

annual report



2002



Mercator

challenge
gift learning
playing
growth
fulfilment
discovering
the world



Annual Report 2002

To take up a *challenge* is rather easy, however overcoming it is something completely

different. The key challenge of Mercator Group is to connect people of various cultures, habits and backgrounds,

to bring together fundamental values that lie within each and every one of us and unite them into a coherent entire-

ty. This is the *gift* that we want to give to the world. We have taken up this challenge and will, as ever,

strive towards the improvement of every aspect of life regardless of where we spread our activities to. This requires

of us not only a great deal of responsibility, but above all it requires a more sophisticated human touch, which has

always been and shall remain Mercator's single most important objective. This approach is clearly evident in every

part of the Mercator Group: from our management board all the way down to the smallest corner store. The com-

mon goal of our large working collective is to adapt the products offered to customers to satisfy their needs to the

highest extent possible, continuously improve the range and quality of our services, and thus contribute our part to

the social wealth. We do not call this process work; we call it *learning*.

To achieve the desired, even expected, level of quality we are always open to creative new ideas and suggestions,

which assure us firm ground for continuous *growth*. On numerous occasions the best ideas

came directly from the customer. It was our will to listen that made it possible for these ideas to be carefully thought

through, improved, tested, upgraded, re-tested, and finally brought to life. We do not call this process business plan-

ning, we call it *playing*; we believe that playing is fun only when all sides are equally involved in it.

There are two more things that we want to bring back into the business world and into our very lives, which we seem to lack: dignity and honesty. Therefore we are always oriented towards a strong and long-term partnership with our customers. We do not hide that a conflict of interests often arises, however we believe that by pledging to the aforementioned values we can overcome even the greatest of differences. We do not call this process business expansion; we call it *discovering the world*.

They say that due to globalisation our world is becoming smaller. This is true but we will never stop trying to make it more warm and homelike at the same time, as we believe that only in this way we will manage to *ful-*
fil our dreams. Bearing this in mind we are ready to take up new challenges. Our efforts cannot just be called a big company; they can only be called *Mercator*.

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* The Annual Report 2002 in English language includes financial information according to the International Financial Reporting Standards, and is not a translation of the Slovenian version of the Annual Report 2002, which is the legal version.

Letter to Shareholders

Dear Shareholders,

I am proud and pleased to report that in 2002 we successfully achieved and exceeded the targets, set in the medium-term business plan for the period 2000 - 2003, therefore a new medium-term plan was prepared in 2002, which sets our strategic objectives and targets until the year 2005. Despite deteriorated market conditions we retained the leading retailer position in Slovenia and consolidated our position and public perception in Croatia and Bosnia and Herzegovina. In 2002 Mercator entered its third strategic market - Serbia, where it intends to expand its business activities in line with planned internationalisation processes.

2002 was another year marked by extensive investment activities in line with adopted medium-term investment plans. In 2002 Mercator successfully continued to expand its retail network on the domestic market. The opening of a new Mercator Centre in Kranj, two larger shopping centres in Logatec and Grosuplje and renewal of a number of stores contributed to achieving the goal of ensuring equal quality of products and services offered to customers in all Slovenian regions. Despite fierce competition in the retail industry the Mercator Group strengthened its market share in 2002 and remained the leading retailer on the domestic market.

In terms of market share on the Croatian market Mercator became the fifth largest retailer of consumer goods in 2002. The year was marked by the opening of a Mercator Centre in Split, announcing the expansion of the retail network in Dalmatia, and refitting of the distribution centre for the supply of the whole Croatian market. In 2002 Mercator's only presence on the market of Bosnia and Herzegovina was the Mercator Centre in Sarajevo, still its market share is ranked among the largest retail chains in the country. Business achievements on the Bosnian market met expectations and in the future our retail network will be further expanded on this market. By entering the third strategic market - Serbia - Mercator achieved its present goals related to internationalisation of business operations. Mercator Centre in Belgrade, which was opened in December 2002, received an enthusiastic welcome and its performance exceeded all expectations. Successful entry of the Serbian market is an excellent basis for further development of retail network and strengthening of market position in Serbia.

A satisfied customer is the focus of all our endeavours. Marketing projects and continuous education of employees of all Group companies are designed to make customers, who visit our stores happy, pleasantly surprised and rewarded. Regular customer surveys show that we achieved our goal as our customers are satisfied with the quality of our products and friendly customer service. The number of our most loyal customers - holders of the Mercator Pika loyalty card - is on the increase as well, as they are more than 270,000. Over 10 million customers visit our stores monthly. In the future we shall continue to listen closely to and satisfy the demands of our customers in all the markets in which we operate and shall take great care of all our other stakeholders.

We are aware that economic achievements are not the only indicator of our business performance and that it is greatly due to our employees, who provide the customers with friendly and high quality services. Special care is therefore paid to our employees whom we offer numerous training opportunities for their professional and personal development. We introduced motivational management and incentive bonuses and contributed to their long-term social security by implementing a voluntary additional collective pension insurance plan. That we are successful has been proven by surveys which show that the satisfaction rate of Mercator's employees exceeds the average satisfaction rate of their peers in the industry and in the Slovenian corporate sector as a whole. Therefore

I wish to thank all my colleagues - their number has gone well over fourteen thousand - who with their devoted work and a friendly smile helped Mercator become the best retailer in South-east Europe.

Successful achievement of set goals is also made possible by the assistance of our partners with whom we efficiently co-operate in providing our customers with high quality products and services. We enhance our co-operation with partners in all the markets in which we operate by numerous joint campaigns. In this way we promote the development of domestic producers and enable them to join us in entering new markets and with partnership relations established with producers on new markets we stimulate their development.

Mercator is well aware of its role in the general social environment and in performing all its business activities it gets involved in the economic, social and cultural development of regions in which it operates. Funds for sponsorships and donations are earmarked for the development of sports, culture, education and environmental projects.

With numerous charitable campaigns we wish to improve the quality of life and help underprivileged persons and institutions in need. In 2002 we paid special attention to projects comprising educational and preventive campaigns related to healthy, happy and safe development of children and teenagers.

We strengthen our competitive position by continually improving our business performance and efficiency.

We wish to climb further up the ladder of the best European retailers. We can pride ourselves on the fact that all our trade companies in Slovenia have obtained the ISO 9001 certificate of quality and that also the non-trade companies are obtaining them. An important

project related to quality is HACCP - a project ensuring good hygiene levels and better control of production processes. The category management project - which is being carefully prepared - will lead to enhanced partnership relations with our suppliers.

As we are well aware of the significant role of our core activity - trade in consumer goods - we continued to transform the non-trade segment of the Group in 2002 and started with preparations for the transformation of the trade segment. In the future we shall continue to rationalise our business operations and take advantage of economies of scale and established links in order to maintain our commitment to quality and improved business performance and efficiency. The goal is to maintain our competitive advantages and the leading position even after Slovenia has entered the European Union.

We regularly monitor our exposure to all key types of risks which could have a material impact on the performance and efficiency of our operations. On the basis of assessed exposure to various types of business risk, financial risk and operating risk we carry out risk management or hedging activities in line with selected policies. In this way we reduce risk exposure and ensure more reliable achievement of set business goals.



Despite a period of extensive investment and development with high growth rates we succeeded in maintaining a high level of financial strength and total assets. This ensured the security of our creditors' investments and their trust in our future operations. In previous years we managed to further consolidate Mercator's financial position by improving the maturity of financial sources within the target capital structure while our policy of early settlement of a major portion of trade payables shows high liquidity which we intend to maintain also in the future. We attach the utmost importance to our shareholders' assessment of our business performance. Our endeavours to create value for shareholders were to a certain extent recognised by the Slovenian capital market in 2002, as the market price of Mercator shares grew by 51.6% in 2002 while the industrial sector stock exchange index only reached a growth of 37%. Including dividend payout our shareholders recorded a 54% return on their investments in Mercator in 2002. In the future we intend to direct all our efforts to generating greater value for our shareholders and to meeting our commitments to all other stakeholders related to Mercator.

In 2002 the operation of the Company was successfully monitored by its Supervisory Board who started performing its function in its present composition in October 2001. To the Supervisory Board who professionally, thoroughly and with dedication supervised the operation of the company Poslovni sistem Mercator, d.d., and the Mercator Group in 2002 I wish to offer my sincere thanks for its successful co-operation and trust, confirmed also by the appointment of the Management Board, enlarged by an additional member, for a further five-year term of office. I am confident that with its committed and professional work the Supervisory Board will significantly contribute to successful operation and achievement of set strategic objectives of the Mercator Group also in the future.

My colleagues in the Management Board join me in reporting that we have experienced another year of excellent achievements. We are delighted to have the opportunity to run a company which in a short period of time succeeded in becoming the largest and one of the most successful companies in Slovenia. I am sure that by pursuing clearly set development goals Mercator will remain the leading Slovenian retailer, despite facing fierce competition, and become an important retail chain on all new markets of South-east Europe and consequently a significant factor of economic development in all the markets in which it will operate. All of this will be made possible with your sincere trust and our common wish to be successful also in the period when Slovenia is part of the European Union!

Ljubljana, 28 March 2003

Zoran Janković,
President of the Management Board





Marjan Sedej (Member of the Management Board), Stanislav Brodnjak (Member of the Management Board), Zoran Janković (President of the Management Board), Jadranka Dakič (Member of the Management Board), Aleš Čerin (Member of the Management Board)

Report of the Supervisory Board

Composition of the Supervisory Board

The operation of the company Poslovni sistem Mercator, d.d., the parent company of the Mercator Group, was monitored in 2002 by its Supervisory Board in accordance with its powers and responsibilities conferred by law and the Company's Articles of Association.

In 2002 the Supervisory Board was composed of the following members: Janez Bohorič, Chairman and members: Vera Aljančič-Falež, Ksenija Bračič, Jože Cvetek, Dragica Derganc, Katja Galof, Matjaž Gantar, Vladimir Jančič, Morena Kocjančič, Matej Narat, Marjan Somrak in Branko Tomažič. On 9 December 2002 Mr. Matej Narat resigned as a member of Supervisory Board for incompatibility of duties.

Throughout the year 2002 the Company's Management Board comprised Zoran Janković, President and CEO and members: Aleš Čerin, Jadranka Dakič and Marjan Sedej.

Activities of the Supervisory Board

Members of the Supervisory Board met regularly and promptly considered and supervised the running of the Company and its operation in 2002. The Supervisory Board met at seven scheduled meetings in 2002.

The Supervisory Board considered and adopted the business plan of the company Poslovni sistem Mercator, d.d. and Mercator Group at its meeting on 29 January 2002. With this the scope of business activities and the goals of the Company and the Group for the year 2002 were determined.

At all meetings in 2002 the Supervisory Board promptly considered the following areas of the Company's operation: current business performance and the assets of the Company and the Group, the work of the Management Board, current investment activities, raising of financial sources and execution of resolutions adopted by the Supervisory Board.

In addition to this regular supervisory activities the Supervisory Board also considered the following important business activities in 2002:

- At its regular meeting on 15 April 2002 the Supervisory Board considered and approved the Annual Report for 2001 with the accompanying audited financial statements and approved the summoning of the Annual General Meeting of Shareholders.
- Together with the Annual Report for 2001 the Supervisory Board considered and approved the proposal for distribution of net profit for 2001 and recommended to the General Meeting of Shareholders a payment of SIT 400 gross dividend per share from the net profit for 2001, which the General Meeting approved. The General Meeting was also proposed to adopt the amendments and supplements to the Company's Articles of Association.
- At its regular meeting on 28 May 2002 the Supervisory Board considered and adopted the Medium-term Plan for the Company and the Group for the period 2002 - 2005, which states the fundamental strategic directions

and goals of the Mercator Group until the end of 2005. In 2002 the mandate of the Management Board expired, therefore, the Supervisory Board appointed for a new mandate of five years (from 1 January 2003 until 1 January 2008) the Management Board composed of: Zoran Janković, President and CEO and members, Jadranka Dakič, Aleš Čerin, Marjan Sedej, and a new member Stanislav Brodnjak of the company Poslovni sistem Mercator, d.d.

- At its regular meeting on 13 August 2002 the supervisory Board of the Company considered the reports on the surveys of shareholder and employee satisfaction conducted in 2002.
- On 4 December 2002, along with the opening of Mercator Center in Belgrade the meeting of Supervisory Board was held in Belgrade, where the Supervisory Board discussed the nine month report on business performance of the company Poslovni sistem Mercator, d.d., and the Mercator Group.
- At its last meeting in 2002, on 19 December 2002, the Supervisory Board adopted the plan of the company Poslovni sistem Mercator, d.d., and the Mercator Group for the year 2003.

Semi-annual and Annual Report for the Year 2002

The Supervisory Board considered and approved the unaudited Semi-Annual report of the Company and Group at its meeting on 13 August 2002. The Company published a summary of the unaudited Semi-Annual report in accordance with legal regulations and the Ljubljana Stock Exchange Rules.

The Supervisory Board considered the unaudited financial statements for 2002 of the Company and the Group with short notes to the statements at its meeting on 18 February 2003 and the Company published its unaudited financial statements in accordance with legal regulations and the Ljubljana Stock Exchange Rules.

The Supervisory Board complimented the Management Board for the excellent business results achieved in 2002, which significantly exceeded the projected results and represent successful implementation of medium-term strategic objectives.

The Supervisory Board considered the Annual Report for 2002, composed of business review and financial report at its meeting on 15 April 2003. It also considered the report of the auditing firm PricewaterhouseCoopers, d.o.o., on the audit of unconsolidated and consolidated financial statements. The meeting was attended by a certified auditor who was available for any additional commentary.

In reviewing the submitted annual Report for 2002 the Supervisory Board took into account the following factors:

- The company Poslovni sistem Mercator, d.d., and the Mercator Group concluded the year 2002 very successfully as they exceeded the projected business results and improved all key elements of business performance compared with 2001.
- Setting up other reserves from the retained net profit for 2002 is in line with the Company's strategic development goals, adopted dividend policy and fiscal factors.
- On 28 March 2003 the auditing firm PricewaterhouseCoopers, d.o.o., issued a positive opinion on the Company's unconsolidated and consolidated financial statements, which are included in the annual report. The Supervisory Board had no comments on auditors' report and expressed its agreement.
- The Supervisory Board regularly monitored the running and the operations of the Company and the Group and promptly considered their business performance and their assets. The Management Board delivered to the Supervisory Board all information, which was latter needed or required for the performance of its supervisory activities.

On the basis of the above said supervisory activities and factors and detailed review of the Annual Report of the company Poslovni sistem Mercator, d.d., and the Mercator Group for 2002, submitted by the company's Management Board, the Supervisory Board established:

- that the Annual Report has been drawn up clearly and transparently,
- that the Annual Report presents a true and fair picture of total assets, liabilities, financial position and operating results of the company Poslovni sistem Mercator, d.d., and the Mercator Group and
- that the Annual Report presents a fair picture of the business development and business position of the company Poslovni sistem Mercator, d.d., and the Mercator Group.

Consequently the Supervisory Board had no comments on the Annual Report of the company Poslovni sistem Mercator, d.d. and the Mercator Group for 2002, submitted by the Management Board and approved it unanimously at its meeting on 15 April 2003.

Proposal for Allocation of Distributable Net Profit

By approving the Annual Report the Supervisory Board also approved the allocation of net profit in accordance with the competencies of the Management Board and the Supervisory Board. The Management Board and the Supervisory Board decided that net profit for 2002 amounting to SIT 2,790,066,039.50* would be allocated to setting up other reserves from profit in accordance with provisions of the Commercial Companies Act.

The distributable net profit of the company Poslovni sistem Mercator, d.d., for the year 2002 amounts to a total of SIT 4,472,576,609.25*, as confirmed by the certified auditor in the auditors' report. The Management Board and the Supervisory Board propose to the General Meeting of Shareholders that the distributable net profit for 2002 be allocated as follows:

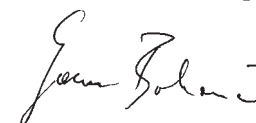
- part of the distributable net profit in the amount of SIT 1,443,826,800.00, deriving from undistributed net profit for year 2000 to be paid as dividend resulting in a gross dividend of SIT 450 per share;
- part of the distributable net profit in the amount of SIT 2,324,727,107.57, deriving from undistributed net profit for 2002, to other reserves from profit;
- the remaining distributable net profit in the amount of SIT 704,022,701.68, deriving from undistributed net profit for 2000, remains undistributed and the decision on its allocation is carried forward to the next year.

The Supervisory Board approved the above said proposal of distributable net profit allocation as it considers it to be in line with the strategic goals, investment activities, dividend policy and fiscal policy of the Company and the Group.

This report has been prepared in accordance with Article 274 a of the Commercial Companies Act and is addressed to the General Meeting of Shareholders.

Ljubljana, 15 April 2003

Janez Bohorič
Chairman of the Supervisory Board



* According to Slovenian Accounting Standards



gift

Key Achievements of 2002

Consolidated net revenues in 2002 increased by 11.9 % over 2001. The Mercator Group obtained a 39.8 % market share in Slovenia, 2.9 % in Croatia and a 1.0 % market share in Bosnia and Herzegovina.

1. Offering products which ensure a better quality of life

a) Satisfying customers' needs, wishes and expectations

- we increased customer satisfaction, created added value of customer services and made customers happy in our stores;
- we improved the quality of offered products of domestic and foreign suppliers at competitive prices with additional services, new marketing activities and special offers for customers;
- at the end of 2002 Mercator had 944 retail units in Slovenia and on new markets;
- over 10 million customers per month visited Mercator stores;
- the internet store was expanded: the number of its users increased by 20 % compared with 2001;
- new private label products were launched on the market; with them Mercator responded and adjusted to changed habits, wishes and needs of customers;
- the number of Pika loyalty card holders grew to 270,000, an increase of 44.6 % compared with 2001, which shows customers' strong loyalty and commitment to Mercator;
- the results of a survey of customer satisfaction showed that 83 % of Mercator's customers in Slovenia were satisfied with products and the level of customer service while in Croatia and Bosnia and Herzegovina satisfied customers exceeded 95 %.

b) Ensuring sales growth and consolidation of our position as the leading retail chain in Slovenia

- expansion of the retail chain in Slovenia continued by the opening of the second Mercator Centre in the Gorenjska region - Mercator Centre Kranj - and two shopping centres in Grosuplje and Logatec;
- during 2002 the oldest Mercator Centre - Mercator Center Koper was refurbished;
- expansion of franchise stores network continued; their number grew from 100 in 2001 to 110 in 2002; the first franchise store of the Intersport chain in Slovenia was opened (in Brežice);
- in 2002 consolidated net sales revenues amounted to SIT 320 billion, representing an increase of 11.9 % over 2001;
- at the year end the Mercator Group obtained a 39.8 % market share in Slovenia.

c) Gaining an important market share in the new markets: in Croatia, Bosnia and Herzegovina and Serbia

- in July 2002 Mercator Centre Split was opened indicating the beginning of expansion of the retail network in Dalmatia;
- the end of 2002 was marked by the entry into the Serbian market with the opening of Mercator Centre in Belgrade where Mercator intends to expand its business activities;
- the company Mercator - H, d.o.o. set up a distribution centre in 2002 for its distribution activities in Croatia;

- at the end of 2002 the Mercator Group obtained a 2.9 % market share in Croatia and approximately 1 % market share in Bosnia and Herzegovina.

2. Long-term partnership with producers

- co-operation with partners took various forms, new were joint marketing campaigns: co-marketing, development of Mercator private labels and of new products and category management;
- in Slovenia as much as 72 % of total goods on Mercator's shelves were made by Slovenian producers, while 28 % were imported goods;
- on the new markets a significant share of merchandise was supplied by local partners.

3. Alliances with foreign strategic partners

- in 2002 we continued to establish contacts with potential strategic partners who would enable the Mercator Group to reach global competitiveness with goods of foreign origin, particularly after Slovenia's entry in the European Union.

4. Maintaining the level of business performance of the best European retailers

a) Increased business efficiency

- in 2002 activities aimed at rationalisation of operations, utilisation of synergetic effects and economies of scale were carried out in all areas of activity;
- processes of restructuring in the non-trade segment of the Group continued; the companies Eta, d.d. and Slosad, d.o.o. merged in September for a more efficient organisation of production of the two companies;
- at the end of 2002 the company Poslovni sistem Mercator, d.d. disposed of its shareholding in the company Mercator - Sremič, d.o.o. due to refocusing in its core activity;
- intensive preparations were carried out for the implementation of the category management, which will require a radical reorganisation of the key business functions and closer co-operation with suppliers;
- by the end of 2002 most of trade companies in Slovenia had already gained the ISO 9001 quality certificate, and among the non-trade companies the company Pekarna Grosuplje, d.d.;
- in addition to the ISO 9001 quality system the HACCP system was introduced in the trade companies of the Mercator Group in 2002, which ensures good hygiene and control of production processes in accordance with the Law on Health and Hygiene Safety of Foods and Materials and Articles Intended to Come into Contact with Foods;
- net sales revenues per employee in the Mercator Group were SIT 23 million in 2002, 6.9 % up on 2001;

b) Ensuring security of investments

- in 2002 a significant portion of current borrowings was replaced by non-current borrowings so that the share of non-current borrowings grew from 47.1 % to 67.1 % ensuring the Mercator Group with adequate maturity of financial sources;
- coverage of non-current assets with non-current liabilities improved from 81.1 % to 92.7 %;
- the Mercator Group maintained the target capital structure in 2002;
- EBITDA, which is an approximate measure of generating of gross cash flows from operations, recorded by the Mercator Group was SIT 24,520 million, and increase of SIT 708 million over 2001;
- the ratio between EBITDA and interest expenses increased from 2.8 in 2001 to 3.2 in 2002, indicating an excellent liquidity. In addition the Group settled a major portion of operating liabilities with early repayments while taking advantage of financial discounts.

Mercator's shareholders recorded a 54 % return on their investments in the Company in 2002.

c) Generating greater shareholders' value

- in 2002 the Mercator Group realised SIT 7,082 million of net profit;
- earnings per share amounted to SIT 2,169 in 2002,
- in 2002 gross dividend of SIT 400 was paid;
- the weighted average daily price of shares in 2002 was SIT 22,254, which was 46.1 % over the 2001 figure; the average daily price of shares on 31 December 2002 was SIT 24,551, a 51.6 % growth compared with the beginning of the year;
- the ratio between EBITDA and net revenues was 7.7 % in 2002, indicating a high level of business efficiency and ability to generate cash flows with business assets;
- including dividend payout Mercator's shareholders recorded a 54 % return on their investments in the Company in 2002.

5. Meeting our commitments to employees and general social environment

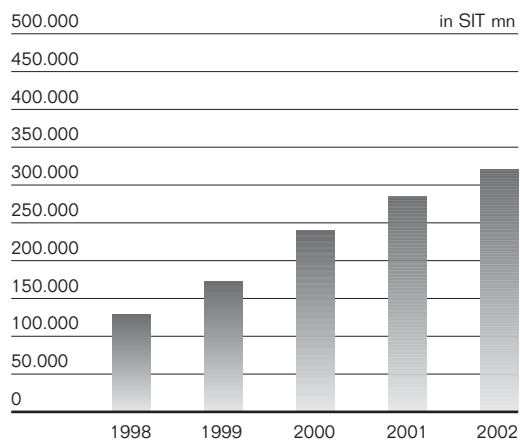
- in 2002 the third measurement of employee satisfaction was conducted in all companies of the Mercator Group; it showed that satisfaction was on the increase;
- in 2002 the first annual interviews with employees were carried out in the parent company;
- in 2002 the employees enrolled in various training programmes; on average 8.6 teaching hours per employee were recorded in 2002;
- for the second consecutive year employees were reimbursed their premiums for supplementary voluntary additional collective pension insurance plan;
- we continued with humanitarian and charitable campaigns,
- we monitored the carrying out of environmental policy;
- we supported various cultural, sporting and scientific activities.

Financial Highlights of 2002

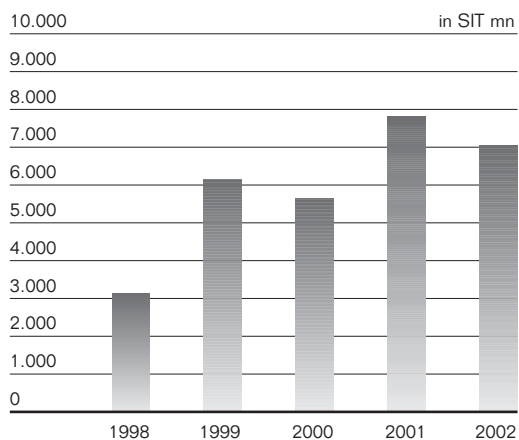
Mercator Group		
Year	2002	2001
Net sales revenues (in SIT mn)	319,777	285,675
Net profit before minority interest (in SIT mn)	7,082	7,824
Net profit after minority interest (in SIT mn)	6,959	7,903
EBITDA (in SIT mn)*	24,520	23,812
Capital expenditure (in SIT mn)	24,491	32,730
Long-term financial investments (in SIT mn)	1,240	3,418
Return on equity	11.0 %	13.5 %
Earnings per share (in SIT)	2,169	2,463
Paid dividend per share (in SIT)	400	300
Market share	39.8 %	37.2 %
As at	31. 12. 2002	31. 12. 2001
Number of employees as at 31 December	14,331	13,692
Number of companies in the Group	25	24

*The method of calculation is described in the section Business Performance Analysis

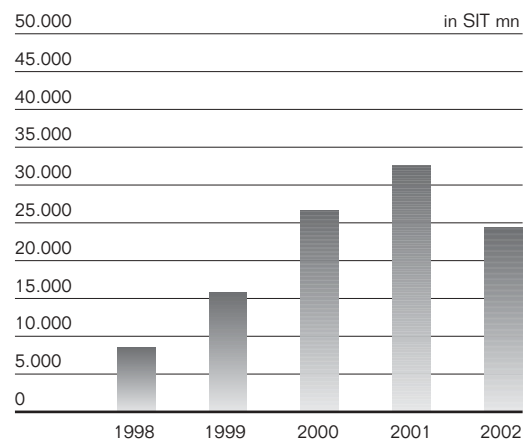
Revenues



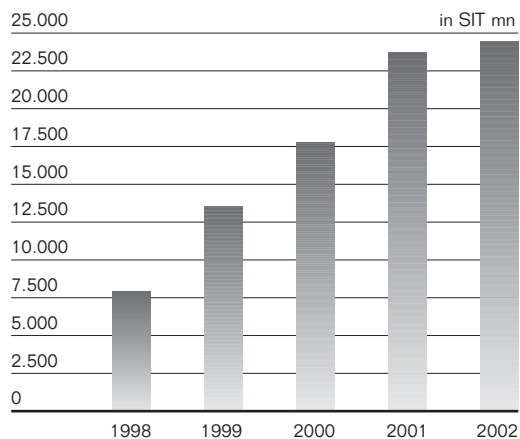
Group profit



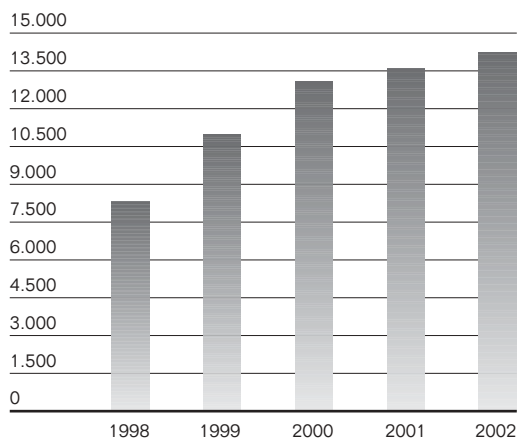
Investments



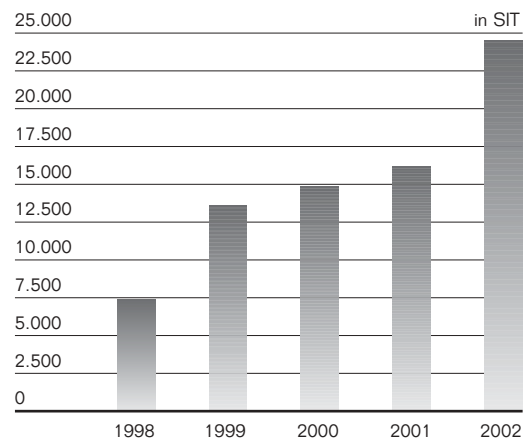
EBITDA



Number of Employees

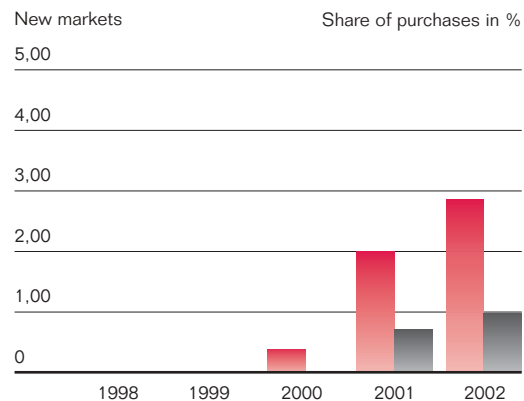
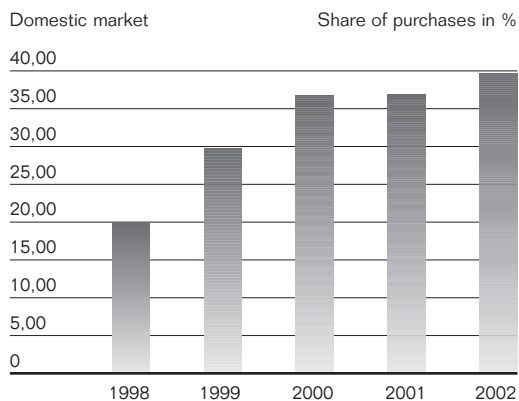


Weighted average daily price of share



Market share

SLO ■
CRO ■
BIH ■



Business Review

General Information

Profile of the Parent Company

Full name	Poslovni sistem Mercator, d.d.
Abbreviated name	Mercator, d.d.
Identification number	5300231
Tax number	45884595
Court registry number	1/02785/00
Date of entry in the court register	12 October 1995
Share capital of the Company	SIT 32,085,040,000
Share nominal value	SIT 10,000
Share listing	Ljubljana Stock Exchange, official market, trading code: MELR
President of the Management Board and CEO	Zoran Janković
Members of the Management Board	Aleš Čerin, Jadranka Dakič, Marjan Sedej, Stanislav Brodnjak (from 1 January 2003)
Chairman of the Supervisory Board	Janez Bohorič

Activities of the Mercator Group

The history of the company Poslovni sistem Mercator, d.d., goes back to 1949, when a wholesale company “Živila Ljubljana” was founded, while the name “Mercator” first appeared in 1953 with the founding of a wholesale trade company “Mercator” in Ljubljana. The basic characteristic of Mercator’s development until the beginning of the nineties was integration of smaller local companies of similar interests from trade, food processing, agriculture, hospitality and other services sectors, all of which retained their legal independence. In 1990 Mercator was registered as Poslovni sistem Mercator, d.d., which was established by transfer of unpaid capital to the parent company by previously integrated companies. Ownership transformation was concluded in 1994 after a public offering of shares. As a joint-stock company with concluded privatisation Poslovni sistem Mercator, d.d. was entered into the court register in October 1995.

