



**Mercator**

**Business Report**  
**for the period I-III 2006**  
**Mercator Group and the company**  
**Poslovni sistem Mercator, d.d.**



Poslovni sistem Mercator, d.d.  
Management Board

May 2006

## TABLE OF CONTENTS

<b>SUMMARY</b>	<b>3</b>
<b>MAJOR EVENTS FOR THE PERIOD I- III 2006</b>	<b>4</b>
<b>FINANCIAL HIGHLIGHTS FOR THE PERIOD I – III 2006</b>	<b>7</b>
<b>COMPANY PROFILE</b>	<b>8</b>
ORGANIZATIONAL STRUCTURE OF THE MERCATOR GROUP	9
OWNERSHIP STRUCTURE	9
COMPANY MANAGEMENT	11
<b>BUSINESS REPORT</b>	<b>12</b>
STRATEGIC POLICIES OF THE MERCATOR GROUP	12
MARKET CIRCUMSTANCES	13
DEVELOPMENT AND INVESTMENTS	14
MARKETING	15
PRODUCT CATEGORY MANAGEMENT AND SUPPLIER RELATIONS	20
SALES	22
LOGISTICS	24
HUMAN RESOURCES	24
ORGANIZATION AND QUALITY	26
INFORMATION TECHNOLOGY	28
FINANCIAL OPERATION	30
SHAREHOLDER RELATIONS	30
RISK MANAGEMENT	33
COMMUNICATION WITH STAKEHOLDERS	33
<b>FINANCIAL STATEMENTS</b>	<b>36</b>
ACCOUNTING POLICIES	36
CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP	36
Consolidated Income Statement	37
Consolidated Balance Sheet	38
Consolidated Cash-Flow Statement	39
Consolidated Movements in Equity Statement	40
Notes to the Consolidated Financial Statements	40
Financial indicators	46
FINANCIAL STATEMENTS OF THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.	47
Income Statement	47
Balance Sheet	48
Cash-Flow Statement	49
Movements in Equity Statement	49
Notes to the Financial Statements	50
Financial indicators	55
<b>EVENTS FOLLOWING THE BALANCE SHEET DATE</b>	<b>56</b>

## SUMMARY

### **In the first quarter of 2006 Mercator operates successfully and in line with the business plan**

**In the period I-III 2006, the net revenues from sales of the Mercator Group amounted to SIT 104.5 billion, which is 14 % more than in the same period last year. Net profit of the Mercator Group in the period I-III 2006 reached SIT 1.9 billion, which is 53.4 % more than in the same period of the previous year, when it amounted to SIT 1.2 billion.**

The profit of the Mercator Group in the first quarter of 2006 was considerably influenced by net proceeds from disposal of fixed assets, mostly pertaining to the sale of the Kanin hotel. If the effects of net proceeds from disposal of fixed assets are omitted, net profit of the Mercator Group in the period I – III 2006 amounts to SIT 1.4 billion (compared to SIT 1.1 billion in the period I – III 2005), which is a 22.0 % increase compared to the same period of the previous year.

**Gross cash flow from operating activities, realized by the Mercator Group in the first quarter of 2006 amounted to SIT 6.7 billion, which is 17.1 % more than in the same period of the previous year. The category of gross cash flow omits any relevant non-cash and non-continuous accounting categories, including the net proceeds from disposal of fixed assets mentioned above, thus representing a comparable indicator.**

In the period I – III 2006, investments of the Mercator Group amounted to SIT 12.6 billion, the majority thereof being allocated in fixed assets.

As at March 31<sup>st</sup> 2006, the Mercator Group had 17,477 employees, 3,535 of which were employed outside Slovenia.

Market conditions in the first quarter of 2006 were harsh in all markets. Revenue growth was positively influenced by intense marketing activities, partial removal of Sunday opening hours restriction, and the beginning of operation of new and renovated retail units. Negative effects on revenue of major shopping centers continue to stem from the remaining restrictions of opening hours, as only stores with alimentary products may operate on Sundays, while almost all other stores are not allowed to be open; thus, normal operation of larger shopping centers is considerably hindered. Furthermore, the acquired Era retail units in Croatia and Slovenia had not attained planned revenues at the end of the first quarter of 2006. Operating costs in the period at hand were significantly influenced by the cost of double pricing, imposed by the plan of preparations for the adoption of

Euro, and costs of integrating the acquired Era's trade operating activities in Croatia and Slovenia into the Mercator Group.

The Management Board estimates that performance was successful in the first quarter of 2006 and that it was in line with the economic or business plan.

## **MAJOR EVENTS FOR THE PERIOD I- III 2006**

### **CORPORATE GOVERNANCE**

The Management Board of the company Mercator, d.d., that assumed its term on January 1<sup>st</sup> 2006, presented the goals set ahead at the press conference held on January 4<sup>th</sup> 2006; after that, it paid a series of representational visits to Mercator's foreign markets. From January to March 2006, the management visited Mercator employees in all regions – both in Slovenia and abroad.

The Supervisory Board of the company Poslovni sistem Mercator, d.d., met twice in the first quarter of 2006, and discussed the Business Plan of the Mercator Group for the year 2006, the non-audited and audited financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., as well as adopted the proposed agenda and resolutions for the 12<sup>th</sup> regular Shareholders Assembly.

### **CONSOLIDATION OF OPERATING ACTIVITIES**

In January 2006 the Era Slovenian retail and wholesale network was integrated into the Mercator Group.

On January 1<sup>st</sup> 2006, the retail operating activities of the company Alpkomerc Tolmin, d.d., were transferred to the controlling company.

On January 26<sup>th</sup> 2006, the company Era Tornado, d.o.o., which had been acquired in 2005, was merged with the company Mercator – H, d.o.o.; at February 28<sup>th</sup>, the company Trgohit, d.o.o., Croatia, was also merged with the same company.

In the period I – III 2006, the company Poslovni sistem Mercator, d.d., performed a capital increase of its subsidiaries abroad in the amount of SIT 3,007 million.

### **MARKETING ACTIVITIES**

In January 2006, we started to upgrade our customer loyalty program. The project included devising a strategy of the Mercator Pika loyalty program, above

all to establish a comprehensive CRM system (Customer Relation Management), and included new benefits for the Mercator Pika card holders.

At the end of 14<sup>th</sup> benefit period, we celebrated the Pika Day on March 25<sup>th</sup> 2006 in Mercator center in Novo mesto.

## **STRATEGIC PROJECTS FOR BOOSTING COMPETITIVENESS**

In the first quarter of 2006, we designed and performed 4 strategic projects for boosting competitiveness of the Mercator Group:

- ✓ optimizing the operation of the Mercator Group,
- ✓ rebuilding the information system,
- ✓ optimization of logistics facilities,
- ✓ category management.

The intent of the projects listed is to improve competitiveness and business performance of the Mercator Group.

## **COMMUNICATION WITH STAKEHOLDERS**

### EMPLOYEES

In January 2006 we upgraded the image and contents of the Mercator internal magazine and named it "Časomer" ("The Time Keeper").

### BUSINESS PARTNERS

We spent the Valentine's Day, February 14<sup>th</sup> 2006, in the company of our suppliers from Slovenia, Croatia, Serbia and Montenegro and Bosnia and Herzegovina, at the traditional Marketing Days, which we organized for the seventh time. Strategic policies, marketing strategy and procurement policies were presented at the event.

### FINANCIAL COMMUNITY

On March 16<sup>th</sup> 2006, the 6<sup>th</sup> traditional Mercator Finance Partners Meeting was held. The meeting included the presentation of Mercator strategic policies for the period 2006-2010, review of business performance in 2005 along with the plan for 2006, and the presentation of financial policies for 2006.

## **SOCIALLY ACCOUNTABLE ACTION AND OPERATION**

In the winter period of the third season of our humanitarian campaign "We Were All Children", which is performed in cooperation with the company Pejo trading, d.o.o., and the "Friends of the Youth Association" of Slovenia, we enabled winter holidays in March to 100 children from socially / financially deprived families.

On March 1<sup>st</sup> 2006, the play "Lumpi's day in the woods" was performed for the first time in the Puppet theatre; the play will cheer the youngsters in Mercator centers and hospitals across Slovenia.

As a part of our central humanitarian campaign "M book", we started in March the musical competition "Books sung out loud", which will take place in Mercator centers until mid-June. Youngsters aged 12 to 16 may join their passion for books and music and contest for the award – recording their own music CD.

## **INFLUENCE OF MARKET CONDITIONS ON THE OPERATING ACTIVITIES**

On February 14<sup>th</sup> 2006, the Constitutional Court withheld the validity of the Trade Act amendment that restricted the opening hours of daily consumer product retail units to a maximum of 10 Sundays per year. Thus, shops with daily consumer products may be open without restrictions on Sundays as well, until the final decision on the issue is reached.

On March 6<sup>th</sup> 2006, Mercator joined with 16 other Slovenian trade companies to file a motion at the Constitutional Court of Republic of Slovenia for the assessment of constitutionality of the 3<sup>rd</sup>, 4<sup>th</sup> and 5<sup>th</sup> paragraph of Article 17 of the new Trade Act; these paragraphs were changed and amended by the 1<sup>st</sup> article of the Act amending the Trade Act, and by article 2, 3 and 4 of the Rules and Regulations for Detailed Definition of Daily Consumer Products.

On March 1<sup>st</sup> 2006, the Act on double pricing was adopted, rendering compulsory the indication of prices both in Slovenian Tolars and in Euros. Trade companies started to indicate prices in both currencies according to the central parity rate.

## **CHANGE IN THE APPLICATION OF ACCOUNTING STANDARDS**

Based on the resolution of the Shareholders Assembly dated August 30<sup>th</sup> 2005 and pursuant the Company Act, the Company Poslovni sistem Mercator, d.d., compiles its financial statements and the Annual report as of January 1<sup>st</sup> 2006, only in accordance with the International Financial Reporting Standards.

## **ISSUE OF NEW SHARES**

On January 31<sup>st</sup> 2006, the company KD Group, d.d., paid for its share of capital increase in the amount of SIT 4,115 million, thus acquiring 106,950 new shares; the company KLM, d.d., paid for a apart of the capital increase option in the amount of SIT 800 million, for 20,790 new shares. January 31<sup>st</sup> 2006 was the official deadline for the subscription of new shares. All invited companies, expect for KLM, d.d., paid for the shares offered in the entire sum. In line with the Supervisory Board resolution, the company Poslovni sistem Mercator, d.d., offered the remaining unsubscribed shares (259,360 shares) to other investors in

the proportionate respective shares, which meant 86,453 shares per investor. As the investors waived the option to subscribe additional shares, these remain non-issued.

On March 28<sup>th</sup> 2006, the increase of the company share capital was duly entered into the Court Register held at the District Court in Ljubljana, with the filing number 1/02785/00. After the increase, the share capital of the company Poslovni sistem Mercator, d.d., amounts to SIT 35,908,440,000.00 and is divided into 3,950,844 ordinary shares with nominal value SIT 10,000.00.

## KEY INFORMATION FOR THE SHAREHOLDERS

On March 31<sup>st</sup> 2006, the average price per share of the company Poslovni sistem Mercator, d.d., traded in the official market (regular quotation) of the Ljubljana Stock Exchange, d.d., with the code MELR, amounted to SIT 36,542.

Book value of the share, calculated as a quotient between the total company equity value and the number of shares, registered in the Court Register as at March 31<sup>st</sup> 2006, amounted on March 31<sup>st</sup> 2006 to SIT 36,360.

Basic net yield of ordinary share, calculated as a quotient between the net profit realized in the period at hand and the number of shares registered in the Court Register as at March 31<sup>st</sup> 2006, amounted to SIT 516 for the period I – III 2006.

## FINANCIAL HIGHLIGHTS FOR THE PERIOD I – III 2006

	Mercator Group				
	1-3 2005	Plan 2006	1-3 2006	Index 1-3 06 / 1-3 05	Index 1-3 06 / plan 06
Sales (in SIT 000)	91,679,654	465,362,410	104,542,906	114.0	22.5
Profit/loss for the financial period (in SIT 000)	1,230,023	6,135,219	1,886,801	153.4	30.8
Cash flow from operating activities (in SIT 000)	5,725,742	30,015,815	6,706,232	117.1	22.3
Capital expenditure (in SIT 000)	9,738,327	40,180,896	11,545,637	118.6	28.7
Long-term financial investment (in SIT 000)	12,417	0	1,016,687	8,187.9	-
Return on equity *	4.8%	4.5%	6.3%	131.0	139.7
Return on sales	1.3%	1.3%	1.8%	138.8	138.8
Cash flow from operating activities / Sales	6.2%	6.4%	6.4%	102.7	100.2
Number of employees based on hours worked	14,703	16,444	16,342	111.1	99.4
Number of employees based on balance (at Mar 31)	15,514	17,643	17,477	112.7	99.1

\* Adjusted on annual basis

## COMPANY PROFILE

Full name	Poslovni sistem Mercator, d. d.
Abbreviated name	Mercator, d. d.
Affairs of the company	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	12. 10. 1995
Nominal value of one share	SIT 10,000
Number of shares quoted at the Ljubljana Stock Exchange as at March 31, 2006	3,590,844
Share listing	Ljubljana Stock Exchange, Official market, trading code MELR
President & CEO	Žiga Debeljak
Management Board Members	Vera Aljančič Falež, Mateja Jesenek, Peter Zavrl
Chairman of the Supervisory Board	Robert Šega

