



**Business Plan  
of the Mercator Group and  
the company Poslovni sistem Mercator,  
d.d.,  
for the year 2012**



Poslovni sistem Mercator, d.d.  
Management Board

January 2012

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## SUMMARY

### **Mercator Group is planning a 3.3-percent revenue growth despite the expectations of notably aggravated economic conditions**

#### Economic conditions

As a result of increasingly harsh conditions in the global financial markets and their effects on the economy in the second half of 2011, the business environment grew more exacting and challenging than expected. This bore a negative impact on the Mercator Group performance from the third quarter forward. After a strenuous third quarter of 2011, the fourth quarter saw business conditions become even more hostile. According to current forecasts, such economic circumstances will persist virtually throughout the Southeastern European region, presumably for the entire 2012. This calls for appropriate measures to counter the crisis, and inevitably affects the business performance. Thus, we expect the trends from the second half of 2011 to be extended into 2012, which means that negative effects of the economic and financial crisis shall be reflected in the composition and volume of consumption, as well as more severe business and financial risks, particularly credit and foreign exchange risks.

#### Counter-crisis measures and strategic projects

Responding to the anticipated major aggravation of economic circumstances, Mercator has already devised a set of counter-crisis measures that are targeted at alleviating the burden of the harsh environment. These measures are also related to the key strategic projects to be implemented in 2012.

There are two subsets of these measures:

- (a) measures to create value for the consumers, which are aimed at improving the competitiveness of our offer in the new, exacting conditions that have made consumers even more price-sensitive;
- (b) measures of internal rationalization and search for internal untapped improvement potential in business processes, working capital, investment, and real estate management.

Within this framework, the following key projects will be implemented in 2012:

- refreshment of fast-moving consumer goods offer in Slovenia;
- establishment of the technical consumer goods chain;
- restructuring of the offer in Croatia;
- real estate monetization project.

#### Sales

In 2012, the Group is planning total revenue of more than EUR 3 billion, which is 3.3 percent more than the estimate for 2011. According to plans, 56% of Group revenue in 2012 will be generated in Slovenia, and the remaining 44% will come from foreign markets. The Group plans to generate the majority of revenue by retail and wholesale of fast-moving consumer goods which will, combined, represent 84% of total revenue.

In addition to the marketing activities, the revenue growth planned for 2012 is also affected by operations of the trade companies Drvopromet, Familija Marketi and Coka. Subject to strategic combinations with Mercator in 2011, their revenue as planned for the entire year will count against Mercator Group total revenue in 2012. The Group is planning numerous activities to provide a competitive offer and generate value for the consumers in all markets.

### Development activities

Responding to the expectations of harsh conditions in 2012, the Group additionally trimmed down its investment plans. Hence, total investment is planned at no more than EUR 88.5 million, with planned divestment of non-core assets in the amount of EUR 10.1 million. Development activities will be pursued further and new retail area will be obtained through lease in order to maximize the amount of new retail area and generate revenue growth without exceeding the allocated investment budget..

### Real property monetization and stable financial operations

In 2012, the activities of real property monetization will continue. They include plans to sell a part of the real estate portfolio worth EUR 250 million. All proceeds from real estate monetization shall be used to reduce the outstanding debt which is planned to decrease notably relative to the end of 2011.

Gross cash flow from operating activities before rental expenses is planned at EUR 214 million for 2012, which is 4.6 percent more than estimated for 2011. Gross cash flows from operating activities is planned to amount to EUR 150 million, with the figure being lower as a result of the planned real property monetization and more stringent economic conditions.

### Net income and dividends

Due to the expected considerably aggravated economic circumstances and the resulting drop in revenue growth, lower investment, price investments required to provide competitive prices for the consumers, costs of strategic projects referred to above, upward pressure on fuel prices, some other costs, and increased operational risks, the performance planned for Mercator Group operations in 2012 falls short of the estimated results for 2011.

Hence, Mercator Group net income for 2012 is planned at EUR 15,708 thousand, which is 34.0 percent less than the 2011 estimate. Due to lower estimated and planned profit, the dividend payment for 2012 considered in this Business Plan amounts to EUR 3.00 gross per ordinary share.

### Human resource management

As at 31 December 2011, Mercator Group had 24,267 employees, of which more than 12 thousand were employed in Slovenia. This makes Mercator the single largest employer in Slovenia and one of the biggest employers in the region of Southeastern Europe. In 2012, no major changes in the number of employees are planned.

### Quarterly review of viability of business plans due to high uncertainty regarding the actual operating conditions

Due to high uncertainty regarding the operating conditions in 2012, the highly volatile situation in the global financial markets, and social and political unrest in many countries of the Southeastern European region in which Mercator Group is conducting business operations, the Management Board shall review after each quarter the viability of the business plans with respect to the actual state of affairs in terms of economic conditions and the related risks. If required, the Management Board shall prepare the necessary adjustments or amendments to the Business Plan and inform the shareholders thereof in interim reports.

# INTRODUCTION

## MERCATOR GROUP PROFILE

### Company Profile

The company Poslovni sistem Mercator, d.d., is the controlling company of a group of associated companies (the Mercator Group), one of the largest corporate groups in Slovenia and the entire region of Southeastern Europe.

Full name	<b>Poslovni sistem Mercator, d.d.</b>
Abbreviated name	Mercator, d.d.
Activity	G 47.110 - Retail in non-specialized food retail outlets
Registration number	5300231
VAT tax code	45884595
Court registry date	1 January 1990
Company share capital as at 31 December 2011	EUR 157,128,514.53
Number of shares issued and paid-up as at 31 December 2011	3,765,361
Share listing	Ljubljana Stock Exchange, d.d., prime market, symbol MELR
President of the Management Board	Žiga Debeljak
Senior Vice Presidents	Mateja Jesenek, Melita Kolbezen, Vera Aljančič Falež, Peter Zavrl, Stanka Čurovič
Supervisory Board Chairman	Robert Šega
Deputy Supervisory Board Chairwoman	Jadranka Dakič

## Mercator Group Composition

### Planned Mercator Group composition as at 31 December 2012:

<b>MERCATOR GROUP</b>	
<b>MERCATOR TRADE SLOVENIA</b>	
<b>Poslovni sistem Mercator, d.d., Slovenia</b>	
Mercator IP, d.o.o., Slovenia (100.0 %)	M.COM, d.o.o., Slovenia (100.0 %)*
<b>MERCATOR TRADE SOUTHEASTERN EUROPE</b>	
Mercator - S, d.o.o., Serbia (100.0 %)	Mercator - B, e.o.o.d., Bulgaria (100.0 %)
Mercator - H, d.o.o., Croatia (99.9 %)	Mercator - A, sh.p.k., Albania (100.0 %)
Mercator - BH, d.o.o., Bosnia and Herzegovina (100.0 %)	Mercator Makedonija, d.o.o.e.l., Macedonia (100.0%)*
M - BL, d.o.o., Bosnia and Herzegovina (100.0 %)	Mercator - K, l.l.c., Republic of Kosovo (100.0 %)*
Mercator - CG, d.o.o., Montenegro (100.0 %)	
<b>MERCATOR REAL ESTATE</b>	
M - nepremičnine, d.o.o., Slovenia (100.0 %)	Investment Internacional, d.o.o.e.l., Macedonia (100.0 %)**
Mercator - Optima, d.o.o., Slovenia (100.0 %)	
<b>OTHER OPERATING ACTIVITIES</b>	
Intersport ISI, d.o.o., Slovenia (100.0 %)	Modiana, d.o.o., Slovenia (100.0 %)
· Intersport S-ISI, d.o.o., Serbia (100.0 %)	· Modiana, d.o.o., Serbia (100.0 %)
· Intersport H, d.o.o., Croatia (100.0 %)	· Modiana, d.o.o., Croatia (100.0 %)
· Intersport BH, d.o.o., Bosnia and Herzegovina (100.0 %)	· Modiana, d.o.o., Bosnia and Herzegovina (100.0 %)
M – Tehnika, d.d., Slovenia (100.0 %)	M - Energija, d.o.o., Slovenia (100.0 %)
M – Tehnika H, d.o.o., Croatia (100.0 %)	Mercator - Emba, d.d., Slovenia (100.0 %)

\* The company has not yet commenced its business operations.

\*\* Project-based real estate company not conducting business operations.

## MERCATOR GROUP BUSINESS STRATEGY

### Vision

**To be the consumers' first choice when shopping for fast moving consumer goods and home products**

### Mission

Mercator mission is:

- 1) To provide optimum value for the consumers with our service and offer of fast moving consumer goods and home products.
- 2) To provide consumers with the best possible service in a pleasant shopping environment, by offering expert support of highly motivated employees.
- 3) To provide returns for our shareholders through growth and efficient operation.
- 4) To manage our operations in a way that improves the quality of life in our social and natural environment.

## Corporate values

Following are Mercator corporate values:

### Responsibility

Each employee is responsible for their work.

### Responsiveness

Prompt response is our advantage.

### Integrity

We work honestly and fairly.

### Learning

We build on our knowledge and experience.

### Respect

Each individual matters and deserves respect.

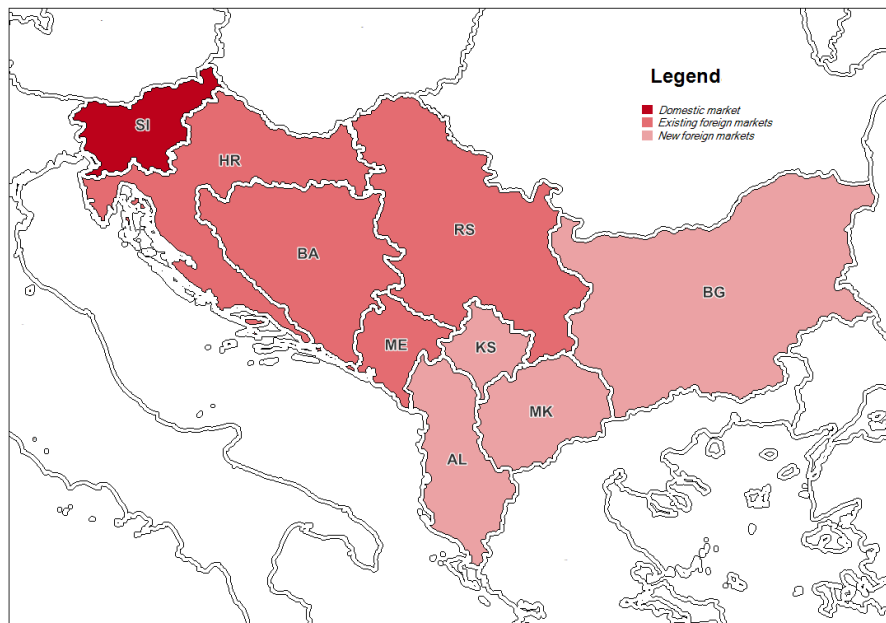
### Cooperation

What one person cannot do, we can accomplish together.

## Strategic objectives

Following are Mercator Group fundamental strategic goals:

- 1) In our **domestic market** (Slovenia):
  - a. To retain the position of the leading fast moving consumer goods retailer.
  - b. To consolidate the position of the second largest retailer of home products.
  - c. To develop supplementary trade services related to our customer loyalty system.
- 2) In **existing foreign markets** (Serbia, Croatia, Bosnia and Herzegovina, Montenegro):
  - a. To consolidate or attain the position of the second largest fast moving consumer goods retailer.
  - b. To rank among the top three retailers of home products.
  - c. To develop supplementary trade services related to our customer loyalty system.
- 3) In **new foreign markets** (Bulgaria, Albania, Macedonia, Republic of Kosovo):
  - a. To rank among the top five retailers of fast moving consumer goods.