Today the company Poslovni sistem Mercator, d.d. is the parent company of a group of related companies Poslovni sistem Mercator, d.d. (the “Mercator Group”) and performs a double role: carries on sales activities in

the region of central Slovenia and holds majority interests in all companies of the Mercator Group, for which it performs the holding company function.

In addition to the parent company, the Mercator Group consists of other trade companies and non-trade companies operating in food processing, agriculture, hospitality and other services.

Trade Activities

In 2002 the Mercator Group consisted of 16 companies, of which 4 operated outside Slovenia. The principal and most extensive activities of the Mercator Group are wholesale and retail sale of consumer goods. With a 39.8 % market share the Group was the market leader in Slovenia and was gaining important shares of the new markets. In Croatia its market share grew from 2 % in 2001 to 2.9 % in 2002, in Bosnia and Herzegovina the estimated market share was 1 %. The trade segment of the Group generated 92.1 % of total sales revenues, of which 22.4 % was made up by wholesale, 72.1 % by retail sale and 5.5 % by sale of services.

In 2002 the Mercator Group consisted of 16 trade companies, of which 4 operated outside Slovenia.



Retailing is divided into the following programmes

- Fast moving consumer goods (FMCG),
- Technical products and furniture,
- Apparel
- Sports - Intersport.

The Mercator Group also includes two specialised companies. The company Mercator - Modna hiša, d.o.o. specialises in clothing and has been operating as a specialised chain of clothing stores dealing in wholesale and retail sale since 2001 in Slovenia. The company Trgoavto, d.d. specialises in selling technical products. During 2002 the company established a joint-venture with the company Avtotehna, d.d., a new company TT - Trgotehna, d.o.o., which will specialise in selling trucks IVECO and at the end of the year the company established another company - TrgoA PSC, d.o.o. which will specialise in selling Renault cars.

The retail network of the Mercator Group is highly diversified and at the end of 2002 comprised 944 various retail units - shopping centres, hypermarkets, supermarkets and department stores, self-service stores and specialised stores. In 2002, 3 new Mercator Centres were opened so that at the end of 2002 the Mercator Group had 18 Centres of which 5 on new markets.

3 new Mercator Centres were opened in 2002. Of total 18 Mercator Centres 5 operated abroad.

An overview of retail units by type of unit as at 31 December 2002 is shown in the following table:

Type of retail unit	No. of units	Net sales area in m ²	Gross sales area in m ²
Hipermarkets	18	57,000	89,045
Supermarkets	58	44,955	70,686
Superettes	263	58,451	106,090
Self-service stores	153	13,094	24,976
Department stores	30	29,475	45,633
Discount and Cash&Carry	26	16,246	22,902
Other smaller stores	44	1,201	2,894
Technical products	104	29,405	91,445
Apparel	148	37,197	46,448
Intersport	14	6,588	8,344
Furniture	27	18,068	23,319
Hotels and restaurants	59	6,561	10,692
Total	944	318,241	542,474
Total with franchise stores	1,054	333,302	542,474

An overview of retail unit structure of the Mercator Group by individual company of the Mercator Group as at 31 December 2002 is shown in the following table:

Company	No. of units	Net sales area in m ²	Gross sales area in m ²
Poslovni sistem Mercator, d.d.	285	90,441	144,573
Mercator - SVS, d.d.	143	45,885	105,586
Mercator - Dolenjska, d.d.	97	35,182	66,579
Mercator - Gorenjska, d.d.	84	25,174	39,871
Mercator - Degro, d.d.	69	19,364	36,239
Mercator - Goriška, d.d.	57	17,431	26,927
Trgoavto, d.d.	31	4,425	11,148
Mercator - Modna hiša, d.o.o.	86	26,328	32,395
Total domestic market	852	264,230	463,318
Mercator - H, d.o.o., Croatia	80	36,521	52,921
Mercator - TC Sarajevo, d.o.o., Bosnia and Herzegovina	5	6,681	10,124
Mercator S, d.o.o., Serbia	7	10,809	16,111
Total new markets	92	54,011	79,156
Total	944	318,241	542,474

Of the total of 944 retail units 852 operated in Slovenia, the remaining 92 abroad: 80 in Croatia, 5 in Bosnia and Herzegovina and 7 in Serbia.

Non-trade Activities

In addition to trade companies the Mercator Group includes companies which operate in the food processing industry, agriculture, hospitality and other services activities.

In 2002 the following food processing companies operated within the Mercator Group:

- The company Mesnine dežele Kranjske, d.d., whose core activities are sale of fresh meat and meat processing. In 2002 the company established a new company MDK-H, d.o.o., which produces and sells meat products in Croatia.
- The company Eta, d.d., which produces sterilised and pasteurised garden products, mustard and various toppings, and deals in fruit processing, producing compotes and frozen line. In 2002 Slosad, d.o.o. joined the company Eta, d.d. enabling a more efficient organisation of production of the two companies. The principal activity of the company Slosad, d.o.o. was production of fruit concentrates.
- The company Pekarna Grosuplje, d.d. is the leading bakery manufacturing bread and fresh pastry in Slovenia. The company owns the company Belpana, d.o.o., Zagreb, which manufactures bread and fresh pastry in Croatia, mostly for the needs of Mercator's retail network.
- The company Mercator - Emba, d.d. deals in coffee roasting, manufacturing cacao, grains, toppings and packed and powdery products.

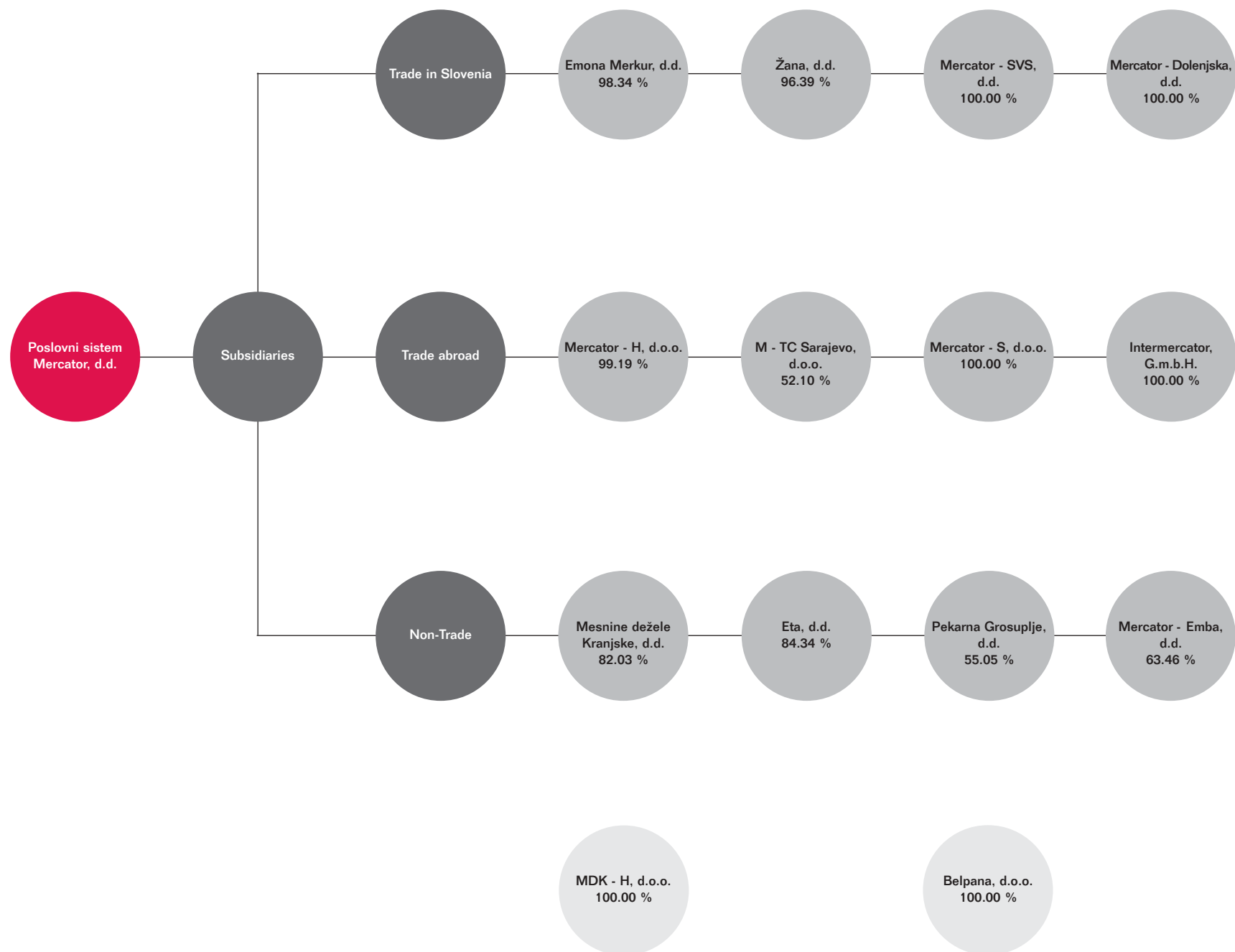
The company Mercator - KŽK Kmetijstvo Kranj, d.o.o is the Group's agricultural company operating florist and garden centres and dealing in agriculture.

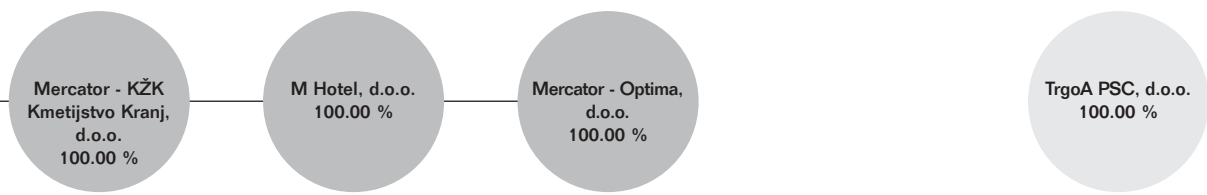
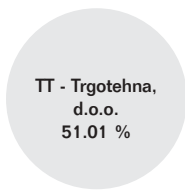
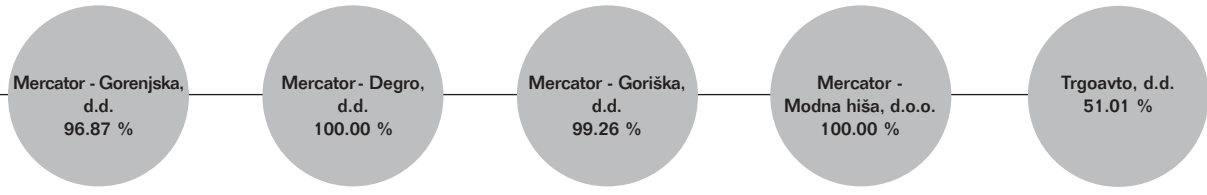
The company M Hotel, d.o.o. operated in the hotel and restaurant segment of the Group. The company Mercator - Sremič, d.o.o. was sold at the end of 2002.

The service company Mercator-Optima, d.o.o. deals in engineering and designing and is closely involved in Mercator's investment activities.

Corporate Structure

As at 31 December 2002 the Mercator Group, which is a group of related companies of the Poslovni sistem Mercator, d.d. (parent company), was composed of:





In 2002 the Group's structure changed due to the following integration processes:

- On 1 January 2002 the company Sloboda, d.d., which had been purchased in 2001, was merged with the company Mercator · H, d.o.o., resulting in improved efficiency of business activities in Croatia;
- On 21 June 2002 the company MDK, d.d. established the company MDK - H, d.o.o to increase its operations in Croatia;
- On 1 July 2002 the company NIP, d.o.o., which was purchased at the beginning of 2002, was merged with the company Mercator - H, d.o.o., thus acquiring a distribution centre in Zagreb for distribution of merchandise in Croatia;
- On 10 September 2002 the company Eta, d.d. was joined by the company Slosad, d.o.o. resulting in improved efficiency of organisation of production of the two countries;
- On 22 October 2002 the companies Trgoavto, d.d. and Avtotehna, d.d. established a new company TT - Trgotehna, d.o.o., which will specialise in selling trucks IVECO; on 3 December 2002 the company Trgoavto, d.d. established a new company TrgoA PSC, d.o.o. which will specialise in selling Renault cars;
- On 24 December 2002 the company Poslovni sistem Mercator, d.d., sold its majority stake in the company Mercator - Sremič, d.o.o. in line with its re-focussing on its core activity.

The Mercator Group had the following participating interests in associated companies:

Associated company	Shareholding 31 December 2002	Shareholding 31 December 2001
Alpkomerc, d.d., Tolmin	20.00 %	20.00 %
Spar Slovenija, d.o.o., Ljubljana	20.00 %	20.00 %
Unileasing, d.o.o., Ljubljana	-	20.00 %

On 18 July 2002 the company Poslovni sistem Mercator, d.d., disposed of its 20 % shareholding in the associated company Unileasing, d.o.o. as its activity was not one of the principal activities of the Mercator Group.

The companies of the Mercator Group have no branch offices.

Management and Supervisory Board

Management Board

Management Board of the company Poslovni sistem Mercator, d.d.,:

President of the Management Board and CEO:

- Zoran Janković

Members of the Management Board:

- Aleš Čerin, in charge of Corporate Activities and Non-trade Business;
- Jadranka Dakič, in charge of Finance, Controlling and Accounting;
- Marjan Sedej, in charge of Trading, Development and Investments in Trade Segment;

At its session on 28 May 2002 the Supervisory Board appointed the present Members of the Management Board for a further five-year term of office from 1 January 2003 to 1 January 2008 and enlarged the Board with a fifth Member:

- Stanislav Brodnjak, in charge of New Markets

Supervisory Board

In 2002 the Company's Supervisory Board was composed of:

Chairman of the Supervisory Board:	Employed with
Janez Bohorič	Sava, d.d., Kranj
Members of the Supervisory Board:	Employed with
Vera Aljančič Falež	Poslovni sistem Mercator, d.d., Ljubljana
Ksenija Bračič	Mercator - SVS, d.d., Ptuj
Jože Cvetek	Mercator - Optima, d.o.o., Ljubljana
Dragica Derganc	Mercator - Dolenjska, d.d., Novo mesto
Katja Galof	Poslovni sistem Mercator, d.d., Ljubljana
Matjaž Gantar	KD Holding, d.d., Ljubljana
Vladimir Jančič	Publikum, d.d., Ljubljana
Morena Kocjančič	Mercator - Degro, d.d., Portorož
Matej Narat	NLB, d.d., Ljubljana (until 9 Dec. 2002 when he resigned for incompatibility of duties)
Marjan Somrak	Zarja, Stanovanjsko podjetje, d.d., Novo mesto
Branko Tomažič	HIT, d.d., Nova Gorica



1. discovering the world

Mission and Strategic Goals

Mission of the Mercator Group

Our business performance is focused on satisfaction of people, who come into contact with Mercator, and who we treat as people with different needs, wishes, expectations and experiences. With a personal touch and comprehensive offer, adjusted to shopping habits and market trends we wish to improve their quality of life.

Our strategy arises from our mission to consolidate our position as the leading retail chain in Slovenia, and to establish itself as an important retail chain in the new markets (in Croatia, Bosnia and Herzegovina and Serbia). In all the markets in which we operate we wish to provide products and services of equal quality standards, increase business efficiency and reach the performance levels of the best European retail chains. We shall pursue our policy of long-term strategic partnerships and expand it to new markets.

We shall generate greater value for our shareholders, increase employee satisfaction and meet our commitments to all other stakeholders. In all the markets in which we operate we shall co-operate with local communities, acting responsibly towards society and the environment.

Key Strategic Goals

The key strategic goals of the Mercator Group are:

1. Offering products which ensure a better quality of life

The focus of Mercator's operations remains a satisfied customer, who we wish to approach, emphasise his personality, consider his feelings, thoughts and habits. With a comprehensive offer, adjusted to shopping habits and market trends we take care for the quality of life of our customers and the general social environment.

Satisfying customers' needs, wishes and expectations

Our goal is to constantly improve the quality of offer and adjust it to the needs, wishes and expectations of the market, monitor shopping habits of target customer groups and of the industry trends in order to ensure customer satisfaction. By developing new sales channels and formats, ongoing enhancement of product range, competitive prices and numerous other marketing activities, we constantly increase or sustain satisfaction and loyalty of our customers.

Ensuring sales growth and consolidation of our position as the leading retail chain in Slovenia by:

- continually developing and modernising our retail and wholesale network, with special emphasis on the construction of modern shopping centres and setting up of new sales formats in all regions of Slovenia;
- competitively priced offer, set up in accordance with the wishes and needs of micro markets;
- intensive marketing activities;

In all the markets in which we operate we wish to provide products and services of equal quality standards, increase business efficiency and enhance the performance of business segments, which assure greater satisfaction of our customers and partners.

- introducing new sales promotion projects reflecting changed customer habits;
- increasing customers' loyalty, especially with the Mercator Pika loyalty card;
- expanding our franchise stores networks, and
- successful wholesale activities.

By the end of 2005 we wish to obtain a 10 % market share in Croatia, a 5 % market share in Bosnia and Herzegovina and a 3 % in Serbia.

Gaining an important market share in the new markets: in Croatia, Bosnia and Herzegovina and Serbia.

By introducing our business policy, corporate values and marketing activities we shall build a distinctive image of Mercator in new markets. By the end of 2005 we wish to obtain a 10 % market share in Croatia, 5 % of the market in Bosnia and Herzegovina and 3 % in Serbia. We wish to become an important, recognised and reputable retail chain in the new markets.

2. Long-term partnership with producers

Mercator wishes to achieve its development goals by pursuing a policy of long-term strategic partnerships and joint penetration of new markets. We wish to offer on our shelves only high quality products at European prices. In doing this we shall give priority to Slovenian production and in the new markets to the local and Slovenian producers. We are aware that we can achieve the set strategic goals only in partnership with producers.

3. Alliances with foreign strategic partners

We wish to find a strategic partner who can enable global competitiveness with goods of foreign origin, especially non-food products. In this way we shall ensure the Mercator Group's competitiveness even after Slovenia's entry in the European Union.

4. Maintaining the level of business performance of the best European retailers

The goal of the Mercator Group is to make our operational processes and results comparable with the most successful European retail chains selling consumer products. We achieve this by pursuing the following objectives:

Improving business efficiency by:

- utilising of economies of scale and close co-operation within the Group;
- setting up uniform operational processes and standards;
- centralising business functions;
- reducing costs;
- performing the concept of category management;
- performing the loyalty marketing concept;
- establishing long-term partnership relations with suppliers;
- continually improving and checking the quality of design and implementation of operational processes, also by implementing the ISO 9001 quality standard in all companies of the Mercator Group;
- up-dating and developing a centralised and integrated management information system at the Group level, and
- appropriate formal and informal organisation of operational processes in individual Group companies and at the Group level.

Ensuring security of investments

We ensure security of creditors' investments by maintaining suitable liquidity and solvency, conservative capital structure, continual improvement of financial strength and consequently long-term growth and development of the Group, and with timely and correct response to changes in the business environment.

Creating Shareholders' value

The key goal of the Mercator Group's business performance is to maximise wealth of its shareholders. We are aware that return on shareholders' investments, which is adequate to the associated risks, and security of creditors' investments are among the key indicators of competitiveness of any market oriented company and a precondition for its long-term survival, growth and development.

By continually improving business efficiency, ensuring long-term growth of the volume of operations and timely and adequate response to threats and opportunities of the business environment we intend to permanently maximise the firm's total market value for shareholders and fulfil our commitments to all other stakeholders.



5. Meeting our commitments to employees and all other stakeholders

Our employees are a key stakeholder and an important bond in the chain of creating value, which by observing the system of values with their work deliver the Mercator Group's strategy. We wish to manage employees by pursuing an internal policy, which, by providing long-term social security and suitable remuneration mechanisms and motivational management, can ensure continual improvement of work success rate and efficiency. We are aware that our employees are our competitive advantage.

In all the markets in which it operates Mercator wishes to participate and be involved in the local community, with its socially responsible operation. With humanitarian and other campaigns we wish to contribute to the social development of the community in which we operate.

6. Ensuring competitiveness of non-trade segment of the Group and expansion of food processing companies' operations to new markets

The Mercator Group continues to restructure its non-trade segment to sustain long-term competitiveness after Slovenia's joining the European Union. Non-trade companies will penetrate new markets together with trade companies and co-operate with high quality products at competitive prices. Strategic partners will be found for those companies, which are not connected with the Group's core business, who will enable their long-term development.

General Economic Environment in 2002

Slovenia

In 2002 Slovenia registered a GDP growth of 3.2 per cent (estimate of Statistical Office of RS), slightly above the 2.9 % growth of the year before. The average annual inflation rate, measured with the average increase in the cost of living over a period of twelve months was 7.5 % in 2002, 1.1 % less than in 2001. The inflation rate during the year (December 2002 to December 2001) was 7.2 %, 2 % less than in 2001. The fastest growth in prices was recorded in the first months, up to April, when the average monthly rate was as much as 1.2 %, mainly as a result of higher value added tax rates and excise duty, after which their growth slowed down. Inflation therefore remains a critical element in the macro-economic image of Slovenia also in 2002. In one year's time prices of products, heavily burdened with taxes or regulated by state, increased the most (alcoholic beverages, tobacco, communications, public utility services, etc.). Food and non-alcoholic beverages went up by on average 7.5 % in 2002, among them mainly edible oil - by 20.3 %. Prices of tobacco products grew by 21.2 %, spirits by 12.6 %, prices of clothing and footwear by 3.3 %. In the last days of 2002 a sharp growth in oil prices was recorded.

In 2002 sales revenues recorded by the retail industry increased in real terms by 4.7 %, of which sales revenues of food products, beverages and tobacco by 1 %.

In 2002 sales revenues recorded by the retail industry increased in real terms by 4.7 %. The highest increase in revenues, in real terms, was reached in the non-food segment, an average of 9.5 %, mainly by specialised stores selling textiles, clothing and leather goods. Followed direct marketing and sale of books and newspapers. High growth was recorded also by pharmaceutical and medical goods and cosmetic articles. Sales revenues reached with food products, beverages and tobacco went up 1.9 % in real terms. At the end of 2002 the number of employees in the food, beverages and tobacco sale industry increased by 4.1 % compared with 2001, while in the non-food sale their growth reached 5.6 % in the same period (Statistical Office of RS, First publication of data).

The base interest rate ("T") was above 7 % throughout 2002. It reached its high in March and May with 8.56 % p.a., and its fluctuations stabilised in the second half of the year which was characterised by a moderate value of 7.3 % p.a. (Bank of Slovenia). Short-term loan interest rates applied by Slovenian banks fell in 2002 mainly as a result of before mentioned reduction of base interest rate. In the first quarter of the year they reached on average 14.19 % in nominal terms and 12.05 % in the last quarter. The annual average was 13.09 %. A downward trend was recorded by interest rates on long-term loans. Real interest rates on such loans fell from T +7.72 % in the first quarter to T + 7 % in the last quarter of the year, while the annual average was 7.35 % (Bank of Slovenia).

EURIBOR as the reference interest rate on foreign exchange loans was much more stable in 2002 compared with previous years. The average interest rate of 3.35 % showed a downward trend from June onwards. In November 2002 EURIBOR fell below 3 % for the first time since 1999 (www.euribor.org).

As expected the exchange rate of EUR/SIT recorded an upward trend in 2002, although slightly slower than the 4.68 % growth of 2001, it lagged behind inflation rate by 3.22 % (Bank of Slovenia).

Croatia

In 2002 the growth of Croatia's GDP reached 5.2 %, more than the 3.8 % growth of the year before. Similar trends were recorded by inflation and exchange rates. During the year a 2.3 % increase in the cost of living was recorded (CRO STAT - Statistical Office of Croatia), slightly more favourable than the year before when it was 2.6 %, showing that the Croatian central bank successfully achieved its key goal of keeping inflation low. Inflationary pressures were weakened by non-monetary factors such as reduced customs duty as a result of liberalisation of foreign trade and further penetration of foreign retail chains of the Croatian market, which brought about higher price competition in the retail industry (Croatian central bank). Growth in exchange rate of HRK against SIT slowed down compared with 2001 (7.86 %), as it only reached 2.16 %. The exchange rate remained stable, without soaring or plunging (Croatian central bank).

