, a growth option was selected that consists in the construction of a coking unit. Then, in 2012, a licence for the coking process was selected and purchased, and the front-end engineering design for the unit was developed. Technologies for the accompanying processes were also purchased and a number of necessary analyses were prepared, along with a method statement. The process of selecting utilities suppliers and product customers was then begun. In 2013, an integrated conceptual design for the entire project will be developed, the terms and conditions of utilities' supplies and product acceptance will be agreed upon, and steps will be taken to secure appropriate financing for the project.

Construction of the coking unit will be a major investment challenge for Grupa LOTOS until 2015. Other important projects are at the decision-making stage, including a hydrogen recovery unit and a sea cargo handling terminal on the Martwa Wisła for petroleum products.

Marketing activities

The LOTOS Group's efforts in the marketing segment are focused on maximising economic benefits by flexibly managing the product stream and consolidating the LOTOS Group's market position, and on developing a controlled, highly-efficient retail chain with a national reach. In order to maximise the retail chain's integrated margin, we make optimum use of our assets and coordinate key areas of the supply chain: planning, procurement, production and distribution. We continue to implement our crude supply diversification strategy by maintaining the availability of supply sources of crude oil delivered both through pipelines and by sea transport, flexibly selecting the types and routes of crude oil supplies, intensifying our presence on the international oil market, and increasing the share of our own production in crude oil supplies.

LOTOS Group's share in domestic fuel market



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

A broad product range, the superb quality of fuels, and continuous quality control have earned us an excellent reputation among consumers and pushed the LOTOS Group’s market share to over 34% in 2012. Efforts aimed at consolidating our market position and extending the service stations network increased our share in the retail market to 8%.

Management approach

In 2001, the LOTOS Group's marketing activities were carried out by Grupa LOTOS as well as subsidiaries: LOTOS Paliwa, LOTOS Oil, and LOTOS Asfalt. Additionally, two more companies, LOTOS Kolej and LOTOS Tank, conducted service activities within the LOTOS Group and outside it.

On January 10th 2012, Grupa LOTOS sold 100% of the shares in LOTOS Parafiny Sp. z o.o. to an entity from outside the LOTOS Group.

Also in 2012, our aviation fuel sales structure was reorganised. LOTOS Tank was originally a logistics and infrastructure subsidiary providing services for Grupa LOTOS. Late 2012, a plan to transfer the aviation fuel business from Grupa LOTOS to LOTOS Tank was devised and implemented. From the beginning of 2013, LOTOS Tank has continued as a sales and logistics company.

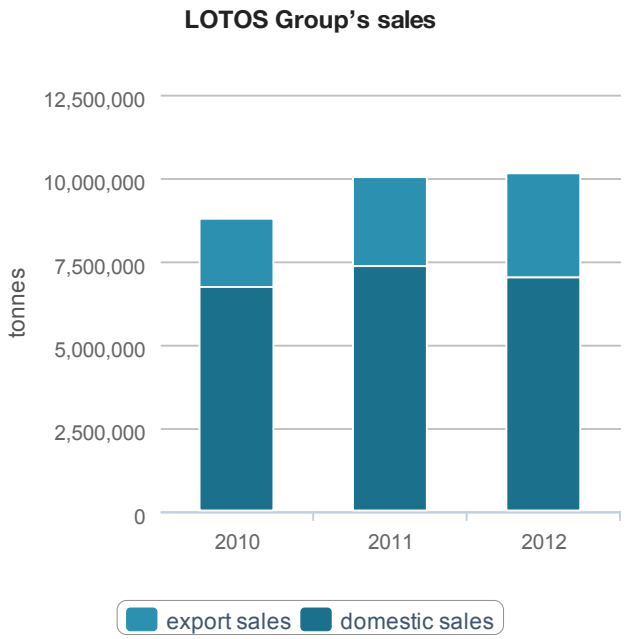
Key products of the marketing segment

Fuel products	
	LOTOS DYNAMIC 98 gasoline – fuel offering better performance and engine protection than standard products. Contains antioxidants and washing additives. The increased content of the washing additive supports better cleaning of the engine, lengthens its useful life and economises fuel consumption.
	LOTOS DYNAMIC DIESEL diesel oil – fuel for modern diesel engines. With its friction-reducing components, it offers more power efficiency and guarantees engine ignition even at -32°C. The additives significantly improve nozzle flow capacity and engine lubricity, and extend the useful life and performance of the engine.
	LOTOS RED diesel heating oil (ONDCO) – owing to its special additives and low sulphur content, LOTOS RED has best-in-class parameters for oxidation resistance and anti-corrosive action. It maintains nozzle cleanness, thus extending the useful life of heating equipment. Because of these features, the product guarantees an optimised combustion process and meets all the requirements for the latest generation furnaces. In addition, it is also highly environmentally friendly, thanks to its significantly reduced emissions of noxious combustion products.
	IZ-40 diesel oil – meets the requirements of arctic fuels and guarantees engine ignition at very low temperatures (CFPP of -32°C).
	LPG – mixture of liquefied hydrocarbons, consisting primarily of propane and butane. With both gasses mixed in correct proportions, the LPG can achieve optimum working parameters.
Non-fuel products	
Engine oils	**LOTOS Quazar**– premium engine oils based on state-of-the-art technologies. This product line, distributed through the chain of Authorised Service Stations, is for cars which have been in use for less than three years. The LOTOS Quazar LLIII 5W-30 oil meets one of the most stringent technical specifications for passenger cars – the German VW 504.00/507.00 norm. It fits with the modern concept of dedicated engine oils which serve the needs of specific vehicle makes. In 2012, a cooperation agreement was signed with the Association of Volkswagen and Audi Dealers in Poland, which brings together authorised dealers of cars manufactured under VW's German, Spanish and Czech car makes. Following the agreement, they became part of our group of partner brands, which had previously comprised Subaru and KIA.

