

# Business plan of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the year 2018



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# EXECUTIVE SUMMARY

**Mercator Group remains focused on its core activity, and improvement of profitability remains its key goal. Mercator Group sales revenue is budgeted at EUR 2.4 billion for 2018 and at EUR 2.5 billion for 2021.**

## **Macroeconomic conditions in the region**

In its Autumn 2017 Economic Forecast the European Commission expects further growth both in the euro zone and in the European Union, at a rate of 2.1% in 2018 and 1.9% in 2019. It will be fuelled by domestic and foreign spending. In Slovenia, economic growth will be even steeper in this year (3.5%) than it was in the previous years. In addition to further growth of exports and private spending, we are also expecting an increase in investment. Gross domestic product (GDP) in the first half of the year was up year-on-year, and the available activity and confidence indicators point to continuation of positive developments in the second half of the year as well. In Serbia and Montenegro, which are Mercator Group's key markets outside Slovenia, positive developments in gross domestic product are forecast. A downward trend in unemployment rate is forecast in Serbia. Unemployment rate in Montenegro will decrease, yet remain high.

## **Entry into the market of Bosnia and Herzegovina**

Mercator re-entered the market of Bosnia and Herzegovina. Transfer of possession and establishment of retail operations in 83 stores took place in September 2017. Mercator's goal is to offer the local consumers a new store concept as developed by Mercator, and especially a broad assortment tailored as closely as possible to the needs and desires of the customers.

## **Higher revenue budgeted**

Mercator Group revenue in 2018 is budgeted at EUR 2.4 billion. By 2021, revenue will increase by 3% to EUR 2.5 billion.

## **Improvement in performance to continue in the future**

In defining and conducting our marketing activities, focusing on satisfying the needs of modern consumers and offering well-priced shopping remain the key policies. Key target tasks are therefore geared towards improving Mercator's pricing perception. We offer our customers a wide assortment of genuine and local products. We pay particular attention to design and orderliness of our stores, and we implement new technologies and services. The new strategy has already had a positive effect on our operations, which is also reflected in improved performance. The performance improvement trend will continue in the future.

## **Divestment of business assets under way**

In 2018, Mercator Group will actively continue the procedures to divest its business assets. This will involve several steps. Divestment proceeds will mostly be allocated to deleveraging.

## **EUR 37.7 million earmarked for investment in 2018**

In 2018, Mercator Group investment will amount to EUR 37.7 million, of which 47.0% will be used for expansion of new retail area; 20.2% will be used for updates and investment maintenance of the existing retail units; 16.7% will be dedicated to IT investments; 5.1% to logistics investments; and 11.0% will be invested in non-trade operations. Investments in Slovenia will account for 64.5% of total investment funds.

# MERCATOR GROUP COMPOSITION

In 2018 Mercator Group will be composed of the following companies:



\*The company does not conduct business operations.

## Other Organizations

The company Poslovni sistem Mercator, d.d., is the founder of the Mercator Humanitarian Foundation whose purpose is provision of humanitarian aid to Mercator employees.

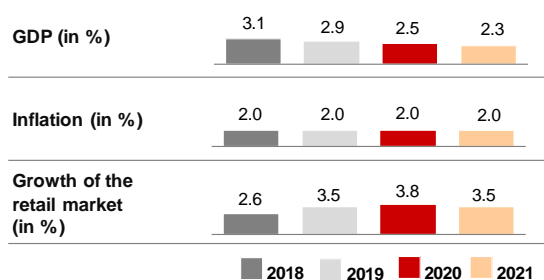
The company Mercator - S, d.o.o., is the founder of the Mercator Solidarity Foundation in Serbia, and Mercator - CG, d.o.o., is the founder of the Mercator Solidarity Foundation in Montenegro. The purpose of both is to provide solidarity aid to the employees in social or economic distress.

