

Questions submitted by Bogdan Kamola, a shareholder, at the Annual General Meeting of Grupa LOTOS S.A. on June 30th 2020, and Grupa LOTOS S.A.'s answers:

1. **The Directors' Report on the operations of Grupa LOTOS S.A. (GL S.A.) and its Group in 2019** showed a net profit of PLN 834.3m, that is 37.5% less year on year.
Please specify the contributing factors and their respective shares in the decline.

Answer:

In 2019, Grupa LOTOS S.A. posted net revenue of PLN 26,313.0m (1.6% less than in 2018), a result of lower prices of petroleum products on global markets and higher sales volumes. The average net selling price of the Company's products was PLN 2,262/tonne (a decrease of PLN 79/tonne, or -3.4%, on 2018).

The total volume of petroleum products, merchandise and materials sold by the Company in 2019 was 11,633.5 thousand tonnes (an increase of 210.3 thousand tonnes, or 1.8%, on 2018).

Cost of sales was PLN 24,509.4m (an increase of 0.6% on 2018). The PLN 424.3m decrease in revenue and the PLN 140.4m increase in cost of sales resulted in a PLN 564.7m decrease in gross profit on sales, to PLN 1,803.6m. The average unit cost of sales was PLN 2,107/tonne (a decrease of PLN 26/tonne, or -1.2%, on 2018), and was lower than the average net selling price by PLN 155/tonne. In 2018, the difference was PLN 207/tonne, that is PLN 52/tonne more.

The 3.8% increase in cost of sales, driven mainly by a 1.8% increase in sales volumes and a 6.9% increase in the average USD/PLN exchange rate in 2019, as well as a 17.1% increase in administrative expenses, caused mainly by higher employee benefits expense, affected the Company's results.

The year-on-year decline in revenue (by 1.6%), increase in cost of sales (by 0.6%), increase in distribution costs (by 3.8%), increase in administrative expenses (by 19.1%) and a smaller loss on other operating activities in 2019 (PLN -20.5m vs PLN -67.2m in 2018) resulted in Grupa LOTOS S.A.'s operating profit of PLN 744.5m (PLN 584.7m, or -44.0%, less than in 2018).

The year-on-year decrease in operating profit was mainly driven by the adverse changes in prices of crude oil and petroleum products on global markets.

As much as 96.5% of the decrease in operating profit was attributable to the decline in profit on sales.

A 16.4% fall in finance income (mainly lower dividends received) further contributed to the year-on-year decrease in the Company's profit in 2019. A 51.1% year-on-year decrease in income tax (mainly due to lower tax base) somewhat offset the overall decline of net profit to PLN 834.3m (-37.5% on 2018).

2. Please provide the amount of expenditure incurred by the LOTOS Group on the following key development project **from their conceptual phase to December 31st 2019**:

- B8 project,
- B4/B6 project,
- Utgard project,
- Yme project,
- NOAKA project,
- project to sustainably develop the LOTOS-brand service station network in the economy and premium segments,

and the financial safety buffer for the projects as at December 31st 2019.

Answer:

As at December 31st 2019, the amount of capital expenditure on the projects, reflected in the gross carrying amount of non-current assets disclosed in the consolidated statement of financial position of Grupa LOTOS S.A. (net of remediation assets and right-of-use assets) is presented below:

| Project | Carrying amount as at December 31st 2019 [PLNm] |
|-------------------------|--|
| B8 | 1,489.18 |
| B4/B6 ⁽¹⁾ | 110.28 |
| Utgard | 371.86 |
| YME | 1,999.93 |
| NOAKA | 213.17 |
| Service station network | 1,697.56 |

⁽¹⁾ Payments to the share capital of Baltic Gas Sp. z o.o. and Baltic Gas Spółka z ograniczoną odpowiedzialnością i wspólnicy sp. k.

As at December 31st 2019 the Company tested the projects' assets for impairment (except assets of the B4/B6 and NOAKA projects). Results of the tests were reflected in the relevant amounts disclosed in the 2019 full-year consolidated financial statements of Grupa LOTOS S.A.

