

**Statement on business
activities of LSI Software S.A.**
Financial statement as at 31.12.2016



Daily work becomes easier

1. Basic information

LSI SOFTWARE SPÓŁKA AKCYJNA (JOINT STOCK COMPANY)

with its registered office in Łódź
176/178 Przybyszewskiego St.

LSI Software S.A. with its registered office in Łódź at 176/178 St. was registered with the National Court Register kept by the District Court for the City of Łódź (20th Commercial Department of the National Court Register) under the following number: KRS 0000059150.

The main scope of the Company's business activities shall include:

- Computer programming activities 62.01 Z

LSISOFT / LSI / PLLSSFT00016
IT
Main Market 5 MINUS

The duration of the Company's business operations shall be unlimited.

The financial statement of LSI Software has been prepared for the period of **1 January 2016 – 31 December 2016**. The comparable period: 1 January 2015 – 31 December 2015.

2. Discussion of the key economic and financial amounts disclosed in the annual financial statement, and in particular description of all factors and events, including non-recurring ones, which had a significant impact on the issuer's business and profit achieved or loss incurred in a given financial year, and discussion of development prospects for the issuer's business in a period covering at least the next financial year

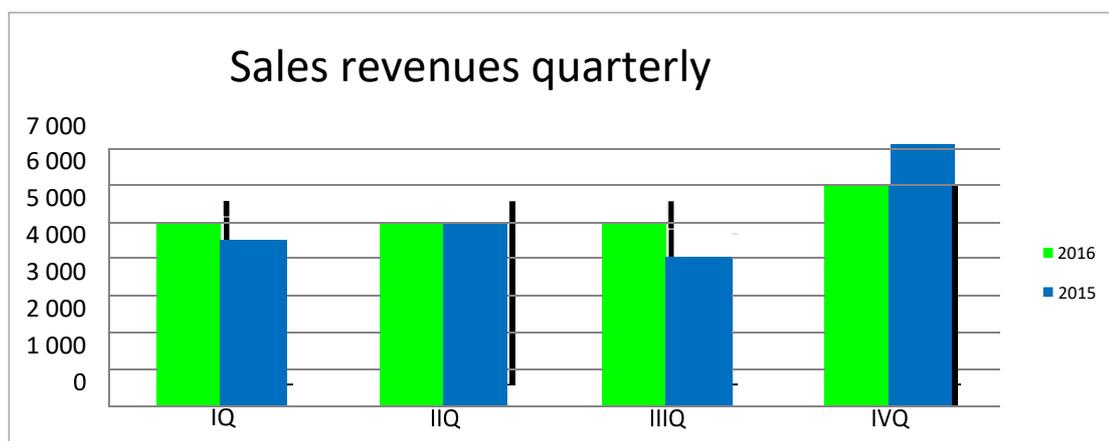
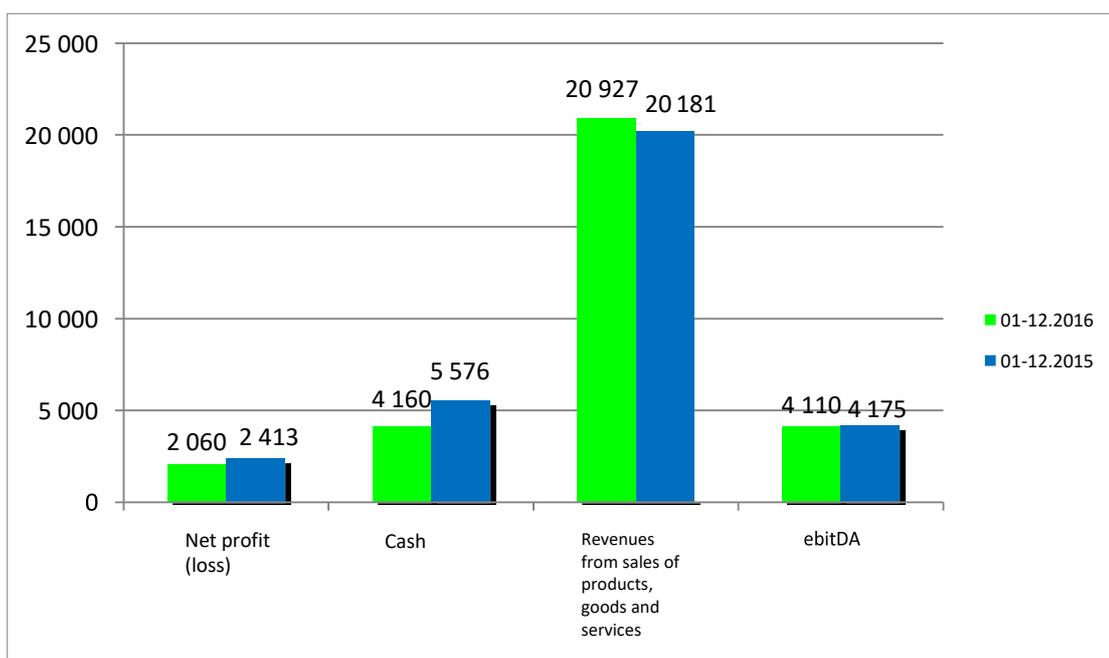
Discussion of the key economic and financial amounts

In 2016, the Issuer as a result of the continued development of its operations, once again generated a 4% growth in sales revenues which reached the level of PLN 20,927 thousand in relation to PLN 20,181 thousand in 2015. As compared to 2015, the profitability of business operations has slightly deteriorated due to intensification of products' promotion, which has a direct impact on the more than twofold increase in cost of sales. It is also important to mention the increased depreciation costs arising in connection with the EU projects completed in 2015.