Bosnia and Herzegovina

In Bosnia and Herzegovina, which continued to face difficulties such as high deficit and external debt, unemployment and diminished foreign help, inflation fell in 2002 from 2.5 % in 2001 to 1.5 % (Federal Statistical Office). The domestic currency - convertible mark is linked to EUR so the growth in exchange rate for KM against SIT equalled the growth of EUR against SIT and was 3.98 %, less than 4.68 % of the year before (Bank of Slovenia). The projected growth of GDP for 2002 was 6 %, close to the estimate for 2001, which was 5.9 % (Ministry of Foreign Affairs of RS). The growth recorded in the retail and service sectors and the revival of the banking sector stimulated the economy and investors. The principal challenges of the new government will be privatisation of larger state companies, reduction of unemployment and changes aimed at improving the conditions for entrepreneurial business.

Serbia

Although the previous regime considerably weakened the economy in Serbia, the positive trend of reforms and economic progress continued in 2002 and reflected in lower inflation, industrial production growth, liberalisation of foreign trade relations and general living standard of the population. In 2002 inflation was 14.2 %, a huge progress compared with the year before, when it was 91 % (National Bank of Yugoslavia). Another indicator of economic progress was the 4 % growth in GDP, same as the year before (estimate of the Serbian government). In 2002 The National Bank of Yugoslavia continued with its regime of controlled floating of exchange rate. The exchange rate of YUM was stable, without soaring or plunging. It slightly depreciated against EUR - by 3.2 % (National Bank of Yugoslavia), while the exchange rate of YUM against SIT fell by 3.02 %, contrary to the 2.6 % depreciation of SIT the year before (Bank of Slovenia).

Marketing and Customers

The principal goal of the Mercator Group's strategy is to satisfy customer needs in shopping for everyday products. We upgraded the marketing strategy to improve the quality of life of our customers and people in general. Customers can find in our stores everyday products and a wide range of other products: from sports wear and sports goods, fashion clothes, furniture and technical products to building materials. We endeavour to offer a most comprehensive range of sales programmes in our shopping centres. In this way we enable customers to shop for various articles in one place. Smaller specialised stores are located in areas where Mercator does not have a large shopping centre close by. This means that even in smaller towns customers have easy access to a wide range of sales programmes.

In line with the demand for everyday products of various target customer groups we concentrated on developing two store formats:

- Hypermarkets located in Mercator Centres and larger supermarkets, where customers can get a wide and comprehensive offer, the opportunity of "one-stop shopping" and wide choice offered by a bigger shopping opportunity. These stores are located near city bypasses with easy access by car and have large car parks and convenient working hours.
- Smaller self-service stores, superettes and small supermarkets are mainly smaller neighbourhood stores; their principal purpose is to satisfy everyday needs of local customers. These stores are located in the vicinity of larger residential areas, their offer is adapted to the customers' daily shopping with the emphasis on fresh, ready meals and convenience foods. Our customers are offered favourable prices, easy access to the stores, a wide choice of articles and regular and attractive sales promotion campaigns which provide an even more comfortable shopping environment.

In 2002 we updated and upgraded the marketing strategy of the clothing chain Modiana, setting the objectives for the future development of the Group's apparel programme. On the basis of a thorough market research of Slovenian buyers of clothes we established that a common name for all clothing stores is required within the specialised clothing chain operated by the subsidiary company M - Modna hiša, d.o.o., namely Modiana, which already is a name recognised by the market. The brand name Modiana represents stores selling clothes with prices and quality of medium grade. To meet up-market demands a new type of clothing store and a new brand name was developed in 2002, which was first launched in Mercator Centre in Split and Mercator Centre in Belgrade. The new brand name is Avenija Mode and represents stores with first class articles and high prices.

Since 1999 Mercator has the licence to use Intersport brand in Slovenia, since 2000 in Croatia and Bosnia and Herzegovina and since 2002 in Serbia. Intersport is an international chain of sports stores. In 25 different countries more than 4,700 Intersport stores have been opened. By end of 2002, 14 Intersport stores were opened, of which 8 in Slovenia and 6 in the neighbouring countries; this trend will also continue in the future. Intersport's business strategy focuses on a wide range of most recent models of world renowned brand names for all types of

sporting activities, and on participating in setting new trends in sports goods. We wish to attract customers with high quality products at competitive prices, with various services and friendly and professional advice to customers who shop for sports goods.

In 2001 Mercator developed a new brand name of stores with cosmetic articles Beautique. Beautique are new chemist's shops located in some Mercator Centres. They excel in large offer of first class cosmetic articles and attentive and professionally trained customer sales staff.

In 2003 a technical chain of Mercator will be set up which will combine the offer of stores presently selling furniture, technical products and building material.

Mercator internet store wishes to be of assistance to those who do not have time to lose on shopping for everyday products in "ordinary" stores. In 2001 the already established Internet shopping in Ljubljana, which had started in 1999, was further expanded to Maribor and its surrounding area. We followed a growing demand for this type of shopping in the Štajerska region. In response to strong demand in the medium-term period we wish to expand the Mercator Internet store to all larger towns in Slovenia and to the new markets where we are present with our shopping centres.

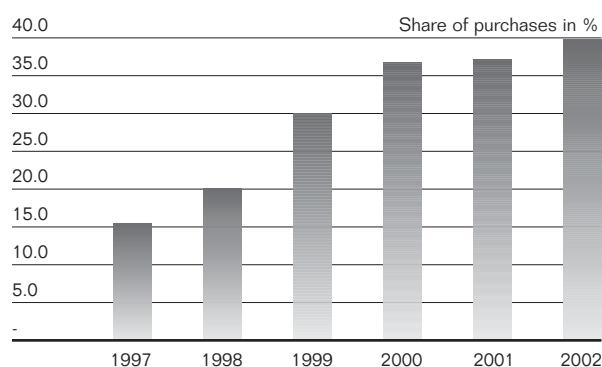
The number of the Internet store customers has grown at a 20 % annual growth rate; the results of customer satisfaction surveys show that most of them are satisfied with this type of shopping, but that with minor improvements and changes we can make their internet shopping more pleasant and comfortable. For this reason the Internet store will be renovated in 2003. The advantages of the renovation will be easier search for products in the Internet store, more information about the product range, characteristics of individual articles will be available and Mercator's trade promotion projects will be more clearly presented, thus enabling the customer to chose the most favourably priced products more quickly, shopping will be quicker and consequently less expensive.

Market Share

We annually monitor the increase in Mercator's market share in all the markets in which we operate. In Slovenia we have been the leading retailer, holding approximately 40 % of the market, for a number of years.

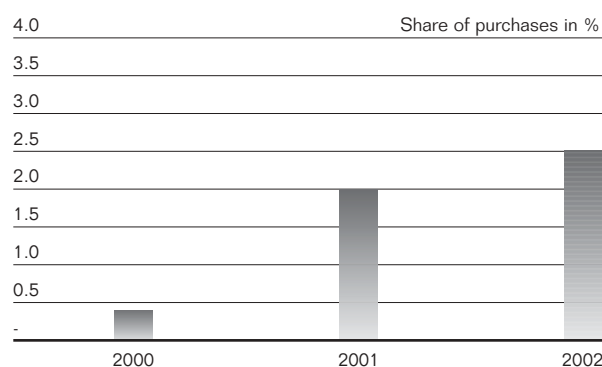
In 2002 Mercator was ranked the fifth largest retailer in terms of market share in Croatia while in Bosnia and Herzegovina it was among the leading retailers holding a 1 % market share. We also wish to become an important retail chain in the Serbian market, which we entered in December 2002 with the opening of the Mercator Centre in Belgrade.

Increase in market share in Slovenia



Source: Gral Iteo, Slovene Trade, November, 2002

Increase in market share in Croatia



Source: GfK, Consumer Scan, December, 2002

Mercator Private Label, Every Day Low Prices and National Shopping Basket (Slovenian, Croatian, Bosnian and Serbian) are our permanent sales promotion products.

Marketing Activities

We develop short-term and long-term sales promotion campaigns. Short-term projects are adjusted to seasons and developed with the aim to offer customers favourable and various products which are best sellers in individual season of the year. Long-term projects have been expanded over the years to include new products. The aim is to make the projects and the products which they include familiar to the customers, providing them the opportunity to buy high quality products of renowned brand names and producers over a longer period of time.

Short-term sales promotion projects

are projects, which are carried out over a short period of time in stores selling everyday products. They include the following projects:

- regular campaigns, which are carried out once a month in all Mercator stores selling everyday products and last 15 days. In 2002 we carried out 11 such campaigns;
- hypermarket campaigns, which are carried out once a month in all Mercator hypermarkets and last 13 days. With these campaigns we wish to enable customers, in periods when shopping is normally increased, to make favourable purchases of best selling products at the most competitive prices. In 2002 we carried out 12 such campaigns;
- campaigns in chemist's shops Beautique, in retail units selling clothing, in Intersport stores, in stores selling furniture, technical products and building materials.

Long-term sales promotion projects

are projects, which are conducted over a longer period; they ensure competitive retail prices to products included in individual projects over a longer period of time:

- **co-marketing and competitions:** competitions and co-marketing activities are conducted in co-operation with reputable producers of brand names within target product lines. In this way we wish to offer customers the best selling brand products under more favourable terms and reward them for their loyalty in buying these brands.
- **Mercator Private Label:** the project "Mercator Private Label" is Mercator's permanent development project of sales promotion. Mercator private label products are offered by the whole retail network, including the Cash&Carry stores. The principal characteristics of these products are high quality and favourable prices.

Mercator stores offer the following "Mercator Private Label" products:

- **generic products**, comprising everyday household products. The line includes 107 various products;
- **Total Body Care** is a private label line including cosmetic and toilet articles for men and women;
- **M-linija** includes clothing and other fabrics for everyday use in households.
- **Lumpi** is a product line for children up to 8 years of age comprising food products, clothes and toys.

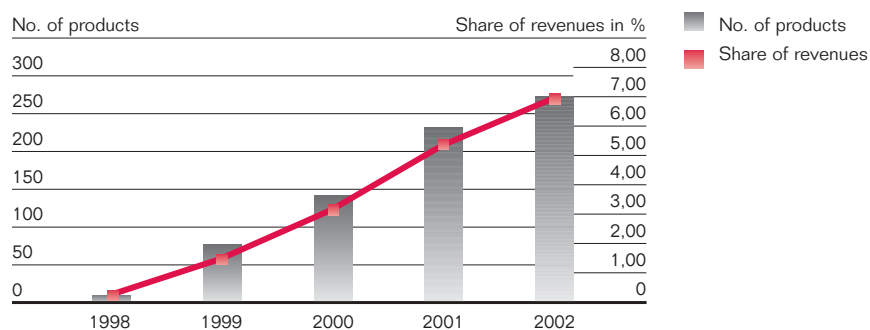
In 2002 the presentation of the "Lumpi" line included numerous activities carried out for our youngest visitors and their parents:

- we presented gifts to babies in maternity hospitals;
- we organised events in Mercator Centres: shows under the name Lumpijada and other interesting events;
- every day low prices: the project **Every Day Low Prices** is another permanent project, familiar to our customers. It comprises the best-selling products of individual product lines of globally well known brand names. The biggest advantage of buying the products from this project is that the customer can buy them at the most competitive prices in Mercator.

We developed a new line of private label products named **The Wishing Table** at the end of 2002.

The line includes convenience food and ready-made meals. In 2003 we are planning to expand the range of private label products with a line named **Healthy Life**, which will include products beneficial to people's health.

Growth in the number of Mercator Private Label products and in the share of retail sales revenues



In 2002 Mercator generated 15.1 % of total sales revenues with retail sale represented by the projects “Every Day Low Prices” and “Mercator Private Label”.

- **National shopping baskets:** the project of national shopping baskets includes the following best-selling products of Slovenian, Croatian, Bosnian and Serbian producers:
 - The Slovenian shopping basket includes 50 best-selling products of Slovenian production, which are on offer in all larger Mercator stores. Some of these products are available also in other Mercator stores with FMCG-line products. The selection of goods in the basket is adjusted every four months to the season and customers' needs and wishes.
 - Croatian, Bosnian and Serbian baskets are created by following the same principle as the Slovenian shopping basket, however they include smaller numbers of products: 26 products are included in the Croatian shopping basket, 31 products in the Bosnian basket and 23 products in the Serbian shopping basket.

Mercator's customers know the sales promotion projects well and are satisfied with them.



Satisfaction with Mercator sales promotion projects



The majority of customers decide on products from the projects Every Day Low Prices, Mercator Private Label and the Slovenian Shopping Basket, while they buy products from short-term sales promotion projects when they are particularly favourably priced.

The Month Magazine

The main purpose of the magazine The Month, which is issued four times a year and has been distributed free of charge to our customers for the third year running, is informing people of the importance of quality in life. Its contents wish to raise people's awareness of the importance of healthy, varied and nutritionally rich meals, a wide range of which can be found in our stores. The Month magazine follows the lifestyles encompassing every day chores, daily meals, sporting activities and token gestures to oneself and to others. It contains practical advice and information about products we offer and about events and interesting facts in our stores.

We conducted a survey of the satisfaction with The Month magazine and established that the readers were mostly satisfied with its contents as more than half liked it or liked it very much.

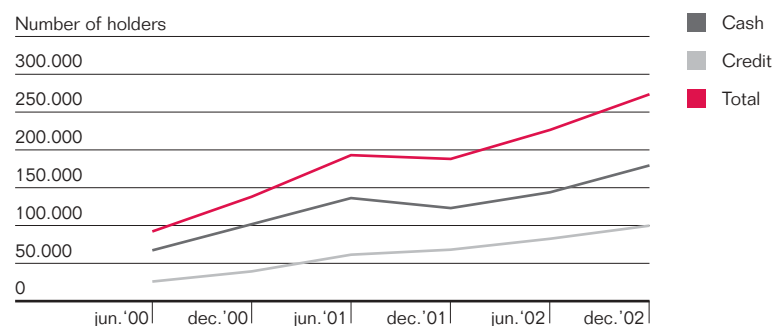
Mercator Pika Loyalty Card

At the end of 2002 there were already more than 270,000 holders of Mercator Pika loyalty card.

With sharp rise in use and popularity among the Mercator customers the Mercator Pika loyalty card ranks among our most important marketing projects. The card represents our direct communication with our loyal customers who generate close to 35 % of total retail sales revenues, as there were over 270,000 holders of Mercator Pika loyalty card at the end of 2002.

Increase in the number of Mercator Pika loyalty card holders

Mercator's customer may chose the free cash card Mercator Pika or credit card Mercator Pika. The blue Mercator Pika cash card is designed for customers paying with cash. The green Mercator Pika credit card is designed for customers who wish to get a deferment of payment.



The advantages offered to the Mercator Pika loyalty card holders are discount coupons given as reward for their loyalty and sent to their home address, which can be used for the purchase of certain products, information about Mercator's product range, possibility of receiving free SMS messages about favourably priced products, about new products on the shelves and about events and shows held in Mercator stores, discounts offered for purchase of sports goods in Intersport stores. We take care that our loyal customers are provided with special offers in Mercator stores. Their loyalty is rewarded every six months when they are offered special discounts in the range of 3 % to 6 % of the value of their purchases in accordance with the Bonus Points System.

Principal Marketing Policies for the Future

Focussing on the offer of healthy, high quality products at competitive prices:

- Development of a new product line within the Mercator Private Label under the name **Healthy Life**;
- Preparation of high quality and competitively priced fresh programme as a whole, with emphasis on fresh fruit and vegetables ;

Focussing on the offer of innovative new products on the market:

- Development of a new product line within the Mercator Private Label under the name **The Wishing Table**;

Development and diversification of store formats and adjustment of offer:

- according to the store format - hypermarket, supermarket and other store formats - we will provide a more diversified and format-adjusted product range, which will be in line with the expectations and wishes of target customers;
- the store format will also be adjusted to the consumers' wellbeing and their way of spending their leisure time;
- in hypermarkets or shopping centres, where customers wish to spend some of their leisure time, we shall continue to create a pleasant atmosphere suitable for shopping as well as social gathering;
- in supermarkets we shall continue to develop and implement store-layout arrangements to enable our customers a comfortable shopping, easy moving on the store premises, provide fast and high quality service, friendly sales staff and special attention will be paid to individual customers;
- in smaller stores we wish to provide the offer expected by the customer of the local neighbourhood area, since smaller Mercator stores are located in areas with different density of population, different eating habits and different demographic characteristics of local customers. We shall develop a new sales format in order to follow new trends which have been detected abroad. A wide, innovative and high quality range of ready meals will be on offer in our stores, our fresh food programme will be varied and of high quality and the store layout arrangement will be attractive and friendly;
- customer sales staff and all other employees will receive further training so that the relationship with customers can be further improved.

Customers

A satisfied customer remains our greatest asset - all Mercator's employees are aware of it. For this reason we conduct numerous market research surveys throughout the year, such as:

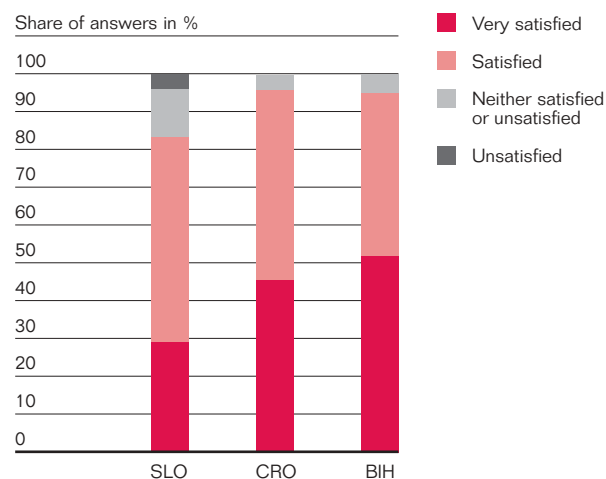
Surveys of customer satisfaction and loyalty, including surveys of:

- shopping habits and lifestyles of population;
- measurement of quality of provided services and products, customer satisfaction and loyalty, and
- monitoring customers' comments, complaints and prise.

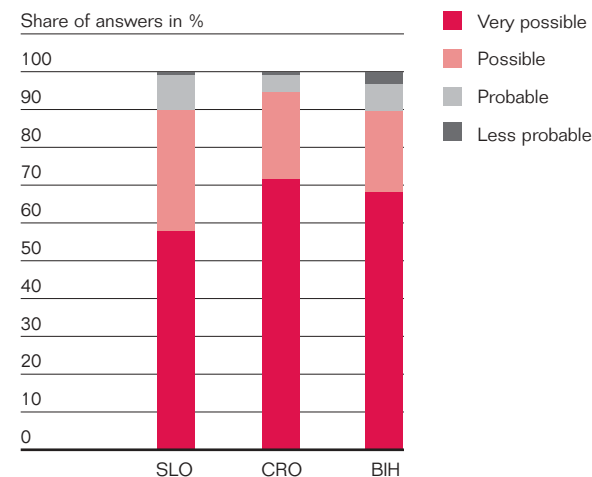
The results of customer satisfaction surveys measured in the markets in which we operate show that our customers are satisfied with the level of services and products offered in our stores. On the Slovenian market, where competition and concentration of retailers are the strongest, 83 % of Mercator's customers are satisfied with the level of service and products in its stores. In Croatia and Bosnia and Herzegovina, where the concentration of retailers is lower, such customers are 95 %.

High degree of customer satisfaction gives rise to strong loyalty and willingness to continue shopping in Mercator stores, since as much as 90 % of customers will certainly continue to shop at the "Best Neighbour" also in the future.

Customers' satisfaction



Future purchases in Mercator



Product marketing surveys assessing:

- customers' perception of sales promotion projects and their efficiency; this is especially important when we introduce new sales promotion projects; in this way we test the response of customers to our activities;
- shopping habits by individual product group, especially those for which we wish to set up the most high quality, price competitive and comprehensive offer;
- suitability of the media for advertising sales promotion projects.

In this way we learn how our customers are satisfied with our sales promotion projects, how well do they know the projects and how many customers buy the articles from our sales promotion projects.

Market analysis and surveys of competition include:

- monitoring the reputation of the corporate brand name Mercator;
- guidelines for price-setting policies which are to ensure price competitiveness;
- analysis of market and competition with which we check Mercator's position in relation to its competitors on local markets, we compare ourselves with the largest retailers in Europe and elsewhere in the world by marketing strategy component;
- monitoring of marketing strategies of competitive retailers and the best retail chains in Europe and elsewhere in the world.

The results of the survey "Reputation 2002", which is annually carried out by the market research agency Kline&Kline, showed that the Mercator Group is ranked by the Slovenian professional and general public among

the most highly reputed and recognised companies. In terms of attractive investments we were assigned above average investment attraction (source: Survey Reputation 2002, Kline&Kline).

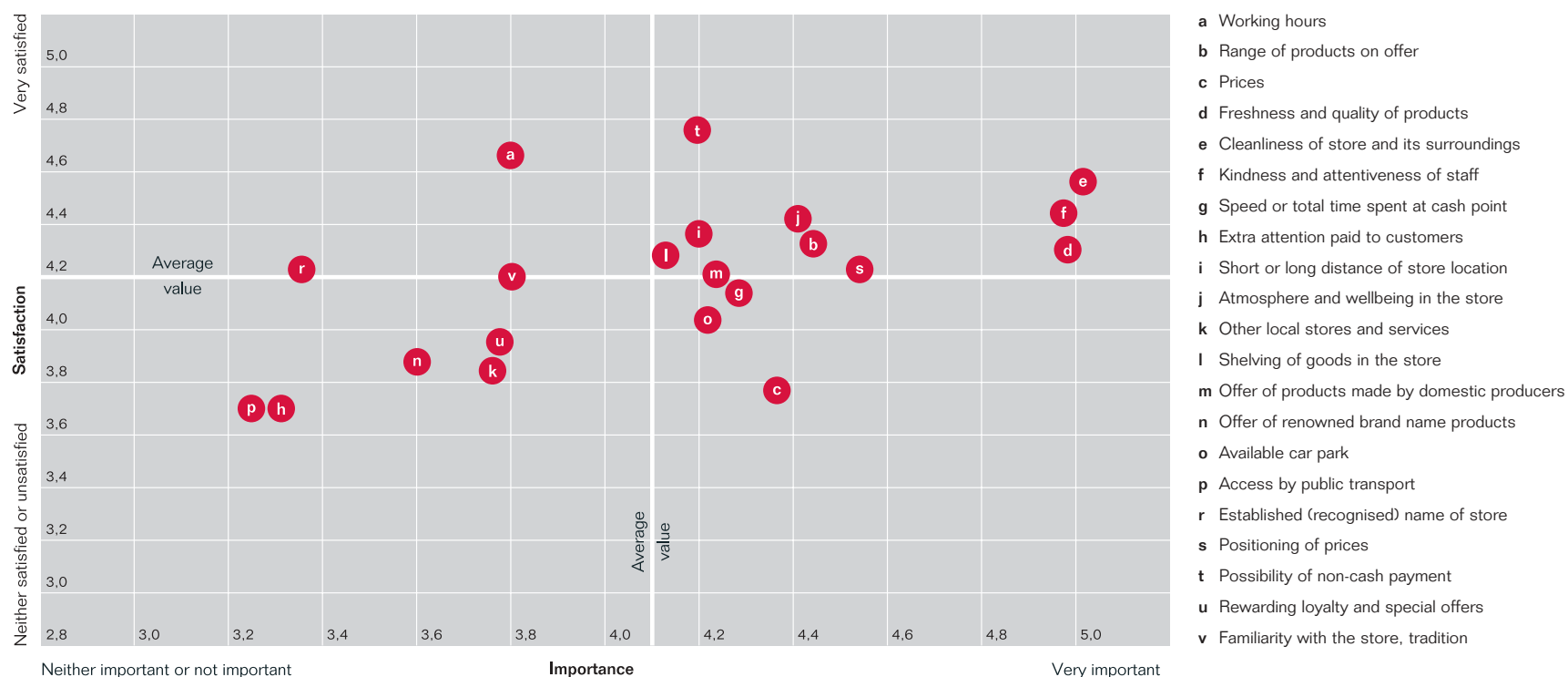
In comparing the data from the survey carried out in 2001, our reputation in the eyes of the general public increased considerably by as much as 39 %. We believe the increase in reputation is mainly a result of:

- extensive advertising of Mercator at the end of 2001 and in the beginning of 2002;
- continuous humanitarian campaigns supported by the media;
- good business results also in 2002 and
- open communication with all stakeholders.

On the market we compare with domestic competitors and larger European retailers. We wish to know which offer and service factors are the most important for the customers on the market; on such basis we prepare our marketing activities and our offer. We are aware that customers in the market need to be pleasantly surprised. We are happy when customers' expectations are exceeded since it is a confirmation that customers needs and wishes have been correctly perceived and fully satisfied. Only a satisfied customer is a loyal customer.

The Mercator Group is ranked by the Slovenian professional and general public among the most highly reputed and recognised companies.

The top left quadrant shows the factors, to which the interviewees attributed below average importance and above average satisfaction, which means that marketing activities, aimed at the factors in this quadrant, were well received by the customers, but were not attributed considerable importance. Factors to which the interviewees attributed below average importance and satisfaction are in the bottom left quadrant and show that customers are less satisfied with them but are also not attributed considerable importance. Factors in the top right quadrant are those to which the interviewees attributed above average importance and satisfaction and show that we were successful in the field to which customers attribute fairly great importance. We wish to gather the highest possible number of factors in this quadrant. Factors to which the interviewees attributed above average importance and below average satisfaction are in the bottom right quadrant. These are factors to which we shall have to pay greater attention in the future, as the customers consider them fairly important and are less satisfied with them in Mercator.



Source: Gral-Iteo: Trade Monitor, 2002

We are pleased that the majority of features under review were gathered in the quadrant which shows that our customers' expectations were exceeded. We are also perceptive enough to establish that there are some elements which give us the opportunity to do more for our customers.

On the basis of market research we set the target groups of Mercator's customers. They are the groups to whom we adjust our marketing strategy and pay the greatest attention.

We set up three key target groups of customers:

- families with children, the most important and the largest target group of customers;
- students, a very price-sensitive target group of customers, monitored by Mercator as the customers of the future, and
- senior citizens, which represent an increasingly important segment, since their numbers grow and according to survey results they do their shopping in smaller, neighbouring stores. These form the larger portion of Mercator's portfolio of stores.

With our offer and presence on the market we also aim at the segment of demanding customers, for which special marketing activities had to be set up, especially a suitable sales format in line with the characteristics of individual micro locations, offer, price strategy and marketing communication, added value has to be offered and favourable rewards for loyalty, adjusted to the characteristic lifestyles, eating and shopping habits.

The main characteristics of Mercator's customers are:

- they are mostly female which points to the fact that in households women buy most of the FMCG-line products,
- the families comprise on average three members,
- the average age is 41, and
- the average formal education is secondary school.



challenge

Purchasing and Suppliers

We are aware that only strategic partnerships with suppliers enable us to provide our customers with high quality products at European prices.

We wish to achieve our development goals by pursuing a policy of strategic partnerships based on Slovenian high quality products, which are well-known and reputable in all countries of the former Yugoslavia. Such co-operation enables us to provide our customers with high quality products at European prices. Joint penetration and common activities in the new markets increase the recognition of partners in the chain and reduce costs.

Ambitious development goals can only be achieved through partnership and long-term relations with our suppliers. We wish to co-operate in setting up a high quality offer, which is comparable with the offer on the European market and is the best value in the markets in which we operate. Together with our partners we wish to expand to new markets by pursuing the strategy of prioritising Slovenian producers in the Slovenian market and in the new markets of Croatia, Bosnia-Herzegovina and Serbia, where the local producers are also involved.

