21. Retained earnings

Retained earnings comprise capital reserves created and used in accordance with the rules stipulated by the applicable laws and deeds of incorporation, as well as current period's profit.

Furthermore, retained earnings include actuarial gains/losses relating to defined post-employment benefits, recognised inclusive of the tax effect, which are posted under Other comprehensive income/(loss), net in the statement of comprehensive income.

As at December 31st 2018 and December 31st 2017, Grupa LOTOS S.A. was restricted in its ability to distribute dividends, as described in detail in Note 12.

21.1 Restricted ability of subsidiaries to transfer funds to the Parent in the form of dividends

In 2018 and 2017, the ability of the LOTOS Group subsidiaries to transfer funds to Grupa LOTOS S.A. in the form of dividends was restricted due to the following arrangements:

- The amount of cash surplus generated by LOTOS Paliwa Sp. z o.o. in a financial year that is available for distribution depends on the achievement of certain ratios defined in credit facility agreements.
- At LOTOS Asfalt Sp. z o.o., dividend payment is restricted under the credit facility agreement for the financing of the EFRA Project, whereby distribution of dividends is not permitted before the first instalment of the credit facility is paid and the EFRA Project is completed (the first instalment was paid on December 21st 2018) . Payment of dividends from operating cash flows is conditional upon fulfilment of the requirements defined in the agreement, including generation of a sufficient cash surplus and achievement of financial ratios at prescribed levels.

These restrictions were applicable as at December 31st 2018 and December 31st 2017.

22. Bank borrowings, non-bank borrowings, notes and finance lease liabilities

	Note	December 31st 2018	December 31st 2017
Bank borrowings	22.1	3,421.2	3,903.0
Non-bank borrowings	22.2	55.8	68.3
Notes	22.3	227.0	313.0
Finance lease liabilities	22.4	180.0	141.6
Total		**3,884.0**	**4,425.9**
including:			
non-current		2,345.3	2,738.3
current		1,538.7	1,687.6

	December 31st 2018	December 31st 2017
At beginning of period	**4,425.9**	**5,557.2**
Proceeds from borrowings	366.6	925.8
Issue of notes	128.2	296.1
Repayment of borrowings	(1,122.3)	(1,236.2)
Redemption of notes	(214.8)	(160.2)
Decrease in finance lease liabilities	(33.0)	(36.8)
Interest, fees and commissions paid	(224.3)	(203.3)
Interest, fees and commissions accrued	206.9	204.7
Prepayments and accruals	17.5	13.6
Exchange differences	313.4	(906.7)
Change in overdraft facilities	2.9	(13.8)
Change in deposits securing payment of interest and principal	(58.7)	(15.8)
Other	75.7	1.3
At end of period	**3,884.0**	**4,425.9**

22.1 Bank borrowings

	December 31st 2018	December 31st 2017
Investment facilities	3,078.4	3,426.9
Working-capital facilities	8.8	139.4
Inventory financing and refinancing facility	752.8	696.8
Funds in bank deposits securing payment of interest and principal(1)	(418.8)	(360.1)
Total	**3,421.2**	**3,903.0**
including:		
non-current	2,158.1	2,633.6
current	1,263.1	1,269.4

* In accordance with IAS 32, Grupa LOTOS S.A. offsets the financial asset (cash reserved for repayment of the facilities) against financial liabilities under the facilities as it has a legally enforceable title to set off the amounts and intends to realise the asset and settle the liability simultaneously. Accumulation of funds for the repayment of credit facilities is expressly provided for in the documentation relating to the investment facilities obtained to finance the 10+ Programme, as well as the inventory financing and refinancing facility. The Company is required to set aside and maintain funds for repayment of principal and interest due over the next six months. The purpose of adopting the net-basis presentation approach in the statement of financial position is to reflect the expected future cash flows from the settlement of two or more financial instruments.

Repayment of the above facilities is secured with:

- power of attorney over bank accounts, blank promissory notes and bank guarantees,
- registered pledges over bank accounts, inventories, existing and future movables, and shares in subsidiaries,
- mortgage,
- transfer of title to property, plant and equipment,
- assignment by way of security of rights under insurance agreements, including insurance of inventories,
- assignment by way of security of rights under inventory storage agreements and the right to compensation from the State Treasury payable in the event that the Group is required to sell emergency stocks below market price,
- assignment by way of security of rights under licence agreements, design agreements and agreements for sale of products,
- assignment by way of security of rights under oil supply agreements,
- assignment by way of security of rights under a conditional loan agreement,
- representation on voluntary submission to enforcement.

