

**Business Report of the  
Mercator Group and  
the company Poslovni sistem Mercator, d.d.,  
for the period I – IX 2007**



Poslovni sistem Mercator, d.d.  
Management Board

November 2007

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## SUMMARY

### Successful operation continues in the third quarter, consistently with the business plan

**In the period from January to September 2007, Mercator Group generated EUR 1,750 million of net revenues from sales, which is 19.3 % more than in the corresponding period of 2006. Net profit of the Group in the first nine months of 2007 amounts to EUR 36.1 million.**

Excluding the revenues of the company M - Rodić, d.o.o., which was merged with the Mercator Group in the last quarter of 2006, and also excluding the revenues of the company Presoflex, d.o.o. (merged into the Mercator Group in August 2007), net sales revenues of the Mercator Group would have grown by 5.6 %. The growth of Group's net sales revenues was positively affected by successful sales abroad and in Slovenia.

Net profit of the Mercator Group in the first nine months of this year also includes extraordinary profits related to the disposal of business and financial assets. Excluding the effect of these extraordinary profits, the **comparable profit before taxes** of the Mercator Group in the period I - IX 2007 amounts to EUR 33.6 million which is 25.1 % more than comparable profit before taxes in the period I - IX 2006 (EUR 26.8 million).

As at September 30<sup>th</sup> 2007, the Group had 20,327 **employees**, of which 34.9 % were employed abroad.

From January to September 2007, Mercator Group generated EUR 115.2 million of **gross cash flow from operating activities**, which is 22.4 % more than in the same period in 2006 and represents 75.2 % of the planned figure for 2007. High growth of gross cash flow is mostly the result of the growth of sales volume and reaping the economies of scale, as well as increased business efficiency resulting from cost optimization of operations, and inclusion of the companies M - Rodić, d.o.o., and Presoflex, d.o.o., into the Mercator Group.

In the third quarter of 2007, **operations and business performance of the Mercator Group in Slovenia** was affected by several events and features.

Among those with positive effect were opening of new outlets, and refurbishment of the existing ones, efficient marketing activities, and effects yielded by the implementation of the general cost optimization project.

Among those with negative effect were further fall of profit margins due to stringent competition, and high growth of labor, energy, and transport costs, and interest rates.

In the third quarter of 2007, **operations and business performance of the Mercator Group abroad** was affected by several events and features.

Among those with positive effect were improved economics and efficiency of operations due to strategic alliances (M-Rodić, Presoflex), procurement/purchasing partnership in Croatia (Mercator-Plodine), opening of new outlets, and efficient marketing activities.

Among those with negative effect were increasingly harsh competition and pressure on the profit margins, growth of operation costs due to inflationary pressures, and high interest rate growth.

**The company management finds the business operations of the Mercator Group in the period from January to September 2007 successful, especially in view of increasingly harsh competition in all markets of our operations, high growth of interest rates, and inflation-related cost pressures. The Management Board estimates that all key objectives planned for 2007 will be attained.**

## KEY EVENTS IN THE PERIOD I - IX 2007

### CORPORATE GOVERNANCE

In period 1 - 9 2007, the Supervisory Board of the company Poslovni sistem Mercator, d.d., met four times and discussed the report on implementation of the strategic optimization projects in 2006, revision of the financing policy of the Mercator Group, report on the operations and performance of the Mercator Group and the company Poslovni sistem Mercator, d.d., in the period 1 - 3 2007, and the semiannual report on operations and performance of the Mercator Group and the company Poslovni sistem Mercator, d.d. Furthermore, the Supervisory Board discussed the Annual Report of the Mercator Group and the company Poslovni sistem Mercator, d.d., and adopted the Annual Report for 2006, Supervisory Board report on the review of the Annual Report, the opinion on the allocation of distributable profit for 2006, and the dividend policy. The Supervisory Board also adopted the new Rules of Procedure of the Supervisory Board of the company Poslovni sistem Mercator, d.d., and the criteria for evaluating the performance of the Management Board of the company Mercator, d.d., as well as assessed the emolument for the Management Board of the company Poslovni sistem Mercator, d.d., for 2006; the Supervisory Board was also presented the legal expertise to the Special Report of the auditing company Deloitte revizija, d.o.o. At its last meeting, the Supervisory Board was informed of the progress of the project of monetization of real-estate property of the Mercator Group, and postponed the final decision on the project to the end of the first quarter of 2008.

On June 27<sup>th</sup> 2007, 13<sup>th</sup> regular Shareholder's Assembly of the company Mercator, d.d., took place. Shareholders adopted the resolutions on the translation of the share capital and nominal value of shares into Euros, introduction of no par value shares, changes of the company activities, approved capital, and allocation of distributable profit, granted discharge

to the Supervisory and Management Board, assessed the emolument of the Supervisory Board and adopted the changes in the amount of attendance fee and other compensation to the Supervisory Board members. The shareholders appointed the company KPMG SLOVENIA, auditing company, d.o.o., as the company auditor for the year 2007; they were also presented the findings of the special auditor that conducted a special audit of some transactions from the last five-year period.

## DEVELOPMENT OF RETAIL NETWORK

- On January 18<sup>th</sup> 2007, a new Hura! discount store was opened in Radovljica, and a Supermarket was opened in Bovec;
- On February 14<sup>th</sup> 2007, a Beautique was opened in Mercator Center Koper;
- On March 21<sup>st</sup> 2007, a Modiana was opened in Europark in Maribor;
- On March 22<sup>nd</sup> 2007, a refurbished Mercator Center Pula was opened;
- On March 29<sup>th</sup> 2007, an extended and refurbished Modiana in Mercator Center Koper was opened;
- On March 30<sup>th</sup> 2007, a Trade center in Bohinjska Bistrica was opened;
- On April 5<sup>th</sup> 2007, a Supermarket in Radeče was opened;
- On April 11<sup>th</sup> 2007, we opened a Hura! discount store in Bučna Vas near Novo mesto;
- On May 10<sup>th</sup> 2007, we opened a specially designed Intersport store in Mercator center Čakovec;
- On May 24<sup>th</sup> 2007, we opened a refurbished hardware and electronics warehouse Novo Celje in Žalec;
- On June 29<sup>th</sup> 2007, we opened a hypermarket Rodić Megamarket, Intersport, Modiana, and Beautique drugstore in the M - Rodić shopping center in Belgrade;
- On July 11<sup>th</sup> 2007, the company Mercator-BH, d.o.o., signed with the company Euro Best-M, d.o.o., an agreement on the purchase of retail facility in Kakanj; this facility started to operate as a Mercator trade center;
- On August 23<sup>rd</sup> 2007, the Mercator center Novi Sad was opened;
- On September 8<sup>th</sup> 2007, an Intersport outlet was opened in Šibenik;
- On September 11<sup>th</sup> 2007, the Galeria Importanne supermarket was opened in Zagreb;
- On September 17<sup>th</sup>, the refurbished Hypermarket Mercator Ljubljana in Šiška was opened;
- On September 20<sup>th</sup>, the second Mercator center in the Croatian capital was opened, the Mercator Center Zagreb II;
- furthermore, we opened the extended and refurbished superette Water Tower (Vodovodni Stolp) in Kranj, supermarket Dobrna, and Cash&Carry in Levec.

## MARKETING ACTIVITIES

- In January 2007, we won the silver prize at the EFFIE competition of communication efficiency, for our advertising campaign for the private label line 'Zdravo življenje – Zdravo je pravo' ('Healthy life' – 'Healthy is the way to go'), and bronze prize for the advertising campaign for the project '5 na dan' ('Five a day').

- Consistently with Mercator's plan to maintain or improve the reputation of the Maximarket convenience store, we founded on February 1<sup>st</sup> 2007 a special club Maxi that offers our loyal customers additional benefits and services in their favorite department store, including the loyalty program.
- On February 14<sup>th</sup> 2007, we organized eighth Mercator marketing days, intended to meet the business partners of the Mercator Group; on March 30<sup>th</sup> 2007, the traditional meeting with all financial partners of the Mercator Group was held.
- As of March, the '**M – srečka**' ('M - Lottery Ticket') was introduced; the product was prepared in cooperation with the Sports Lottery.
- In April, we extended Mercator's offer with the service M Holidays which includes offering tourist arrangements, prepared in cooperation with the tourist agency Kompas. Each month, a hypermarket flyer and an 'M holidays' flyer are prepared to point out at least three tourist arrangements offered by the M holidays, and the benefits for the Mercator Pika card holders and others. In October edition of the flyer, M holidays offer for the fall holidays (usually a week of holidays at the end of October / beginning of November) was presented.
- As a socially accountable company, we started to include the Fair Trade products into the assortments offered in our major trade centers. In six outlets (hypermarkets Ljubljana, Koper, Nova Gorica, Kranj Primskovo, Celje, and Maximarket), 78 various Fair Trade products are offered (cosmetics, dry program, and fruit). We are currently preparing for the extension of the assortment offered (starting in the Ljubljana hypermarket). Special stands and aisles were installed to draw attention to the project; in May and September it was additionally supported by promotions and presentations at points of sale.
- As of July, the Mercator Pika **business card** was launched, providing a simple and favorable payment method to **corporate entities, individual entrepreneurs, societies, and other institutions** for their shopping at Mercator outlets in Slovenia. By function, the Mercator Pika business card can be either a **debit** or **credit** card, as well as a customer benefit card with a special loyalty benefit scale / schedule.
- In August, the **one millionth Mercator Pika card holder** was included in the Mercator Pika card system.
- In Mercator hypermarkets in Celje, Koper, Maribor - Pobrežje, Nova Gorica, Slovenj Gradec, Novo mesto, and Ljubljana, self-service cashiers called 'Tic-Tac' were installed; these cashiers allow the customers to carry out the check-out by themselves.
- New customer loyalty programs were also developed in foreign markets. In May, the program 'Chic' was launched in Croatia and Bosnia and Herzegovina; in Serbia, customer loyalty program in cooperation with the local supplier Metalac was introduced.
- On September 17<sup>th</sup>, the first part of the shopping center Mercator Ljubljana was opened. Internal TV station was set up for the first time in the Ljubljana hypermarket, as were the info stands. A new line of juices called **Five a day O.K. (Smoothy)** was launched, as well

as a line of traditionally produced high-quality products, called '**Five a day Premium**'. Upon the opening, a special opening catalogue was launched; the opening was also supported by extensive communication in the press.

- In September, we responded to the prices increases for elementary aliments by launching the project **Stop the inflation!**. A basket of elementary aliments with the lowest total price in the market was offered; the prices of the products in the basket were either retained at previous levels, or even decreased. Products included in the project were labeled appropriately at points of sale with distinctive signs.
- The project of **revision or establishment of unified Mercator corporate websites and Mercator Pika card websites** in all markets of Mercator's operations was successfully completed.

## STRATEGIC ALLIANCES

On May 21<sup>st</sup> 2007, the owner of the Croatian trade company Presoflex, d.o.o., the company Poslovni sistem Mercator, d.d., and the company Mercator - H, d.o.o., signed an agreement on strategic alliance between the companies Presoflex, d.o.o., and Mercator - H, d.o.o.; the alliance was completed on July 18<sup>th</sup> 2007. Thereby, the companies Poslovni sistem Mercator, d.d., and Mercator - H, d.o.o., became 100 % owners of the company Presoflex, d.o.o. Mercator paid for a part of the purchase price with own shares from the treasury shares fund, in compliance with the authorization of the Shareholder's Assembly. Thus, the selling party received 21,525 MELR shares at a price of EUR 334.51 per share, which corresponds to the average market price per MELR share in June 2007. By forging this strategic alliance, Mercator's market share in Croatian market rose to approximately 6 %. This strategic alliance is consistent with the pursuit of Mercator's growth strategy and the ambition to attain the position of the leading FMCG retailer in Southeastern European region.

## ISSUE OF NEW SECURITIES

Based on the decision dated December 28<sup>th</sup> 2006, the Ljubljana Stock Exchange included on January 3<sup>rd</sup> 2007 the 174,517 newly issued shares, issued for the purpose of partial payment of the 76 % share in the company M - Rodić, d.o.o., into the stock market listing. The number of Mercator shares being traded on the Ljubljana Stock Exchange thus amounts to 3,765,361.

## CHANGE IN EQUITY

Consistently with the resolution adopted at the 13<sup>th</sup> Shareholders Assembly of Mercator, d.d., the change in company equity was duly entered into the Court Register on July 12<sup>th</sup> 2007. The equity of the company Mercator, d.d., thus amounts to EUR 157,128,514.53; it is divided into 3,765,361 ordinary registered no par value shares.

## CHANGE IN THE ORGANIZATIONAL STRUCTURE OF THE MERCATOR GROUP

Consistently with the strategy of focusing on its core activity, i.e. FMCG retail, the company Poslovni sistem Mercator, d.d., disposed on September 19<sup>th</sup> of its 100 % ownership share in the company M-Hotel, d.o.o., active in the field of catering and hotel services.

The company Poslovni sistem Mercator, d.d., is currently studying the option to acquire appropriate strategic partners for the companies M-Emba, d.d., and Eta, d.d.; however, no decisions have been adopted on the matter thus far.

## KEY INFORMATION FOR THE SHAREHOLDERS

As at September 30<sup>th</sup> 2007, the average price per share of the company Poslovni sistem Mercator, d.d., as traded in the regular official market of the Ljubljana Stock Exchange, d.d., with the code MELR, amounted to EUR 370.00.

**Share book value**, calculated as the ratio between the value of the equity of the company Poslovni sistem Mercator, d.d., as at September 30<sup>th</sup> 2007, and the weighted average number of ordinary shares in the period at hand, excluding treasury shares, amounts to EUR 176.90.

**Basic net earnings per ordinary share**, calculated as the ratio between net profit of the company Poslovni sistem Mercator, d.d., and weighted average number of ordinary shares in the period at hand, excluding the treasury shares, amounts to EUR 6.50.

## KEY EVENTS FOLLOWING THE BALANCE SHEET DATE

After the end of the accounting period 1 - 9 2007, the following major events affected the operations of the Mercator Group:

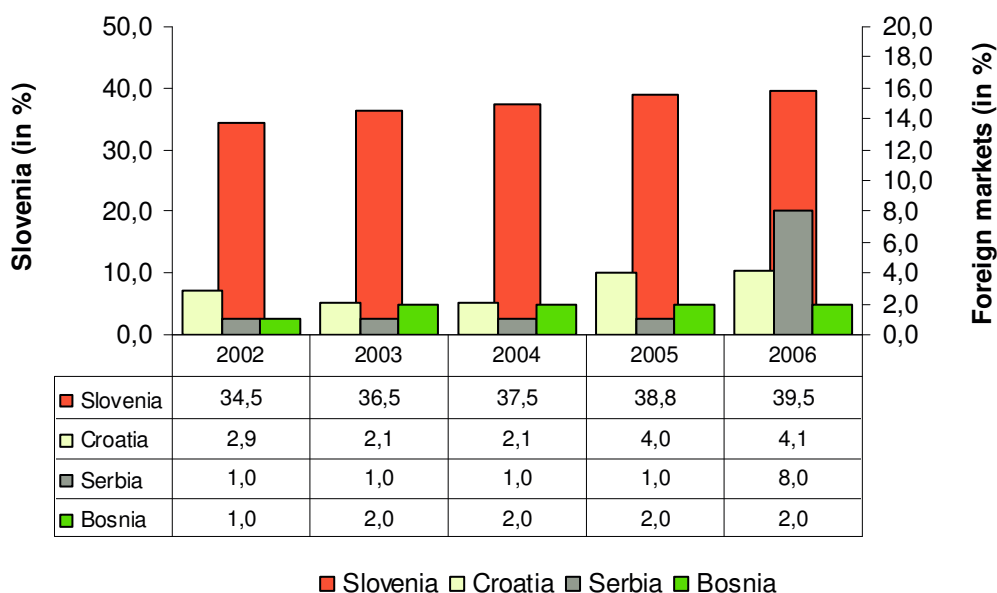
- In the second half of October 2007, a new retail facility called **Maxi ambient** was opened in the Maximarket passageway. The facility is introducing a new sales format offering products for the home and home ambiance; by presenting a combination of furniture and selected accessories for the home, these outlets provides pleasant shopping atmosphere and offers numerous ideas for decorating your house or apartment.
- This year's **central humanitarian campaign** which presents annually the culmination of Mercator's efforts in the spirit of social accountability is being carried out in cooperation with over 1,300 Mercator's business partners. Our attention was drawn to the fact that there are only 14 sets of magnetic resonance (MR) equipment in operation in Slovenia, and decided to donate funds to the new Neurological Clinic of the University Medical Center for new MR tomography equipment. Activities have been under way throughout the fall; the value of donation is approximately EUR 1.4 million, of which one half will be donated by Mercator, while the remaining half will be contributed by its partners.
- On October 19<sup>th</sup> 2007, **Mercator center Rijeka** was opened in Croatia, with total area of 11,766 square meters.

## FINANCIAL HIGHLIGHTS FOR THE PERIOD I - IX 2007

Mercator Group					
	1 - 9 2006	Plan 2007	1 - 9 2007	Index 1-9 07 / 1-9 06	Index 1-9 07 / plan 07
Net sales revenues (in EUR 000)	1,466,145	2,338,722	1,749,704	119.3	74.8
Operating profit (in EUR 000)	45,750	81,463	58,783	128.5	72.2
Profit / loss before income tax (in EUR 000)	29,692	43,798	44,738	150.7	102.1
Profit for the financial period (in EUR 000)	21,343	30,436	36,121	169.2	118.7
Comparable profit before income tax (in EUR 000)	26,871	40,053	33,624	125.1	83.9
Comparable profit for the financial period (in EUR 000)	19,512	28,209	27,726	142.1	98.3
Gross cash flow from operating activities (in EUR 000)	94,139	153,093	115,196	122.4	75.2
Capital expenditure (in EUR 000)	108,470	202,282	89,781	82.8	44.4
Long - term financial investments (in EUR 000)	1,347	0	40,370	2,997.5	-
Return on equity*	5.2%	4.9%	7.5%	143.4	152.2
Return on sales	1.5%	1.3%	2.1%	141.8	158.8
Gross cash flow from operating activities / sales	6.4%	6.5%	6.6%	102.5	101.3
Number of employees based on hours worked	16,533	19,363	19,099	115.5	98.6
Number of employees as at the end of the period	17,399	20,683	20,327	116.8	98.3

\*The indicator is adjusted to represent projected annual level.

## MARKET SHARES BY MARKETS / COUNTRIES – MARKET PROGRAM



Market share for Slovenia is determined based on Mercator's empirical estimation. Due to methodological restrictions, the existing survey "Slovenian Trade" only accounts for relative market shares among individual major retailers, while failing to provide reliable estimations of absolute market shares.