The structure of merchandise purchased in 2002 by the Mercator Group, is of the following origin:

Structure of merchandise by origin



In Slovenia Mercator generates 72 % of sales with Slovenian products and 28 % with products from other countries.

In the new markets we wish to generate 40 % of sales with Slovenian products, 40 % with local products and 20 % of sales with products from other countries.

Concentration of purchases of merchandise is high and dependent on Mercator's position in a particular country and on the development stage of its market and economy. 75 % of total purchase value is supplied to the Mercator Group by relatively few suppliers.

Concentration of purchases of the Mercator Group by country:

Country	Number of suppliers, who supply 75 % of total purchase value	Total number of suppliers
Mercator in Slovenia	123	1,906
Mercator in Croatia	107	587
Mercator in Bosnia and Herzegovina	70	333

10 largest suppliers of merchandise supply an almost equal share of total value in the Slovenian market (27.9 %) as in the market of Bosnia and Herzegovina (28.0 %), while in the Croatian market this share is slightly smaller (22.8 %). These 10 largest suppliers mainly have their registered offices in the same country as Mercator's trade companies.

Co-operation with Suppliers

Strategic partnership with suppliers is built and will be built with the following activities and projects:

Long-term contractual relations with suppliers

We enter into framework agreements with suppliers of merchandise for a period of one or more years. The agreements stipulate all the elements of relations between the Mercator Group and the supplier. "Central" agreements have been made with all the largest suppliers by the parent company. With local (individual) suppliers, who represent only 3 % of total purchasing, agreements were entered into by individual trade companies. The framework agreements with our suppliers ensure us the most favourable purchasing terms (prices, discounts, payment terms etc.) on account of the size of our share in their sales realisation.

Joint penetration of the new markets enables greater recognition of own brand names and lower costs in all areas.

Development of products under the Mercator private label and development of new products: by following new world trends, changing lifestyles and shopping habits of customers we shall develop new products with our suppliers, and products, which will be included in the "Mercator Private Label" project.

Co-marketing activities, which we carry out in co-operation with reputable producers of brand names within target product lines. In this way we wish to offer customers the best selling brand products under more favourable terms and reward them for their loyalty in buying these brands.

Price policy: we are consistent in stipulating in our supply agreements that we should be given at least 30 day notice of any price increase, which should receive prior approval of the Mercator Group. In addition we endeavour to reduce the prices on the market in which we operate by a number of price projects (for example: Mercator Private Label, Every Day Low Prices, National Shopping Baskets, etc.).

Category management: practice of world retailers has shown that the category management process brings optimum results only if there is co-operation with suppliers. Such co-operation has to be based on mutual trust and respect, where suppliers' knowledge and experiences of marketed products are of utmost importance. The final goal is optimisation and maximisation of sales within a particular product line.

Electronic data interchange: in 2002 regular electronic data interchange (orders) was carried out with 21 larger suppliers and one buyer and a test interchange was made with 7 more suppliers, the remaining 15 invited suppliers will be included in the system by the middle of 2003.

We are aware that the base for long-term and efficient co-operation with key suppliers in all the markets in which we operate can only be a partnership relation and co-operation between the retailer and the producer whose final goal is to provide to customers high quality products of Slovenian, Croatian, Bosnian and Serbian producers at competitive prices.

- With this purpose Mercator organises traditional Mercator's Marketing Days, where we wish to present to our key suppliers our vision and development strategy, the emerging global trends in the retailing and food processing segments and possibilities of an even closer co-operation.

In 2002 we organised the third such meeting with our key suppliers. The meeting has become a traditional event and the number of participants increases every year. At the Marketing Days we presented to the participants Mercator's mission, vision, goals and the strategy of future expansion. The strategy remains directed towards further expansion to new markets and liaison with Slovenian, Croat, Bosnian and Serbian producers in order to create stronger partnerships and more successful future co-operation. In this we shall always demand that our partners provide high quality products, which meet all the required standards at competitive prices. Upon the same quality and favourable price terms Mercator will replace the goods of suppliers from the countries in which it does not expand its retail network with goods from the countries where it operates as a retailer.

We also presented to our partners the basis on which we wish to build our future co-operation. This is joint expansion to new markets, which means that we and our suppliers have to know and understand the conditions on individual markets - know the cultural, social and legal environment and customers' expectations on those markets. These international meetings are therefore useful and effective as regards the knowledge of individual markets in which we jointly operate.

Development and Investment Activities

Research and Development

Research and development activities in the Mercator Group are performed by the parent company Poslovni sistem Mercator, d.d. In 2002 the Mercator Group earmarked 1.5 % of net sales revenues for development. In addition to permanent tasks of market research and development, such as surveys of the market, customers, competition, setting up common standards for retail units, the activities are also directed at the development of equipment in hypermarkets, development of new sales formats and brand names and development in the process of category management.

In 2002 considerable funds were invested in the development of equipment in hypermarkets. Our intention was to create a favourable shopping environment for our customers, make their shopping easier. We rearranged the deli departments in the form of deli islands. We also rearranged and modernised the fresh fruit and vegetable department making the shopping friendlier. All changes in hypermarkets were introduced to the model of trends and guidelines from abroad where visual merchandising has longer been implemented; its goal is to conjure up a specially enchanting environment for each department and the whole store. Mercator has been preparing for the implementation of this concept in its stores.

In 2002 we developed a new clothing sales format, new sales concept and new brand name; it was first launched in Mercator Centre Split and Mercator Centre Belgrade. The brand name "Avenija Mode" represents stores with first-class clothes at high prices.

In 2002 we continued with activities related to the implementation of category management process. Its goal is to improve business efficiency and maximise sales and minimise costs by setting up a system of responsibilities and powers of individual job performers in line with the concept of the process and by increasing added value for customers, shareholders, employees and suppliers. To prepare this very demanding and complex process, which requires organisational changes and changes in terms of work contents, reengineering of operational processes and changes in corporate culture, we drew up a transitional plan, with which we shall overcome the obstacles posed by the process in a way which is more easy, efficient and friendly to the employees.

In line with the requirements of the category management our marketing strategy was upgraded in 2002, especially as regards adjusting the marketing activities for individual product groups according to the customers' wishes and expectations. We drew up a detailed segmentation and redistribution of all product groups, acquired a computer program for category management, Apollo, and carried out a pilot process with five key suppliers. In the process of category management a close co-operation between the retailer and the supplier is very important.

For the requirements of our warehouse and distribution activities we invested in land and buildings through the acquisition of the company Nip, d.o.o., and set the foundations for the development of a logistical centre in Croatia.

In 2002 the Mercator Group invested a total of SIT 25,731 million. According to the policy of retail development, investments were mainly directed at acquisition of new retail units, in which a favourable shopping environment will be created for our customers and their shopping made easier.

In the field of integration and modernisation of the IT system we continued in 2002, in co-operation with external experts, with the development of IT systems, with which we adjust to the dynamics of integration processes in the Mercator Group. In the field of information technology we continued to implement the Centralised Supply project.

In the field of development in 2003 we wish to prepare diagrams of planning for all principal, target product lines, on which shelving of products in stores will be based. In particular we wish to form an efficient product range in Mercator's hypermarkets in Slovenia, which will reflect the needs, expectations and wishes of the market. Further implementation of the category management process will continue also by training of employees with the computer program Apollo.

To maintain our market share in Slovenia in times of severe competition and consequently more demanding and conscious customers we wish to continue to expand our retail capacities and refurbish existing stores according to Mercator standards. We wish to complete the standards for the chain of chemist's shops Beautique and prepare standards for the technical chain. This will require that existing, already established Mercator standards be adjusted and upgraded in line with new development trends and guidelines appearing in the European and world markets.

Investments

In 2002 Mercator continued with successful implementation of the investment plan in line with adopted development strategy, which is principally directed at acquiring new retail capacities in the form of shopping centres. The whole Mercator Group invested a total of SIT 25,731 million in 2002, of which SIT 24,491 million in fixed assets and SIT 1,240 million in non-current financial investments.

Capital Expenditure

In 2002 capital expenditure in the Mercator Group amounted to SIT 24,491 million, of which SIT 14,154 million refer to investments abroad. The major portion of the Group's total capital expenditure (77.9 %) refers to construction of Mercator Centres, the remaining to renewal of retail units, investments in distribution centres and in IT systems.

The Mercator Group

Type of capital expenditure	Value (in SIT mn)	Structure (in %)
Mercator Centres and hypermarkets	19,083	77.9
- in Slovenia	5,671	23.1
- abroad	13,412	54.8
Stores with FMCG	498	2.0
Non-food stores	333	1.4
Total new units	19,914	81.3
Total refurbishments	2,887	11.8
Total investments in trade segment	22,801	93.1
- of which in Slovenia	8,846	36.1
- of which abroad	13,955	57.0
Total investments in non-trade segment	1,690	6.9
- of which in Slovenia	1,491	6.1
- of which abroad	199	0.8
Total investments of the Mercator Group	24,491	100.0

By building a Mercator Centre in Kranj and with activities related with construction of Mercator Centre in Celje - its opening is scheduled for 2003 - we fully achieved the goals, set in previous years, to open a Mercator Centre in every regional centre. At the end of 2002 we had 11 Mercator Centres and two hypermarkets in Slovenia, which operate within shopping centres but are not owned by Mercator. The hypermarket in the Mercator Centre in Koper, which in 1998 was the first Mercator's experiment at the new method of marketing, was refurbished in 2002 and introduced novelties enabling a wider offer and shopping environment. Smaller types of shopping centres were opened in smaller Slovenian towns in 2002 (Logatec, Grosuplje) - so called trade centres, which presently operate in 6 towns.

Construction of shopping centres also continued outside the Slovenian borders. In Croatia we opened a Mercator Centre in Split, in Serbia, a Mercator Centre in Belgrade, which is also the first of its kind in Serbia.

In the Mercator Group the share of capital expenditure of Mercator's trade companies is the highest, the major portion referring to investments in new units. Despite a large number of new units, 88 existing units were fully refurbished.

New sales capacities in 2002 for Mercator's sales programmes:

	No. of units	Gross sales area in m ²
Hypermarkets and supermarkets	6	26.606
Clothing stores Modiana, Avenija mode	4	5.156
Franchise stores Benetton, Sisley, Playlife	3	688
Sports stores INTERSPORT	3	2.283
Furniture and white goods showrooms	3	3.769
Chemist's shop Beautique	2	235
Restaurants	2	1.602
Technical products store Trgoavto	2	381
Garden centres Aura, Florist's	2	334
Bars Santana Coffee shops	3	521
Total	30	41.575

In 2002 the following Mercator Centres were opened:

- **Mercator Centre Kranj**

It was opened on 19 April 2002. It is a new building with 11,248 m² of useful space and 751 parking spaces. 211 parking spaces are in the basement area, the remaining 540 are outside. The principal programme is a large hypermarket with 5,899 m² of total space, of which 4,028 m² of sales area. Within the hypermarket operate a fishmonger's shop and a bakery. Other Mercator's programmes are: bar Santana Coffee Shop, sports store Intersport, clothing store Modiana, Garden Centre Aura, chemist's shop Beatique, store of technical products Trgoavto. The Centre has inside and outside playgrounds. 20 premises with a total space of 1,968 m² are occupied by tenants providing various sales programmes and services.

- **Mercator Centre Split**

It was opened on 5 July 2002. It is a new building with 18,679 m² of useful space and 750 parking spaces in the basement of the building. The principal programme is a hypermarket, with 8,180 m² of total space, of which 5,048 m² of sales area. Within the hypermarket operate a fishmonger's shop and a bakery. Other Mercator's programmes are: bar Santana Coffee Shop, self-service restaurant, sports store Intersport, showroom displaying furniture and technical products, franchise stores United Colours of Benetton, Sisley and Playlife and clothing store Avenija mode. In this store the concept "shop in shop" - sale of products by brand names in individual "corners" was used for the first time in Mercator. The Centre has an inside playground. 32 premises with a total space of 2,602 m² are occupied by tenants providing various sales programmes and services.

· Mercator Centre Belgrade

It was opened on 5 December 2002. It is a new building with 29,529 m² of useful space and 916 parking spaces, which are in the basement of the building, except for the 107 outside parking spaces. The principal programme is a hypermarket, with 8,800 m² of total space, of which 5,439 m² of sales area. Within the hypermarket operate a fishmonger's shop and a bakery. Other Mercator's programmes are: bar Santana Coffee Shop, self-service restaurant, sports store Intersport, chemist's shop Beatique, clothing store Avenija mode, previously Modiana with the "shop in shop" concept and showroom displaying furniture and technical products. The Centre has a large inside playground. 43 premises with a total space of 4,257 m² are occupied by tenants providing various sales programmes and services.

In 2002 the Mercator Group earned SIT 5,656 million by disposal of obsolete fixed assets. 75.8 % of total fixed assets was disposed of in the trade segment and the rest in the non-trade segment of the Group.

Non-current Financial Investments

In 2002 the Mercator Group carried out long-term financial investments in the total amount of SIT 1,240 million, of which SIT 1,040 million refer to the acquisition of the company NIP, d.o.o. By this acquisition the company Mercator - H, d.o.o. obtained a distribution centre in Zagreb for distribution of merchandise in Croatia.

The Group divested itself of SIT 427 million of long-term financial investments, which mostly refer to the disposal of our investment in the companies Mercator - Sremič, d.o.o. and Unileasing, d.o.o.

Human Resources Management and our Employees

At the end of 2002 the Mercator Group had 14,331 employees, which, compared to the 2001 figure, was an increase of 4.7 %.

In 2002 the employees of the Mercator Group were greatly influenced by the opening of two large Mercator Centres in the new markets, in Split and Belgrade, which involved recruiting and training of new personnel. A new survey of employee satisfaction and of the climate of industrial relations was conducted and in the parent company the first interviews with employees were held.

Number of Employees in the Companies of the Mercator Group

Company	No. of employees based on hours worked in 2002	No. of employees as at 31 December 2002	No. of employees as at 31 December 2001
Poslovni sistem Mercator, d.d.	4,214	4,393	3,648
Emona Merkur, d.d.	3	1	587
Žana, d.d.	107	116	117
M - SVS, d.d.	1,660	1,618	1,661
M - Dolenjska, d.d.	1,036	1,046	1,098
M - Gorenjska, d.d.	1,068	1,107	964
M - Degro, d.d.	983	988	1,056
M - Goriška, d.d.	760	773	808
M - H, d.o.o.	1,113	1,252	487
- Sloboda	-	-	555
M - TC Sarajevo, d.o.o.	230	254	233
M - S, d.o.o.	370	383	-
Trgoavto, d.d.	275	272	296
- TT-Trgotehna, d.o.o.	-	-	-
- TrgoA PSC, d.o.o.	-	-	-
M - Modna hiša, d.o.o.	547	581	554
Intermercator, G.m.b.H.	4	4	4
Total trade	12,370	12,788	12,068
MDK, d.d.	636	651	713
- MDK-H, d.o.o.	1	1	-

Company	No. of employees based on hours worked in 2002	No. of employees as at 31 December 2002	No. of employees as at 31 December 2001
Eta, d.d.	257	308	257
Slosad, d.o.o.	31	-	47
Pekarna Grosuplje, d.d.	227	217	200
- Belpana, d.o.o.	-	-	-
M - Emba, d.d.	94	95	94
M - KŽK Kranj, d.o.o.	183	192	188
M Hotel, d.o.o.	44	48	49
M - Sremič, d.o.o.	39	-	43
M - Optima, d.o.o.	33	31	33
Total non-trade	1,545	1,543	1,624
Total Mercator Group	13,915	14,331	13,692

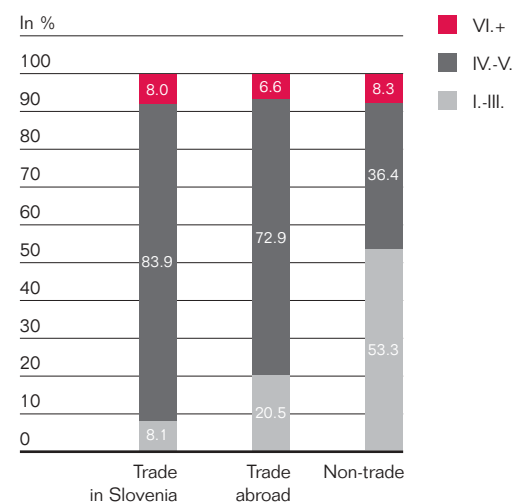
At the end of 2002 the Mercator Group had 14,331 employees. Compared with the 2001 figure, the number of employees in the Group increased by 4.7 %. The highest increase was recorded in the trade segment (6 %) due to the opening of Mercator Centre Kranj within the company Mercator - Gorenjska, d.d. In the new markets the number of employees increased due to the opening of Mercator Centres in Split and Belgrade.

In 2002 the Mercator Group had 2,328 newly employed, 1,689 employees left and 1,011 employees fluctuated within the Mercator Group, mainly due to the takeover of the retail segment of the company Emona Merkur, d.d. In 2003 we expect further growth in the number of employees in the Mercator Group, mainly due to expansion of retail network in the new markets (Croatia, Bosnia and Herzegovina and Serbia).

Demographic and Educational Structure of Employees

The average age of employees in the Mercator Group is 39.5 years. At the end of 2002 the educational structure of the Group was as follows: the first group ("I.-III." primary school level) comprised 2,104 employees or 14.7 % of total employees, the second group ("IV. and V." secondary school level) 11,106 employees or 77.5 % and the third group ("VI. or over" higher education and university degrees) 1,121 employees or 7.8 % of total employees. The average education level (measured with: 1 - I. primary education level, 8 - VIII. university degrees) of employees in the Mercator Group was 4.12 on 31 December 2002.

Structure of Employees by Education Group in the Mercator Group on 31 December 2002



Absenteeism

In the Mercator Group the total hours of sick leave in 2002 were 1,657,304, of which 812,557 were charged to the companies and 844,748 hours to the Health Insurance Institute of Slovenia. The absenteeism rate in the Mercator Group was 5.54 %.

Motivation of Employees

In 2002, 17,533 employees participated in various forms of training and education, which was an average of 8.6 teaching hours per employee.

Training and Education

17,533 employees participated in the various forms of training and education in the Mercator Group in 2002. In the Group 123,610 hours of education were carried out, representing an average of 8.6 teaching hours per employee.

In addition to functional training and education, we monitored the progress of 206 trainees, 295 employees attending external study programmes, awarded scholarships to 47 high school and university students, monitored 208 trainees in our retail and production units and enabled 869 high school and university students and holders of our scholarships work practice.

Supplemental Additional Collective Pension Insurance

In 2002 pension scheme was paid for 10,108 employees in Mercator Group.

Mercator's supplemental voluntary additional collective pension insurance plan was carried out within the Pension Programme of the Insurance Company Pokojninska Družba A, d.d.

Annual Interviews

In the parent company Poslovni sistem Mercator, d.d. the first annual interviews of employees on the managing and executive positions were conducted. We carried out 688 interviews. The interviewees confirmed that annual interviews are a necessary and useful novelty in the field of human resources management, which contributes to mutual relations and better communication between managers and their subordinates, and improves the knowledge of the goals and work of individuals, and helps discover hidden, unutilised capabilities of employees.

Other Benefits for Employees

Mercator shows its commitment to its employees by organising social activities and providing other benefits. We organise annual gatherings of all Mercator's employees "The Mercator's Day" and a meeting before the New Year's Eve. Employees can use Mercator's holiday accommodation facilities and free medical check ups and avail of some specialist medical services.

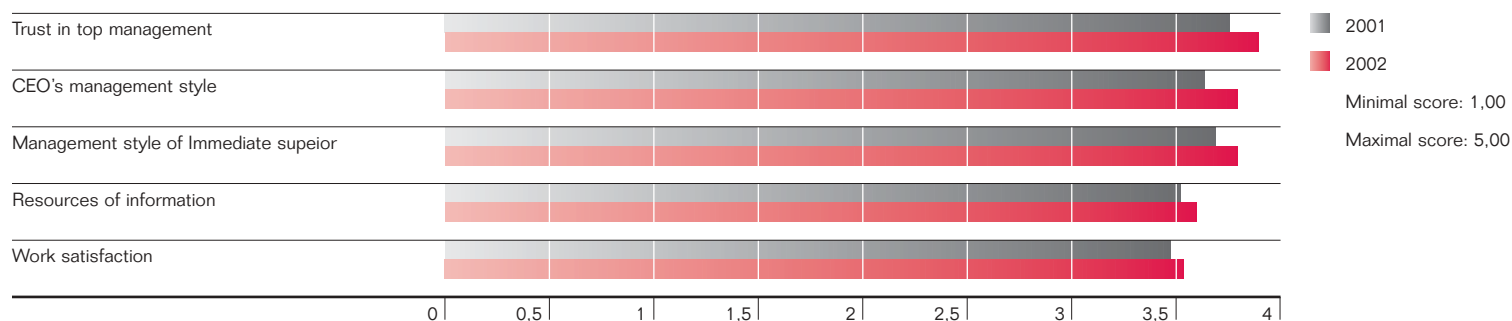
Measuring Employee Satisfaction

For the third consecutive year we measured employee satisfaction in Mercator. The research was carried out by the Centre for Public Opinion Pooling at the Faculty of Social Sciences in Ljubljana in April and May 2002. A telephone survey was conducted of representative samples of employees of individual Group companies.



learning

Average scores by Section in Measuring Employee Satisfaction in 2001 and 2002



Measuring Industrial Relations Climate

In November 2002 the largest trade companies of the Mercator Group (Poslovni sistem Mercator, d.d., Mercator - SVS, d.d., Mercator - Dolenjska, d.d., Mercator - Gorenjska, d.d., Mercator - Degro, d.d. and Mercator - Goriška, d.d.) participated for the second time in the industrial relations climate research (SiOK) carried out in Slovenian companies by the Chamber of Commerce and Industry in the form of written survey of 100 representative employees of individual participating companies. The results of the survey confirmed the outcomes of Mercator's survey of employee satisfaction.

Safety at Work

At Mercator we are conscious that we spend about one third of our lives at our place of work, therefore we try to make our work environment safe, healthy, friendly and pleasant for all participants. In 2002 we produced a "Statement on safety at work and assessment of risk" with which we assessed the health and safety at work and decided to take preventive measures to improve the level of health and safety at work. The assessed situation was satisfactory, however minor shortcomings appeared which we started eliminating in line with set plans.

In 2002 we improved the conditions for safety at work.

In 2002 we carried out training in safety at work of new recruits and periodically trained the employees in all Mercator's companies. We carried out the training in accordance with Article 24 of the "Law on health and safety at work" (Official Gazette of RS, nos. 56/99 and 64/01). We also conducted training for delivering first aid in cases of work-related injury and will continue with it in 2003 as required by the "Rules on equipment and first aid procedure, and on organisation of rescue service in the case of accident at work" (Off. Gazette of SFRY no. 21/71).

We inspected and tested our work equipment. Machines were fitted with warning notices giving instruction for safety at work. With measurements of microclimatic conditions and illumination we looked for any irregularities at individual places and eliminated them in the shortest time possible, thus reducing the possibility of any injuries or disease.

On the basis of research into accidents at work we established that the accident rates increased due to the increase in the number of employees. However, the number of injuries per 1000 employees decreased as the employees were better trained in the field of safety at work. We noticed that the number of accidents occurring on the way to or from workplace were on the increase.

Pursuant to the risk assessment carried out by a medical expert, which is part of the "Statement on safety at work and assessment of risk", we introduced regular medical check ups in 2002.

In 2002 we carried out regular annual checking of fire extinguishers and the network of fire hydrants. In co-operation with local voluntary fire brigades we trained our employees to extinguish fire outbreaks. We fitted workplaces with evacuation plans and extracts from the fire emergency response plan. We updated the fire emergency response plan, which defines in more detail the duties and responsibilities of individuals.

Quality

We dedicate all our knowledge and attention to the quality of our products and services. By introducing quality standards we integrate all our efforts into an efficient system, with which we wish to ensure long lasting customer satisfaction, successful performance, development of the Company and a firm base for development and satisfaction of employees, owners and the general social environment.

ISO 9001

In 2002 we successfully continued with the project “Quality ISO 9001 in the Trade Companies of the Mercator Group” aimed at developing and introducing a quality system pursuant to the ISO 9001 standard and setting up uniform operational processes and documentation in the trade companies of the Mercator Group. The companies Poslovni sistem Mercator, d.d., Mercator - SVS, d.d. Mercator - Gorenjska, d.d. and Mercator - Dolenjska, d.d., which obtained this certificate, were in 2002 joined by:

- Mercator - Modna Hiša, d.o.o.,
- Mercator - Degro, d.d., and
- Mercator - Goriška, d.d.

Mercator - Goriška, d.d. was the first company in the Mercator Group to be awarded the ISO 9001:2000 certificate of quality. The company Trgoavto, d.d. suspended the implementation of the project due to company reorganisation. Project-related activities were also carried out on the new markets - Mercator - H, d.o.o. and Mercator - TC Sarajevo, d.o.o., while the introduction of the ISO 9001 quality system in the company Mercator - S, d.o.o. will begin in 2003.

The non-trade companies of the Mercator Group have also been implementing the quality system. In 2002 the company Pekarna Grosuplje, d.d. obtained the ISO 9001 certificate.

In the year under review the quality system was successfully upgraded. Important new developments were:

- setting up of Mercator standards; a set of documents, promptly updated and revised in accordance with legislation, international standards and a system of permanent improvements. In the Quality Control Division the documents are kept on file in paper and electronic form, in line with the prescribed procedure; they are also available to all employees on Mercator’s internal pages. Among the documents included in the collection “Mercator Standards” are the Rules of Procedure, which are binding on Mercator’s employees.
- Mercator’s Records are a collection where individual records are kept on files. New standards and legislation do not arise from the fact that procedures have to be documented, but that performers of operational processes have to prove that they act in accordance with requirements. Records are the most frequent evidence. Who produces records, when and according to what procedure, is determined by documented procedures included in

By implementing Mercator standards, which are adjusted to the legislation, international standards and are continuously improved, we provide a solid basis for upgrading the quality of the Group as a whole.

Mercator Standards. On the basis of records analyses can be made, which are frequently documented in reports, considered on various levels of management. Results of analyses are useful to the running of business and initiating of corrective or preventive measures - the system of permanent improvements. The collection Mercator's Records is available on Mercator's internal pages and includes the recent reports, minutes and other written material.

- Regular training for quality standards enables employees to meet the demands of customers and competition, force us to promptly improve the quality of our services and products. That entails introduction of new processes and technologies, which are difficult to implement and control. Continuous training of employees is a precondition for providing high quality services. The slogan "Quality Means People" is not a mere cliché, as only qualified and motivated employees can provide customers with high quality services. First the Board of Management and individual managers are responsible for the transfer of the required knowledge to employees, then the Mercator's training department, which regularly follows the latest education and training material and organises training courses.
- Information support, which enables the linkage of all trade companies of the Mercator Group with the collection of documents. Last year access to Mercator's Standards and Mercator's Reports was made available on Mercator's internal pages, thus making it easily accessible to a wider circle of employees. In co-operation with the Information Division, which runs the project "Information Support to Collective Work" the information support in this segment will be further improved.
- Transition to operation in accordance with the ISO 9001:2000 quality standard, as a result of adjustment to the requirements of this standard. In this respect we prepared the "Procedures for Quality Control Management in the Trade Companies of the Mercator Group", which apply to all the Group's trade companies. The new standards encourage efficient implementation and improvement of the quality control system to increase customer satisfaction.