Bank borrowings by currency

	Currency of credit facility advanced to the Group		
	USD	PLN	Total
December 31st 2018	3,200.2	221.0	**3,421.2**
December 31st 2017	3,627.9	275.1	**3,903.0**

Bank borrowings bear interest based on:

- 1M, 3M or 6M LIBOR (USD), depending on the interest period selected at a given time − in the case of USD-denominated facilities,
- O/N, 1M or 3M WIBOR - in the case of PLN-denominated facilities.

The bank margins on the contracted facilities are within the range of 0.85pp. – 3.1pp.

As at December 31st 2018, the average effective interest rate for the credit facilities denominated in US dollars was approximately 4.46% (December 31st 2017: 3.50%). The average effective interest rate for PLN-denominated facilities (excluding the syndicated facilities contracted by the Parent) was approximately 3.54% (December 31st 2017: 3.60%).

For sensitivity analysis of borrowings with respect to currency and interest rate risks, see Notes 27.3.1 and 27.4.1 respectively. For analysis of contractual maturities of the borrowings, see Note 27.5.

In connection with its investment credit facilities and the credit facility incurred to finance and refinance inventories, the Parent is required to maintain its Tangible Consolidated Net Worth (TCNW) at the level specified in the facility agreements. Under the facility agreement for refinancing and financing of inventories, the Parent is also required to comply with the covenant requiring it to maintain the Loan to Pledged Inventory Value Ratio at or below the level specified in the facility agreement. As at December 31st 2018 and December 31st 2017, the Parent complied with this requirement.

Proceeds from and repayment of bank borrowings

In 2018, proceeds from the Group's bank borrowings were PLN 366.6m (2017: PLN 925.8m), while cash outflows on repayment of borrowings were PLN 1,109.5m (2017: PLN 1,223.4m). These amounts are presented in the consolidated statement of cash flows as cash flows from financing activities under Proceeds from bank borrowings and Repayment of bank borrowings, respectively.

In 2018, proceeds from bank borrowings related to:

- investment facilities for the financing of the EFRA Project (PLN 233.4m),
- working capital facilities of AB LOTOS Geonafta (PLN 133.2m).

In 2018, repayments of bank borrowings related mainly to:

- the Parent's investment facilities for the financing of the 10+ Project (PLN 632.5m),
- investment facilities for the financing of the EFRA Project (PLN 78m),
- LOTOS Paliwa Sp. z o.o.'s investment credit facilities for the financing and refinancing of the purchase of service stations (PLN 36.8m),
- credit facilities of LOTOS Exploration and Production Norge AS (PLN 181.3m),
- credit facilities of AB LOTOS Geonafta (PLN 163.7m),
- SPV Baltic Sp. z o.o.'s investment facility for the purchase of the company's multi-purpose platform (PLN 12.1m).

In 2018 and 2017, there were no defaults under the facilities.

As at December 31st 2017, a covenant was not complied with and the non-current portion of liabilities under the credit facility agreement concluded by SPV Baltic Sp. z o.o. with PKO BP, amounting to PLN 51.1m, was presented under current liabilities. As at the date of preparation of the financial statements for 2017, SPV Baltic Sp. z o.o had a letter from PKO BP stating that the bank waived its right to treat the non-compliance with the covenant as an event of default. As at December 31st 2018, the company complied with all covenants under the agreement.

In addition, because as at December 31st 2017 one of the covenants under credit facility agreements of AB LOTOS Geonafta was not complied with, the long-term portion of liabilities under those credit facilities of PLN 8.5m was presented under current liabilities. As at December 31st 2017, the bank did not accelerate the facilities. As at the date of preparation of the financial statements for 2017, AB LOTOS Geonafta had a letter from the bank stating that the bank waived its right to treat the non-compliance with the covenant as an event of default.

For more information on the Group's bank borrowings, see the Directors' Report on the operations of Grupa LOTOS S.A. and the LOTOS Group in 2018.

22.2 Non-bank borrowings

	December 31st 2018	December 31st 2017
Provincial Fund for Environmental Protection and Water Management in Gdańsk (WFOŚiGW)	4.6	5.2
Agencja Rozwoju Przemysłu S.A.	51.2	63.1
Total	**55.8**	**68.3**
including:		
non-current	42.2	4.4
current	13.6	63.9

The loan advanced by Agencja Rozwoju Przemysłu S.A. was intended for the financing of a purchase of a drilling rig; the other loans were taken out to partly finance upgrade of locomotives and a rail tank car cleaning facility, as well as upgrade of the dust removal unit at a CHP plant.