## COMPANY PROFILE

Full name	Poslovni sistem Mercator, d.d.
Abbreviated name	Mercator, d.d.
Activity	G 52.110 Retail in non-specialized food retail outlets
Identification number	5300231
VAT Tax Code	45884595
Court registry number	1/02785/00
Court registry date	October 12 <sup>th</sup> 1995
Company share capital as at September 30 <sup>th</sup> 2007	EUR 157,128,514.53
Nominal value of one share	EUR 41.73
Number of shares quoted at the Ljubljana Stock Exchange as at September 30 <sup>th</sup> 2007	3,765,361
Share listing	Ljubljana Stock Exchange, official market, prime market, trading code MELR
President of the Management Board & CEO	Žiga Debeljak
Management Board Members	Vera Aljančič Falež, Mateja Jesenek, Peter Zavr
Chairman of the Supervisory Board	Robert Šega
Deputy chairman of the Supervisory Board	Kristjan Sušinski

## COMPOSITION AND ORGANIZATION OF THE MERCATOR GROUP

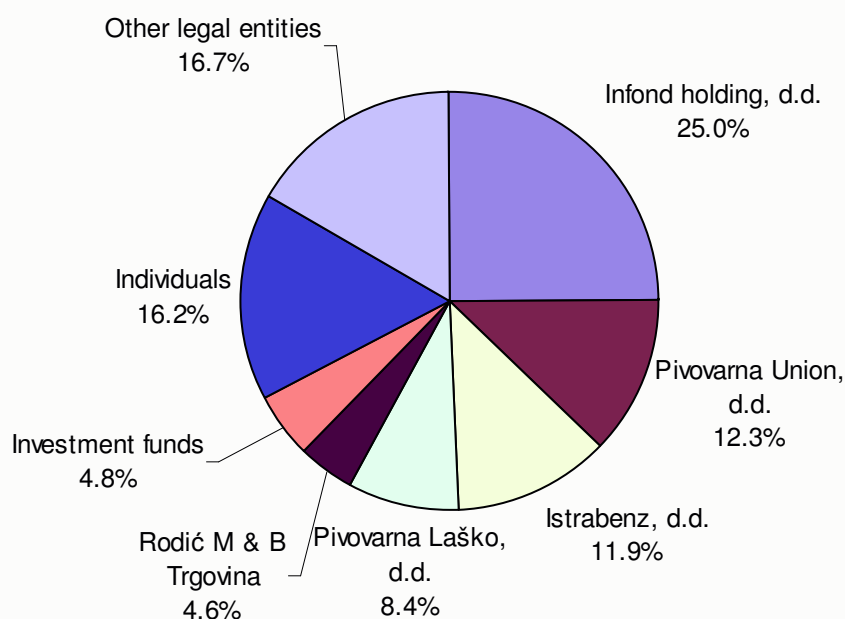
December 31 <sup>st</sup> 2006	September 30 <sup>th</sup> 2007
<b>TRADING COMPANIES IN SLOVENIA</b>	
Poslovni sistem Mercator, d.d.	Poslovni sistem Mercator, d.d.
M.COM, d.o.o. (100.0 %)*	M.COM, d.o.o. (100.0 %)*
<b>TRADING COMPANIES IN FOREIGN MARKETS</b>	
M - H, d.o.o., Hrvaška (99.9 %)	M - H, d.o.o., Croatia (99.9 %)
	- Presoflex, d.o.o., Croatia (100.0 %)
M - S, d.o.o., Srbija (100.0 %)	M - S, d.o.o., Serbia (100.0 %)
M - Rodić, d.o.o., Srbija (76.0 %)	M - Rodić, d.o.o., Serbia (76.0 %)
M - BH, d.o.o., Bosna in Hercegovina (100.0 %)	M - BH, d.o.o., Bosnia and Hercegovina (100.0 %)
Mercator Makedonija, d.o.o., Makedonija (90.0 %)	Mercator Makedonija, d.o.o., Macedonia (100.0 %)
<b>NON – TRADING COMPANIES</b>	
Pekarna Grosuplje, d.d. (79.9 %)	Pekarna Grosuplje, d.d. (97.5 %)
- Belpana, d.o.o., Hrvaška (100.0 %)	- Belpana, d.o.o., Croatia (100.0 %)
Eta, d.d. (97.3 %)	Eta, d.d. (97.3 %)
M - Emba, d.d. (76.8 %)	M - Emba, d.d. (97.1 %)
M - Optima, d.o.o. (100.0 %)	M - Optima, d.o.o. (100.0 %)
M Hotel, d.o.o. (100.0 %)	

\* The company was founded in 2006, but it has not yet commenced its operating activities.

## COMPANY OWNERSHIP STRUCTURE

On September 30<sup>th</sup> 2007, the Share Register of the company Poslovni sistem Mercator, d.d., indicated 17,223 shareholders or 26 more compared to the situation as at December 31<sup>st</sup> 2006.

As at September 30<sup>th</sup> 2007, the ownership structure of the company Poslovni sistem Mercator, d.d., was as follows:



### Major shareholders

As at September 30<sup>th</sup> 2007, the following ten largest shareholders combined owned 71.31 % of the company:

	Shareholder	Country	Number of shares	Ownership share
1	Infond Holding, d.d.	Slovenia	941,301	25.00%
2	Pivovarna Union, d.d.	Slovenia	464,390	12.33%
3	Istrabenz, d.d.	Slovenia	448,797	11.92%
4	Pivovarna Laško, d.d.	Slovenia	317,498	8.43%
5	Rodić M & B Trgovina	Serbia	174,517	4.63%
6	Radenska, d.d., Radenci	Slovenia	96,952	2.57%
7	Smallcap World Fund	USA	69,933	1.86%
8	KLM Naložbe, d.d.	Slovenia	61,490	1.63%
9	East Capital Balkan Fund	Sweden	57,320	1.52%
10	NFD 1 Delniški investicijski sklad, d.d.	Slovenia	52,973	1.41%
<b>TOTAL</b>			<b>2,685,171</b>	<b>71.31%</b>

## Foreign shareholders

As at September 30<sup>th</sup> 2007, the share of foreign investors in the company Poslovni sistem Mercator, d.d., amounted to 14.35 %, which is 0.95 percentage points more than at the end of 2006.

## CORPORATE GOVERNANCE

### Management Board

Management Board of the company Poslovni sistem Mercator, d.d., consists of the President and three board members who assumed their respective five-year terms on January 1<sup>st</sup> 2006.

As at September 30<sup>th</sup> 2007, members of the Management Board owned the following number of company shares:

Name and surname	Number of shares	Ownership share
Žiga Debeljak	1,100	0.02921%
Vera Aljančič Falež	30	0.00080%
Mateja Jesenek	1,000	0.02656%
Peter Zavrl	60	0.00159%
<b>TOTAL</b>	<b>2,190</b>	<b>0.05816%</b>

### Supervisory Board

As at September 30<sup>th</sup> 2007, Supervisory Board of the company consisted of ten members. The following table shows the number of Mercator shares and the total share of the company owned by individual members of the Supervisory Board of the company Poslovni sistem Mercator, d.d.

	President of the Supervisory Board	Number of shares	Ownership share
1.	Robert Šega	0	0.00000%
	Members of the Board (representatives of capital)		
2.	Matjaž Božič	0	0.00000%
3.	Dušan Mohorko	0	0.00000%
4.	Kristjan Sušinski	0	0.00000%
5.	Mateja Vidnar	0	0.00000%
	Members of the Board (workers representatives)		
6.	Ksenija Bračič	0	0.00000%
7.	Jože Cvetek	2,000	0.05312%
8.	Dragica Derganc	0	0.00000%
9.	Jelka Žekar	400	0.01062%
10.	Ivica Župetič	0	0.00000%
	<b>TOTAL</b>	<b>2,400</b>	<b>0.06374%</b>

# BUSINESS REPORT

## BUSINESS STRATEGY OF THE MERCATOR GROUP

### Vision

**To be the leading retail chain with FMCG program (market program) in Southeastern Europe.**

### Mission

Our business is aimed at creating:

- benefit for customers,
- benefit for employees,
- benefit for suppliers,
- benefit for owners,
- benefit for wider environment.

### Corporate values

- We are bound by trust and mutual respect.
- Nobody understands customer preferences better than us.
- Our operations are diligent and transparent in each moment and at all levels.
- We are expanding with solid corporate culture.

### Strategic policies

- Remain the largest retailer in Slovenia;
- Become leading retailer on neighboring markets of SE Europe: in Croatia, in Serbia, and in Bosnia and Herzegovina;
- Enter other SE Europe markets on long-term;
- Develop non-market programs;
- Provide profitability of business operations.

### Strategic objectives

- Growth of net revenues from trading operations in the annual average of 5 % (organic growth without partnerships).
- Target market quotas until the year 2010:
  - Slovenia 40 %,
  - Croatia 12 %,
  - Serbia 10 %,
  - Bosnia and Herzegovina 5 %,The said market shares include growth by strategic alliances and partnerships.

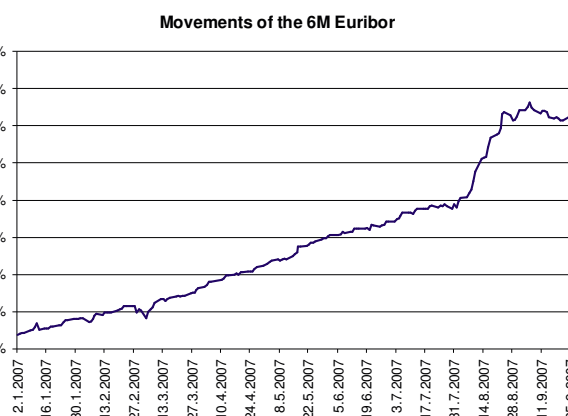
- Investments: EUR 130 - 150 million per year.
- Improve business performance and boost efficiency.

Detailed explanations regarding the business strategy and plans of the Mercator Group can be found in the Mercator Group Annual Report for the year 2006 and in the Mercator Group Business Plan for the year 2007. Both documents have been published on the electronic dissemination information system of the Ljubljana Stock Exchange, d.d., called SEOnet, and on the company website at [www.mercator.si](http://www.mercator.si).

## IMPACT OF ECONOMIC CONDITIONS ON BUSINESS OPERATIONS IN THE PERIOD 1 - 9 2007

Economic conditions in the period 1 - 9 2007 had a positive effect on Mercator's performance in all markets of the company's operations as high economic growth fueled consumption, particularly in non-alimentary segments. Among the aspects that adversely influenced company operations were high growth of interest rates, increased level of competition, and inflation-related cost pressures. In the last quarter, high prices of agricultural products in world markets led to increased inflationary pressure and raising prices by the suppliers.

The period 1 - 9 2007 also saw high growth of the European inter-bank offered interest rate – Euribor. Six-month Euribor rose by 0.9 percentage point in the first nine months of 2007, causing additional increase in variable interest rates. In August 2007, the USA mortgage market crashed. The effects of the crash also affected major European banks as the European Central Bank (ECB) was forced to



provide a large sum of additional financial assets to support liquidity of commercial banks. This was one of the reasons why the ECB did not raise the key interest rate in the beginning of September 2007. Regardless of increasing inflationary pressures in the Euro zone, international pundits estimate that the ECB will not raise interest rates until the end of 2007.

In 2007, **Slovenia** successfully adopted euro as its national currency, which will positively affect further economic development. In 2006, average annual rate of inflation amounted to 2.5 %; for 2007, the inflation is estimated to amount to 3.4 %. Slovenian economic growth in 2006 amounted to 5.2 %, and the analysts expect the growth to accelerate even further in 2007, to reach 5.8 %. Main generators of high economic growth are strong investment dynamics and growing exports. Favorable conditions in the labor market and partly the new personal income tax legislation affected the real growth of private consumption in this year.

In the beginning of 2007, **Croatia** resumed its negotiations on accession to the European Union; however, final decision on the date of entry into the EU has not been set yet. Croatian political arena is gradually preparing for the parliamentary elections that are to take place by

the end of November 2007. In 2006, GDP growth rate amounted to 4.8 %; for 2007, the analysts predict higher economic growth than in the year before, as Croatia retained considerably high domestic demand and investment dynamics. In the first three quarters of 2007, the intra-annual economic growth amounted to as high as 8.6 %. Average annual inflation in 2006 amounted to 3.2 %, but is expected to fall below 3 % again in 2007.

After several months of negotiation, **Serbia** got a new government in May 2007. The delay in formation of the new government brought the implementation of structural reforms and privatization of strategically relevant companies to a halt. Fiscal and monetary policy have been consistent thus far; fiscal policy in particular has been restrictive and the government is expected to carry on with such policy. Real GDP growth in 2006 amounted to 5.7 %, mainly fueled by the service sector. Growth forecast for 2007 is even higher by a margin, as it has been calculated at 6.5 %. The main generator of economic growth is domestic demand and high export rate. Average rate of inflation in 2006 was 11.7 %; at the end of 2006, it amounted to 6.6 %. With the assumption that fiscal and monetary policy remain at least as restrictive as in 2006, deceleration of inflation is expected to continue, possibly reaching 5.8 % at the end of 2008.

In early 2007, **Bosnia and Herzegovina** carried on its preparations for privatization of national companies, attracting great interest of the international stock market investors. Due to last year's elections and lengthy post-election negotiations on the formation of new government left the reforms in a standstill for a while. Bosnia and Herzegovina still has not managed to sign the important Stabilization and Association Agreement with the European Union; such agreement would positively affect the country's further development. Despite numerous political, economic, and social problems, progress is discernible in the country. In 2006, economic growth amounted to 6.2 %, while the forecasts for 2007 are aimed even slightly higher.

## DEVELOPMENT AND INVESTMENT ACTIVITIES

### Capital expenditure

In the period 1 - 9 2007, capital expenditure of the Mercator Group amounted to EUR 89,781 thousand, which is 44.4 % of total planned annual amount of capital expenditure; of this amount, EUR 48,396 thousand (53.9 %) were invested abroad. Major share of total investment was allocated for the construction of shopping centers.

Country	Investment 1-9 2007 (EUR thousand)	Composition (in %)
<b>Slovenia</b>	<b>41,385</b>	<b>46.1</b>
Total investment within trade operations	40,316	44.9
Total investment within non-trade	1,069	1.2
<b>Croatia</b>	<b>17,938</b>	<b>20.0</b>
<b>Bosnia and Herzegovina</b>	<b>3,668</b>	<b>4.1</b>
<b>Serbia</b>	<b>26,790</b>	<b>29.8</b>
<b>Total</b>	<b>89,781</b>	<b>100.0</b>

## SLOVENIA:

- On March 30<sup>th</sup> 2007, **Trade Center Bohinjska Bistrica** was opened, operating in the ground floor of a commercial-residential building. The Trade Center has a total area of 1,517 m<sup>2</sup> and it includes 92 outdoor parking lots. It comprises a supermarket, a Modiana, and four outlets leased to select supplementary service providers.
- On September 17<sup>th</sup> 2007, the first stage of extension and refurbishment of the **Mercator center Ljubljana** was completed. In cooperation with a specialized agency, a new concept was developed for the hypermarket, based on emphasized offer of fresh programs and merging of particular categories into departments, intended for target customers. Simultaneously with the hypermarket, 26 leased outlets were reopened in the zone next to it and in its vicinity.
- Opening of other facilities:
  - opening of a supermarket in Bovec,
  - opening of a Hura! discount store in Radovljica,
  - opening of a Modiana in Europark Maribor,
  - opening of a Beautique and an extended and refurbished Modiana in Mercator center in Koper,
  - opening of a supermarket in Radeče,
  - opening of a Hura! discount store in Novo mesto - Bučna vas,
  - opening of the refurbished hardware and electronics warehouse Novo Celje in Žalec,
  - opening of an extended and refurbished superette Water Tower (Vodovodni stolp) in Kranj,
  - opening of a supermarket Dobrna,
  - opening of a Cash & Carry center in Levec.

## FOREIGN MARKETS:

- On June 29<sup>th</sup> 2007, a Rodić Megamarket, Intersport, Modiana, and a Beautique were opened in the **shopping center M - Rodić in Belgrade**.
- In Bosnia and Herzegovina, **trade center Kakanj** was purchased from the company Eurobest; on July 16<sup>th</sup> 2007, commercial activity was commenced in this facility. The center includes a hypermarket, a restaurant, and four outlets leased to providers of supplementary offer.
- On August 23<sup>rd</sup> 2007, **Mercator center Novi Sad** was opened in Serbia. The two-storey facility has a total area of 22,028 square meters. The basement and ground floor include 499 parking spaces. The center includes a hypermarket, Intersport, a textile outlet Fashion Avenue (Avenija mode), a Beautique drugstore and perfume shop, a restaurant, and a café. The remaining area includes 63 outlets leased to various providers of supplementary offer.

- On September 20<sup>th</sup> 2007, **Mercator center Zagreb II** was opened. As indicated by the name of the facility, this is Mercator's second shopping center in the Croatian capital. The center is located in a commercial and residential building and it has a total area of 6,783 square meters. Program mix is offered in a hypermarket, Intersport, Modiana, café, and 11 outlets leased to supplementary offer providers.
- Opening of other facilities:
  - the second stage of refurbishment of the MC Pula was completed (opening took place on March 22<sup>nd</sup> 2007);
  - inclusion of an Intersport outlet in MC Čakovec (opened on May 10<sup>th</sup> 2007);
  - refurbishment of hypermarket and outlets to be leased, and rearrangement of MC Split;
  - opening of an Intersport outlet in Šibenik (opened on September 8<sup>th</sup> 2007);
  - opening of supermarket Galerija Importanne in Zagreb (opened on September 11<sup>th</sup> 2007);
  - opening of supplementary offer outlets in the premises of the discontinued furniture outlet in MC Tuzla.
- On October 19<sup>th</sup> 2007, **Mercator center Rijeka** was opened. The facility has a total area of 11,766 square meters, and a basement with 446 parking spaces, with additional 74 parking spaces outdoors. The center includes a hypermarket, Intersport, Modiana, a café, and 27 outlets leased to providers of supplementary offer.

By the end of 2007, opening of the refurbished passage of the Maximarket department store in Ljubljana is planned, as well as opening of the extended and refurbished MC Ljubljana (2<sup>nd</sup> stage), trade center (TC) Sevnica, MC Koper, MC Ptuj II ('Super-City' – Super mesto), TC Inđija, extended and refurbished supermarket Vojkova in Ljubljana, and some other facilities, as planned.

### **Investment into available-for-sale financial assets**

Mercator Group's investment into available-for-sale financial assets in the period 1 - 9 2007 amounted to EUR 40,370 thousand; they relate to the purchase of ownership share in the company Presoflex, d.o.o., additional purchase of minority interest in subsidiaries Mercator - Emba, d.d., and Pekarna Grosuplje, d.d., and other acquisitions.

## MARKETING

### Foundations of long-term marketing strategy

Mercator Group's marketing strategy is based on the development of high-quality and price competitive offer upgraded by a high level of service. Thus we create added value for our customers as we offer them products and services that contribute to improvement of the quality of their leisure time, an aspect that is increasingly important in contemporary lifestyle. We are continuously monitoring the wishes and preferences of our customers and we direct

our efforts towards their satisfaction, hence winning their trust and loyalty to the Mercator Group.

Mercator Group strives to provide the following for its customers:

- ❑ **The best offer of fresh products**
  - daily best offer of fruit and vegetables at the most favorable prices,
  - focus on all fresh program categories,
  - offer of wholesome, healthy products, and
  - offer of ready-made products.
  
- ❑ **The most interesting and fashionable offer of non-alimentary products**
  - offer of impulse products, and
  - attractive offer of products for the home and pleasant ambiance.
  
- ❑ **The most interesting offer of seasonal products**
  - favorable shopping for the most interesting season-related products.
  
- ❑ **Innovative offer of products and services**
  - development of new technologies,
  - development of new store formats, and
  - development of supplementary services: M Mobil, M Holidays, clubs, customer loyalty programs, and new partners.