In the opinion of the Management Board, the implementation of the adopted strategy aiming to introduce the Company's products to foreign markets as well as additional expenditures associated with their promotion will bring, in subsequent periods, tangible results in the form of increased sales growth and improved profitability of the issuer.

Additional information significant for the assessment of the financial situation:

- increase in costs of depreciation by PLN 94 thousand, associated with EU projects completed in 2015, has been neutralized, and will continue to neutralize in subsequent years with prepayments on subsidies,
- for another consecutive year, the Company's debt ratio has been reduced from 31% to 27%.
- a double increase in other operating income was reported (from the level of PLN 644 thousand at the end of 2015 to PLN 1,217 thousand for the year 2016).



Indicator	2016	2015
Return on sales (%)	9,84	11,96
Liquidity ratio	2,14	2,51
Debt ratio	0,27	0,31
Receivables turnover ratio (days)	81,12	70,36
Liabilities turnover ratio (days)	28,41	37,42

Events of unusual nature

Due to resignation on 10 March 2015 of former president of the Management Board of BluePocket S.A. and failure to appoint a new Management Board of this company, by the day of preparation of the report hereof, the Issuer did not receive financial statements of BluePocket S.A. for the years 2015 and 2016. At the same time, due to the fact that the meetings of the Supervisory Board are not attended by members appointed by Bastion Venture Fund sp. z o.o. S.K.A. as a Shareholder, LSI Software S.A. is not able to independently appoint the Management Board of BluePocket S.A. which results in the actual lack of the Issuer's ability to govern financial and operating policies of this entity.

Development prospects

The Issuer expects that 2017 will be a period of significant acceleration in growth of the Company both on the domestic and foreign markets. The basis for this growth on the domestic market will be an additional revenue generated by new branches established in 2016 in Szczecin, Białystok and Rzeszów supporting new areas of Poland. For 2017, the opening of another branch is planned. These actions are aimed at broadening the Group's operating scale in Poland and strengthening its presence in the operated markets, which, in the opinion of the Management Board, should also result in the increased sales growth.

At the same time, in connection with the development of the **POSitive® Cinema** distribution network (previously POSitive® Show), at the beginning of 2017 LSI Software S.A. acquired a new distributor in South America, and is currently in the process of setting up a new subsidiary to bring introduce this product to the North American market, and eventually other Group's solutions intended for catering and hospitality industries. In 2016, LSI Software S.A. also established cooperation with a partner from the cinema industry, together with which acquires customers from Western and Eastern Europe.

The Issuer also took part in trade fairs outside Poland to promote current and newly developed product groups, which market launches were scheduled for this year. POSitive® Cinema was as first officially introduced to the market during the International Cinema Fairs - CineEurope (CCIB) in Barcelona in June 2016. After the June market release, LSI Software also took part in the international cinema industry conventions organized in Odessa and St. Petersburg (Kino Expo), so a new Company's solution was presented to the potential buyers from the markets of Eastern Europe and Asia. The last trade show in which LSI Software S.A. took part was the CinemaCon in Las Vegas in March 2017, during which the Company presented its solution to customers from around the world including US-based cinema networks.

This product, despite its relatively short life span, is currently enjoying a great deal of interest in the movie industry, which, according to the Board, will have a positive impact on the financial results of LSI Software S.A. in 2017. At the same time it should be pointed out that upon the conclusion of the agreement with Cinema 3D S.A., the Issuer has reached the 75%-share in the market of the largest cinema networks in Poland.

In addition, the Company's Management Board undertakes actions aimed at increasing the Group's market share in particular industries through direct acquisitions or investments in new products. As a result, the Ordinary General Meeting of Shareholders held on 27 June 2015 adopted a resolution concerning the amendment of the Company's Articles of Association to authorize the Management Board to increase the shares capital as part of the procedure of increasing the authorized capital. However, considering the significant cash resources and low level of the Group's debt, the Management Board assumes financing of this transaction with own funds and bank credit in order to avoid the dilution of current shareholders' share capital, as it was in the case of acquisition of shares in GiP Sp. z o.o.

Development prospects of the Group are also enhanced as a result of acquiring the EU funds for the years 2014 – 2020. LSI Software S.A. has signed, inter alia, a contract for co-financing activities related to the internationalization of the company within the Regional Operational Program of the Łódź Voivodship. These actions will lead to the expansion of the Issuer's offer to foreign markets. Furthermore, in the opinion of the Management Board, EU funds should also boost sales of the Company in connection with an increase in investments executed by entities operating in industries operated by the Group.

Implementation of the above development strategy, as well as a strong financial foundations of the Group which is a market leader in its industry, create a stable basis for further, organic growth of both LSI Software S.A. and its subsidiaries.

3. Risk factors and threats to which the Company is exposed

Factors associated with the business operations of the Company

- **Risk associated with the introduction of new products of the Company and the development of existing ones**

The dynamic development of information technology and methods of data transmission and processing, enforces the need to keep up with new technologies. IT companies are forced to constantly renew offered products and services and to develop new technology solutions. There is a risk associated with the difficulties in keeping up with the market development in this area, as well as it is uncertain whether the introduction of a new product that is currently being developed or will be developed by the Company, would be positively welcomed by potential customers. In order to minimize mentioned risk, the Company continuously analyzes the trends in the IT services market, effectively responds to market's demand for new solutions as well as effectively adjusts the catalogue of offered products and methods for their use to customers' expectations. The Company systematically establishes and maintains business relationships with suppliers and customers and ensures a high technological level of its own products and services associated with them.

