



**Business Report of the Mercator Group and the  
company Poslovni sistem Mercator, d.d.,  
for the period I – IX 2006**



Poslovni sistem Mercator, d.d.  
Management Board

November 2006

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## SUMMARY

**In the period January – September 2006, Mercator operates successfully and in line with the business plan**

**In the period I-IX 2006, the net revenues from sales of the Mercator Group amounted to SIT 351.3 billion, which is 18 % more than in the same period last year. Net profit of the Mercator Group in the period I-IX 2006 reached SIT 5.1 billion, which is 83.3 % of the net profit planned for the entire year 2006.**

Business results in the period I-IX 2006 and I-IX 2005 are not directly comparable as the profit in both periods was considerably influenced by some extraordinary accounting events, particularly the impairment of goodwill and fixed assets due to acquisition of Era companies and real-estate in Croatia in the year 2005, which amounted to SIT 4.1 billion, and the proceeds from the sale of shares to the company Sava, d.d., in the year 2005, in the amount of SIT 1.5 billion.

**If relevant single non-cash-related or extraordinary accounting proceeds are eliminated, the comparable net profit in the period I-IX 2006 amounted to SIT 4.5 billion, which is 20.2 % more than the comparable net profit in the period I-IX 2005, which amounted to SIT 3.8 billion.<sup>1</sup>**

Gross cash flow from operating activities, realized by the Mercator Group in the period I-IX 2006 amounted to SIT 22.6 billion, which is 19.9 % more than in the same period of the previous year, and represents 75.1 % of the planned value for 2006.

In the period I-IX 2006, total investments of the Mercator Group amounted to SIT 26.3 billion, the majority thereof being allocated in fixed assets.

As at September 30<sup>th</sup> 2006, the Mercator Group had 17,339 employees, 3,659 of which were employed outside Slovenia.

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

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<sup>1</sup> Detailed information on the calculation of comparable categories of net revenues from sales, profit before taxes and net profit are shown in the section Explanations to the consolidated financial statements.

## MAJOR EVENTS IN THE PERIOD I - IX 2006

### CORPORATE GOVERNANCE

The Supervisory Board of the company Poslovni sistem Mercator, d.d., met four times in the period I-IX 2006, and discussed the Business Plan of the Mercator Group for the year 2006, the unaudited and audited financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the year 2005, the Business Reports of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period I – III 2006 and I – VI 2006, adopted the reports on merging the companies Mercator – Modna hiša, d.o.o., Mercator – SVS, d.d., Emona Maximarket, d.d., and Alpkomerc Tolmin, d.d., to the company Poslovni sistem Mercator, d.d., took notice of the results of the appraisal of Era real-estate in Slovenia, adopted the proposed agenda and resolutions for the 12<sup>th</sup> regular Shareholders Assembly, approved the issue of new shares of the company Poslovni sistem Mercator, d.d., from the approved capital, and appointed Mr. Sušinski as the new vice-president of the Supervisory Board.

On May 17<sup>th</sup> 2006, the 12<sup>th</sup> regular meeting of the Shareholders Assembly of the company Poslovni sistem Mercator, d.d., was held. The agenda included passing the following resolutions:

- Resolution on the allocation of distributable profit and payment of dividends in the gross amount of SIT 600.00 per ordinary share,
- Resolution on the authorization to the management to purchase and dispose of treasury shares,
- Resolution to appoint PricewaterhouseCoopers, d.o.o., Ljubljana as the company auditor for 2006,
- Resolution proposed by the companies Pivovarna Laško, d.d., and Pivovarna Union, d.d., to appoint Deloitte & Touche, d.o.o., from Ljubljana, as a special auditor who will look into the management of some business transactions in the last five years.

At the Assembly, the Supervisory Board was discharged of responsibilities for the year 2005, while the discharge to the Management Board for the year 2005 was not passed.

## CONSOLIDATION OF OPERATING ACTIVITIES

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

On January 1<sup>st</sup> 2006, the retail operating activities of the company Alpkomerc Tolmin, d.d., were transferred to the controlling company; On April 1<sup>st</sup> 2006, the same was performed for the retail activities of the companies Mercator – Modna hiša, d.o.o., and Emona Maximarket, d.d.

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

On May 25<sup>th</sup>, the company Poslovni sistem Mercator, d.d., founded the company M.COM, d.o.o., Ljubljana, which to this date is not conducting any business operations.

On June 21<sup>st</sup> 2006, the merger of the real-estate management company Savski otok, d.o.o., with the company Poslovni sistem Mercator, d.d., was entered into the Court Register.

On September 1<sup>st</sup> 2006, the merger of the company M – Modna hiša, d.o.o., to the company Poslovni sistem Mercator, d.d., was duly entered into the Court Register.