	LOTOS Thermal Control – product line dedicated to passenger cars and comprising synthetic semi-synthetic and mineral products. The automotive product line is supplemented by products dedicated to older cars (City line), as well as gear oils and consumable fluids.
	LOTOS Turdus – product line for modern trucks. LOTOS Turdus oils meet the requirements of and have been approved by leading truck engine producers, including Man, Scania, Tatra, MB, Volkswagen, Volvo and Renault. With the support of experts around the world, the entire TURDUS line was given a technological upgrade. A new, advanced generation of oils was created, providing best-in-class protection for specialist engines compliant with the Euro 4, Euro 5 and Euro 6 standards. Step-by-step implementation of the new technology was begun in 2012, with completion scheduled for 2013. Work on revamping the product's naming also got under way in 2012. On its completion, consumers will be able to intuitively choose the right lubricant product for their fleet.
	RG Trans – product for older lorries.
	Agrol – products for agriculture applications which guarantee trouble-free performance in any weather and under any operating conditions. Agrol products meet international quality standards and the quality requirements of leading machinery manufacturers.
	Marinol – highly specialised marine oils.
Industrial oils	**Transmil** – gear oils.
	Hydromil – hydraulic oils.
	Remiz – turbine oils.
Plasticizers	**TDAE and RAE** class plasticisers offered under the QUANTILUS T50 and QUANTILUS T60 brands, used by European and Asian tyre and rubber manufacturers. These products meet the requirements of the EU REACH directive concerning the registration of chemical products, and have been approved by global tire manufacturers.
Bitumens	**MODBIT modified bitumens** – state-of-the-art bitumens that enhance road surfaces' resistance to rutting, extending their durability and increasing their resistance to extreme weather conditions. In 2012, production technology for the rubber-modified bitumen was developed. The new product will be released to market in 2013.
Petrochemical product	
	Xylene fraction is a new product, launched in 2012, that is obtained through reformate splitting. It is used as feedstock in plastics production. The xylene's separation reduces the share of aromatic hydrocarbons in the range of gasoline components produced by the Gdańsk refinery. This will contribute to the greater technological flexibility of the refinery, while allowing it to sell some of the components on the fuel or petrochemical market.

Achievements

In 2012, the LOTOS Group sold in excess of 10.1 million tonnes of products, which represents a 1% rise on the previous year. This was chiefly led by stronger sales volumes of heavy fuel oil, LPG and naphtha. Similarly to 2011, the volumes of petroleum products sold outside Poland were also on the rise. Increased exports were recorded chiefly for diesel oils, aviation fuels, engine gasolines, and heavy fuel oils. We also posted sales of crude oil from the Lithuanian deposits, which were supplied to external customers.



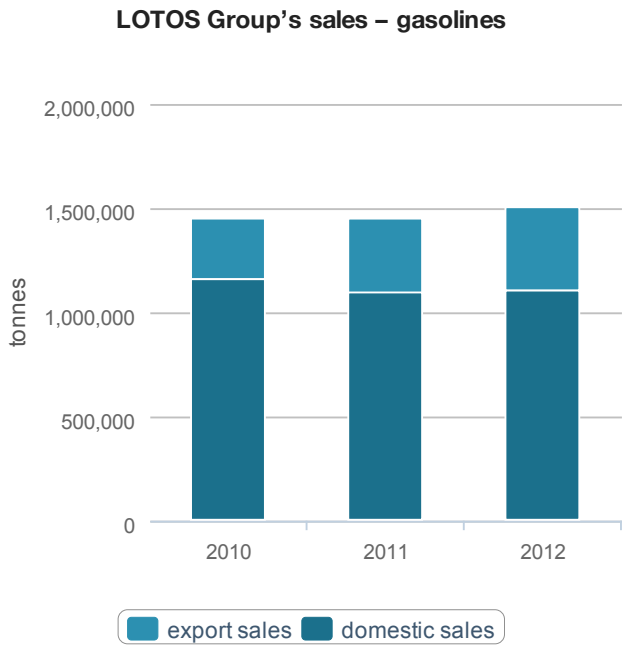
Source: The LOTOS Group in-house data.