## MERCATOR GROUP PERFORMANCE HIGHLIGHTS ESTIMATED FOR YEAR 2012

	Mercator Group		Index Plan 2012/ Estimate 2011
	Plan 2012	Estimate 2011	
Revenue (EUR thousand)	3,030,387	2,932,887	103.3
Results from operating activities (EUR thousand)	76,376	89,856	85.0
Profit before income tax (EUR thousand)	24,172	33,260	72.7
Profit for the financial period (EUR thousand)	15,708	23,800	66.0
Gross cash flow from operating activities (EUR thousand)	150,275	161,591	93.0
Gross cash flow from operating activities before rental expenses (EUR thousand)	214,264	204,912	104.6
Capital expenditure (EUR thousand)	88,452	119,857	73.8
Return on equity*	2.0%	3.0%	65.4
Return on sales	0.5%	0.8%	63.9
Gross cash flow from operating activities / revenue	5.0%	5.5%	90.0
Gross cash flow from operating activities before rental expenses / revenue	7.1%	7.0%	101.2
Number of employees based on hours worked	23,350	22,613	103.3
Number of employees as at the end of the period	24,915	24,267	102.7

# BUSINESS REPORT

## EXPECTED CONDITIONS IN TERMS OF ECONOMY AND COMPETITION IN THE YEAR 2012

### **Economic conditions in the markets of Mercator operations in 2012**

Forecasts for 2012 include a drop in economic growth and further aggravation of the debt crisis in the eurozone as the key indexes which are precursors to any changes in the economic environment started to decline as early as in the third quarter of 2011. Consumer confidence index, the first harbinger of change in the economic atmosphere in the retail industry, deteriorated further in all markets of the Group operations; moreover, unemployment rates have also hit the highest levels of the recent years. Drastic austerity measures that European countries were forced to adopt may lead to another liquidity crunch that would stop investment and cash flows. The debt crisis that has impeded access to financing in recent months is therefore the main risk in further recovery of the European economy.

According to the forecast of the Institute of Macroeconomic Analysis and Development, raw material prices are expected to steady, albeit at a relatively high level, while euro is expected to depreciate relative to the dollar.

Credit activity in Slovenia is expected to be even more restricted. It is anticipated that the amount of liabilities of Slovenian banks due for payment to foreign banks will increase in 2012, while credit demand will be lower.

#### **Slovenia**

According to the Institute of Macroeconomic Analysis and Development, economic growth reached 1.5% in 2011. Forecasts by the Raiffeisen Bank analysts expect economic growth in 2012 at a negative figure of -1.5%. Inflation in 2011 is estimated to have amounted to 2.0 % for 2011; in 2012, it is expected at the same level.

#### **Serbia**

In 2011, Serbian economy is estimated to have grown by 1.7% while inflation amounted to 11.2%. For 2012 a lower economic growth rate is anticipated, at 1.0%. Inflation, too, is expected to be lower in 2012 than in the year before; it is forecast at 6.6%. In 2011, the average Serbian dinar exchange rate amounted to RSD 102.00 per 1 EUR; for 2012, depreciation of the Serbian dinar is anticipated, driving the exchange rate to RSD 104.00 per 1 EUR.

#### **Croatia**

Economic growth in Croatia in 2011 is estimated at 0.6 percent. Expectations for 2012 place the growth rate in the negative figures at -1.0 percent. Inflation rate in 2011 is estimated to have reached 2.4 percent; in 2012, inflation rate is expected to rise slightly to 2.5 percent. Average annual exchange rate for Croatian kuna in 2011 amounted to HRK 7.44 per 1 EUR. For 2012, the average kuna exchange rate is forecast at HRK 7.40 per 1 EUR.

## **Bosnia and Herzegovina**

According to the 2011 estimates, the economy of Bosnia and Herzegovina grew by 1.8 percent in 2011; for 2012, the economy in this country is expected to see a zero growth rate. Estimates see inflation in 2011 at 3.7 percent; in 2012, it is expected to drop to 2.8 percent. The exchange rate of the convertible mark is pegged to the euro in the ratio of BAM 1.96 per 1 EUR.

## **Montenegro**

Increase in Montenegrin gross domestic product in 2011 is estimated at 2.0 percent; in 2012, economic growth is expected to increase as GDP growth is anticipated at 3.2 percent. Inflation for 2011 is estimated at 3.25 percent; in 2012, it is expected to drop to 2.0 percent. Montenegrin official currency is the euro.

## **Albania**

Albanian economic growth for 2011 is estimated at 2.5 percent, while inflation estimates are at 3.9 percent. For 2012, economic growth is forecast at the same level as in the year before; inflation rate is expected at 3.5 percent. In 2011, the average exchange rate of the Albanian lek was ALL 134.00 per 1 EUR; for 2012, it is projected at ALL 139.00 per 1 EUR.

## **Bulgaria**

According to estimates, Bulgaria saw economic growth of 3.0 percent in 2011 while the inflation rate was at 4.4 percent. Gross domestic product is expected to grow by 1.2 percent in 2012. Inflation will be lower than in 2011, amounting to 1.5 percent in 2012. The exchange rate of Bulgarian lev is pegged to the euro at a rate of BGN 1.96 per 1 EUR.

**In the second half of 2011, particularly in the last quarter of the year, economic circumstances saw further aggravation and deterioration. The decline in key macroeconomic indexes is signalling a new wave of the economic crisis. Economic circumstances in all markets of Mercator operations deviated further, for the worse, from to the expectations for 2011.**

**Macroeconomic conditions for 2012, too, are notably different from those assumed in the Mercator Group Medium-Term Business Plan for the Period 2011-2015; therefore, the expectations of future performance of the company included in this plan are no longer realistic. Since the high uncertainty regarding the future macroeconomic conditions renders any forecast of realistic expectations all but impossible, the medium-term forecasts shall be updated in the Business Plan for 2013, or whenever the economic situation and operating conditions in the markets become more stable and predictable.**

## Consumer behaviour and impact of the market situation on consumption in 2012

Following is an account of the expectations for fast-moving consumer goods retail in respective markets of Mercator operations in 2012.

- higher unemployment rate and lower purchasing power will result in even higher price sensitivity on the part of the consumers, which will drive the retailers to focus on competitive pricing; which will require further price investments;
- entry of discount retailers or consolidation of their position in the markets where they are already present;
- possibility of acquisition of a major regional player by large international retailers that sees potential in Southeastern Europe;
- further consolidation and modernization of the market;
- expansion of the retail network and opening of larger store formats, particularly by more powerful regional retailers, in all markets of Mercator operations, except Slovenia. In Slovenia, development of convenience store format and supermarket appears more likely.

Trade is a relatively stable and consolidated industry in Slovenia; however, the importance of discount stores and drug stores is increasing. Hence, the market situation is highly competitive as discount stores are making their presence felt in the retail business, taking up a notable share of the market in addition to the conventional retailers. In the upcoming year or two, relatively stable operations can be expected, as well as high pressure on the prices. Opening of new store formats is anticipated, especially supermarkets and convenience stores, while the number of smaller stores is expected to remain more or less the same. Further price investment will be required until the economic conditions and the psychology of consumption and actual consumption stabilize.

Fast-moving consumer goods retail in Serbia is less consolidated. Traditional retail or smaller store formats account for more than half of the market in terms of value. It is expected that hypermarkets, supermarkets, Cash & Carry stores, and discount stores, currently not present in the market, will be developed at an upbeat pace in the coming years. Moreover, further consolidation of the market is expected. In 2010, Belgian retailer Delhaize entered the market by taking over the Serbian trade company Delta. Competitiveness is expected to intensify in the Serbian market in 2012. Delhaize is renowned for aggressive pricing policy in all markets of their operations. In addition, we also expect the discount retailer Lidl to open the first stores in the Serbian market in the following year or two.

On 30 December 2011, the government of the Republic of Serbia adopted a regulation setting a 10-percent cap for the margins on some products. Such restriction of margins will certainly affect the level of gross profit margin in Serbia, Mercator Group second most important market.

Retail in Croatia is highly competitive. The market is regionally scattered due to the presence of several international retail chains, in addition to a still relatively substantial number of local retailers. The share of traditional trade (smaller store formats) represents approximately a third of the entire market in terms of value. The share of the discount retailer Lidl and drug stores has seen a notable rise. Negative effects of the economic crisis on consumption in FMCG, perceived as early as in 2009, persisted in 2010; in 2011, slight stabilization of consumption was observed, which is most likely a result of the solid summer season. In 2012, we are expecting further stagnation and intensified competition. In the years ahead, market consolidation will continue with supermarkets and smaller

neighbourhood stores remaining the predominant store formats. Severe market conditions can be expected.

Trade industry in Bosnia and Herzegovina is rather under-consolidated and the key players in the markets are just emerging. The market is dominated by smaller store formats, and the marketplaces are still very important. Consolidation is expected in the near future, along with up-tempo development of modern store formats. Nevertheless, smaller stores are expected to retain an important share in the composition of retail outlets. Major store formats in the market of Bosnia and Herzegovina are predominantly developed by international retailers: Mercator, Agrokor, and Delhaize.

Trade industry is relatively non-consolidated in Montenegro, but Mercator Group managed to acquire the key local retail chains despite the harsh economic conditions, thus becoming the largest retailer in the country. Further consolidation of the market is expected, although the Montenegrin market may be of less interest to major international players due to its small size.

In Bulgaria, presence of major international retail chains, such as Carrefour, Rewe, Metro and the Schwarz Group which includes Lidl and Kaufland, is more widespread than in other markets of Mercator operations, which has resulted in highly competitive conditions, although the market shares are fairly evenly distributed among these players. The market is relatively scattered and traditional; however, following the improvement of macroeconomic conditions, rapid market development with consolidation of market shares can be expected. Discount retailers (Lidl, Penny) will play an important role in the future.

Trade in Albania is mostly traditional, which is a legacy of a long period of the country's isolation and lower development rate. The market is highly scattered, with a major share of traditional retail. Late in 2011, Carrefour entered the market. Albanian market is seen as a promising territory by the international retailers since rapid market development and convergence with the European standards is expected in the future.

**Due to uncertain market conditions in all markets of Mercator operations, competition and economic circumstances are expected to become harsher in 2012. Mercator Group is taking every effort to see that the drop in the purchasing power of our consumers, resulting from the aggravation of the economic situation, is as painless as possible for them. Therefore, we shall continue to invest heavily into lower prices in 2012. This will allow us to maintain market share; on the downside, it will also lead to a drop in gross profit which will be impossible to compensate for entirely with the ongoing cost rationalization measures.**

## DEVELOPMENT AND REAL ESTATE MANAGEMENT

In 2012, Mercator Group efforts in real estate development and management will continue to be geared towards meeting the goals laid down in the adopted development strategy. In addition to obtaining new retail area, based solely on leaseholds, the investment plans will be focused primarily on refurbishments or updates of the Group own retail network.

One key project in this regard which has been commenced by Mercator Group in 2011 is Refreshment of FMCG Offer which is to provide the conditions for introducing a new concept of sale. The project shall include about 130 Mercator stores in Slovenia and in Croatia.

Furthermore, Mercator Group shall carry out various development activities to optimize Mercator real estate management, and analyze the possibilities to update the concept of Mercator shopping centers, to improve the composition of third-party providers and the mix of products and services there, and to establish strategic partnerships with renowned international providers. Shopping centers shall be refurbished and technical consumer goods stores shall be introduced to Getro Cash&Carry and hypermarkets in Croatia. The Group will also proactively develop relations with local and international investors and seek opportunities in their projects.

**Following are Mercator key goals in real estate management:**



**Investment and divestment**

In 2012, Mercator Group investment into property, plant, and equipment (CAPEX) will amount to EUR 88,452 thousand. 49.1% of this sum is planned for investment in Slovenia; 47.2% will be invested in existing foreign markets (Serbia, Croatia, Bosnia and Herzegovina, and Montenegro); and 3.8% will be invested in new foreign markets (Albania and Bulgaria).

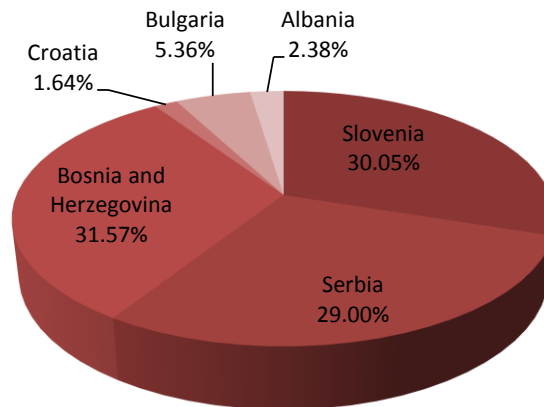
Investments in development of retail capacity (Mercator centers, trade centers, Roda centers, individual stores, and stores within other shopping centers) shall represent 29.5 % of total investments; 59.4 % will be allocated for refurbishment of the existing facilities; and the remaining 11.1 % will be invested into logistics, IT, and non-trade activities.