# EFFECT OF ECONOMIC CONDITIONS AND COMPETITION ON MERCATOR GROUP OPERATIONS IN THE PERIOD 2018–2021

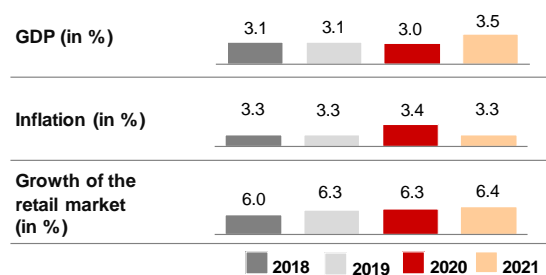
In its Autumn 2017 Economic Forecast the European Commission expects further growth both in the euro zone and in the EU, at a rate of 2.1% in 2018 and 1.9% in 2019. It will be fuelled by domestic and foreign spending. Private spending is expected to pick up pace as conditions in the labour market continue to improve; moreover, further recovery of investment is expected. Export growth will see a further increase, consistently with the expected growth of the global economy. Optimism regarding further growth and persistence of stimulative ECB policy have resulted in an improvement of lending terms for businesses and households, which in turn boosted the credit flows. In this year, the amount of credit extended to businesses has started to increase, and the growth of credit to households has increased, too. Conditions in the banking system continue to improve.

Forecasts are promising in the markets where Mercator is present as a retailer, with 3% GDP growth expected in all markets. Moreover, retail market growth is expected as well, with Serbia seeing the highest growth rate of 6%. More detailed macroeconomic forecasts for the period from 2018 to 2021 are presented below.

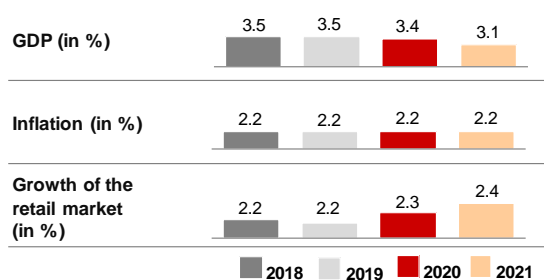
## Slovenia



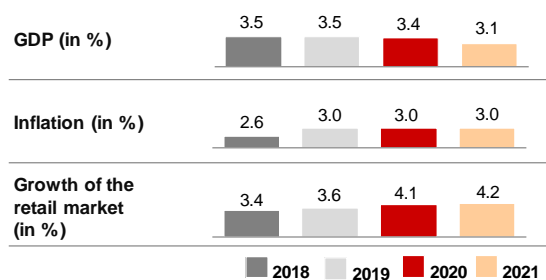
## Serbia



## Montenegro



## Bosnia and Herzegovina



## Changes in consumer behaviour and effect of the market situation on consumption

Favourable economic developments are expected to persist in 2018 in **Slovenia**. The dynamics of gross domestic product growth will rely in particular on high export growth, dynamics of state investments, and slower growth of employment. Expected improvement in the general economic situation and conditions in the labour market has had a positive effect on consumer confidence and it has provided an impetus to household consumption growth.

Similar trends are also estimated for **Serbia** and **Montenegro**. Positive developments are expected with regard to gross domestic product and household consumption. A downward trend in unemployment rate is forecast for Serbia. Unemployment will also decrease slightly in Montenegro, but it will remain high.

Consumer confidence improved in all markets in 2017; nevertheless, just under 50% of consumers in Slovenia still believe the country is in a recession. Majority of consumers (66%) do not expect any improvement in 2018<sup>1</sup>.

## MARKETING

### Store formats, and category management

#### Store formats

As to date, we shall continue to monitor in the years ahead the trends in retail in order to be better suited to tackle the challenges in this highly competitive activity. We shall respond to the changes in the environment and consumer shopping behaviour, and adjust the concepts of our stores accordingly. Innovation in implementation of new technological solutions will continue to play a major part. We shall continue to keep abreast of the new developments and maintain Mercator's leading position in innovative technological solutions and new store concepts. We are looking to offer our customers a shopping environment with modern design in as many locations as possible, and to provide a rich offer of products for everyday consumption, as we remain true to our slogan "Mercator: my best neighbour". On the other hand, we are also looking to optimize our operating revenue.

In 2018, we shall focus on updates of our **supermarkets**, which will involve an upgraded concept in terms of both offer and store design. We will be focused even more on the consumers to whom we are looking to offer the best shopping experience and value for money.

Also planned are refurbishments of **smaller store formats**, i.e. the neighbourhood stores that bring Mercator closest to the shoppers in their local environment. In 2018, we will also turn our attention to Mercator's largest format, the **hypermarket**, as several of these will be refurbished, too. The refurbishments are focused on strategic adjustment of the format to new conditions in the market. Thus, the relations and ratios between respective product categories will be adjusted; the assortment will be optimized with more stress will be placed on fresh program.

**New store design** and **new program mix concept** (with emphasis on fresh produce departments, in particular fruit and vegetables, and a bakery shop) will underscore Mercator's fundamental policy towards the consumers and our competitive edge, and thus it will pursue its mission of being the best local retailer in every market if its operations.