In the period I – IX 2006, the company Poslovni sistem Mercator, d.d., performed a capital increase of its subsidiaries abroad in the amount of SIT 3,846 million.

## EXPANDING OUR OPERATIONS WITH CAPITAL TIES

On July 5<sup>th</sup> 2006, the companies Holding Rodić M&B and Poslovni sistem Mercator, d.d., signed the agreement on strategic partnership in the field of trade activities; the agreement was completed on October 19<sup>th</sup> 2006. Based on this agreement, Poslovni sistem Mercator, d.d., became a 76% owner of the company M-Rodić, d.o.o., while the remaining 24 % will be retained by the Holding Rodić M&B until 2008 (12 %) and 2009 (12 %) when the remaining shares will also be sold to Mercator. The company M-Rodić, d.o.o., is a newly incorporated company, to which all trade activities and pertaining assets, property and trademarks of the Holding Rodić M&B were transferred.

The agreed starting price for the purchase of 100 % of share capital of the company M-Rodić, d.o.o., Novi Sad, is EUR 152 million, whereby the part of the price pertaining to the 24 % ownership share is dependent on the business results of the company M-Rodić, d.o.o., in the years 2007 and 2008; thus, the final price shall presumably be between EUR 137 and 177 million, subject to results attained.

The purchase price will partly be paid for by shares of the company Poslovni sistem Mercator, d.d., partly by assuming financial responsibilities of the seller, and partly in cash.

When paying for the first 76 % ownership share in M-Rodić, d.o.o., the company Poslovni sistem Mercator, d.d., will pay EUR 30 million in shares, and the remaining part by other means; the two 12 % shares which shall be purchased in 2008 and 2009, will be paid for in shares entirely.

By establishing the strategic partnership, Mercator became the second largest trade company in Serbia, holding an approximately 8 % market share in 2007. Holding Rodić M&B, on the other hand, became one of the largest individual owners of the company Mercator, d.d. After the sales of 76% share of its company, it will acquire approximately 4.6 percent ownership of the company Mercator, d.d.; after the entire transaction will have been completed, this percentage will be accordingly higher.

## RETAIL NETWORK DEVELOPMENT

On April 12<sup>th</sup> 2006, we opened the renovated Mercator center in Samobor and an Intersport outlet at an elite location in the center of Zagreb, on Ban Jelačić Square.

On June 15<sup>th</sup> 2006, a new supermarket was opened in the Šentpeter parking garage which is located in the close vicinity of the Ljubljana University Medical Centre; the supermarket extends over 900 m<sup>2</sup>.

On June 21<sup>st</sup> 2006, the company Mercator – S, d.o.o., started the construction of a new Mercator facility - the Mercator Center Novi Sad. Not counting the garage/parking capacity, the facility will extend over 20,000 m<sup>2</sup> of surface; moreover, it will offer 499 roofed parking spots. Opening of the Mercator Center Novi Sad is scheduled for the third quarter of 2007.

On July 6<sup>th</sup> 2006 we opened a Trade Center in Mostar. It is located on a landed property of 6,015 m<sup>2</sup>. The facility has two storeys with a total surface of 5,170 m<sup>2</sup>. The ground floor also includes a garage with 116 parking spots, while the first floor features a 1,951 m<sup>2</sup> supermarket, Intersport, Modiana with a drugstore, Santana coffee bar and other leased outlets.

On August 3<sup>rd</sup> 2006 we opened a 784 m<sup>2</sup> supermarket in Novigrad. Total area of the main building located on landed property of 1,817 m<sup>2</sup> amounts to 1,784 m<sup>2</sup>. The facility also includes 82 parking spots, of which 20 are owned by Mercator, while the other ones are leased.

On September 26<sup>th</sup> 2006 we opened a Trade Center in Lesce. The center shares a larger commercial facility with Merkur. The area of the landed property that pertains to Mercator is 13,269 m<sup>2</sup>, while the relevant total area of the single storey building is 3,016 m<sup>2</sup>. Mercator also owns 250 outdoor parking spots.

## MARKETING ACTIVITIES

In January 2006, we started to upgrade our customer loyalty program. The project included devising a strategy of the Mercator Pika loyalty program, above all to establish a comprehensive CRM system (Customer Relation Management) and to include new benefits for the Mercator Pika card holders.

In order to improve price competitiveness and customer satisfaction, we employed innovative approaches to perform attractive new sales promotion activities: the "Yes!" campaign with purchases tied to Tuesdays, loyalty campaign of collecting bonus points for a present and favorable prices for the Tognana porcelain products, weekend campaigns with flagship fresh products "Clearly the lowest prices", and emphasizing the importance of a healthy diet with the "Vitamin of the day" campaign.