Sales of engine fuels

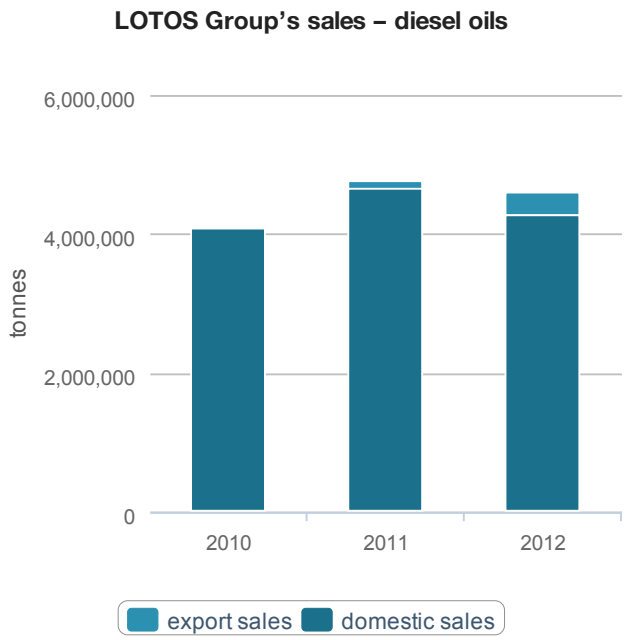
In the context of sagging domestic demand for gasoline (down 5.4% in 2012), increased sales of the product reported by the LOTOS Group (up 1% on 2011) were a success. We also recorded a 14% growth (of 48,000 tonnes) in sales to customers outside Poland, including in Scandinavia and Great Britain.

Driven by a decline in domestic demand for diesel oil (down 9.4% in 2012), the LOTOS Group's domestic sales of the product were down 8% compared with the previous year. Another factor pushing sales down was sharp growth in the retail price of diesel oil. Our achievements included winning Shell as a customer with us as the principal supplier, as well as continued cooperation with Statoil and BP.

In the period under review, we recorded a three-fold increase in diesel oil export volumes, which account for more than 10% of the LOTOS Group's total export sales. Our diesel oil was sold to customers in Great Britain, Germany, France, Finland, the Czech Republic, Denmark, and the Russian Federation.

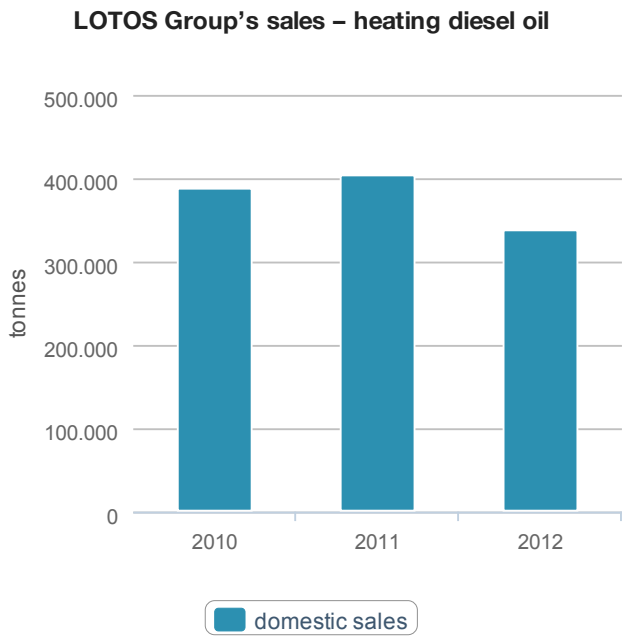


Source: The LOTOS Group in-house data.



Source: The LOTOS Group in-house data.

Sales of diesel heating oil

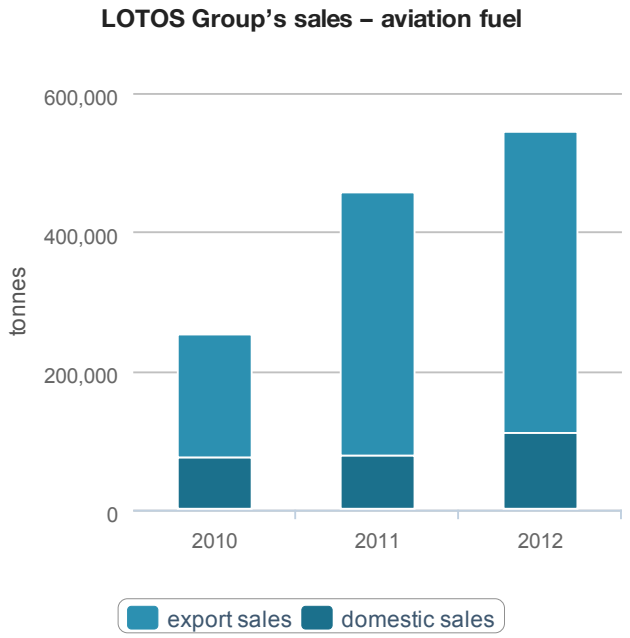


Source: The LOTOS Group in-house data.