HACCP

In addition to the requirements of the ISO 9001 standard of quality other quality systems are being contemplated by Mercator. Presently the most important is the system ensuring safety of food HACCP (Hazard Analysis Critical Control Points), which enables us to identify, assess and control the risks associated with safety of food, and practice good hygiene, thus increasing consumer protection.

In 2002 we completed the project "Introduction of the HACCP System in the Trade Companies of the Mercator Group". We prepared HACCP studies on products or product groups associated with the risk of hygiene and food safety and documented good hygiene and production practices. Appropriate procedures were introduced in some parts of retail, warehousing and production. Next year the system will be extended to all retail, warehousing and production units, in line with the requirements of the "Act on health suitability of foods and products and substances that come in contact with food".

Systems ensuring hygiene and food safety have been successfully implemented in the following production companies of the Mercator Group: Pekarna Grosuplje, d.d., MDK, d.d., Eta, d.d. and Mercator - Emba, d.d.

IT Systems

With the expansion of the Mercator Group information technology has become of key importance, since high quality and timely information about the Group's operation is a precondition for high quality decision making and business efficiency of individual companies and the Group as a whole.

We are aware that an efficient management information system is a competitive advantage in the increasingly competitive business environment, therefore the IT development closely follows the strategic development of the Mercator Group. As in previous years, in 2002 we continued to develop our information systems in co-operation with external experts.

In 2002 we continued with intensive development and updating of the IT systems in trade companies of the Mercator Group.

The key project remains the project of central purchasing with central registers of business partners and products, which will enable centralised electronic management of suppliers, articles, product ranges and prices. These data will be allocated to wholesale applications and retail units in EPOS systems. From wholesale applications and EPOS systems the data will be transferred in the finance and accounting application and in the data bank of goods flows. The necessary information support for the implementation are EPOS systems, which have been set up in all stores. The data bank will be the source for detailed analyses of goods flow in wholesale and retail sale, category management and customer relations management (CRM). Because large volumes of data will be transferred from a large number of stores to the bank data and from the head office to the stores, a system of integral data transfer is being developed via message types. We finalised the first phase of the retail data bank and ensured the basis for the implementation of information support to the "Category Management" project.

In addition to information support to the processes of purchasing and sales, central information systems for finance and accounting, and for human resources management were developed. These two systems were upgraded in the data bank. For the strategic level requirements the projects "Strategic Controlling" and "Strategic Human Resources Management System" were enhanced and finalised.

In the fields of infrastructure and safety four projects were completed with the aim to ensure high quality and reliable implementation of information support systems:

- project of internal exchange of data where a message system was developed which ensures the transfer of messages between all the various systems in Mercator, especially between the central supply and the stores;
- project of renovation of the central network between Mercator's companies;
- project of safe access to Mercator's information sources, where we ensured supervision and monitoring of access to information sources;
- project of anti-virus protection.

In 2002 we continued with intensive development and updating of the IT systems, which represent the basis for high quality decision making for the Group as a whole.

In 2002 the Mercator Group allocated SIT 737 million to investments in information technology. The share of total information costs of the Mercator Group in net sales revenues was 1 % in 2002.

With the above projects the goods management process in wholesale and retail sale will be completed in 2003.

The key goals of IT development in the Mercator Group for the future years are:

- support to management and decision making: ensuring high quality information for decision making and managing;
- support to efficient operational processes: with information support and automatisation improve the efficiency of operational processes;
- support to unification: support must be provided to unified operational processes in the Mercator Group.

Financial Operations

In 2002 the Mercator Group continued to deliver the adopted financial strategy.

The first strategic objective in the field of capital structure is to achieve a ratio between capital and debt, which will ensure appropriately low average weighted cost of capital at moderate financial risks. The target capital structure of the Mercator Group is the 1:1.5 ratio between shareholders' equity, stated as shareholders' equity plus long-term provisions according to International Financial Reporting Standards, and debt capital, stated as concurrent and current borrowings. The second objective of the Group refers to at least 90 % coverage of non-current liabilities with non-current assets. At the year end a 92.7 % coverage was reached, which meant that the goal was achieved. The ratio improved considerably compared with the year before as the Group replaced a significant part of current borrowings with non-current borrowings, and almost all new borrowings are of long-term maturity. Thus the financing risk was reduced and the Group's financial strength improved, since we reduced the share of borrowings maturing within one year.

In 2002 cash management was a particular challenge for us, for the successfully implemented transfer to transaction accounts in banks in May demanded new knowledge and a new method of work. Adjusting of balances on various accounts of individual companies required accurate planning of outflows and inflows as well as prompt response to unexpected events.

Borrowings grew in 2002 by 9.0 % (SIT 7.6 billion) and reached SIT 91,862 million at the year end. The increase in borrowings represented an additional source of financing in the implementation of the medium-term business plan of the Group and in the strengthening of its market position in Slovenia.

In 2002 the Group considerably improved the term structure of financial sources by replacing current with non-current financial sources. During the year non-current financial liabilities increased by 54.4 % and current liabilities decreased by 31.2 %. At the end of 2002 non-current financial lia-

At the end of 2002 the Mercator Group reached its target long-term coverage of fixed assets, as it has reached 92.7 %.

Long-term loans 67 %

Short-term loans 33 %

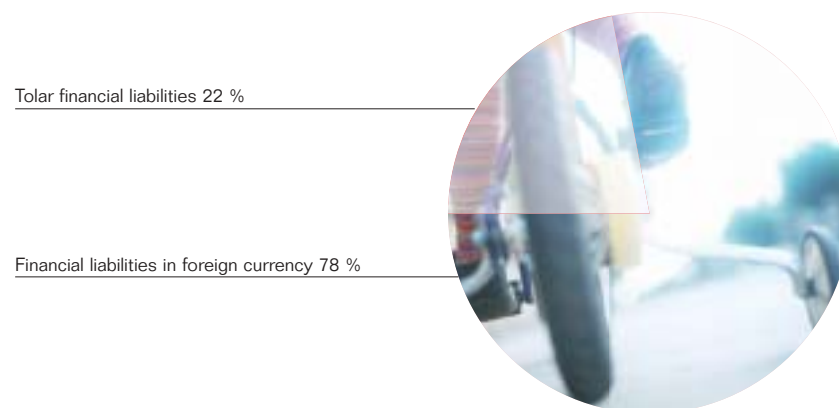


The ratio between non-current and current financial liabilities.

bilities represented 66.5 % of total financial liabilities, the rest was made up of current financial liabilities.

At the year end total borrowings represented 22.2 % and foreign currency borrowings 77.8 % of total financial liabilities. Foreign currency borrowings were linked to the market interest rates EURIBOR and LIBOR. Non-current total borrowings included a revaluation clause, current borrowings had fixed nominal interest rates.

The ratio between financial liabilities in tolars and foreign currency is shown in the following picture:



In 2002 we continued to use long-term finance lease, which offered acceptable interest rates and long maturity periods, and represents an opportunity to diversify our financial sources. In addition to the finance lease agreement for Mercator Centre in Jesenice in the amount of EUR 6 million, we entered into a finance lease agreement for EUR 18 million for the financing of Mercator Centre in Kranj in 2002.

In 2002 we did not issue any tranches under the Euro commercial papers programme (which represents a form of short-term bridge financing by the issue of short-term securities with maturity of 7 to 364 days on the international money market), as we turned to improving the term structure of our financial sources.

In the Mercator Group special care is paid to ensuring equal financing terms for all the companies of the Mercator Group. Such terms were already achieved in the past due to Mercator's recognition on the domestic market, while on the new markets we obtain them by issuing guarantees of the Parent Company. If such method of financing subsidiaries is not possible, the borrowing is raised by the parent company which then transfers it to the involved subsidiary. By a unified arranging of financial sources and use of banking and other financial services inside the Group, we managed to considerably cut the finance costs and costs of financial services.

Financial Risk Management

We are aware that continual and regular monitoring and managing all risks to which the Mercator Group is exposed are the essential for successful and efficient achieving of set strategic goals and for accomplishing our mission.

We define risk as any uncertainty associated with future business transactions, which can reduce the probability of achieving set strategic goals. In the Mercator Group risks are assessed within the framework of three groups:

- business risks, which are associated with the uncertainty of future competitiveness, revenues generation and cost control and of maintaining the value of operating assets and managing operating liabilities;
- financial risks, which are associated with the uncertainty of generating financial revenues, managing of financial expenses, maintaining the value of financial assets, managing of financial liabilities and ensuring liquidity and solvency;
- operating risks, which are associated with the uncertainty of planning, implementing and monitoring operational processes and activities in the company.

Business Risks

The Mercator Group management considers that exposure to business risks is low, which means that the level of uncertainty related to the Group's future competitiveness, development and growth, business performance and value of total assets is not high.

The reasons for the assessment of business risk as low are as follows:

- adopted strategic objectives of the Mercator Group are based on its competitive advantages;
- over 92 % of total revenues of the Group derive from retail and wholesale of merchandise, of which the major portion refers to the fast moving consumer goods,
- the majority of consumer products are normal products with a low income demand elasticity, which would ease up the effect of eventual recession or of substantial reduction in the real purchasing power on the domestic market,
- the 39.8 % share of the domestic market with even distribution throughout Slovenia represents a stable and strong source of the Group's revenues and a good competitive position, even after Slovenia will have entered the European Union,
- high negotiating power of the Mercator Group in relation to the suppliers substantially reduces the risk associated with changes in purchase prices and conditions,
- the characteristics of trade activity and the price policy enable a reasonable transfer of changed purchase prices to selling prices, which reduces the risk of change in return on sales,

We consider that exposure to business and operating risks is low, and exposure to financial risks is moderate.

- efficient and adequate decentralisation of the Group's organisation and management enables a fast and appropriate response to changes in local environments and efficient implementation of set goals within the whole Group,
 - fixed costs represent only about one fifth of total operating costs, which points to low operating leverage of the Group,
 - the risk of obsolescence, destruction or other reduction in value of operating assets is low, as they are all properly insured,
 - all non-commercial risks associated with the activities on foreign markets are properly insured, commercial risks are monitored and reduced by appropriate business measures,
 - market research shows that the quality of offer and price competitiveness of the Group's trade sector is high, which also results from the purchase frequency rate recorded in Mercator, which exceeded 90 % in 2002.
- The Group actively manages business risks by taking various measures to reduce its exposure to individual types of business risk.

Financial Risks

In 2002 the Mercator Group, in line with its key strategic goals, pursued the adopted financial risk management policy, which on the basis of assessed risk exposure defines adequate measures and procedures to mitigate financial risks.

Exposure to individual types of financial risk is assessed semi-annually and suitable risk management policies are adopted. On the basis of previously adopted methodology we prepared the assessment of the Group's exposure to different types of financial risk and determined that the Group's exposure to financial risks was moderate.

The next paragraphs describe the key characteristics of the Group's exposure to various types of financial risk.

Credit risk arises from the Mercator Group's wholesale activities and from non-trade activities.

The Mercator Group management considers that exposure to credit risk is low for the following reasons:

- in 2002 revenues from wholesale and non-trade activities accounted only for 28.2 % of total revenues of the Mercator Group;
- buyers or business partners were dispersed, maximum exposure to individual buyers was low;
- the Group took regular measures and carried out activities to protect against credit risks.

In 2002 the Mercator Group carried out the following activities and took the following measures to protect against credit risks:

- we regularly monitored our business partners' operations;
- we determined the maximum exposure to individual business partners;
- we carried out centralised monitoring of debtors;
- we limited open account payments on new markets;
- we requested the buyers to submit an insurance instrument at the beginning of business co-operation;
- we applied a formalised collection procedure for receivables due;
- we carried out active bilateral and multilateral set-off and barter deals.

Mercator's exposure to interest rate risk arises from its position as a borrower, from its raising credits with interest rates which can change upon credit's roll-over and from non-current foreign currency borrowing, which are mainly linked to floating reference interest rate EURIBOR.

The Mercator Group management considers that exposure to interest rate risk is moderate for the following reasons:

- the decreasing trend of interest rates, both short-term on the domestic market and reference interest rates EURIBOR was recorded in 2002;
- the achieved and expected fluctuation of reference interest rates is relatively low;
- macroeconomic factors and expected changes in the general business and economic environment indicate that relatively low interest rates will be maintained to prevent eventual recession in the world economy.

In 2002 the Mercator Group assessed, in line with the adopted financial risk management policy, that exposure to interest rate risk was moderate and consequently no hedging instruments were required. However, we have constantly monitored developments and forecasts and are ready for prompt response to eventual changes.

Exposure to currency risk arises from the Group's cash flows and financial liabilities, which are denominated in the following foreign currencies: EUR, HRK (Croatian Kuna) and YUM (Yugoslav Dinar).

The Mercator Group management considers that exposure to currency risk is low for the following reasons:

- the exchange rate of EUR against SIT is predictable and stable, the Bank of Slovenia has been implementing a consistent exchange rate policy;
- the exchange rate of HRK against SIT is predictable and stable as also the Croatian National Bank has been implementing a consistent exchange rate policy;
- the exchange rate of the Bosnian Mark is fixed to EUR;
- exposure to fluctuations in YUM exchange rates is low as the Group only recently started its operations on the Serbian market, in addition the Group reduces its exposure by purchasing merchandise in Serbia also for sales to other markets.

In 2002 the Mercator Group assessed, in line with the adopted financial risk management policy, that exposure to currency risk was moderate and consequently no hedging instruments were required.

The Group's exposure to inflation risk is assessed as low, mostly as a result of the leading market position in Slovenia and important market positions on the new markets, which enables the Group to adequately compensate for eventual negative inflation effects by improving the generated economic benefits. No instruments for reduction of inflation risk exposure exist, therefore active protection is not possible.

The Mercator Group is not exposed to the risk of reduced liquidity and change in market price of securities, as it has no materially significant investments in traded securities.

We consider that exposure to liquidity risk is low for the following reasons:

- In 2002 retail sales revenues accounted for as much as 72.1 % of total sales revenues. The large majority was in the form of prompt cash payments, representing assured daily inflows and changes in the volume of inflows were low and predictable. Bank inflows referring to settlement of payables from credit card payments were assured as well.
- Within the Treasury Department a cash management system is in place, which helps in managing liquidity and projecting cash flows.
- The Group can raise large cash amounts during a given day from accounts opened with commercial banks or granted revolving facilities, and can use the Euro commercial paper programme.
- Early payments due to utilisation of financial discounts represent additional liquidity reserves. In the event of low liquidity the Group can suspend its early payments and thus release the liquidity reserve.
- In 2002 the Group considerably improved the term structure of borrowings (refinancing of current with non-current borrowings), which indirectly resulted in lower liquidity risk due to smaller share of borrowings maturing within one year, and smaller probability of unsuccessful refinancing.
- In debt financing the Group co-operates with the majority of Slovenian banks and numerous foreign banks,

- which reduces the liquidity risk associated with potential fall-out of individual sources of finance.
- The Group regularly monitors changes in external environment which influence the liquidity requirements and takes appropriate measures to ensure adequate liquidity.
- The cash balances on transaction accounts of the Mercator Group are stable as a result of accurate and prompt cash flow management.

Exposure to solvency risk is assessed as low due to suitable capital structure of the Mercator Group, high quality assets and great financial strength.

Within the risk management activities the Mercator Group pursues a unified policy of property insurance, insurance of property interests and persons to eliminate various risks which could jeopardise the company's operations, cause significant material damage or endanger the safety of employees. The Mercator Group companies have concluded the following insurance contracts with insurance companies:

- property insurance, which among other includes earthquake insurance, fire insurance, insurance against burglary, machinery breakdown insurance, professional liability insurance, computer insurance, insurance of goods in cold-storage depot, insurance of stocks, etc.
- export credit insurance with the Slovene Export Company, which includes insurance against non-commercial risks, such as restricted transfer risk, expropriation risk and risks of war and civil unrest;
- personal insurance in the form of voluntary collective accident insurance of employees and compulsory and supplementary health insurance.

The principal goal of the policy is to ensure cost-effective insurance against various types of risks upon the consideration of analyses of risk exposures, past experience and implementation of preventive measures. We consider that comprehensive insurance of property, operations and people additionally reduces financial and business risks to which the Mercator Group is exposed.

Operating Risks

The management of the Mercator Group considers that exposure to operating risk is low, which means that the level of uncertainty related to planning, implementing and monitoring of operational processes and activities undertaken in pursuing business goals, is not high.

The reasons for the assessed low exposure to operating risk are:

- all principal and supporting operational processes in the trade segment are completely unified and centrally balanced, as are most of the key operational processes in non-trade Group companies;
- in all Group companies unified procedures for liquidation and authorisation of all business events, which lead to changes in economic benefits, have been introduced and, in addition, regular and detailed planning and monitoring of operation and business effects of all organisational units has been ensured;
- all regional trade companies have implemented the ISO 9001 management system, which ensures formalisation and standardisation of business activities and allocation of responsibility for their implementation, and regular checking of suitability of implementation by external and internal assessments;
- all regional trade companies have implemented a system of internal monitoring of implementation of operational processes in the retail segment which is the Group's core segment;
- all Group companies are required to have their annual reports audited by external auditors, which includes the assessment of their key internal control systems;
- at the Group level the Internal Audit Department carries out audits of internal control systems and of finance, accounting, controlling and other operational processes in all Group companies twice a year.

The management considers that above mentioned activities and measures ensure a suitable reduction of operating risks to which the Group is exposed.

The Mercator Group management considers the selected business, financial and operational risk management policies suitable for the low to moderate risk levels and provide an adequate reduction of risk exposure in terms of ensuring reliable achievement of set strategic objectives.



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Creating Shareholders' Value

Ownership Structure of Poslovni sistem Mercator, d.d., as at 31 December 2002



In 2002 the number of shareholders of the company Poslovni sistem Mercator, d.d. increased by 345 so that on 31 December 2002 the Company's share register had 20,931 shareholders recorded. 2002 was the first year, after privatisation had been completed six years ago, when the number of shareholders increased.

As at 31 December 2002, ten major shareholders held a total of over 55 % of the Company's shares:

- Kapitalska družba pokojninskega in invalidskega zavarovanja, d.d. (Capital Fund) (16.78 %);
- Slovenska odškodninska družba, d.d. (Slovenian Compensation Fund)(13.57 %);
- KD Group, Finančna družba, d.d. (12.18 %);
- Zavarovalnica Triglav, d.d. (2.64 %);
- Sava, d.d. (2.56 %);
- Triglav steber I, pooblaščen investicijska družba, d.d. (2.49 %);
- Zoran Janković (1.47 %);
- Zlata Moneta I, pooblaščen investicijska družba, d.d. (1.37 %);
- Krona Senior, pooblaščen investicijska družba, d.d. (1.24 %);
- Bank Austria Aktiengesellschaft, Vienna (1.19 %).

At the end of 2002 members of the Management Boards of the parent company and of subsidiary companies held approximately 4.2 % of Company shares, of which 2.1 % refer to members of the parent company's Management Board. Members of the Supervisory Board had a 0.1 % stake in the company Poslovni sistem Mercator, d.d.

In 2002 the Company's share register had 345 new shareholders. On 31 December 2002 the Company Poslovni sistem Mercator, d.d., had 20,931 shareholders recorded.

Members of the Management Board	Number of shares	Participation in total capital
Zoran Janković	47,013	1.47 %
Aleš Čerin	5,624	0.18 %
Jadranka Dakič	5,599	0.17 %
Marjan Sedej	5,950	0.19 %
Stanislav Brodnjak	3,070	0.10 %
Total	67,256	2.11 %
Members of the Supervisory Board	Number of shares	Participation in total capital
Janez Bohorič	0	0.00 %
Vera Aljančič Falež	30	0.00 %
Ksenija Bračič	75	0.00 %
Jože Cvetek	2,000	0.06 %
Dragica Derganc	142	0.00 %
Katja Galof	42	0.00 %
Matjaž Gantar	0	0.00 %
Vladimir Jančič	0	0.00 %
Morena Kocjančič	500	0.02 %
Marjan Somrak	0	0.00 %
Branko Tomažič	0	0.00 %
Total	2,789	0.09 %

At the end of 2002 the participation of foreign investors in the capital of the company Poslovni sistem Mercator, d.d., was 2.45 %, which was 0.46 % over the end of 2001 figure.

Shareholder Information

	31 Dec 2002	31 Dec 2001	Index 2002 / 2001
Number of ordinary shares	3,208,504	3,208,504	100.0
Market capitalisation (in SIT mn)	78,771	51,976	151.6
Market value per share (in SIT)	24,551	16,199	151.6
Annual low (in SIT)	16,183	13,393	120.8
Annual high (in SIT)	27,166	17,225	157.7
Weighted average market price, excluding block and cross trades (in SIT)	22,254	15,234	146.1
Earnings per share (in SIT)	2,169	2,463	88.1
Price / earnings ratio (P/E)	11.32	6.58	172.0
Capital yield (in %)	51.55	8.88	580.4
Dividend yield (in %)	2.47	2.02	122.5
Total yield (in %)	54.02	10.90	495.7

Movements in the Market Price of Shares

The Company's share capital is divided into 3,208,504 ordinary registered shares, trading on the official market of the Ljubljana Stock Exchange Inc., Ljubljana, with the nominal value of SIT 10,000 per share. From 22 December 1997, when the shares were listed on the Ljubljana Stock Exchange, to 31 December 2002, their value grew by 471.4 %.

The shares are listed on the official market of the Ljubljana Stock Exchange under the trading code: MELR.

The shares' average daily price in the period from 31 December 2001, when it was SIT 16,199 to 31 December 2002, when it was SIT 24,551, increased by 51.6 %. In this period its high was SIT 27,166 and its low was SIT 16,183. Market capitalisation of the Company at the year end was SIT 78.8 billion, which was 7.8 % of total market capitalisation of listed shares. The weighted average market price of shares (excluding block and cross trades) was SIT 22,254, which was 10.2-times the value of earnings per share.

Earnings per share in 2002 fell 11.9 % compared with 2001 and amounted to SIT 2,169 at the end of 2002.

In accordance with the Securities Market Act provisions and the Ljubljana Stock Exchange Rules, the Company regularly informed the public of its business results and other important events.

A comparison of movements of the average daily price of MELR and the SBI 20 index in 2002 is shown in the following graph:

From 22 December 1997 to 31 December 2002 the value of the Company's shares grew by 471.4 %. The shares average daily price increased by 51.6 % in the period from 31 December 2001 to 31 December 2002.



To enable comparison the trend of the SBI 20 index has been adjusted so that the ratio of the price of MELR and SBI 20 is 7.6 during the whole period under review as it was on 1 January 2002.

The industrial sector index Trade rose by 37.1 % in 2002, while the average daily price of Mercator shares grew by 51.6 %, which shows an excellent trend compared with other retailers included in the index composition.



To enable comparison the trend of the Trade index has been adjusted so that the ratio of the price of MELR and the Trade index is 9.0 during the whole period under review as was on 1 January 2002.

Dividend Policy

In 2002 the gross dividend value amounted to SIT 400 per ordinary share.

In 2002 the Company pursued the adopted dividend policy, which had been selected on the basis of shareholders' expectations, capital structure of the Company, investment opportunities and aspects of taxation. At the 8th Annual General Meeting the shareholders of the company Poslovni sistem Mercator, d.d., held on 31 May 2002 adopted a resolution to allocate part of the net profit for 2000, amounting to SIT 1,283,401,600, to payment of dividends in the gross amount of SIT 400 per ordinary share. In 2002 gross dividend value was higher than in 2001 by SIT 100 in nominal terms. The Company will pursue the set dividend policy also in the future.

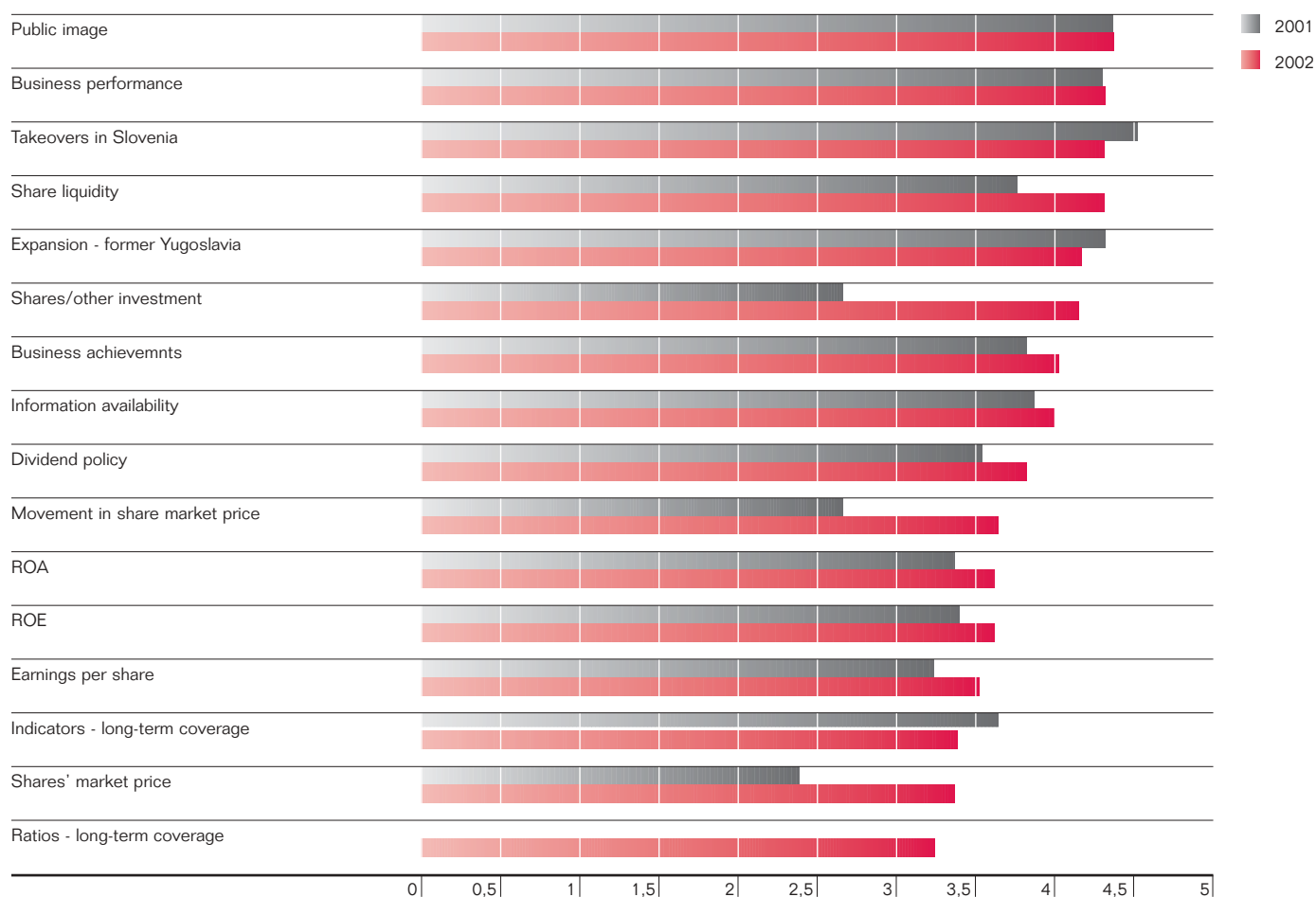
The Management and the Supervisory Boards propose to the General Meeting of Shareholders that a gross dividend of SIT 450 per share be paid in 2003.

Shareholder Satisfaction

In accordance with the ISO 9001 standard and in co-operation with the Faculty of Social Sciences - Institute of Social Sciences: Centre for Public Opinion Pooling and Mass Communications we carried out our second survey of shareholder satisfaction in 2002, which included 300 major shareholders of the Company. The primary goal of the survey was to monitor shareholders satisfaction over a longer time period. The results showed that rates for the majority of elements improved compared with 2001.