- **Risk associated with the changes of the growth-rate of ERP software market**

Recently, the ERP software market in Poland as compared to the growth rate of gross domestic product, maintained an upward trend. In accordance with publications and industry analysis presenting growth forecasts for this area of services, further intensification of this market should be assumed. However, for the assessment of aforementioned assumptions, the potential economic fluctuations (which, as a consequence, may be significant for the potential clients of the Company while making investment decisions regarding the use of IT solutions offered by the Company) shall also be of considerable importance.

In order to reduce this risk, the Company develops its operations by diversifying its own customers area. The Company addresses its product portfolio to companies operating in various business sectors. The distribution of the offer among several market areas effectively reduces the dependence on customers thereby reducing this risk.

- **Risk associated with the change of criteria regarding the technology provided by technology partners**

The development of the Company's activities depends to a large extent on access to modern Information Technology solutions. Currently, the main partner in this regard is Microsoft - the largest software producer in the world. Microsoft, under the partnership agreement, cooperates with the Group in the field of implementation of the system environment and databases. It cannot be excluded that in future the status of the partnership may change, particularly with regard to a possible increase of cost associated with an access to technology, which in turn could result in the need to change the pricing policy for customers. All these facts would for sure partially reduce the competitiveness in the IT services market.

- **Risk associated with the loss of key employees**

The Company's operations and its development prospects depend largely on the knowledge and experience of highly qualified personnel. It is typical for the companies operating in IT sector. The dynamic development of IT companies in Poland and in the European Union may contribute to the growth in the demand for highly qualified and experienced staff. The main method for obtaining employees is to offer them competitive salary and working conditions. There is a risk that the loss of key employees could result in delays in the implementation of works.

Any increase in costs of employment may have a negative impact on the Company's financial results and development opportunities. The Company establishes optimal incentive schemes which build positive relationships with employees, reduce the staff turnover and enable maintaining a stable base of qualified and highly experienced IT employees.

Factors associated with the environment in which the Company operates

- **Risk associated with the instability of legal system**

The Polish legislation and its interpretation are subject to frequent changes. Many of the existing legal provisions, particularly tax provisions, have not been formulated in a sufficiently precise manner so they lack a clear interpretation. Any changes in the law may have a negative impact on the Company's business activities and the environment in which the Company operates. Entry into force of new regulations which are significant for the economic relations may result in different problems associated with interpretation, inconsistent judicial decisions, disadvantageous interpretations adopted by public authorities, etc., which in turn can, directly or indirectly, translate into worse operating conditions for the Company.

- **Risk related to the macroeconomic and geopolitical situation of Poland and the world**

The activities of the Company and the pace of the development of its product offer are closely associated with the overall economic situation of the country. The financial result of the Company is undoubtedly affected by such factors as the level of GDP, the level of business investments, the level of inflation, the level of foreign exchange rates against zloty (PLN) and geopolitical situation in the region. Any slowdown in economic growth, the decline of investments, in particular in the field of modern technology as well as the inflation growth could have a negative impact on operations and financial position of the Company and its financial results. Due to the import, the low value of zloty (PLN) is also recognized by the Company as a threat. The macroeconomic situation and the results of the Company may also be affected by the geopolitical conditions prevailing in the region, including the ongoing dispute over the Polish Constitutional Court and the Ukrainian conflict. In order to reduce the potential negative effects of aforementioned factors, the Company diversifies its operating areas also throughout addressing its offer to foreign clients.

- **Risk of competition**

The rising competition from both Polish and foreign IT companies shall significantly affect the business operations of the Company. The consolidation of companies in the market shall also constitute a serious threat. Furthermore, the growing number of institutions benefiting from its own experts in the field of IT solutions may affect the Company's competitiveness to other entities which in turn may have a negative impact on the business activities and financial result. Therefore, it cannot be excluded that the growing competitive pressure will not affect the level of profitability of the Company's business.

- **Risk of industry consolidation**

Consolidation processes in the IT industry lead to strengthening the largest entities in the market which enables them an access to new customers. The strongest companies seek to take over weaker companies operating in niche segments of the IT market. The Company, aiming to strengthen its position in the market, also plans the acquisition of companies in certain market segments.

- **Financial risk**

The purpose of the Company's financial risk management is to reduce to an acceptable level the volatility of cash flows and financial performance generated on the core business of the Company. The main financial instruments used by the Issuer are:

- cash,

- short-term deposits,
- foreign exchange and forward transactions,
- loans granted,
- overdrafts and long-term credits,
- lease agreements.

The main purpose of these instruments is to ensure the financial security and stability of current business operations of the Issuer through stabilizing and minimizing the liquidity risks, foreign currency and interest rates risks, as well as the efficient allocation of available financial resources.

Currency risk management strategy applied by the Issuer assumes the maximum use of natural hedging. The Company strives to maximize structural matching of revenues and expenses in the same currency as the executed contracts. Net exposure to currency risk which is not hedged in a natural manner, shall be hedged at the time of the transaction up to a maximum of 100% of the estimated value of net exposure, exclusively with the use of approved types of derivatives, i.e. forward transactions.

4. Statement on compliance with corporate governance rules

Indication of a set of corporate governance principles applied by the issuer

On 13 October 2015 the Warsaw Stock Exchange Supervisory Board adopted a Resolution No 26/1413/2015 on the adoption of a new set of corporate governance principles "Best Practice for GPW Listed Companies 2016" (hereinafter "Best Practice 2016") which came into force as of 1 January 2016. The subject document is available on the following website: www.corp-gov.gpw.pl. On 27 January 2016, the Company disclosed the relevant report on compliance with new Best Practice and, in accordance with rule I.Z.1.13, published on its website a statement on the Company's compliance with the corporate governance recommendations and principles contained in Best Practice 2016.