<b>Capital expenditure</b>		
	<b>Plan 2012 (in EUR 000)</b>	<b>Structure (in %)</b>
Slovenia	43,397	49.1%
Serbia	21,559	24.4%
Croatia	17,183	19.4%
Bosnia and Herzegovina	2,749	3.1%
Montenegro	214	0.2%
Bulgaria	2,226	2.5%
Albania	1,124	1.3%
<b>TOTAL</b>	<b>88,452</b>	<b>100.0%</b>

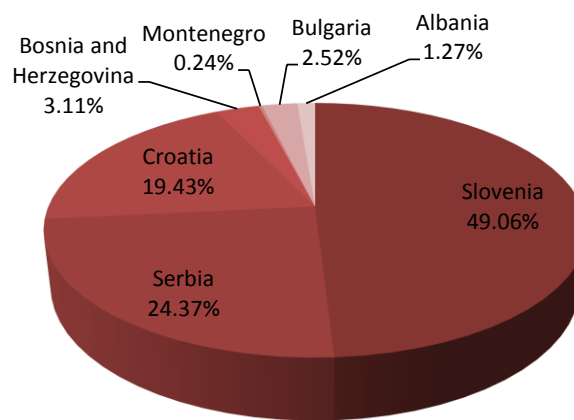
In 2012, Mercator Group will obtain 83,914 square meters of new gross area, all by operating lease.

In 2012, Mercator Group will divest EUR 10,086 thousand worth of property, plant and equipment.

## Share of newly launched facilities by markets



## Share of investments by markets



## Overview of planned retail unit openings by markets in 2012

### Slovenia

- Area of new facilities: 25,215 m<sup>2</sup>
- Number of new retail units: 6
- Openings: MC Novo mesto II, hypermarket, Intersport, and Modiana in Stožice in Ljubljana, hypermarket and Intersport in Supernova in Nova Gorica.

### Serbia

- Area of new facilities: 24,332 m<sup>2</sup>
- Number of new retail units: 12
- Openings: hypermarket and Intersport in Voždovac, Roda center Valjevo, Roda center Kruševac, and 8 Familija Beograd units spanning a total area of 7,120 square meters.



## Croatia

- Area of new facilities: 1,374 m<sup>2</sup>
- Number of new retail units: 2
- Openings: Supermarket in Kurilovac, Modiana at the City Center One East in Zagreb.

## Bosnia and Herzegovina

- Area of new facilities: 26,492 m<sup>2</sup>
- Number of new retail units: 31
- Openings: TC Bihać, supermarket in Prijedor, Laktaši, and Banja Luka, and 27 Drvopromet units spanning a total area of 14,355 square meters (of which 25 are retail units and the rest are offices and a warehouse).



## Bulgaria

- Area of new facilities: 4,501 m<sup>2</sup>
- Number of new retail units: 5
- Openings: 5 supermarkets

## Albania

- Area of new facilities: 2,000 m<sup>2</sup>
- Number of new retail units: 2
- Openings: 2 supermarkets

## Summary of total gross retail area as at 31 December 2011

Gross retail area in square meter	Used for own operations	Leased out	Total as at 31 December 2011
Owned retail area	831,683	182,785	1,014,468
Leased retail area	388,803	14,894	403,697
<b>Total retail area</b>	<b>1,220,486</b>	<b>197,679</b>	<b>1,418,165</b>
Owned warehouse capacity	145,590	0	145,590
Leased warehouse capacity	54,398	0	54,398
<b>Total warehouse capacity</b>	<b>199,988</b>	<b>0</b>	<b>199,988</b>
Owned commercial facilities	25,756	2,093	27,849
Leased commercial facilities	5,293	71	5,364
<b>Total commercial facilities</b>	<b>31,049</b>	<b>2,164</b>	<b>33,213</b>
<b>GROSS AREA UNDER MANAGEMENT</b>	<b>1,451,524</b>	<b>199,843</b>	<b>1,651,367</b>
- of which owned	1,003,030	184,878	1,187,907
- of which leased	448,494	14,965	463,459

**Activities of real property monetization**

Reaping the growth potential laying in real property is highly important for successful operations. Mercator Group is managing approximately 1.7 million square meters of real property, of which nearly three quarters are owned by the Group. Most comparable European competitors actually own a lesser share of property; as a result, Mercator financial statements report a higher relative debt in comparison.

In its Medium-Term Business Plan for the Period 2011-2015, Mercator Group specified real estate monetization in Slovenia and Croatia as one of the strategic goals. The project included announcing a tender by the company Poslovni sistem Mercator, d.d., in 2011, to select an international real estate consultant to provide the needed expertise. Having provided the most favourable offer, as well as proof of adequate experience in the field, the company Cushman & Wakefield, a global real-estate consultancy headquartered in London, was selected.

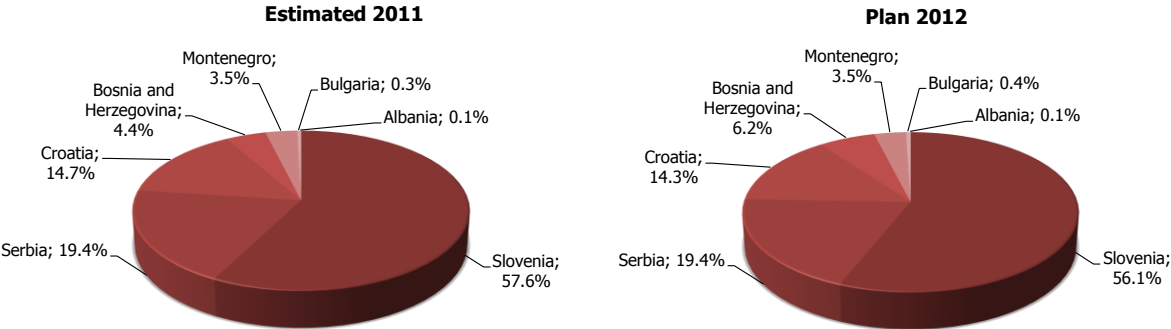
In 2012, the company Poslovni sistem Mercator, d.d., is carrying on the activities of the Mercator real estate monetization project. Working with the selected consultancy, the company will single out the property that is to be monetized and select the legal, financial, and other advisers for the project. This will be followed by activities to structure an appropriate real estate portfolio to be presented to international investors. Mercator shall also perform a test of market conditions in the real property market and identify the investors interested in the project. The following stage will include selecting the investors, and sale and leaseback of a part of the real estate portfolio in Slovenia and Croatia, in the approximate value of EUR 250 million. The entire proceeds shall be used to reduce the debt which will make Mercator debt indicators more comparable to those of the majority of the international competitors. In 2013, the project will be carried on, with the second stage of monetization being planned, again worth EUR 250 million.

**SALES AND MARKETING**

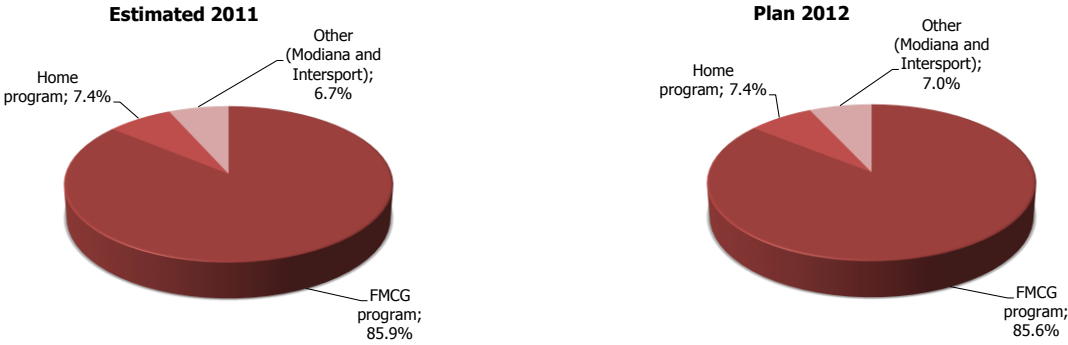
**Sales**

In 2012, Mercator Group is planning to generate EUR 3,030,387 thousand of revenue, which is 3.3 percent more relative to the 2011 estimate. Revenue is planned to rise by 0.4 percent in Slovenia; in foreign markets, the growth will amount to 6.6 percent.

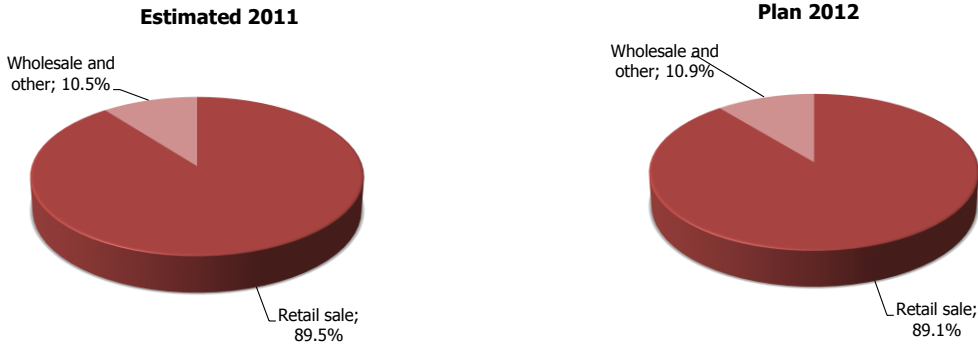
**Mercator Group revenue by geographical segments:**



**Mercator Group revenue from trade operations by programs:**



**Mercator Group revenue by type of sale:**



**Marketing**

Mercator Group vision, mission, and operating strategy place the consumers at the heart of our efforts. Particular attention is paid to relationship with the customers and building of trust by providing high-quality and wide offer of products of renowned brands and private labels, the best level of service, contemporary and pleasant shopping experience, and activities aimed at care for the environment and the people. Our marketing activities are geared towards attaining consistency between operations and communication with the customers in all markets of our operations.

In 2012, we shall continue to conduct the planned activities to pursue our vision. This will include focusing on accomplishing the four key tasks presented below.

**1. Mercator is providing competitively priced offer for the consumers.**

In 2012, our sales promotion activities shall pursue the policy of making Mercator the first choice for consumers shopping for products for the household and their homes (fast-moving consumer goods), with the strategic upgrade of **providing competitively priced offer**.

Revised sales promotion activities shall allow the following in 2012:

- attaining the goals planned by carrying out the right projects;
- reducing the number of projects and thus improving the transparency thereof;
- simpler planning of products to be included in the sales promotion campaigns;
- preparation of a focused and simple communication with the consumers.

Campaigns to be carried out shall be target oriented and made more appealing. The focus shall be placed on more conspicuous product placement at the stores, and other support activities. Occasionally, the campaigns will also involve theme-oriented activities that will offer the consumers a more specialized and favourably priced offer. A lot of attention will be paid to special offers for the Mercator Pika card holders. The offer and the activities will be clearly indicated and exposed at the stores. One key change to be introduced is the unified labelling of all elements in communication materials and at the stores. Special care will be devoted to product labelling in all special offers and campaigns, and to exposing the seasonal offer and products included in the special theme-oriented campaigns.

Our Call Center will continue to play a very important role in the communication with the consumers in 2012. Highly effective user support requires real-time access to various types of information, particularly those required for smooth and effective communication and for offering help to the customers and the users. Therefore, integration and connections between the Call Center and other support systems will have to be provided.

As regards the services offered to our consumers, we shall continue to develop the Lumpi and Healthy Lifestyle clubs. In 2012, M Holidays travel services will continue to provide convenient and well-priced offer designed for the target group of customers, and a friendly service. In planning the offer, we shall maintain the connection to other projects, especially the Mercator Pika card, sales programs, and customer loyalty clubs.

In 2012, sales promotion activities will be conducted at the Maxen petrol stations in Slovenia. The activities will be related to the FMCG program and will be implemented in order to promote the use of Maxen petrol stations.



## 2. Mercator is developing quality private label products for the consumers.

Seeking to keep up with the market trends of private label and category development and considering the fact that Mercator is looking to introduce as many private label products as possible in the future, central focus in the ensuing period will be placed on development of key activities to improve the appeal of the private labels for the consumers, consistently with the newly devised strategy.

Priority tasks in 2012 in terms of private label development strategy shall be focused on the following:

- upgrade of the private label strategy;
- optimization of private label lines;
- assignment of priorities in terms of revision of private label lines in order to improve competitiveness and appeal of the private label for the consumers;
- boosting promotion and communication support to private labels.