## ORGANIZATIONAL STRUCTURE OF THE MERCATOR GROUP

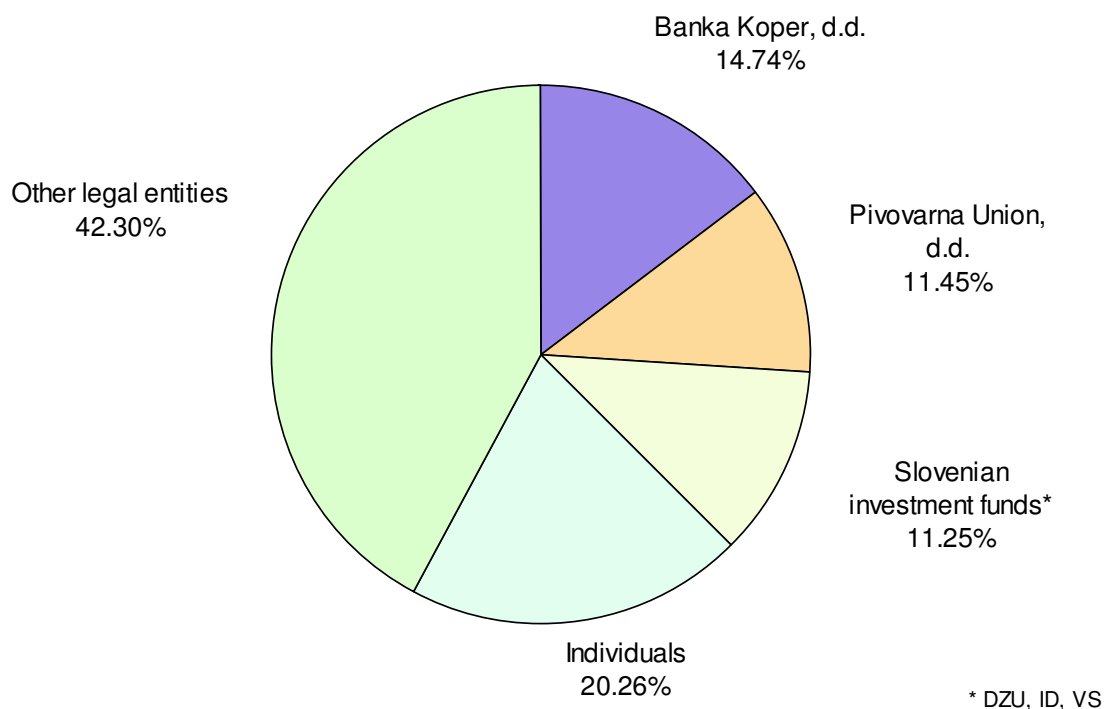
31. 12. 2005	31. 3. 2006
<b>TRADING COMPANIES IN SLOVENIA</b>	
Poslovni sistem Mercator, d.d.	Poslovni sistem Mercator, d.d.
M - SVS, d.d. (100.00 %)	M - SVS, d.d. (100.00 %)
Alpkomerc Tolmin, d.d. (97.45 %)	Alpkomerc Tolmin, d.d. (97.45 %)
Emona Maximarket, d.d. (98.95 %)	Emona Maximarket, d.d. (98.95 %)
M- Modna hiša, d.o.o. (100.00 %)	M- Modna hiša, d.o.o. (100.00 %)
Savski otok, d.o.o. (100.00 %)	Savski otok, d.o.o. (100.00 %)
<b>TRADING COMPANIES ABROAD</b>	
M - H, d.o.o., Croatia (99.85 %)	M - H, d.o.o., Croatia (99.85 %)
- Era Tornado, d.d., Croatia (100.00 %)	Merged with the company M – H, d.o.o. (26.1.2006)
- Trgohit, d.o.o., Croatia (100.00 %)	Merged with the company M – H, d.o.o. (28.2.2006)
M - S, d.o.o., Serbia (100.00 %)	M - S, d.o.o., Serbia (100.00 %)
M - BH, d.o.o., Bosnia (100.00 %)	M - BH, d.o.o., Bosnia (100.00 %)
Mercator Macedonia, d.o.o., Macedonia (90.00 %)	Mercator Macedonia, d.o.o., Macedonia (90.00 %)
<b>NON-TRADING COMPANIES</b>	
Pekarna Grosuplje, d.d. (75.13 %)	Pekarna Grosuplje, d.d. (75.13 %)
- Belpana, d.o.o. (100.00 %)	- Belpana, d.o.o. (100.00 %)
Eta, d.d. (97.33 %)	Eta, d.d. (97.33 %)
M - Emba, d.d. (69.17 %)	M - Emba, d.d. (69.17 %)
M - Optima, d.o.o. (100.00 %)	M - Optima, d.o.o. (100.00 %)
M Hotel, d.o.o. (100.00 %)	M Hotel, d.o.o. (100.00 %)

## OWNERSHIP STRUCTURE

### Ownership structure

On March 31<sup>st</sup> 2006 the Share Register of the company Poslovni sistem Mercator, d.d. indicated 19,649 shareholders or 752 or 3.7 % less compared to the situation as at Dec. 31, 2005 (20,401).

**Ownership structure of the company Poslovni sistem Mercator, d.d., on March 31, 2006:**



**Major shareholders**

As at March 31, 2006 the following ten major shareholders owned jointly 57.6 % of the company:

1	Banka Koper, d.d.	14.74 %
2	Pivovarna Union, d.d.	11.45 %
3	Infond holding, d.d.	6.67 %
4	Pivovarna Laško, d.d.	6.56 %
5	Istrabenz, d.d.	5.16 %
6	Delniški vzajemni sklad Triglav steber I	3.32 %
7	NFD 1 delniški investicijski sklad, d.d.	3.13 %
8	Sava, d.d.	2.94 %
9	Poslovni sistem Mercator, d.d.	2.12 %
10	Small world fund	1.50 %

As at March 31, 2006 the share of foreign investors in the company Poslovni sistem Mercator, d.d., amounted to 7.5 % which is 0.9 % increase compared to the year end 2005.

## COMPANY MANAGEMENT

### Supervisory Board

As at March 31, 2006 the Supervisory Board consisted of eleven supervisors. The twelfth supervisor will presumably be appointed at the 12<sup>th</sup> regular annual meeting of the Shareholder's Assembly to be held on May 17, 2006. Following is the chart of MELR shares owned by the members of the Supervisory Board of the company Poslovni sistem Mercator, d.d., as at March 31, 2006:

	Chairman 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.	Gorazd Čuk (Deputy Chairman)	0	0.00000 %
4.	Dušan Mohorko	0	0.00000 %
5.	Kristjan Sušinski	300	0.00935 %
6.	Mateja Vidnar	0	0.00000 %
Members of the Board (workers representatives)			
7.	Ksenija Bračič	0	0.00000 %
8.	Jože Cvetek	2,000	0.06233 %
9.	Dragica Derganc	0	0.00000 %
10.	Jelka Žekar	500	0.01558 %
11.	Ivica Župetič	0	0.00000 %
	<b>TOTAL</b>	<b>2,800</b>	<b>0.08727 %</b>

Supervisor Gorazd Čuk resigned as the Deputy Chairman and the Supervisory Board member of the company Poslovni sistem Mercator, d.d., on April 12, 2006.

### The Management

The Management of the company Poslovni sistem Mercator, d.d., consists of the President and three members, starting their relevant 5-year terms of office on Jan. 1, 2006.

As at March 31, 2006 the members of the Management Board of the company Poslovni sistem Mercator, d.d., owned the following number of MELR shares:

Name and surname	Number of shares	Ownership share
Žiga Debeljak	1,100	0.03428 %
Vera Aljančič Falež	30	0.00094 %
Mateja Jesenek	1,000	0.03117 %
Peter Zavrl	60	0.00187 %
<b>TOTAL</b>	<b>2,190</b>	<b>0.06826 %</b>

## BUSINESS REPORT

### STRATEGIC POLICIES OF THE MERCATOR GROUP

#### VISION

**To be the leading retail chain for food and general consumption goods for home (market program) in South-East Europe.**

#### MISSION

Our business is aimed to create:

- Benefit for customers;
- Benefit for associates;
- Benefit for suppliers;
- Benefit for owners;
- Benefit for wider environment.

#### CORPORATE VALUES

- We are bound by trust and mutual appreciation;
- Nobody understands customer requirements and desires better than us;
- Our operations are prudent and transparent in each moment and at all levels;
- We expand 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 Montenegro, and in Bosnia and Herzegovina;
- Enter other SE Europe markets on long-term;
- Develop non-market programs;
- Provide profitable business operations.

#### STRATEGIC OBJECTIVES

- Growth of net revenues from trading operations in the annual average of 5% .
- Target market quotas until the year 2010:
  - Slovenia 40 %,
  - Croatia 12 %,
  - Serbia and Montenegro 10 %,
  - Bosnia and Herzegovina 5%.

- Investments: EUR 130 – 150 million annually;
- Increase business productivity and efficiency.

Detailed assumptions regarding the strategic policies of the Mercator Group are contained in the Mercator Group Annual Report for the year 2005 and in the Mercator Group Business Plan Summary for the year 2006. Both documents have been published at the stock exchange electronic information system.

## MARKET CIRCUMSTANCES

### **Sunday opening hours**

As of January 1<sup>st</sup> 2006, the Act amending the Trade Act came into force, restricting the Sunday opening hours of commercial facilities to a maximum of 10 Sundays per year. On February 14<sup>th</sup> 2006, the Constitutional Court withheld the validity and performance of a part of the Article of the Trade Act that contains this restriction. Consequently, shops with daily consumer products are allowed to be open at Sundays without any restrictions.

On March 6<sup>th</sup> 2006, Mercator joined 16 other Slovenian trade companies to file with the Constitutional Court of the Republic of Slovenia a motion to assess the constitutionality of the 3<sup>rd</sup>, 4<sup>th</sup> and 5<sup>th</sup> paragraph of article 17 of the new Trade Act, as amended by article 1 of the Act amending the Trade Act and articles 2, 3 and 4 of the Rules and Regulations for Detailed Definition of Daily Consumer Products.

### **Mercator preparations for the adoption of Euro**

In 2006 Slovenia is actively preparing for the adoption of Euro as the national currency, which should take place in the beginning of 2007. The first stage of Slovenian adoption of Euro began on March 1<sup>st</sup> 2006, when the Act on Double Pricing (indicating prices both in Tolars and in Euros) came into force. The main purpose of this Act is to acquaint the consumers with the new currency and help them adjust to the adoption of Euro. Trade companies must indicate product and service prices in Tolars and Euros, according to the central parity rate.

The project of Euro adoption was of great importance to Mercator and we wish to be prepared for the new currency as well as possible; hence, we were additionally motivated to participate actively in the preparation of the Euro Adoption Act. The adoption of Euro will have a positive effect on Mercator financial operations, as it will presumably decrease conversion costs, unify fees for overseas and domestic payment transactions and simplify payment procedures within Slovenia. On the other hand, double price indication and other preparations for the adoption of Euro required costs that were estimated at SIT 1 billion annually.

## General economic conditions

The first quarter of 2006 was marked by growth of the European inter-bank offered rate – EURIBOR. In the first three months of 2006, EURIBOR grew by more than 0.3 percentage point, causing the increase of variable interest rates. The growth of variable interest rates raised in turn the costs of financial debts.

The South European markets are increasingly important for Mercator; thus, the stabilization of macroeconomic environment and the accession of the region to European Union are of great interest for us. In Serbia, inflation remains considerable, causing inflation-related problems; however, the Serbian government has set ahead the goal to slash inflation to less than 10% in 2006.

## DEVELOPMENT AND INVESTMENTS

In the period 1 - 3 2006 Mercator Group realized SIT 11,546 million of investments into fixed assets, representing 28.7 percent realization of annual investment plan. The largest segment of all investments of the Mercator Group in total amount of SIT 7,625 million goes to the acquisition of Era retail outlets in Slovenia.

Country	Value (in thousands SIT)	Structure (in %)
Slovenia	8,923,191	77.3
Total investments in trading branch	8,853,677	76.7
Total investments in non-trading branch	69,514	0.6
Croatia	1,451,896	12.6
Bosnia and Herzegovina	932,110	8.1
Serbia and Montenegro	238,440	2.1
<b>TOTAL</b>	<b>11,545,637</b>	<b>100.0</b>

In addition to the integration of Era shops into the Mercator retail network in Slovenia, during the period 1 - 3 2006 we reopened the modernized supermarket in Tržič, and the superette Konzum in Senovo.

In the relevant period we also commenced the construction works on the Mostar Shopping Mall in Bosnia and Herzegovina, and the modernization of MC Samobor in Croatia.

In the first quarter of 2006 we also acquired several new building locations: in the town of Dragomer in Slovenia for the supermarket, in Sežana for the Hura! discount store, and in Croatia for the Mercator Center in the eastern Zagreb region.

## MARKETING

### Customer Relations Management

In line with the goals and the strategy of the Mercator Pika card and in order to offer added value to our loyal customers, the customer loyalty system of the Mercator Pika card is being developed, comprising additional benefits and surprises our loyal Mercator Pika card holders.

**As at March 31<sup>st</sup> 2006, there were 610,223 Mercator Pika card holders in Slovenia** – of these, 385,099 held blue cards, 223,518 held green cards and 1,606 held golden Pika cards. In Croatia, 81,502 Pika card holders were registered on the same day, with 68,390 holders of blue, 13,013 of green and 99 holders of golden card (green and golden card were introduced to the market on February 1<sup>st</sup> 2005); In Serbia and Montenegro, there were 37,989 Pika card holders in Serbia and Montenegro and 46,074 holders in Bosnia and Herzegovina (the green and golden card were introduced on August 1<sup>st</sup> 2005). **Hence, the total number of Mercator Pika card holders amounts to 775,788.** From January 1<sup>st</sup> to the end of March 2006, the number of card holders grew by 54,225, primarily due to marketing activities focused on the Pika card, that were performed in all markets of our operation, as well as merging the Era retail network to the Mercator Group, when **12,512** holders of the "Zrno na zrno ("Bit by Bit") card were agreed to sign up for the Mercator Pika card.

From January 1<sup>st</sup> to March 31<sup>st</sup> the following activities in the field of customer relations management:

- **upon the merging of ob Era retail network to the Mercator Group**, 12,512 holders of the "Zrno na zrno" ("Bit by Bit") card exchanged their former card for the Mercator Pika card;
- **all golden Mercator Pika card** were awarded for their loyalty with a free six-month subscription to the National Geographic magazine;
- **the "Double point"** campaign was performed 54 times;
- upon the conclusion of the 14<sup>th</sup> benefit period (in MC Novo mesto), a special **Pika Day** was held, including the final drawing and additional benefits for the customers (double points, free gifts for the customers etc.);
- **spreading the versatile applicability of the Mercator Pika card in the field of tourist services**; as of April 1<sup>st</sup>, Postojnska jama – turizem, d.d., was included in the Mercator Pika Card system;
- in the first quarter of 2006, we performed regular monthly **sales promotion activities for the holders of Mercator Pika card**, in all Mercator product ranges, as well as with the business partners in the Mercator Pika card system.

## Development of retail brand products

Mercator retail brand is a permanent strategic project that is represented throughout the Mercator retail network, in all franchise stores and all Cash&Carry stores. The fundamental characteristics of Mercator retail brand products are excellent quality, favorable price and a distinctive graphical image of each product range. The project includes products from all categories.