### Customer Relationship Management

Mercator Pika card holders by countries as at end of September 2007:

Mercator Pika card holders	Slovenia	Croatia	Serbia	BH	Total
As at 30 <sup>th</sup> September 2007	731,487	152,371	66,101	68,741	1,018,700
Share in total retail sales in the period 1 - 9 2007	48.65%	31.18%	26.14%	35.85%	39.76%*

*\*Note: the data in the table does not include revenues of the company M - Rodić, d.o.o., where Mercator Pika card was introduced as of October 2007.*

**In the period 1 – 9 2007, the following activities were successfully carried out in the field of customer relation management:**

- ❑ With regard to **Mercator Pika card** we carried out two Pika Days upon the completion of the 16<sup>th</sup> and 17<sup>th</sup> customer benefit period, respectively; monthly sales promotion activities for the Mercator Pika card holders, which proved successful in Slovenian market were also carried out abroad. We also included new contract partners into the Mercator Pika card system, namely Terme Dobrna (a spa resort), Mestna Optika Ljubljana (Optician's), Lion Style (Urko shops), and footwear manufacturer Alpina.
  
- ❑ as a sign of our gratitude, the **Golden Mercator Pika card** holders were invited in June to a summer pre-clearance sale with a 30 percent discount; in September, they were

offered an opportunity to award two green payment-credit card holders with a personal recommendation, thus providing them the golden card. Golden Mercator Pika card holders were also offered free subscription to the magazine 'Moje finance' for six months, and 15 percent fall discount for clothing and footwear. In September, 5,037 existing Green Mercator Pika card holders were invited to apply for the Golden Mercator Pika card, as their purchases totaled over EUR 3,500, whereby they have proven their loyalty to Mercator and acquired the right to apply for the Golden Mercator Pika card.

- In February 2007, we founded the **Maxi Club** and developed a customer loyalty program for the club members. We also launched the website [www.klubmaxi.si](http://www.klubmaxi.si), enabling subscription for the e-news. By September 30<sup>th</sup>, 4,658 Mercator Pika card holders had joined the club. In addition, **automatic monthly creation of loyalty coupons** was introduced for the Maxi Club members; these coupons are created based on past purchases in the Maximarket convenience store.
- As of July, the Mercator Pika business card was launched, enabling a simple and favorable method of payment at Mercator outlets in Slovenia to **corporate entities, individual entrepreneurs, societies, and other institutions**.
- Extension of the **Mercator web store** included extending the Mercator web store Celje to the wider environment of the city, which took place in April, and commencement of preparations for the introduction of units in Kranj and Zagreb. **In the period 1 – 9 2007, Mercator web store saw a 91.2 % growth of sales compared to the same period last year.**
- The project of **redesigning** or setting up **Mercator corporate portals and Mercator Pika card websites** was successfully completed in all markets of Mercator's operation.
- With regard to the 'M mobil' **club**, new services were introduced as of February 1<sup>st</sup>, as a part of the strategy to relate the 'M mobil' project with the trade / FMCG offer – "More on the line, more on pika". This is intended to communicate the introduction of the 'M mobil' bonus system that will be linked to the sum spent on 'M mobil' account. In May, sales-info points were opened in Mercator centers Ljubljana and Kranj-Primskovo. In Koper, the 'M mobil' stand was opened in September.
- Activities related to the **Healthy Living** club included several prize competitions. As the June edition of the Healthy Living magazine was issued, the manual coupons were discontinued as they were replaced by automatic recognition of products with discounts for the Healthy living club members at the cashier. The website at [www.uzivajmozdravo.si](http://www.uzivajmozdravo.si) was also revised; the website keeps the club members up to date with club-related contents.

## Development of private label lines

### SLOVENIA

- In the period from January to September 2007, we actively undertook the redesign of packaging for the **Mercator Line** products. As at end of September 2007, the line comprised 512 products, of which 255 already featured redesigned packaging. In March, **M – Lottery Ticket** (M - srečka) was introduced in Mercator's aisles; it was prepared in cooperation with the Sports Lottery. We also carried out a sales promotion campaign of the Mercator private label, which included a flyer presenting all private labels under the Mercator brand.
- We also commenced the activities of redesigning the **Total Body Care** line (Popolna nega), in order to raise the quality and the price segment of the product line and to endow it with an image of a distinctive line of products for body care. At the end of September 2007, the line included 74 products.
- In February 2007, we made a final decision to introduce a new line that will replace and upgrade the **M-line (M – linija)**. This is the **Ambient** line (Ambient) which will include products for the home. The line also features a new comprehensive graphic image and will be related to the new sales format called Home ('Dom'). As at end of September, the Ambient line included six products. Simultaneously, the cancellation of M-line has started, which also involves relocation of particular products; at the end of September 2007, the number of products in the line was down to 92.
- At the beginning of the year, we concentrated a lot of our efforts on the revision of the **Lumpi** line (products for children aged up to 6), in order to make it more friendly for both children and parents. As at end of September 2007, 210 products were included in the line. Lumpi took part in various events, and we also made arrangements with the Ljubljana Zoo to enable our customers the purchase of entry tickets to the Zoo by Mercator Pika card at Mercator hypermarkets. In September, we carried out for the third consecutive year the extensive educational campaign "Safe Way to School"; this year, the campaign was focused on raising the awareness of parents and children about the daily way to school. Activities were also carried out at various sports and cultural events.
- At the end of September 2007, the line **Wishing Table** (Mizica pogrni se!) included 123 products. Upon the introduction of new products, we also 'refreshed' the packaging. In October, the sales promotion campaign "Wishing Table's Advice" ("Mizica, svetuj!") was launched.
- With regard to the **Healthy Living** line (Zdravo Življenje) we started the adjustment of declarations to the new European regulations. In April, we carried out an extensive promotion campaign with the key message "Do Something Good for Yourselves", and in September we sponsored the Europa Dona running competition, The World Day of Heart, and provided samples for tasting. At the end of September 2007, the line included 75 products.

- Due to increased demand for organic products, we decided to include them in all existing lines of our private label. Hence, we developed the **EKO** symbol. Currently, 26 products are labeled with the Eco symbol.
- The goal of the new **generic line** (generična linija) is to offer the most favorable shopping in the market. In March, marketing of this line took place, and the products were also presented on the private label flyer. At the end of September 2007, the line included 33 products.
- With regard to development of Mercator private label line products, we are also developing the project '**Five a day - let some color into your life**' ('**5 na dan – obarvajmo življenje**') aimed at promotion of fruit and vegetables consumption among our customers. In January, we carried out an extensive marketing campaign in order to boost fruit and vegetables sales, which involved handing out presents to our customers, according to the total of the receipts they had collected. Furthermore, an offer of juices **5 a day O.K. ("Smoothie")** was developed, as well as a line of traditionally produced high-quality products, called "**Five a day Premium**"; this line was launched upon the opening of the refurbished hypermarket Ljubljana in September.

As at end of September 2007, a total of **1,577** products were included in the Mercator private label line in Slovenian market, of which 198 had been newly developed in the period from the beginning of the year. In Slovenian market, products of the Mercator private label line accounted for nearly 12.4 % of total retail sales in the period 1 - 9 2007.

**Products of the Mercator private label line are also being developed in all foreign markets of Mercator's operations.**

Number of products and share of Mercator private label line product sales in total retail revenues in foreign markets as at September 30<sup>th</sup> 2007

	Number of products	Share of sales
Croatia	415	2.91 %
Serbia	522	1.09 %
Bosnia and Herzegovina	600	2.38 %

### Sales promotion projects

Among the projects that were carried out in Slovenia in the period 1 - 9 2007 are "**Every Day Low Price**" (Trajno nizka cena), "**Exclamation Mark!**" (Klicaj!), and "**Slovenian basket**" (Slovenska košarica). As of the end of June 2007, we started to revise the projects Exclamation Mark! and Every Day low Prices in order to combine them in a single project called 'Every Day Low Prices'. At the end of September, the project included 933 products.

Short-term activities included **regular campaigns**, **hypermarket campaigns**, and **cash & carry** campaigns. We stepped up the focus on **weekend campaigns** that were also revised

in June; their offer is based on fruit and vegetables. Sale of fruit and vegetables is also promoted with the project '**Vitamin of the Day**' (Vitamin dneva) which takes place every week from Tuesday to Wednesday.

In **Hura!** discount stores we carried out several regular and one opening campaign in the period from January to September 2007. Campaigns rounded in currently relevant topics are also backed by Hura! news. Weekend campaigns that are aimed at promoting the sales of fresh products are backed by advertisements in Slovenske novice daily paper.

Sales promotion projects were also carried out in non-market programs:

- **Hardware and electronics program:** we carried out regular and specialized campaigns, as well as campaigns related to Mercator projects 'M mobil' and Healthy Living, and the hypermarket campaigns related to particular themes.
- **Textile and beauty program:** in the field of textile, we carried out a post-season clearance sale and other season-related activities, sent a spring and fall letter to our best customers, and offered the service of fashion consulting. In addition, we organized spring and fall Fashion Event in Maribor and Ljubljana. In Beautique perfume and drugstores, we carried out regular campaigns, make-up days, and customer loyalty activities based on collecting the stamps for bonuses. We are also preparing monthly attractive offer for the Maxi Club members.
- **Intersport:** regular campaigns and winter and summer clearance sales were carried out; we issued program guides for running, roller-blade skating, trekking, and cycling, and we set up the redesigned and revised web portal. We were also among the sponsors of the event Jure Košir Ski Legend, we co-organized and sponsored the events Hit Cup & INTERSPORT Ski Test 2007, Žogarija ("Play Ball!") 3 on 3, National Championship for elementary school pupils in cross-country running, and Cherry marathon, and we were the general sponsor of the Kranjska Gora Ten (Kranjskogorska desetka), Andrejček running competition, and traditional Charge on Vršič (Juriš na Vršič).

The campaign '**YES! Coupon**' was carried on. In this campaign, the customers who purchase products in the amount of EUR 50 or more on any Tuesday, receive a 'YES! Coupon' which entitles them to discount at shopping on the following Tuesday. In Serbia, we also carried on the project "Kupon Utorak" ("Coupon on Tuesday"), in order to improve the price competitiveness of the MC Beograd and MC Čačak.

We also carried out the **Chic customer loyalty program** that was extended to April 30<sup>th</sup> 2007 due to its popularity; on April 5<sup>th</sup> 2007, we launched a new customer loyalty program with the slogan '**Collect, enjoy, and live comfortably**' which ended at the end of September. In October, new customer loyalty program will be launched, called '**Collect and select!**'

From June 18<sup>th</sup> 2007 to September 9<sup>th</sup> 2007, **prize contest "We are getting a car in Mercator..."** took place. Twelve customers selected by a draw, who submitted in time their prize coupons with corresponding stickers which they obtained upon purchases in alimentary /FMCG stores or in regular campaign flyers, were presented an automobile Opel Corsa which they are entitled to use for two years.

In September, we responded to the prices increases for elementary aliments by offering a basket of elementary aliments with the lowest total price in the market. The project was called **Stop the inflation!**, and the basket comprises products whose prices were either retained at previous levels, or even decreased.

Sales promotion activities that have proven successful in Slovenia, within all sales programs, are also being carried out in foreign markets. In 2007, we focused in all markets primarily on improving price competitiveness and localization of all marketing approaches. We carried out long-term and short-term projects. Among the more notable ones were Tognana and Chic in Croatia and in Bosnia and Herzegovina, and customer loyalty program in cooperation with the supplier Metalac in Serbia.

## CATEGORY MANAGEMENT AND SUPPLIER RELATIONS

### Category management

In the period 1 - 9 2007, we carried on our category management activities. We worked with our key suppliers ("category captains") and prepared measures to improve on-the-aisle economics for some categories of the market program.

The measures were first implemented in pilot hypermarkets; then, implementation of the first and second wave of categories was extended to the supermarket sales network. The measures include improvements in the field of assortment choice and layout of the products in the aisles (introduction of 'planograms' in hypermarkets and supermarkets). Implementation of measures is structurally monitored, and the challenges are being tackled and overcome along the way.

Due to the transition to active category management, organization was also adapted to the process. Standard model of organization was prepared for the executive fields of market, textile, and hardware and electronics, with straightforward control and decision-making processes, and clearly defined tasks and responsibilities. In the executive field of market program, operations have already been revised to correspond to the new organization; in the executive fields of hardware and electronics, and textile, organization is still being harmonized.

To monitor the results of the implemented measures, automated and structured method of key performance indicator monitoring was introduced at the level of particular categories.

With regard to the improvement of conditions for the private label products, a purchasing / procurement team in charge of tenders / calls for applications was appointed, and the process was modernized and harmonized. Starting from the most relevant to the least relevant categories of private labels, demand queries are sent to current and new potential product suppliers, and supplier negotiations are conducted. With some categories, new contracts with improved conditions have already been signed; these will come into force as of the end of this year, when pro products of new suppliers will be introduced in the aisles.

## Procurement of trade goods and supplier relations

In the period 1 - 9 2007, cooperation with the suppliers was based on

- establishment of mutual relations based on the principles of category management concept (objectifying the business relations),
- increasing benefit or efficiency for both partners, based on costs reduction and improvement of productivity (reducing packaging, activities for introduction of half-pallets etc.), and
- marketing healthy and safe food and products.

We demand from our suppliers that their assortment is marketable and appealing, and adjusted to the requirements of a contemporary consumer. In line with the category management concept, new products were introduced into the assortment (system of distributors was introduced); furthermore, the new products were optimized from the aspect of their contribution to total sales and margin, and appropriate measures of pricing policy, promotion policy, and positioning in the aisles / at the point of sale were carried out. Particular attention was paid to the assortment of target categories, with emphasis on the fresh programs. Further activities of increasing purchases from common and global purchasing sources were carried out.

More emphasis was allocated to creating innovative sales promotion activities that are especially oriented towards marketing the products from target categories (e.g. fruits and vegetables, fresh programs, non-alimentary products), and other long-term projects, such as 'Every Day Low Prices', Slovenian Basket, and private labels. In addition, efforts were made to increase the number of products in the private label project as one of the company's key strategic projects in all markets of its operations.

Agreements made with our suppliers for this business year were carried out in our outlets. Particular attention was paid to business relations with suppliers in foreign markets, particularly to optimization of our transactions (improvement of purchasing conditions through negotiations) with suppliers in Croatia and Serbia.

At the end of September, negotiations with suppliers for the following business year were commenced.

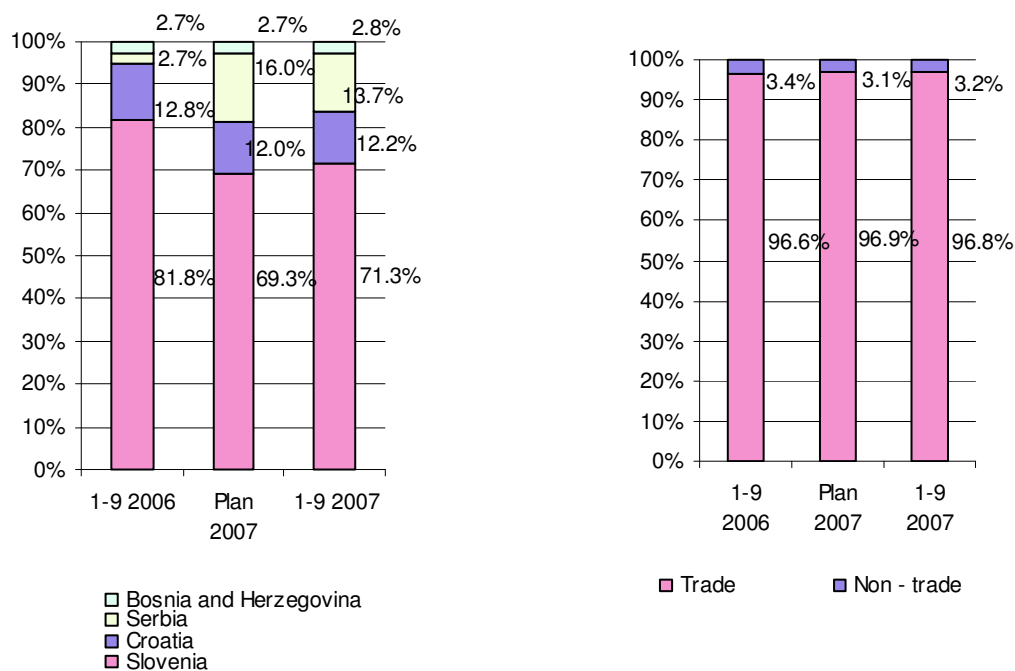
## SALES AND STORE FORMATS

### Mercator Group

In the period 1 - 9 2007 Mercator Group realized EUR 1,749,704 thousand of net sales revenues, which is 19.3 % more than the corresponding period last year and represents 74.8 percent of the planned figure for the year 2007.

Within the trading segment, Mercator Group realized 96.8 % of net sales revenues, of which 71.3 % were made in Slovenia and 28.7 % were made abroad.

## Net sales revenues for the Mercator Group by branches and regions



In the period 1 - 9 2007 trading companies in Slovenia recorded nominal increase in sales revenues of 3.5 % compared to the same period last year, which is mainly the consequence of successful marketing activities and opening of new and refurbished retail outlets.

Trading companies abroad recorded in the period 1 - 9 2007 a nominal increase in net sales revenues of 88.9 % compared to the same period last year, which is mostly the result of integrating the business of the company M - Rodić, d.o.o., in the last quarter of 2006, and the company Presoflex, d.o.o., as of August 1<sup>st</sup> 2007, into the Mercator Group.

Without the integration of the company M - Rodić, d.o.o., and Presoflex, d.o.o., into the Mercator Group, the increase of net sales revenues for the Mercator Group would have been 5.6 %.

## Structure of retail units

Structure of retail units of the Mercator Group by the type of shops, particular selling programs, and by particular markets as at September 30<sup>th</sup> 2007:

ACTIVITY	Slovenia	Croatia	Serbia	BiH	Mercator Group		
	Number of units				No. of units	Gross sales area (in m <sup>2</sup> )	Net sales area (in m <sup>2</sup> )
Hypermarkets	18	12	9	4	43	234,229	147,284
Supermarkets	124	26	20	2	172	194,743	124,269
Superettes	305	50	18	-	373	154,035	87,753
Neighborhood stores	92	23	5	1	121	19,966	10,724
Cash & Carry	10	-	-	-	10	16,414	11,068
Hard discount stores	15	-	-	-	15	11,696	8,751
<b>TOTAL FMCG programme</b>	<b>564</b>	<b>111</b>	<b>52</b>	<b>7</b>	<b>734</b>	<b>631,084</b>	<b>389,850</b>
<b>Technical programme</b>	<b>117</b>	<b>13</b>	<b>2</b>	<b>-</b>	<b>132</b>	<b>156,343</b>	<b>82,467</b>
Technical programme	82	11	-	-	93	117,265	53,393
Furniture programme	35	2	2	-	39	39,078	29,074
<b>Clothing programme and drugstores</b>	<b>98</b>	<b>29</b>	<b>6</b>	<b>5</b>	<b>138</b>	<b>50,648</b>	<b>42,052</b>
Clothing programme	81	29	4	4	118	48,077	40,037
Drugstores and perfumeries	17	-	2	1	20	2,572	2,016
Intersport	26	14	2	4	46	22,618	17,507
Restaurants	26	17	4	9	56	16,813	9,806
<b>TOTAL specialised programmes</b>	<b>267</b>	<b>73</b>	<b>14</b>	<b>18</b>	<b>372</b>	<b>246,422</b>	<b>151,832</b>
<b>TOTAL</b>	<b>831</b>	<b>184</b>	<b>66</b>	<b>25</b>	<b>1,106</b>	<b>877,506</b>	<b>541,682</b>
Franchise stores	203	32	-	-	235	43,868	28,282
<b>TOTAL with franchise stores</b>	<b>1,034</b>	<b>216</b>	<b>66</b>	<b>25</b>	<b>1,341</b>	<b>921,374</b>	<b>569,964</b>

Note: The table also comprises retail units of the company Presoflex, d.o.o.; strategic alliance with this company was completed on July 18<sup>th</sup> 2007.