In order to step up the competitiveness of private labels in all markets of our operations, the following development priorities and policies shall be pursued:

- improving the appeal and competitiveness of the private label product assortment;
- improving the competitiveness of product pricing;
- improving the efficiency of private label product placement in the aisles;
- efficient and extensive promotion of the changes in the private label lines.

In terms of composition, private labels include the following three key segments: Mercator line, value added products and product lines, and Premium line.

A change in the Mercator line is planned in order to design a line of products that will represent the first choice for the consumer and become a synonym of quality. This will provide the base upon which the distinctiveness and recognition of all other private label lines shall be built. More emphasis shall be placed on communicating and promoting our private labels. Mercator labels and lines of products that will require introduction in the market or more substantial support shall be the top priority with regard to product exposure in advertising and promotion. Their promotion shall be sensibly distributed throughout the year.

### **3. Shopping offered by Mercator is transparent, simple, and well-priced.**

Mercator Group is committed to rendering high-quality services that allow the consumers a pleasant and convenient shopping experience. To this end, we are constantly looking for new solutions that would make shopping at our stores easier and more interesting for our customers.

Consistently with the strategy laid down, we shall focus on the following in terms of store format development:

- development of convenience stores,
- refreshment of the retail network in Slovenia and Croatia by modernizing the store concept.

In order to remain faithful to Mercator tradition of being a modern and innovative retailer, one of the key tasks of store format development shall be carried on in 2012, focusing on upgrade of the existing standards and developing of new ones for respective store concepts. The goals of these activities will be to unify, optimize, rationalize, and modernize the implementation of particular projects, which will afford the consumer a fast and simple shopping experience.

Regarding the web store, we shall adjust the existing business model to make it more customer-oriented, as well as offer the service of personal claim of the ordered goods at selected locations.

### **4. Mercator is committed to sustainable operations for the benefit of the consumer and the environment.**

Mercator is manifesting its integration into the local environment through initiatives for local manufacturing, healthcare and care-free development of children, humanitarian activities, and sustainable development. Mercator shall continue to invest in the social environment, both at the national and local level in 2012.



In 2012, we shall carry on the project "Draft solutions for packaging made of environmentally friendly raw materials". The project is looking to yield environmentally friendly and highly efficient solutions for farmers and small growers to make sure their fresh produce reaches Mercator aisles and the final consumers.

Our central humanitarian campaign will include donations to support various projects in education, culture, and sports.

## **Digital communication**

The basic goal of digital communication activities in 2012 will be to provide a transparent, simple, and well-priced shopping experience for the consumers. This will include focusing even more on shopping for fast-moving consumer goods. The pursuit of this goal and efforts to adapt to the new generations of consumers, to improve the interactivity, and to build trust, will allow us to revise Mercator web store, improve the user experience through Mercator Profile, and develop specially tailored offer on the portal Moja Pika in 2012.

### **Websites and web stores**

Mercator Market web store shall be upgraded in Slovenia to offer the service to a broader population, both through the established service of home delivery and through development of a new concept of personal claim of the goods at select locations.

In Croatia, we shall revise the suitability of the business model and expand the delivery area; in Serbia and in Bosnia and Herzegovina, we shall re-examine the possibility and viability of introducing the service. In all markets of Southeastern Europe, we shall further pursue the activities or revising the websites and introducing the portal Moja Pika.

Both [www.mercator.si](http://www.mercator.si) and other web sites and Mercator own channels on social networking sites in the Slovenian market shall play an important role in communicating Mercator activities. Communication through the central website [www.mercator.si](http://www.mercator.si) is adjusted to the consumer's wishes and expectations, and it is connected to the online social networks. Early in the year, we shall also introduce Mercator Profile which will allow a unique login to all Mercator websites, simple management of user pages with all logins and data, and smooth and streamlined transition between Mercator websites. A new web presentation will be developed for Mercator centers throughout Slovenia. We shall also revise the M Holidays website to improve the user experience. Mercator corporate site will be established as an independent website of the Mercator Group in 2012.

### **Activities at social networking sites**

We shall continue to maintain constant presence on social networking sites by providing our custom contents; in addition, we shall use this channel to respond to the subjects and topics of our interest. We shall use the tools Facebook, Twitter, YouTube, LinkedIn, Wikipedia, Foursquare, and Google+ and upgrade their use consistently with their development. In each quarter, we shall carry out at least one prize contest which will be carried out in cooperation with our business partners and/or it will be related exclusively to Mercator projects. Prize contests will be supported by web and/or mobile applications.

### **Mobile applications and mobile websites**

Consistently with the activities at Mercator websites, we shall also prepare in 2012 the solutions for smart phones and tablet computers. From the aspect of users, the applications related to the offer of private label lines, activities regarding the shopping experience, and convenience in shopping by using a mobile device will be of particular interest.

**Monitoring Mercator presence in digital media**

In 2012, we shall continue to build trust through digital media as we respond promptly to the topics of highest current relevance. Communication will be adjusted to the digital media, and the approach will take on a more personal note as the two-way communication allowed by the digital media will enable us to obtain feedback from the consumers. Starting points and rules of communication and appearance in social networking sites shall be laid down for all companies in the Southeastern European markets, and our presence shall be monitored in all markets.

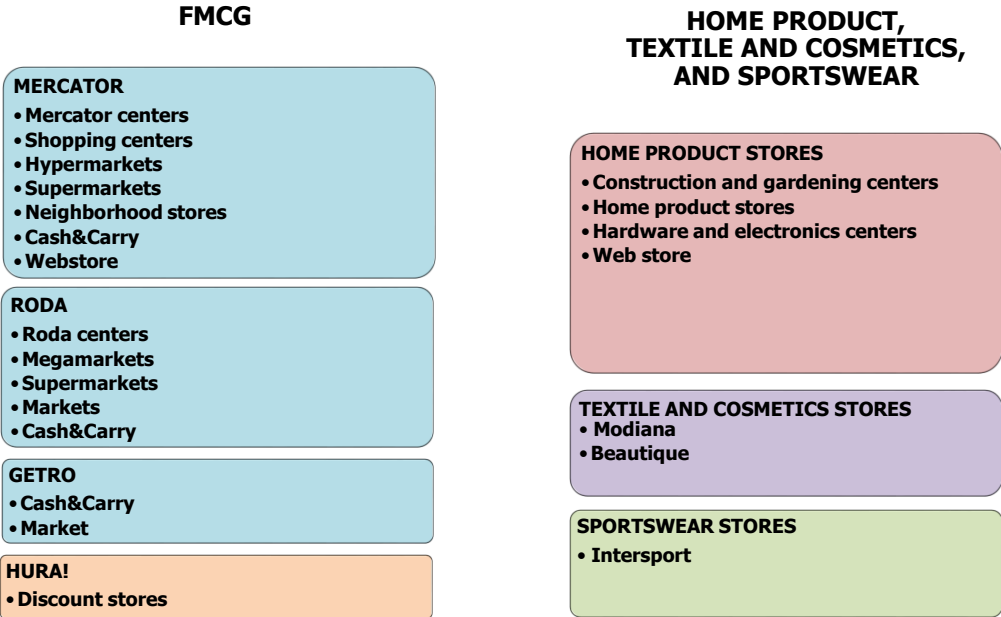
**Store Formats**

In 2012, Mercator store format development shall be focused on re-defining particular elements that jointly form the marketing mix, and on positioning of respective stores in the market. Spearheading the changes and the upgrades to the existing elements of the store and marketing concept for individual store formats will be a mix of activities intended to improve the existing offer and competitiveness of particular stores, and, as a result, to improve the quality of life for our consumers.

Special emphasis shall be placed on individual technical and technological improvements at the stores, aimed at establishing better working conditions for our employees on the one hand, and at developing solutions for sustainable development on the other. As a retailer with a strong sense of corporate social responsibility, we are looking to generate savings in energy costs at individual stores and thereby to contribute to more rational natural resource management.

The entire set of planned changes represents Mercator efforts to come closer to the perceived needs and expectations of the customers in the altered market conditions, and to offer them more for their money. We are looking to convey a clear message at the very point of sale, or at the stores, that Mercator is a retailer whose mix of offer, products, and services provides the customers added value for their money, and that Mercator is the first and the right choice for the consumers.

Brands and store formats operating within the Mercator Group:



## Composition of retail units as at 31 December 2011

COUNTRY	SLOVENIA	SERBIA	CROATIA	BOSNIA AND HERZEGOVINA	MONTE-NEGRO	ALBANIA	BULGARIA	MERCATOR GROUP		
ACTIVITY	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Gross sales area	Net sales area
Hypermarkets	21	15	13	7	2	1	4	63	297,891	194,539
Supermarkets	62	21	21	13	5	-	-	122	175,972	113,942
Neighbour stores	400	75	47	42	72	2	1	639	275,731	164,019
Comfort stores	1	-	1	1	-	-	-	3	6,215	3,669
Getro market	-	-	23	-	-	-	-	23	12,518	7,986
Cash & Carry	13	5	16	-	-	-	-	34	144,533	102,741
Hard discount stores	11	-	-	-	-	-	-	11	8,102	5,753
Restaurants	22	7	-	2	1	-	-	32	9,573	5,579
M Holidays	13	-	-	-	-	-	-	13	229	229
<b>TOTAL FMCG program</b>	<b>543</b>	<b>123</b>	<b>121</b>	<b>65</b>	<b>80</b>	<b>3</b>	<b>5</b>	<b>940</b>	<b>930,764</b>	<b>598,457</b>
Home program	63	13	12	-	3	-	-	91	134,752	74,140
Furniture program	30	1	-	-	1	-	-	32	32,515	24,246
<b>Total home program</b>	<b>93</b>	<b>14</b>	<b>12</b>	<b>-</b>	<b>4</b>	<b>-</b>	<b>-</b>	<b>123</b>	<b>167,267</b>	<b>98,386</b>
<b>Clothing program and drugstores</b>	<b>95</b>	<b>17</b>	<b>33</b>	<b>12</b>	<b>1</b>	<b>-</b>	<b>-</b>	<b>158</b>	<b>70,773</b>	<b>59,367</b>
Clothing program	76	9	33	8	1	-	-	127	67,178	56,381
Drugstores and perfumeries	19	8	-	4	-	-	-	31	3,594	2,986
Intersport	32	9	29	9	2	2	-	83	51,683	39,824
<b>TOTAL specialised programs</b>	<b>127</b>	<b>26</b>	<b>62</b>	<b>21</b>	<b>3</b>	<b>2</b>	<b>-</b>	<b>241</b>	<b>122,456</b>	<b>99,191</b>
Franchise stores	225	5	52	-	-	-	-	282	51,980	34,274
<b>TOTAL with franchise stores</b>	<b>988</b>	<b>168</b>	<b>247</b>	<b>86</b>	<b>87</b>	<b>5</b>	<b>5</b>	<b>1,586</b>	<b>1,272,466</b>	<b>830,307</b>

In 2012, retail network shall be adjusted within the framework of planned investment and development activities. The Group will secure new retail area exclusively by operating lease.

# Counter-crisis measures and strategic projects in 2012

## Twelve measures to counter the crisis in 2012

In efforts to manage the risks in the best possible way, the company Mercator adopted 12 counter-crisis measures for 2012, which represent a constructive approach to the anticipated hostility of the economic environment, higher unemployment rate, drop in purchasing power of the consumers, and their increased price-sensitivity. The measures are targeted at generating value for the consumers and rationalizing the operations.

<p><b>1. Let us work with the suppliers to find internal untapped improvement potential and invest the savings into better prices for the consumers!</b></p>	<p><b>LET US GENERATE VALUE FOR OUR CUSTOMERS – LET US BE DETERMINED AND INNOVATIVE!</b></p>
<p><b>2. Let us increase the share of private label sales and adjust the product assortment to the changed consumer behaviour!</b></p>	
<p><b>3. Let us communicate more efficiently with the consumers, and find new sales channels to reach new consumers!</b></p>	
<p><b>4. Let us revise the Mercator Pika customer loyalty system and bring it closer to a wider range of consumers!</b></p>	
<p><b>5. Let us revise the offer of the home products and become the leading technical consumer goods retailer in the entire region!</b></p>	
<p><b>6. Let us boost the appeal of other offer for the consumers: Modiana, Intersport, hospitality services, M-Mobil, M Holidays, Maxen!</b></p>	
<p><b>7. Let us improve our inventory and receivables management, and obtain additional sources to finance more investment!</b></p>	<p><b>LET US FIND THE INTERNAL IMPROVEMENT POTENTIAL – LET US BE EFFICIENT!</b></p>
<p><b>8. Let us improve the efficiency of the processes in sales and invest the savings into favourable pricing!</b></p>	
<p><b>9. Let us improve the efficiency of the processes in logistics and invest the savings into favourable pricing!</b></p>	
<p><b>10. Let us improve the efficiency of the processes in administration and invest the savings into favourable pricing!</b></p>	
<p><b>11. Let us invest within the limits of our own sources and let us improve the usage efficiency of our real property!</b></p>	
<p><b>12. Let us partly monetize our real property and reduce our debt to further consolidate our financial stability and development potential!</b></p>	

## **Refreshment of the offer of market program in Slovenia**

According to the market analyses, customers are responding to persisting recession by doing more of their shopping at discount stores, and by being more perceptive of special offers and products included in the customer loyalty programs. By revising and refreshing Mercator offer in Slovenia, we are looking to improve the satisfaction of our customers and to generate growth of sales revenue and market share.