In the first three months of 2006, we continued to pursue the following goals:

- establishing reputation and distinctiveness of the retail brand product ranges,
- increasing the number of products included in the retailer brand product ranges,
- increasing the share of retail brand products in the total sales,
- promoting consumption by sales promotion activities and by innovative communication,
- establishing and managing customer relations – Mercator is a trustworthy partner.

### **Mercator retail brand products are developed within the following product ranges:**

- **Mercator products:** the range includes daily consumer products for households and is intended primarily to the price-sensitive customers, as it offers the best price/quality ratio. At the end of March 2006, the range included 309 products. At the end of March, a new comprehensive graphical image of the product range was designed and the revision of product packaging is already under way. Within one year, the new image will be applied to the entire product range.
- **"Popolna nega" (Perfect Care):** This product range includes cosmetic products for both men and women who are price-sensitive and do not pay particular attention to brands when buying cosmetic products. At March 31<sup>st</sup>, the product range included 73 products.
- **M-linija ("The M-line"):** This product range includes textile products (clothing, bedclothes, textile products for kitchen etc.) for daily use, intended for price-sensitive customers. At the end of March 2006, it included 181 products.
- **Lumpi:** Lumpi is a product range for children up to 10 years of age. At the end of March 2006, a total of 244 products were included in the range.
- **"Mizica, pogrni se!" ("The Table is Laid"):** The 99 products of this product range should be of great help to anyone that wishes to live a full life despite

the constant rush and spend their free time to family, sports and friends. These products enable a simple preparation of a quality and tasty meal. This line's development follows closely the trend of inclusion of instant preparation products that only need to be added some water or merely reheated.

- **Zdravo življenje ("Healthy life"):** Selected products of the "Healthy life" product range follow the recommendations and contemporary findings in the field of healthy nutrition. At the end of March 2006, the range included 77 products. In March 2006, several activities were performed to raise customer awareness and thus additionally increase their trust towards the "Healthy life" products. These activities were performed in cooperation with the Slovenian National Association for Prevention of Cardiac and Coronary Diseases which performed free cholesterol level tests, blood pressure tests and blood sugar tests; with representatives of the Health Protection Institute of the RS, who educated our customers about the healthy food preparation; with Cindi Slovenia, that performed presentations of Nordic walking in Mercator centers and informed about the possibilities to quit smoking; with the team of dr. Sentočnik, who advised on obesity prevention; and with the cooks Dantes and Jakob Polajžar, who prepared dishes with the "Healthy life" products. The campaign was accompanied by TV advertisements, printed ads, internet ads, and by a campaign recipe booklet.
- **5 na dan ("Five per day") project:** From January 9<sup>th</sup> to February 9<sup>th</sup> 2006, we performed an extensive advertising campaign in order to boost sales of fruits and vegetables. The customers were offered a variety of presents, according to the quantity of goods purchased. The campaign was very successful, as the sales of products from fruit and vegetables category increased by 80% in this period.

**As at March 31<sup>st</sup> 2006, Mercator retailer brand included a total of 983 products** (when different tastes, colors, sizes and fragrances are accounted for); 48 of these were developed in the first three months of the current year.

The products of the Mercator retailer brand are developed in all markets of the Mercator operations. In **Croatia**, there were 475 **products** with the Mercator retailer brand at the end of March 2006; in **Serbia and Montenegro** there were **432 products**, and in **Bosnia and Herzegovina**, there were **623**.

Key projects within the **Mercator retail brand** product ranges, which are aimed at increasing distinctiveness and a positive reputation in 2006, and which will be supported by active communication, are Lumpy, "The Table is Laid", "Healthy Life" and generic products. Apart from this, the graphical image of Mercator retail brand will be redesigned, while other product ranges will be further developed to improve their distinctiveness. Product ranges will be upgraded by focusing on price competitiveness and the requirements of specific customer segments.

In 2006, we started to develop the new range of generic products within our retailer brand. This range that will be introduced to Mercator stores at the end of June will include daily consumer products for the most price-sensitive customers. The goal of this range will be to offer products at the lowest price in the market.

### Sales Promotion Projects

In 2006 we updated the established forms of short-term and long-term sales promotion activities, upgraded them and added new ones. In general, we made our approach to sales promotion more aggressive, in order to attain the following two goals:

- to be the and distinctive supplier of special offer goods in all markets of our operation,
- to make the customers perceive us as the company that offers value added, or the company that offers something more.

All activities are focused on **improving price competitiveness and the choice of special offer products.**

Among the long-term projects are the following:

- the project "**Permanently low price**" ("**Trajno nizka cena**"), which included 807 products in the first quarter of 2006;
- **The Exclamation mark!**, which comprised 200 products,
- **Slovenian basket**, comprising a total of 60 products in the period from March 1<sup>st</sup> to May 31<sup>st</sup>, 55 of which were present in the entire network, 6 in the hardware and electronics range and 4 products in the textile chain..

Within the short-term activities, we perform **regular campaigns and hypermarket campaigns**, with special emphasis on the projects "**Doubtlessly the best price**" ("**Brez dvoma najboljša cena**") and "**Super price**" ("**Super cena**"). In the period I – III 2006, we performed 6 regular and 6 hypermarket campaigns. The former were consistently theme-oriented (e.g. "The Household Days", "The Winter Days", "Let's Tend to the Garden", "I Live a Healthy Life"). Within these fields, we increased the presence of hardware and electronic products and seasonal products of the non-market program that we wish to offer our customers at a particularly low price.

Starting this year, we perform the **weekend campaigns** that also received ample communication support. The emphasis of weekend campaigns is on fresh program and fruit and vegetables, while other attractive products are also included. From New Year's to April we carried out 9 weekend campaigns. From February to April we also performed 5 "Sunday campaigns", which were aimed at reestablishing the habit of Sunday shopping with our customers after the

rejection of amendments to the modified Trade Act. In April, the campaign was joined with the weekend campaigns.

The "**Vitamin of the Day**" campaign that takes place once a week is aimed at boosting the sales of fruit and vegetables, and particularly to motivate our customers for healthy nutrition; in the first quarter of this year, this campaign took place nine times. The hypermarkets and larger supermarkets also feature the "**days of fruit and vegetables**" twice a month; these are particularly emphasized at the point of sale (stands etc.); seven such campaigns were carried out in the period at hand.

These activities are performed in all markets of our operation (including Serbia and Montenegro, Bosnia and Herzegovina and Croatia).

Planned activities were also performed within other Mercator programs and product ranges.

In the first quarter of this year, two regular campaigns took place in **Intersport**, as well as the winter clearance sale of clothes and sports equipment; we also organized a major event called "Intersport Snow Party" in Kranjska Gora (January) and published a special catalogue for the Crazy Creek trademark.

Apart from the winter post-season clearance sale, the **textile product range** also saw in the first quarter of 2006 the special offer of interior equipment textile (curtains, bedclothes etc.) and numerous special offers in cooperation with our suppliers (Valentine's Day – Lisca, Skinny, MH Design, Sinequanonne, Mexx, Subrina,...).

Three regular campaigns and two co-marketing activities in cooperation with our suppliers Orbico (Max Factor) and Oblak Commerce (Juvena cosmetics) were carried out in **Beautique drugstores**. In cooperation with the Mesec magazine and the Orbico supplier we performed the first of a series of styling makeovers.

In the **Hura! discounts** we carried out six regular campaigns in the period 1 – 3 2006. These campaigns are rounded up in currently relevant themes ("Cold and Breakfast", "Valentine's Day", "Women's Day", "Let's Tend to the Garden", "Everything for Your Baby" etc.), while numerous other campaigns are carried out in cooperation with our suppliers. Regular cooperation with local TV quiz-shows "The Land of Bounty" ("Dežela zakladov"), which we sponsored, proved very successful as well.

The distinctiveness of **Mercator's hardware and electronics range** was improved this year particularly by including electronics and hardware products in the sales promotion activities in all types of stores. Within the regular sales promotion campaigns, more emphasis is placed on the seasonal character of products and on products that offer the best price/quality ratio. We also

performed two regular campaigns for specialized hardware and electronics stores and three special offer campaigns that included household appliances and construction material (including the Adut stores).

### Structure of Retail Units

The composition of retail units of the Mercator Group according to store types and individual product ranges as at March 31<sup>st</sup> 2006:

ACTIVITY	No. of units	Net sales area in m2	Gross sales area in m2
Hypermarkets	31	86,147	132,052
Supermarkets	135	99,049	154,272
Superettes	355	83,036	145,851
Self-service stores	150	12,703	23,624
Cash & Carry	10	10,851	13,834
Department store	1	8,041	12,642
Hura! discounts	12	6,419	8,990
<b>Total FMCG programme</b>	<b>694</b>	<b>306,246</b>	<b>491,265</b>
<b>Tehnickal programme</b>	<b>142</b>	<b>85,520</b>	<b>158,911</b>
Tehnickal programme	99	54,130	117,087
Furniture programme	43	31,390	41,824
<b>Clothing programme</b>	<b>146</b>	<b>45,397</b>	<b>54,599</b>
Clothing programme	124	43,392	52,023
Drug stores and perfumeries	22	2,005	2,576
<b>Intersport</b>	<b>39</b>	<b>14,333</b>	<b>18,617</b>
<b>Restaurants</b>	<b>67</b>	<b>15,994</b>	<b>21,396</b>
<b>Other</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total specialised programmes</b>	<b>394</b>	<b>161,244</b>	<b>253,522</b>
<b>TOTAL</b>	<b>1,088</b>	<b>467,491</b>	<b>744,788</b>
Franchise stores	174	22,188	34,961
<b>TOTAL with franchise stores</b>	<b>1,262</b>	<b>489,679</b>	<b>779,749</b>

## PRODUCT CATEGORY MANAGEMENT AND SUPPLIER RELATIONS

### PRODUCT CATEGORY MANAGEMENT

Mercator started to introduce the product category management (PCM) system already some time ago, but until this year it was performed for only a few product categories, while in the year 2006 we started to implement it within the comprehensive rationalization of operations of the Mercator Group.

The Project has been designed with the objective of being completely implemented by the end of the year 2009. Many related activities have been underway on several tenths of product categories, selected among those that recorded the highest sales figures in the total sales structure. The new

organization of product lines entered into force on April 1, 2006 has been entirely subject to the PCM project, which resulted in the creation of initial conditions for the work on the project. Gradually the micro organization will be adjusted and complemented in accordance with the implementation of the PCM in the field.

With the implementation of the project we expect savings in form of increased sales and consequently increased profits. Successful implementation depends largely on the changes in the business attitude in relation to the understanding of the role and the importance of product categories, suppliers, and sales space, and the relevant changes in the related processes. To accomplish the changes we prepared a comprehensive educational program for all employed associates who will be involved in the PCM project at their work places.

### **PURCHASING OF TRADE GOODS AND SUPPLIER PARTNERSHIPS**

The Management of Mercator took the decision that supply contracts from the year 2005 remain valid in the year 2006. Also, negotiations will be shifted from Spring to Autumn period, which is more appropriate from the aspect of planning the operations, both for suppliers as for the traders. New approach has been presented to the suppliers at the traditional marketing days in February, with the identification of areas in which we wish to collaborate with suppliers in the first half of the year 2006 (increased and improved promotional sales projects, increased supply ability, removal of deficiencies in the marking of goods, etc.).

In the purchasing area the first quarter of the year 2006 emphasized close collaboration with suppliers, preparation and implementation of new promotional sales projects and quality improvement of the existing ones. We also initiated the activities on the new line of the Mercator brand name, and accelerated the activities introduction of brand names on foreign markets.

Within the program of general rationalization of operations of the Group we opened several new sub-projects related to the purchasing of goods, rationalization of purchasing procedures and refreshment of stock, and at the same time we actively participate in the project of optimization of logistic infrastructure and restructuring of the IT-systems – material operations.

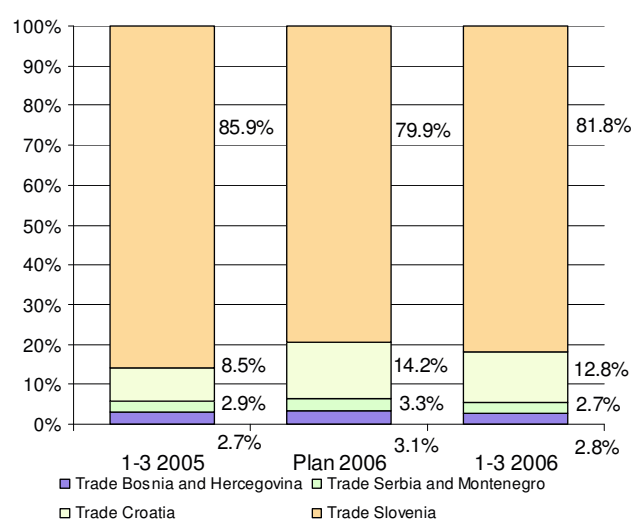
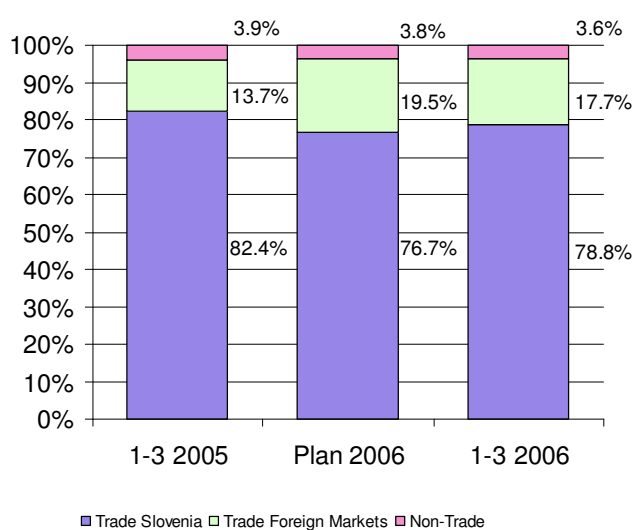
## SALES

### Mercator Group

In the period 1-3 2006 the Mercator Group realized SIT 104,543 million of net revenues from sales, which is 14 % more than the comparable period last year and amounts to 22.5 % of planned net revenues from sales for the year 2006

In the trading sector the Mercator Group realized 96.4 % of net revenues from sales in the year 2005, of which 81.7 % in Slovenia and 18.3 % abroad.