The Management Board of LSI Software S.A. discloses the following information in accordance with Par. 91 Section 5 item 4 of the Regulation of the Minister of Finance of 19 February 2009 on current and periodic information and with consideration of Par. 29 Section 5 of the Warsaw Stock Exchange Rules as regards the scope and structure of the report on compliance by listed companies with corporate governance rules.

Indication of the extent to which the Issuer derogates from the application of corporate governance rules and explanation of the reasons for this derogation

According to the current state of compliance with Best Practice, the Company does not apply 4 recommendations: III.R.1., IV.R.2., IV.R.3., VI.R.3.

According to the current state of compliance with Best Practice, the Company does not apply 15 detailed principles: I.Z.1.10., I.Z.1.16., I.Z.1.20., I.Z.2., II.Z.2., II.Z.8., III.Z.1., III.Z.2., III.Z.3., III.Z.4., III.Z.5., IV.Z.2., IV.Z.9., V.Z.6., VI.Z.2.

I.Z.1.10. financial projections, if the company has decided to publish them, published at least in the last 5 years, including information about the degree of their implementation

The Company does not publish and did not publish the financial projections in the last 5 years.

I.Z.1.16. information about the planned transmission of a general meeting, not later than 7 days before the date of the general meeting

The Company does not apply the principle regarding the transmission of the general meeting due to a low degree of shareholding dispersion and significant costs associated with applying this rule.

I.Z.1.20. an audio or video recording of a general meeting

The Company does not apply the principle regarding an audio or video recording of a general meeting due to a low degree of shareholding dispersion and significant costs associated with applying this rule.

I.Z.2. A company whose shares participate in the exchange index WIG20 or mWIG40 should ensure that its website is also available in English, at least to the extent described in principle I.Z.1. This principle should also be followed by companies not participating in these indices if so required by the structure of their shareholders or the nature and scope of their activity.

The shareholding structure and the nature and scope of business activities do not support the application of this principle. However, the Company ensures the availability of its website is available in English to the extent required under the Liquidity Support Program.

II.Z.2. A company's management board members may sit on the management board or supervisory board of companies other than members of its group subject to the approval of the supervisory board.

This derogation is temporary. The Company will make every effort to ensure that at the forthcoming meeting of the Supervisory Board of the Company, the issue regarding performing by Member of LSI Software S.A. Management Board of functions in a company from outside the group, is reviewed.

II.Z.8. The chair of the audit committee should meet the independence criteria referred to in principle II.Z.4.

The Company has not established an audit committee. Therefore, the principle is not applied.

III.R.1. The company's structure should include separate units responsible for the performance of tasks in individual systems or functions, unless the separation of such units is not justified by the size or type of the company's activity.

Company's structure will not include separate units responsible for the performance of tasks in individual systems or functions, due to the fact that it is not justified by the size or type of the Company's activity.

III.Z.1. The company's management board is responsible for the implementation and maintenance of efficient internal control, risk management and compliance systems and internal audit functions

The Company has not separated the internal audit functions due to the fact that it is not justified by the size or type of the Company's activity.

III.Z.2 Subject to principle III.Z.3, persons responsible for risk management, internal audit and compliance should report directly to the president or other member of the management board and should be allowed to report directly to the supervisory board or the audit committee.

The Company has not separated the internal audit functions due to the fact that it is not justified by the size or type of the Company's activity.

III.Z.3 The independence rules defined in generally accepted international standards of the professional internal audit practice apply to the person heading the internal audit function and other persons responsible for such tasks.

The Company has not separated the internal audit functions due to the fact that it is not justified by the size or type of the Company's activity.

III.Z.4 The person responsible for internal audit (if the function is separated in the company) and the management board should report to the supervisory board at least once per year with their assessment of the efficiency of the systems and functions referred to in principle III.Z.1 and table a relevant report.

The Company has not separated the internal audit functions due to the fact that it is not justified by the size or type of the Company's activity.

III.Z.5 The supervisory board should monitor the efficiency of the systems and functions referred to in principle III.Z.1 among others on the basis of reports provided periodically by the persons responsible for the functions and the company's management board, and make an annual assessment of the efficiency of such systems and functions according to principle II.Z.10.1. Where the company has an audit committee, it should monitor the efficiency of the systems and functions referred to in principle III.Z.1, which however does not release the supervisory board from the annual assessment of the efficiency of such systems and functions.

The principle is not applied by the Company in respect of the internal audit functions due to the size and type of the Company's activity.

IV.R.2. The principle is not applied by the Company in respect of the internal audit functions due to the size and type of the Company's activity. If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through: 1) real-life broadcast of the general meeting; 2) real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting; 3) exercise of the right to vote during a general meeting either in person or through a plenipotentiary.

The Company does not provide for the possibility of conducting the General Meeting by means of electronic communication due to a low degree of shareholding dispersion and significant costs associated with applying this rule.

IV.R.3. Where securities issued by a company are traded in different countries (or in different markets) and in different legal systems, the company should strive to ensure that corporate events related to the acquisition of rights by shareholders take place on the same dates in all the countries where such securities are traded.

The shares of the Company are listed in Poland only.

IV.Z.2. If justified by the structure of shareholders, companies should ensure publicly available real-time broadcasts of general meetings.

The Company does not apply the principle regarding the transmission of the general meeting due to a low degree of shareholding dispersion and significant costs associated with applying this rule.

IV.Z.9. Companies should strive to ensure that draft resolutions of the general meeting contain a justification, if it helps shareholders to pass a resolution with adequate understanding. If a matter is put on the agenda of the general meeting at the request of a shareholder or shareholders, the management board or the chair of the general meeting should request presentation of the justification of the proposed resolution. In important matters and matters which may give rise to any doubt of shareholders, the company should provide a justification, unless it otherwise provides the shareholders with information necessary to pass a resolution with adequate understanding.