Due to effective downward pressures on purchasing power and changes in the shopping behaviour, central attention is paid to constant adjustment to the needs and expectations of our customers by carefully selecting our offer and managing our pricing and promotion policy.

Following are the aspects that the program of Refreshment of Mercator FMCG Offer in Slovenia is particularly focused on.

- Responsive, carefully thought out, and efficient assortment management. Customers will be offered more different products in stores of all formats; offer of fresh program will be expanded, but at the same time, the depth of the offer at smaller stores will be rationalized, which means that a smaller number of products of the same type will be offered. These measures are aimed at satisfying a larger number of consumers' needs.
- We shall increase the share of private label products in our offer. Revision and update of private label lines is in full swing, as are the improvement of quality of these products and development of new innovative products.
- Sound pricing management will allow us to permanently provide fair and competitive prices for our customers. By increasing the share of favourably priced private label products, we are looking to change our customers' perception of our competitiveness in terms of pricing.
- Customer loyalty system will be upgraded to include, in addition to the savings for the customer, more instant benefits.
- Emphasis is placed on continuous modernization and new visual identity or design of the stores, which provides a pleasant shopping experience. In this regard, we shall pursue the principle of simple and fast shopping, as well as optimize the retail area and the program mix.
- By implementing new solutions in 2012, we shall also revise the processes (sales area and assortment management, private label product life cycle management, management of inventory and logistics processes at the stores and distribution centers, analytic support to decision-making in material operations, supply management and management of non-trade goods consumption, maintenance of equipment and real estate) and cut operating costs.

## **Refreshment and restructuring of FMCG offer in Croatia**

The main goal of the refreshment project in Croatia is to adjust the offer to the changes in shopping behaviour. In Croatia, the project will be carried out both in Mercator retail units and in Getro retail units; at the same time, Getro shopping centers are also being restructured to optimize the retail area and to attract exciting third-party providers. The offer at the Getro shopping centers will be more appealing to the price-sensitive customers due to a wider offer.

The project was commenced in November 2011; 2012 will be the year of key changes. Adjusted offer shall first be tested in the first half of the year at Mercator and Getro test units. The target is to implement the new offer at all stores in the last quarter of 2012, starting with Getro retail units and followed by Mercator retail units.

Key adjustments oriented towards the final consumer shall include the following:

- expanding the breadth and reducing the depth of the assortment;
- investing into competitive pricing in order to promote perception of a retailer offering well-priced products;
- boosting the share of revenue from private label products;
- adjusting the customer loyalty system to a broader group of consumers;
- improved communication with the consumers.

In addition to stepping up the investments into competitive pricing and improving the perception in this regard, the company Mercator - H, d.o.o, shall also adjust the cost of its operations. Administration expenses shall be cut, as well as operating costs, logistics per-unit costs, and rental expenses at shopping centers. Furthermore, productivity of shopping centers shall be improved, and Getro center in Zagreb shall be re-branded to Mercator center.

### **Establishing a hardware and electronics store chain**

Consistently with the focus on the core activity, the company Poslovni sistem Mercator, d.d., transferred the home program to an independent business entity; in November, the company M - Tehnika, trgovina in storitve (trade and services), d.d., was founded. Through a network of subsidiaries, the company and the entire M - Tehnika Group shall also be present in other markets of Southeastern Europe where Mercator Group is already conducting operations.

The M - Tehnika Group shall manage a total of 124 stores in Slovenia, Serbia, Montenegro, and Croatia, and employ over 1,300 people. Parallel to independent development and specialization, the Group will pursue a strategy of reaping the synergies – through economies of scale – by offering home products at Mercator FMCG units in all Mercator Group markets.

The Group will attain its goals by focusing market activities on sales to individuals and businesses.

Primary target group of customers in the process of sale to individuals is the active workforce, while secondary groups include young families, active women, youth (high school and college students), and retirees. The company shall prepare, by respective store formats, appropriate offer for these target groups, upon which its recognition will be built; an appropriate combination of offered products with the best added value shall be managed in a controlled manner. The company shall become the market and price leader in target product categories. It shall respond to the drop in purchasing power by offering low-priced products, and private labels will be introduced to gain a competitive edge through distinction.

The company M-Tehnika, d.d., is looking to offer its consumers quality home products in different price segments, and the best advice. Confidence and loyalty of the largest possible number of customers will be built by additional innovative combinations in terms of offer of complementary products or services, and by a permanent reasonably priced offer.

Working with businesses, establishing long-term business relationships with key strategic buyers shall be of paramount importance; with all other customers, maintaining a professional business relation will be the key. Orientation towards more demanding segments of customers with lower credit risk shall be essential. Target groups of customers include retailers and franchise stores, legal persons offering services of building completion and finishing, and public enterprises.

Particular attention will be paid to the needs of manufacturers of the products included in the retail offer.

The company's offer will also be present online where its revised sales policy will mostly address the segment of younger buyers.

For 2012, the company M - Tehnika, d.d., laid down ambitious plans which will be attained by conducting the following activities:

- optimization of processes and cost-efficiency;
- adjustment of organization;
- improvement of purchasing terms;
- more efficient supply and inventory management;
- standardization of the sales area;
- changes to the product assortment;
- introduction of supplementary services;
- new marketing approaches.

## FINANCIAL MANAGEMENT

Mercator Group net financial debt at the end of 2012 is anticipated at EUR 732,298 thousand, which is 33.9 percent less than the estimate for 2011. Mercator Group will reduce the debt by efficient management of financial liabilities and assets, and by monetizing a part of its real property.

in EUR 000	<b>Plan 31 Dec. 2011</b>	<b>Estimate 31 Dec. 2011</b>	<b>Index Plan 31 Dec. 2012/ Estimate 31 Dec. 2011</b>
Non-current financial liabilities excl. other financial liabilities	593,335	849,540	69.8
Current financial liabilities excl. other financial liabilities	202,670	331,799	61.1
Derivative financial instruments (liabilities)	3,379	4,000	84.5
<b>Financial liabilities including derivative financial instruments</b>	<b>799,384</b>	<b>1,185,339</b>	<b>67.4</b>
Cash and cash equivalents	16,364	12,171	134.5
Derivative financial instruments (assets)	229	500	45.8
Available-for-sale financial assets	3,015	3,500	86.2
Loans and deposits	47,478	61,530	77.2
<b>Financial assets</b>	<b>67,086</b>	<b>77,701</b>	<b>86.3</b>
<b>NET FINANCIAL DEBT</b>	<b>732,298</b>	<b>1,107,638</b>	<b>66.1</b>
Net financial debt / Gross cash flow from operating activities	<b>4.87</b>	<b>6.85</b>	<b>71.1</b>
Net financial debt / Fair value of real estate	47.8%	64.4%	74.2

In 2012 and 2013, Mercator Group is planning to monetize some of its commercial property in Slovenia and Croatia, with expected total value of EUR 500 million. Thereby, the predominant form of financing will no longer be financing through equity but rather financing through long-term operating lease of commercial facilities.

At the end of 2011, average 6-month EURIBOR stood at 1.62%. In 2012, analysts are forecasting the 6-month EURIBOR at 1.35%; however, margins or mark-ups are expected to rise simultaneously. For Mercator Group, this will translate into higher price of debt, both in terms of new borrowings from commercial banks and in terms of interest expenses, which in turn will affect the net finance expenses in 2012.

Mercator Group estimated debt-to-equity (capital structure) ratio as at 31 December 2011 stands at 1:1.34. The ratio is a quotient between equity, which includes share capital as reported in financial statements and long-term provisions, and net financial debt. This ratio is planned at 1:0.88 for the end of 2012. In 2012, Mercator Group will succeed in improving the composition of financial liabilities by maturity. The share of long-term financial liabilities as at 31 December 2012 is planned at 74.5% (71.9% according to the estimate for 31 December 2011).

For 2012, Mercator Group is planning a ratio between variable and fixed, or hedged, financial liabilities of approximately 40:60.

### **Dividend policy**

Pursuant to the resolution adopted at the 17th regular Shareholders Assembly held on 22 June 2011, the company Poslovni sistem Mercator, d.d., paid out gross dividend of EUR 8.00 per ordinary share.

Due to expectations of harsh economic circumstances in 2012, the dividend payment for 2012 considered by the company Poslovni sistem Mercator, d.d., in this Business Plan amounts to EUR 3.00 gross per ordinary share. Management Board will work with the Supervisory Board to examine each year the suitability of the proposed amount of dividend, considering the relevant business and financial aspects; the decision on actual payment of dividends, however, lies with the Shareholders Assembly.

## **RISK MANAGEMENT**

### **Managing the key risks in 2012**

#### **Business Risks**

Business risks are related to company operations and our core activity.

Exposure of trade companies to business risks increases as a result of economic conditions which involve changes in the shopping behaviour of the consumers, and particularly due to a drop in their purchasing power. The unemployment rate is the key indicator of purchasing power and the sense of security on the part of the consumers. In recent months, this category has reached the highest levels in the last five years in the key markets of Mercator operations. Consumer confidence is low; furthermore, an increasing share of the general population is expecting further deterioration of their financial position. As a result, the trend of rationalizing the consumption and shopping behaviour has been fully established.

Exposure to business risks is further amplified by unpredictable reactions by the competitors, changes in economic policies, foreign exchange fluctuations, and changes in the prices of tradable commodities.

### **Risk of a decline in purchasing power**

*Assessment of the risk of a decline in purchasing power (size of market) due to challenging economic conditions.*

In recent years, markets of Mercator operations were beset by the economic crisis which is expected to extend into a new cycle in 2012. Increase in the unemployment rate which has reached record levels in Mercator key markets, paired with the drop in purchasing power of the general population, translates into a decline in consumption. Consumer uncertainty, anticipated worsening of personal financial position, and higher propensity to save will permanently affect the shopping behaviour and shift it towards more rational consumption.

### **Risks of sub-optimum marketing mix and effects of the competitive environment**

*Assessment of risk based on market conditions and Mercator position in the Group target markets.*

Operations in strenuous conditions require even greater control and responsiveness in Mercator core activity, which has to be attained by management of the entire marketing mix (price, place – locations, products – assortment, promotion etc.) as this is the only way to secure our growth and adaptability to the changes in the environment.

### **Risks in the supply process**

*Assessment of global impact on Mercator supply processes.*

Given the expected stagnation or minimum growth of consumption in key markets, managing the risks pertaining to supply source management will be the key to securing the competitive edge and the capital power for Mercator Group further successful development.

## **Financial risks**

Financial risks include those that may negatively affect the ability to generate finance income, management of finance expenses, maintaining the value of financial assets, and managing financial liabilities.

As in the years to date, we shall pay attention in 2012 to the management of financial risks which include credit risk, currency risk, interest rate risk, and liquidity risk.