## Development of new technologies in Mercator outlets

### Type A hypermarket (hypermarket Ljubljana)

In September 2007, following a refurbishment, Mercator hypermarket in Ljubljana resumed its operation. The hypermarket is a case of implementing a completely novel concept that was developed in cooperation with the renowned agency JosDeVries.

Hypermarket is aimed at the most demanding customers as it offers them pleasant, attractive shopping environment, with extensive choice of quality goods at affordable prices.

Apart from rational pricing, the emphasis is targeted at the following aspects:

1. Rich and high-quality offer – particularly within the fresh program, some categories of the dry program (e.g. winery, organic food program), cosmetics, products for the home, etc.;
2. Care for health and ecological awareness – demand for the offer focusing on quality, freshness, no-additive nutrition etc., particularly within the fresh program;
3. Comfortable shopping and desire for education – customers with affinity for novelties and technological equipment of points of sale.

Considerable emphasis is also given to attractive, pleasant, colorful, and versatile shopping environment created by carefully designed and decorated shopping ambiance.

**Modern technological equipment** in particular departments endows the hypermarkets with a sense of contemporaneity.

- setting-up self-check-out cashiers,
- setting up the info stands,
- setting up advertisement displays that communicate to the customers the information on daily benefits, special offers, and other messages, etc.

In addition to the features listed above, we enriched our offer with a wide array of additional services that represent Mercator's major competitive edge over other retailers.

#### Comfort shop (Importanne Gallery)

In September, a comfort shop was opened in the renowned trade center Importanne Gallery in the center of Zagreb; by type, such outlet is a of super-standard FCMG retail unit. It is primarily aimed at customers with above-average shopping demands, as they:

- expect comfort during shopping – due to their stringent and stressful daily schedule, these customers tend to seek increasingly more comfort in their leisure time;
- are aware of the importance of healthy and safe nutrition – pronounced care for healthy nutrition affects shopping decisions;
- appreciate multiculturalism – the consumer is in contact with foreign cultures and has experience with ethnic cuisines, which increases the demand for this type of aliments.

Target group of customers are those belonging to the middle to higher income class and seek different, innovative, and attractive offer.

#### Introduction of self-check-outs in Mercator retail units

Following a positive response by the customers, the introduction of self-check-outs was carried; hence, these were installed in five more hypermarkets. By the end of the year, introduction in three more hypermarkets in Slovenia is planned, as well as hypermarket in Rijeka which will be the first hypermarket in Croatia to offer such equipment. Customer response to using the self-check-outs are very favorable in all hypermarkets, as these check-outs account for an average of 15 percent of total purchases, in some hypermarkets even more.

#### Introduction of info-stands in Mercator outlets

Mercator was the first Slovenian retailers to introduce info stands in retail outlets. These stands offer customers completely new, high-quality service that provide added value which improves customer satisfaction when shopping in Mercator.

Info-stands were installed in three specialized departments where the sales personnel lack professional knowledge and experience for consulting on products, while the categories are defined as target categories of vital importance for our customers: winery, fruit and vegetables, and fresh meat.

The info stands employs touch screen displays to enable the customers to browse for detailed information on particular products. One of the key functions of the stand is also the display of recipes for particular dishes which can be either printed at the stand, or sent to desired address by e-mail.

#### Development of new services in Mercator

The opening of the refurbished hypermarket in Ljubljana introduced some additional services aimed to create value added for the customers who demand and expect more when shopping. Considerable emphasis is placed on the offer at fresh program departments, particularly fruit and vegetables (preparation of ready-cut or chopped vegetable and fruit salads, fresh juices, etc.) and the culinary island with a 'warm meal station' (preparation of various types of dishes).

In cooperation with an external service provider, Mercator also started introduced **photography services** which are offered at the acoustics department, as a part of the 'photo corner'. Customers can now order and collect their photos at the point of sale, or produce their own photos at the 'photo stand'. Furthermore, customers will be offered the option to place their orders via internet and collect the photos at selected Mercator outlet.

Another feature introduced upon the opening of the refurbished hypermarket in Ljubljana was the service called '**Recipe of the week**' which is intended primarily to facilitate our customers' decisions on what to prepare for lunch. Thus, Mercator teamed up with expert Mr. Oseli to prepare the recipe of the week, along with a complete offer of products required to prepare the dish. The project is complemented with a live demonstration directly at the point of sale, while the customer can also taste the dish once it is prepared.

Added value for our customers at the Ljubljana hypermarket is also provided by new offer of products for the connoisseurs – the so-called **gourmet corner**. The offer of the gourmet corner comprises select specialties from across the globe.

## LOGISTICS

In the period 1 - 9 2007, we continued to provide quality logistics services for all entities of the system that require them. Major changes were introduced in the processes of order processing. In addition to the control of order completion, delivery, and agreed delivery schedules, the level of goods deliverability, punctuality of delivery, and employment / usage of logistics capacities for carrying out the daily scope of tasks were monitored on daily basis.

Implementation of four strategic projects for improving competitiveness also included further execution of **logistics infrastructure optimization project**; the following activities were among the major ones in this period:

#### In Slovenia:

- Integration and consolidation of warehouses:
  - discontinuation of refrigerated goods warehouse in Nova Gorica and redirection of supply to refrigerated goods warehouse in Zalog;

- preparation of documentation for setting up the reloading station for the Primorska region at the Sermin location;
  - preparation of documentation for moving the fruit and vegetables warehouse in Maribor to the location Bohova and releasing the current location to enable the construction of a C&C;
  - termination of the rental of paper warehouse.
- Activities for construction of the Mercator Logistic Center (MLC):
- Two providers offering the most favorable and appropriate technological solutions were selected for the final round of the selection process. Analyses of projects offered were conducted, and the first round of negotiations has been completed.
  - Study on geotechnical and hydro-geological features of the land lot was conducted.
  - Physical planning agreement between the Domžale municipality and the company ICJ, d.o.o., is being prepared for the construction of sanitary facilities in Želodnik.
- Transition of inventory replenishing units from organizational structure of program sectors to the organizational structure of logistics, and implementation of computer support for automatic inventory replenishment (pilot implementation at DC Slovenčeva).

In foreign markets:

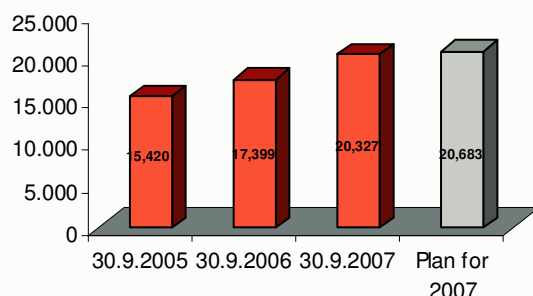
- Activities for unifying and harmonizing the logistic operations of the Mercator Group: in Croatia and in Serbia, activities were carried out in order to harmonize the methodology and criteria for providing the logistics services in these areas in such way that the logistics of the Mercator Group will be uniformly developed from the same starting points.

## HUMAN RESOURCES

### Number of employees

At the end of the third quarter of 2007, 20,327 employees were employed in the Mercator Group, of which 34.9 % were employed in foreign markets. The company Poslovni sistem Mercator, d.d., employed 12,646 people or 62.2 % of all employees of the Mercator Group. Compared to the end of 2006, the number of employees in the Group rose by 4.0 %.

Mercator remains the largest employer in the region. In the third quarter of 2007, the company was recruiting new employees for the new Mercator centers and other retail units planned for opening.



Number of employees by companies of the Mercator Group:

	No. of employees as at 31 December 2006	No. of employees as at 30 September 2007	Planned no. of employees as at 31 December 2007	Plan realisation of no. of employees as at 30 September 2007 (in %)	No. of employees based on hours worked in 1 - 9 2007
Poslovni sistem Mercator, d.d.	12,957	12,646	13,079	96.7	12,089
<b>Trade in Slovenia</b>	<b>12,957</b>	<b>12,646</b>	<b>13,079</b>	<b>96.7</b>	<b>12,089</b>
Mercator - H, d.o.o.	2,484	2,765	2,547	108.6	2,308
Presoflex, d.o.o.		528		-	100
Mercator - S, d.o.o.	512	720	751	95.9	743
M - Rodič, d.o.o.	2,300	2,396	2,988	80.2	2,634
Mercator - BH, d.o.o.	596	676	628	107.6	588
Mercator Makedonija, d.o.o.	0	0	0	-	0
<b>Trade abroad</b>	<b>5,892</b>	<b>7,085</b>	<b>6,914</b>	<b>102.5</b>	<b>6,373</b>
<b>Total trade</b>	<b>18,849</b>	<b>19,731</b>	<b>19,993</b>	<b>98.7</b>	<b>18,462</b>
Pekarna Grosuplje, d.d.	246	241	248	97.2	246
Belpana, d.o.o.	0	0	0	-	0
Eta, d.d.	235	218	225	96.9	209
Mercator - Emba, d.d.	121	118	125	94.4	117
Mercator - Optima, d.o.o.	37	19	41	46.3	19
M Hotel, d.o.o.	51	0	51	-	46
<b>Total non - trade</b>	<b>690</b>	<b>596</b>	<b>690</b>	<b>86.4</b>	<b>637</b>
<b>Total Mercator Group</b>	<b>19,539</b>	<b>20,327</b>	<b>20,683</b>	<b>98.3</b>	<b>19,099</b>

Average age of the employees in the Mercator Group is 39.4 years; 70.9 % of all employees are female. In the company Poslovni sistem Mercator, d.d., average age of the employees amounts to 41.6 years, and the share of women is 74.9 %.

### Staff turnover

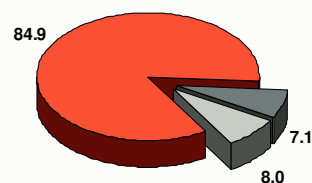
In the first three quarters of 2007, staff turnover in Mercator Group amounted to 9.2 % and rose by 1.7 percentage point compared to the period 1 - 9 2006. Highest rates were recorded non-trade activity (16.6 %), followed by Serbia (15.5 %), Croatia (10.8 %), and Bosnia and Herzegovina (10.5 %). Staff turnover was lowest in trade activity in Slovenia, amounting to 6.6 %. Staff turnover was highest among sales and warehouse personnel.

2,853 workers were newly employed in the Mercator Group, of which 569 were employed in the company Poslovni sistem Mercator, d.d. 2,065 employees left the Group, of which 896 were from the parent company.

### Composition by education and type of work

Average education level is increasing every year. In the Mercator Group, the first education group (1<sup>st</sup> to 3<sup>rd</sup> level education) accounted for 1,618 employees or 8.0 percent of all employees; the second group (employees with 4<sup>th</sup> and 5<sup>th</sup> level education) included 17,261 employees or 84.9 percent, and the third group (employees with 6<sup>th</sup> or higher level of education) included 1,448 employees or 7.1 percent of the total number of employees.

Educational structure in Mercator Group as at 30 th September 2007



In the company Poslovni sistem Mercator, d.d., the first education group comprised 1,100 employees, or 8.7 %, the second group

comprised 10,687, or 84.5 %, and the third group comprised 859, or 6.8 % of all employees.

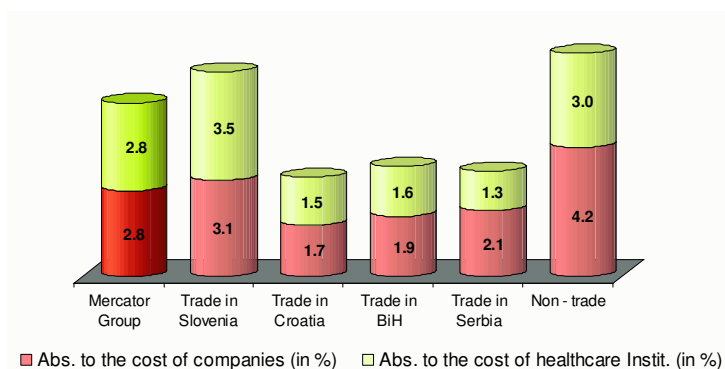
Among the employees there were 80.5 percent of sales personnel and other operative employees management (operative, middle, and top) accounted for 10.4 percent, while support functions included 9.1 percent of employees (of which 3.7 percent were experts and 5.4 percent were allocated to administrative tasks).

### **Employment of the disabled**

Mercator employs 930 disabled persons; 881 of them are employed in the parent company. The share of disabled employees in the parent company amounts to 7.0 %, which is 5.0 % above the quota stipulated by the disabled persons employment system for trade industry (2.0 %).

### **Absenteeism**

In the period 1 - 9 2007, total level of sick leave absenteeism in the Mercator Group amounted to 5.6 %, of which 2.8 % was to the cost of companies and 2.8 % was to the cost of healthcare institutions. Sick leaves of all employees combined amounted to 1,675,375 hours, of which 824,773 hours were to the cost of companies and 850,602 hours were to the cost of healthcare institutions.



In Poslovni sistem Mercator, d.d., total level of sick leave absenteeism amounted to 6.6 percent, of which 3.1 percent was to the cost of the company, and 3.5 percent was to the cost of the Healthcare Institute. Sick leaves of all employees combined amounted to 1,292,784 hours, of which 605,972 hours was to the cost of the company, and

686,812 hours was to the cost of the Healthcare Institute.

In the period 1 - 9 2007, 815 female employees of the Mercator Group were on maternity leave, and 90 male employees were on paternity leave.

## **ORGANIZATION AND QUALITY OF OPERATIONS**

In the period 1 - 9 2007, activities related to organization and quality of operations were focused on the development of organizational structures, rationalization of business processes and standards of operation, and prevention of any discrepancies:

- We unified the organization of trade companies in foreign markets. We introduced new standards for determining the minimum and correction number of service providers for business units and entered any changes into the register of organizational units, keeping it up to date at all times. We also took part in the

revision of the compensation system and updating of the work post catalogue. We are actively involved in the maintenance of the document collection on Mercator Standards.

- External assessments of the ISO 9001 quality management system were carried out in the companies Poslovni sistem Mercator, d.d., and Mercator - H, d.o.o. Spring and summer part of the internal assessment were also conducted. Based on the findings, corrective measures were initiated. We developed an application for electronic management of councils that is being implemented as a pilot for the council of the Management Board and other councils.
- We conducted internal controls in business units, coordinated inspection examinations and goods withdrawal, and carried out training. We took part in the finalization of the Guidelines of Sound Hygienic Practice based on the principles of the HACCP system in fresh meat and fish departments, which were adopted and confirmed in July 2007 by the Management Board of the Slovenian Chamber of Commerce. The new guidelines have been implemented at butchery departments, and we are setting up our own microbiological sampling program that depends on quantity of minced meat produced in advanced, and the quantity of prepared meat products in individual units. We are also setting up a new system of checking the valid documents of the aliment safety system which will also include the new documents for our own internal control in catering and in butcheries.

In the period 1 - 9 2007, performance of the **strategic project of general operations optimization** of the Mercator Group included improvement of efficiency and reduction of operating costs:

- We completed the development and worker training for tools that enable more accurate planning of flexible work time allocation in retail outlets, automatic generation of orders in retail outlets and in procurement department, and introduction of warehouse management system and transport route planning system.
- In operation of the market program retail units, the introduction of flexible allocation of working hours yielded in over 30 % of the outlets, in combination with other retail measures implemented, the planned increase in outlet productivity.
- In the system of centralized procurement / purchasing of non-trade goods and services, optimization of processes and settings for the newly introduced SAP information system were carried out. Thus, we established the initial stage for rationalizing the operations with non-trade goods and services. The largest purchasing groups were introduced to the methodology of managing non-trade goods and services procurement based on determining the procurement profile and selection of purchasing strategies, selection of suppliers and integration with them, and constant improvement of processes.

Consistently with the strategic project of redesigning the IT system, activities were carried out in the period 1 - 9 2007 in the following key areas:

➔ **revision of the IT system (PIS)**

- In the field of support functions, we started to employ as of January 1<sup>st</sup> 2007 the IT solution SAP, and carried out the transition to euro. New software solution has been introduced in all planned segments, i.e. accounting, controlling, and finance; furthermore, the introduction of the SAP IT solution is carried on in the field of human resource management and investment management.
- Within the material operation project we completed the project business model and prepared the implementation time schedule. According to the plan, the software solution G.O.L.D. will have been implemented and put into operation by December 2009, in all trade companies of the Mercator Group.

➔ in the **field of IT support to projects of general operations optimization in the Mercator Group**, we introduced the IT support for automatic preparation / compilation of the order proposition in market retail units, and IT support for planning the flexible working time allocation in outlets - FDS:

- in the **field of IT support to management and decision-making**, the data warehouse of material operation and CRM was extended and upgraded (inclusion of Mercator - H, d.o.o., and clubs Healthy Living and Maxi);

➔ in the field of **IT support to logistics** we upgraded the IT support for transport rout planning (RPS) and paperless operation in warehouse (WMS), introduced a system for compiling orders by employing distributors, and implemented, as a pilot project, the automatic ordering system in Mercator - H, d.o.o.

➔ in the field of **IT support to retail** we carried on the unification and harmonization of IT support to retail, introduction of 'tic tac' self-check-out cashiers (in a total of six retail units), carried on the development and upgrading of IT support to retail in all markets, consistently with the marketing campaigns (Mercator Pika business card, season sale tents, sales corners SiMobil M Mobil, discounts for the Healthy Living club members, etc.);

- in the field of **infrastructure and safety**, the transition of data warehouse to the new platform was carried out, and the Citrix environment was extended (Mercator-BH, d.o.o.);

➔ in the field of **teamwork and electronic operation**, we introduced an (e-)bulletin and e-councils, and included new suppliers to the computer data exchange system (a total of 197 suppliers are included).

In the company M - Rodić, d.o.o., the harmonization of IT support for retail and wholesale was completed in compliance with the standards of support to the companies of the Mercator Group in new markets.

## FINANCIAL OPERATIONS

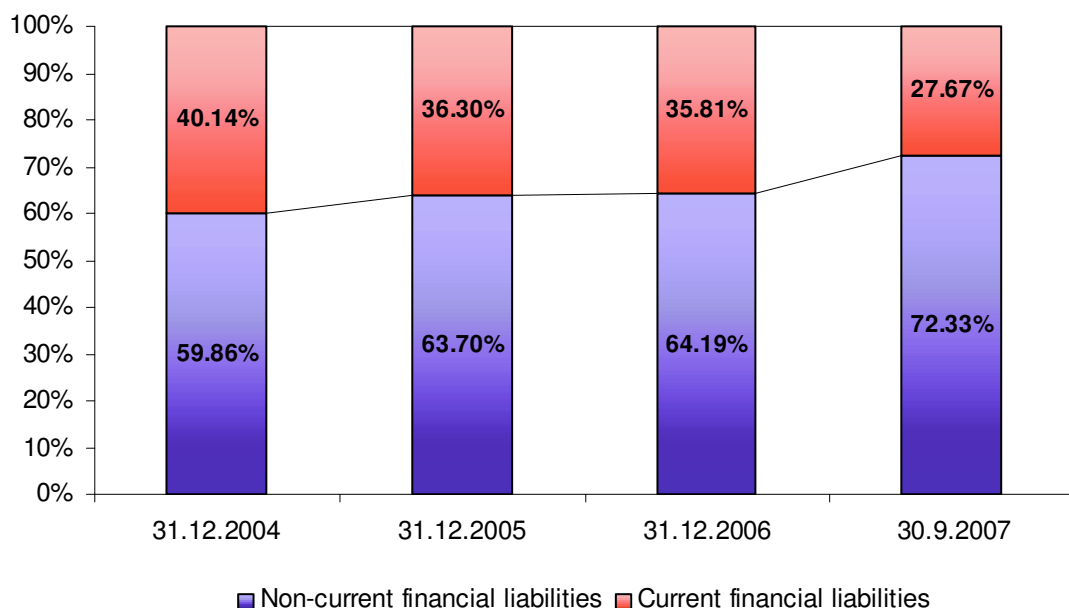
Financial liabilities, including liabilities from financial lease, fell by 1.96 % in the Mercator Group in the first nine months of 2007 compared to the end of 2006; this is primarily the result of revised policy of current liability management in 2007, and the dynamics of investment projects.