The survey on shareholder satisfaction in 2002 showed that rates for the majority of elements improved compared to 2001. We can conclude, that Mercator's shareholders are satisfied with their company.

Ranking of Shareholder Satisfaction Criteria by Degree of Satisfaction



Source: Market Research of Shareholder Satisfaction, Centre of Public Opinion Pooling and Mass Communications, 2002

We can conclude that Mercator's shareholders are satisfied with their Company. As in the year before high rates were given to the Company's public image, availability of information, business performance and business strategies - the latter obtained slightly lower rates than in 2001. A very important turnaround occurred at the rating of the shares' market price and its comparison with other shares and other investments. These elements were attributed considerably better rates than in 2001. The second change refers to rates having an impact on shares' market prices - here the focus is on internal factors which can be influenced by the Company, especially the achieved business results and investment policy.

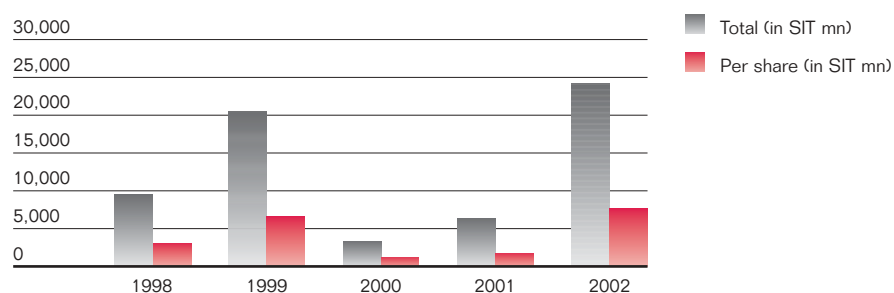
Creating Shareholders' Value

We are aware that the key goal of our operation is to maximise wealth of our shareholders while meeting our commitments to all other stakeholders.

Because of the characteristics of the Slovenian capital market the shares' market price does not always reflect its fair market value, however, in the last few years the capital market has recognised to some extent the value generated for shareholders. This was measured as the annual change in the Company's market capitalisation, taking into account the weighted average daily price of shares in December of the previous year versus the price in December of the year under review. In this way we eliminated in part the impact of eventual short-term changes in price due to lower market liquidity and other inefficiencies affecting daily share prices.

The graph below shows the recognised value for shareholders in total and per share in the years 1998 - 2002. In the period under review the company Poslovni sistem Mercator, d.d. generated SIT 64,021 million of value for shareholders in nominal terms, which is SIT 19,954 per share.

Acknowledged Generated Value for Shareholders



We shall continue to engage in those business activities with which we can create long-term growth in the value of our shareholders' wealth.

Business Performance Analysis

Business Results by Segments

For segment reporting requirements the Mercator Group defined business and regional segments, taking into account various groups of activities or services performed by the Group companies, and geographical regions where business activities are performed.

In terms of business segments the Mercator Group is organised into three business segments: trade on the domestic market, trade on foreign markets and non-trade, which comprises all the remaining activities which the Mercator Group performs on the domestic and foreign markets.

In terms of geographical segments the Group's business segments operate in two main geographical areas: Slovenia, which comprises all areas of operation on the domestic market, and foreign markets, which comprises all areas of operations in the markets of Croatia, Bosnia and Herzegovina, Serbia and Austria.

The following table shows net sales revenues, net profit or loss and capital expenditure of the Mercator Group by business segment in 2002:

(in SIT mn)	Net sales		Net profit		Capital expenditure	
	2002	2001	2002	2001	2002	2001
Trade	307,943	272,259	6,891	8,576	22,801	31,674
- in Slovenia	275,568	253,690	8,850	9,760	8,844	19,316
- abroad	32,375	18,569	-1,959	-1,184	13,955	12,358
Non-trade	26,480	25,170	191	-752	1,690	1,056
Total revenues	334,423	297,429	7,082	7,824	24,491	32,730
Inter-segment eliminations	-14,646	-11,754	-	-	-	-
Total (consolidated)	319,777	285,675	7,082	7,824	24,491	32,730

In 2002 the Mercator Group performed successfully and exceeded projections, set up for 2002.

The following table shows net sales revenues, net profit or loss and capital expenditure of the Mercator Group by geographical segments in 2002:

(in SIT mn)	Net sales		Net profit		Capital expenditure	
	2002	2001	2002	2001	2002	2001
Slovenia	291,220	268,376	9,044	9,008	10,337	18,024
Abroad	33,423	18,677	-1,961	-1,184	14,154	14,706
Inter-segment eliminations	-4,866	-1,378	-	-	-	-
Total (consolidated)	319,777	285,675	7,082	7,824	24,491	32,730

In 2002 the Mercator Group performed successfully and generated SIT 319,777 million of net sales revenues, which is 11.9 % up the 2001 figure and exceeded projections for 2002 by 4.5 %. In 2002 the Mercator Group generated SIT 7,082 million of net profit, which is 9.5 % lower compared with 2001.

Some Financial Ratios

	2002	2001
Profitability ratios		
Return on equity	11.0 %	13.5 %
Return on sales	2.2 %	2.8 %
EBITDA to sales	7.7 %	8.3 %
Financial structure ratios		
Capital and long-term provisions to total liabilities	34.5 %	34.0 %
Financial liabilities to total liabilities	43.9 %	43.4 %
Financial liabilities to capital and long-term provisions	127.3 %	127.5 %
Long-term coverage of fixed assets	92.7 %	81.1 %
Productivity ratios		
Revenues per employee per work hour (in SIT thousand)	22,981	21,507
Added value per employee per work hour (in SIT thousand)	4,875	4,745

The profitability and productivity ratios have been calculated at average values of balance sheet elements. EBITDA is calculated as total profit or loss before tax, costs of depreciation and interest expenses. Added value is calculated as the sum of EBITDA plus staff costs. Financial structure ratios are calculated as at 31 December.

Profitability ratios slightly decreased relatively to year 2001 due to start-up costs on new markets, where the Group is quickly expanding its operations according to the set strategic objectives.

In 2002 the Mercator Group, in line with adopted strategic financial objectives and in accordance with financial requirements, obtained mainly non-current financial sources, and refinanced a significant portion of current financial sources with non-current financial sources. As a result the share of non-current financial debts in total financial debts increased from 47.1 % at end of 2001 to 67.1 %, at the end of 2002. Consequently the ratio of long-term coverage of fixed assets improved from 81.1 % at the end of 2001 to 92.7 % at the end of 2002 and reached the target 90 % coverage. A more conservative term structure of financial sources provides the Mercator Group with additional financial strength and power.

Productivity, measured with net revenues per employee per work hour increased despite growing retail revenues in total revenues. Productivity growth was mostly a result of increased retail revenues generated in retail units with larger space - Mercator Centres and supermarkets. Along with improved business performance, efficiency and productivity, the added value per employee has grown also. Compared to 2001 it increased by over 2.5 %.

Performance of the Companies within Mercator Group

Trade companies of the Mercator Group efficiently adhere to Mercator's business standards.

The next section highlights the performance of the Mercator Group companies in 2002.

Trade Companies

Emona Merkur, d.d.

For the company Emona Merkur, d.d. 2002 was characterised by preparations for the merger with the parent company Poslovni sistem Mercator, d.d., which had taken over all retail activities in the region of Central Slovenia already in 2001. In 2002 the Company was engaged in efficient management of the remaining assets, while its revenues mostly arise from disposal of stocks. The company Emona Merkur, d.d. is scheduled to merge with the parent company Poslovni sistem Mercator, d.d. by the end of 2003.

Žana, d.d.

In 2002 the company Žana, d.d. operated in line with adopted Mercator standards. Its full inclusion in the Mercator Group meant that it managed to obtain better supply terms in purchasing goods and improve its competitiveness. The Company's investment activities in 2002 included mainly investments in renewals of retail units because of implementation of Mercator standards. At the end of 2002 the company Poslovni sistem Mercator, d.d. acquired the Company's retail units and at the beginning of 2003 took over its activities. In 2003 the company Žana, d.d. will be merged with the parent company.

Mercator - SVS, d.d.

The company M - SVS, d.d. focussed its activities on maintaining its leading position as retailer in fast moving consumer goods in the North-eastern region of Slovenia. In 2002 it mainly invested in the opening of a super-market in Ljutomer and renewal of 6 retail units. After its CEO Stanislav Brodnjak left to join the Management Board of the parent company, on 1 January 2003 Samo Gorjup, former member of the Management Board, in charge of marketing, was appointed the new CEO. In 2003 the Company's operation will be affected by the setting up of a chain of technical products and furniture retailing within the Mercator Group.

Mercator - Dolenjska, d.d.

The company M - Dolenjska, d.d. achieved slightly lower results in 2002 than in 2001, which was due to increasing competition in the region. The Company endeavoured to retain its market share in the region of Dolenjska, Bela Krajina and Posavje in the field of fast moving consumer goods and streamlined its activities in terms of staff costs, especially overhead costs. In 2002 the Company invested most of its funds in two larger and numerous smaller renewals of retail units, in the development of the project: Mercator Centre in Trebnje and in the finalisation of the projects from previous years. In 2003 the Company will continue to reduce costs and increase the

sales volume on account of the newly opened Mercator Centre in Trebnje. Its operation will be affected by the setting up of a chain of technical products within the Mercator Group.

Mercator - Gorenjska, d.d.

Company M - Gorenjska, d.d. performed successfully in 2002. In April 2002 it opened a new Mercator Centre in Kranj and improved the quality of its retail activities in the Gorenjska region. The Company's investments included renewals of 10 retail units and the development of new retail units, which will be opened in 2003. For 2003 further investment activity is planned, directed to the construction of new retail units in the region of Gorenjska: NC Bled, NC Škofja Loka and SM Gorenja vas.

Mercator - Degro, d.d.

In 2002 the company M - Degro, d.d. failed to reach its business goals, mainly on account of increasing competition in the region of Koper and of poor performance. In 2002 the Company invested in the renewal of 4 retail units, including the largest - Hypermarket in Koper. At the end of 2002 the company Poslovni sistem Mercator, d.d. purchased from the company M - Degro, d.d. the Mercator Centre in Koper as the first phase of the scheduled takeover of this company's operation. During the first half of 2003 Poslovni sistem Mercator, d.d. will gradually take over the activities of retail and wholesale and logistics to streamline and efficiently organise the business operations in the Coastal region.

Mercator - Goriška, d.d.

In 2002 the company M - Goriška, d.d. endeavoured, despite fierce competition due to its closeness to Italy, to increase the volume of its sales and its services and improve its offer. The Company's investments were earmarked for the completion of the Mercator Centre in Nova Gorica, to 3 larger and some smaller renewals of retail units, purchase of the retail unit Ajdovščina from the company Poslovni sistem Mercator, d.d. to complete the regional coverage of the Mercator Group, for the purchase of 3 retail units from outside companies and purchase of computer and other equipment. In 2003 the Company will continue to reduce costs and increase its sales volume on account of refurbished retail units and new acquisitions from 2002. By training and motivating its employees, high quality services and a wide product range the Company will strive to ensure the loyalty of its customers, their trust and commitment.

Mercator - H, d.o.o.

At the beginning of 2002 the company M - H, d.o.o. acquired the company Sloboda, d.d. which contributed to efficient planning of the Company's operation in Croatia. Later in the year the company NIP, d.o.o. was acquired together with its distribution centre in Zagreb. The Company's investments included construction of the Mercator Centre in Split, which was opened on 5 July 2002, marking the entry to Dalmatia and enlargement of the retail network in the country. The Company's research and development activities were directed to improving existing retail units and adjusting to Mercator standards. At year end the Company began to prepare the project documentation for the construction of a new Centre in Osijek. At the end of 2002 the Company's market share was 2.9 %. On 1 January 2003 the Management Board of the company M - H, d.o.o., consisting of one member - Stanislav Brodnjak, was changed. In 2003 the company M - H, d.o.o. plans a severe costs reduction and setting up of efficient organisation of retail activities. It intends to obtain a stronger position on the Croatian market and create the required conditions for improving business performance and becoming one of the five leading retailers in the country. At the beginning of 2003 the Company's capital was increased by the company Poslovni sistem Mercator, d.d. to achieve an appropriate capital structure.



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Mercator - TC Sarajevo, d.o.o.

In 2002 the company M - TC Sarajevo, d.o.o. achieved the target growth in sales volume and projected cost reduction. Its market share was 1 % at the end of 2002. In 2003 the construction of the Mercator Centre in Tuzla will start, while its opening is scheduled for 2003. In the first quarter of 2003 the Company's capital was increased by the company Poslovni sistem Mercator, d.d., to achieve an appropriate capital structure.

Mercator - S, d.o.o.

On 5 December 2002 the company M - S, d.o.o., opened the first Mercator Centre in Belgrade, which marked the Mercator Group's entry to the Serbian market. The entry to the Group's third strategic market received a warm welcome. In 2003 the company M - S, d.o.o. intends to consolidate its position on the market and set up efficient cost management, while no new investments are planned for 2003.

Trgoavto, d.d.

Despite increased competition in 2002 the company Trgoavto, d.d. performed successfully, which was due to adjustment of organisation, inter-segment relations and cost cutting. Its investments in 2002 were mainly directed to the opening of new retail units, within the Mercator Centres and on other locations, and in acquiring interest participation in newly established subsidiary companies: the company TT - Trgotehna, d.o.o. (51 % shareholding), which took over the operation of the Sales and Maintenance Centre Iveco, and the company TrgoA PSC, d.o.o. (100 % shareholding), which took over the operation of the Sales and Maintenance Centre Renault. In the first half of 2003 the company Poslovni sistem Mercator, d.d. is scheduled to sell its participating interest in the company Trgoavto, d.d. to a strategic partner due to the parent company's re-focussing on sale of food products, and because it is estimated that the new majority owner will ensure the Company successful long-term development and growth in line with adopted strategic objectives.

Mercator - Modna hiša, d.o.o.

With the setting up of a clothing chain the company M - Modna hiša, d.o.o. became the largest specialist and recognised clothing retailer in Slovenia. The taking over of specialised stores of the Mercator Group companies in 2002 was the second phase of the clothing chain project, where the focus was on creating a corporate image, setting up of efficient information system and unification of purchasing and pricing policies. Penetration of new markets (Croatia, Bosnia and Herzegovina and Serbia) within the Mercator Centres was of key importance for the Company's expansion. In 2002 the Company invested in construction of new units within the Mercator Centres, opened in 2002, renewals of some retail units that had been taken over within the clothing chain project, and in the refurbishment of Modna hiša in Maribor. Considerable funds were earmarked for the modernisation of stores, which had been taken over, to meet the clothing stores standards. In 2003 the Company plans to open 3 retail units (TC Levec, TC Trebnje, MC Celje), to implement ISO standards and to continue with the restructuring of the clothing chain. Despite increasing competition on the domestic market the Company plans to improve its business performance and efficiency with the aim to become the largest and the best clothing retailer in Slovenia and to establish the largest clothing chain on the new markets.

Intermercator, G.m.b.H.

The company Intermercator, G.m.b.H. performed successfully in 2002. Sales to the companies Poslovni sistem Mercator, d.d. and Eta, d.d., which are its largest buyers, increased in 2002 compared with previous years, which had a favourable impact on the Company's performance. In 2003 the Company will continue to provide high quality services, deal with suppliers under favourable terms, upgrade and improve its information system, work successfully with its business partners and train employees.

Non-trade Companies

MDK, d.d.

In 2002 the company Mesnine dežele Kranjske, d.d. pursued the goal to become the leading company in the meat processing industry in Slovenia, strongly oriented to the Croatian market and to the markets of the European Union. It was awarded a gold medal for offering to the market packed fresh meat and the nomination "Champion" for spiced packed meat on the International Agricultural and Food Fair in Gornja Radgona, in successfully launched new products and co-operated in over 100 sales promotion campaigns. In 2002 the Company invested in renewals of existing buildings, in computer equipment and in financial investments in subsidiary companies. In 2002 the Company founded a subsidiary company MDK - H, d.o.o. (100 % shareholding), which operates in Croatia and whose core activity is production and sale of meat products and fresh meat. The company was founded to increase the sale of own products and own brands on the Croatian market. In 2002 the Company's research and development activities were directed to developing new products and changing existing products by applying up-to-date technology procedures to adjust them to the adopted legislation and to distribution of fresh meat according to the HACCP system. 2003 will mark the beginning of technological renovation of production in the company Mesnine dežele Kranjske, d.d. and the Company will begin to make profit. In the future the Company will continue to develop meat processing, excluding slaughtering, with emphasis on specialised retail of fresh beef.

Pekarna Grosuplje, d.d.

In 2002 the company Pekarna Grosuplje, d.d. firmly consolidated its position as the second leading Slovenian manufacturers of bread and fresh pastry goods. Sales volumes increased compared with 2001 in all product lines and with all major buyers. In 2002 the Company founded a subsidiary company Belpana, d.o.o. in Croatia (100 % shareholding), and began with activities related to the construction of a bakery. In 2002 the Company invested in continual modernisation of technological equipment and expansion of retail network. The two largest projects were an automated line for fresh pastry and a new facility for storage of frozen products and despatch of finished products. The Company also co-operated in equipping 30 retail units for baking on location, where most of the equipment is owned by the Company. The Company's research and development activities were directed to 10 new kinds of bread, 7 kinds of fresh pastry and to improvement of existing products, manufacturing and packaging. This was recognised by the Chamber of Commerce and Industry of Slovenia which presented the Company's CEO Štefan Plankar an award for exceptional achievements in the corporate sector in 2002. In 2003 the Company will continue to strengthen the position of one of the leading production companies in Slovenia and expand to the Croatian market, where it will start building a bakery.

Eta, d.d.

In September 2002 the company Eta, d.d. merged with the company Slosad, d.o.o. which resulted in more efficient organisation of production of the two companies and improved business performance within the Mercator Group. The Company's investments were directed to modernisation of production and information technology. In 2002 the Company successfully developed a new production and sales programme (baked vegetables) which will be launched in 2003, some new products were already launched as a result of investments in the renewal of production plant for ready meals. In 2003 the company Eta, d.d., will continue to invest in modernisation of technology, raw material base and production in the regions where raw materials and workforce are cheaper than in Slovenia. The Company's goal is to lease a raw material base and purchase production facilities in Serbia, which will have a favourable impact on production restructuring and help increase its market share.

The efforts of the company Slosad, d.o.o., prior to the merger, were directed to the forthcoming merger process and introduction of new joint programmes, which were to rationalise and specialise production and sales pro-

grammes and use the synergetic effects in sales and purchase on common markets and improve the competitiveness of Mercator's food processing segment. The Company's development activities included adjustment of its programme of logistics to veterinary requirements in order to obtain import and export permits for storing food of animal origin. Investments were mainly directed to the renewal of existing plants.

Mercator - Emba, d.d.

In 2002 the company M - Emba, d.d. successfully penetrated the demanding West-European market, where high quality and price competitiveness of its products were acknowledged. On the basis of monitoring world trends in nutrition and according to demands of the domestic market, the Company continued to develop new products within established production lines. In 2002 it invested in the purchase and technological renovation of production equipment and expansion of the chain of bars Santana Coffee Shop in Slovenia and to the new markets. In 2003 the Company plans to increase exports to European markets and increase its presence on the markets of Croatia, Bosnia and Herzegovina and Serbia, which is mainly associated with the expansion of Mercator's retail network on new markets.

Mercator - KŽK Kmetijstvo Kranj, d.o.o.

The company M - KŽK Kranj, d.o.o. operated mainly in Slovenia in 2002. Its trade activities were carried out in an increasingly competitive environment of florist activities, its operations in agriculture were marked by processes of restructuring. The Company's investments in 2002 were mainly directed to agricultural activity, garden centres and the opening of new retail units within the Mercator Centres. In 2003 the Company expects to reduce its agricultural production due to faster denationalisation of land, therefore disposal of the whole company or a merger with a company within the industry is a possibility.

M Hotel, d.o.o.

The company M Hotel, d.o.o. successfully increased its accommodation capacities in 2002 and endeavoured to provide services of higher quality, which resulted in increased number of regular guests. The Company's investments in 2002 included hotel refurbishment and investments in hotel equipment. In 2003 the Company will continue with similar activities.

Mercator - Sremič, d.o.o.

In 2002 the company M - Sremič, d.o.o., despite efforts in marketing, its offers of congress tourism and acquisition of additional hotel business, failed to considerably improve its performance. The main reason was deterioration of the economy in the Krško municipality and the whole Posavje region. On 24 December 2002 the company Poslovni sistem Mercator, d.d., sold its shareholding in M - Sremič, d.o.o. due to strategic re-focussing on trade activities.

Mercator - Optima, d.o.o.

In 2002 the company M - Optima, d.o.o. completed its business projects, the major of which was designing and engineering the Mercator Centres in Split and Belgrade. The Company performed successfully in 2002, its investments included upgrading and updating of computer, telecommunication and logistic equipment. The Company successfully followed the world trends in engineering and organisation to ensure comprehensive finalisation of projects, and searched for new solutions to problems related to existing retail equipment, economical use of energy and new technologies in designing buildings and furniture and fittings. The Company's main goal remains to fully fulfil the obligations to its principal client, the company Poslovni sistem Mercator, d.d., in terms of quality and price and due dates. The Company plans to improve its business performance, financial strength and competitiveness, which will help in achieving set strategic objectives and accomplishing its mission.

Supporting Social Activities and Environment

Involvement in the local environment increases our social responsibility and concern for the improvement of the quality of life as well as for the future of these environments. These are also the fundamentals on which we build a long-lasting, future-oriented partnership.

The attitude towards the environment and reputation in dealing with environmental considerations are of key importance for pursuing and delivering our business strategies. We are aware that our involvement in the local environments throughout Slovenia and on the new markets increases our social responsibility and concern for the future of these environments. Our development and business excellence strategy is therefore complemented by a well considered and carefully planned approach towards the environment. A genuine attitude towards people, adjustment to their way of life and responding to the needs of the wider environment are the bases on which we build a long-lasting, future-oriented partnership.

Involvement in the Environment

Mercator encourages the economic and social development and welfare of all the environments in which it operates. In all our markets we give priority to local producers and employ their workforce. Involvement in the environment generates wider economic and social effects, sets up friendly and well kept environments for customers and employees and improves the quality of offered products and services. Our performance in this respect is confirmed by acknowledgements received from local communities, praise from our customers, awards and quality certificates received by our trade companies. One of Mercator's key values is concern for the health of customers and their quality of life. Therefore in 2002 we completed the project "Introduction of HACCP System in the Trade Companies of the Mercator Group".

The Association of Trade at the Chamber of Commerce and Industry of Slovenia ranked the following Mercator's retail units among the best kept stores with highly professional staff in 2002: department store Žana in Žalec, store Boč in Rogaška Slatina, Mercator's hypermarkets in Kranj and Slovenj Gradec, Intersport store in the Mercator Centre in Slovenj Gradec, store with technical products in the Mercator Centre in Jesenice and supermarket in Šmarje pri Jelšah.

A genuine attitude towards people, adjusting to their personal preferences and way of life, sensitivity to the needs of the environment and concern for the future are the key values of Mercator's development objectives, which we attain by our socially responsible activity.

Social Responsibility

We accomplish our mission by playing an active role in the economic environment and exert a cultural and social influence by responding to the needs of the wider environment. With donations and sponsorships we support and cultivate good human relations, develop and strengthen activities of local and national importance in various sectors of social life. We direct our funds where the needs are more pressing and offer help to those who need it most.

As sponsor Mercator is actively involved in satisfying the needs of the general social environment. Sponsorships and donations are earmarked for the development of sports, culture, education and projects related to protection of environment. Culture, sports and entertainment - be it events or shows - become pleasant experiences, widen horizons and improve the quality of life. Success and recognition achieved in culture, sports and entertainment lead to strengthening of the personality, recognition and reputation of sponsors and donors and of our country.

Each year we pay particular attention to our principal humanitarian campaign. With it we wish to improve Mercator's reputation and corporate image and affirm it as a socially responsible company, sensitive to people's needs, and as a socially involved leading Slovenian corporation. In previous year we helped institutions and centres, which provide care and education to people with special needs, first-aid posts and maternity hospitals. This principal humanitarian campaign of the Mercator Group's trade segment has become a tradition and will be organised it in 2003 as well. In this way we wish to show our compassion for people and listen to those who need help the most.

In 2002, in pursuing our business strategy, whereby we also consider people's susceptibility, we expanded existing dimensions of Mercator's corporate image with sponsorships and donations. We responded to the needs of the general environment by carrying out our cultural and social dimensions and showing concern for the life of each individual. Hence we supported various charitable projects of health centres, education and training centres and similar institutions. We sponsored sporting organisations and individual sportsmen and sportswomen, co-operated in various cultural and educational events and projects.

Wherever Mercator operates it gets involved with charitable campaigns, education, culture and sports at the local and national levels.

In 2002 Mercator joined the Foundation "Use Your Head at the Party", which carries out educational and preventive campaigns during events attended by the young, concerning alcohol, drugs, sex and other problems associated with their life. Attention is focussed on preventing drinking alcohol and driving and promotes having fun without the consumption of alcohol. Mercator also supported the project "Golden Graduates", where we presented gifts to the best graduates in Slovenia and supported and encouraged education among the young.

Poslovni sistem Mercator, d.d. and its partner Procter&Gamble started a charitable campaign in 2002 aiming at ensuring safe play areas for as many children as possible in Slovenia. The campaign was named "Let's Renovate Playgrounds". In Mercator's stores 10 tolar of each Procter&Gamble article sold went for the renovation of playgrounds throughout Slovenia. Mercator and Procter&Gamble together renovated nine public playgrounds in nine Slovenian municipalities - Tržič, Sevnica, Lendava, Trbovlje, Logatec, Slovenj Gradec, Koper, Maribor and Podbrdo - which had been selected upon proposals from the general public. Municipalities contributed to the success of the campaign. They all warmly welcomed the initiative and co-operated by preparing the land to ensure professional and safe in-building of new play elements. With this project we showed that it is also important to co-operate with business partners in matters concerning care for local communities.

Environmental Activities

Poslovni sistem Mercator, d.d. made its first step towards environment protection, on behalf of the Mercator Group, by submitting the Annual Report on the Management of Packaging and Disposable Packaging for 2001 to the Ministry of the Environment, Spatial Planning and Energy at the end of March 2002. Thus it complied with the first stipulation from the Rules on The Management of Packaging and Disposable Packaging (Official Gazette of RS, no. 104/00), which is one of by-laws of the Law on Environment Protection. To be able to draw up the Annual Report on the Management of Packaging and Disposable Packaging for 2001 a snap shot overview of the flow of packaging material had to be made in all trade and production companies of the Mercator Group.



In addition we also prepared a snap shot overview of the qualitative and quantitative status of disposable packaging in Mercator stores and used it to comply with Articles 12 and 13 of the Rules, which require free recovery of disposable bulk and transport packaging from end users. Special premises had to be designated for recovery, collection, sorting and temporary storage of disposable bulk and transport packaging near Mercator shopping centres and customers had to be informed about them.

In 2002 Mercator carefully prepared for the third stipulation of the Rules which requires that, at least as regards obligations arising from disposable packaging, in 2003 all involved parties enter into an agreement with the Company for the Management of Disposable Packaging - SLOPAK, d.o.o., which was founded in June 2002. Mercator is one of the founders and partners of SLOPAK.

By complying with some of the stipulations of the Rules and preparing the snap shot overview of disposable packaging management, Mercator obtained the necessary base for its environmental policy, which will be complemented by various projects in the future.

Non-trade companies of the Mercator Group carried out other forms of environmental activity.