This principle will be applied unless its application will not be detrimental to the Company.

V.Z.6. In its internal regulations, the company should define the criteria and circumstances under which a conflict of interest may arise in the company, as well as the rules of conduct where a conflict of interest has arisen or may arise. The company's internal regulations should among others provide for ways to prevent, identify and resolve conflicts of interest, as well as rules of excluding members of the management board or the supervisory board from participation in reviewing matters subject to a conflict of interest which has arisen or may arise.

The Company does not apply this principle. The Company, however, does not prejudice the possibility of preparation of internal regulations providing among others for ways to prevent, identify and resolve conflicts of interest, as well as rules of excluding members of the management board or the supervisory board from participation in reviewing matters subject to a conflict of interest.

VI.R.3. If the supervisory board has a remuneration committee, principle II.Z.7 applies to its operations.

The Company has not appointed a remuneration committee within its Supervisory Board.

VI.Z.2. To tie the remuneration of members of the management board and key managers to the company's long-term business and financial goals, the period between the allocation of options or other instruments linked to the company's shares under the incentive scheme and their exercisability should be no less than two years.

Before the entry into force of the "Best Practice for GPW Listed Companies 2016", as part of the incentive programs, the instruments were used, which were characterized by the fact that the period between their allocation and execution was less than 2 years.

Description of the main features of the Issuer's internal control and risk management systems in relation to the process of preparing financial statements

Internal control and risk management in relation to the process of preparing financial statements are executed by the Supervisory and Management Boards, and employees at all levels. Developed and implemented system of internal control in the field of accounting records ensures the reliability, completeness and timeliness of the information contained in the financial statements, as well as compliance with applicable laws and regulations. The Company monitors significant legal risk factors on an ongoing basis. Quarterly, semi-annual and annual financial statements are submitted periodically by the Management Board to the Supervisory Board.

Indication of shareholders holding, directly or indirectly significant blocks of shares

As at 28 April 2017

Person	Number of shares	Number of votes	% of votes at GM
Grzegorz Siewiera/SG Invest Sp. z o.o.	1 000 000	2 600 000	53,49%
Piotr Kraska/Yavin Limited	443 488	443 488	9,12%

Identification of holders of any securities conferring special control powers with respect to the Issuer, including a description of such powers

As at 28 April 2016, 400 000 B-series registered shares are multiple-vote securities which means that each share entitles to five (5) votes at the General Meeting of the Company, giving a total of 2 000 000 votes held by Grzegorz Siewiera.

Restrictions on voting rights, such as limitations of the voting rights

There are no such restrictions.

Restrictions on the transfer of ownership rights to the Issuer securities

There are no such restrictions.

Description of the rules regarding the appointment and dismissal of managing persons; description of managing persons' powers

The rules regarding the appointment and dismissal of managing persons of the Issuer are strictly defined in the Management Board Rules and in the Articles of Association of LSI Software S.A.

Description of rules regarding the changes to the Issuer's Articles of Association

Changes to the Articles of Association are among competences of the General Meeting. Each time, after the registration of changes to the Articles of Association, the consolidated text is determined by the Supervisory Board. The text of the Company's Articles of Association is available on the websites of the Issuer and websites of the Warsaw Stock Exchange.

The last changes to the Company's Articles of Association were introduced under Resolutions No 25 and 26/2016 of the Ordinary General Meeting of LSI Software S.A. held on 30 June 2016.

Manner of operation of the General Meeting and its basic powers

The General Meeting of LSI Software S.A. operates on the basis of the Rules of the General Meeting and the Company's Articles of Association.

Composition and changes to the composition of issuer's managing and supervising bodies

As at 1 January 2016, the composition of LSI Software S.A. Management Board was as follows:

- Bartłomiej Grduszak – President of the Management Board
- Michał Czwojdziański – Member of the Management Board
- Henryk Nester – Member of the Management Board

On 30 June 2016, the General Meeting appointed Mr. Grzegorz Strąk as Member of the Management Board.

As at 31 December 2016, the composition of LSI Software S.A. Management Board was as follows:

- Bartłomiej Grduszak – President of the Management Board
- Michał Czwojdziański – Member of the Management Board
- Henryk Nester – Member of the Management Board
- Grzegorz Strąk – Member of the Management Board

As at 1 January and 31 December 2016, the composition of LSI Software S.A. Supervisory Board was as follows:

- Grzegorz Siewiera – Chairman of the Supervisory Board
- Krzysztof Wolski – Vice-Chairman of the Supervisory Board
- Andrzej Kurkowski – Member of the Supervisory Board
- Piotr Kardach – Member of the Supervisory Board
- Grzegorz Kwiatkowski – Member of the Supervisory Board

The composition and manner of appointing the members of the Supervisory Board, the rights and obligations of Members of the Supervisory Board, the competences of the Supervisory Board, managing the works of the Supervisory Board, convening the meetings of the Supervisory Board, the manner of adopting the resolutions are described in detail in the Rules of the Supervisory Board available on the Company's corporate website.

5. Significant proceedings pending before a court, before a relevant body for conducting arbitration proceedings or before government bodies

As at 31 December 2016 as well as at the day of the financial statement hereof disclosure, any proceedings concerning issuer's or its subsidiary undertakings' liabilities or claims whose aggregate value represents at least 10% of the issuer's equity, were not pending.