As at September 30<sup>th</sup> 2007, the Mercator Group reached the capitalization ratio of 1 : 1.14 (this ratio was 1 : 1.21 at the end of the year 2006) between share capital which includes balance sheet share capital and provisions for other liabilities and charges, and debt capital which includes non-current and current financial liabilities and non-current liabilities from financial lease.

As at September 30<sup>th</sup> 2007, the long- term coverage of non-current assets with non-current liabilities for the Mercator Group amounted to 88.0 %, which is an improvement compared to the end of 2006, when the coverage was 85.7 %.

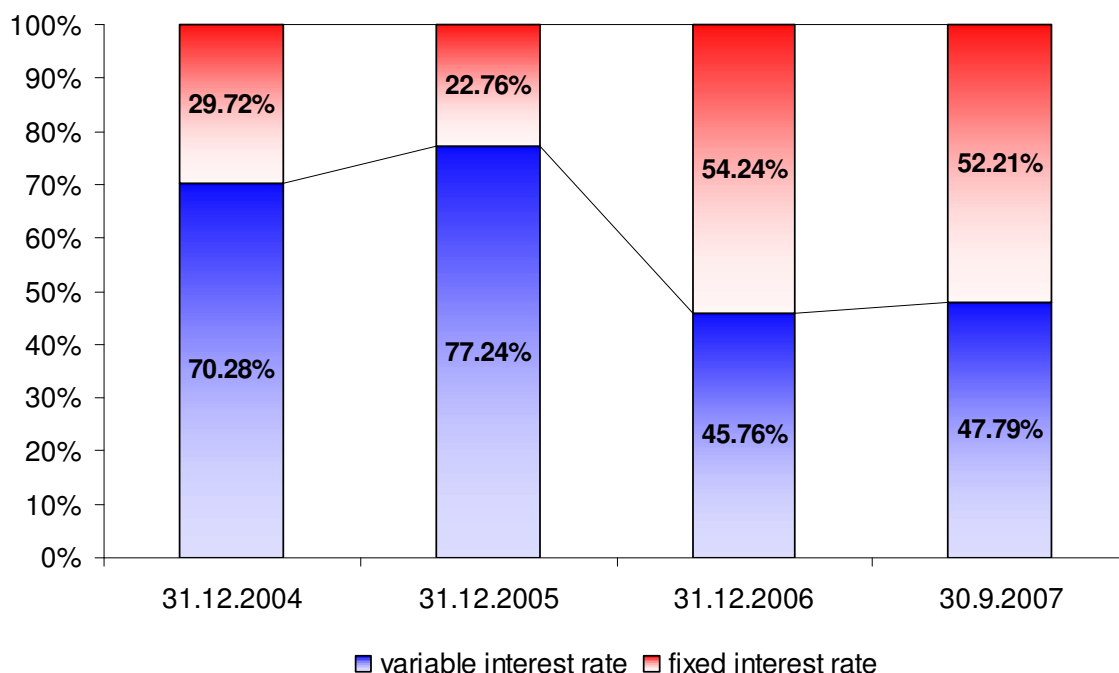
The share of non-current financial liabilities in total financial liabilities as at September 30<sup>th</sup> 2007 amounted to 72.3 %, while current financial liabilities represented the remaining 27.6 percent; this indicates a slight increase in the share of non-current financial liabilities in total financial liabilities, compared to the end of 2006.

Ratio between current and non-current financial liabilities of the Mercator Group



In the recent years, the company mostly signed agreements with variable interest rate, while borrowing at fixed interest rate, particularly with current financial liabilities. As the last two years have seen a considerable growth in variable interest rates, we protected a part of Mercator's financing liability portfolio already in 2006, in the sum of EUR 350 million, by employing interest rate swaps and free interest rate collars.

Ratio between variable and fixed or hedged financial liabilities of the Mercator Group



In the period 1 - 9 2007, Mercator granted both long-term and short-term bilateral loans for financing new investment activities, as well as for refinancing the existing sources. During this period, we also signed three agreements on financial lease for the facilities of MC Rijeka, MC Pobrežje, and TC Nove Jarše, in the total value of EUR 34.2 million.

## SHAREHOLDER RELATIONS

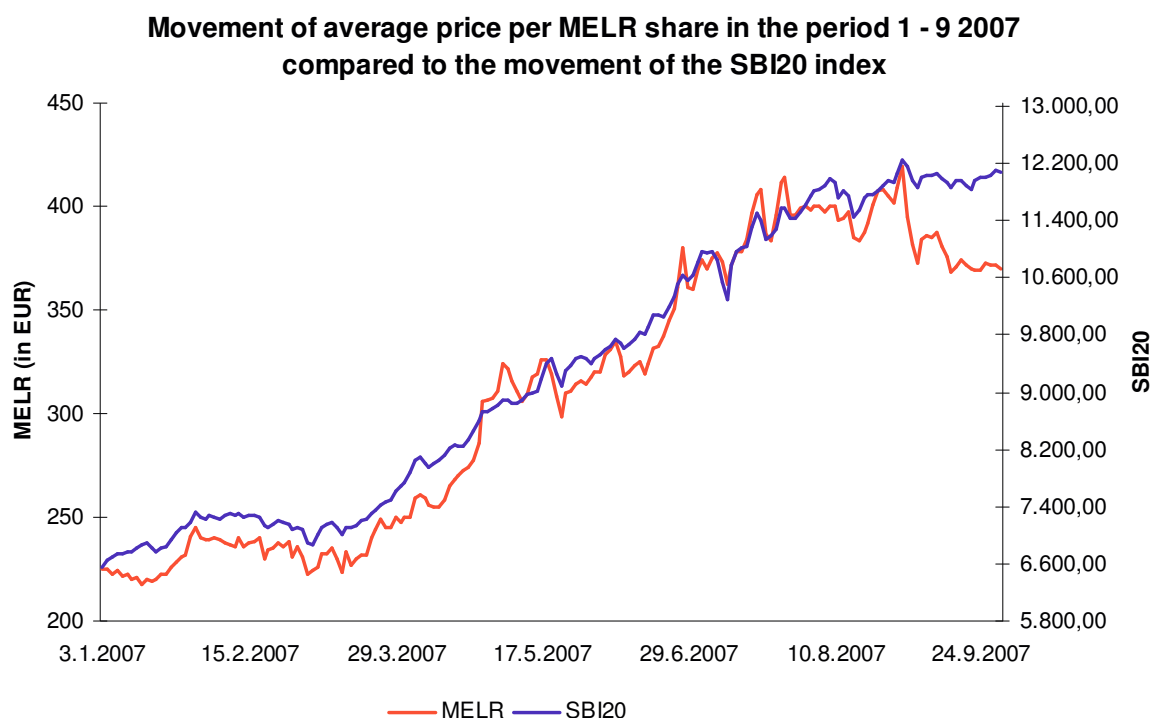
### Key Information for the Shareholders

Shareholder information	30.9.2007
Number of shares registered in Court Register	3,765,361
Market capitalization as of 30th September 2007 (in EUR)	1,393,183,570
Market value per share as at 30th September 2007(in EUR)	370.00
Book value per share as at 30th September 2007 (in EUR)	176.90
Annual low (in EUR)	217.82
Annual high (in EUR)	419.00
Weighted average market price, excluding block and cross traders (in EUR)	315.76
Earnings per share (in EUR)	6.50

## Mercator Share

Share capital of the company Poslovni sistem Mercator, d.d., as at September 30<sup>th</sup>, was divided into 3,765,361 shares. They are listed on the prime market of the Ljubljana Stock Exchange, d.d., under the trading code MELR.

Movement of average price per MELR share in the period 1 - 9 2007, compared to the movement of the SBI20 index:



## Dividend Policy

Supervisory Board of the company Poslovni sistem Mercator, d.d., adopted at its regular meeting held on April 17<sup>th</sup> 2007 the company dividend policy for the period 2007 - 2010. Based on the newly adopted dividend policy, the Supervisory Board and the company Management Board proposed to the Shareholder's Assembly in the years 2007 - 2010 the payment of dividend in the following sums: EUR 4.00 per share in 2007, EUR 4.25 per share in 2008, EUR 4.50 per share in 2009, and EUR 4.75 per share in 2010. At the 13<sup>th</sup> regular Shareholder's Assembly held on June 27<sup>th</sup> 2007, the resolution on payment of dividends in the amount of 4.00 EUR per share was adopted. The Supervisory Board and the Management Board estimate that adopted dividend policy – considering the development, taxation, and other relevant issues – represents an appropriate compromise between dividend yield of the shareholders and employment of net profit for financing company investment plans; on one hand, this will enable long-term maximization of shareholder benefit, while on the other hand it will support long-term growth and development of the Mercator Group. The actual sum of dividend per share in each respective year will be subject to the decision of the Shareholder's Assembly; the Supervisory Board and the company Management Board must only submit a harmonized proposal of the allocation of the distributable balance sheet profit for each business year.

## RISK MANAGEMENT

In compliance with the Rules and Regulations on Risk Management in the Mercator Group, the company carried on with its risk management process in the period 1 - 9 2007. By systematic monitoring, analysis, and control of risks, the critical factors that may occur or that occur in all process of company operations, particularly in the critical ones, may be effectively perceived.

In Mercator, the risks that are monitored and controlled are classified into three groups: **business risks**, **financial risks**, and **operational risks**; the established register of risks is supplemented as required, and the exposure to individual types of risks is continuously evaluated.

Compared to the end of 2006, exposure of the Mercator Group to critical risks **did not change considerably** in the period 1 - 9 2007.

## ENVIRONMENT PROTECTION ACTIVITIES

Consistently with the relevant legislation, activities of Mercator Group's trade companies are oriented towards continuous reduction of harmful effects on the environment, and towards prevention of pollution. The following activities were included among those that are aimed at reducing the usage of raw materials and energy in the period 1 - 9 2007:

- The collective scheme of the company Zeos for handling waste electrical and electronic equipment, which Mercator previously agreed to join, was formally launched. Furthermore, we are in the process of negotiating the agreement on the services of handling the waste electrical and electronic equipment related to the services of collection, transport, and temporary storage of waste electrical and electronic equipment in the company Poslovni sistem Mercator, d.d.
- In cooperation with the company Zeos, we installed in 51 retail units special collection bins for waste light bulbs; our customers may dispose of their waste bulbs in this bin upon the purchase of new, economic light bulbs.
- Next to the 'M Mobil' stands in MC Koper and MC Kranj, a collection bin was installed to allow our customers disposal of waste mobile phones. Such possibility of disposal will be offered to our customers in other 'M Mobil' stands / points as well.
- We introduced a new harmonized method of organic waste treatment, relating to waste such as animal byproducts, waste cooking oil and fats, kitchen waste, and waste fruits and vegetables. The new method of separation and collection of organic waste, yields numerous advantages in addition to decreased costs of organic and sanitary waste treatment; among these are the possibility to reallocate two employees, setting up / arrangement of records required in the field of insurance, and providing appropriate hygienic conditions).
- In cooperation with the company for waste packaging treatment Slopak, and waste collection company Tisa, we organized our own way of waste wooden packaging treatment, which has increased our revenues from services of waste wooden packaging

treatment. Furthermore, we have set up the possibility to produce wooden pellets that could subsequently be used for wooden biomass heating at a selected location.

- Based on the agreement with our new power supplier, we are receiving monthly records of power consumption by individual power-consuming locations. Thus, we established centralized control over power consumption by particular locations.
- Based on conducted analyses and data on power consumption in 2006 submitted by the power supply companies, a report was compiled titled "Proposals for Reduction of Investment and Operational Costs of Electricity"; the report includes three proposals for reduction of power costs.
- We also contacted Slovenian Power Plant Holding Company and discussed the possibility of cooperation in a development-oriented pan-Slovenian campaign called *Energija.si* (Energy.si). The philosophy of the brand *Energy.si* is to connect and promote cooperation between various partners in order to encourage efficient use of energy.
- In order to educate our employees, the monthly internal magazine started publishing the series of popular articles dealing with the protection of environment and safe consumption of energy. Furthermore, internal training was conducted for 68 shift managers, on efficient use of raw materials, materials, and energy in Mercator.

## SOCIALLY ACCOUNTABLE ACTION

### Integration into the social environment

Socially accountable action of the Mercator Group in all markets was consistent with the adopted strategy and the concept that place Mercator among the major socially accountable companies in the region. Mercator is a notable sponsor and donator in all environments of its presence, and in all areas where our help is needed: humanitarian aid, culture, education, sports, etc.

#### Slovenia

- In Mercator centers, tolar coins were collected to support four humanitarian organizations and their activities. Mercator sponsored the Humanitarian Institute Vid (Vision), as well as organizations offering aid to women and children in distress, and the so-called safe houses. Furthermore, the company donated funds to socially deprived families through a humanitarian campaign organized by the Dnevnik daily paper.
- Among Mercator's major donations in 2007 were the donations to the Postojna Hospital for Women Conditions, Ljubljana Rehabilitation Institute, and Clinical Department of Anesthesiology and Surgical Intensive Therapy. In September, warning posters were set up in all Mercator shopping centers about the lymphoma prevention.
- Sponsorships in the field of science include support to the University of Ljubljana, Faculty of Arts of the University of Ljubljana, and Faculty of Economics of the University of Ljubljana (preparation of the EFA – European Financial Association – International Conference); Mercator is also the co-founder of the Research and Innovation Institute of University of Ljubljana.

- In the field of culture, Cankarjev Dom and National University Library were the two major recipient of Mercator's sponsorship funds; we also supported the institute 'Plavajoče Gledališče' (Swimming Theatre), the Prešeren Theatre, organization of Borštnik Meeting, an exhibition in the National Gallery, and the International Biennial of Graphic Arts.
- With regard to sports, Mercator remains loyal to handball by sponsoring the National Handball Association, Handball Club Krim, as well as numerous local sport clubs and projects in the field of basketball, football, and swimming; Mercator is also the traditional sponsor of the Alpe Adria (Alps & Adriatic) bicycle race and the Franja marathon, and works regularly with the Slovenian Olympic Committee.
- Among the numerous interesting projects that Mercator importantly contributed to were also the activities called 'Z glavo na zabavo' (Think and Party), an incentive for healthy fun and partying without harmful substances, as well as the campaign 'Ločujmo, varujmo!' ('Separate and Protect!') which teaches the young generation to handle waste responsibly. We also contributed to the campaign of the Slovenian Association of Friends of Youth which involved taking 200 children to holiday. Each year, Mercator provides funds for summer activities of pre-school children.
- Mercator also donated considerable funds to kindergartens across Slovenia in order to finance the purchase of playing facilities, holiday camps, and daytrips; the company also contributed donations to pensioners' societies and to the institution Children Aid Foundation for their project 'Health-safe schools'.

### **Serbia**

The company Mercator - S, d.o.o., carried on its donation activities by donating funds for the visual arts workshop "Praise the hand" for children with the Down syndrome, as well as sponsored the Institute for Mothers and Children from New Belgrade and provided aid to the Center for Promotion of the Works of Nikola Tesla. Upon the opening of the trade center M-Rodić, the company M-Rodić, d.o.o., donated funds to the Gallery of the Serbian Society for constructing a ramp for the disabled, and supported the operation of Faculty of Agriculture in Novi Sad, and the association The Spirit of the Sport.

### **Bosnia in Herzegovina**

- The company Mercator - BH, d.o.o., sponsored the members of the Karate Association of BH, the European vice champions, who have won several medals at top level competitions both at home and abroad; the company also sponsored the Željezničar Table Tennis Club and the Tuzla bicycle race.
- In Mercator centers we organized the promotion of healthy food, and we also organized public measuring of blood pressure and provided advice to the visitors with regard to the prevention of hypertension.
- We donated funds to the Association "Education is Building BH" which provides holidays for children, as well as to Ljubica Ivezić Children's Shelter from Bjelava and Tuzla Shelter for Homeless Children.
- The company Mercator - BH, d.o.o., sponsored the Red Cross of the Sarajevo district, high vocational trade school, and the independent union of commerce workers.

## Croatia

- The company Mercator - H, d.o.o., sponsored a children masquerade carnival and the graduation parade, Athlete of the Year pageant, and donated funds for the dental prevention care program in kindergartens.
- Our company was the sponsor of the Center for Raising and Education of Children and Youngsters, Association of Dystrophy Patients and Patients Suffering from Cerebral Palsy and Poliomyelitis (Infantile Paralysis), the Sports Association of Blind People, SOS-community of the Young, and the Association for Tooth Decay Prevention and Oral Hygiene.
- In the field of culture, sponsorship funds were contributed to the Ulysses Theatre, the Rujanski Susreti (September Meetings) colony, and the Lapidary Museum.

## Communication with Customers

- In the period 1 - 9 2007 we carried on the development of the monthly **magazine Mesec** ('Month') in Slovenia and in Croatia. The copies 'Mesec April' and 'Mesec June', and 'Mesec September' were issued. We also prepared the monthly electronic version of the magazine, called 'eMesec'. (<http://mesec.mercator.si>). The Mesec magazine contains news on different events, latest news and presentations of products from the Mercator outlets, as well as useful and interesting tips for improving the quality of life.
- In the middle of February, we presented for the second time in a row the **Best Sales Person Award**. Over 15,000 voting cards were submitted by customers from Slovenia, Croatia, and Bosnia and Herzegovina, giving awards to 14 saleswomen and salesmen.
- In the first months of this year, we enhanced the monthly event paper **The Event Roundabout** that we started publishing at the end of 2006. The purpose of the paper is to provide to our customers more than merely information on events and other features in Mercator centers; hence, it also includes categories such as Do Not Miss, Mercator News, Roundabout Advice, Interview, Roundabout Entertainment, Column, Roundabout Pulse, and many other interesting features.
- In pursuit of our intention to offer the best service for our customers, numerous novel features were introduced in the refurbished hypermarket in Ljubljana, such as **self-check-out cashiers 'Tic Tac'** where the customers can carry out the check-out process of their shopping independently; **info stands** that aid the customers by providing additional information on products and advice on a particular group of products; **photo corner** where customers can produce and print their photos by employing various media at the point of sale, and the **internal TV station** with useful information for the customers.

## Communication with employees

Our human resource strategy was pursued consistently with the relevant plan. In the period 1 - 9 2007, our attention was devoted primarily to the following activities:

### 1. Career planning for key and promising employees:

We defined the competencies of the company, separately for experts and managers, which our key employees should acquire in order to perform successfully and efficiently. We selected 31 most promising young employees from all markets of our operations. They will be included in the first Mercator Business Academy which will commence at the end of 2007. We prepared a proposal for systemization with parallel work posts for expert and management staff.