### **Credit risks**

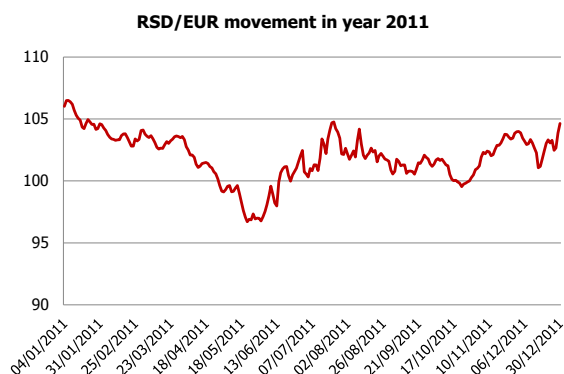
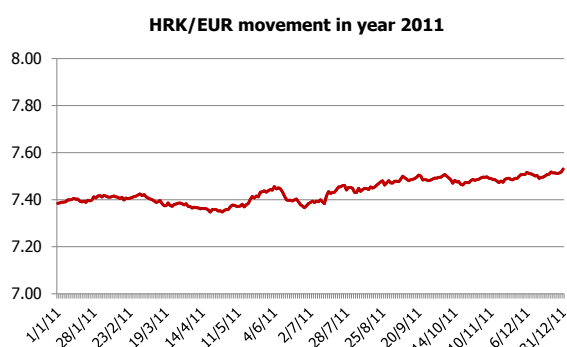
*Assessment of the risk that receivables resulting from deferred payment will only be settled partly or not at all.*

In 2012, Mercator Group shall pay attention to payment defaults by our third-party wholesale customers, Pika card holders, and lessees at our commercial facilities. Risks pertaining to the said groups of buyers will be managed by instigating collection procedures for customers with a record of defaults, and by entering mutual offsetting deals with wholesale customers and suppliers. With wholesale customers with a weaker rating, we shall seek first-grade insurance, and we shall monitor customers with a record of late payments to mitigate our exposure. Initial limits to Mercator Pika card holders will be approved according to their rating; in case of a default on the payment of their payables, their cards shall be blocked or revoked.

## Currency risk

*Assessment of the loss of economic benefit due to changes in exchange rate.*

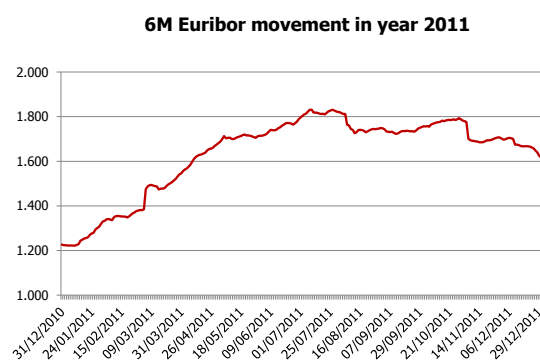
Exposure of Mercator Group to currency risk will be assessed by monitoring the changes in exchange rates as well as their macroeconomic background and all other related aspects. Considering the expected changes in macroeconomic indicators, we shall seek to adapt our operations in a way that mitigates or entirely hedges or evades the currency risk.



## Interest rate risk

*EURIBOR interest rate is subject to market fluctuations and it is changing daily, which can lead to increased financing costs.*

Interest rate risk at Mercator Group will be managed by regular monitoring of the changes in interest rates and by examining the possibilities to sign derivative financial instruments for hedging the said risk in case of interest rate hikes. At least a 50-percent share of all financial liabilities used for financing non-current assets, and at least 25% of total financial liabilities will continue to be hedged in the future.



## Liquidity risk

*Assessment of the risk that at a certain moment, the company will be short of adequate liquid assets needed to settle its current liabilities.*

If long-term financing sources are available in financial markets, we shall manage our liquidity risk in 2012 by converting a part of the short-term financial liabilities into long-term liabilities by signing bilateral long-term loans or syndicated loans, or by issuing debt securities.

## Operational risks

Operational risks are related to the implementation and control of business processes and activities at the Mercator Group, and to the consumption and costs incurred in the progress of these processes.

## **Strategic risks**

*Risks of pursuit and attainment of the specified strategy and integration of companies into the Group.*

In a period where activities are targeted at Mercator Group long-term development, we shall maintain quality and up-to-date communication with all stakeholders to retain and improve Mercator reputation in the public. We shall proactively implement corporate activities and control the pursuit of the Mercator Group strategy.

## **Category management operational risks**

*Risks related to delivery failures, increase in the prices of traded commodities, and seasonal effects.*

Operational risks of category management shall be mitigated by conducting business with proven suppliers who are devoted to safety and quality of products in manufacturing and supplying, and who operate with a sense of respect for human rights and a responsible attitude towards the environment.

## **Risks of investment and international development**

*Risk of impeded development and expansion of business operations, and higher possibility of contract breaches.*

Shrinking of available investment funds renders development and expansion of our retail network increasingly harder; in addition, it increases the possibility of failure to comply with the provisions and covenants specified in the contracts and agreements already signed. This also increases the need for operating lease of both buildings and equipment. Therefore, coordination of new development projects will have to be all the more efficient.

## **IT operational risks**

*Risk of failure of the central IT systems.*

Risk of failure of central information technology systems shall be mitigated by employing parallel system spaces fitted with equipment intended to improve the reliability and availability of key IT systems.

## **Accident and cost risk**

*Risk of major loss events and risk of an increase in operating costs.*

We shall prevent or hedge our exposure to accident risks by proactive prevention measures and activities, and insurance of loss events. The projects of optimizing our operations will reduce the costs and contribute to the improvement in cost efficiency. We shall increase the efficiency of processes in sales, logistics, and administration, and improve inventory and receivables management. We shall invest within the limits of our own funds, and we shall partly monetize our real property in order to consolidate the Mercator Group financial stability.

## **Food safety risks**

*Risk pertaining to the failure to meet the requirements of healthcare compliance or product safety.*

We shall continuously monitor shelf life and best before dates, as well as product labelling and the tidiness and hygiene of our stores. We shall conduct product monitoring activities

and maintain a product withdrawal or recall system to make sure the products in our aisles are of adequate quality.

### **Environmental risks**

*Risk of inefficient use of fuels and failure to manage other environmental aspects.*

Decreasing the use of fuels, particularly electric energy, will be a key activity for us. We shall conduct projects that result in efficient use of fuels and management of other environmental aspects, consistently with the requirements of sustainable development.

### **Healthcare and fire safety risks**

*Risk related to failure of fire safety systems and risk of injury at work or illness/deterioration of health.*

Employees will be provided with working environments that are in compliance with the requirements of work ergonomics and labour legislation; this, in turn, will also reduce the effects of injury at work and detrimental effects to health. We shall provide flawless operation of fire safety systems and effective measures in case of any extraordinary events.

### **Human resource risks**

*Risk pertaining to a lack of human resources and health and dissatisfaction of the employees.*

Paramount activity of human resource risk management shall be to reduce the fluctuation of key employees, and to hire required human resources that are in shortage to provide smooth and unhindered operations. In order to reduce absenteeism, we shall promote the awareness of the importance of a healthy lifestyle among our employees, and carry on our education and training activities as we find them to be the key vehicles for boosting employee motivation.

### **Legal risks**

*The risk pertaining to relations regulated by labour law, civil law, contractual obligations law/liability legislation, and intellectual property law; and protection of business secrecy.*

We shall manage the risks of worker claims, any risks pertaining to disclosure of a business secret, and risks of compliance of operations in terms of competition, which is a result of the fact that the company Poslovni sistem Mercator, d.d., is still under surveillance of the Competition Protection Office of the Republic of Slovenia (UVK) for compliance with the commitments regarding concentration and dominant position in the market.

**According to the forecasts by analysts, we can expect to enter a new cycle of economic crisis and the resulting further aggravation of economic circumstances in the coming years, which in turn would bear a negative impact on Mercator Group operations in all of its markets. Due to a high level of uncertainty regarding the future development of business circumstances, any assessment of the effects on the exposure to risks would be quite unreliable. The Management Board shall assess the exposure to key risks on regular basis and devise appropriate measures to mitigate or hedge such risks as far as reasonably possible.**

# SUSTAINABILITY REPORT

## WE CARE

**Mercator operations are sustainable and responsible, creating a healthy and safe future for the people and the environment.**

The fundamental principle of sustainable development is that our needs today should be satisfied in a way that does not threaten the future of the generations to come. As one of the largest retailers in the region, we declare our responsibility, the need, and the commitment to make our conduct and business decisions consistent with the principles of sustainable development conceived of as a balance of business policies, corporate social responsibility, environment protection, and economic sustainability. Especially in the highly challenging year 2012, our sustainable development activities will be conducted in a way that is rational and well thought out in terms of the costs incurred and usage of all sources available for our operations.

## WE CARE ABOUT OUR CUSTOMERS



Care for the customers is Mercator core and fundamental principle and it will remain the maxim of sustainable development activities in 2012. Our care shall be manifest through activities to guarantee food safety, with emphasis on Mercator private label lines.

### Strategic GOALS

### Activities planned for 2012

Care for food safety.

- Controlling the safety and quality of Mercator private label products in order to make sure that all private label food/alimentary products are additionally examined by the end of 2012.
- Conducting internal control at least once per year at every store.
- Systemic establishment of monitoring at open hypermarket departments of prepared food (food sampling and surface swabbing).
- Systematic collection of data from in-house and national product safety and quality control, removals, withdrawals, recalls, and recorded complaints as a part of the supplier review.

Introduction of environmentally friendly formats, standards, and technologies at our stores.

- Gradual introduction of closed refrigerators to the retail network in order to cut power consumption and boost the sales of refrigerated products.
- Unified and exposed positioning of organic and locally grown products at respective store formats.
- Installation of technological equipment or machinery that consumes less power for its operation.
- Examining the viability of rolling out the electronic shelf labeling to the entire retail network.

Marketing approaches related to the offer of environmentally friendly and well-priced products and services, and informing and educating the consumers about the environmentally friendly activities.

#### Slovenia:

- Introduction of the first products by farmers and small growers in packaging made of environmentally friendly raw materials.
- Award for efficient activities to promote sustainable development at the stores within the "Naj prodajalna" (Best Store) project.

Southeastern European markets:

- Printing flyers on recycled paper.
- Offer of biodegradable shopping bags.
- Additional labelling of local organic products at the stores/points of sale.

## WE CARE ABOUT OUR EMPLOYEES



Human resource development will focus on developing leadership skills of both current and future leaders. Transfer of knowledge shall be based on the work of internal instructors, intergenerational cooperation, internal mobility, and training of newly recruited personnel at retail units, as well as on the promotion of awareness among our employees about the importance of a healthy lifestyle.

### Number of employees

	Number of employees planned as at 31 December 2012	Number of employees as at 31 December 2011	Number of employees planned 31 Dec. 2012/31 Dec. 2011	Number of employees based on hours worked as planned in 2012
Poslovni sistem Mercator, d.d.	9,534	9,462	100.8	8,925
Mercator IP, d.o.o.	392	399	98.2	323
<b>Mercator Trade Slovenia</b>	<b>9,926</b>	<b>9,861</b>	<b>100.7</b>	<b>9,247</b>
Mercator - S, d.o.o.	4,513	4,565	98.9	4,413
Mercator - H, d.o.o.	3,284	3,417	96.1	2,869
Mercator - BH, d.o.o.	1,574	1,289	122.1	1,558
M - BL, d.o.o.	339	292	116.0	316
Mercator - CG, d.o.o.	1,444	1,429	101.0	1,470
Mercator - B, e.o.o.d.	378	268	141.0	266
Mercator - A, sh.p.k.	163	134	121.6	144
<b>Mercator Trade Southeastern Europe</b>	<b>11,695</b>	<b>11,394</b>	<b>102.6</b>	<b>11,035</b>
Mercator - Optima, d.o.o.	15	15	100.0	13
<b>Mercator real estate</b>	<b>15</b>	<b>15</b>	<b>100.0</b>	<b>13</b>
Mercator - Emba, d.d.	116	110	105.5	117
M - Energija, d.o.o.	10	6	166.7	9
M - Tehnika, d.d.	1,131	1,121	100.9	1,120
M - Tehnika H, d.o.o., Croatia	200	0	-	98
Intersport ISI, d.o.o.	338	327	103.4	329
Intersport S-ISI, d.o.o.	134	108	124.1	113
Intersport H, d.o.o.	260	254	102.4	245
Intersport BH, d.o.o.	68	63	107.9	60
Modiana, d.o.o., Slovenia	598	595	100.5	566
Modiana, d.o.o., Serbia	134	133	100.8	132
Modiana, d.o.o., Croatia	203	202	100.5	193
Modiana, d.o.o., Bosnia and Herzegovina	87	78	111.5	73
<b>Other operating activities</b>	<b>3,279</b>	<b>2,997</b>	<b>109.4</b>	<b>3,055</b>
<b>MERCATOR GROUP</b>	<b>24,915</b>	<b>24,267</b>	<b>102.7</b>	<b>23,350</b>

### Strategic GOALS

Leadership development, employee training.