#### Net revenues from sales of Mercator Group by sectors



Trading companies in Slovenia recorded 8.8 % nominal increase in net revenues from sales in the period 1-3 2006 compared to the same last year period, mostly resulting from the acquisition of Era's retail units, opening of new retail outlets, and increase in revenues resulting from aggressive marketing activities.

In the period 1-3 2006 in Slovenia, in the acquired Era's trading operations we realized SIT 3.5 billion of net revenues from sales, representing 84 % of the periodic plan of net revenues from sales. We are therefore carrying out numerous activities for the increase in productivity and implementation of Mercator standards of operations.

Trading companies abroad recorded 46.8 % nominal increase in net revenues from sales in the period 1-3 2006 compared to the same last year period, which is mostly the consequence of acquisition of the company Era Tornado, d.o.o., and Trgohit, d.o.o., at the end of the year 2005, and the successful operations of existing Mercator shops.

In the period 1-3 2006 in Slovenia, in the acquired Era's trading operations in Croatia we realized SIT 3.4 billion of net revenues from sales, representing 74 %

of the periodic plan of net revenues from sales. In the company Mercator – H d.o.o., we are therefore carrying out numerous activities for the increase of revenues and productivity, and implementation of Mercator standards of operations.

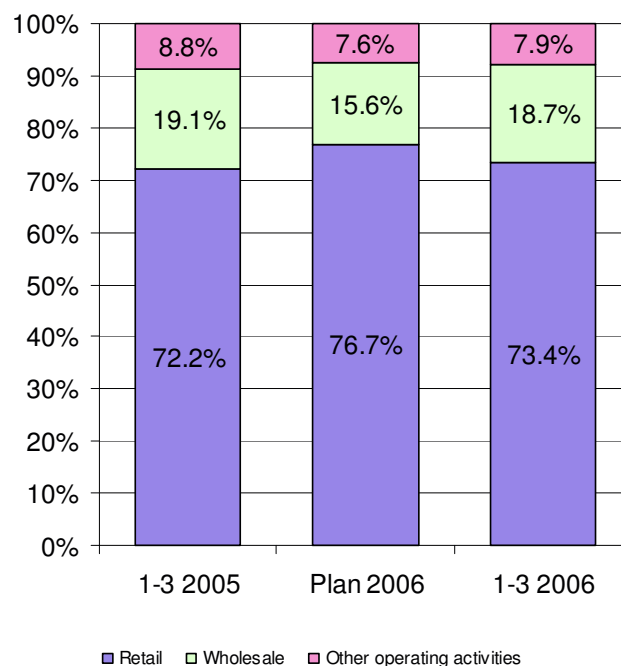
Without the revenues realized within the acquired Era's outlets in Croatia and in Slovenia, net revenues from sales of the Mercator Group for the first quarter of the year 2006 would amount to SIT 97.6 billion, which would represent 6.5 % growth compared to the same period last year.

Non-trading sector recorded increase in net revenues from sales for 3.6 % in the first quarter of the year 2006.

### Poslovni sistem Mercator, d.d.

In the period 1-3 2006 the company Poslovni sistem Mercator, d.d., realized SIT 71,805 million of net revenues from sales, which is 9.6 % more than the comparable period last year and amounts to 22.2 % of planned net revenues from sales for the year 2006.

#### Net revenues from sales of the company Poslovni sistem Mercator, d.d. by sectors



## LOGISTICS

Below are the activities carried out in the period 1-3 2006 in the area of logistics:

- ✓ Takeover of Era, d.d., warehouses  
On Jan. 23, 2006 we took over the stock of goods and 202 warehouse employees of the company Era, d.d. Unified IT-support of logistic operations has been introduced at takeover.
- ✓ Rerouting of direct supply shipments to the shipments via warehouses (integration of supply)  
In January 2006 we performed the integration of supplies by the suppliers Perutnina Ptuj and Perutnina Pivka. Rerouting represents approximately 12% increase in the extent of operations in the cooled goods warehouse in Zalog.
- ✓ Commencement of the Optimization of Logistic Infrastructure Project  
In February 2006 we initiated the strategic project named Optimization of Logistic Infrastructure. The activities include centralization and integration of the logistic operations at as few existing locations as possible, and the preparations for the erection of the central logistic center.
- ✓ Other important projects and tasks:  
Following projects and tasks within the project of general optimization of operations of the Mercator Group are currently underway:
  - preparations for the implementation of the planning and optimization of supply (POS) program;
  - restructuring, upgrade, and unification of IT support of logistics, and implementation of paper-free operations (WMS).

## HUMAN RESOURCES

The following focal points highlighted the management of human resources in the period 1-3 2006:

- ☞ As of Jan. 1, 2006 we took over 101 employee from the company Alpkomerc Tolmin, d.d., and transferred them to the parent company;
- ☞ As of Feb. 1, 2006 the parent company took over 1,041 employees from the company Era, d.d., and transferred 208 employees from the company Era, d.d., to the company M – SVS, d.d.
- ☞ We carried out employment procedures for the transfer of employees from the companies Mercator - Modna hiša, d.o.o., and Emona Maximarket, d.d., into the parent company;
- ☞ From the Disabled Employment Incentive Fund we received a reward for exceeded disabled employment rate of 4 % (effective as of Jan 1, 2006), and the decree related to the tax exemption payment for the

disabled employees (effective as of Feb. 1, 2006). The average total monthly amount of the reward for exceeding the limit is SIT 4 million, and tax exemption amounts to SIT 5.7 million monthly. Funds received from tax exemption are allocated to the general improvement of working conditions for disabled persons;

- ☞ We have prepared promotion proposals for 178 associates, in accordance with the new organizational scheme, effective from April 1, 2006;
- ☞ We adopted the education and training plan for the year 2006; as at March 31, 2006 we realized 22 % of the planned on the job training for the year 2006;

### Overview of Employees in the Mercator Group

	No. of employees based on hours worked in financial period	Number of employees based as at 31 March 2006	Number of employees based as at 31 December 2005
Poslovni sistem Mercator, d.d.	9,780	10,615	9,458
M - SVS, d.d.	1,574	1,646	1,491
Alpkomerc Tolmin, d.d.	33	15	152
Emona Maximarket, d.d.	378	393	394
M - Modna hiša, d.o.o.	498	535	544
<b>Total Trade - Slovenia</b>	<b>12,263</b>	<b>13,204</b>	<b>12,039</b>
M - H, d.o.o.	2,327	2,480	1,842
Era Tornado, d.o.o.	-	-	636
Trgohit, d.o.o.	-	-	42
M - S, d.o.o.	531	559	565
M - BH, d.o.o.	494	496	506
<b>Total Trade - Foreign Market</b>	<b>3,352</b>	<b>3,535</b>	<b>3,591</b>
<b>Total Trade</b>	<b>15,615</b>	<b>16,739</b>	<b>15,630</b>
Pekarna Grosuplje, d.d.	247	241	241
Eta, d.d.	254	269	272
M - Emba, d.d.	124	124	125
M - Optima, d.o.o.	38	39	39
M Hotel, d.o.o.	64	65	65
<b>Total Non-Trade</b>	<b>727</b>	<b>738</b>	<b>742</b>
<b>Mercator Group</b>	<b>16,342</b>	<b>17,477</b>	<b>16,372</b>

## ORGANIZATION AND QUALITY

In the period 1-3 2006 the activities in the field of organization and quality were aimed at rationalization of operations:

### → **Standardization of operations to increase business efficiency**

Activities performed in the period 1-3 2006:

- Set up and approved new organization of the parent company, and the macro-organization of retail companies on foreign markets.
- Complemented and published new catalog of work posts in the parent company.
- Continued renewal of standards to define minimum and correctional number of associates in retail units.
- Kept the Mercator Standards Collection, with 75 new or revised documents in three months.

### → **Carrying out the General Optimization of Operations Project in the Mercator Group**

Activities performed in the period 1-3 2006:

- Execution of the General Optimization of Operations Project in the Mercator Group:
  - We prepared detailed report regarding the accomplishment and the results of the General Optimization of Operations Project in the Mercator Group for the year 2005,
  - We set up and approved new organization of the General Optimization of Operations Project in the Mercator Group, and published a new updated version of the Rules and Regulations,
  - We defined priority tasks within the Project, redefined schedules of activities, and approved the methods of monitoring and confirming the results of measures via the internal revision, and compiled the Rules of Proceedings for the internal review of the Project.
- Realization of the General Optimization of Operations Project in the Mercator Group:
  - We led preliminary activities for the setting up of new organization of the parent company and companies abroad,
  - We compiled a list of activities by processes and commenced preparing the analysis of the results regarding the optimization of operation processes in the year 2005,
  - We carried out the final stage of the Application Setting Renewal project, the ERP choice, and submitted the proposal for the control of product movements in the Mercator Group to be carried out by help of the program tool G.O.L.D.,

- We commenced the preparation of the project for the integration of the company Mercator – SVS, d.d., to the parent company,
- We worked on the identification and definition of new measures in the projects Other Support Processes and Sales IT Support, and carried out open measures in line with the redefined executive plans for the projects Increase of Market Program Sales Staff Productivity, Centralized Collection of Tenders for Materials and Services, Optimization of Warehousing and Transport, and Optimization of Stock.

**→ Standardization of operations within the Mercator Group – Mercator Standards – subject to legal regulations, good Mercator practices, and international standards**

Activities performed in the period 1-3 2006:

- We issued the following company Rules and Regulations: Good Sanitary Habits applying the HACCP principles for the retail operations; Comprehensive Protection of Data and Information Policy; Quality Management Rules and Regulations for trading companies, members of the Mercator Group. Underway are also particular activities in the field of environmental protection,
- Company Mercator - S, d.o.o., carried out the ISO 9001 project activities; we are prepared for the commencement of the certification procedure by the assessment company SIQ,
- We carried out all activities related to the renewal assessment for the ISO 9001 standard in the companies Poslovni sistem Mercator, d.d., and Mercator - SVS, d.d., to be performed in May 2006; assessment dates for companies abroad have also been set;
- We monitored the system of suggestions, commendations and inconsistencies.

**→ By preventive internal control actions prevent disagreements of goods, and performance of inconsistent business processes**

Activities performed in the period 1-3 2006:

- Performed 383 inspection reviews, and received 693 documents.
- Performed 209 regular and 11 extraordinary controls.
- Performed 16 trainings with the topic of compulsory legislation and Mercator Standards, and above all internal control to secure healthy food based on the DHN standards and HACCP system principles for the Mercator Group staff.

## INFORMATION TECHNOLOGY

The activities performed in the first quarter of the year 2006 included the renewal of the following key areas of operations:

- **IT support of the project for the general optimization of operations in the Mercator Group:**
  - IT support of automatic ordering included the POS contractor Mikropis (2 testing retail units),
  - in the company Mercator – H, d.o.o., we unified and updated the existing IT support of automatic ordering in line with the general optimization of operations project in the Mercator Group (testing of Supermarket Kalča and MC Zagreb);
  
- **Renewal of business information system (BIS)**
  - within the BIS SF (support functions) system we started to carry out the business plan (training and workshops) for the introduction of integral information solutions for the supportive processes (SAP),
  - within the BIS MO project (material operation) we have completed the analysis and the choice of the comprehensive IT solution for the field of retail, wholesale, procurement and logistics. In selection procedures we were deciding between two batch solutions. Based on reference visits, a series of workshops performed to acquaint ourselves with the operations of both and based on the following criteria:
    - functional properties (basic logistic processes, retail processes, central data)
    - technical characteristics
    - possibility of implementation by the solution supplier
    - stability of the solution supplier
    - price and commercial terms,the project team recommended to choose the G.O.L.D. as the comprehensive software solution; the Supervisory Board of the BIS project agreed with the proposal. After the completion of commercial negotiations, we signed an Agreement on Cooperation with the Aldata Solutions Company, defining all key elements of our further cooperation.
  
- **IT support for management and decision-making:**
  - all retail units that were integrated into the common procurement during the first quarter of this year were also included in the material operation data warehouse (389 units until March 31<sup>st</sup> 2006),
  - we designed IT support for sales reports to the supplier P&G,

- we designed the scenario for data transfer between ROEN and SAP;
- **IT support to warehouse operation and logistics:**
  - we unified the IT support in the company Era, d.d.,
  - we unified the IT support in all smaller C&Cs,
  - we designed IT support for instructive conversinbo to Euros;
- **IT support to retail:**
  - we continued to decrease the number of POS contractors,
  - we completed the preparations to include retail units from companies Alpkomerc, d.d., and Emona Maximarket, d.d.,
  - we continued to include retail units to common procurement system (70 retail units with the Mikropis POS program have been included),
  - we established the electronic sale of MOBI cards in additional 80 retail units;
- **facilities and security:**
  - operation of computer systems was regularly monitored,
  - we designed upgrade plans for the existing hardware, in order to enable handling of increased quantity of data for the data warehouse,
  - we have set up the IT facilities for a training environment for the selected comprehensive IT solution SAP,
  - we designed a plan to set up a development environment for the SAP batch solution.

All new solutions for operation support in the company Poslovni sistem Mercator, d.d., are developed uniformly for all trade companies. Therefore, we also continued to implement the solutions in trade companies abroad:

- we merged 45 units of the Era retail network in Croatia to the company Mercator – H, d.o.o.,
- we established a logical connection between Era warehouse in Karlovac and the warehouse in Velika Gorica,
- we adjusted the IT support of the company Mercator – H, d.o.o., to the Act on packaging treatment,
- we completed the implementation of VAT (data exchange in support systems) in the companies Mercator – H, d.o.o., and Mercator – BH, d.o.o.

## FINANCIAL OPERATION

Due to growth of operating activities volume and the realization of investment activities plan in Slovenia, and particularly in new markets, financial liabilities, including liabilities from financial leasing, continued to increase in the first quarter of 2006.

At the end of the first quarter of 2006, Mercator Group reached the capital composition of 1 : 1.30 (this ratio was 1 : 1.25 at the end of the year 2005) between equity which includes balance sheet share capital and long-term provisions, and debt capital which includes financial liabilities.

At the end of the first quarter of 2006, the long-term financing rate in the Mercator Group amounted to 87.7 %, which means that this indicator has remained virtually unchanged compared to the end of 2005.