6. Information on basic products, services and the markets

The main scope of the Company's business activities has not changed and is focused on the production, sale and implementation of proprietary software. The Company is a provider of integrated IT solutions for business management, in particular in the following segments of the small and medium-sized enterprises:

- **Retail** - solutions in this group of clients include all the processes occurring in the traditional commercial enterprise. Starting from ordering goods, through warehouse management at the headquarters level, logistics services for stocking own stores, complaints, sales registration in points of sale ending with data analysis in the headquarters. System ensures the maintenance of such areas of the enterprise as accounting, finance, HR and payroll.
- **Hospitality** – products in this group are intended for the hospitality market. Mentioned products support not only the catering activities but also the restaurant (restaurants chain) or hotel management as well as the organization of conferences. The offer also includes comprehensive systems for managing sport activities and SPA centers.
- **Recreation and sport facilities** - solutions in this group are intended for different-size recreation and sport facilities i.e. swimming pools, water parks, sport and entertainment centers, stadiums, exhibition halls. The system integrates software and technical infrastructure ensuring a comprehensive customer service.
- **Cinemas** - products for cinema networks management and operation of off-line and on-line sale in network's individual facilities.
- **Small and medium-sized companies of any business line** – ERP and project management products.
- **Healthcare** - communication supporting devices.
- **Logistics** – communication supporting devices.

The following product lines are available in the Company's product range:

- **POSitive® Cinema** – system for sales and customer service in cinemas and for cinema networks management
- **POSitive® Hospitality** - system for sales and customer service in restaurants and for restaurant networks management (POSitive Restaurant brand) and integrated booking, sales and guest management systems in hotel facilities, and systems for the management of the network of such facilities (InteliHotel brand)
- **POSitive® ESOK** –Hospitality, electronic customer service, integrates innovative IT software and technical infrastructure, provides managers with full control of key areas of the facility's operations; integrated with POSitive Hospitality
- **POSitive® Retail** –sales systems and customer service systems for retail industry,
- **Bastion® ERP** – ERP- class systems for accounting, stock management, distribution and HR and payroll intended for SMEs
- **Jirasolutions** – platform for project management and information flow in the enterprise
- **Qiki** –application for restaurant's clients for online ordering before the scheduled visit - for client's and restaurant service's time saving
- **Szeryf24** –application allowing associating a recording from a camera with operations performed on the sales systems; intended for controlling the sales staff.

The Company is also involved in the production of dedicated software which is developed on special request of customers on the basis of the analysis of needs and technological capabilities and financial resources of the recipient. The realization of products developed under 'the special request' may be carried out within three areas:

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(Unless otherwise stated, all figures are expressed in thousand PLN)

- Modifications to the existing software developed by the Company,
- Adjusting the software of other developers,
- Production of completely new dedicated software developed on the basis of profound analysis of processes being the subject of this newly created software.

Apart from the software development, the Company provides the services associated with:

- implementation, sales and maintenance of own software;
- consultancy in the field of the flow of information and optimization of business processes in the pre-analysis phase;
- maintenance of network infrastructure.

7. Information on main outlets

In 2016 the majority of the Company's revenue was associated with the sales on a domestic market. The Issuer and its subsidiaries undertake actions in order to introduce the Group's products on foreign markets based on local distributors. In addition, since 2016 Softech Sp. z o.o. began steady supplies of goods for customers from other countries of Central and Eastern Europe. In connection with the development of the POSitive® Cinema distribution network, at the beginning of 2017 LSI Software S.A. acquired a new distributor in South America, and is currently in the process of setting up a new subsidiary to bring introduce this product to the North American market. The sales of the Company are of dispersed nature. In the structure of sales, in relation to the turnover value, there are no significant recipients of services and solutions of the Company. Diversified portfolio of customers allows retaining the independence from individual buyers. Small and medium-sized companies are the largest group among the Company's clients.

8. Information on significant agreements

On 1 February 2017, as a result of negotiations with Mr. Maciej and Leszek Guzowski and Mr. Marek Pawlak, LSI Software S.A. acquired 204 participating interests in Przedsiębiorstwo Projektowo – Wdrożeniowe „GiP” Sp. z o.o. (Limited Liability Company) with its registered office in Warsaw, of nominal value amounting to PLN 500 each, for the total amount of PLN 4.65 million increased by additional benefit in the amount equal to the dividend value paid by „GiP” Sp. z o.o. to LSI Software S.A. as a distribution of profit for the year 2016. The acquired participating interests constitute 100% of the share capital of “GiP” Sp. z o.o. and the corresponding percentage of votes at the general meeting of shareholders. The transaction was financed with own funds of the Issuer and investment credit in the amount of PLN 1.75 million, secured by a mortgage established on the immovable property.

On 30 September 2016 LSI Software S.A. concluded an agreement with MOSTOSTAL WARSZAWA S.A. The subject agreement regards the development and delivery of Electronic Customer Service System within an investment project “The construction of the Water Center in Tychy”. The value of concluded agreement amounts to PLN 900 thousand while the completion of the contract is planned for the end of April 2017.

On 30 June 2016, the Issuer concluded an agreement with Cinema 3D S.A. in Legnica. The agreement covers the development, implementation and maintenance in Cinema 3D S.A. cinema network of the POSitive® Show System which is a comprehensive solution for managing the network of entertainment undertakings including cinemas, theaters, stadiums and other facilities of similar purpose. The estimated value of the subject of the agreement defined as the total value of the benefits resulting from the agreement throughout the period of its duration is PLN 3.8 million net. The estimated value of the Agreement, with consideration of future orders made by the Ordering Party (excluding the potential supply of equipment) is PLN 5.1 million net.