### 2. Dialogue with the employees at all levels (internal communication):

In Mercator, d.d., intensive negotiations took place with the representative trade unions on the new company collective labor agreement that was signed on September 28<sup>th</sup> 2007, valid as of January 1<sup>st</sup> 2008 for the general part, and March 1<sup>st</sup> 2008 for the compensation part.

### 3. Internal and external staff recruitment:

- ➔ In the beginning of the year, we adopted the internal staff recruitment system which promotes the fundamental idea that department heads enable transfers of successful employees in line with human resource requirements. Thus, we are making an effort to keep successful employees and enable their personal and professional development.
- ➔ A lot of attention was also paid to staff recruitment when opening major retail units in Croatia, Serbia, and Slovenia.
- ➔ Upon the acquisition of the company Presoflex, d.o.o. (August 1<sup>st</sup> 2007) 528 employees joined the group in Croatian market; upon the disposal of the company M hotel, d.o.o. (September 19<sup>th</sup> 2007), 46 employees left the group.
- ➔ We are seeking new ways of recruiting staff through websites and Employment Offices. We enhanced the design and contents of our employment advertisements, prepared special flyers for human resource advertising in our major retail units, and examined the possibilities of employing citizens from foreign, non-European countries for work at the warehouses.

### 4. Transfer of knowledge and experience:

- ➔ In the period 1 - 9 2007, 18,330 employees took part in education programs in the Mercator Group. 331 employees were paid off-the-job education, 732 high-school and university students were admitted to practical work, 95 interns were included in the internship program, scholarships were provided for 24 high-school and college students, and 4 apprentices were trained.
- ➔ We are establishing a tutor / coaching network in order to improve the efficiency of sales personnel training. The first group of Shift Manager School has commenced the training program.

- ➔ As a part of the project "Catch Your Vocation", we worked with local employment agencies to present the trade, or commerce, vocations (salesman/saleswoman, baker, butcher, etc.) to employment seekers.
- ➔ We have worked closely with the Education and Training Committee (Slovenian Chamber of Commerce) in the project of preparing the vocational standards for revision of the vocational programs of relevance for trade activity.

#### 5. Compensation and motivation:

- ➔ In the Mercator Group, 1,841 employees (9.1 percent of all employees) were promoted in the period 1 - 9 2007; of these promotions, 1,018 (8.1 % of total) took place in the parent company.
- ➔ In the period at hand, 1,196 employees of the Mercator Group were presented various awards for their work (of which 532 were annual awards for achievements in 2006, 15 were Mercator Awards for outstanding achievements, and 649 were project awards).
- ➔ The competition "Looking for the Best Boss" was completed. According to the criteria, 13 nominees were selected, of which four were presented an award, and the others were presented a letter of commendation.

#### 6. Inter-cultural organizational development:

- ➔ On June 9<sup>th</sup> 2007, 23 thousand employees and their family members took part in the Mercator Day in Velenje – the traditional festivity of employees of the Mercator Group. Apart from daytrips and sports activities, employees and their families were entertained by musicians from all countries of Mercator's operations.
- ➔ In Slovenia, we organized the 1<sup>st</sup> Days of Human Resource Management, where our external stakeholders (Ministry of Labor, Family, and Social Affairs, Healthcare Insurance Institute of Republic of Slovenia, various educational, healthcare, and human resource institutions) were presented Mercator's human resource strategy, measures, and expectations about the future cooperation and strategic partnership with each of them.
- ➔ In September, employee satisfaction and organizational climate was measured again by the SiOK survey. The results of the survey are expected by the end of 2007.
- ➔ We prepared the business plan for transition to the new IT system SAP-HCM, which should provide appropriate integrated IT support to all human resource processes in the Group. Thus, we are planning to introduce the following modules: Organizational Management, Human Resource Administration, Education and Training, Human Resource Development, and Employment.

#### 7. Safety and health of our employees:

- ➔ On September 6<sup>th</sup> 2007, the Mercator Mountaineering Society was founded. The founding was celebrated by 160 employees and their family members by a promotional hike to Vogel.
- ➔ Through the Humanitarian Fund, we offered aid to 95 employees, allocating EUR 84,761.01. Employees were paid out 260 solidarity aids in the total sum of EUR

264,828.43, and 8 solidarity scholarships were granted in the total sum of EUR 12,531.87.

- ➔ Analysis on preventive medical examinations of the employees in 2006, and analysis on health-related absenteeism in 2006 were conducted for the parent company. The results have shown that the most common medical problems or, most common reason for absenteeism, of our employees are related to spine-problems and problems related to stress and exhaustion. Based on the results of both analyses, we are preparing a program of preventive and curative measures.
- ➔ We initiated a solidarity campaign for aid to those affected by the flooding in Slovenia.

### Communication with shareholders and financial community

In 2007, we continue to pursue the policy of prompt, transparent, and professional communication with the shareholders and financial community. In February, the management published the non-audited financial statements of the parent company and the entire Group for the year 2006 in the electronic information and dissemination system SEOnet. Likewise, the shareholders and financial community were kept informed via the SEOnet in regard to all major business events and issues.

At the end of March 2007, Mercator organized the 7<sup>th</sup> traditional **meeting of financial partners** of the Mercator Group. The participants were presented the business results for the previous year and business plans and financial policy for the year 2007.

On April 11<sup>th</sup>, we took part in the Day of Slovenian Capital Market in Ljubljana, organized by Ljubljana Stock Exchange, d.d., and the Central Securities Clearing Corporation, d.d. Domestic and International portfolio investors were presented the performance in the previous year and our plans for the future. We also took part in the Day of Slovenian Capital Market for Croatian institutional investors, which took place in Zagreb on June 12<sup>th</sup> under the sponsorship of the Ljubljana Stock Exchange. On September 11<sup>th</sup> and 12<sup>th</sup> we presented our company and the Group to foreign investors at 'road shows' that were organized by the Ljubljana Stock Exchange, d.d., in Milan and Vienna.

### Communication with business partners

- On February 14<sup>th</sup> 2007, Mercator prepared for the eighth year in a row the **Mercator Marketing Days**, a traditional meeting of the company management with the major suppliers and partners from Slovenia, Croatia, Serbia, and Bosnia and Herzegovina. Over four hundred participants of this year's meetings gathered in Cankarjev dom where they were presented the development strategy of the Mercator Group for the current year.

## FINANCIAL REPORT

### ACCOUNTING POLICIES

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period 1 - 9 2007, were compiled in compliance with the International Financial Reporting Standards, and they are unaudited.

Data for the comparable period 1 - 9 2006 in the following financial statements is translated from tolar to euros according to closing exchange rate EUR/SIT as at the balance sheet date.

In the preparation of financial statements, the most recent interpretations of the MSRP were considered, with comparability of financial statements between the periods being sensibly provided.

### CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

Consolidated financial statements of the Mercator Group include the company Poslovni sistem Mercator, d.d., and 12 subsidiaries, in which the controlling company holds directly or indirectly a majority interest. These subsidiaries are the following:

- **In Slovenia:** Eta, d.d., Pekarna Grosuplje, d.d., Mercator - Emba, d.d., Mercator - Optima, d.o.o., M Hotel, d.o.o. (the company was disposed of on September 19<sup>th</sup> 2007 and is included in the Mercator Group for the period 1 - 9 2007);
- **Abroad:** Mercator - H, d.o.o., Croatia, Presoflex, d.o.o., Croatia (the company was acquired on July 18<sup>th</sup> 2007 and has been included in the Mercator Group as of August 1<sup>st</sup> 2007), Belpana, d.o.o., Croatia, Mercator - S, d.o.o., Serbia, M - Rodić, d.o.o., Serbia, Mercator - BH, d.o.o., Bosnia and Herzegovina, Mercator Makedonija, d.o.o., Macedonia.

## Consolidated Income Statement

in EUR 000

	Type of revenue / expense / cost	1 - 9 2006	Plan 2007	1 - 9 2007	Index 1 - 9 2007 / 1 - 9 2006	Index 1 - 6 2007 / Plan 2007
<b>A.</b>	<b>NET SALES REVENUES</b>	<b>1,466,145</b>	<b>2,338,722</b>	<b>1,749,704</b>	<b>119.3</b>	<b>74.8</b>
1.	Revenue from products sold	19,805	29,225	22,701	114.6	77.7
2.	Revenue from services sold	95,137	160,111	117,825	123.8	73.6
3.	Revenue from goods and material sold	1,351,203	2,149,386	1,609,178	119.1	74.9
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-1,060,490</b>	<b>-1,714,619</b>	<b>-1,289,620</b>	<b>121.6</b>	<b>75.2</b>
1.	Production costs	-31,057	-44,343	-34,749	111.9	78.4
2.	Purchase value of goods and material sold	-1,043,510	-1,677,969	-1,260,266	120.8	75.1
3.	Received discounts	16,056	8,743	6,167	38.4	70.5
4.	Other expenses	-1,979	-1,050	-772	39.0	73.6
<b>C.</b>	<b>GROSS PROFIT</b>	<b>405,655</b>	<b>624,103</b>	<b>460,084</b>	<b>113.4</b>	<b>73.7</b>
D.	Selling and marketing costs	-298,683	-435,242	-328,497	110.0	75.5
E.	Administrative expenses	-69,919	-115,650	-85,233	121.9	73.7
F.	Other gains - net	8,697	8,252	12,429	142.9	150.6
<b>G.</b>	<b>OPERATING PROFIT</b>	<b>45,750</b>	<b>81,463</b>	<b>58,783</b>	<b>128.5</b>	<b>72.2</b>
H.	Finance income	9,801	6,070	17,443	178.0	287.4
I.	Finance costs	-25,859	-43,736	-31,488	121.8	72.0
<b>J.</b>	<b>PROFIT BEFORE INCOME TAX</b>	<b>29,692</b>	<b>43,798</b>	<b>44,738</b>	<b>150.7</b>	<b>102.1</b>
K.	Income tax expense	-8,064	-12,705	-7,975	98.9	62.8
L.	Deferred income tax	-285	-657	-642	225.3	97.7
<b>M.</b>	<b>PROFIT FOR THE FINANCIAL PERIOD</b>	<b>21,343</b>	<b>30,436</b>	<b>36,121</b>	<b>169.2</b>	<b>118.7</b>
N.	Profit attributable to equity holders of the Company	16,689	29,352	36,066	216.1	122.9
O.	Profit attributable to minority interest	223	1,084	55	24.5	5.0
<b>P.</b>	<b>GROSS CASH FLOW FROM OPERATING ACTIVITIES</b>	<b>94,139</b>	<b>153,093</b>	<b>115,196</b>	<b>122.4</b>	<b>75.2</b>
R.	Number of employees based on hours worked	16,533	19,363	19,099	115.5	98.6

## Consolidated Balance Sheet

in EUR 000

	Type of assets / liabilities	31.12.2006	Plan 31.12.2007	30.9.2007	Structure 30.9.2007	Index 30.9.2007/ 31.12.2006
	<b>ASSETS</b>					
<b>A.</b>	<b>NON-CURRENT ASSETS</b>	<b>1,418,675</b>	<b>1,510,712</b>	<b>1,470,201</b>	<b>75.0%</b>	<b>103.6</b>
I.	Property, plant and equipment	1,303,811	1,404,411	1,344,282	68.6%	103.1
II.	Investment property	13,094	13,094	12,527	0.6%	95.7
III.	Intangible assets	86,678	82,636	95,044	4.9%	109.7
IV.	Deferred income tax assets	5,572	2,665	8,528	0.4%	153.1
V.	Derivative financial instruments	1,986	903	5,211	0.3%	262.4
VI.	Trade and other receivables	2,147	0	643	0.0%	29.9
VII.	Available-for-sale financial assets	5,387	7,003	3,966	0.2%	73.6
<b>B.</b>	<b>CURRENT ASSETS</b>	<b>442,500</b>	<b>420,586</b>	<b>489,218</b>	<b>25.0%</b>	<b>110.6</b>
I.	Inventories	225,803	219,509	243,756	12.4%	108.0
II.	Trade and other receivables	198,415	191,369	229,625	11.7%	115.7
III.	Current income tax receivables	247	0	0	0.0%	-
IV.	Cash and cash equivalents	18,035	9,708	15,838	0.8%	87.8
	<b>TOTAL ASSETS</b>	<b>1,861,175</b>	<b>1,931,298</b>	<b>1,959,420</b>	<b>100.0%</b>	<b>105.3</b>
<b>A.</b>	<b>EQUITY</b>	<b>647,880</b>	<b>648,984</b>	<b>676,805</b>	<b>34.5%</b>	<b>104.5</b>
	<b>Capital and reserves attributable to equity holders of the Company</b>	<b>606,975</b>	<b>608,395</b>	<b>675,775</b>	<b>34.5%</b>	<b>111.3</b>
I.	Ordinary shares	157,126	157,126	157,129	8.0%	100.0
II.	Share premium	193,298	193,298	198,848	10.1%	102.9
III.	Revenue reserves	143,801	145,219	229,277	11.7%	159.4
IV.	Revaluation reserve	48,537	48,537	47,239	2.4%	97.3
V.	Retained earnings	57,912	47,699	0	0.0%	0.0
VI.	Profit for the financial period	0	12,527	36,066	1.8%	-
VII.	Currency translation reserve	6,301	3,989	7,216	0.4%	114.5
	<b>Minority interest in equity</b>	<b>40,905</b>	<b>40,589</b>	<b>1,030</b>	<b>0.1%</b>	<b>2.5</b>
	<b>LIABILITIES</b>					
<b>B.</b>	<b>NON-CURRENT LIABILITIES</b>	<b>567,397</b>	<b>635,703</b>	<b>617,255</b>	<b>31.5%</b>	<b>108.8</b>
I.	Financial liabilities	515,057	586,696	569,006	29.0%	110.5
II.	Derivative financial instruments	180	0	0	0.0%	-
III.	Deferred income tax liabilities	16,211	16,514	15,218	0.8%	93.9
IV.	Retirement benefit obligations	19,045	19,470	18,914	1.0%	99.3
V.	Provisions for other liabilities and charges	16,904	13,023	14,117	0.7%	83.5
<b>C.</b>	<b>CURRENT LIABILITIES</b>	<b>645,898</b>	<b>646,611</b>	<b>665,360</b>	<b>34.0%</b>	<b>103.0</b>
I.	Trade and other payables	356,805	384,049	438,955	22.4%	123.0
II.	Current income tax payables	1,724	0	8,734	0.4%	506.6
III.	Financial liabilities	287,369	262,562	217,671	11.1%	75.7
	<b>TOTAL LIABILITIES</b>	<b>1,213,295</b>	<b>1,282,314</b>	<b>1,282,615</b>	<b>65.5%</b>	<b>105.7</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>1,861,175</b>	<b>1,931,298</b>	<b>1,959,420</b>	<b>100.0%</b>	<b>105.3</b>
	Number of employees as at the end of the period	19,539	20,683	20,327		104.0

## Consolidated Cash Flow Statement

in EUR 000

	Cash flows	1 - 9 2006	Plan 2007	1 - 9 2007
<b>A</b>	<b>OPERATING ACTIVITIES</b>			
	<b>Cash generated from operations</b>	<b>48,920</b>	<b>218,393</b>	<b>167,431</b>
1	Interest paid	-24,372	-43,736	-30,333
2	Income tax paid	-8,350	-12,705	-7,975
<b>I</b>	<b>Net cash generated from operating activities</b>	<b>16,198</b>	<b>161,952</b>	<b>129,123</b>
<b>B</b>	<b>INVESTING ACTIVITIES</b>			
1	Acquisition of subsidiaries, net of cash acquired	0	0	-40,260
2	Purchases of property, plant and equipment (PPE)	-106,869	-191,007	-87,032
3	Purchases of intangible assets	-1,600	-11,275	-2,749
4	Purchases of available-for-sale financial assets	-1,347	0	-110
5	Purchases of current investments	0	0	0
6	Loans made	-872	-204	-5,990
7	Proceeds from disposal of subsidiaries	0	0	9,100
8	Proceeds from sale of PPE	10,247	12,193	7,960
9	Proceeds from sale of intangible assets	15	21	138
10	Proceeds from sale of available-for-sale financial assets	1,631	207	10,308
11	Proceeds from sale of current investments	0	375	0
12	Interest received	8,472	6,033	6,074
13	Dividends received	0	0	393
14	Loan repayments received	2,716	0	445
<b>II</b>	<b>Net cash used in investing activities</b>	<b>-87,608</b>	<b>-183,656</b>	<b>-101,722</b>
<b>C</b>	<b>FINANCING ACTIVITIES</b>			
1	Proceeds from issuance of shares	20,515	0	0
2	Proceeds from sell of treasury shares	0	0	7,200
3	Proceeds / repayments of borrowings	56,429	33,250	-21,943
4	Dividends paid to Company's shareholders	-8,758	-10,213	-14,723
<b>III</b>	<b>Net cash used in financing activities</b>	<b>68,185</b>	<b>23,037</b>	<b>-29,465</b>
<b>1</b>	<b>Increase/decrease of cash and cash equivalents</b>	<b>-3,224</b>	<b>1,333</b>	<b>-2,065</b>
2	Cash at the beginning of the period	16,532	8,250	18,035
3	Currency translation differences	44	125	-133
<b>IV</b>	<b>Cash at the end of the period</b>	<b>13,352</b>	<b>9,708</b>	<b>15,838</b>

## Consolidated Statement of Changes in Equity

in EUR 000

	Share capital		Revenue reserves				Revaluation reserve	Retained earnings	Profit for the year	Currency translation reserve	Minority interest	Total
	Ordinary shares	Share premium	Legal reserves	Reserves for treasury shares	Treasury shares	Other revenue reserves						
Balance as at 1 January 2006	140,050	159,863	13,389	5,220	-5,220	109,329	50,263	76,658	-	-4,476	5,951	551,027
Restatement:												
Adjustment according to IAS 12	-	-	-	-	-	-	-7,666	-10,313	-	-	-	-17,979
Balance as at 1 January 2006 (Restated)	140,050	159,863	13,389	5,220	-5,220	109,329	42,597	66,346	-	-4,476	5,951	533,048
Revaluation of PP&E to fair value	-	-	-	-	-	-	1,963	-7,945	-	-	-	-5,982
Cash flow hedge net of tax	-	-	-	-	-	-	-	-630	-	-	-	-630
Currency translation differences	-	-	-	-	-	-	-	-	310	-	-	310
Income tax refund from previous year	-	-	-	-	-	-	-	3,199	-	-	-	3,199
Net income (expense) recognised directly in equity	-	-	-	-	-	-	1,963	-5,376	-	310	-	-3,103
Profit for the financial period	-	-	-	-	-	-	-	-	20,991	-	348	21,338
Total recognised income and expense in the financial period	-	-	-	-	-	-	1,963	-5,376	20,991	310	348	18,236
Issue of share capital	5,330	15,181	-	-	-	-	-	-	-	-	-	20,511
Treasury shares	-	-	-	-320	320	-	-	319	-	-	-	319
Dividend payout	-	-	-	-	-	-	-	-8,820	-	-	-	-8,820
Change in share capital of subsidiaries	-	-	-	-	-	-	-	-	-	-	63	63
Balance as at 30 September 2006	145,380	175,043	13,389	4,900	-4,900	109,329	44,561	52,469	20,991	-4,166	6,362	563,358

in EUR 000

	Share capital		Revenue reserves				Revaluation reserve	Retained earnings	Profit for the year	Currency translation reserve	Minority interest	Total
	Ordinary shares	Share premium	Legal reserves	Reserves for treasury shares	Treasury shares	Other revenue reserves						
Balance as at 1 January 2007	157,126	193,298	13,389	4,900	-4,900	130,412	48,537	57,912	-	6,301	40,905	647,880
Revaluation of PP&E to fair value	-	-	-	-	-	-	17,306	-1,298	20,011	-	1,268	1,499
Cash flow hedge net of tax	-	-	-	-	-	-	-	3,405	-	-	-	3,405
Currency translation differences	-	-	-	-	-	-	-	-	-	-353	-	-353
Net income (expense) recognised directly in equity	-	-	-	-	-	-	17,306	-1,298	23,416	-	915	4,552
Profit for the financial period	-	-	-	-	-	-	-	-	36,066	-	55	36,121
Total recognised income and expense in the financial period	-	-	-	-	-	-	17,306	-1,298	23,416	36,066	915	40,671
Disposal of treasury shares	-	5,550	-	-	1,651	-	-	-	-	-	-	7,200
Dividend payout	-	-	-	-	-	-	-	-14,806	-	-	-	-14,806
Allocation of net profit in line with the Management/Supervisory Board/Shareholders Assembly resolution	3	-	-	-	-	66,520	-	-66,523	-	-	-	0
Change in share capital of subsidiaries	-	-	-	-	-	-	-	-	-	-	-4,142	-4,142
Balance as at 30 September 2007	157,129	198,848	13,389	4,900	-3,249	214,237	47,239	0	36,066	7,216	1,030	676,805

## Notes to the Consolidated Financial Statements

### NOTES TO THE CONSOLIDATED INCOME STATEMENT

- **Net sales revenues**

Net sales revenues for the period 1 - 9 2007 amounted to EUR 1,749,704 thousand and arrived at 74.8 % of planned net sales revenues for the year 2007, and exceed the figures from the comparable period last year by 19.3 %.