In June 2006, we founded the "Health & pleasure" club, intended for people of all ages, who share the idea of a healthy lifestyle. The first issue of the club's magazine "Health & pleasure" with the circulation of 40,000 was launched, offering special prices on products from this range.

As of August 1<sup>st</sup> 2006, Mercator was the first Slovenian retailer to enter the mobile communication market, by launching its pre-paid sets M mobil.

In 2006, we also started to develop a new generic line of the retailer brand products. The aim of this line is to offer the most favorable prices in the market. The line currently includes 11 products. On the other hand, the comprehensive graphic image of the existing Mercator line was redesigned; thus, the packaging of the products from this line is being intensively redesigned since June.

## STRATEGIC PROJECTS FOR BOOSTING COMPETITIVENESS

In the period I – IX 2006, we designed and performed 4 strategic projects for boosting competitiveness of the Mercator Group:

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

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

## EXPANDING OUR OPERATIONS WITH CAPITAL TIES

### EMPLOYEES

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

On June 10<sup>th</sup> 2006 the traditional Mercator Day was held in Velenje. This central festivity of the Mercator Group employees was attended by 22,500 employees and their family members.

### BUSINESS PARTNERS

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

### FINANCIAL COMMUNITY

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

## SOCIALLY ACCOUNTABLE ACTION AND OPERATION

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

On March 1<sup>st</sup> 2006, the play "Lumpi's Day in the Woods" was performed for the first time in the Puppet theatre; the play will seek to cheer up the youngsters in Mercator Centers and hospitals across Slovenia.

As a part of our central humanitarian campaign "M book", we started in March the musical competition "Books Sung Out", which took place in Mercator Centers until mid-June. Youngsters aged 12 to 16 may join their passion for books and music and contest for the award – recording their own music CD. Recording is currently under way and will be completed in November.

From April to July 2006, 14 events called Lumpi 3 on 3 – Žogarija ("Play Ball competition") were held in Mercator Centers across Slovenia, as well as one event in Croatia, Serbia and Bosnia and Herzegovina, respectively. The events were organized in cooperation with the company Media Šport Marketing. The final event took place on July 1<sup>st</sup> 2006 in front of the MC Celje.

During the fall, four events called "Z glavo na zabavo" ('Be smart while having fun') were held in Mercator Centers across Slovenia; six more are planned until the end of the year.

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

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

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

On November 2<sup>nd</sup> 2006, the Parliament adopted the changes and amendments to the Trade Act, based on which the operation of retail facilities is again permitted on Sundays; the amended Act will come into force presumably in mid-November 2006.

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

Pursuant Paragraph 3, Article 38 of the Prevention of Restriction of Competition Act, and the reasonable application of the provisions of the General Administrative Procedure Act, the Competition Protection Office of Republic of Slovenia, adopted the resolution on May 4<sup>th</sup> 2006, that it does not object to the reported / notified concentration of the companies Poslovni sistem Mercator, d.d., and Era, d.d., which came about following the acquisition of a part of the assets (real-estate) of the company Era, d.d.; the Competition Protection Office thereby states that the concentration complies with the rules and regulations of the competition.

## **ISSUE OF NEW SHARES**

On January 31<sup>st</sup> 2006, the company KD Group, d.d., paid for its share of capital increase in the amount of SIT 4,115 million, thus acquiring 106,950 new shares; the company KLM, d.d., paid for a part of the capital increase option in the amount of SIT 800 million, for 20,790 new shares. January 31<sup>st</sup> 2006 was the official deadline for the subscription of new shares. All invited companies, except for KLM, d.d., paid for the shares offered in the entire sum. In line with the Supervisory Board resolution, the company Poslovni sistem Mercator, d.d., offered the remaining unsubscribed shares (259,360 shares) to other investors in the proportionate respective shares, which meant 86,453 shares per investor. As the investors waived the option to subscribe additional shares, these remain non-issued.

On March 28<sup>th</sup> 2006, the increase of the company share capital was duly entered into the Court Register held at the District Court in Ljubljana, with the filing number 1/02785/00. After the increase, the share capital of the company Poslovni sistem Mercator, d.d., amounts to SIT 35,908,440,000.00 and is divided into 3,590,844 ordinary shares with nominal value SIT 10,000.00.

On April 24<sup>th</sup> 2006, the company Poslovni sistem Mercator, d.d., obtained an approval from the Securities Market Agency, for organized trading with newly issued shares, with a suspensive condition of registering the shares in the central register of dematerialized securities; On April 26<sup>th</sup> 2006, the company obtained an approval from the Ljubljana Stock Exchange, d.d., on the expansion of listing for the newly issued shares of the company Poslovni sistem Mercator, d.d., with a suspensive condition of registering the shares in the central register of dematerialized securities.