A slide in domestic demand for diesel heating oil by approximately 13.9%, to the benefit of more competitive heating fuels, caused our 2012 sales of the product to shrink 16% year on year. As in the previous years, diesel heating oil was sold exclusively on the domestic market.

Sales of aviation fuel

Relative to 2011, the total sales volume of JET fuel by the LOTOS Group grew by 40%. Our principal distribution channel for the product was sales by sea, to Sweden, Russia and Lithuania. The product was also sold to customers in the Czech Republic. At home, aviation fuel sales were made to end customers, wholesale customers and airports. In 2012, the key customer for our aviation fuel was Petrolot, a distribution company with a national reach, and the airports in Wrocław and Rzeszów. On the domestic market, we provided supplies to wholesale customers operating in the aviation industry. We



Source: The LOTOS Group in-house data.

were successful in growing sales to retail customers operating their own aircraft or active in flying clubs or small-size airports and airfields.

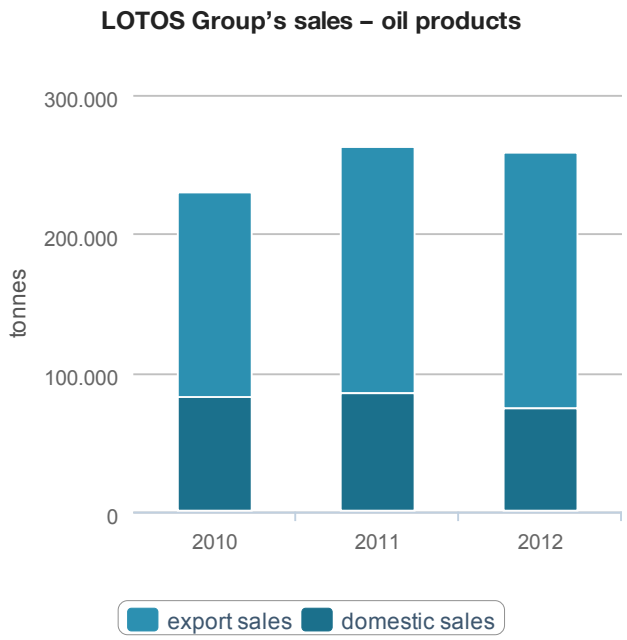
Sales of oil products

The total volume of oil products sold in 2012 remained broadly flat on 2011, amounting to around 260,000 tonnes.

The two principal distribution channels were wholesale, including through Authorised Distributors and LOTOS Oil Partners, and direct sales.

As part of the wholesale distribution system, which is our most important sales channel, we established the Authorised Trade Distributor for Shippers sales force in late 2012 and early 2013, which enhanced the channel's efficiency.

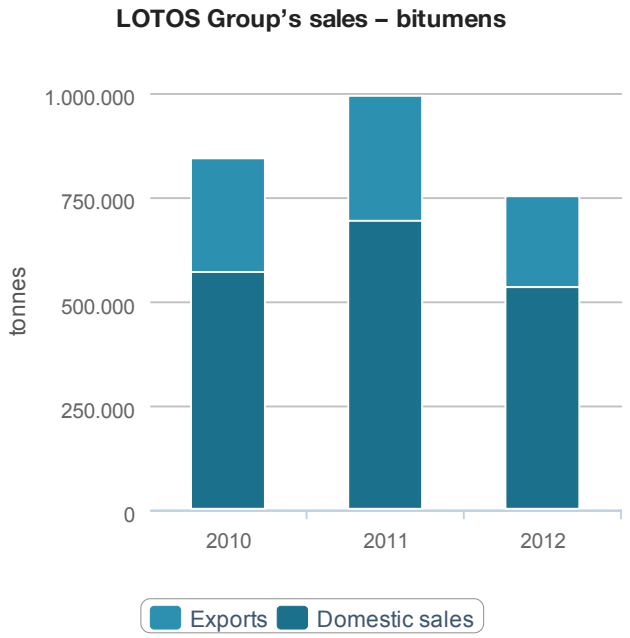
The main foreign markets for LOTOS Group's oil products were the EU countries, as well as countries in Central and Eastern Asia, the Middle East, and Africa. In 2012, partners in Turkmenistan, Macedonia and Jordan joined our customer base. An important business event in this period was the signing of a letter of intent in Azerbaijan with KIA Motors representatives, concerning possible sales of LOTOS products through authorised dealers.



Source: The LOTOS Group in-house data.

Sales of bitumens

There was a 24% year-on-year drop in total bitumen sales in 2012. This decrease was attributable to the weaker financial performance of construction companies, as well as the economic crisis prevailing in the EU and the related decline in infrastructure investment.