As a result of broadening the scope of works associated with the implementation of the agreement of 9 November 2015 concluded with HELIOS S.A. and the expected higher amount of revenue from this contract, the estimated value of the agreement will exceed 10% of the equity of the Issuer and will amount to approx. PLN 3 million net. The contract covers the development, implementation and maintenance of the POSitive® Show System in HELIOS S.A. cinema network. The agreement was concluded for an indefinite period while the completion of implementation of the system is to take place no later than until February 2017.

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In the reported period, except for the agreements indicated above, other agreements of lower value or with smaller contractors were not concluded.

9. Organizational or capital relations between the Issuer and other entities with the indication of Issuer's major domestic and foreign investments

The composition of LSI Software Group shall be as follows:

- LSI Software S.A., as a dominant entity,
- Softech Sp. z o.o., as a subsidiary undertaking in which LSI Software S.A. holds 100% of the shares; entity incorporated on 13 September 2016,
- LSI Software s.r.o. as a subsidiary undertaking in which LSI Software S.A. holds 100% of the shares; entity incorporated on 13 September 2016,
- BluePocket S.A., as a subsidiary undertaking in which LSI Software S.A. holds 50% of the shares.

Due to resignation on 10 March 2015 of former president of the Management Board of BluePocket S.A. and failure to appoint a new Management Board of this company, by the day of preparation of the report hereof, the Issuer did not receive financial statements of BluePocket S.A. for the years 2015 and 2016. At the same time, due to the fact that the meetings of the Supervisory Board are not attended by members appointed by Bastion Venture Fund sp. z o.o. S.K.A. as a Shareholder, LSI Software S.A. is not able to independently appoint the Management Board of BluePocket S.A. which results in the actual lack of the Issuer's ability to govern financial and operating policies of this entity. Due to the above, the Management Board of LSI Software S.A. adopted for consolidation under the equity method, the last financial result approved by the Management Board of BluePocket S.A., that is financial result for the period of 1 January – 30 September 2014. In 2016, BluePocket S.A. was not consolidated and will not be consolidated until regaining by LSI Software S.A. of the ability to govern the financial and operating policy of this entity.

10. Information on significant transactions concluded by the issuer or its subsidiary undertakings with associates on other than market terms

The Issuer concludes buy/sell transactions with all associates. Transactions are executed on market terms as applicable to transaction with other undertakings.

11. Information on credit and loan contracts concluded and terminated in a given financial year

In 2016, the Company extended, for a further period, an overdraft facility in the amount of PLN 1,500 thousand. Information on other agreements is disclosed in notes to the financial statement.

12. Information on loans granted in a given financial year, including loans granted to associates

On 26 February 2016, LSI Software S.A. granted a loan at the amount of PLN 240 thousand to Mr. Grzegorz Siewiera – Chairman of the Supervisory Board of the Company. The repayment date falls on 28 February 2018. This loan is a long-term financial asset.

13. Information on sureties and guarantees granted and received in a given financial year, including to and from associates

The Issuer has granted a surety to the amount of PLN 750 thousand, for a loan agreement contracted on 25 October 2011 by a subsidiary undertaking – Softech Sp. z o.o. with mBank S.A.

Furthermore, the Company granted performance guarantees to the following entities which are not members of the Group:

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1. Special purpose vehicle - Wałbrzyskie Centrum Sportowo - Rekreacyjne "AQUA-ZDRÓJ" Spółka z o.o. (Limited Liability Company) in the amount of PLN 114,1 thousand with expiry date of 23 November 2016
2. SNEF Polska Sp. z o.o. (Limited Liability Company) in the amount of PLN 34,4 thousand with expiry date of 20 August 2017
3. Domy Wczasowe WAM Sp. z o.o. (Limited Liability Company) – in the amount of PLN 28,8 thousand with expiry date of 31 March 2016.

As at 31 December 2016, the total value of guarantees and sureties granted amounts to PLN 784 thousand.

14. Use of proceeds from the issue

Such information was disclosed in the financial statements for previous years.

15. Acquisition of own shares

The Management Board of LSI Software S.A., in accordance with the Resolution No 34/2012 of the Ordinary General Meeting of Shareholders of 14 June 2012, on 1 January 2013 commenced the Share Buy-Back Program. Until day of the report hereof preparation, LSI Software S.A. repurchased 33 958 own shares accounting for 1.04% of the share capital and entitling to 33 958 votes at the Ordinary General Meeting of Shareholders. The average purchase price per share amounted to PLN 3.14.

In the period from 9 July 2014 to 25 August 2016 the Company sold the total of 22,500 own shares to the Company's key managers, in accordance with clause 2.1 of the Resolution no 34/2012 on the authorization of Management Board to acquire shares own adopted by the Ordinary General Meeting on 14 June 2012.

As a result of this transaction, the total number of own shares currently held by the Company is 11 458, which represents 0.35% of the share capital and 0.24% of the total number of votes at the General Meeting of the Issuer. Average price of acquired shares was PLN 3.14.

16. Differences between financial results presented in the annual financial statement and previously published forecasts

The Issuer did not publish financial forecasts for 2016.

17. Assessment of financial resources management

Described in Par. 2.

18. Evaluation of the feasibility of investment plans, including capital investments

Investment expenditures planned for 2017 will be financed with the Company's own funds and the funds obtained from the European Union. The Issuer also plans to raise capital from venture capital funds.

In addition, the Company's Management Board undertakes actions aimed at increasing the Group's market share in particular industries through direct acquisitions or investments in new products. As a result, the Ordinary General Meeting of Shareholders held on 27 June 2015 adopted a resolution concerning the amendment of the Company's Articles of Association to authorize the Management Board to increase the shares capital as part of the procedure of increasing the authorized capital. However, considering the significant cash resources and low level of the Group's debt, the Management Board assumes financing of this transaction with own funds and bank credit in order to avoid the dilution of current shareholders' share capital, as it was in the case of acquisition of shares in GiP Sp. z o.o.