### Activities planned for 2012

- Reform and assessment of leader competencies.
- Founding a leadership competency center.
- Internal instructor training.
- Carrying out the 5th International Mercator Business Academy.
- Establishing a system of mass improvements named Mercator Creator.
- Introduction and implementation of new human resource corporate standards.
- Presenting awards and prizes: Mercator Awards, Best Boss, Best Stores.
- Implementing the measures of the Family-Friendly Company project.

Inclusion of employees, care for health and safety.

## WE CARE ABOUT NATURE



Our relation and attitude towards our natural environment is systematically established by implementing the principles of energy-efficient construction or refurbishment of stores and office buildings, promoting efficient use of energy, and by careful waste management, as well as by considering other relevant environmental aspects. Providing sustainable logistics and proactively conveying the right information and presenting our environmentally friendly offer to our customers.

### Strategic GOALS

Reducing consumption of power and fuels for heating by implementing savings measures, by current maintenance, and by investments.

### Activities planned for 2012

- Replacing the existing fluorescent lighting with LED lighting in lightboxes.
- Regular monthly monitoring of environmental reports.
- Analyzing the energy consumption status.
- Careful planning of consumption and use of alternative energy sources.
- Upgrade of the central control systems with a power consumption monitoring system.
- Introducing refrigeration equipment control.
- Calculation and monitoring of the carbon footprint for the company, sustainable trade, and Mercator private labels.
- Announcement of environmental topics on the Mercator Portal.
- Further cooperation in the PLASTiCE international project.
- Separate waste collection for our customers.
- Further implementation of the project of replacement of current freight vehicles with new environmentally friendly freight vehicles.

Cutting the use of natural resources and waste generation.

Expanding the use of environmentally friendly freight vehicles.

Relocation of logistics services to energy-efficient and people- and environmentally friendlier, suitably located facilities outside urban areas.

- Consistently with the strategic plan of logistics development, we shall continue the gradual preparations for relocation of logistics activities to energy-efficient, and environmentally and human-friendly facilities outside urban areas.

## WE CARE ABOUT OUR SOCIAL ENVIRONMENT



Mercator's donations are a notable contribution to efficient solutions in key areas of social life, particularly regarding healthcare and social care. Mercator sponsorships, on the other hand, support numerous sports and cultural events and educational activities.

### Strategic GOALS

Sponsorships and donations.

### Activities planned for 2012

- Our investments into our social environment, both nationally and locally, will include supporting over 2,000 projects in Slovenia and markets of Southeastern Europe.

## WE CARE ABOUT PARTNERSHIP WITH OUR SUPPLIERS



Partnership with suppliers is a key element in expressing sustainable responsibility in business. We work with the suppliers to build solid partnerships based on transparent and straightforward business relations, while making every effort necessary to establish an environmentally friendly supply chain.

### Strategic GOALS

Working with proven suppliers.

### Activities planned for 2012

- In 2012, we shall do business with proven suppliers who are devoted to supplying safe and quality products, who guarantee compliance of food and materials, and who operate with a strong sense of respect for human rights and the environment.
- Increasing the number of products by Slovenian growers and products by other local farms.

## WE CARE ABOUT QUALITY



In order to provide all-around quality, our activities include implementation of international management systems, preventive action of internal controls, efficient documentation and non-compliance management, implementation of corrective/preventive measures, and monitoring key quality indicators at the Mercator Group level.

### Strategic GOALS

Maintenance, implementation, and certification of international quality management systems at Mercator Group companies by independent certified bodies.

Management of documentation, records, non-compliance, and corrective and preventive measures at the Mercator Group.

Systemic monitoring of quality management processes at the Mercator Group.

### Activities planned for 2012

- Maintaining the 13 certified quality management systems implemented at the Mercator Group companies.
- Introduction of new quality management systems at the Mercator Group companies.
- Monitoring the sustainable development activities consistently with the Global Reporting Initiative guidelines.
- Managing the Mercator Standards document collection and required records for all Mercator Group companies.
- Providing systemic monitoring of non-compliance and the relevant corrective/preventive measures, and establishing and maintaining a reporting system for the entire Mercator Group.
- Introduction of monitoring applications for environmental indicators at all Mercator Group trade companies.
- Monitoring the internal control at the level of the entire Mercator Group and setting up the reporting system.

Establishing IT support for managing the quality management system requirements at the Mercator Group.

- Implementation of improvement processes (innovation, audits, operational risks etc.) at the Mercator Group level.
- Development of a new application for monitoring the findings of the internal controls.
- Introduction of a new monitoring application for non-compliance, proposals, and commendations at all Mercator Group companies.
- Adjustment of the existing applications: document and record management applications, environmental indicator monitoring applications, and council management applications.
- Providing required training for application users.

# FINANCIAL REPORT

## ACCOUNTING POLICIES

All financial statements of the Mercator Group have been prepared in compliance with the International Financial Reporting Standards and they are unaudited.

## CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

Poslovni sistem Mercator, d. d. (hereinafter referred to as Mercator, d. d.), is a company headquartered in the Republic of Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. Planned consolidated financial statements for the year 2012 and estimated consolidated financial statements for the year 2011 include the company Mercator, d.d., and its subsidiaries, as follows:

- **in Slovenia:** Intersport ISI, d.o.o., Modiana, d.o.o., Eta, d.d. (until 1 June 2011), Mercator-Emba, d.d., Mercator-Optima, d.o.o., Mercator IP, d.o.o., M.COM, d.o.o., M-nepremičnine, d.o.o., and M-Energija, d.o.o. (as of 1 August 2011), and M-Tehnika, d.d. (as of 8 November 2011);
- **abroad:** Mercator - H, d.o.o., Croatia, Intersport - H, d.o.o., Croatia, Modiana, d.o.o., Croatia, Mercator - S, d.o.o., Serbia, Intersport S - ISI, d.o.o., Serbia, Modiana, d.o.o., Serbia, Mercator - BH, d.o.o., Bosnia and Herzegovina, M - BL, d.o.o., Bosnia and Herzegovina, Intersport - BH, d.o.o., Bosnia and Herzegovina, Modiana, d.o.o., Bosnia and Herzegovina, Mercator - CG, d.o.o., Montenegro, Mercator - K, l.l.c., Kosovo, Mercator Makedonija, d.o.o.e.l., Macedonia, Investment Internacional, d.o.o.e.l., Macedonia, Mercator - B, e.o.o.d., Bulgaria, and Mercator - A, sh.p.k., Albania;

(hereinafter referred to as "Mercator Group"). Mercator Group predominant operating activity is retail and wholesale of fast-moving consumer goods.

## Condensed consolidated statement of financial position

	Plan 31 Dec. 2012	Estimate 31 Dec. 2011	Index Plan 31 Dec. 2012/Estimate 31 Dec. 2011
EUR thousand			
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	1,681,787	1,906,481	88.2
Investment property	3,204	3,630	88.3
Intangible assets	40,640	47,640	85.3
Deferred tax assets	11,030	9,945	110.9
Loans and deposits	45,564	59,637	76.4
Available-for-sale financial assets	3,015	3,500	86.1
	<b>1,785,240</b>	<b>2,030,833</b>	<b>87.9</b>
<b>Current assets</b>			
Inventories	286,969	309,776	92.6
Trade and other receivables	245,410	263,690	93.1
Current tax assets	0	0	-
Loans and deposits	1,914	1,893	101.1
Derivative financial instruments	229	500	45.8
Cash and cash equivalents	16,364	12,171	134.5
	<b>550,886</b>	<b>588,030</b>	<b>93.7</b>
<b>Total assets</b>	<b>2,336,126</b>	<b>2,618,863</b>	<b>89.2</b>
<b>EQUITY</b>	<b>796,698</b>	<b>791,185</b>	<b>100.7</b>
<b>LIABILITIES</b>			
<b>Non-current liabilities</b>			
Trade and other payables	4,122	2,579	159.8
Financial liabilities	593,335	849,540	69.8
Deferred tax liabilities	63,913	50,482	126.6
Provisions	35,951	35,905	100.1
	<b>697,321</b>	<b>938,506</b>	<b>74.3</b>
<b>Current liabilities</b>			
Trade and other payables	635,643	551,987	115.2
Current tax liabilities	415	1,386	29.9
Financial liabilities	202,670	331,799	61.1
Derivative financial instruments	3,379	4,000	84.5
	<b>842,107</b>	<b>889,172</b>	<b>94.7</b>
<b>Total liabilities</b>	<b>1,539,428</b>	<b>1,827,678</b>	<b>84.2</b>
<b>Total equity and liabilities</b>	<b>2,336,126</b>	<b>2,618,863</b>	<b>89.2</b>

## Condensed consolidated income statement

	<b>Plan 2012</b>	<b>Estimate 2011</b>	<b>Index Plan 2012/ Estimate 2011</b>
EUR thousand			
Revenue	3,030,387	2,932,887	103.3
Cost of sales	(2,862,826)	(2,767,056)	103.5
<b>Gross profit</b>	<b>167,561</b>	<b>165,831</b>	<b>101.0</b>
Administrative expenses	(105,433)	(103,433)	101.9
Other income	14,248	27,458	51.9
<b>Results from operating activities</b>	<b>76,376</b>	<b>89,856</b>	<b>85.0</b>
Finance income	3,936	5,563	70.8
Finance expense	(56,140)	(62,159)	90.3
<b>Net finance expense</b>	<b>(52,204)</b>	<b>(56,596)</b>	<b>92.2</b>
<b>Profit before income tax</b>	<b>24,172</b>	<b>33,260</b>	<b>72.7</b>
Income tax expense	(8,464)	(9,460)	89.5
<b>Profit for the period</b>	<b>15,708</b>	<b>23,800</b>	<b>66.0</b>

## Notes to condensed consolidated financial statements

### Notes to condensed consolidated income statement

#### Sales revenue

In 2012, Mercator Group will generate EUR 3,030,387 thousand of sales revenue, which is 3.3 percent more relative to the 2011 estimate. Sales revenue will rise by 0.4 percent in Slovenia; in international markets, the growth will amount to 6.6 percent.

#### Costs of sales

For 2012, Mercator Group costs of sales, which include the cost (purchase value) of goods sold, production costs, selling and marketing costs, and other expenses, are planned at EUR 2,862,826 thousand. Depreciation and amortization cost for 2012 is planned at EUR 77,550 thousand; the estimate for this figure in 2011 stands at EUR 81,305 thousand.

#### Gross profit

Gross profit for 2012 is planned at EUR 167,561 thousand. Relative to the 2011 estimate, gross profit will rise by 1.0 percent in 2012. Hence, gross profit will represent a 5.5 percent share in sales revenue, which is 0.2 percentage point less than the estimated share for 2011. The decrease in gross profit is a result of lower profit margins introduced by Mercator as a response to the diminished purchasing power of the consumers.

#### Administrative expenses

Mercator Group administrative expenses for 2012 are planned at EUR 105,433 thousand, which is 1.9 percent more than the estimate for 2011. The drop in the share of administrative expenses in sales revenue is a result of the cost rationalization measures,

which, however, will fall short of fully compensating the decrease in gross profit due to lower profit margins.

### **Results from operating activities**

Mercator Group results from operating activities in 2012 are planned at EUR 76,376 thousand, which is 15 percent below the 2011 estimate.

### **Finance income and expenses**

Finance income will amount to EUR 3,936 thousand, the major part of which will be finance income from interest received (EUR 2,697 thousand).

Finance expenses in 2012 will amount to EUR 56,140 thousand, the major part of which will be finance expenses for interest paid (EUR 50,436 thousand).

### **Profit before income tax**

For 2012, Mercator Group is planning to generate EUR 24,172 thousand of profit before income tax, which is 27.3 percent less than the estimate for 2011.

### **Profit for the financial period**

Mercator Group net income for 2012 is planned at EUR 15,708 thousand, which is 34.0 percent less than the 2011 estimate.

### **Gross cash flow from operating activities**

Mercator Group gross cash flow from operating activities in 2012 is planned at EUR 150,275 thousand, which is 7.0 percent less than the estimate for the year before. The decrease is mostly an effect of the planned monetization which will result in higher rental expenses.

### **Gross cash flow from operating activities before rental expenses**

The relevant indicator of the ability to generate operating cash flow, which also accounts for the expansion of Mercator Group retail network through operating lease, is gross cash flow from operating activities before rental expenses which is planned at EUR 214,264 thousand for 2012, or 4.6 percent above the estimate for 2011.

## **Notes to condensed consolidated statement of financial position**

### **Assets**

As at 31 December 2012, Mercator Group assets are planned to amount to EUR 2,336,126 thousand, which is a decrease of EUR 282,737 thousand relative to the estimate for 31 December 2011.