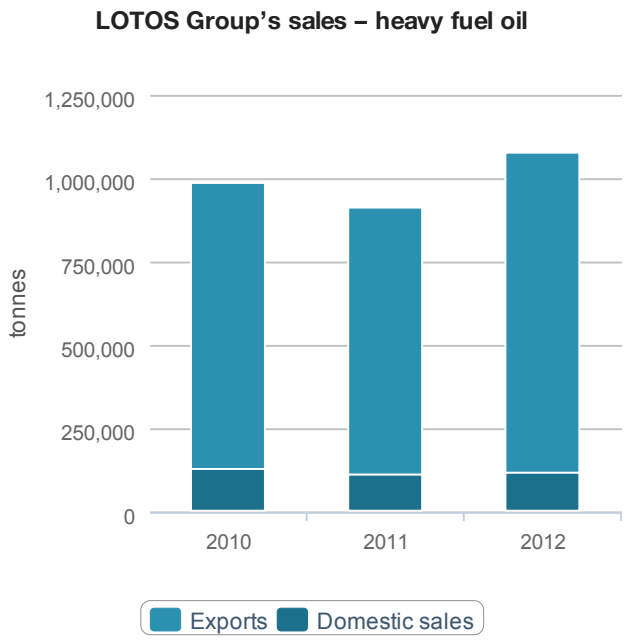
Source: LOTOS Group in-house data.

Similarly to previous years, road bitumen had the largest share in total bitumen sales which amounted to 80%. The remaining volume of bitumens sold included modified bitumens and bituminous emulsions.

The main export markets were the EU states of Finland, Romania, Sweden, Switzerland and the Czech Republic.

In 2012, we maintained the leading position in sales of technologically advanced modified bitumens, traded under the name MODBIT, which were given the Najwyższa Jakość Quality International award.

Sales of heavy fuel oil

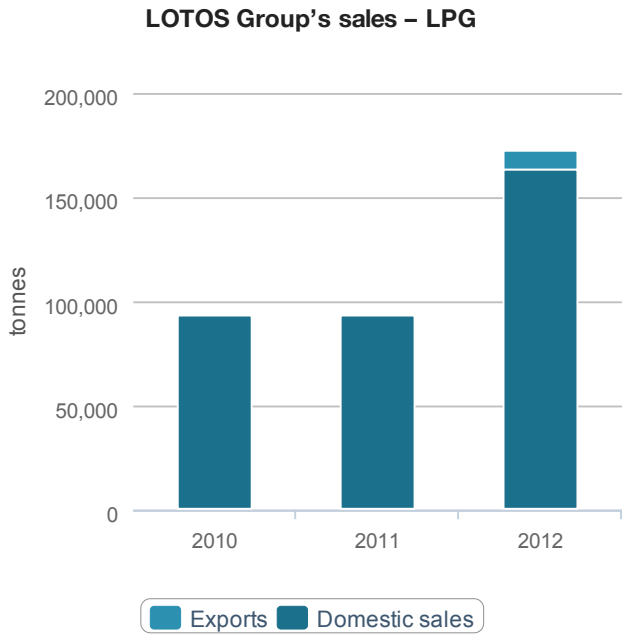


Source: LOTOS Group in-house data.

In 2012, the total volume of heavy fuel oil sales grew by 18% year on year. Domestic and export sales were up by 3% and 20%, respectively. Heavy fuel oil was shipped mainly to Rotterdam, Scandinavian ports and countries on the Baltic Sea, with power companies being key customers.

Sales of LPG

In 2012, LPG sales increased due to the higher demand for cheaper substitute fuel (LPG), in response to the growing prices of other engine fuels. Another driver in the LOTOS Group's increased sales was the introduction of high-pressure natural gas from the new pipeline to the refinery's network.



Source: LOTOS Group in-house data.

Chain of LOTOS service stations

In 2012, work continued on expanding the LOTOS service station chain by adding new stations under two business models, i.e. own stations (CODO) and partner stations (DOFO). Within both models, new LOTOS service stations in the premium segment (under the LOTOS brand) and in the economy segment (under the LOTOS Optima brand) were launched.