At the end of the first quarter of 2006, the total financial liabilities of the Mercator Group amounted to SIT 179.4 billion. Long-term financial liabilities at the end of the first quarter of 2006 represented 59.5 % of all financial liabilities, with the short-term liabilities representing the remaining 40.5 %.

The increase of financial liabilities, particularly the short-term ones, in the first quarter of this year, is a consequence of inter-year dynamics of current asset, derivative investments, takeover of Era operations in Slovenia, and extensive use of financial discounts with premature payments to suppliers.

## SHAREHOLDER RELATIONS

### Key information or the shareholders

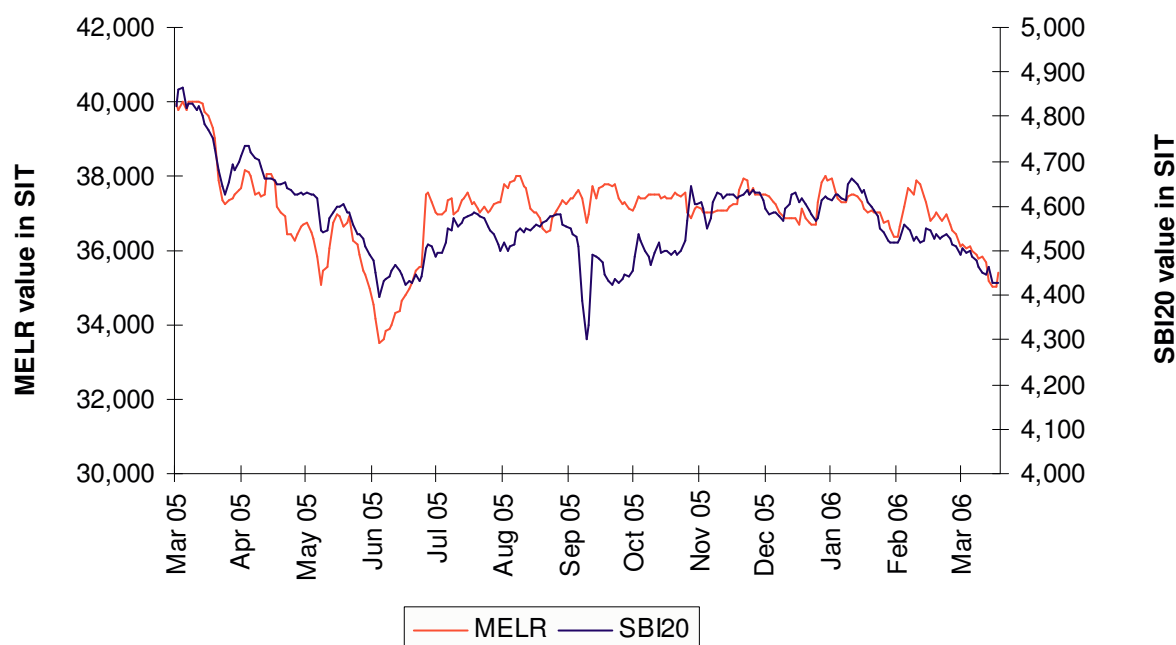
Share capital of the company Poslovni sistem Mercator, d.d., as at March 31<sup>st</sup> 2006, was divided into 3,590,844 shares; however, 382,340 shares that were issued during the recent capital increase, have not yet been entered into the Central Register of dematerialized securities with the Central Securities Clearing Corporation (KDD, d.d.). Thus, only 3,208,504 regular nominal shares were listed and traded at the Ljubljana Stock Exchange. Nominal value per share amounts to SIT 10,000.

The shares of the company Poslovni sistem Mercator, d.d., are listed in the official market (first quotation) of the Ljubljana Stock Exchange, d.d., with the code MELR.

Shareholder Information	31 March 2006
Number of shares	3,590,844
Market capitalisation (in SIT 000)	131,217,699
Market value per share (in SIT)	36,542
Book value per share (in SIT)	36,360
Annual low (in SIT)	35,003
Annual high (in SIT)	38,007
Weighted average market price, excluding block and cross trades (in SIT)	37,184
Earnings per share (in SIT)	516

## Price per share movement

Movement of average price per MELR share in the first quarter of 2006, compared to the movement of the SBI20 index, is shown in the following chart:



## Dividend policy

Company shareholders will discuss the amount of dividend for the year 2005 at the 12<sup>th</sup> regular annual meeting of the Shareholder's Assembly, called for May 17, 2006. The Management and the Supervisory Board of the company proposed to the Assembly the payment of dividends in gross amount of SIT 600 per share.

## Increase of capital

The process of capital increase of the company Poslovni sistem Mercator, d.d. was concluded on Jan. 31, 2006. On July 19, 2005 the Management and the Supervisory Board of the company Poslovni sistem Mercator, d.d., approved the

resolution regarding the increase of registered capital of the company by the issuance of up to 641,700 ordinary shares with nominal value of SIT 10,000 and market value of SIT 38,000 (this price was valid until October 31, 2005, and after that date it was increased for accrued interest by the 5 % annual interest rate). The entire emission of new shares was offered to the well informed investors known beforehand in the non-public procedure: half of the entire emission of new shares was offered to the Retirement and Disabled Insurance Capital Fund, National Compensation Agency, and the KD Group, d.d., while the remaining half was offered to the company KLM, d.d.

Until the conclusion date of the capital increase process, that is until Jan. 31, 2006 the companies participating in the capital increase process paid-in 382,340 ordinary shares with nominal value of SIT 10,000.00. The total paid-in amount for new shares is SIT 14,615,147,723.50. New shares give the new owners equal rights as the existing shareholders. Immediately after the conclusion of the payments for new shares Mercator initiated the relevant procedures to obtain the approval by the National Securities Market Agency for organized trading, entry of stock in the Central Clearing Agency Register, and the enlistment of new stock to the organized market of the Ljubljana Stock Exchange.

<b>Company</b>	<b>Number of shares</b>	<b>Payment date</b>	<b>Value of payment (SIT)</b>
Capital Fund	106,950	27.10.2005	4,064,100,000.00
National Compensation Agency	106,950	15.12.2005	4,089,153,037.50
KD Group, d.d.	106,950	31.1.2006	4,115,318,355.00
KLM, d.d.	40,700	28.10.2005	1,546,600,000.00
	20,790	31.1.2006	799,976,331.00
<b>Total</b>	<b>382,340</b>		<b>14,615,147,723.50</b>

A total of 147,650 newly issued shares paid-in in October was entered in the Court Register on Dec. 28, 2005, and the remaining 234,690 newly issued shares paid-in by the end of January was entered on March 28, 2006.

On April 24, 2006 the company Poslovni sistem Mercator, d.d., received the approval by the National Securities Market Agency for organized trading with newly issued shares, and on April 26, 2006 the approval by the Ljubljana Stock Exchange related to the extension of enlistment of the newly issued stock by the company Poslovni sistem Mercator, d.d.

On May 3, 2006 all newly issued stock in the process of capital increase was entered in the Central Register of non-materialized securities, and on May 5, 2006 all newly issued stock was enlisted in the stock market quotation.

## RISK MANAGEMENT

In the year 2006 the Mercator Group continues to devote great concern to the category of risk management. In accordance with the adopted business policy of the company risk management has therefore become an important segment of the entire management process.

In Mercator all risks have been monitored and controlled within three major groups: business risks, financial risks, and operational risks.

In the period 1-3 2006 the exposure of the Mercator Group to the particular types of risks has not considerably changed compared to the year 2005.

## COMMUNICATION WITH STAKEHOLDERS

### Communication with customers

On March 25, 2006 on the occasion of the conclusion of the 14<sup>th</sup> credit period in Mercator Center Novo Mesto the company celebrated the event called '**Pikin dan**' (The Pika Day) with numerous prizes, awards and guest signers, concluded with grand sweepstake draw, where we presented customers with 10 monetary prizes and 99 material prizes. On new markets we celebrated the Pika Day on March 18, 2006: in Croatia at the Mercator Center Zagreb, in Bosnia and Herzegovina at the Mercator Center Sarajevo, and in Serbia and Montenegro at the Mercator Center Beograd.

In the year 2006 we continue the development of the monthly **Mesec** in Slovenia and in Croatia. The first number of the magazine in the year 2006 was issued in April.

### Communication with associates

The Mercator internal magazine has been renamed into **Časomer** (The Timer). **Časomer** got the upgraded contents and modernized design.

In January at the venue of the Restaurant Maxim we presented 17 prizes for the Best Shop Assistant according to the customers' selection.

### Communication with financial community

In the period 1-3 2006 our efforts were aimed at the continued professional communication with shareholders and the rest of the financial community. Using the Ljubljana Stock Exchange electronic information system SEO-net we regularly informed the shareholders and other members of the financial

community with business results, plans, and other important events of our business operations.

In March we organized the 6<sup>th</sup> Traditional Meeting of Mercator Financial Partners, where we presented the strategic policies of the Mercator Group for the period 2006 – 2010, and the financial policy in the year 2006.

### **Communication with environment**

At the conclusion of the humanitarian action ***Za čiste otroške želje*** (Pure Children Wishes) on January 10 we donated to the Slovenian day care centers the amount of SIT 1 million, and thereby allocated total funds of SIT 10 million for the restructuring of children playgrounds.

In January we donated SIT 2 million to the Clinical Center in Ljubljana for the acquisition of the CT device for the diagnostic procedures of oncology patients. Within the humanitarian action ***Vsi smo bili otroci*** (We were all children once) at the conclusion of the third consecutive winter season in March financed holidays on snow for 100 children from socially weak families.

At the beginning of March in the *Lutkovno gledališče Ljubljana* (Puppet Theater) we staged the premiere of the children puppet show *Lumpijev gozdni dan* (Lumpy's Day in the Woods). The play cheers our youngest visitors in all Mercator Centers throughout Slovenia.

Within the central humanitarian action in March 2006 Mercator commenced with the musical competition *Odpete knjige* (Singing Books), which will take place in Mercator Centers until mid June. By joining the affection towards books and towards music youngsters aged 12 to 16 will have the opportunity to compete for the grand prize – recording own musical CD, which will then be on sale in all Mercator shops.

### **Communication with business partners**

In the year 2006 we continued the active communication with our business partners. In February we organized the 7<sup>th</sup> Marketing Days, and on the occasion we presented to our suppliers from Slovenia, Croatia, Serbia and Montenegro, and Bosnia and Herzegovina our strategic policies, marketing strategy, and the purchasing policy of the Mercator Group.

### **Communication with media**

In the first three months of the year 2006 we actively responded to numerous questions from the press related to future objectives and strategic policies of the Mercator Group, limited Sunday opening hours, merger of the company Era and its operations, introduction of Euro, and investments both at home and abroad.

The Management of Mercator presented the strategic assumptions and the objectives set for the period 2006 – 2010 at the press conference on January 4, 2006.

## FINANCIAL STATEMENTS

### ACCOUNTING POLICIES

In accordance with the resolution adopted by the Shareholder's Assembly at the meeting held on Aug. 30, 2005 and in line with the Commercial Corporations Act, as of Jan. 1, 2006 the company Poslovni sistem Mercator, d.d., has been preparing its accounting statements and annual report in accordance with the International Financial Reporting Standards (IFRS). Accordingly, starting with Jan. 1, 2006 the Mercator Group also prepares its accounting statements and the annual report exclusively in accordance with the International Financial Reporting Standards.

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period 1-3 2006 have not been audited.

### CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

In addition to the parent company Poslovni sistem Mercator, d.d., consolidated financial statements of the Mercator Group comprise 15 subsidiaries in which the parent company directly or indirectly holds the controlling ownership share, as follows:

- in Slovenia: Mercator – SVS, d.d., Alpkomerc Tolmin, d.d., Emona Maximarket, d.d., Mercator – Modna hiša, d.o.o., Savski otok, d.o.o., Pekarna Grosuplje, d.d., Belpana, d.o.o., Eta, d.d., Mercator – Emba, d.d., Mercator – Optima, d.o.o., M Hotel, d.o.o.;
- abroad: Mercator – H, d.o.o. (Croatia), Mercator – S, d.o.o. (Serbia and Montenegro), Mercator – BH, d.o.o. (Bosnia and Herzegovina), Mercator Makedonija, d.o.o. (Macedonia).

## Consolidated Income Statement

in SIT 000

	Type of revenue / expense / cost	1-3 2005	Plan 2006	1-3 2006	Index	Index
1	2	3	4	5	6=5/3	7=5/4
<b>A.</b>	<b>SALES</b>	<b>91,679,654</b>	<b>465,362,410</b>	<b>104,542,906</b>	<b>114.0</b>	<b>22.5</b>
1.	Revenue from products sold	1,367,079	6,905,448	1,468,790	107.4	21.3
2.	Revenue from services sold	5,087,397	29,503,462	7,123,224	140.0	24.1
3.	Revenue from goods and material sold	85,225,178	428,953,500	95,950,892	112.6	22.4
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-66,108,896</b>	<b>-337,447,864</b>	<b>-74,876,713</b>	<b>113.3</b>	<b>22.2</b>
1.	Production costs	-2,373,438	-11,271,325	-2,471,499	104.1	21.9
2.	Purchase value of goods and material sold	-63,694,633	-326,153,969	-72,285,024	113.5	22.2
3.	Other expenses	-40,825	-22,569	-120,190	294.4	532.5
<b>C.</b>	<b>GROSS PROFIT/LOSS</b>	<b>25,570,758</b>	<b>127,914,546</b>	<b>29,666,194</b>	<b>116.0</b>	<b>23.2</b>
Č.	Selling and marketing costs	-19,139,884	-90,400,677	-22,048,845	115.2	24.4
D.	Administrative expenses	-4,906,604	-24,364,691	-4,814,926	98.1	19.8
E.	Other gains - net	518,049	1,584,628	1,080,922	208.7	68.2
<b>F.</b>	<b>OPERATING PROFIT/LOSS</b>	<b>2,042,319</b>	<b>14,733,807</b>	<b>3,883,345</b>	<b>190.1</b>	<b>26.4</b>
G.	Financial revenue	572,080	1,067,158	320,970	56.1	30.1
H.	Financial costs	-1,372,747	-6,658,111	-1,821,164	132.7	27.4
<b>I.</b>	<b>PROFIT/LOSS BEFORE INCOME TAX</b>	<b>1,241,652</b>	<b>9,142,853</b>	<b>2,383,152</b>	<b>191.9</b>	<b>26.1</b>
J.	Income tax expense	-11,628	-3,557,636	-611,351	5,257.6	17.2
K.	Deferred tax	0	550,000	115,000	-	20.9
<b>L.</b>	<b>PROFIT/LOSS FOR THE FINANCIAL PERIOD</b>	<b>1,230,024</b>	<b>6,135,218</b>	<b>1,886,801</b>	<b>153.4</b>	<b>30.8</b>
M.	Profit/loss attributable to equity holders of the Company	1,210,704	5,993,020	1,860,933	153.7	31.1
N.	Profit/loss attributable to minority interest	19,320	142,198	25,868	133.9	18.2
<b>O.</b>	<b>Gross cash flow from operating activities</b>	<b>5,725,742</b>	<b>30,015,815</b>	<b>6,706,232</b>	<b>117.1</b>	<b>22.3</b>