<sup>1</sup> Nielsen: Consumer Confidence Index, Q2 2017, Slovenia

## Category management and procurement

In the period 2015–2017, we completed the revision of the material operations processes. This will allow us to establish new, modern infrastructure and use it to more easily and much **more efficiently manage the range of retail units**, and to **make the work of employees at retail units easier**.

In 2018, we shall continue to actively support and **promote and local offer** at Mercator stores in all markets of our operations. At the same time, we will provide the most sought-after and best-selling products, while remaining mindful of the locally specific aspects of the various regions. We will be more efficient in our promotional activities. We shall introduce new features and maintain a neat and customer-friendly sales area. We shall continue to educate our sales staff in all departments and regions to provide quality offer.

Key category management activities will remain focused on the pursuit of the following key goals:

- establish quality multi-level offer of branded and private label products of various lines;
- provide competitive prices for renowned brands and private labels, and attractive offer in sales promotion activities;
- efficiently manage the store area at a level of particular products or product or categories, and the store as a whole; and
- providing appropriate sales service in our stores (at the point of sales).

## Marketing

Mercator's communication with the customers relies on five key areas:



### 1. Value for money

Mercator offers customers more for their money, and our price offer is continuously upgraded. Customer loyalty cards create a new and improved price offer.

## **2. Local**

Mercator's close bond with the local community is manifest in a broad offer of local produce that the customers can find on our shelves. Several thousand locally made fresh products are introduced and offered under the "We Love Local" project.

## **3. Freshness and quality**

Mercator offers its customers much more than high-quality products and services. This applies in particular to the category of fresh produce. Mercator's quality is based on freshness to which we pay particular attention in our stores' supply process.

## **4. Assortment**

At Mercator, we offer our customers the most relevant and innovative offer that meets their needs and expectations. Store assortment is tailored to the needs of respective stores. We introduce innovative products, we communicate with our customers throughout the year, and we provide a good shopping experience.

## **5. Unique service**

Mercator is striving to make its customers feel comfortable. Therefore, focus on the services is one of Mercator's key areas. We offer our customers a consistent experience across all key points of our communication (the store, call centre, internet, digital platforms etc.), which gives us a competitive edge.



# EMPLOYEES

Employees are at the core of our operations as they are the key to customer satisfaction and thereby to the attainment of Mercator's business goals. Our activities in human resource management will involve the following:

- **We are improving the efficiency** of the attainment of our goals (optimum usage of the available resources, competencies, and potentials according to the possibilities and situation in the market).
- **The employees are our competitive advantage** (quality of service based on integrity and friendly, respectful, and professional communication with the customers).
- Strategic human resource management **goals are changing** in compliance with the changes in the labour market, consistently with the business policies of the management, regional needs, and characteristics and possibilities or operational implementation at the local level.

**Our key goal is to have competent, satisfied, and motivated employees.**

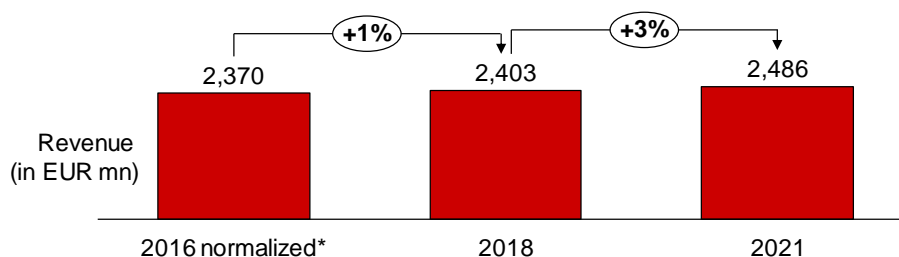


# PERFORMANCE HIGHLIGHTS OF MERCATOR GROUP FOR THE YEAR 2018<sup>2</sup>

## Revenue

In 2018, Mercator Group is planning to increase its revenue. Focus will be on the customer and a revised marketing strategy. In 2018, Mercator Group's total revenue will reach EUR 2.4 billion.