As at the end of 2012, the LOTOS service station chain comprised:

Premium segment

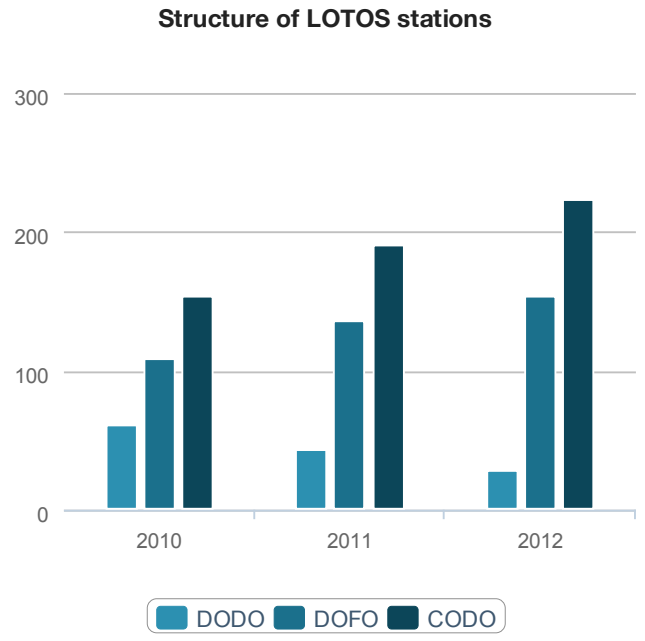
- 152 own stations (CODO)
- 124 partner stations (DOFO)
- 28 patronage stations (DODO)

Economy segment

- 71 own stations (CODO)
- 30 partner stations (DOFO)

Non-fuel sales are a material area of operations of the LOTOS service station chain. In this respect, the key directions in 2013, similarly to last year, will include:

- Continued development of the Cafe Punkt food service,
- Expansion of the range of food product,
- Development of the range of car wash services, including with respect to touch-free car washes.



Source: In-house analysis by LOTOS Paliwa.
Legend: DODO – Dealer-Owned Dealer-Operated, patronage stations, DOFO – Dealer-Owned Franchise-Operated, partner stations, CODO – Company-Owned Dealer-Operated, own stations.

Other achievements in the service station chain segment in 2012 include:

1. Expanded cooperation with foreign car fleets at selected LOTOS own stations;
2. The addition of a new feature to the LOTOS Biznes range, enabling settlement of road tolls in Western Europe and viaToll payments in Poland;
3. Implementation of a new Premium segment visualisation concept for the own and partner networks;
4. Implementation of the Café Punkt food service concept;
5. Acquisition of five new locations for motorway service stations;
6. The launch of the fourth edition of the LOTOS Navigator loyalty programme

LOTOS Optima after one year of operations

At the end of 2012, the LOTOS Optima chain comprised 101 sites, doubling the number of LOTOS Paliwa's economy stations relative to 2011. The one hundredth LOTOS Optima station was opened in Białogard, in the Province of Szczecin. At present, LOTOS Optima outlets operate across the country. LOTOS Optima stations sell diesel oil, 95 and 98 unleaded gasoline, as well as a segment-specific range of non-fuel products and services.

Maciej Szozda

Vice-President of the Grupa LOTOS Board

A successful year for LOTOS Optima

In 2012, the LOTOS Optima chain expanded, doubling the number of economy service stations in the chain. This is a great success for LOTOS Paliwa, achieved in spite of the difficult conditions on the fuel market.

It was more than two years ago that we first assumed that the economy segment would see dynamic growth. Even though our predictions were met with scepticism on the markets, we executed our plan in full, while breaking the Polish record for the number of new additions to a service station chain in a single year. We take great pride in the fact that we managed to repeat that feat in 2012, which was not an easy year.

Customers choose LOTOS Optima because its service stations offer quality fuels at competitive prices. In the current economic climate, that is a very powerful advantage. Our recipe for success is in the combination of our quality fuels with conveniently located stations, a good selection of products and the high quality of our services.

To our trade partners, we offer favourable terms of cooperation and an attractive franchising system which involves competitive licence fees and a good investment package. Another key element in our offer is the guarantee that LOTOS Paliwa will perform fuel quality tests at its own expense, ensure stable supplies of LOTOS fuels and enable the implementation of an optimum pricing policy based on tools provided by a global industry leader. Our experience has shown that prospective partners attach great importance to the possibility of promoting their own brand, which we also provide. Service stations have a uniform design, but we allow our dealers to promote themselves by displaying their names and logos on the forecourt totems next to the LOTOS logo.

LOTOS Optima is targeted at all companies interested in cooperating with LOTOS Paliwa, including those that already operate in the Premium segment. If these companies seek to diversify their services under a franchise agreement, they can open one or several LOTOS Optima service stations and expand their portfolio by adding economy segment products.

Despite the difficult conditions prevailing on the fuel market, we intend to continue dynamically developing this segment of our offering. The year 2012 confirmed the assumption that the development of economy service stations has been the right decision, which is why we intend to maintain this course in 2013. Our success is not only the growing number of service stations, but also the quality of our product and service offering and professional customer service. Those three key parameters were at the top of our agenda in 2011-2012, and will remain a priority in 2013.

Meanwhile, the growing number of our service stations is driven by the expanding road network, the construction of new stations and adaptation of existing facilities. It should be noted that all stations have a uniform interior design, which makes them stand out from other service stations operating in the economy segment. For our service stations, we chose a modern silhouette and pastel colours. Paired with the yellow lettering, this combination is not only unique on the Polish market, but also well-received by our customers, who consider it up-to-date, attractive and suitable for the segment in which LOTOS Optima operates. The stations are relatively small, but tailored specifically to cater to areas with lower potential.