Revenues resulting from the sale of goods and materials take 92.0 % of total net sales revenues, while the remaining 8.0 % originates from sales of products and services.

Without revenues originating from the company M - Rodić, d.o.o., and Presoflex, d.o.o., the Mercator Group would have realized EUR 1,548,742 thousand of net sales revenues in the period 1 - 9 2007, which would have represented a 5.6 % increase compared to the same period in the year 2006.

- **Cost of goods sold**

Costs of goods sold including production costs, purchase value of sold goods and material and other operating expenditures in the relevant period amounted to EUR 1,289,620 thousand, and exceed the same category by 21.6 % compared to the same period last year, which is mostly the consequence of increased scale of operations.

- **Gross profit**

Gross profit for the period 1 - 9 2007 amounted to EUR 460,084 thousand, which is a 13.4 % increase compared to the period 1 - 9 2006 and represents 73.7 % of the 2007 plan.

- **Selling costs and administrative expenses**

Selling costs and administrative expenses amounted to EUR 413,730 thousand and exceed the figures for the comparable period last year by 12.2 %, representing 75.1 % of the 2007 plan. Growth of costs is a result of the increased scale of operations, inclusion of the company M - Rodić, d.o.o., and Presoflex, d.o.o., into the Group, and the growth of prices in some cost elements (power, transport, labor, etc.).

## Expenses by nature

in EUR 000

	Type of Cost	1 - 9 2006	Plan 2007	1 - 9 2007	Index 1-9 07 / 1-9 06	Index 1-9 07 / Plan 2007
1	Costs of material	50,402	78,906	51,904	103.0	65.8
2	Costs of services	103,453	160,856	118,430	114.5	73.6
3	Depreciation and amortisation	51,873	74,969	59,691	115.1	79.6
4	Labour costs	185,733	296,224	201,987	108.8	75.0
5	Other expenses	10,176	10,250	17,240	169.4	168.2
6	Cost of goods sold	1,027,454	1,671,305	1,254,099	122.1	75.0
7	<b>TOTAL COSTS</b>	<b>1,429,092</b>	<b>2,265,511</b>	<b>1,703,351</b>	<b>119.2</b>	<b>75.2</b>

Also included among the administrative expenses are the losses from the disposal of PPE in the amount of EUR 1,254 thousand, and adjustments in current assets in the amount of EUR 4,681 thousand.

- **Other revenues from operations**

Other revenues from operations amounted to EUR 12,429 thousand, of which EUR 3,107 thousand is related to proceeds from disposal of PPE and EUR 2,879 thousand to disposal, or decrease, of provisions, while the remaining other revenues from operations relate to various other revenues (compensations, donations, subsidies, written-off receivables, etc.). In the period 1 - 9 2006, proceeds from the disposal of PPE amounted to EUR 3,484 thousand.

- **Operating profit**

Operating profit for the period 1 - 9 2007 amounts to EUR 58,783 thousand, which is EUR 13,033 thousand, or 28.5 % more than the same figure for the period 1 - 9 2006; this is mostly the result of higher net revenues, improved cost efficiency, and increase in other revenues from operations. Operating profit represents 72.2 % of the 2007 plan.

- **Finance income and costs / expenses**

Finance income amounted to EUR 17,443 thousand, which is EUR 7,642 thousand, or 78.0 percent more than in the period 1 - 9 2006. Financial revenues were mostly generated by disposals of financial investment into companies, positive currency translation differences, revenues from default interest, revenues from dividends, and regular interest from financing.

Finance costs for the relevant period amount to EUR 31,488 thousand, of which a major portion relates to costs from interest paid to commercial banks, financial lease, and bonds, and the related currency translation differences. Compared to the same period last year, they represent a 21.8 % increase, mostly resulting from increases in interest rates.

in EUR 000

	1 - 9 2006	1 - 9 2007	Index 1-9 07 / 1-9 06
Net regular interest	19,080	24,366	127.7
Net default interest	-3,877	-2,192	56.5
Net currency translation differences	-181	102	-
Net gains from disposal of financial assets	-513	-9,261	1,805.3
Other net finance costs (income)	1,549	1,029	-
<b>Total net finance costs</b>	<b>16,058</b>	<b>14,045</b>	<b>87.5</b>

- **Profit for the financial period**

In the period 1 - 9 2007 the Mercator Group realized EUR 36,121 thousand of net profit, which is EUR 14,778 thousand more than in the same period last year.

Profit for the periods 1 - 9 2007 and 1 - 9 2006 were also affected by extraordinary accounting events, such as proceeds from disposal of PPE and financial assets. Excluding these effects, the comparable net profit before taxes for the period 1 - 9 2007 amounts to EUR 33,624 thousand, which is 25.1 % more than the comparable net profit for the period 1 - 9 2006 (EUR 26,871 thousand).

Calculation of comparable profit before taxes and comparable net profit is shown in the following table:

in EUR 000

	1 - 9 2006	Plan 2007	1 - 9 2007	Index 1 - 9 2007 / 1 - 9 2006	Index 1 - 9 2007 / Plan 2007
<b>Profit before income tax</b>	<b>29,692</b>	<b>43,798</b>	<b>44,738</b>	<b>150.7</b>	<b>102.1</b>
Net gains form disposal of PPE	-2,308	-3,708	-1,853	80.3	50.0
Net gains from disposal of financial assets	-513	-37	-9,261	1,805.3	25,030.4
<b>Comparable profit before income tax</b>	<b>26,871</b>	<b>40,053</b>	<b>33,624</b>	<b>125.1</b>	<b>83.9</b>
Adjusted income tax	-7,359	-11,844	-5,898	80.1	49.8
<b>Comparable profit for the financial period</b>	<b>19,512</b>	<b>28,209</b>	<b>27,726</b>	<b>142.1</b>	<b>98.3</b>

- **Gross cash flow from operating activities**

Gross cash flow from operating activities of the Mercator Group for the period 1 - 9 2007 amounted to EUR 115,196 thousand, which is 22.4 % more compared to the period 1 - 9 2006, arriving at 75.2 % of the 2007 plan.

The calculation is shown in the following chart:

in EUR 000

	1 - 9 2006	Plan 2007	1 - 9 2007	Index 1-9 07/ 1-9 06	Index 1-9 07/plan 07
Profit for the financial period	21,343	30,436	36,121	169.2	118.7
Income tax	8,349	13,362	8,618	103.2	64.5
Depreciation and amortisation	51,882	74,967	59,691	115.1	79.6
Net gains from disposal and impairment of property, plant and equipment	-2,308	-3,708	-1,853	80.3	50.0
Net movements in provisions	-516	368	-2,378	460.9	-
Net gains/losses from disposal of financial assets	-513	-37	-9,261	1,805.3	25,030.4
Net interest	15,902	37,705	24,259	152.6	64.3
<b>Gross cash flow from operating activities</b>	<b>94,139</b>	<b>153,093</b>	<b>115,196</b>	<b>122.4</b>	<b>75.2</b>

## NOTES TO THE CONSOLIDATED BALANCE SHEET

- **Property, plant and equipment, investment property and intangible assets**

As at September 30<sup>th</sup> 2007, the value of PPE, investment property, and intangible assets amounts to EUR 1,451,853 thousand, which is EUR 48,270 thousand more than at the beginning of the year; these assets represent 74.1 % of total assets. The change in value

was affected by new investment, depreciation, disposal of commercially unviable assets, disposal of the company M Hotel, d.o.o., and currency translation differences.

- **Derivative financial instruments**

As at September 30<sup>th</sup> 2007, the positive fair value of derivative financial instruments intended for the hedging the risks related to cash flow, amounts to EUR 5,211 thousand, which is EUR 3,225 thousand more than at the end of 2006. In the period 1 - 9 2007, no new agreements on derivative financial instruments were signed.

- **Non-current trade and other receivables**

Non - current trade and other receivables as at September 30<sup>th</sup> 2007 amount to EUR 643 thousand; they include long-term loans granted and deposits.

- **Available-for-sale financial assets**

Available-for-sale financial assets as at September 30<sup>th</sup> 2007 amount to EUR 3,966 thousand, which is EUR 1,421 thousand less than as at December 31<sup>st</sup> 2006.

- **Inventories**

Inventories of raw materials, material, and trade goods as at September 30<sup>th</sup> 2007 amount to EUR 243,756 thousand, and represent 49.8 % of the total current assets. Compared to the beginning of the year, the value of inventories rose by EUR 17,953 thousand, or 8.0 %.

- **Current trade and other receivables**

As at September 30<sup>th</sup> 2007, current trade and other receivables amounted to EUR 229,625 thousand, which is EUR 31,210 thousand, or 15.7 %, more than at the beginning of the year. Other current receivables include short-term granted loans, deposits, and short-term financial investments, which together amount to EUR 12.892 thousand as at September 30<sup>th</sup> 2007, as well as prepaid expenses in the amount of EUR 7,072 thousand.

- **Equity**

In the period 1 - 9 2007, the equity of the Group rose by EUR 28,924 thousand. The changes are primarily related to the following:

- increase by net profit of the majority interest holder attained in the period 1 - 9 2007, in the amount of EUR 36,066 thousand;
- increase in equity due to disposal of treasury shares in the amount of EUR 7,200 thousand;
- increase in equity by the adjustment of fair value of derivative financial instruments in the amount of EUR 3,405 thousand;
- increase due to special equity revaluations in the amount of EUR 1,499 thousand;

- decrease in equity due to currency translation differences in the translation of financial statements of foreign companies into the representation currency, in the amount of EUR 353 thousand;
- decrease in equity due to the payment of dividends in the amount of EUR 14,806 thousand;
- decrease of minority interest in the amount of EUR 4,087 thousand.

Net return on equity, calculated as the ratio between net profit and average equity in the period at hand, amounts to 7.5 %.

- **Financial liabilities**

Non - current financial liabilities as at September 30<sup>th</sup> 2007 amount to EUR 569,006 thousand, and have increased by EUR 53,949 thousand compared to the beginning of the year.

Current financial liabilities as at September 30<sup>th</sup> 2007 amount to EUR 217,671 thousand, and have decreased by EUR 69,698 thousand compared to the beginning of the year.

Total financial liabilities in the period 1 - 9 2007 fell by EUR 15,749 thousand, which is mostly the result of revised policy of current payables management in 2007.

Compared to the beginning of the year, the maturity of financial liabilities has changed. Non-current financial liabilities now represent 72.3 % of the total financial liabilities, and current financial liabilities represent the remaining 27.7 % (as at December 31<sup>st</sup> 2006, the ratio between non-current and current financial liabilities was 64.2 vs. 35.8).

In the composition of financial liabilities by currencies, financial liabilities in EUR represent 97.5 %, and financial liabilities in other currencies represent the remaining 2.5 %.

The share of financial liabilities by variable interest rate in the total financial liabilities amounts to 47.8 %, while liabilities with fixed or hedged interest rate represented the remaining 52.2 % of total liabilities.

- **Retirement benefit obligations**

As at September 30<sup>th</sup> 2007, the total retirement benefit obligations amount to EUR 18,914 thousand and they have not changed considerably compared to the beginning of the year. During the year, the value of retirement benefit obligations may change due to the currency translation differences in companies abroad; at the end of the year, the obligations are re-measured and adjusted as necessary.

- **Provisions for liabilities and charges**

As at September 30<sup>th</sup> 2007, the provisions amounted to EUR 14,117 thousand. Compared to the beginning of the year, provisions have decreased by EUR 2,787 thousand.

- **Deferred income taxes**

In 2007, Mercator Group has recognized both deferred income tax liabilities and deferred income tax assets. As at September 30<sup>th</sup> 2007, the net deferred income tax liabilities totaled EUR 6,690 thousand.

- **Trade and other payables**

Trade and other payables as at September 30<sup>th</sup> 2007 amounted to EUR 438,955 thousand, which is EUR 82,150 thousand more than at the beginning of the year. The increase is primarily the result of the increased scale of operations, and the revised policy of current payables management.

During a recent case in 2006, Slovenian law practitioners adopted the view that normative and tariff part of the collective labor agreement for trade industry related to commuting refund are mutually inconsistent; as a result, employees are receiving more benefits than stipulated. Mercator has already taken steps to protect its interest. Since probability and amount of any liabilities of Slovenian companies of the Mercator Group, related to these proceedings, cannot be estimated, they are not included among the potential liabilities.

## Financial Indicators

	Mercator Group		
	1 - 9 2006	Plan 2007	1 - 9 2007
<b>Indicators of profitability</b>			
Return on equity	5.2%	4.9%	7.5%
Return on sales	1.5%	1.3%	2.1%
<b>Indicators of financial structure</b>			
Financial liabilities / equity	1.33	1.31	1.16
Equity and provisions for liabilities and charges to total equity and liabilities	36.2%	34.3%	35.3%
Financial liabilities to total equity and liabilities	47.1%	44.0%	40.1%
Trade and other payables to total equity and liabilities	14.3%	19.9%	22.4%
<b>Indicators of operating efficiency and productivity</b>			
Labor costs per hours worked (in EUR 000)	15.0	13.9	14.1
Sales / labor costs	7.9	8.7	8.7
Revenues per employee per hours worked (in EUR 000)	118	121	122
Value added per employee per hours worked (in EUR 000)	22.6	21.8	22.1
Gross cash flow from operating activities / sales	6.4%	6.5%	6.6%
Total costs without depreciation and provisions / sales	21.6%	20.4%	19.9%
Invested capital (in EUR 000)	1,283,800	1,496,549	1,504,371
Gross cash flow from operating activities / invested capital	9.8%	10.2%	10.2%

Note: Value added is calculated as the sum of gross cash flow from operating activities and labor costs. Indicator costs of sales and overhead activities without depreciation and provisions on net revenues is calculated as the ratio between total costs (without the purchase value of goods sold, costs of depreciation and provisions) and net revenues. Invested capital represents the differences between total liabilities and current trade and other payables at the beginning of the financial period.

## FINANCIAL STATEMENTS OF THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.

For comparability, financial statements of the company Poslovni sistem Mercator, d.d., for the period 1 - 9 2007, also comprise the operations of the companies merged in the last quarter of the year 2006.

**The company Poslovni sistem Mercator, d.d., has a double role in the Mercator Group: it is the parent company that owns all ownership shares in the Group's subsidiaries; simultaneously, it is the operative company, carrying out all trade and other activities in Slovenia. Thus, the application of financial statements of the company Poslovni sistem Mercator, d.d., for economic analysis of the operation of the Mercator Group is not appropriate. For such analysis, it would be more sensible to apply only the consolidated financial statements that represent the performance of the Mercator Group as a uniform business entity.**

### Income Statement

in EUR 000						
	Type of revenue / expense / cost	1 - 9 2006	Plan 2007	1 - 9 2007	Index	Index
1	2	3	4	5	6 = 5/3	7=5/4
<b>A.</b>	<b>NET SALES REVENUES</b>	<b>1,189,840</b>	<b>1,611,509</b>	<b>1,241,644</b>	<b>104.4</b>	<b>77.0</b>
1.	Revenue from products sold	1,830	2,544	2,406	131.5	94.6
2.	Revenue from services sold	80,877	133,558	93,042	115.0	69.7
3.	Revenue from goods and material sold	1,108,454	1,476,375	1,147,512	103.5	77.7
4.	Decrease of sales for given discounts	-1,322	-968	-1,317	99.6	136.0
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-864,832</b>	<b>-1,153,322</b>	<b>-907,967</b>	<b>105.0</b>	<b>78.7</b>
1.	Production costs	-845	0	-2,061	243.8	-
2.	Purchase value of goods and material sold	-876,815	-1,157,594	-909,020	103.7	78.5
3.	Received discounts	13,087	4,453	3,231	24.7	72.6
4.	Other expenses	-259	-180	-117	45.3	65.1
<b>C.</b>	<b>GROSS PROFIT</b>	<b>325,007</b>	<b>458,187</b>	<b>333,677</b>	<b>102.7</b>	<b>72.8</b>
D.	Selling and marketing costs	-230,175	-317,387	-293,189	127.4	92.4
E.	Administrative expenses	-57,824	-83,920	-4,775	8.3	5.7
F.	Other gains - net	5,612	6,254	8,323	148.3	133.1
<b>G.</b>	<b>OPERATING PROFIT</b>	<b>42,621</b>	<b>63,134</b>	<b>44,035</b>	<b>103.3</b>	<b>69.7</b>
H.	Finance income	4,915	5,957	16,827	342.4	282.5
I.	Finance costs	-16,097	-30,544	-28,300	175.8	92.7
<b>J.</b>	<b>PROFIT BEFORE INCOME TAX</b>	<b>31,439</b>	<b>38,547</b>	<b>32,562</b>	<b>103.6</b>	<b>84.5</b>
K.	Income tax expense	-7,446	-10,458	-7,738	103.9	74.0
L.	Deferred income tax	-272	-659	-633	233.0	96.2
<b>M.</b>	<b>PROFIT FOR THE FINANCIAL PERIOD</b>	<b>23,722</b>	<b>27,430</b>	<b>24,190</b>	<b>102.0</b>	<b>88.2</b>
N.	Number of employees based on hours worked	12,447	12,425	12,089	97.1	97.3