3. Last year, GL S.A.'s marketing expenditure was ca. PLN 82.2m. Has a cost-benefit analysis been carried out to determine the expenditure's effect on:
 - a) Grupa LOTOS S.A.'s market position – share in the domestic retail fuel market.
 - b) Clients – product perception,
 - c) Marketing assets – brand value.

Answer:

The amount of marketing expenditure includes the budget for marketing and sponsorship activities. The analysis of effectiveness of the marketing and sponsorship activities carried out by Grupa LOTOS S.A. includes monitoring of a number of metrics which depend on the type of project and objectives of specific initiatives (e.g. short-term sales promotion campaigns at the service stations).

In 2019, the Company's most important marketing project was the NAJ campaign and the related activities promoting the food offering.

The post-campaign studies prove the high effectiveness of the activities:

- awareness of the LOTOS brand increased (unaided awareness by 3.5 percentage points; aided awareness by 4.9 percentage points), which helped the brand regain the second position in the sector;
- awareness of the Cafe Point brand increased by 2 percentage points, and the brand became the sector's leader in terms of unaided brand awareness;
- the subjective assessment of quality of the LOTOS fuels increased by 3.8 percentage points, which, apart from the availability of service stations, is one of the key drivers of motorists' decisions which retail chain to choose.

Analyses based on weekly sales reports and year-on-year market dynamics indicated that the marketing activities contributed to the successful delivery of both fuel and non-fuel retail sales targets at the service stations.

The Company does not monitor the current brand value to analyse the effectiveness of its marketing activities.

4. In the materials prepared for the purposes of the Grupa LOTOS AGM convened for June 30th 2020, the Management Board **stated** that the profitability metrics used to assess the Police Polymers project included:

- net present value - NPV,
- internal rate of return - IRR,
- refund period - PP,

however no values of the metrics were given.

Please specify their values and clarify what the criteria were applied to select the metrics.

- a) Has Grupa Azoty concluded any contracts for the supply of feedstock and other materials for production of propylene and polypropylene, and have any product off-take agreements been signed?

Answer:

As per the proposal to the General Meeting of June 3rd 2020, both the Polimery Police project itself (the "Project"), which is implemented by Grupa Azoty Polyolefins S.A. ("GAP S.A."), and Grupa LOTOS S.A.'s financial participation in GAP S.A., were subject to profitability analysis performed for transactions of this type, using standard profitability metrics provided in internal project management procedures applied at the LOTOS Group.

With the Company's best interests, business secrets, best shareholder communication practices, and confidentiality obligations owed to the other Project participants in mind, Grupa LOTOS S.A. will not publish the actual values of these profitability metrics.

However, the Company would like to assert that all the metrics mentioned in the enquiry are at acceptable levels. The internal rate of return (IRR) is higher than the weighted average cost of capital (WACC) assumed for the Project, and the NPV is positive. These estimates were also reiterated in an independent opinion of a business adviser working on the transaction. Further, a related shareholder agreement contains clauses designed to mitigate the risk of the minimum rate of return not being achieved on the proposed equity investment, in order to better protect Grupa LOTOS S.A.'s interests as a partner in the Project.

According to the information obtained by Grupa LOTOS S.A. in a due diligence process, GAP S.A. (the company responsible for implementing the Project) is holding talks and has made preliminary arrangements with potential feedstock suppliers and customers, and is ready to sign final contracts when the process has entered a phase when such contracts can be performed.

5. When making the decision to participate in the Project, did the Management Board of Grupa LOTOS S.A. take into account the risks associated with false data provided by the Original Sponsor (Grupa Azoty Zakłady Chemiczne Police S.A.) in its 2014 and 2015 annual reports and in the third quarter 2016 report?

The Polish Financial Supervision Authority (PFSA) imposed fines on Grupa Azoty Zakłady Chemiczne Police S.A. totalling PLN 1m for these violations.