I am certain that in 2013 our service station development model will once again prove to be a success.

Logistics

Grupa LOTOS is making intensive efforts to steadily enhance the logistics and distribution of products, raw materials and components. Actions taken include optimisation of the fuel terminal network and road, sea and rail transport (taking into account customer expectations), and seasonal changes in sales, as well as efforts to reduce costs throughout the logistics chain.

In 2012, we extended the scope of our logistics services by implementing new IT systems for data exchange, broadening the fuel distribution offer and significantly improving the process of secondary logistics management. At the same time, we conducted preparatory work to achieve full automation and centralisation of driver service processes at our own depots. Planned for completion in 2013, this project will help us satisfy customer's needs, standardise work and improve cost efficiency.

The smooth operation of the logistics system has ensured the security of product distribution in the LOTOS Group, helped meet statutory requirements on the creation, maintenance and turnover of mandatory stocks, and enabled the LOTOS Group to attain the National Indicative Target for marketed bio-components.

In 2012, Grupa LOTOS earned additional revenue from sales of logistics services to third-party customers, including quality inventory exchange and the stock ticket service, consisting in the fee-based maintenance of mandatory reserves of fuels.

Sea transport

Freight transport by sea is a vital element of the LOTOS Group's logistics chain. We enjoy the considerable advantage of having direct access to the product pipelines linking the Gdańsk refinery to the liquid fuel handling facilities at Port Północny. Maritime transport is the Company's main mode of exporting petroleum products and supplying a significant portion of the raw materials and components used in production. The number of tankers carrying the Company’s imports and exports was slightly reduced in 2012, relative to 2011, primarily as a result of optimisation of the volume of cargo moved (larger export of petroleum products, particularly heavy fuel oil) and changes in the structure of biocomponent suppliers (a significant share of supplies from domestic companies).

The liquid fuel handling terminal owned by Naftoport handles 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 to export surplus products and sell them on the Scandinavian, Northern and Western European markets, and the Baltic states. The direct connection to the port also makes it easier to conduct import deliveries of petroleum products, mainly diesel oil and light fuel oil components.

Grupa LOTOS enjoys the advantageous position of having a refinery at a short distance from a cargo handling terminal, which allows it to diversify its supply sources and facilitates the shipping of crude oil from own reserves under the Baltic Sea and in Lithuania, and - in the future - crude oil produced from reserves under the North Sea.

We are consistent in our efforts to take over the management of cargo transportation by sea, or to control the transportation process on the longest possible section of the supply chain, from the affreightment of ships to the formal handling of sea transport. This ensures greater control and helps streamline the planning process as regards cargo handling at sea ports, allowing us to reduce the frequency of ship detention and optimise related costs. In 2012, Grupa LOTOS took over most of the activities related to securing vessels for sea transport on its own, cutting out third-party intermediation services.

Financial standing

In 2012, we launched preparatory work related to the comprehensive modernisation of the Poznań fuel depot. The project, which will be financed with our own funds, is scheduled for completion in 2014.

Also in 2012, we continued design work on the construction of the sea cargo handling terminal in Martwa Wisła, in the immediate vicinity of the Gdańsk refinery. The aim of the project is to enable handling of component and product loads with a unit volume of up to 5,000 tonnes for exports and imports on Grupa LOTOS' own wharf.

In 2012, LOTOS Kolej operated rolling stock of ca. 3,600 rail cars and nearly 100 locomotives, including some of the most advanced electric locomotives: a Bombardier TRAXX MS/DC, and a Siemens ES64F4, as well as TRAXX DE Diesel locomotives.

Rail transport

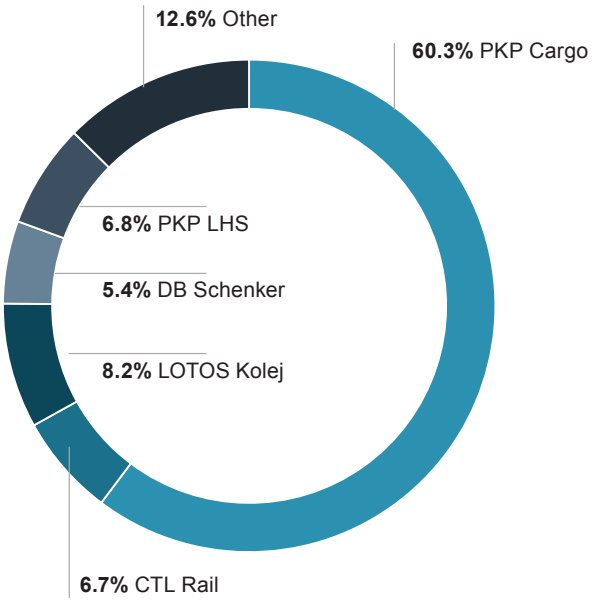
In order to ensure the most effective use of their assets, LOTOS Group companies commission rail transport services from LOTOS Kolej, providing a comprehensive transport solutions. LOTOS Kolej covers all stages of freight rail transport, including technical maintenance services for rolling stock, and is the only private operator in Poland able to offer both full-train and single-car freight services, which is a significant competitive advantage on the market. The company operates an innovative rail logistics system of real-time monitoring of the location and technical and commercial parameters of every train being started. The company is among the market leaders in terms of using the most modern locomotive fleets in Poland, which increases the efficiency of its transport services, guaranteeing their high quality.