As at 31 December 2012, the value of Mercator Group non-current assets is planned at EUR 1,785,240 thousand, which is EUR 245,593 thousand less than the estimate for 31 December 2011. The decrease is a result of the planned divestment of a part of the Group property within the monetization project. Property, plant, and equipment will represent the largest share of non-current assets at 96.7 percent (EUR 1,725,631 thousand), which is EUR 232,120 thousand less than the estimate for the end of 2011.

As at 31 December 2012, the value of Mercator Group current assets is planned at EUR 550,886 thousand, which is EUR 37,144 thousand less than at the end of 2011. The largest share thereof will include inventories (52.1%) and trade and other receivables (44.5%).

### **Equity and liabilities**

As at 31 December 2012, Mercator Group equity is planned to amount to EUR 796,698 thousand, which is EUR 5,513 thousand, or 0.7 %, more than the estimate for the end of 2011.

As at 31 December 2012, the value of Mercator Group total financial liabilities is planned at EUR 796,005 thousand, which is EUR 385,334 thousand less than the estimate for the end of 2011. Net financial debt of the Mercator Group, calculated as the difference between the Group financial liabilities and financial assets, will amount to EUR 732,298 thousand as at 31 December 2012 (estimate for 31 December 2011: EUR 1,107,638 thousand).

Provisions for other liabilities and charges as at 31 December 2012 are planned at EUR 35,951 thousand. Compared to the estimate for the end of 2011, provisions are planned to increase by EUR 46 thousand.

Trade and other payables as at 31 December 2012 are planned to amount to EUR 639,765 thousand, which is EUR 85,199 thousand more than at the 2011 year end.

As at 31 December 2012, long-term coverage of non-current assets with non-current liabilities at the Mercator Group is planned at 83.7 percent, which is 1.5 percentage points less than as at the end of 2011.

### **Effect of monetization on the planned consolidated income statement and statement of financial position**

Consistently with the progress of the strategic project of Mercator Group real estate monetization, sale and leaseback of a part of the real estate portfolio in Slovenia and in Croatia is planned for mid 2012, with estimated total value of EUR 250 million.

Planned sale shall be reflected in the statement of financial position as a decrease in property, plant, and equipment by a total of EUR 250 million. The entire proceeds will be used to repay the financial liabilities, particularly short-term financial liabilities, which will bear a positive impact on the entire composition of Mercator Group financial debt.

The sale of real estate is expected to generate gains in the amount of EUR 5 million, which will directly affect the income statement. Another positive effect of the reduction of debt by EUR 250 million will be the decrease in finance expenses for interest in the amount of EUR 6.25 million, and lower depreciation and amortisation costs in the amount of EUR 3.75 million. Leaseback of divested property will cause an increase in rental expenses by a planned amount of EUR 10 million.

### **Key elements of business performance in the 2011 estimate**

Intensified hostility of the business conditions, already noted in the Business Report of the Mercator Group and the Company Poslovni sistem Mercator, d.d., for the Period 1-9 2011, did not subside and the economic circumstances grew even harsher in the fourth quarter. We have witnessed aggravation of economic conditions in all markets of Mercator operations throughout 2011. Despite the rather optimistic expectations and forecasts of economic recovery announced at the time when our 2011 plans were being prepared, the crunch of the economic crisis has not eased off; on the contrary, according to the most recent forecasts by the pundits, both eurozone countries and countries of the Western Balkans should brace for another recession, this time caused by further deepening of the crisis in the financial markets in Europe and beyond.

Mercator Group performance in the last quarter of 2011 was marred by the following effects which in turn affected the performance for the entire year:

- Unfavourable changes in exchange rates relative to the period 1-9 2011; these pushed the net currency translation differences in the negative direction by more than EUR 4.5 million in the last quarter.

- More extensive investment in competitive pricing (price investments) which were introduced to partly compensate for the drop in the purchasing power of our customers; this resulted in weaker operating results.
- Harsher economic conditions had a more negative impact on the program of products for the home, as well as on the textiles and sportswear program. Weaker performance by the technical consumer goods program was a result of higher propensity to save on the part of the consumers who consistently postponed the purchase of durables because of the anticipated aggravation of the economic crisis. In addition to lower purchasing power, Intersport sportswear program additionally suffered from a poor winter season resulting from unfavourable weather conditions. Sales of textiles were affected by feeble response by consumers to clearance sales and special offers.
- In wholesale, we responded to increased exposure to credit risks by introducing measures to restrict sales to customers with a history of late payments and defaults. The measure depressed the wholesale revenue below the expected level, which resulted in a loss of wholesale profit margin.
- Lower-than-planned purchasing volumes in respective categories affected the attainment of annual commercial terms. This, in turn, had a negative impact on the performance of virtually all trade programs for the entire year.
- In December, we paid out additional reward to our employees, in an effort to additionally improve our sales service by boosting employee motivation and satisfaction during harsh times.
- In the last quarter of 2011, Mercator Group conducted activities to integrate the operations of the companies Drvopromet, d.o.o., and Familija Marketi, d.o.o., thereby incurring operating costs of company integration; full effect in terms of revenue and returns is only expected next year.

Considering the changes in the particular aspects of performance, occurring at the Mercator Group level in the second half of 2011 and particularly in the last quarter, the Management Board devised as early as in December 2011 a set of measures to counter the crisis. Paired with the strategic projects, they are targeted at mitigating the negative effects and risks of the business environment on the operations and performance of the Mercator Group.

## **FINANCIAL REPORT OF THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.**

Poslovni sistem Mercator, d. d. (hereinafter referred to as Mercator, d. d.), is a company headquartered in the Republic of Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. The company Mercator, d.d., is the parent/controlling company of a group of associated companies headquartered in Slovenia, Serbia, Croatia, Bosnia and Herzegovina, Montenegro, Bulgaria, Albania, Kosovo, and Macedonia.

The company has a double role: it is predominantly engaged in fast-moving consumer goods retail and wholesale; however, it also performs various group-related corporate tasks for the companies included in the Mercator Group. Hence, employing the financial statements of the company Poslovni sistem Mercator, d. d., for economic analysis of Mercator Group operation is inappropriate. For such analysis, it is more sensible to apply above all the consolidated financial statements that present an account of the performance of the Mercator Group as a uniform business entity.

**Due to the transfer or a part of operating activities to the companies M-Tehnika, d.o.o., financial statements of the company Poslovni sistem Mercator, d.d., are not fully comparable between particular periods in terms of substance.**

## Condensed statement of financial position

	Plan 31 Dec. 2012	Estimate 31 Dec. 2011	Index Plan 31 Dec. 2012/Estimate 31 Dec. 2011
EUR thousand			
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	853,582	993,067	86.0
Investment property	3,204	3,615	88.6
Intangible assets	5,854	9,317	62.8
Deferred tax assets	10,081	9,238	109.1
Loans and deposits	971	952	102.0
Investment into equity of subsidiaries	632,659	618,659	102.3
Available-for-sale financial assets	2,738	2,738	100.0
	<b>1,509,089</b>	<b>1,637,586</b>	<b>92.2</b>
<b>Current assets</b>			
Inventories	94,357	154,755	61.0
Trade and other receivables	139,481	159,697	87.3
Current tax assets	9,759	9,568	102.0
Loans and deposits	38,675	40,984	94.4
Derivative financial instruments	229	225	102.0
Cash and cash equivalents	4,687	5,597	83.7
	<b>287,188</b>	<b>370,826</b>	<b>77.4</b>
<b>Total assets</b>	<b>1,796,277</b>	<b>2,008,412</b>	<b>89.4</b>
<b>EQUITY</b>	<b>837,662</b>	<b>816,901</b>	<b>102.5</b>
<b>LIABILITIES</b>			
<b>Non-current liabilities</b>			
Trade and other payables	2,466	2,499	98.7
Financial liabilities	452,677	466,131	97.1
Deferred tax liabilities	53,492	53,238	100.5
Provisions	22,490	22,102	101.8
	<b>531,125</b>	<b>543,970</b>	<b>97.6</b>
<b>Current liabilities</b>			
Trade and other payables	267,620	359,799	74.4
Current tax liabilities	9,805	9,759	100.5
Financial liabilities	146,686	273,759	53.6
Derivative financial instruments	3,379	4,224	80.0
	<b>427,490</b>	<b>647,541</b>	<b>66.0</b>
<b>Total liabilities</b>	<b>958,615</b>	<b>1,191,511</b>	<b>80.5</b>
<b>Total equity and liabilities</b>	<b>1,796,277</b>	<b>2,008,412</b>	<b>89.4</b>

## Condensed income statement

EUR thousand	Plan 2012	Estimate 2011	Index Plan 2012/ Estimate 2011
Revenue			
Cost of sales	1,447,837	1,614,171	89.7
<b>Gross profit</b>	<b>(1,312,216)</b>	<b>(1,472,804)</b>	<b>89.1</b>
	<b>135,621</b>	<b>141,367</b>	<b>95.9</b>
Administrative expenses			
Other income	(66,475)	(73,261)	90.7
<b>Results from operating activities</b>	<b>7,200</b>	<b>10,403</b>	<b>69.2</b>
	<b>76,346</b>	<b>78,509</b>	<b>97.2</b>
Finance income			
Finance expense	4,806	9,525	50.5
<b>Net finance expense</b>	<b>(47,150)</b>	<b>(51,055)</b>	<b>92.4</b>
	<b>(42,344)</b>	<b>(41,530)</b>	<b>102.0</b>
<b>Profit before income tax</b>			
	<b>34,002</b>	<b>36,979</b>	<b>91.9</b>
Income tax expense			
	(6,510)	(7,396)	88.0
<b>Profit for the period</b>			
	<b>27,492</b>	<b>29,583</b>	<b>92.9</b>

## Notes to condensed financial statements

### Notes to condensed income statement

#### Sales revenue

In 2012, sales revenue of the company Poslovni sistem Mercator, d.d., will amount to EUR 1,447,837 thousand.

#### Costs of sales

Costs of sales at the company, which include the cost (purchase value) of goods sold, production costs, selling and marketing costs, and other expenses, are planned at EUR 1,312,216 thousand for 2012.

#### Gross profit

Gross profit for 2012 is planned at EUR 135,621 thousand. The planned share of gross profit in sales revenue is 9.4 percent.

#### Administrative expenses

Company administrative expenses for 2012 are planned at EUR 66,475 thousand.

#### Results from operating activities

In 2012, company result from operating activities will amount to EUR 76,346 thousand.

#### Finance income and expenses

Finance income for 2012 is planned at EUR 4,806 thousand. It mostly pertains to income from regular interest on short-term receivables and income from default interest.

Finance expenses for 2012 are planned at EUR 47,150 thousand, of which a major portion relates to interest expense on non-current liabilities.

### **Profit before income tax and net income**

In 2012, the company is planning to generate EUR 34,002 thousand of profit before income tax, with net income planned at EUR 27,492 thousand.

## **Notes to condensed statement of financial position**

### **Assets**

Mercator Group assets as at 31 December 2012 are planned at EUR 1,796,277 thousand, which is EUR 212,135 thousand less than estimated for 31 December 2011.

As at 31 December 2012, the value of Mercator Group non-current assets is planned at EUR 1,509,089 thousand, which is EUR 128,497 thousand less than the estimate for 31 December 2011. Property, plant, and equipment will represent the largest share of non-current assets at 57.2 percent (EUR 862,640 thousand), which is EUR 143,359 thousand less than the estimate for the end of 2011.

The planned value of Mercator Group current assets as at 31 December 2012 amounts to EUR 287,188 thousand, which is EUR 83,638 thousand less than at the end of 2011. Trade and other receivables will represent the largest portion of total current assets (48.6%), followed by inventory (32.9%).

### **Equity and liabilities**

As at 31 December 2012, company equity is planned to amount to EUR 837,662 thousand.

As at 31 December 2012, the value of Mercator Group financial liabilities is planned at EUR 599,363 thousand, which is EUR 140,527 thousand less than the estimate for 31 December 2011.

Provisions for other liabilities and charges as at 31 December 2012 are planned at EUR 22,490 thousand. Compared to the estimate for the end of 2011, provisions are planned to increase by EUR 388 thousand.

Trade and other payables as at 31 December 2012 are planned to amount to EUR 270,086 thousand, which is EUR 92,212 thousand less than as at 31 December 2011.