

## THE THIRD PILLAR OF THE SOCIAL RESPONSIBILITY STRATEGY OF THE LOTOS CAPITAL GROUP

### ENERGY SECURITY = BUSINESS RESPONSIBILITY

target = establish economic values

risk management, intellectual capital, market share, brand value, reputation

The [mission](#) of Grupa LOTOS includes, without limitation, innovative development that must be consistent with the safety policy in the power sector. This element being included in the Company's key statement, i.e. its mission, clearly shows that it is an important issue in everyday operations of the Company and the entire Capital Group. It is necessary to note that at present, for the Company, "energy security" means safety in the power sector, covering all issues relative to the production of raw materials to generate energy, as well as the very media (conventional and non-conventional fuels, including fossil fuels like coal, gas, electricity, nuclear energy, heat, etc.).

The approach of Grupa LOTOS to energy security issues is depicted with the following elements:

- **Exploration of oil (upstream).** For many years, Grupa LOTOS has been consistently carrying out a programme of vertical integration of the Capital Group in order to preserve margins at each stage: from the exploration of raw materials (oil) through to the distribution of products in individual markets. The natural consequence of such a development concept was a strategy consisting of the maximisation of oil exploration in the Baltic Sea (the activity of LOTOS Petrobaltic) and the search for further development opportunities in other basins and onshore (Lithuania). As a result, the Company established LOTOS Exploration & Production Norge, the subsidiary of LOTOS Petrobaltic, which should commence production from the YME deposit in the second half of 2010 and is the owner (holding various percentages of shares) of nine other concessions in the Norwegian Shelf. Grupa LOTOS is also interested in other regions of the world, which are systematically monitored in terms of their development opportunities (e.g. the region of the Caspian Sea).
- Apart from ensuring the safety of the delivery of strategic raw material, i.e. oil, in Poland, upstream development is mainly a business project. In the next 10-20 years, oil prices are expected to stay within the range of USD 70–100 per [barrel](#) (OPEC's projection), which

guarantees that exploration will be profitable. Moreover, all forecasts of the structure of the consumption of energy media clearly show, apart from the increasing role of renewable and unconventional fuels, that oil will be the major raw material at least till 2030 (OPEC, IEA).

- At present, Grupa LOTOS is mainly supplied with Russian raw material given this strategy's profitability (Russian oil is cheaper than oil from sea supplies), while shareholders pay attention mainly to economics since the Company is listed in the Warsaw Stock Exchange. At the same time, to fulfil its mission, the Concern bought spot (single) cargo of various types of oil supplied by sea in order to establish its portfolio of available raw materials and analyse the structure of proceeds coming from its processing. This means that if an economic trend changes (e.g. Russian oil becomes more expensive than sea supplies, the so-called differential disappears), Grupa LOTOS will be ready to buy raw materials from countries other than Russia without breaking the supply of fuel production and rapidly changing the structure of its proceeds.
- **Refinery expansion – 10+ Programme.** The Refinery development programme was developed as a result of thorough market studies. Their conclusions clearly pointed out to the emerging trend of the so-called dieselisation both in Europe and in Poland, with petrol-driven cars are more and more often replaced with diesel vehicles. In addition, the deficit in the production of fuel oil by Polish refineries reached 30% of demand. The Refinery of Grupa LOTOS in Gdańsk has been expanded in order to increase oil processing given the increasing consumption in Poland and to increase a share in the total pool of products of medium distillates, including in particular fuel oil. It is necessary to point out that before the finance of the 10+ Programme was effected (the consortium of 18 banks), recognised oil sector advisors (Wood MacKenzie) reviewed all the Company's projections on the development of the fuel market in Poland. The test was positive for Grupa LOTOS. Taking into account the year 2009, it is necessary to note that the general slow-down of economic development in Poland did not affect the consumption of fuel like it did in the 15 states of the old European Union. Demand is still expected to grow in 2010.
- **Market.** Grupa LOTOS, as a market-oriented and vertically integrated oil corporation, plans its actions on the basis of market analysis. This means that it takes on projects which fulfil market needs in an optimum manner and, at the same time, provide the Company with the maximum possible profit. As a result, the Company imports significant volumes, in particular of fuel oil, in order to balance the market (cover the deficit of consumption arising from too little home production of that assortment). In such a manner, the sales of Grupa LOTOS exceed its own output significantly. Volumes mentioned will be gradually replaced with products manufactured by the Refinery in Gdańsk. The growth of domestic production will automatically reduce the Company's dependence on foreign supplies, contributing to increases in energy security (understood as independence from third party supplies).
- **Logistics.** The accurate operation and safety of the fuel market are also determined by logistics connections. In Poland, this area is managed by specialised entities from the PERN Group: PERN Przyjaźń SA, Operator Logistyczny Paliw Płynnych (OLPP) and

Naftoport. Logistics is not the core activity of Grupa LOTOS; however, it is fundamental for the Company's operations. This is why the Company closely cooperates with the abovementioned entities, presents its own initiatives on a parallel basis, including the construction of salt caverns in the Pomerania region. Poland has rich geological structures, in particular in the Pomerania region, which may be used to construct underground warehouses of oil and certain fuels in the form of salt caverns (leach extraction of salt deposits). The strategic location, the vicinity of Naftoport and the North Pipeline (connecting the Friendship pipeline with Naftoport in Gdańsk), as well as the Refinery in Gdańsk, means that such warehouses could be used as a strategic logistic centre not only in Poland, but in other countries of the region (Scandinavia, Baltic states, Germany) or alliances (NATO), as well. Additionally, as a result of the construction of the pipeline Odessa – Brody – Gdańsk, caverns will play the role of buffer warehouses. Grupa LOTOS took the initiative to carry out a project of constructing salt caverns in the Pomerania region; however, it is not able to complete it without acceptance of the Polish government.