As a result of its continuous development, LOTOS Kolej has the potential to fully satisfy the transportation needs of LOTOS Group companies and, increasingly, to render transport services to third-party customers.

In 2012, LOTOS Kolej transported a total of ca. 10.6m tonnes, including cargoes of over 4.4m tonnes hauled for third-party customers.

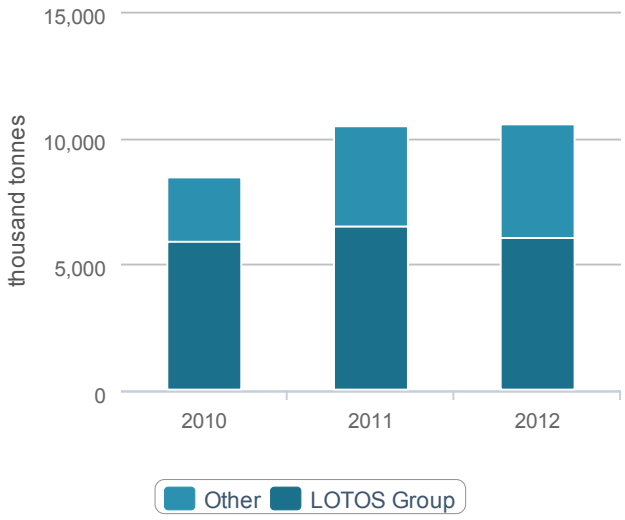
LOTOS Kolej is one of the leading freight rail carriers in Poland, ranking second with a market share of 8.21%.

LOTOS Kolej's share in the domestic freight market in 2012



Source: In-house analysis based on the Office of Rail Transportation data, January 2013.

Volume of rail freight hauled by LOTOS Kolej by transport activity (thousand tonnes)



Source: In-house analysis based on data sourced from the LOTOS Group.

Development plans

Prospects for the LOTOS Group's downstream segment will depend on market expectations and will be oriented towards more efficient use of the economic potential of the modernised and extended Grupa LOTOS refinery in Gdańsk.

Fuels

In the retail segment, the most important plan is to expand the budget LOTOS Optima chain with new service stations and to consistently grow the Premium segment, including motorway coverage. Other growth opportunities involve establishing long-term commercial relations with international operators and beginning cooperation with hypermarket chains. We can take advantage of these opportunities thanks to our openness to novel solutions designed to facilitate mutual cooperation and settlement of accounts (e.g. electronic transfer of data and e-invoices).

Engine and industrial oils

Research on the domestic lubricant market in the passenger car engine oils segment shows a decline in demand for mineral-based products. In response to a difficult economy, we are seeking new growth opportunities. Thanks to the competitive advantage of the Oil Service offered by LOTOS Oil, we can achieve further growth in sales to industrial customers and maintain large market shares.

Bitumens

2012 witnessed the collapse of the road infrastructure market. Many of the construction companies engaged in road construction projects were declared bankrupt and went into liquidation. With the banks starting to withdraw from financing road projects, the slump is expected to continue in 2013. The uncertainty prevailing on the construction market invites a strategy that is underpinned by cooperation with the construction groups able to finance their operations with stable funding sources. We are also expanding our offering to include new technologies and products, like modified bitumens with an addition of rubber. Adoption by LOTOS Asfalt of a new sales policy is planned for 2013.

Logistics

Development of Grupa LOTOS logistics capabilities will involve optimisation of the supply chain, consolidation of operating activities, product swapping with other market participants, further reduction in shipping and storage costs, and the increased activity and competitiveness of entities providing logistics services on the home market.

Trading

Our activities in the trading area in 2013 will focus on optimising the structure of crudes, which will mainly involve increasing the share of crude supplied by sea. Deliveries of crude produced by LOTOS Geonafta in Lithuania are also expected to begin. Work will continue on improving and further integrating the key functions and competences necessary for integrated margin management. The Gdańsk refinery's process system for export petroleum products has stabilised, so we do not expect any major movement in sales structure and volumes. Export sales volumes will depend on the volumes sold on the domestic market, and also on the volumes of crude processed at the Gdańsk refinery and the crude processing structure. Export sales volumes may fall slightly due to the maintenance shutdown of the refinery planned for spring 2013. As part of our optimisation of the supply chain, products supplementing the petroleum product mix will continue to be purchased or borrowed.