## Consolidated Balance Sheet

in SIT 000

1	Type of assets / liabilities	31.12.2005	Plan 31.12.2006	31.3.2006	Structure 31.3.2006	Index 7=5/3	Index 8=5/4
	<b>ASSETS</b>						
	<b>A. NON-CURRENT ASSETS</b>	<b>281,200,346</b>	<b>303,233,915</b>	<b>288,847,157</b>	<b>76.1%</b>	<b>102.7</b>	<b>95.3</b>
I.	Property, plant and equipment	275,551,749	297,754,831	282,346,231	74.4%	102.5	94.8
II.	Intangible assets	2,425,106	2,223,320	2,439,143	0.6%	100.6	109.7
III.	Deferred income tax assets	683,504	1,240,121	759,048	0.2%	111.1	61.2
IV.	Derivative financial instruments	27,770	30,000	27,770	0.0%	100.0	92.6
V.	Trade and other receivables	2,512,217	1,985,643	3,274,965	0.9%	130.4	164.9
	<b>B. CURRENT ASSETS</b>	<b>86,178,549</b>	<b>84,986,865</b>	<b>90,678,197</b>	<b>23.9%</b>	<b>105.2</b>	<b>106.7</b>
I.	Inventories	43,109,610	43,602,447	49,821,127	13.1%	115.6	114.3
II.	Trade and other receivables	38,390,093	37,599,412	36,372,556	9.6%	94.7	96.7
III.	Other financial assets at fair value through profit and loss	718,042	270,407	1,886,244	0.5%	262.7	697.6
IV.	Cash and cash equivalents	3,960,805	3,514,599	2,598,271	0.7%	65.6	73.9
	<b>TOTAL ASSETS</b>	<b>367,378,895</b>	<b>388,220,780</b>	<b>379,525,354</b>	<b>100.0%</b>	<b>103.3</b>	<b>97.8</b>
	<b>A. EQUITY</b>	<b>132,048,107</b>	<b>139,959,237</b>	<b>133,917,086</b>	<b>35.3%</b>	<b>101.4</b>	<b>95.7</b>
	Majority interest equity	130,622,020	136,937,006	132,449,793	34.9%	101.4	96.7
	Minority interest	1,426,087	3,022,231	1,467,293	0.4%	102.9	48.6
	<b>LIABILITIES</b>						
	<b>B. NON-CURRENT LIABILITIES</b>	<b>110,854,659</b>	<b>114,133,565</b>	<b>115,641,501</b>	<b>30.5%</b>	<b>104.3</b>	<b>101.3</b>
I.	Borrowings	106,239,658	109,904,945	106,771,720	28.1%	100.5	97.1
III.	Deferred income tax liabilities	386,430	0	4,546,704	1.2%	1,176.6	-
IV.	Retirement benefit obligations	4,228,571	4,228,620	4,323,076	1.1%	102.2	102.2
	<b>C. CURRENT LIABILITIES</b>	<b>124,476,130</b>	<b>134,127,978</b>	<b>129,966,766</b>	<b>34.2%</b>	<b>104.4</b>	<b>96.9</b>
I.	Trade and other payables	60,693,940	66,753,353	54,179,059	14.3%	89.3	84.7
II.	Borrowings	60,382,752	63,975,187	72,626,422	19.1%	120.3	108.8
III.	Provisions for other liabilities and charges	3,399,438	3,399,438	3,161,286	0.8%	93.0	93.0
	<b>TOTAL LIABILITIES</b>	<b>235,330,789</b>	<b>248,261,543</b>	<b>245,608,268</b>	<b>64.7%</b>	<b>104.4</b>	<b>98.9</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>367,378,895</b>	<b>388,220,780</b>	<b>379,525,354</b>	<b>100.0%</b>	<b>103.3</b>	<b>97.8</b>

## Consolidated Cash-Flow Statement

in SIT 000

	Cash flows	Plan 2006	1-3 2006
1	2	3	4
<b>A</b>	<b>Cash flows from operating activities</b>		
	<b>Gross cash flow from operating activities before change in working capital</b>	<b>30,015,815</b>	<b>6,706,232</b>
	<b>Changes in working capital</b>		
1	Trade and other receivables	-790,681	2,017,537
2	Inventories	492,837	-6,711,517
3	Trade and other payables	5,342,939	-7,036,785
	<b>Cash generated from operations</b>	<b>35,060,911</b>	<b>-5,024,534</b>
4	Interest paid	-5,797,824	-1,417,809
5	Income tax paid	-3,557,636	-496,351
<b>I</b>	<b>Net cash generated from operating activities</b>	<b>25,705,451</b>	<b>-6,938,693</b>
<b>B</b>	<b>Cash flows from investing activities</b>		
1	Acquisition of subsidiaries, net of cash acquired	0	0
2	Purchases of property, plant and equipment (PPE)	-39,225,584	-11,338,995
3	Proceeds from sale of PPE	3,243,115	1,161,157
4	Purchases of intangible assets	-955,312	-206,642
5	Proceeds from sale of intangible assets	20,152	2,647
6	Movement of non-current investments	0	-698,168
7	Purchase of current investments	0	-1,671,619
8	Loans made	6,667	0
9	Loan repayments received	0	3,702
10	Proceeds from sale of current investments	304,089	465,580
11	Interest received	474,857	167,427
<b>II</b>	<b>Net cash used in investing activities</b>	<b>-36,132,016</b>	<b>-12,114,912</b>
<b>C</b>	<b>Cash flows from financing activities</b>		
1	Proceeds from issuance of shares	4,915,295	4,915,295
2	Purchase of treasury shares	0	0
3	Proceeds/repayments from borrowings	7,257,722	12,775,732
4	Dividend paid to Company's shareholders	-2,142,032	0
<b>III</b>	<b>Net cash used in financing activities</b>	<b>10,030,985</b>	<b>17,691,027</b>
<b>1</b>	<b>Net increase/decrease in cash</b>	<b>-395,580</b>	<b>-1,362,578</b>
2	Cash at beginning of the financial period	3,960,805	3,960,805
3	Exchange gains/losses on cash	-50,626	44
<b>IV</b>	<b>Cash at end of the financial period</b>	<b>3,514,599</b>	<b>2,598,271</b>

## Consolidated Movements in Equity Statement

in SIT 000

	Attributable to equity holders of the Company			Minority capital	Total
	I. Share capital	II. Other reserves	III. Retained earnings		
<b>Balance as at 1 January 2006</b>	<b>41,153,268</b>	<b>14,208,756</b>	<b>75,259,996</b>	<b>1,426,087</b>	<b>132,048,107</b>
Restatement:					
Employee benefit obligations	0	-4,213,891	-94,506	0	-4,308,397
<b>Balance as at 1 January 2006 (adjusted)</b>	<b>41,153,268</b>	<b>9,994,866</b>	<b>75,165,490</b>	<b>1,426,087</b>	<b>127,739,710</b>
Profit/loss for the financial period	0	0	1,860,933	25,868	1,886,801
Issue of share capital	4,915,295	0	0	0	4,915,295
Cash flow hedge net of tax	0	0	0	0	0
Currency translation differences	0	-154,219	0	0	-154,219
Increase in share capital of existing subsidiaries	0	0	0	15,339	15,339
Revaluation of PP&E to fair value	0	-539,456	0	0	-539,456
Deferred tax	0	53,617	0	0	53,617
<b>Balance as at 31 March 2006</b>	<b>46,068,563</b>	<b>9,354,807</b>	<b>77,026,423</b>	<b>1,467,293</b>	<b>133,917,086</b>

## Notes to the Consolidated Financial Statements

### NOTES TO THE CONSOLIDATED INCOME STATEMENT

- Net revenues from sales**

Net revenues from sales for the relevant period amounted to SIT 104,543 million and arrived at 22.5 % of planned net revenues from sales for the year 2006, and exceed the figures from the comparable period last year for 14.0 %, which is considerably the consequence of taking over the retail units from the company Era Velenje, d.d., by the companies Poslovni sistem Mercator, d.d., and Mercator – SVS, d.d., in January, as well as the takeover of companies Era Tornado, d.o.o., and Trgohit, d.o.o., at the end of the year 2005. Revenues resulting from the sale of goods and materials take 92 % of net revenues, while the remaining 8 % originates from revenues from sales of products and services.

Without revenues originating from the acquired Era outlets in Slovenia and in Croatia, Mercator Group would realize SIT 97.6 billion in the period 1-3 2006, which would represent 6.5 % increase compared to the same period in the year 2005.

- Cost of goods sold**

Expenses associated with sold products including production costs, cost value of sold goods and materials and other operating expenditures in the relevant period amounted to SIT 74,877 million, and exceed the same category for 13.3 %

compared to the last year figures, which is mostly the consequence of increased extent of operations.

- **Gross profit**

Gross profit from sales for the period 1 - 3 2006 amounted to SIT 29,666 million, which is a 16 % increase compared to the period 1 - 3 2005 and represents 23.2 % of the 2006 plan.

- **Expenditures for sales and general operations**

Expenditures for sales and general operations amounted to SIT 26,864 million and exceed the figures for the comparable period last year for 11.7 %, representing 23.4 % of the 2006 plan.

Expenditures by natural categories

in SIT 000

	Type of Cost	1-3 2005	Plan 2006	1-3 2006	Index	Index
1	2	3	4	5	6=5/3	7=5/4
1	Costs of Material	3,203,730	16,502,337	3,888,917	121.4	23.6
2	Costs of Services	5,688,289	31,778,417	6,611,068	116.2	20.8
3	Depreciation	3,454,803	15,477,144	3,985,988	115.4	25.8
4	Employee benefit expense	13,184,808	60,063,896	14,493,944	109.9	24.1
5	Other Expenses	929,121	2,237,468	475,542	51.2	21.3
6	Costs of Goods Sold	63,694,633	326,153,969	72,285,025	113.5	22.2
	<b>TOTAL COSTS</b>	<b>90,155,384</b>	<b>452,213,231</b>	<b>101,740,484</b>	<b>112.9</b>	<b>22.5</b>

Cost of material amounted to SIT 3,889 million, and recorded 21.4 % increase compared to the same period last year, which is largely the consequence of increases in the cost of energy due to long winter season and low temperatures.

Cost of services amounted to SIT 6,611 million and recorded a 16.2 % increase compared to the same period last year. Increase is mostly the consequence of integration of the company Era operations in Slovenia and in Croatia, the project of dual price tagging required by the expected introduction of Euro, and due to certain intensified marketing activities.

- **Other revenues from operations**

Other revenues from operations amounted to SIT 1,081 million, of which SIT 698 million is related to profit from the sale of fixed assets, while other revenues from operations (compensations, donations, subsidies, written-off due claims) amounted to SIT 383 million. In the category of profit from the sale of fixed

assets the largest portion of profit originates from the sale of Hotel Kanin in Bovec in the amount of SIT 461 million.

- **Profit from operations**

Profit from operations for the period 1 - 3 2006 amounted to SIT 3,883 million and exceeds the figures realized in the comparable period in the year 2005 for SIT 1,841 million or 90.1 %, originating from higher net revenues and improved cost efficiency. Profit from operations represents 26.4 % of the 2006 plan.

- **Financial revenues**

Financial revenues amounted to SIT 321 million, which is SIT 251 million less than in the period 1-3 2005.

- **Financial expenditures**

Financial expenditures for the relevant period amounted to SIT 1,821 million and represent mostly expenditures for regular interest on loans from commercial banks. Compared to the same period last year they represent 32.7 % increase, mostly the consequence of higher interest rates and higher borrowing.

- **Profit for the period**

In the period 1-3 2006 the Mercator Group realized SIT 1,887 million of profit, which is SIT 657 million more compared to the same period last year, and represents 30.8 % of the 2006 plan. Without the effect created by the net profit from the sale of fixed assets, the Mercator Group would realize SIT 1,380 million of profit which would represent 22 % increase related to the comparable profit realized in the same period of the year 2005 (SIT 1,132 million).

- **Gross cash flow from operations**

Gross cash flow from operations of the Mercator Group for the period 1-3 2006 amounted to SIT 6,706 million, which is 17.1 % more compared to the period 1-3 2005 and represents 22.3 % of the 2006 plan. Compared to the period 1-3 2005, gross cash flow from operational activities increased in relative terms for more than the net revenues from sales, which indicates efficient business operations in the sense of controlling and reducing expenses in the process of consolidation and optimization of operations.

The following chart displays the relevant calculation:

	in SIT 000	
	<b>1-3 2005</b>	<b>1-3 2006</b>
Profit/loss for the financial period	1,230,023	1,886,801
Income tax	11,628	496,351
Depreciation of property, plant and equipment	3,327,725	3,824,553
Depreciation of intangible assets	127,078	161,435
Net gains from sale of property, plant and equipment	-98,285	-675,137
Movement of provisions for other liabilities and charges	82,307	-238,152
Interest received	-151,646	-167,427
Interest paid	1,196,911	1,417,809
<b>Cash flow from operating activities</b>	<b>5,725,742</b>	<b>6,706,232</b>

In the period 1 – 3 2006 the Mercator Group realized 22.3 % of the planned gross cash flow from operating activities for the entire year 2006.

## NOTES TO THE CONSOLIDATED BALANCE SHEET

- **Fixed assets**

The value of fixed assets as at March 31, 2006 amounted to SIT 284,785 million and represents an increase of SIT 6,808 million compared to the situation as at Dec. 31, 2005. The change largely originates from:

- investments in total amount of SIT 11,546 million;
- depreciation in the amount of SIT 3.986 million;
- divestment of obsolete fixed assets in the amount of SIT 489 million;
- other net reductions and exchange rate in the amount of SIT 263 million.