**Mercator Group revenue**

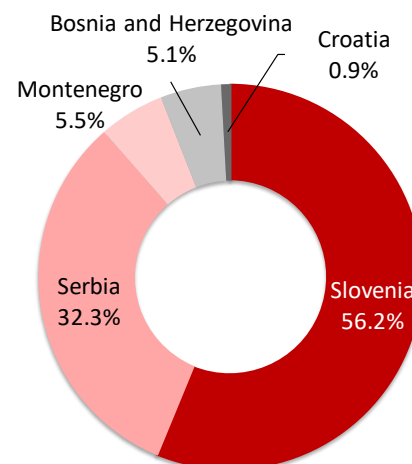


\* excluding the effect of Intersport and Modiana operations, impairment adjustments to receivables from Agrokor Group

## Revenue development by markets

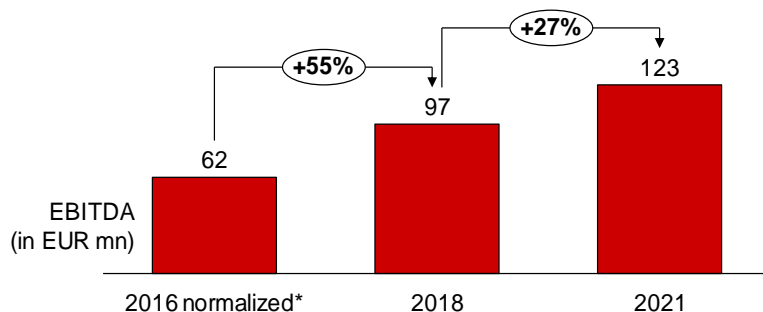
The highest share of revenue in 2018 will be generated in Slovenia (56.2%) and Serbia (32.3%), followed by Montenegro (5.5%). Revenue growth is also planned for the market of Bosnia and Herzegovina as Mercator resumed its retail operations at 83 stores in this country in September 2017. The lowest share of revenue will be generated in Croatia (0.9%) where Mercator retains its real estate management operations.

**Mercator Group revenue by markets - Plan 2018**



## Gross cash flow from operating activities

**Mercator Group EBITDA**



\* excluding the effect of Intersport and Modiana operations, impairment adjustments to receivables from Agrokor Group, extraordinary revenue of Mercator – S, d.o.o

Performance improvement will also be evident in the improvement of gross cash flow from operating activities (EBITDA) which will amount to EUR 97 million in 2018.

<sup>2</sup> Due to the comparability between periods the data do not include the impact of new standards on the statements (IFRS 9, IFRS 15, IFRS 16).

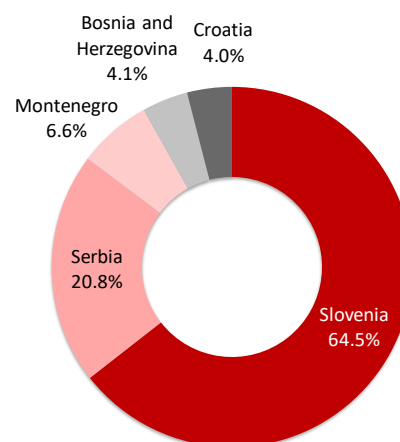
## Investment overview

In 2018, Mercator Group will further pursue its current real estate management strategy, which means that leasing real property will still be preferred to acquisition or construction of our own, and that priority will be given to refurbishment of the existing stores.

In 2018, Mercator Group investment will amount to EUR 37.7 million, nearly half of which will be allocated to new retail units. Majority of investments will be carried out in the markets of Slovenia and Serbia where the highest increase in store area and the most store refurbishments are planned. Of this amount, 64.5% will be invested in Slovenia, and 35.5% will be invested internationally.

Investment into expansion of retail area will account for 47.0% of total investment in 2018; refurbishments and investment maintenance of existing units will account for 20.2%; 16.7% will be invested in IT; 5.1% will be invested in logistics; and the remaining 11.0% will be invested in non-trade operations.

**Mercator Group investments by markets - Plan 2018**



## Deleveraging and divestment of business assets

In 2018, Mercator Group will continue to observe the covenants arising from the financial restructuring agreements, and well as those from other financial arrangements. Cash flow to be generated by Mercator Group in 2018 will be largely allocated to deleveraging or repayment of financial liabilities maturing in 2018. In 2018, we will resume our real estate divestment project. The divestment procedures will include several steps, and the proceeds will be used primarily for deleveraging.

## Working capital

With regard to inventory management, Mercator Group is planning improvements for 2018 resulting from the organization of responsibility of the purchasing / sourcing function, responsibility for the level of inventory, and responsibility for inventory optimization at the level of products and retail units. In receivables management, activities will take place to improve the structure of receivables, especially those from wholesale customers.