The company MDK, d.d. prepared the required planning documents for the construction of water purification plant in 2002, which will significantly improve the quality of waste water. Regular measurements of generated gases, waste water and noise are carried out by authorised institutions licensed by the Ministry of the Environment, Spatial Planning and Energy. Measurements show that environmental impact is being managed as the assessed values of pollution are kept within legally permitted levels. In cattle breeding and beef production they endeavour to preserve the natural manufacture of animal feeds, despite economical pressures in the industry, and combine it with putting animals out to pasture, which has an important impact on the quality of production and on preserving the land. In 2002 projects were carried out which improved the attitude towards natural environment (they reduced water consumption and consequently reduced quantities of waste water, reduced all emissions of burnt gas and noise, modernised the boiler room and reduced heating oil consumption, minimised the possibility of NH₃ emission in the natural environment, by investing in a new chamber with a new gas production they significantly reduced the emission of smoky gas in the air, they implemented a fast cooling system after pasteurisation of meat products, which reduced water consumption and set up automated indicator of chlorine content in the water tank.

The company Eta, d.d., which is oriented to long-term production of safe and healthy food, is very particular about selecting raw material areas and raw materials and apply very high standards in their requirement for fault free raw materials and completely refuse to use any genetically altered raw materials. As they are aware of the importance of clean, healthy and safe environment they plan and implement their technological procedures so as to reduce any potentially harmful impacts on the environment. They manage waste and energy in a similar way.

The activities of the company Pekarna Grosuplje, d.d. have a much smaller environmental impact, however, the Company monitors and reduces it even further by selecting the best available and energy efficient equipment when modernising technological processes; they use excess heat in cooling systems for heating sanitary and industrial waste water, use the heat of burnt gases from furnaces for heating sanitary and industrial waste water, they fit production plants with air-conditioning systems and prevent emission of flour dust in the air, they designed closed and covered premises for separate collection and disposal of waste: paper and cardboard packaging, plastic, organic waste, waste oil from machines and vehicles, they process technological waste (waste flour and dough) to make animal feeds, they use robotic equipment for hard work (loading furnaces), they renovated part of sanitary and industrial waste water sewer system and built a new part and connected it with the main sewerage system, they arranged parking spaces for trucks and cars in accordance with legislation (rain water and waste water from laundry is removed by collectors of oil), they completed the facade on flour silos and renewed the facade of other buildings and tidied up the surrounding area.

The goal of the environmental policy of the company Mercator - Emba, d.d. is not only to comply with legal environmental requirements, but also to continually improve the environmental and business parameters. As their activity makes them a potential polluter of the environment in 2002 they started with systematic environmental management by carrying out the following activities: using environment-friendly packaging and minimising the use of packaging per product unit, setting up waste sorting system, raising customers' environmental awareness with instructions about packaging management (they set up a dangerous waste management system in co-operation with their suppliers), they modernised technological procedures to ensure efficient use of energy and generate a friendlier environment for work (reduced noise level) and they reduced the environmental impact of by-products.

The agricultural company Mercator - KŽK Kmetijstvo Kranj, d.o.o., which is among the major primary food producers in Slovenia, has in the recent years been less concerned with the volume of production than with the quality of garden products, grain, animal feeds, milk, with feeding cattle and rearing thoroughbred animals. In the last decade they restructured the basic agricultural production to ensure a higher level of quality, to provide safe and healthy food and cost-effective products. By using modern farm machinery they reduced the use of energy for cultivating land and use of chemical substances for protection of crop against pests and disease; for 12 years they have not used toxic chemicals, which were only banned this year. With regular annual checking of cultivated soil they minimise the use of mineral fertilisers to obtain high quality crop and seeds of potato and grain. With systematic control of soil and products (milk, wheat, barley, rye, potato, sugar beet, onion, buckwheat, etc.) and persistent implementation of technological procedures they maintained and improved their reputation of high quality and healthy food producer, who fully complies with European quality standards and applicable European legislation.



fulfillment

Significant Post Year-end Events

In 2003 the Mercator Group continues to operate in line with the economic plan for 2003, which was adopted by the Supervisory Board of the company Poslovni sistem Mercator, d.d. at its 8th session held on 19 December 2002. After the end of 2002 the following significant events occurred:

- Since 1 January 2003 the Management Board of the parent company Poslovni sistem Mercator, d.d. has five members for a term of office from 1 January 2003 until 1 January 2008. Existing members were joined by Stanislav Brodnjak, in charge of new markets.
- To improve business performance the company Poslovni sistem Mercator, d.d. took over all retail activities of the company Žana, d.d. on 1 January 2003, and later in the year the company will be merged with the parent company.
- At the beginning of 2003 business co-operation in wholesale supply of the company Spar Slovenija, d.o.o. was terminated, as the latter set up its own distribution centre. In 2002 the Mercator Group generated SIT 11.5 billion of sales revenues from wholesale supply of Spar Slovenija, d.o.o.
- In March 2003 ASPIAG Management AG, partner of Poslovni sistem Mercator, d.d. in the company Spar Slovenija, d.o.o. in which he participates with a 80 % stake, announced its wish to exercise his call option for the remaining 20 % shareholding in the company Spar Slovenija, d.o.o. The call and put options for the before mentioned interest in the company and purchase price of approximately SIT 0.9 billion were agreed by a partnership deed in 1997.
- On 6 February 2003 the company Poslovni sistem Mercator, d.d. increased the capital of the company Mercator - TC Sarajevo, d.o.o. by KM 23.2 million to achieve a more appropriate capital structure.
- On 21 February 2003 the company Poslovni sistem Mercator, d.d. increased the capital of the company Mercator - H, d.o.o. by HRK 300 million to achieve a more appropriate capital structure.
- On 11 March 2003 the company Poslovni sistem Mercator, d.d. signed a binding preliminary agreement about the sale of shareholding in the company Trgoavto, d.d. due to strategic re-focussing on trade in food products. The sale is scheduled for the first half of 2003, the agreed purchase price is SIT 1.4 billion.
- Negotiations about the company Mercator - KŽK Kmetijstvo Kranj, d.o.o. with a strategic partner will be finalised in 2003.
- In March 2003 the company Poslovni sistem Mercator, d.d. started taking over the retail and wholesale activities of the company Mercator - Degro, d.d. to improve the efficiency of business operations in the Coastal region.
- In 2003 a chain of technical products retailing units will be set up within the Mercator Group, comprising all specialised stores of the technical products programme.

Plans for the Future

We shall achieve our strategic goals by improving our business efficiency and financial strength and by gaining a flexible competitive position.

In 2003 the Mercator Group will continue to implement the medium-term business plan for the period 2002 to 2005 which was adopted in 2002.

The Group's key objectives for the future years derive from adopted strategies. In 2003 we want:

- to provide the right offer for a high quality of life of our customers by increasing the level of quality on the basis of further sales promotion projects, training of customer sales staff, expansion and development of Mercator Pika loyalty card and creating a pleasant shopping environment in our stores;
- to maintain the sales volume and market share in Slovenia by implementing an extensive investment plan, including the opening of two new shopping centres, a Mercator Centre in Trebnje and a Mercator Centre in Celje;
- to further increase our market shares on the new markets and start building two new shopping centres, a Mercator Centre in Osijek and in Tuzla;
- to intensify partnership relations with Slovenian producers and producers in the countries in which the Mercator Group operates;
- to increase business efficiency by further reducing costs, taking advantage of economies of scale, setting up a chain of technical products retailing units and further transforming the trade and non-trade segments of the Group;
- to expand non-trade companies' operations to new markets;
- to ensure security of creditors' investments by maintaining appropriate liquidity and solvency levels, by increasing the Company's financial strength and maintaining an appropriate capital structure;
- to continue to provide long-term social security and satisfaction of employees through an appropriate remuneration system, continuous education and voluntary additional pension insurance plan, along with our concern for the general social environment.

The Management Board of Poslovni sistem Mercator, d.d. considers that the Mercator Group will in 2003, despite strong competition and decreased volume of wholesale operations in Slovenia and growing competition on the domestic and new markets, increase its business efficiency, financial strength and competitive power, which will further contribute to the delivery of strategic objectives and accomplishment of its mission.

Financial Report

Principal Accounting Policies

Basis of preparation

The consolidated financial statements are prepared in accordance with and comply with International Financial Reporting Standards which include the standards and the interpretations issued by the IASB and the SIC. The consolidated financial statements are prepared under the historical cost convention except as disclosed in the accounting policies below. Unless otherwise stated the amounts in these financial statements are expressed in millions of Slovenian tolar.

Consolidation

Subsidiary undertakings, which are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealised gains and losses on transactions between Group companies have been eliminated. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group. Minority interest is separately disclosed.

Revenue recognition

Sales are recognised upon delivery of products and customer acceptance, if any, or performance of services (mainly rental income and marketing support revenues), net of sales taxes and discounts, and after eliminating sales within the Group. Revenue from the sale of the goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer.

Other revenues earned by the Group are recognised on the following bases:

- Interest income (as it accrues unless collectability is in doubt in which case the amount is written down to recoverable amounts and interest income is thereafter recognised based on the rate of the interest that was used to discount the future cash flow.
- Dividend income (when the Group's right to receive payment is established).

Investments in associated undertakings

Investments in associated undertakings are accounted for by the equity method of accounting. These are undertakings over which the Group has between 20 % and 50 % of voting rights, and over which the Group exercises significant influence, but which it does not control.

Equity accounting involves recognising in the income statement the Group's share of the associates' profit or loss

for the year. The Group's interest in the associate is carried in the balance sheet at an amount that reflects its share of the net assets of the associate and includes goodwill on acquisition.

A list of the Group's principal associated undertakings is set out in notes.

Foreign currencies

Foreign currency transactions in Group companies are accounted for at the exchange rates prevailing at the date of the transactions; gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement. Such balances are translated at year-end exchange rates.

Income statements of foreign entities are translated into the Group's reporting currency at the weighted average exchange rates for the year and balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation are taken to shareholders' equity.

Financial instruments

The Group's financial instruments include cash and cash equivalents, investments, receivables, accounts payable and borrowings. As in 2001 period the Group did not have any derivative instruments.

The Group adopted IAS 39 - Financial instruments: Recognition and Measurement, on 1 January 2001.

Information about financial risk management policies is included in Business Review.

Goodwill and negative goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired enterprise at the date of acquisition, and is amortised using the straight-line method over its estimated useful life, not exceeding 5 years.

Where an indication of impairment exists, the carrying amount of goodwill is assessed and written down immediately to its recoverable amount.

Negative goodwill arises on acquisition when the fair values of the Group's share of the net assets of the acquired enterprise exceed the consideration paid. Negative goodwill arose from expectations of future losses and expenses that are identified in the Group's plan for each acquisition and can be measured reliably, but which do not represent identifiable liabilities. It is recognised to the income statement when such losses and expenses are incurred or using the straight-line method over its estimated useful life, not exceeding 5 years. Negative goodwill is presented in the same balance sheet classifications as goodwill.

Intangible assets

Expenditure on acquired patents, trademarks and licences is capitalised and amortised using the straight-line method over their useful lives, generally over 5 years. The carrying amount of each intangible asset is reviewed annually.

Where an indication of impairment exists, the carrying amount of intangible assets is assessed and written down immediately to its recoverable amount.

Investments

At 1 January 2001 the Group adopted IAS 39 and classified its investments into the following categories: trading, originated, held-to-maturity and available-for-sale.

Investments that are acquired principally for the purpose of generating a profit from short-term (less than one year) fluctuations in price are classified as trading, and are included in current assets. These assets are carried at fair value, and realised and unrealised gains and losses arising from changes in the fair value of trading assets are included in the income statement in the period in which they arise.

Loans and receivables, originated by the enterprise by providing money, goods or services are provided to construction companies to finance site development projects, and to consumer credit organisations, and classified as originated investments. These assets are measured at amortised cost.

Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets; during the period the Group did not hold any investments in this category.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; during the period the Group did not hold any investments in this category.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Property, plant and equipment

All property, plant and equipment is recorded at historical cost, less depreciation.

Depreciation is calculated on the straight line method so as to write off the cost of each asset to their residual values over their estimated useful life as follows:

	Years
Buildings	20 - 40
Office equipment	3 - 10
Plant and machinery	10 - 15
Plantations and livestock	2 - 15
Leasehold improvements	3 - 8

Land is not depreciated as it is deemed to have an indefinite life and construction in progress is not depreciated until put in use.

Where the carrying amount of an asset is greater than its estimated recoverable amount it is written down to its recoverable amount.

Gains and losses on disposal of property, plant and equipment are determined by reference to their carrying amounts and are taken into account in determining operating profit.

Borrowing costs relating to the financing of the construction of property, plant and equipment are expensed as incurred.

Impairment of long lived assets

Property, plant and equipment and other non-current assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount which is higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

Investment property

Investment property, principally comprising office buildings, is held for long-term rental yields and is not occupied by the Group. Investment property is stated at historical cost less depreciation and impairment losses. Depreciation is calculated on the straight-line method to write off the cost of investment property to their residual values over estimated useful lives. Estimated useful lives of investment property are the same as those of similar property, plant and equipment. Gains or losses on disposal of investment property are determined by reference to their carrying amounts and are taken into account in determining operating profit.

Inventories

Inventories are stated at the lower of cost or net realisable value, using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads, but excludes interest expense. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

Trade receivables

Trade receivables are carried at original invoice amount. An estimate is made for doubtful receivables based on a review of all outstanding amounts at the year end. Provisions made for impairment are written off during the year in which they are determined as such.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, deposits held on call with banks, and investments in money market instruments, excluding bank overdrafts. In the balance sheet, bank overdrafts are included in borrowings under current liabilities. Cash and cash equivalents are carried in the balance sheet at cost.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Deferred income taxes

Deferred income tax is provided, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Currently enacted tax rates are used to determine deferred income tax.

The principal temporary differences arose from: revaluations of certain non-current assets, provisions for retirement benefits and jubilee bonuses, tax losses carried forward and certain other provisions recognised only for tax purposes, reflected in the statutory financial statements of the Group and not in the IFRS financial statements. Deferred tax assets relating to the carryforward of unused tax losses are recognised to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilised.

Borrowings

Borrowings are recognised initially at the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowing.

Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of finance cost is charged to the income statement over the lease period.

Property, plant and equipment acquired under finance leases is depreciated over the shorter of the useful life of the asset or the lease term.

Treasury shares

Where the company or its subsidiaries purchases the company's equity share capital, the consideration paid including any attributable incremental external costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

Dividends

Until formal approval is obtained in the annual general meeting, proposed dividends are treated as retained earnings.

Audited Consolidated Financial Statements of the Mercator Group in Accordance with International Financial Reporting Standards

Consolidated Income Statement of the Mercator Group for the Year Ended 31 December 2002

(all amounts in millions of Slovenian tolar)	31. 12. 2002	31. 12. 2001
Sales	319,777	285,675
Cost of sales	(234,255)	(210,362)
Gross profit	85,522	75,313
Other operating revenues	4,844	2,444
Selling and distribution costs	(60,967)	(50,446)
Administrative expenses	(14,576)	(13,140)
Operating profit	14,823	14,171
Net finance costs	(7,194)	(6,603)
Share of result before tax of associated undertakings	121	220
Profit before tax	7,750	7,788
Tax	(668)	36
Group profit before minority interest	7,082	7,824
Minority interest	(123)	79
Net profit	6,959	7,903
Earnings per share in tolar	2,169	2,463

Consolidated Balance Sheet of the Mercator Group as at 31 December 2002

(all amounts in millions of Slovenian tolar)	31. 12. 2002	31. 12. 2002	31. 12. 2001	31. 12. 2001
Assets				
Non-current assets				
Property, plant and equipment	131,296		117,994	
Investment property	4,113		3,441	
Intangible assets	431		437	
Goodwill and negative goodwill	(774)		(968)	
Investments in associated undertakings	1,356		1,319	
Other investments	999		1,160	
Non-current receivables	731		896	
Deferred tax assets	5,655		6,122	
		143,807		130,401
Current assets				
Inventories	34,695		31,217	
Financial investments	1,030		2,903	
Trade and other receivables	26,155		26,306	
Prepaid expenses	689		757	
Cash and cash equivalents	3,053		2,724	
		65,622		63,907
Total assets		209,429		194,308

**Consolidated Balance Sheet of the Mercator Group as at 31 December 2002
(continued)**

(all amounts in millions of Slovenian tolar)	31. 12. 2002	31. 12. 2002	31. 12. 2001	31. 12. 2001
Equity and liabilities				
Capital and reserves				
Ordinary shares	32,085		32,085	
Share premium	619		618	
Retained earnings	32,957		27,281	
Other reserves	234		-	
		65,895		59,984
Minority interest		4,552		5,037
Non-current liabilities				
Borrowings	61,097		39,563	
Provisions for employee benefits	464		370	
		61,561		39,933
Current liabilities				
Trade and other payables	43,763		42,148	
Accruals	1,644		1,738	
Borrowings	30,765		44,737	
Other provisions	1,249		731	
		77,421		89,354
Total liabilities		138,982		129,287
Total equity and liabilities		209,429		194,308

Consolidated Cash Flow Statement of the Mercator Group for the Year Ended 31 December 2002

(all amounts in millions of Slovenian tolar)	31. 12. 2002	31. 12. 2001
Cash flows from operating activities		
Cash generated from operations	19,823	17,950
Interest received	786	1,542
Interest paid	(7,623)	(8,348)
Tax paid	(240)	(568)
Net cash from operating activities	12,746	10,576
Cash flows from investing activities		
Acquisition of subsidiaries, net of cash acquired	(1,040)	(2,676)
Purchase of property, plant and equipment	(22,400)	(31,421)
Purchase of intangible assets	(212)	(252)
Movement on non-current investments	(197)	(859)
Purchase of current investments	-	(2,485)
Loans made	(1,439)	(752)
Disposal of subsidiary, net of cash disposed	255	872
Proceeds from sale of property, plant and equipment	4,561	6,268
Proceeds from sale of current investments	3,187	1,490
Proceeds from sale of intangible assets	1	47
Dividends received	85	68
Loan repayments received	589	1,321
Net cash used in investing activities	(16,610)	(28,379)
Cash flows from financing activities		
Purchase of treasury shares	(14)	(1,059)
Proceeds from borrowings	50,748	55,985
Repayments on borrowings	(45,276)	(36,210)
Dividends paid	(1,283)	(964)
Net cash from financing activities	4,175	17,752
(Decrease)/increase in cash and cash equivalents	311	(51)
Movement in cash and cash equivalents		
At beginning of year	2,724	2,775
(Decrease) / increase	311	(51)
Effects of exchange rate changes	18	-
At end of year	3,053	2,724

Consolidated Statement of Changes in Shareholders' Equity

(all amounts in millions of Slovenian tolar)	Ordinary shares	Share premium	Treasury shares	Retained earnings	Other reserves	Total
Balance at 1 January 2001	32,085	600	-	20,342	-	53,027
Net profit	-	-	-	7,903	-	7,903
Sale of treasury shares	-	18	1,059	-	-	1,077
Purchase of treasury shares	-	-	(1,059)	-	-	(1,059)
Dividend payments	-	-	-	(964)	-	(964)
Currency translation differences	-	-	-	-	-	-
Balance at 31 December 2001	32,085	618	-	27,281	-	59,984
Balance at 1 January 2002	32,085	618	-	27,281	-	59,984
Net profit	-	-	-	6,959	-	6,959
Sale of treasury shares	-	1	14	-	-	15
Purchase of treasury shares	-	-	(14)	-	-	(14)
Dividend payments	-	-	-	(1,283)	-	(1,283)
Currency translation differences	-	-	-	-	234	234
Balance at 31 December 2002	32,085	619	-	32,957	234	65,895

According to Slovenian legislation only a portion of the retained earnings of the parent company are available for distribution at 31 December 2002. These amounted to 4,473 million tolar, of which 1,444 million tolar (SIT 450 per share) will be proposed to the General Meeting for distribution to its shareholders in 2003.

Notes to the Consolidated Financial Statements of the Mercator Group

The consolidated financial statements of the Mercator Group include the financial statements of Poslovni sistem Mercator, d.d., the parent company, and the financial statements of all subsidiary companies, in which the parent company directly or indirectly, holds a majority shareholding.

Due to activities related to mergers and acquisitions and on account of consolidation within the Group, the following changes in the structure of the Mercator Group occurred in 2002:

- The subsidiary companies TT-Trgotehna, d.o.o., Belpana, d.o.o. and MDK-H, d.o.o. were established in 2002.
- In September Slosad, d.o.o. was merged with Eta, d.d.
- In December 2002 the parent company Poslovni sistem Mercator, d.d. sold its majority stake in the company Mercator Sremič, d.o.o.

The financial statements of the Mercator Group are prepared and fully comply with International Financial Reporting Standards, but it has to be emphasised that the only financial statements that are legally required in Slovenia are the financial statements of the parent company Poslovni sistem Mercator, d.d., prepared in accordance with Slovenian Accounting Standards.

In the notes all amounts are shown in millions of Slovenian tolar unless otherwise stated.

Segment information

The Group is organised into two main business segments:

- Trade which consist of retail and wholesale of fast moving consumer goods, apparel goods and technical goods. Fast moving consumer goods trade represent the core business of the Mercator Group.
- Non-trade which consists of food-processing, agriculture and hospitality & other services.

Primary reporting format - business segments

Year ended 31 December 2002	Trade	Domestic Trade	Trade in Fore- ign Markets	Non-trade	Elimina- tions	Group
Revenues-external	305,084	273,932	31,152	14,693	-	319,777
Revenue from other segments	2,859	1,636	1,223	11,787	(14,646)	-
Segment revenues	307,943	275,568	32,375	26,480	(14,646)	319,777
Segment result	11,298	11,913	(615)	816	2,709	14,823
Finance cost (net)	(4,060)	(2,720)	(1,340)	(502)	(2,632)	(7,194)
Share of associates						121
Profit before tax						7,750
Tax	(545)	(541)	(4)	(123)	-	(668)
Group profit						7,082
Minority interest						(123)
Net profit						6,959
Segment assets	273,147	223,563	49,584	25,828	(96,557)	202,418
Associates						1,356
Deferred tax assets						5,655
Total assets						209,429
Segment liabilities	162,467	122,481	39,986	11,440	(34,925)	138,982
Capital expenditure	22,801	8,846	13,955	1,690	-	24,491
Depreciation and amortisation	8,053	6,366	1,687	1,093	-	9,146
Negative goodwill amortisation	(1,020)	(1,020)	-	(92)	-	(1,112)
Impairment charge	(371)	-	(371)	-	-	(371)

Primary reporting format - business segments

Year ended 31 December 2001	Trade	Domestic Trade	Trade in Fore- ign Markets	Non-trade	Elimina- tions	Group
Revenues-external	271,158	252,604	18,554	14,517	-	285,675
Revenue from other segments	1,101	1,086	15	10,653	(11,754)	-
Segment revenues	272,259	253,690	18,569	25,170	(11,754)	285,675
Segment result	11,595	12,093	(498)	22	27	11,645
Finance cost (net)	(1,724)	(1,031)	(693)	(585)	(1,769)	(4,078)
Share of associates						220
Profit before tax						7,788
Tax	227	227	-	(191)	-	36
Group profit						7,824
Minority interest						79
Net profit						7,903
Segment assets	245,821	219,079	26,742	23,330	(82,284)	186,867
Associates						1,319
Deferred tax assets						6,122
Total assets						194,308
Segment liabilities	149,759	129,979	19,780	10,006	(30,479)	129,286
Capital expenditure	31,674	19,316	12,358	1,056	-	32,730
Depreciation and amortisation	6,623	5,883	740	1,053	-	7,676
Negative goodwill amortisation	(1,300)	(1,300)	-	-	-	(1,300)

Secondary reporting format - geographical segments

Although the Group's business segments are managed centrally, they operate in two main geographical areas:

- Slovenia is the home country of the parent company which is also the main operating company. The areas of operation in Slovenia are: trade (retail and wholesale), food-processing, agriculture and hospitality & services.
- Former Yugoslav countries, which include Croatia, Bosnia-Herzegovina and Serbia. The area of operations in these countries is trade (retail).

Country	Sales		Total assets		Capital expenditure	
	2002	2001	2002	2001	2002	2001
Slovenia	291,220	268,376	249,187	171,988	10,337	18,024
Former Yugoslav countries	33,423	18,677	49,787	33,650	14,154	14,706
Inter-segment	(4,866)	(1,378)	(89,545)	(11,330)	-	-
Total	319,777	285,675	209,429	194,308	24,491	32,730

Operating profit

The following items have been charged or credited in arriving at operating profit:

	2002	2001
Depreciation on property, plant and equipment	8,657	7,251
Impairment of property, plant and equipment	371	-
Net gain on disposal of property, plant and equipment (included in 'Other operating revenues')	(2,327)	(1,644)
Repair and maintenance expenditure	3,327	2,651
Amortisation of intangible assets		
- goodwill (included in 'Administrative expenses')	274	275
- other intangibles assets (included in 'Administrative expenses')	216	150
Amortisation of negative goodwill (included in 'Other operating revenues')	(1,112)	(1,300)
Rent expense	996	944
Staff costs	43,316	39,215
Impairment of receivables, net	570	869

Staff costs

	2002	2001
Wages and salaries	30,108	26,802
Social security costs	5,368	4,510
Other payroll costs - including accrued vacation pay	7,840	7,903
	43,316	39,215

The average number of persons employed by the Group during the year (calculated based on hours worked) was 13,915 (2001: 13,283).

Finance costs (net)

	2002	2001
Interest income	786	1,542
Revenue from investments	209	47
Other financial revenues including gains	205	238
Finance income	1,199	1,827
Net foreign exchange transaction (losses)	(513)	(30)
Interest expense	(7,623)	(8,348)
Realised and unrealised losses on financial investments	(256)	(52)
Finance costs	(7,880)	(8,400)
Net finance costs	(7,194)	(6,603)

Tax

	2002	2001
Current tax	240	568
Deferred tax	427	(572)
Share of tax of associated undertakings	-	(32)
Tax charge/(credit)	668	(36)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

	2002	2001
Profit before tax	7,750	7,788
Expected tax calculated at the rate of 25 %	1,937	1,947
Income not subject to tax	-	(454)
Expenses not deductible for tax purposes	1,041	835
Utilisation of tax reliefs	(2,310)	(2,364)
Tax charge/(credit)	668	(36)

Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Company and held as treasury shares. There are no dilutive ordinary shares.

	2002	2001
Net profit attributable to shareholders (millions of tolar)	6,959	7,903
Number of ordinary shares in issue	3,208,504	3,208,504
Basic earnings per share (tolars)	2,169	2,463

Property, plant and equipment

	Land and buildings	Plant and machinery	Office and other equipment	Leasehold improvements	Livestock and plantation	Construction in progress	Total
Costs							
At 31 December 2001	124,489	12,001	26,684	566	219	8,321	172,280
Exchange differences	700	-	131	-	-	79	910
Acquisition of subsidiaries	1,040	-	-	-	-	-	1,040
Additions	16,789	2,096	3,025	-	65	376	22,351
Disposals / transfers	(4,071)	(3,333)	(1,148)	-	(127)	(329)	(9,009)
As at 31 December 2002	138,947	10,764	28,691	566	157	8,447	187,572
Accumulated depreciation							
At 31 December 2001	32,609	5,306	15,979	363	29	-	54,286
Exchange differences	68	-	37	-	-	-	105
Charge for the year	3,723	2,035	2,501	56	14	-	8,328
Impairment charge	371	-	-	-	-	-	371
Disposals / transfers	(2,909)	(3,011)	(865)	-	(29)	-	(6,814)
As at 31 December 2002	33,861	4,330	17,652	419	14	-	56,276
2002 Net book value	105,086	6,435	11,039	147	143	3,921	131,296
2001 Net book value	91,880	6,695	10,705	203	190	8,321	117,994

Bank borrowings are secured by land and buildings with carrying value of 4,410 million tolar at 31 December 2002 (7,830 million tolar at 31 December 2001).