Repayment of the loans is secured with:
- registered pledge over assets,
- registered and financial pledges over shares,
- assignment by way of security of rights under insurance policies and sale agreements,
- assignment by way of security of claims related to bank accounts,
- blank promissory notes and representation on voluntary submission to enforcement,
- sureties issued by Group companies.

The loans are denominated in the Polish złoty. The loans bear interest based on 1M WIBOR or the rediscount rate.

As at December 31st 2018, the average effective interest rate for the loans was approximately 4.60% (December 31st 2017: 4.61%).

For interest rate risk sensitivity analysis of the loans, see Note 27.4.1.
For analysis of contractual maturities of the loans, see Note 27.5.

Proceeds from and repayment of non-bank borrowings

In 2018 and 2017, the Group did not contract any non-bank borrowings, whereas repayments of non-bank borrowings were PLN 12.8m (2017: PLN 12.8m). These amounts are presented in the consolidated statement of cash flows as cash flows from financing activities under Proceeds from non-bank borrowings and Repayment of non-bank borrowings, respectively.

As at December 31st 2017, one of the covenants under the loan agreement concluded by SPV Baltic Sp. z o.o. with Agencja Rozwoju Przemysłu was not complied with and the non-current portion of liabilities under the loan, amounting to PLN 51.1m, was presented under current liabilities. As at the date of preparation of the financial statements for 2017, SPV Baltic Sp. z o.o had a letter from Agencja Rozwoju Przemysłu stating that it waived its right to treat the non-compliance with the covenant as an event of default. As at December 31st 2018, the company complied with all covenants under the agreement.

22.3 Notes

In 2016, the SPV B8 Spółka z ograniczoną odpowiedzialnością Baltic S.K.A. (upstream segment) concluded agreements with Bank Gospodarstwa Krajowego S.A. (BGK) and Polski Fundusz Rozwoju S.A. (the Polish Development Fund, PFR) (Fundusz Inwestycji Infrastrukturalnych – Dłużny Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych) for the financing of the development of the B8 oil field in the Baltic Sea, including senior notes and subordinated notes programme agreements.

Security under the above agreements includes:
- pledges over shares,
- pledge over bank accounts,
- pledge over receivables,
- pledge over assets.

As at December 31st 2017, due to an event of default under the terms and conditions of the notes, there were grounds for their early redemption at the option of PFR and BGK. The financing entities did not exercise this right. On July 25th 2018, B8 spółka z ograniczoną odpowiedzialnością Baltic S.K.A. and BGK concluded an annex to the senior note programme agreement and annexes to the terms and conditions of the notes issued by the company and acquired by BGK. On July 27th 2018, B8 Spółka z ograniczoną odpowiedzialnością Baltic S.K.A. issued notes with a total nominal value of USD 30m. The issue proceeds were used to redeem all notes acquired by Polski Fundusz Rozwoju S.A. As at December 31st 2018, the company had the right to issue additional notes for USD 27.9 under the agreement. All the issued notes are due at dates falling in the period from September 30th 2020 to June 30th 2022. In relation to the outstanding notes of B8 Spółka z ograniczoną odpowiedzialnością Baltic S.K.A., because as at December 31st 2018 there was a default on one of the financial covenants changed by the annex, the non-current portion of liabilities under the agreement, amounting to PLN 227m, was presented under current liabilities. As at December 31st 2018, BGK did not accelerate the liabilities.

As at December 31st 2018, the liability under the outstanding notes issued by B8 Spółka z ograniczoną odpowiedzialnością Baltic S.K.A., net of issue costs, was PLN 227m (December 31st 2017: PLN 201.3m).

In 2013, LOTOS Petrobaltic S.A. (upstream segment) issued medium-term notes under an agreement with Bank Pekao S.A. of October 29th 2013. In 2018, LOTOS Petrobaltic S. A. redeemed all outstanding notes. As at December 31st 2017, the liability under LOTOS Petrobaltic S.A.'s outstanding notes, net of issue costs, was PLN 111.7m.

The security created in respect of the note issue programme comprised:
- assignment by way of security,
- power of attorney over bank accounts,
- blank promissory note,
- representation on voluntary submission to enforcement,
- mortgage,
- assignment by way of security of claims under property insurance agreements and agreement for drilling rig services.