The property of the company Era, took over by the Mercator Group in the first quarter of the year 2006, are being assessed as at April 1, 2006 by the certified appraiser. The proceeds will be recorded in line with the accounting standards in the periodical financial statements of the Mercator Group for the period 1 – 6 2006.

- **Derivative financial instruments**

As at March 31, 2006 the value of derivative financial instruments, designated as cash - flow hedges, amounted to SIT 28 million. The balance had not changed compared to the situation at the beginning of the year.

- **Long term financial investments**

Long term financial investments as at March 31, 2006 amounted to SIT 3,275 million and recorded an increase of SIT 763 million compared to the balance recorded on Dec. 31, 2005 which is largely the consequence of purchasing property in Macedonia (Saem, d.o.o., Macedonia) and in Croatia (Consultbiro, d.o.o., Croatia) acquired through the above named companies.

- **Inventories**

As at March 31, 2006 the value of raw materials, general material, and trading goods amounted to SIT 49,821 million, and in the structure of current assets represented 54.9 %. Compared to the balance at the beginning of the year the extent of inventories recorded an increase of SIT 6,711 million which is largely the consequence of integration of Era's retail network.

- **Trade and other receivables**

As at March 31, 2006 the trade and other receivables amounted to SIT 36,373 million and recorded a reduction of SIT 2,017 million compared to the balance at the beginning of the year, which is mostly the consequence of cashing liabilities from credit card purchases, as these are always higher at the year end compared to other periods during the business year.

- **Other financial assets at fair value**

Other financial assets by fair value include current financial investments and short term approved loans and deposits which as at March 31, 2006 amounted to SIT 1,886 million and represent an increase for SIT 1,168 million compared to the balance at the beginning of the year 2006, which is largely the consequence of short term deposit for the acquisition of land property in Zagreb.

- **Equity**

in SIT 000

	<b>31 December 2005</b>	<b>31 March 2006</b>
Majority interest equity	130,622,020	132,449,793
Minority interest	1,426,087	1,467,293
<b>Total</b>	<b>132,048,107</b>	<b>133,917,086</b>

In the period 1-3 2006 the majority interest recorded an increase of SIT 1,828 million. Changes are related to the:

- increase in the amount of SIT 4,915 million from capital increase of the parent company by the KD Group, d.d., and the company KLM, d.d.;
- increase resulting from realized net profit for the period 1-3 2006 in the amount of SIT 1,861 million;

- reduction of capital resulting from specific value adjustment in the amount of SIT 486 million related to the depreciation of value increment of fixed assets;
- reduction of capital resulting from rate differences in long term financial investments in the amount of SIT 154 million;
- reduction of capital resulting from adjustment or reduction of allocated provisions for deferred taxes in the amount of SIT 4,213 million and liabilities for final settlement compensations and jubilee bonuses in the amount of SIT 95 million.

- **Financial liabilities**

Long term financial liabilities as at March 31, 2006 amounted to SIT 106,772 million and recorded an increase of SIT 532 million compared to the beginning of the year. Increase is largely the consequence of the financial lease of the shopping mall in Ptuj, integrated into the company Mercator - SVS, d.d., by the takeover of Era's retail network.

Short term financial liabilities as at March 31, 2006 amounted to SIT 72,626 million and recorded an increase of SIT 12,243 million compared to the beginning of the year. The largest portion of short term liabilities from financing originates from current borrowings from commercial banks. Increase in short term financial liabilities is largely the consequence of movements in working capital, and intensive application of financial discounts in premature settlement of liabilities towards the suppliers.

Compared to the beginning of the year the maturity of financial liabilities has considerably changed, so that the long term financial liabilities represent 59.5 %, and short term liabilities 40.5 % of the overall structure of financial liabilities.

- **Retirement benefit obligations**

As at March 31, 2006 the retirement benefit obligations amounted to SIT 4,323 million representing SIT 94 million increase compared to the beginning of the year.

- **Trade and other payables**

As at March 31, 2006 trade and other payables amounted to SIT 54,179 million representing a reduction of SIT 6,515 million compared to the beginning of the year. Reduction is largely the consequence of seasonal purchasing disposition, reduction of liabilities from investments, and aggressive application of financial discounts for premature settlement of liabilities towards suppliers.

- **Long term provisions**

As at March 31, 2006 the balance of long term provisions amounted to SIT 3,161 million. Compared to the balance at the beginning of the year the long term provisions recorded a reduction of SIT 238 million.

## Financial indicators

	Mercator Group		
	1-3 2005	Plan 2006	1-3 2006
<b>Indicators of Profitability</b>			
Return on Equity	4.8%	4.5%	6.3%
Return on Sales	1.3%	1.3%	1.8%
<b>Indicators of Financial Structure</b>			
Borrowings / Equity	1.10	1.24	1.34
Equity and Long-term Provisions to Total Liabilities	40.7%	36.9%	36.1%
Borrowings to Total Liabilities	43.3%	44.8%	47.3%
Trade and Other Payables to Total Liabilities	15.8%	18.3%	14.3%
<b>Indicators of Operating Efficiency and Productivity</b>			
Labor Costs per work hours (in SIT 000)	3,946	3,653	3,902
Sales / Labor Costs	7.0	7.7	7.2
Revenues per Employee per work hours (in SIT 000)	27,436	28,300	28,148
Value Added per Employee per work hours (in SIT 000)	5,659	5,478	5,708
Cash Flow from Operating Activities / Sales	6.2%	6.4%	6.4%
Total Costs without Depreciation / Sales	25.1%	23.7%	24.4%
Invested Capital (in billion SIT)	237	307	307
Cash Flow from Operating Activities / Invested Capital	10.6%	9.8%	9.7%

Note: Added value is calculated as the total of gross cash flow from operations and labor costs. The item total costs without depreciation and provisions against net revenues is calculated as the ratio between total expenditures (without cost value of sold goods, depreciations and provisions), and net revenues. Invested capital represents the difference between total liabilities and short term trade and other payables at the beginning of the financial period.

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

To provide the comparability of company operations for the period 1-3 2006 with the operations in the same period last year, the Financial Statements of the company Poslovni sistem Mercator, d.d., for the period 1-3 2005 have been adjusted to suit the requirements of the International Financial Reporting Standards.

**Income Statement**

in SIT 000

1	Type of revenue / expense / cost 2	1-3 2005 3	Plan 2006 4	1-3 2006 5	Index 6=5/3	Index 7=5/4
<b>A.</b>	<b>SALES</b>	<b>64,300,217</b>	<b>323,231,216</b>	<b>71,805,288</b>	<b>111.7</b>	<b>22.2</b>
1.	Revenue from products sold	98,226	271,290	105,650	107.6	38.9
2.	Revenue from services sold	4,479,679	24,853,804	5,646,146	126.0	22.7
3.	Revenue from goods and material sold	59,722,312	298,106,122	66,053,492	110.6	22.2
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-46,431,937</b>	<b>-233,657,595</b>	<b>-51,886,346</b>	<b>111.7</b>	<b>22.2</b>
1.	Production costs	-38,134	-402,416	-38,137	100.0	9.5
2.	Purchase value of goods and material sold	-46,368,858	-233,255,179	-51,842,395	111.8	22.2
3.	Other expenses	-24,945	0	-5,814	23.3	-
<b>C.</b>	<b>GROSS PROFIT/LOSS</b>	<b>17,868,280</b>	<b>89,573,621</b>	<b>19,918,942</b>	<b>111.5</b>	<b>22.2</b>
Č.	Selling and marketing costs	-12,143,726	-57,626,225	-13,541,682	111.5	23.5
D.	Administrative expenses	-3,904,852	-20,495,804	-3,517,254	90.1	17.2
E.	Other gains - net	315,364	6,395,308	321,565	102.0	5.0
<b>F.</b>	<b>OPERATING PROFIT/LOSS</b>	<b>2,135,066</b>	<b>17,846,899</b>	<b>3,181,571</b>	<b>149.0</b>	<b>17.8</b>
G.	Financial revenue	205,287	749,477	173,230	84.4	23.1
H.	Financial costs	-935,573	-4,541,637	-1,150,486	123.0	25.3
<b>I.</b>	<b>PROFIT/LOSS BEFORE INCOME TAX</b>	<b>1,404,780</b>	<b>14,054,739</b>	<b>2,204,315</b>	<b>156.9</b>	<b>15.7</b>
J.	Income tax expense	0	-2,991,385	-450,800	-	15.1
K.	Deferred tax	0	500,000	100,000	-	20.0
<b>L.</b>	<b>PROFIT/LOSS FOR THE FINANCIAL PERIOD</b>	<b>1,404,780</b>	<b>11,563,354</b>	<b>1,853,515</b>	<b>131.9</b>	<b>16.0</b>
M.	Number of employees based on hours worked	9,147	10,585	9,780	106.9	92.4

## Balance Sheet

in SIT 000

	Type of assets / liabilities	31.12.2005	Plan 31.12.2006	31.3.2006	Structure 31.3.2006	Index 7=5/3	Index 8=5/4
1	2	3	4	5	6	7=5/3	8=5/4
	<b>ASSETS</b>						
	<b>A. NON-CURRENT ASSETS</b>	<b>237,643,490</b>	<b>257,498,346</b>	<b>246,481,347</b>	<b>79.9%</b>	<b>103.7</b>	<b>95.7</b>
I.	Property, plant and equipment	142,300,926	166,705,168	147,120,840	47.7%	103.4	88.3
II.	Intangible assets	950,877	2,153,764	885,986	0.3%	93.2	41.1
III.	Deferred income tax assets	550,502	600,000	650,502	0.2%	118.2	108.4
IV.	Derivative financial instruments	27,770	30,000	27,770	0.0%	100.0	92.6
V.	Trade and other receivables	93,813,415	88,009,414	97,796,249	31.7%	104.2	111.1
	<b>B. CURRENT ASSETS</b>	<b>62,672,466</b>	<b>69,180,475</b>	<b>61,839,378</b>	<b>20.1%</b>	<b>98.7</b>	<b>89.4</b>
I.	Inventories	25,471,684	26,846,938	29,582,048	9.6%	116.1	110.2
II.	Trade and other receivables	33,922,497	39,028,404	30,694,283	10.0%	90.5	78.6
III.	Other financial assets at fair value through profit and loss	1,459,168	1,465,237	606,678	0.2%	41.6	41.4
IV.	Cash and cash equivalents	1,819,117	1,839,896	956,369	0.3%	52.6	52.0
	<b>TOTAL ASSETS</b>	<b>300,315,956</b>	<b>326,678,821</b>	<b>308,320,725</b>	<b>100.0%</b>	<b>102.7</b>	<b>94.4</b>
	<b>A. EQUITY</b>	<b>123,998,458</b>	<b>138,322,599</b>	<b>130,564,864</b>	<b>42.3%</b>	<b>105.3</b>	<b>94.4</b>
I.	Share capital	41,187,421	34,657,464	46,102,715	15.0%	111.9	133.0
II.	Other reserves	21,114,436	14,680,559	20,912,033	6.8%	99.0	142.4
III.	Retained earnings	61,696,601	88,984,576	63,550,116	20.6%	103.0	71.4
	<b>LIABILITIES</b>						
	<b>B. NON-CURRENT LIABILITIES</b>	<b>79,898,160</b>	<b>88,945,126</b>	<b>78,494,152</b>	<b>25.5%</b>	<b>98.2</b>	<b>88.3</b>
I.	Borrowings	74,763,870	85,576,511	73,359,862	23.8%	98.1	85.7
II.	Deferred income tax liabilities	2,153,528	0	2,153,528	0.7%	100.0	-
III.	Retirement benefit obligations	2,980,762	3,368,615	2,980,762	1.0%	100.0	88.5
	<b>D. CURRENT LIABILITIES</b>	<b>96,419,338</b>	<b>99,411,095</b>	<b>99,261,709</b>	<b>32.2%</b>	<b>102.9</b>	<b>99.8</b>
I.	Trade and other payables	51,089,602	45,505,608	34,612,414	11.2%	67.7	76.1
II.	Borrowings	42,803,688	51,379,440	62,177,143	20.2%	145.3	121.0
III.	Provisions for other liabilities and charges	2,526,048	2,526,047	2,472,152	0.8%	97.9	97.9
	<b>TOTAL LIABILITIES</b>	<b>176,317,498</b>	<b>188,356,221</b>	<b>177,755,861</b>	<b>57.7%</b>	<b>100.8</b>	<b>94.4</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>300,315,956</b>	<b>326,678,821</b>	<b>308,320,725</b>	<b>100.0%</b>	<b>102.7</b>	<b>94.4</b>
	Number of employees based on balance (at Mar 31)	9,458	11,480	10,615	-	112.2	92.5

## Cash-Flow Statement

in SIT 000

	Cash flows	Plan 2006	1-3 2006
1	Cash generated from operations	5,500,361	-12,742,164
2	Interest received	749,476	173,230
3	Interest paid	-4,521,637	-1,150,486
4	Income tax paid	-2,991,385	-350,800
	<b>Net cash generated from operating activities</b>	<b>-1,263,185</b>	<b>-14,074,058</b>
	<b>Cash flows from investing activities</b>		
1	Purchases of subsidiaries	-1,490,985	-3,008,529
2	Purchases of property, plant and equipment (PPE)	-19,542,066	-7,051,526
3	Purchases of intangible assets	-1,200,000	-17,550
4	Movement of non-current investments	0	-678,184
5	Loans made	0	-120,000
6	Proceeds from sale of subsidiaries	0	0
7	Proceeds from sale of PPE	1,670,972	182,669
8	Proceeds from sale of intangible assets	0	0
9	Proceeds from sale of current investments	1,250,975	1,006,027
10	Dividend received	0	0
11	Loan repayments received	405,059	13,662
	<b>Net cash used in investing activities</b>	<b>-18,906,045</b>	<b>-9,673,431</b>
	<b>Cash flows from financing activities</b>		
1	Proceeds from issuance of shares	4,915,295	4,915,294
2	Proceeds/repayments from borrowings	17,429,220	17,969,447
3	Purchase of treasury shares	0	0
4	Dividend paid to Company's shareholders	-2,154,506	0
	<b>Net cash used in financing activities</b>	<b>20,190,009</b>	<b>22,884,741</b>
	Net increase/decrease in cash	20,779	-862,748
	Cash at beginning of the financial period	1,819,117	1,819,117
	Net increase/decrease in cash	20,779	-862,748
	Cash at end of the financial period	1,839,896	956,369

## Movements in Equity Statement

in SIT 000

	I. Share capital	II. Other reserves	III. Retained earnings	Total
<b>Balance as at 31 December 2005</b>	<b>41,187,421</b>	<b>21,114,436</b>	<b>61,696,601</b>	<b>123,998,458</b>
Profit/loss for the financial period	0	0	1,853,515	1,853,515
Revaluation of PP&E to fair value	0	-312,939	0	-312,939
Purchase of treasury shares	0	0	0	0
Dividend paid	0	0	0	0
Cash flow hedge net of tax	0	0	0	0
Currency translation differences	0	110,536	0	110,536
Issue of share capital	4,915,294	0	0	4,915,294
<b>Balance as at 31 March 2006</b>	<b>46,102,715</b>	<b>20,912,033</b>	<b>63,550,116</b>	<b>130,564,864</b>

## Notes to the Financial Statements

### NOTES TO THE INCOME STATEMENT

- **Net revenues from sales**

Net revenues from sales for the period 1-3 2006 amounted to SIT 71,805 million which is an increase over the comparable period last year for 11.7 %, and represent 22.2 % of planned net revenues from sales for the year 2006.