## Balance Sheet

in EUR 000

1	Type of assets / liabilities	31.12.2006	Plan 31.12.2007	30.9.2007	Structure 30.9.2007	Index
	2	3	4	5	6	7=5/3
	<b>ASSETS</b>					
<b>A.</b>	<b>NON-CURRENT ASSETS</b>	<b>1,199,494</b>	<b>1,241,526</b>	<b>1,250,821</b>	<b>78.9%</b>	<b>104.3</b>
I.	Property, plant and equipment	722,427	776,983	728,935	46.0%	100.9
II.	Investment property	12,893	12,596	12,527	0.8%	97.2
III.	Intangible assets	9,947	18,103	6,505	0.4%	65.4
IV.	Deferred income tax assets	5,536	2,638	8,381	0.5%	151.4
V.	Derivative financial instruments	1,986	903	5,211	0.3%	262.4
VI.	Trade and other receivables	592	592	465	0.0%	78.5
VII.	Available-for-sale financial assets	446,112	429,711	488,797	30.8%	109.6
<b>B.</b>	<b>CURRENT ASSETS</b>	<b>321,908</b>	<b>300,248</b>	<b>335,046</b>	<b>21.1%</b>	<b>104.1</b>
I.	Inventories	162,817	146,680	167,739	10.6%	103.0
II.	Trade and other receivables	156,597	147,856	167,062	10.5%	106.7
III.	Current income tax receivables	0	0	0	0.0%	-
IV.	Cash and cash equivalents	2,493	5,712	246	0.0%	9.9
	<b>TOTAL ASSETS</b>	<b>1,521,402</b>	<b>1,541,773</b>	<b>1,585,867</b>	<b>100.0%</b>	<b>104.2</b>
<b>A.</b>	<b>EQUITY</b>	<b>617,398</b>	<b>615,714</b>	<b>658,578</b>	<b>41.5%</b>	<b>106.7</b>
I.	Ordinary shares	157,126	157,126	157,129	9.9%	100.0
II.	Share premium	193,298	193,298	198,848	12.5%	102.9
III.	Revenue reserves	69,867	69,867	195,827	12.3%	280.3
IV.	Revaluation reserves	74,988	74,988	71,978	4.5%	96.0
V.	Retained earnings	112,429	93,006	10,606	0.7%	9.4
VI.	Profit for the financial period	9,691	27,430	24,190	1.5%	249.6
	<b>LIABILITIES</b>					
<b>B.</b>	<b>NON-CURRENT LIABILITIES</b>	<b>440,939</b>	<b>415,960</b>	<b>433,212</b>	<b>27.3%</b>	<b>98.2</b>
I.	Financial liabilities	397,384	376,249	392,956	24.8%	98.9
II.	Derivative financial instruments	180	0	0	0.0%	-
III.	Deferred income tax liabilities	13,490	13,401	12,710	0.8%	94.2
IV.	Retirement benefit obligations	16,105	15,092	16,105	1.0%	100.0
V.	Provisions for other liabilities and charges	13,779	11,218	11,441	0.7%	83.0
<b>C.</b>	<b>CURRENT LIABILITIES</b>	<b>463,065</b>	<b>510,099</b>	<b>494,077</b>	<b>31.2%</b>	<b>106.7</b>
I.	Trade and other payables	252,233	280,014	299,246	18.9%	118.6
II.	Current income tax payables	1,235	0	8,293	0.5%	671.5
III.	Financial liabilities	209,597	230,085	186,538	11.8%	89.0
	<b>TOTAL LIABILITIES</b>	<b>904,004</b>	<b>926,059</b>	<b>927,289</b>	<b>58.5%</b>	<b>102.6</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>1,521,402</b>	<b>1,541,773</b>	<b>1,585,867</b>	<b>100.0%</b>	<b>104.2</b>
	Number of employees as at the end of the period	12,957	13,079	12,646		97.6

## Cash Flow Statement

in EUR 000

	Cash flows	1 - 9 2006	Plan 2007	1 - 9 2007
<b>A</b>	<b>Operating activities</b>			
1	Cash generated from operations	-3,466	179,824	110,219
2	Interest paid	-16,019	-30,544	-20,467
3	Income tax paid	-7,446	-10,458	-7,738
	<b>Net cash generated from operating activities</b>	<b>-26,930</b>	<b>138,821</b>	<b>82,013</b>
<b>B</b>	<b>Investing activities</b>			
1	Acquisition of subsidiaries, net of cash acquired	-16,058	-12,364	-34,011
2	Purchases of property, plant and equipment (PPE)	-61,041	-89,698	-41,426
3	Purchases of intangible assets	-427	-7,603	-898
4	Purchases of available-for-sale financial assets	-2,920	0	-98
5	Purchases of current investments	0	0	0
6	Loans made	-287	0	0
7	Proceeds from disposal of subsidiaries	0	0	9,100
8	Proceeds from sale of PPE	10,641	11,726	5,087
9	Proceeds from sale of intangible assets	0	0	0
10	Proceeds from sale of available-for-sale financial assets	0	0	9,259
11	Proceeds from sale of current investments	4,279	0	0
12	Interest received	4,167	5,920	2,898
13	Dividends received	0	0	393
14	Loan repayments received	304	-571	445
	<b>Net cash used in investing activities</b>	<b>-61,343</b>	<b>-92,590</b>	<b>-49,251</b>
<b>C</b>	<b>Financing activities</b>			
1	Proceeds from issuance of shares	20,515	0	0
2	Proceeds from sell of treasury shares	0	0	7,200
3	Proceeds/repayments of borrowings	76,655	-35,879	-27,487
4	Purchase of treasury shares	0	0	0
5	Dividends paid to Company's shareholders	-8,758	-10,213	-14,723
	<b>Net cash used in financing activities</b>	<b>88,412</b>	<b>-46,093</b>	<b>-35,009</b>
	Increase/decrease of cash and cash equivalents	139	139	-2,247
	<b>Movements of cash and cash equivalents</b>			
	Cash at the beginning of the period	7,592	5,573	2,493
	Increase/Decrease	139	139	-2,247
	Currency translation differences	0	0	0
	<b>Cash at the end of the period</b>	<b>7,731</b>	<b>5,712</b>	<b>246</b>

## Statement of Changes in Equity

in EUR 000

	Share capital		Revenue reserves				Revaluation reserve	Retained earnings	Profit for the year	Total
	Ordinary shares	Share premium	Legal reserves	Reserves for treasury shares	Treasury shares	Other revenue reserves				
<b>Balance as at 1 January 2006</b>	140,074	159,890	13,391	5,221	-5,221	73,431	74,617	53,498	2,624	517,526
Adjustment according to IAS 19	0	0	0	0	0	0	0	-4,261	0	-4,261
<b>Balance as at 1 January 2006 (adjusted)</b>	140,074	159,890	13,391	5,221	-5,221	73,431	74,617	49,237	2,624	513,264
Revaluation of PP&E to fair value (increase of revaluation reserve)	0	0	0	0	0	0	640	-7,461	0	-6,821
Cash flow hedge net of tax	0	0	0	0	0	0	0	398	0	398
Currency translation differences	0	0	0	0	0	0	1,792	0	0	1,792
<b>Net income (expense) recognised directly in equity</b>	0	0	0	0	0	0	2,432	-7,063	0	-4,631
Profit for the financial period	0	0	0	0	0	0	0	0	23,722	23,722
<b>Total recognised income and expense in the financial period</b>	0	0	0	0	0	0	2,432	-7,063	23,722	19,091
<b>Purchase of treasury shares</b>	0	0	0	320	-320	0	0	-320	0	-320
Dividend payout	0	0	0	0	0	0	0	-8,822	0	-8,822
Allocation of net profit in line with the Shareholders Assembly resolution	0	0	0	0	0	59	0	16,962	-17,021	0
Issue of share capital	5,331	15,183	0	0	0	0	0	0	0	20,515
<b>Balance as at 30 September 2006</b>	145,405	175,074	13,391	5,541	-5,541	73,490	77,049	49,995	9,325	543,729

in EUR 000

	Share capital		Revenue reserves				Revaluation reserve	Retained earnings	Profit for the year	Total
	Ordinary shares	Share premium	Legal reserves	Reserves for treasury shares	Treasury shares	Other revenue reserves				
<b>Balance as at 1 January 2007</b>	157,126	193,298	13,389	4,900	-4,900	56,478	74,988	122,119	0	617,398
Revaluation of PP&E to fair value	0	0	0	0	0	16,999	-3,010	7,201	0	21,190
Cash flow hedge net of tax	0	0	0	0	0	0	0	3,405	0	3,405
<b>Net income (expense) recognised directly in equity</b>	0	0	0	0	0	16,999	-3,010	10,606	0	24,595
Profit for the financial period	0	0	0	0	0	0	0	0	24,190	24,190
<b>Total recognised income and expense in the financial period</b>	0	0	0	0	0	16,999	-3,010	10,606	24,190	48,786
Disposal of treasury shares	0	5,550	0	0	1,651	0	0	0	0	7,201
Dividend payout	0	0	0	0	0	0	0	-14,806	0	-14,806
Allocation of net profit in line with the Management/Supervisory Board resolution	3	0	0	0	0	107,311	0	-107,314	0	0
<b>Balance as at 30 September 2007</b>	157,129	198,848	13,389	4,900	-3,250	180,788	71,978	10,606	24,190	658,578

## Notes to the Financial Statements

### NOTES TO THE INCOME STATEMENT

- **Net sales revenues**

Net sales revenues for the period 1 - 9 2007 amounted to EUR 1,241,644 thousand, which is an increase over the comparable period last year by 4.4 %, and represents 77.0 % of planned net sales revenues for the year 2007.

Revenues resulting from the sale of goods and materials amounted to EUR 1,147,512 thousand, which is EUR 39,058 thousand or 3.5 % more compared to the same period last year.

Revenues from sales of products and services amounted to EUR 95,449 thousand, which is a 15.4 % increase compared to the same last year period.

- **Cost of goods sold**

Cost of goods sold including production costs, purchase value of goods and materials, and other operating expenditures in the relevant period, amounted to EUR 907,967 thousand, and exceed the last year figures for the same category by 5.0 %; this is mostly the consequence of increased scale of operations.

- **Gross profit**

Gross profit for the period 1 - 9 2007 amounted to EUR 333,677 thousand, which is 2.7 % more than in the period 1 - 9 2006, and represents 72.8 % of the 2007 plan.

- **Selling costs and administrative expenses**

Selling costs and administrative expenses amount to EUR 297,965 thousand, which is 3.5 % more than in the same period last year; the figure represents 74.2 % of the planned value for 2007.

## Expenses by nature

in EUR 000

	Type of Cost	1 - 9 2006	1 - 9 2007	Index
1.	Costs of material	22,959	22,495	98.0
2.	Costs of services	74,475	76,939	103.3
3.	Depreciation and amortisation	32,829	32,419	98.8
4.	Labour costs	150,915	156,173	103.5
5.	Other expenses	6,820	9,939	145.7
6.	Cost of goods sold	864,832	907,967	105.0
7.	<b>TOTAL COSTS</b>	<b>1,152,831</b>	<b>1,205,932</b>	<b>104.6</b>

Costs of material amounted to EUR 22,495 thousand, and recorded a 2.0 % decrease compared to the same period last year.

Costs of services amount to EUR 76,939 thousand, and have risen by 3.3 % compared to the same period of the last year. Increase in the costs of services is predominantly the result of rising costs of transport and telecommunications, and current maintenance costs.

Labor costs amounted to EUR 156,173 thousand, which is 3.5 % more than in the same period last year. In the period 1 - 9 2007, labor costs per employee from hours worked amount to EUR 17.3 thousand, which is 6.6 percent more than in the corresponding period last year.

Also included among the administrative expenses are the losses from the disposal of PPE in the amount of EUR 753 thousand, and adjustments in current assets in the amount of EUR 4,023 thousand.

- **Other revenues from operations**

Other revenues from operations in the period 1 - 9 2007 amounted to EUR 8,323 thousand, which is 48.3 % more than in the same period last year. Comprising this increase, disposed / decreased provisions due to projects of optimization of operations and category management account for EUR 2,879 thousand, and proceeds from the disposal of PPE amounted to EUR 1,272 thousand (in the period 1 - 9 2006, proceeds from disposal of PPE amounted to EUR 3,270 thousand). EUR 4,172 thousand relates to other revenues, including mostly collected claims that were previously written off, proceeds from remunerations and other revenues.

- **Operating profit**

Operating profit for the period 1 - 9 2007 amounts to EUR 44,035 thousand which is EUR 1,414 thousand more than the figure for the same period last year and represents 69.7 % of the planned figure for 2007.

- **Finance income and costs / expenses**

In the period 1 - 9 2007, finance income amounted to EUR 16,827 thousand of which EUR 13,652 thousand relates to financial revenues from shares owned in companies (disposal of the company M Hotel, d.o.o., dividends received, disposal of various commercially unviable financial assets, etc.).

Finance costs in the period 1 - 9 2007 amounted to EUR 28,300 thousand, of which the better part of EUR 20,741 relates to finance costs for interests and other liabilities.

- **Profit for the financial period**

Company net profit for the period 1 - 9 2007 amounted to EUR 24,190 thousand, which is EUR 469 thousand more than in the same period of the last year, and represents 88.2 % of the 2007 plan.

## NOTES TO BALANCE SHEET

- **Property, plant and equipment, investment property and intangible assets**

As at September 30<sup>th</sup> 2007, the value of PPE, investment property, and intangible assets amounts to EUR 747,967 thousand, which is EUR 2,700 thousand more than at the beginning of the year. These assets represent 47.2 % of total assets. The change in value is a result of investment, amortization and depreciation, and disposal of commercially unviable assets.

- **Derivative financial instruments**

As at September 30<sup>th</sup> 2007, the derivative financial instruments intended for hedging the risks to cash flow, at positive fair value, amounted to EUR 5,211 thousand, which is EUR 3,225 thousand more than at the end of 2006. The difference is indicated as increase in equity.

- **Non-current trade and other receivables**

Non-current trade and other receivables as at September 30<sup>th</sup> 2007 amount to EUR 465 thousand, which is EUR 127 thousand less than at the beginning of 2007.

- **Available-for-sale financial assets**

Available-for-sale financial assets as at September 30<sup>th</sup> 2007 amount to EUR 488,797 thousand, and are primarily related to ownership shares in the subsidiaries of the Mercator Group in Slovenia and abroad. Compared to the beginning of the year, available-for-sale financial assets have increased by EUR 42,684 thousand, which relates mostly to the purchase of additional share in the subsidiaries abroad.

- **Inventories**

Inventories of raw materials, material, and trade goods as at September 30<sup>th</sup> 2007 amount to EUR 167,739 thousand, and represent 50.1 % of total current assets. Compared to the beginning of the year, the value of inventories rose by EUR 4,922 thousand, or 3.0 %.

- **Current trade and other receivables**

As at September 30<sup>th</sup> 2007, current trade and other receivables amounted to EUR 167,062 thousand, which is EUR 10,464 thousand or 6.7 % more than at the beginning of the year. Among other current receivables are the short-term loans granted, deposits, and short-term financial investments, which amounted to EUR 1,098 thousand as at September 30<sup>th</sup> 2007.

- **Equity**

In the period 1 - 9 2007, company equity increased by EUR 41,180 thousand. The changes relate to the following:

- increase by net profit attained in the period 1 - 9 2007, in the amount of EUR 24,190 thousand;
- increase in equity by the adjustment of fair value of derivative financial instruments in the amount of EUR 3,405 thousand;
- decrease in equity by liabilities for payment of dividends in compliance with the resolution of Shareholder's Assembly that took place on June 27<sup>th</sup> 2007, in the amount of EUR 14,806 thousand.
- increase due to special revaluations of equity in the amount of EUR 21,191 thousand;
- increase in the amount of EUR 7,200 thousand due to the payment of purchase price for the ownership share in the company Presoflex, d.o.o., with treasury shares from the treasury shares fund.

#### Treasury shares

As at December 31<sup>st</sup> 2006, the company Poslovni sistem Mercator, d.d., owned 63,906 own / treasury shares with total value of EUR 4,900 thousand. In July 2007, the company Poslovni sistem Mercator, d.d., allocated 21,525 treasury shares with a value of EUR 7,200 thousand, for the purchase of ownership share in the company Presoflex, d.o.o. The difference between total purchase price and the decrease in treasury shares in the amount of EUR 5,550 thousand, is recorded as a paid up equity surplus. As at September 30<sup>th</sup> 2007, the company Poslovni sistem Mercator, d.d., owned 42,381 treasury shares with a total value of EUR 3,250 thousand.

Basic return on equity calculated as the ratio between net profit and average equity in the period at hand amounts to 5.2 %.

- **Financial liabilities**

As at September 30<sup>th</sup> 2007, financial liabilities amounted to EUR 579,494 thousand, which is EUR 27,487 thousand less than at the end of 2006. The decrease is related to the revised policy of current payables management in 2007.

Compared to the beginning of the year, the maturity of financial liabilities has changed. Non-current financial liabilities now represent 67.8 % of the total financial liabilities, and current liabilities represent the remaining 32.2 % (as at December 31<sup>st</sup> 2006, the ratio between non-current and current financial liabilities was 65.5 vs. 34.5).

- **Retirement benefit obligations**

As at September 30<sup>th</sup> 2007, the total retirement benefit obligations amounted to EUR 16,105 thousand, and they have not changed considerably compared to the beginning of the year. During the year, the value of retirement benefit obligations will not be changed; at the end of the year, the obligations shall be re-measured and adjusted as necessary.

- **Provisions for liabilities and charges**

As at September 30<sup>th</sup> 2007, the provisions for liabilities and charges amounted to EUR 11,441 thousand. Compared to the beginning of the year, these provisions have decreased by EUR 2,338 thousand. Comprising these changes, EUR 2,879 thousand relates to the disposal / decrease of provisions due to projects of operations optimization and category management, while the increase in provisions for liabilities and charges in the amount of EUR 541 thousand relates to increase in provisions for improvement of working conditions for the disabled.

- **Deferred taxes**

In the period 1 - 9 2007, the company has recognized both deferred income tax payables and receivables. As at September 30<sup>th</sup> 2007, net deferred income tax liabilities totaled at EUR 4,329 thousand.

- **Trade and other payables**

Trade and other payables as at September 30<sup>th</sup> 2007 amounted to EUR 299,246 thousand, which is EUR 47,013 thousand more than at the end of 2006.

During a recent case, Slovenian law practitioners adopted the view that normative and tariff part of the collective labor agreement for trade industry related to commuting refund are mutually inconsistent; as a result, employees are receiving more benefits than stipulated. Mercator has already taken steps to protect its interest. Since probability and amount of any liabilities of Slovenian companies of the Mercator Group, related to these proceedings, cannot be estimated, they are not included among the potential liabilities.

## Financial indicators

	Poslovni sistem Mercator, d.d.		
	1 - 9 2006	Plan 2007	1 - 9 2007
Indicators of profitability			
Return on equity	10.7%	4.6%	5.2%
Return on sales	2.0%	1.7%	1.9%
Indicators of financial structure			
Financial liabilities / equity	0.98	0.98	0.88
Equity and provisions for liabilities and charges to total equity and liabilities	41.5%	40.7%	42.2%
Financial liabilities to total equity and liabilities	39.9%	39.3%	36.5%
Trade and other payables to total equity and liabilities	16.7%	18.2%	19.4%
Indicators of operating efficiency and productivity			
Labor costs per hours worked (in EUR 000)	16,166	16,709	17,225
Sales / labor costs	7.9	7.8	8.0
Revenues per employee per hours worked (in EUR 000)	127,458	129,699	136,950
Value added per employee per hours worked (in EUR 000)	23,958	24,754	25,343
Total costs without depreciation and provisions / sales	21.1%	22.1%	20.8%