Proceeds from and payments under notes

In 2018, proceeds from notes issued by the Group were PLN 128.2m (2017: PLN 296.1m) and were related to the special purpose vehicle B8 Spółka z ograniczoną odpowiedzialnością Baltic S.K.A. In the same period, outflows on note redemption amounted to PLN 214.8m (2017: PLN 160.2m) and were related to the following companies: LOTOS Petrobaltic S.A. (PLN 113.8m) and B8 Spółka z ograniczoną odpowiedzialnością BALTIC S.K.A. (PLN 101.0m). These amounts are presented in the statement of cash flows as cash flows from financing activities under: Issue of notes and Redemption of notes, respectively.

For sensitivity analysis of the notes with respect to currency and interest rate risks, see Notes 27.3.1 and 27.4.1, and for analysis of their contractual maturities see Note 27.5.

22.4 Finance lease liabilities

	Minimum lease payments		Present value of minimum lease payments	
	December 31st 2018	**December 31st 2017**	**December 31st 2018**	**December 31st 2017**
Up to 1 year	56.6	57.4	35.0	41.3
From 1 to 5 years	161.3	121.6	106.3	100.3
Over 5 years	43.1	-	38.7	-
Total	**261.0**	**179.0**	**180.0**	**141.6**
Less finance costs	(81.1)	(37.4)	-	-
Present value of minimum lease payments	**179.9**	**141.6**	**180.0**	**141.6**
including:				
non-current			145.0	100.3
current			35.0	41.3

The Group uses finance leases primarily to finance rolling stock assets.

For sensitivity analysis of finance lease liabilities with respect to currency and interest rate risks, see Notes 27.3.1 and 27.4.1, and for analysis of their maturities, see Note 27.5.

22.4.1 Undisclosed liabilities under operating lease agreements

As at December 31st 2018 and December 31st 2017, future minimum lease payments under non-cancellable operating leases were as follows:

	December 31st 2018	December 31st 2017
Up to 1 year	177.5	156.0
From 1 to 5 years	225.3	318.2
Over 5 years	969.2	918.9
Total	**1,372.0**	**1,393.1***

*During the work on the implementation of IFRS 16 and following a thorough analysis of contracts, contracts not previously recognised as operating lease payments were identified. The Group has restated the presentation data for 2017. Operating lease payments are recognised as an expense over the lease term on a straight-line basis, therefore the change did not affect the reporting items in the comparative period.

23. Derivative financial instruments

	Note	December 31st 2018	December 31st 2017
Non-current financial assets:		**9.1**	**2.7**
Commodity swaps (raw materials and petroleum products)		2.1	0.7
Interest rate swap (IRS)		7.0	2.0
Current financial assets:		**15.3**	**161.8**
Commodity swaps (raw materials and petroleum products)		11.7	34.0
Currency forward and spot contracts		-	13.1
Interest rate swap (IRS)		0.8	7.3
Currency swap		2.8	107.4
Financial assets	**26.1**	**24.4**	**164.5**
Non-current financial liabilities:		**6.9**	**6.7**
Commodity swaps (raw materials and petroleum products)		6.6	0.1
Interest rate swap (IRS)		0.3	6.6
Current financial liabilities:		**47.4**	**72.7**
Commodity swaps (raw materials and petroleum products)		15.0	3.7
Currency forward and spot contracts		21.8	9.5
Interest rate swap (IRS)		6.8	21.2
Currency swap		3.8	38.3
Financial liabilities	**26.1**	**54.3**	**79.4**

For description of the derivative financial instruments, see Note 7.22. For description of objectives and policies of financial risk management, see Note 27. For classification of derivative financial instruments by fair value hierarchy, see Note 23.1.

For sensitivity analysis of derivative financial instruments in terms of market risk related to changes in raw material and petroleum product prices, see Note 27.1.1.

For currency risk sensitivity analysis of derivative financial instruments, see Note 27.3.1.

For interest rate sensitivity analysis of derivative financial instruments, see Note 27.4.1.

For information on contractual maturities of derivative financial instruments, see Note 27.5.
For information on maximum credit risk exposure of derivative financial instruments (financial assets), see Note 27.6.

23.1 Fair value hierarchy

	December 31st 2018	December 31st 2017
	Level 2	
Financial assets		
Commodity swap	13.8	34.7
Currency forward and spot contracts	-	13.1
Interest rate swap (IRS)	7.8	9.3
Currency swap	2.8	107.4
Total	**24.4**	**164.5**
Financial liabilities		
Commodity swap	21.6	3.8
Currency forward and spot contracts	21.8	9.5
Interest rate swap (IRS)	7.1	27.8
Currency swap	3.8	38.3
Total	**54.3**	**79.4**