As a result of changes in local accounting standards Mercator Group appraised its land and buildings. A valuation was obtained on the basis of fair market value by an independent registered valuer and compared with carrying values. As a result, an impairment charge as of 31 December 2002 in the amount of 371 million tolar relating to buildings was recorded to reduce its carrying value to recoverable value.

Total recoverable value of land and buildings amounts to 146,863 million tolar as of 31 December 2002.

Investment property

	2002	2001
Costs		
At beginning of year	5,643	5,417
Additions	2,140	510
Disposal / transfer	(2,042)	(284)
At 31 December	5,741	5,643
Accumulated depreciation		
At beginning of year	2,202	1,946
Depreciation charge for the period	329	278
Disposal / transfer	(903)	(23)
At 31 December	1,628	2,202
Net book value at 31 December	4,113	3,441

Rental revenues from investment and other properties of 1,093 million tolar (2001: 965 million tolar) were recognised by the Mercator Group in 2002.

Fair values of investment property at 31 December 2002 are substantially equal to their book values.

Intangible assets

	2002	2001
Costs		
At beginning of year	709	406
Exchange differences	4	-
Acquisition of subsidiaries	-	115
Additions	212	252
Disposal / transfer	(6)	(64)
At 31 December	919	709
Accumulated amortisation		
At beginning of year	272	124
Exchange differences	1	-
Amortisation charge for the period	272	150
Disposal / transfer	(1)	(2)
At 31 December	488	272
Net book value at 31 December	431	437

Intangible assets represent expenditure on rights, patents and trademarks.

Investments in associated undertakings

	2002	2001
Opening net book amount	1,319	1,135
Share of results before tax	121	220
Share of tax credit	-	32
Net share of results of associates	121	252
Distribution of dividend	(85)	(68)
Closing net book amount	1,356	1,319

The principal associated undertakings are:

	% interest held 2002	% interest held 2001
Alpkomerc, d.d.	20	20
Spar Slovenija, d.o.o.	20	20

Both associated undertakings are incorporated in Slovenia.

Other investments

Other investments of 999 million tolar (2001: 1,160 million tolar) refer to diversified investments in other companies.

Non-current receivables

Non-current receivables of 731 million tolar (2001: 896 million tolar) comprise mainly loans given to employees for housing, the majority of which are secured by bills of exchange.

The current portion of the above items are shown in Note: Financial investments (tradable and non-tradable).

Loans are denominated in Slovenian tolar with the following weighted average interest rates:

(in %)	2002	2001
Other loans	10.3	13.3 (T+4.7)

The non-current receivables are expected to mature as follows:

	2002	2001
Between 1 and 2 years	57	8
Between 2 and 3 years	137	276
Between 3 and 4 years	184	131
Between 4 and 5 years	307	179
Later than 5 years	46	302
	731	896

“T” represents the base interest rate used by Slovenian banks and is an approximation of the average inflation in the last 12 months. The average “T” for the 2002 year was 7.7 % (2001: 8.6 %).

Inventories

	2002	2001
Raw materials	1,368	1,351
Work in progress	3,008	2,868
Finished goods	935	1,120
Merchandise	30,717	26,686
Advances paid for inventories	167	340
Less: Provision for impairment of inventories	(1,500)	(1,148)
	34,695	31,217

Trade and other receivables

	2002	2001
Trade receivables	26,824	27,001
Receivables from associated undertakings	2,281	1,788
Other receivables	116	13
Less: Provision for impairment of receivables	(3,066)	(2,496)
	26,155	26,306

Financial investments (tradable and non-tradable)

	2002	2001
Tradable financial investments	2	2,517
Loans, originated by the enterprise	1,028	386
	1,030	2,903

Tradable financial assets are carried at fair value which represents the market value of each financial asset at year end.

Prepaid expenses

Prepaid expenses of 689 million tolar (2001: 757 million tolar) comprise mainly accrued supplier rebates and prepaid items.

Cash and cash equivalents

	2002	2001
Cash at bank and in hand	3,053	2,724

Trade and other payables

	2002	2001
Trade payables	38,856	35,178
Amounts due to associated undertakings	32	23
Social security and other taxes	2,429	4,462
Other payables	2,446	2,485
	43,763	42,148

Accruals

Accruals of 1,644 million tolar (2001: 1,738 million tolar) comprise mainly accrued discounts payable on bonus points to the holders of Mercator-Pika loyalty cards.

Borrowings

	2002	2001
Current		
Revolving bank borrowings	29,858	43,905
Loans from other companies	907	832
	30,765	44,737
Non-current		
Bank borrowings	55,465	37,733
Loans from other companies	5,632	1,830
	61,097	39,563
Total borrowings	91,862	84,300

The interest rate exposure of the borrowings of the Group was as follows:

	2002	2001
Total borrowings:		
- at fixed rates	21,900	31,191
- at floating rates	69,962	53,109
	91,862	84,300

The weighted average effective interest rates of borrowings at balance sheet date, nominated in Slovenian tolar were as follows:

(in %)	2002	2001
bank borrowings:		
- short-term	10.9	12.7 (T+4.1)
- long-term	11.9 (T+4.6)	13.6 (T+5.0)
loans from other companies	9.6	11.9 (T+3.3)

“T” represents the inflation index used by Slovenian banks, which is the average inflation for the preceeding 12 month period. In January 2002 “T” was 7.3 %, in December 2002 7.3 % and the average yearly “T” in 2002 was 7.7 %. In January 2001 it was 8.6 %, in December 2001 7.3 %. The average yearly “T” was 8.6 % in 2001.

Floating rates mainly refer to interest rates linked to EURIBOR. Fixed rates mainly refer to loans from domestic banks with fixed real interest rate, but linked to the inflation index “T”.

The carrying amount of all borrowings approximate fair values.

The weighted average effective interest rates of borrowings at balance sheet date, denominated in foreign currencies were as follows:

(in %)	2002	2001
bank borrowings:		
- short-term	5.1	5.4
- long-term	4.4	5.1
loans from associated undertakings	5.1	5.8
loans from other companies	6.0	5.4

The currency structure of borrowings in millions of tolar:

	2002	2001
in Tolars	20,375	30,578
in EUR	70,207	51,922
in Croatian Kuna (HRK)	596	1,036
in Swiss Francs (CHF)	684	764
	91,862	84,300

Maturity of non-current borrowings:

	2002	2001
Between 1 and 2 years	16,757	6,870
Between 2 and 3 years	15,551	12,049
Between 3 and 4 years	9,018	6,989
Between 4 and 5 years	11,515	7,638
Over 5 years	8,256	6,017
	61,097	39,563

Finance lease liabilities - minimum lease payments:

	2002	2001
Not later than 1 year	409	108
Later than 1 year and not later than 5 years	1,640	430
Later than 5 years	5,815	1,487
	7,864	2,025
Future finance charges on finance leases	2,334	669
Present value of finance lease liabilities	5,530	1,356

The present value of finance lease liabilities is as follows:

	2002	2001
Not later than 1 year	177	42
Later than 1 year and not later than 5 years	788	191
Later than 5 years	4,565	1,123
	5,530	1,356

The carrying values of all borrowings approximate fair values. The percentage of non-current borrowings within total borrowings was 67 % at 31 December 2002 (47 % at 31 December 2001). In 2002 the Group improved the term structure of borrowings by refinancing a substantial portion of current borrowings with non-current borrowings.

Deferred income taxes

Deferred income taxes are calculated on all temporary differences under the liability method using a principal tax rate of 25 % (2001 : 25 %).

The movement in the deferred income tax account is as follows:

	2002	2001
At beginning of year - net deferred tax asset	6,122	5,550
Income statement (charge)/credit	(427)	572
Disposal of subsidiary	(40)	-
At end of year - net deferred tax asset	5,655	6,122

The deferred tax assets and liabilities and deferred tax (charge)/credit in the income statement are attributable to the following items:

	31 December 2001	(Charged) / credited to income	31 December 2002
Deferred income tax liabilities			
Provisions and other items	(710)	(191)	(901)
	(710)	(191)	(901)
Deferred income tax assets			
Provisions not recognised for tax purposes	53	23	76
Intangible assets revaluation not recognised for accounting purposes	78	-	78
Tangible assets revaluation not recognised for accounting purposes	6,701	(259)	6,442
Disposal of subsidiary	-	(40)	(40)
	6,832	(276)	6,556
Net deferred income tax asset	6,122	(467)	5,655

As the deferred tax assets and liabilities are with the same fiscal authority they are netted in the balance sheet.

Potential tax benefits from tax loss carry forwards existing on 31 December 2002 are as follows:

Expiring in:	
2005	79
2006	786
2007	625
Total	1,490
Less valuation allowance:	(1,490)
	0

Provision for employee benefits

	2002	2001
Provision for jubilee and retirement payments	464	370

Provisions are made for the estimated liability of statutory retirement payments and jubilee (long service) bonuses as a result of service rendered by employees up to the balance sheet date, discounted to present value. The above provision has been made for expected payments. In 2002 additional provision of 94 million tolar was made.

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The cost of social security payments is expensed in the same period as the related salary cost. The Group is paying contributions for its employees to a voluntary additional collective pension insurance plan according to the Law on pension insurance from 1 January 2001, from which the Group has no future obligations.

Other provisions

	Denationalisation claims	Environmental liabilities	Legal claims	Total
At 31 December 2001	536	80	115	731
Additional provisions	64	-	-	64
Utilised during year	(25)	-	-	(25)
Reclassification from accruals	-	-	479	479
At 31 December 2002	575	80	594	1,249

Denationalisation claims refer to potential liabilities of the Group arising from the Law on Denationalisation. Management is at present unable to estimate the timing of cash outflows relating to denationalisation claims. Environmental liabilities refer to potential liabilities of the Group arising from the Law on Privatisation.

Group companies are the defendants in various legal actions provided for under obligations for legal claims. In the opinion of management, after taking appropriate legal advice, the outcome of other legal actions will not give rise to any significant unprovided loss.

Goodwill and negative goodwill

	Goodwill	Negative goodwill	Total
Goodwill			
At 31 December 2001	1,370	(4,914)	(3,544)
Additions	-	(645)	(645)
Disposals	-	-	-
At 31 December 2002	1,370	(5,558)	(4,188)
Accumulated amortisation			
At 31 December 2001	478	(3,054)	(2,576)
Amortisation charge/(credit) for the period	274	(1,112)	(838)
At 31 December 2002	752	(4,166)	(3,414)
Net book value at 31 December 2002	618	(1,392)	(774)
Net book value at 31 December 2001	892	(1,860)	(968)

Financial instruments

The Group adopted IAS 39 on 1 January 2001. The adoption did not have any financial impact on the Group's financial statements, since the Group did not hold any derivative financial instruments, hedges, and available-for-sale assets as of 1 January 2001.

At 31 December 2002 the Group did not hold derivative financial instruments, hedges, available-for-sale assets or held-to-maturity assets.

Contingent liabilities

At 31 December 2002 the Group had no contingent liabilities in respect of bank and other guarantees or other matters arising in the ordinary course of business from which it is anticipated that material unprovided liabilities will arise.

Commitments

The amount of capital expenditure contracted for at the balance sheet date but not recognised in the financial statements was as follows:

	2002	2001
Property, plant and equipment	5,920	16,647

Certain of these commitments are denominated in EUR. Management consider, that due to the close correlation of the movement in the domestic currencies/EUR exchange rates with domestic inflation rates, there are no significant financial impacts of these commitments that need to be accounted for at 31 December 2002.

The Group does not have any significant non-cancellable leases at 31 December 2002.

Minority interest

	2002	2001
At start of year	5,037	5,701
Increase in capital share of existing subsidiaries	(608)	(121)
Acquisition of subsidiaries	-	573
Share of net profit / (loss) of subsidiaries	123	(79)
Disposal of subsidiary	-	(1,037)
At end of year	4,552	5,037

Cash generated from operations

	2002	2001
Profit before tax	7,750	7,788
Adjustments for:		
Depreciation	8,656	7,251
Amortisation	490	425
Impairment charge	371	-
Net gain on sale of property, plant and equipment	(2,327)	(1,644)
Loss on disposal of subsidiary	174	-
Interest income	(786)	(1,542)
Amortisation of negative goodwill	(1,112)	(1,300)
Interest expense	7,623	8,348
Currency translation differences	234	-
Share in results of associated undertakings	(121)	(220)
	20,952	19,105
Changes in working capital (excluding the effects of acquisition and disposal of subsidiaries):		
- trade and other receivables	191	(5,383)
- inventories	(3,485)	(600)
- payables	2,071	4,821
- provisions	94	7
Cash generated from operations	19,823	17,950

Disposal of subsidiary

At the end of the year 2002 the Group disposed of its interest in the company Mercator Sremlč, d.o.o. The sales, results and net cash flows for this company in 2002 were as follows:

	2002
Sales	251
Operating costs	(275)
Operating (loss)	(24)
Finance income (net)	9
(Loss) before tax	(16)
Deferred tax	(3)
Net (loss)	(19)
Non-current assets	344
Current assets	118
Total assets	461
Total liabilities	33
Net assets	429
Less minority interest	-
Groups share of net assets	429
Proceeds from sale	255
Loss on disposal of subsidiary	174

Related party transactions

Related party transactions refer to transactions with associated undertakings and are as follows:

	2002	2001
Sales to associated undertakings	19,243	14,884
Receivables from associated undertakings	2,417	1,788
Payables due to associated undertakings	43	23

Sales to associated undertaking were carried out on commercial terms and at market prices.

There were no loans given to directors. Total emoluments to members of the Management Board equalled 278 million tolar in the year 2002.

Management Responsibility Statement

The consolidated financial statements are the responsibility of the Company's management. The consolidated financial statements present a true and fair view of the financial position of the Group at 31 December 2002, and of the results of its operations and changes in financial position for the year then ended.

Management confirms that appropriate accounting policies are applied on a consistent basis and that the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures are based on principle of prudence. Management is responsible for ensuring an appropriate accounting and internal control structure to protect the assets of the Group and comply with relevant laws and regulations.

Management also confirms that the consolidated financial statements with disclosures are prepared under the going concern assumption and in accordance with International Financial Reporting Standards which include the standards and interpretations issued by the IASB and SIC.

On behalf of the Board of Directors:

Jadranka Dakič
Member of the Board of Directors
for Finance, Controlling and Accounting



Zoran Janković
President of the Board of Directors



Report of the Auditors

To the Management of Poslovni sistem Mercator, d.d.

We have audited the accompanying balance sheet of Poslovni Sistem Mercator, d.d. (the Company) and its subsidiaries (the Group) at 31 December 2002 and the related income and cash flow statements for the year then ended. These financial statements set out on pages 94 to 120 are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the financial statements present fairly in all material respects the financial position of the Group at 31 December 2002 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

Ljubljana, 28 March 2003

Audited Financial Statements of the Parent Company Poslovni sistem Mercator, d.d. in Accordance with Slovenian Accounting Standards

Due to significant changes, made in Slovenian Accounting Standards in 2002 valid from 1 January 2002, all items in financial statements of the company Poslovni sistem Mercator, d.d. for 2001 year were properly adjusted. However, financial statements in years 2002 and 2001 are not fully comparable.

Balance Sheet of the Company Poslovni sistem Mercator, d.d. as at 31 December 2002

In SIT mn	2002	Year ended 31 December 2001
Assets		
Non-current assets	118,095	111,983
Intangible assets	371	436
Property, plant and equipment	50,594	43,859
Non-current financial investments	67,130	67,688
Current assets	43,472	42,416
Inventories	10,771	9,494
Trade and other receivables	19,117	17,688
Current financial investments	12,901	14,372
Cash and cash equivalents	683	862
Prepaid expenses	605	449
Total assets	162,172	154,848
Equity and liabilities		
Capital	79,802	76,311
Share capital	32,085	32,085
Share premium	652	651
Reserves	13,036	7,547
Retained earnings	2,148	3,805
Net profit for the year (undistributed)	2,325	2,790
Valuation adjustments of capital	29,556	29,433
Provisions	3,601	3,433
Non-current borrowings	36,258	29,182
Non-current trade and other payables	4,062	22
Current borrowings	13,365	24,238
Current trade and other payables	24,576	21,059
Accruals	508	603
Total equity and liabilities	162,172	154,848

Income Statement of the Company Poslovni sistem Mercator, d.d. for the Year Ended 31 December 2002

In SIT mn	Year ended 31 December	
	2002	2001
Sales	137,499	116,059
Cost of sales	(100,366)	(85,335)
Gross profit	37,133	30,724
Selling and distribution costs	(21,813)	(17,587)
Administrative expenses	(7,668)	(6,325)
Other operating revenues	964	526
Operating profit	8,616	7,338
Revenues from investments	2,702	3,959
Interest revenues from non-current receivables	512	263
Interest revenues from current receivables	1,433	1,984
Current and non-current investments write-offs	(3,416)	(3,231)
Interest expenses and other financial expenses	(5,106)	(5,372)
Profit from ordinary activities	4,741	4,940
Extraordinary revenues	17	1,138
Extraordinary expenses	(35)	(11)
Profit from extraordinary activities	(18)	1,128
Tax	(74)	(487)
Net profit	4,649	5,580

Cash Flow Statement of the Company Poslovni sistem Mercator, d.d. for the Year Ended 31 December 2002

In SIT mn	2002	Year ended 31 December 2001
Cash flows from operating activities		
Inflows from operating activities	136,896	112,422
Revenues relating to operating activities	138,463	116,585
Extraordinary revenues relating to operating activities	17	1,138
Increase in trade and other receivables	(1,430)	(5,130)
Increase in prepaid expenses	(156)	(171)
Outflows from operating activities	(120,548)	(99,929)
Expenses exclusive of depreciation and provisions	(126,625)	(105,728)
Extraordinary expenses relating to operating activities	(35)	(11)
Tax on profit and other taxes	(74)	(487)
Increase in inventories	(1,277)	(1,328)
Increase in trade and other payables	7,557	8,423
Increase in accruals	(95)	(798)
Net inflows/(outflows) from operating activities	16,346	12,493
Cash flows from investment activities		
Inflows from investment activities	4,732	3,959
Revenues relating to investment activities	2,703	3,959
Decrease in non-current investments	558	-
Decrease in current investments	1,471	-
Outflows from investment activities	(13,308)	(33,422)
Expenses relating to investment activities	(3,416)	(3,231)
Increase in intangible assets	(67)	(333)
Increase in property, plant and equipment	(9,825)	(13,584)
Increase in non-current investments	-	(14,042)
Increase in current investments	-	(2,233)
Net inflows/(outflows) from investment activities	(8,576)	(29,464)

Cash Flow Statement of the Company Poslovni sistem Mercator, d.d. for the Year Ended 31 December 2002 (continued)

In SIT mn	2002	Year ended 31 December 2001
Cash flows from financing activities		
Inflows from financing activities	9,313	23,797
Revenues relating to financing activities	1,945	2,247
Increase in capital (without net profit)	124	4,627
Increase in non-current borrowings	7,076	13,035
Increase in provisions	168	1,180
Increase in current borrowings	-	2,709
Outflows from financing activities	(17,262)	(6,335)
Expenses relating to financing activities	(5,106)	(5,372)
Decrease in capital (dividends paid)	(1,283)	(963)
Decrease in current borrowings	(10,873)	-
Net inflows/(outflows) from financing activities	(7,949)	17,462
Closing balance of cash and cash equivalents as at 31 Dec	683	862
Increase/(decrease) in year	(179)	492
Opening balance of cash and cash equivalents as at 1 Jan	862	370

The financial statements of the company Poslovni sistem Mercator, d.d. for the year ended 31 December 2002, prepared in accordance with Slovenian Accounting Standard have been audited by PricewaterhouseCoopers and an unqualified opinion was issued on 28 March 2003.

Overview of Contact Persons in the Company Poslovni sistem Mercator, d.d.

Divisions in the company Poslovni sistem Mercator, d.d.

Dunajska 107, 1001 Ljubljana
Telephone: 01 560-10-00
E-mail: info@mercator.si
Internet: www.mercator.si

Function	Name and surname	Telephone	E - mail
Board			
President of the Management Board and CEO	Zoran Janković	01 560-11-96	zoran.jankovic@mercator.si
Member of the Board for Corporate Activities and Non-trade Segment	Aleš Čerin	01 560-17-42	ales.cerin@mercator.si
Member of the Board for Finance, Controlling and Accounting	Jadranka Dakič	01 560-16-80	jadranka.dakic@mercator.si
Member of the Board for Marketing, Development, IT and Investments in Trade Segment	Marjan Sedej	01 560-16-77	marjan.sedej@mercator.si
Member of the Board for New Markets	Stanislav Brodnjak	01 560-17-66	stanislav.brodnjak@mercator.si
Marketing activities			
Vice President for Units Abroad	Mitja Marinšek	01 560-14-46	mitja.marinsek@mercator.si
Vice President for Trading	Franc Prvinšek	01 560-11-77	franc.prvinsek@mercator.si
Director of Projects Abroad	Marko Gvardjančič	01 560-12-57	marko.gvardjancic@mercator.si
Director for Centres Abroad	Franc Rezar	00 381 11 311-06-13	franc.rezar@mercator-s.co.yu
Director of Marketing	Mateja Jesenek	01 560-12-54	mateja.jesenek@mercator.si
Director of Retail Development	Jelka Žekar	01 560-17-22	jelka.zekar@mercator.si
Director of Investments	Marko Umberger	01 560-17-39	marko.umberger@mercator.si
Director of Grocery Retail Director of Fresh Food Retail	Andrej Sotelšek Jože Sadar	01 560-12-10 01 560-13-13	andrej.sotelsek@mercator.si joze.sadar@mercator.si
Director of Fruit and Vegetables Retail	Peter Sajovic	01 234-36-22	peter.sajovic@mercator.si

Function	Name and surname	Telephone	E - mail
Director of Non-food Retail	Irena Novinec	01 560-13-71	irena.novinec@mercator.si
Director of Sports and Clothing	Pavle Pirc	01 560-16-70	pavle.pirc@mercator.si
Director of Technical Products and Building Materials Retail	David Prinčič	01 560-16-61	david.princic@mercator.si
Director of Furniture Retail	Vinko Savnik	01 560-15-80	vinko.savnik@mercator.si
Director of Agency Services, Imports and Exports	Metka Nedelko	01 560-12-98	metka.nedelko@mercator.si
Director of Agency Services and Sales	Matjaz Pirc	01 560-14-13	matjaz.pirc@mercator.si
Director of IT and Organisation	Franc Kodela	01 560-11-90 02 749-31-00	franc.kodela@mercator.si
Director of Quality Control	Božo Virant	01 560-16-35	bozo.virant@mercator.si
Director of Retail	Peter Zavrl	01 560-32-74	peter.zavrl@mercator.si
Director of Wholesale	Srečko Bukovec	01 560-32-21	sreco.bukovec@mercator.si
Director of Logistics	Marko Cedilnik	01 560-32-20	marko.cedilnik@mercator.si
Finance, controlling and accounting activities			
Director of Finance	Dean Čerin	01 560-16-76	dean.cerin@mercator.si
Director of Controlling and Accounting	Žiga Debeljak	01 560-16-79	ziga.debeljak@mercator.si
Human resources, legal, internal and corporate activities			
Director of HRM	Aljoša Prajs	01 560-15-02	aljosa.prajs@mercator.si
Director of Legal Affairs	Vera Aljančič Falež	01 560-12-40	vera.aljancic@mercator.si

The Mercator Group

Trade companies

Poslovni sistem Mercator, d.d.

Head Office: Dunajska cesta 107, 1113 Ljubljana
President of the Management Board: Zoran Janković
Members of the Management Board: Aleš Čerin, Jadranka Dakič, Marjan Sedej, Stanislav Brodnjak

Emona Merkur, d.d.

Head Office: Dunajska cesta 107, 1113 Ljubljana
Director: Aleš Čerin

Žana, d.d., Žalec

Head Office: Mestni trg 2, 3310 Žalec
Director: Dolfe Naraks

Mercator - SVS, d.d.

Head Office: Rogozniška 8, 2250 Ptuj
President of the Management Board: Samo Gorjup
Member of the Management Board: Marjana Olstrak

Mercator Dolenjska, d.d.

Head Office: Livada 8, 8000 Novo mesto
President of the Management Board: Stanislav Hribar
Members of the Management Board: Janez Blažič, Lidija Jarc

Non-trade companies

MDK, d.d.

Head Office: Agrokombinarska 63, 1000 Ljubljana
Director: Anton Zorc

Eta, d.d.

Head Office: Kajuhova pot 4, 1240 Kamnik
Director: Franc Alojz

Pekarna Grosuplje, d.d.

Head Office: Gasilska 2, 1290 Grosuplje
Director: Štefan Plankar

Mercator - Emba, d.d.

Head Office: Slovenčeva 21, 1000 Ljubljana
Director: Mladen Mladenič

Mercator - KŽK Kmetijstvo Kranj, d.o.o.

Head Office: Begunjska ulica 5, 4000 Kranj
Director: Janez Tavčar

Mercator - H, d.o.o.

Head Office: Hrvatske bratske zajednice 1, 10410 Velika Gorica
President of the Management Board: Stanislav Brodnjak

Mercator - TC Sarajevo, d.o.o.

Head Office: Ložionička 16, 71000 Sarajevo
Director: Mensud Lagumdžija

Mercator - S, d.o.o.

Head Office: Bulevar umetnosti 4, 11070 Novi Beograd, ZRJ
Director: Vladimir Kravčuk

**Mercator
Degro, d.d.**

Head Office: Lucija, Obala 144,
6320 Portorož
**President of the Management
Board:**
Boris Požar
T 05 671-66-01
E boris.pozar@mercator.si
**Members of the Management
Board:**
Marinela Jankovič
T 05 671-66-03,
E marinela.jankovic@mercator.si
Mirko Milavec
T 05 671-66-02
E mirko.milavec@mercator.si

**Mercator
Gorenjska, d.d.**

Head Office: Kidričeva cesta
54, 4220 Škofja Loka
**President of the Management
Board:**
Ludvik Leben
T 04 51-10-102
E ludvik.leben@mercator.si
**Members of the Management
Board:**
Miro Podrekar
T 04 51-10-180
E miro.podrekar@mercator.si
Marjan Nagode
T 04 511-01-40
E marjan.nagode@mercator.si

**Mercator
Goriška, d.d.**

Head Office:
Gregorčičeva 19, 5000
Nova Gorica
**President of the
Management Board:**
Silvan Makuc
T 05 334-30-02
E goriska@siol.net

Trgoavto, d.d.

Head Office: Pristaniška
43/a, 6000 Koper
Director:
Igor Sepič
T 05 663-62-18
E igor.sepic@
mercator-trgoavto.si

**Mercator - Modna
hiša Maribor, d.o.o.**

Head Office: Partizanska 3-5,
2000 Maribor
Director:
Jožef Šilec
T 02 235-60-22
E jozef.silec@m-modnahisa.si

**Intermercator,
G.m.b.H**

Head Office: Bahnhofstr. 38,
c/V. Postfach 131.A-9021
Klagenfurt/Celovec
Director:
Stanislav Kavkler
T 00 43 463 516-262
E kavkler.intermercator@aon.at

M Hotel, d.o.o.

Head Office: Derčeva
ulica 4, 1000 Ljubljana
Director:
Sonja Černič Lagerwall
T 01 513-70-04
E sonja.cemic@m-hotel.si

**Mercator - Optima,
d.o.o.**

Head Office: Dunajska
cesta 105, 1113 Ljubljana
Director:
Primož Goslar
T 01 560-19-00
E primoz.goslar@
mercator-optima.si