19. Assessment of factors and events of unusual nature which may affect the operational results for the financial year

The Management Board did not recognize any unusual events affecting the financial situation and position of the Company in 2016.

20. External and internal factors significant to the issuer's development; description of business activities development prospects in the subsequent financial year

External factors

Economic and political situation:

Poland's economic situation is still recognized as one of the most interesting in the region and promising in terms of positive GDP growth and continued favorable growth prospects.

The threat to the maintenance of the current economic trends, the Company identifies in the area of the current political situation in the country, which together with the growing budget deficits can lead to higher risks of investing in Poland and the capital outflow.

Competition:

The company is one of the leaders in its industry, which thanks to consistent development policy and diversification will certainly allow competing successfully with other players in the market.

Internal factors

Organization of the Group.

The composition of LSI Group allows continuing business activities through the intensified internal development of owned entities.

Development prospects of the Company

The Issuer expects that 2017 will be a period of significant acceleration in growth of the Company both on the domestic and foreign markets. The basis for this growth on the domestic market will be an additional revenue generated by new branches established in 2016 in Szczecin, Białystok and Rzeszów supporting new areas of Poland. For 2017, the opening of another branch is planned. These actions are aimed at broadening the Group's operating scale in Poland and strengthening its presence in the operated markets, which, in the opinion of the Management Board, should also result in the increased sales growth.

At the same time, in connection with the development of the **POSitive® Cinema** distribution network (previously POSitive® Show), at the beginning of 2017 LSI Software S.A. acquired a new distributor in South America, and is currently in the process of setting up a new subsidiary to bring introduce this product to the North American market, and eventually other Group's solutions intended for catering and hospitality industries. In 2016, LSI Software S.A. also established cooperation with a partner from the cinema industry, together with which acquires customers from Western and Eastern Europe.

The Issuer also took part in trade fairs outside Poland to promote current and newly developed product groups, which market launches were scheduled for this year. POSitive® Cinema was as first officially introduced to the market during the International Cinema Fairs - CineEurope (CCIB) in Barcelona in June 2016. After the June market release, LSI Software also took part in the international cinema industry conventions organized in Odessa and St. Petersburg (Kino Expo), so a new Company's solution was presented to the potential buyers from the markets of Eastern Europe and Asia. The last trade show in which LSI Software S.A. took part was the CinemaCon in Las Vegas in March 2017, during which the Company presented its solution to customers from around the world including US-based cinema networks.

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This product, despite its relatively short life span, is currently enjoying a great deal of interest in the movie industry, which, according to the Board, will have a positive impact on the financial results of LSI Software S.A. in 2017. At the same time it should be pointed out that upon the conclusion of the agreement with Cinema 3D S.A., the Issuer has reached the 75%-share in the market of the largest cinema networks in Poland.

In addition, the Company's Management Board undertakes actions aimed at increasing the Group's market share in particular industries through direct acquisitions or investments in new products. As a result, the Ordinary General Meeting of Shareholders held on 27 June 2015 adopted a resolution concerning the amendment of the Company's Articles of Association to authorize the Management Board to increase the shares capital as part of the procedure of increasing the authorized capital. However, considering the significant cash resources and low level of the Group's debt, the Management Board assumes financing of this transaction with own funds and bank credit in order to avoid the dilution of current shareholders' share capital, as it was in the case of acquisition of shares in GiP Sp. z o.o.

Development prospects of the Group are also enhanced as a result of acquiring the EU funds for the years 2014 – 2020. LSI Software S.A. has signed, inter alia, a contract for co-financing activities related to the internationalization of the company within the Regional Operational Program of the Łódź Voivodship. These actions will lead to the expansion of the Issuer's offer to foreign markets. Furthermore, in the opinion of the Management Board, EU funds should also boost sales of the Company in connection with an increase in investments executed by entities operating in industries operated by the Group.

Implementation of the above development strategy, as well as a strong financial foundations of the Group which is a market leader in its industry, create a stable basis for further, organic growth of both LSI Software S.A. and its subsidiaries.

21. Changes to the basic principles of the Issuer's business and Capital Group management

Such changes did not occur.

22. Agreements concluded between the Issuer and managing persons providing for the compensation in case of managing persons' resignation or dismissal from position held

Such agreements were not concluded.

23. Value of remuneration, awards or benefits paid to each managing or supervising person in issuer's enterprise

Information about the remuneration of members of the Management Board and the Supervisory Board is included in the Additional Explanatory Notes attached to this annual report.

24. Total number and value of shares held by managing and supervising persons

Members of the Management/Supervisory Board	Number of shares held	Nominal value of shares (in PLN)
Michał Czwojdzński (Member of the Management Board)	19 000	19 000
Grzegorz Siewiera (Chairman of the Supervisory Board)	1 000 000	1 000 000
Krzysztof Wolski (Vice-Chairman of the Supervisory Board)	1 000	1 000

25. Information on agreements which in future, may result in changes in proportion of shares held by shareholders

According to the best knowledge of the Management Board, as at the date of publication of the financial statement hereof, there are no agreements which in future, may result in changes in proportion of shares held by shareholders.

26. Information on the control system for employee share schemes

Not applicable.

27. Information on agreements with an entity authorized to audit financial statements

Described in paragraph 28 of Explanatory Notes.

Prepared by:

Management
Board:

Bartłomiej Grduszak

Bartłomiej Grduszak

Dariusz Górski

Michał Czwojdzński

Henryk Nester

Grzegorz Strąk

Łódź, 28 April 2017