Revenues resulting from the sale of goods and materials amounted to SIT 66,053 million, which is 6,331 million or 10.6 % more compared to the same period last year. Net increase is largely the consequence of:

- Increase in revenues of Mercator Centers in Celje, Kamnik, Domžale, Trebnje and in Hypermarkets Brežice and Kranj – Savski otok;
- Revenues of the Novo Mesto I. hypermarket, taken over from the company Era, d.d., in January 2006;
- Revenues of market program outlets taken over from the company Alpkomerc Tolmin, d.d., and Era, d.d., retail outlets integrated in the parent company operations in January 2006, in addition to the newly opened units;
- Increase in revenues by the hardware store outlets, mostly due to newly opened units, as well as due to the units taken over from the companies Alpkomerc Tolmin, d.d., and Era, d.d., Intersport shops and Hura! discount outlets, newly opened units, Beautique outlets; and
- Increase in revenues of external commerce.

Revenues from sales of products and services amounted to SIT 5,752 million, which is 25.6 % increase compared to the same last year period, representing 22.9 % of planned revenues from sales of products and services for the year 2006.

- **Cost of goods sold**

Expenses associated with sold products including production costs, cost value of sold goods and materials and other operating expenditures in the relevant period amounted to SIT 51,886 million, and exceed the same category for 11.7 % compared to the last year figures, which is mostly the consequence of increased extent of operations.

- **Gross profit**

Gross profit from sales for the period 1 - 3 2006 amounted to SIT 19,919 million, which is an 11.5 % increase compared to the period 1 - 3 2005 and represents 22.2 % of the 2006 plan.

- **Expenditures for sales and general operations**

Expenditures for sales and general operations amounted to SIT 17,059 million and exceed the figures for the comparable period last year for 6.3 %, representing 21.8 % of the 2006 plan. Net increase of expenses largely originates from the integration of existing expenditures of the merged companies Alpkomerc, d.d., and Era, d.d., retail outlets, as well as some newly opened units.

Expenditures by natural categories

in 000 SIT

1	Type of Cost	1-3 2005	Plan 2006	1-3 2006	Indeks	Indeks
	2	3	4	5	6=5/3	7=5/4
1.	Costs of Material	1,201,925	6,106,875	1,367,814	113.8	22.4
2.	Costs of Services	3,816,882	19,954,128	4,123,130	108.0	20.7
3.	Depreciation	1,813,407	8,036,084	1,892,175	104.3	23.5
4.	Provisions for other liabilities and charges	0	0	0	-	-
5.	Employee benefit expense	8,914,164	41,813,374	9,505,588	106.6	22.7
6.	Other Expenses	302,200	2,211,570	170,229	56.3	7.7
7.	Costs of Goods Sold	46,431,937	233,657,595	51,886,346	111.7	22.2
8.	<b>TOTAL COSTS</b>	<b>62,480,515</b>	<b>311,779,626</b>	<b>68,945,282</b>	<b>110.3</b>	<b>22.1</b>

Cost of material amounted to SIT 1,368 million, and recorded 13.8 % increase compared to the same period last year, which is largely the consequence of increases in the cost of energy and heating bills.

Cost of services amounted to SIT 4,123 million and recorded a 8.0 % increase compared to the same period last year. Increase is mostly the consequence of integration of the company Era operations in Slovenia into the parent company, the project of dual price tagging required by the expected introduction of Euro, and due to certain intensified marketing activities.

Expenditures from general operations include losses in the sale of fixed assets in the amount of SIT 23 million, and value adjustments of fixed assets in the amount of SIT 24 million.

- **Other revenues from operations**

Other revenues from operations amounted to SIT 322 million, of which SIT 123 million is related to profit from the sale of fixed assets, 97 million to collected written-off receivables, and the remaining portion to other revenues from operations.

- **Profit from operations**

Profit from operations for the period 1 - 3 2006 amounted to SIT 3,182 million and exceeds the figures realized in the comparable period in the year 2005 for SIT 1,047 million. Profit from operations represents 17.8 % of the 2006 plan.

- **Financial revenues**

Financial revenues realized in the period 1-3 2006 in the amount of SIT 173 million are mostly related to revenues from default payment interests from short term receivables from operations, and represent SIT 32 million less than in the period 1-3 2005.

- **Financial expenditures**

Financial expenditures for the period 1-3 2006 amounted to SIT 1,150 million and represent SIT 215 million increase compared to the same period last year, originating mostly from expenditures for regular interest on loans from commercial banks.

- **Profit for the period**

In the period 1-3 2006 the company realized SIT 1,854 million of profit, which is SIT 449 million more compared to the same period last year, and represents 16.0 % of the 2006 plan.

## NOTES TO THE BALANCE SHEET

- **Fixed assets**

The value of fixed assets as at March 31, 2006 amounted to SIT 148,007 million which is an increase of SIT 4,755 million compared to the situation as at Dec. 31, 2005, and represents 48 % in the overall structure of fixed assets. The change largely originates from:

- investments in total amount of SIT 7,069 million;
- depreciation in the amount of SIT 1,892 million;
- divestment of obsolete fixed assets in the amount of SIT 109 million;
- other net reductions in the amount of SIT 313 million, mostly related to depreciation and sale of revalued fixed assets.

- **Derivative financial instruments**

As at March 31, 2006 the value of derivative financial instruments, allocated for the hedging of cash flow from oscillations, amounted to SIT 28 million. The balance had not changed compared to the situation at the beginning of the year.

Except for the agreements related to the changes in interest rates the company had not applied any other derivative financial instruments.

- **Long term financial investments**

As at March 31, 2006 the long term financial investments including long term approved lending and deposits amounted to SIT 97,796 million and are mostly related to ownership shares in the Mercator Group companies in Slovenia and abroad. Compared to the balance recorded at the beginning of the year the long term investments recorded an increase of SIT 3,983 million of which 3,007 million is related to capital increase of the companies Mercator – H, d.o.o., and Mercator – S, d.o.o.

- **Inventories**

As at March 31, 2006 the value of raw materials, general material, and trading goods amounted to SIT 29,582 million, and in the structure of current assets represented 47.8 %. Compared to the balance at the beginning of the year the extent of inventories recorded an increase of SIT 4,110 million or 16.1 % which is largely the consequence of taking over the operations of the company Alpkomerc Tolmin, d.d., and the acquisition of Era, d.d., retail network.

- **Trade and other receivables**

As at March 31, 2006 the trade and other receivables amounted to SIT 30,694 million and recorded a reduction of SIT 3,228 million or 6.6 % compared to the balance at the beginning of the year.

- **Other financial assets at fair value**

Other financial assets of the company include among other the current financial investments and short term approved loans and deposits which as at March 31, 2006 amounted to SIT 607 million which is SIT 852 million less compared to the balance at the beginning of the year 2006. The reduction is largely the consequence of repaid short term lending to the companies Mercator - SVS, d.d., Emona Maximarket, d.d., and Eta, d.d.

- **Equity**

in SIT 000

	<b>31 December 2005</b>	<b>31 March 2006</b>
Share capital	41,187,421	46,102,715
Other reserves	21,114,436	20,912,033
Retained earnings	61,696,601	63,550,116
<b>Total</b>	<b>123,998,458</b>	<b>130,564,864</b>

Changes in equity for the period 1-3 2006 are related to the:

- increase in the amount of SIT 4,915 million, of which SIT 4,115 million is related to the increase of capital by the KD Group, d.d., and SIT 800 million by the company KLM, d.d.;
- increase resulting from realized net profit for the period 1-3 2006 in the amount of SIT 1,854 million;
- reduction of capital resulting from specific value adjustment in the amount of SIT 313 million related to the depreciation of value increment of fixed assets, and the sale of revalued fixed assets;
- increase of capital resulting from rate differences in long term financial investments in the amount of SIT 111 million;

In the period 1-3 2006 the company Poslovni sistem Mercator, d.d., neither purchased nor sold own stock.

- **Financial liabilities**

As at March 31, 2006 the financial liabilities amounted to SIT 135,537 million which is an increase of SIT 17,969 million compared to the beginning of the year 2006. Increase is largely the consequence of new borrowing with domestic and foreign commercial banks and other companies.

Compared to the beginning of the year the maturity of financial liabilities has considerably changed, so that the long term financial liabilities represent 54.1 %, and short term liabilities 45.9 % of the overall structure of financial liabilities (as at Dec. 31, 2005 the relationship between long and short term financial liabilities was 63,6 : 36,4).

- **Retirement benefit obligations**

As at March 31, 2006 the retirement benefit obligations amounted to SIT 2,981 million and had not changed compared to the balance at the beginning of the year. The amount of retirement benefit obligations will not change during the year, and at the year end the company will recheck the allocated amount and adjust it accordingly if required.

- **Trade and other payables**

As at March 31, 2006 trade and other payables amounted to SIT 34,161 million representing a reduction of SIT 16,928 million compared to the beginning of the year. Reduction is largely the consequence of repaid liabilities from the purchase of property.

- **Long term provisions**

As at March 31, 2006 the balance of long term provisions amounted to SIT 2,472 million. Compared to the balance at the beginning of the year the long term provisions recorded a reduction of SIT 54 million. Changes are related to:

Increase of long term provisions for other purposes	+	6 million
Reduction of long term provisions from the disbursement of provisions	-	60 million
<b>Total changes</b>	<b>=</b>	<b>54 million</b>

### Financial indicators

	Poslovni sistem Merctor, d.d.		
	1-3 2005	Plan 2006	1-3 2006
<b>Indicators of Profitability</b>			
Return on Equity	6.2%	9.2%	6.5%
Return on Sales	2.2%	3.6%	2.6%
<b>Indicators of Financial Structure</b>			
Borrowings / Equity	0.93	0.99	1.04
Equity and Long-term Provisions to Total Liabilities	47.8%	43.1%	43.1%
Borrowings to Total Liabilities	42.9%	41.9%	44.0%
Trade and Other Payables to Total Liabilities	8.9%	13.9%	11.2%
<b>Indicators of Operating Efficiency and Productivity</b>			
Labor Costs per work hours (in SIT 000)	4,288	3,950	4,277
Sales / Labor Costs	7.2	7.7	7.6
Revenues per Employee per work hours (in SIT 000)	30,929	30,537	32,305
Value Added per Employee per work hours (in SIT 000)	6,184	6,397	6,490
Cash Flow from Operating Activities / Sales	6.1%	8.0%	6.9%
Total Costs without Depreciation / Sales	22.1%	21.7%	21.2%
Invested Capital (in billion SIT)	187	249	249
Cash Flow from Operating Activities / Invested Capital	9.3%	10.4%	8.7%

## EVENTS FOLLOWING THE BALANCE SHEET DATE

Business operations of the Mercator Group and the company Poslovni sistem Mercator, d.d. after the conclusion of the accounting period 1 - 3 2006 have been distinguished by the following major events:

- ✓ On April 12, 2006 we reopened the renovated Mercator Center in Samobor, and the Intersport shop, number 13 in Croatia, at the elite location in the center of Zagreb, at the Ban Jelačić Square.
- ✓ On April 14, 2006 the companies TUP Rodić M&B CO, d.o.o. from Novi Sad and Poslovni sistem Mercator, d.d. signed the Letter of Intent for the strategic association in the field of trading with food and similar products in Serbia and Montenegro and in wider region.
- ✓ On April 24, 2006 the company Poslovni sistem Mercator, d.d. received the approval by the National Securities Market Agency for organized trading with newly issued shares with the deferred condition of entering the shares into the Central Register of non-materialized securities, and on April 26, 2006 the approval by the Ljubljana Stock Exchange related to the extension of enlistment of the newly issued stock by the company Poslovni sistem Mercator, d.d. with the deferred condition of entering the shares into the Central Register of non-materialized securities.
- ✓ On May 3, 2006 the company Poslovni sistem Mercator, d.d. received a decree issued by the Central Clearing Agency by which an additional amount of 382,340 shares marked MELR in total amount of SIT 3,823,400,000.00 is entered in the Central Register of non-materialized securities.
- ✓ On May 5, 2006 the Ljubljana Stock Exchange enlisted 382,340 newly issued shares of the company Poslovni sistem Mercator, d.d. to the trading quotation. The number of issued shares subject to trading at the Ljubljana Stock Market therefore totals 3,590,844 shares.
- ✓ On May 4, 2006 the National Agency for the Protection of Competition adopted the decree pursuant Article 38, Section 3 of the Competition Restraint Prevention Act, and applicable provisions of the General Administrative Proceedings Code: concerning the reported concentration originating from the acquisition of ownership between the Poslovni sistem Mercator, d.d., Dunajska cesta 107, Ljubljana, and Era, Trgovina z živilskimi in neživilskimi izdelki, d.d., Prešernova 10, Velenje, the Agency has no remarks and hereby declares that the concentration is in accordance with the relevant competition rules and regulations.

- ✓ Mercator Group has the intention to conclude a syndicated loan arrangement in the amount of up to € 150 million with the International Finance Corporation (IFC). The loan is to be used for the financing of Mercator activities in the markets of Croatia, Serbia, and Bosnia and Herzegovina, both for investments and for refinancing of existing financial sources, in accordance with the annual financial plan of the Mercator Group.