Answer:

The fines imposed by the Polish Financial Supervision Authority on Grupa Azoty Zakłady Chemiczne Police S.A. for a breach of disclosure obligations are not related to the Polimery Police Project and, since Grupa LOTOS S.A. is of the view they are irrelevant to the transaction, they were not taken into account in the project assessment process.

6. Following the judgment of the Court of Justice of the European Union of October 16th 2019 in Case C-189/18 (Right to deduct VAT. Principle of respect for the rights of defence. Interpretation of Article 47 of the CFR), on January 15th 2020 the Company moved for the resumption of proceedings in cases in which the Tax Audit and Administration Authorities issued decisions imposing VAT liabilities totalling PLN 168.2m on the Company.

What are the effects of these proceedings in the part concerning reversal of the tax authorities' decisions concerning 2010 and 2011 and suspension of the proceedings for 2012?

Answer:

In connection with the judgment of the Court of Justice of the European Union of October 16th 2019 in Case C-189/18 Glencore, on January 15th 2020 the Company moved for the resumption of proceedings in cases in which the following decisions were issued:

- decision by the Director of the Tax Chamber in Gdańsk, dated December 29th 2015, upholding the decision by the Director of the Tax Audit Office in Bydgoszcz, dated September 28th 2015, determining the Company's VAT liabilities for selected individual months of 2010 at a total amount of PLN 48.4m;

- decision by the Director of the Tax Chamber in Gdańsk, dated February 29th 2016, upholding the decision by the Director of the Tax Audit Office in Bydgoszcz, dated September 28th 2015, determining the Company's VAT liabilities for individual months of 2011 at a total amount of PLN 112.5;

- decision by the Director of the Tax Administration Chamber in Gdańsk, dated October 25th 2018, upholding the decision by the Head of the Gdańsk Customs and Tax Office in Gdynia, dated January 19th 2018, determining the Company's VAT liabilities for January 2012 at a total amount of PLN 7.3m;

and after resumption of the proceedings, for:

- reversal of the decisions by the tax authorities of both instances and discontinuation of the tax proceedings in the case concerning the proceedings for 2010–2011;

- suspension of the proceedings until final conclusion of the court proceedings – with respect to the proceedings concerning 2012, in connection with proceedings pending before the Supreme Administrative Court, initiated by the Company's cassation complaint.

The motions for the resumption of VAT proceedings for individual months of 2010, 2011 and for January 2012 went through the initial stage of formal examination and the proceedings were resumed, but the final decision on the merits of the case remains unknown. The proceedings concerning January 2012 have been suspended pending resolution of the case by way of ordinary procedure (until final conclusion of the court proceedings).

7. What is the scenario for the PKN Orlen and Grupa LOTOS merger if the European Commission denies PKN ORLEN's merger clearance request?

Answer:

The process of potential acquisition of Grupa LOTOS S.A. by PKN ORLEN is ongoing. The European Commission is expected to take a decision by July 22nd 2020. Further steps taken by PKN ORLEN, the company designated by the State Treasury as the leader of the process, will depend on the antitrust regulator's final decision. The remedial measures contained in such decisions will play an important role in all action plan scenarios.

8. What progress has been made in the upstream business deleveraging process?

Answer:

The upstream deleveraging project called the 'second Norwegian circle' (Resolution No. 22 of the Annual General Meeting of June 28th 2019) was completed on schedule, that is by December 2nd 2019. All objectives of the project were achieved.

Also, expenditure related to the project was approximately PLN 15m less than stated in the proposal to the AGM, owing to favourable movements in the USD/NOK and PLN/NOK exchange rates.

In line with the guidelines set out in Section 2 of the AGM resolution, the Management Board provided the Supervisory Board with detailed monthly reports on the progress in implementing the capital increase at LOTOS Upstream.

9. GL S.A.'s legal and management consultancy expenses amounted to approximately PLN 4.65m in 2019. What were the relative proportions of:
- legal expenses,
 - management consultancy expenses?

Answer:

The stated legal and management consultancy expenses of approximately PLN 4.65m comprised solely legal expenses.