On May 3<sup>rd</sup> 2006, Poslovni sistem Mercator, d.d., received a decision from the Central Securities Clearing Corporation, d.d., on entering the additional amount of 382,340 shares with the MELR code, in the total nominal sum of SIT 3,823,400,000.00, into the central register of dematerialized securities.

On May 5<sup>th</sup> 2006, the Ljubljana Stock Exchange included the 382,340 newly issued shares of the company Poslovni sistem Mercator, d.d., into its listing. The number of shares issued and being traded at the Ljubljana Stock Exchange, d.d., now amounts to 3,590,844 shares.

On its 6<sup>th</sup> regular meeting held on August 30<sup>th</sup> 2006, the Supervisory Board adopted the resolution, stipulating that immediately after the company management adopts the resolution on issuing new shares from the approved capital, the Supervisory Board will decide on the approval of this resolution by correspondence; similarly, the Supervisory Board would decide by correspondence on the changes in the share capital and changes and amendments to the company Articles of Association. This was realized at the correspondence session held on October 20<sup>th</sup> 2006.

## KEY INFORMATION FOR THE SHAREHOLDERS

On September 30<sup>th</sup> 2006, the average price per share of the company Poslovni sistem Mercator, d.d., traded in the official market (regular quotation) of the Ljubljana Stock Exchange, d.d., with the code MELR, amounted to SIT 41,344.

Book value of the share, calculated as a quotient between the total company equity value and the number of shares, registered in the Court Register as at September 30<sup>th</sup> 2006, amounted to SIT 36,191.

Basic net yield of ordinary share, calculated as a quotient between the net profit realized in the period at hand and the number of shares registered in the Court Register as at September 30<sup>th</sup> 2006, amounted to SIT 1,493 for the period I – IX 2006.

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

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

## FINANCIAL HIGHLIGHTS FOR THE PERIOD I – IX 2006

	Mercator Group				
	1-9 2005 (adjusted)	Plan 2006	1-9 2006	Index 1-9 06 / 1-9 05	Index 1-9 06 / plan 06
Net sales revenues (in SIT 000)	297,796,288	465,362,411	351,286,461	118.0	75.5
Profit/loss from operating activities (in SIT 000)	5,175,195	14,733,808	10,961,687	211.8	74.4
Profit/loss before taxes (in SIT 000)	3,683,569	9,142,855	7,114,126	193.1	77.8
Profit/loss for the financial period (in SIT 000)	2,528,471	6,135,219	5,113,534	202.2	83.3
Comparable operating profit/loss (in SIT 000)*	8,301,031	14,538,671	10,124,945	122.0	69.6
Comparable profit/loss before income tax (in SIT 000)*	5,319,871	8,790,704	6,314,766	118.7	71.8
Comparable profit/loss for the financial period (in SIT 000)*	3,755,698	5,871,106	4,514,014	120.2	76.9
Gross cash flow from operating activities (in SIT 000)	18,819,118	30,015,815	22,555,787	119.9	75.1
Capital expenditure (in SIT 000)	37,228,101	40,180,896	25,989,229	69.8	64.7
Long-term financial investment (in SIT 000)	9,091,606	0	322,690	3.5	-
Return on equity **	3.0%	4.6%	5.2%	172.2	112.8
Return on sales	0.8%	1.3%	1.5%	171.4	110.4
Gross cash flow from operating activities / Sales	6.3%	6.4%	6.4%	101.6	99.5
Number of employees based on hours worked	14,773	16,444	16,533	111.9	100.5
Number of employees based on balance	16,337	17,643	17,399	106.5	98.6

\* Detailed information on the calculation is shown in the section Explanations to the consolidated financial statements

\*\* Adjusted to annual basis.

## COMPANY PROFILE

Full name	Poslovni sistem Mercator, d.d.
Abbreviated name	Mercator, d.d.
Affairs of the company	G 52.110 Retail in non-specialized food retail outlets
Identification number	5300231
VAT Tax Code	45884595
Court registry number	1/02785/00
Court registry date	12.10.1995
Nominal value of one share	SIT 10,000
Number of shares quoted at the Ljubljana Stock Exchange as at September 30 <sup>th</sup> 2006	3,590,844
Share listing	Ljubljana Stock Exchange, Official market, trading code MELR
President & CEO	Žiga Debeljak
Management Board Members	Vera Aljančič Falež, Mateja Jesenek, Peter Zavrl
Chairman of the Supervisory Board	Robert Šega

## ORGANIZATIONAL STRUCTURE OF THE MERCATOR GROUP

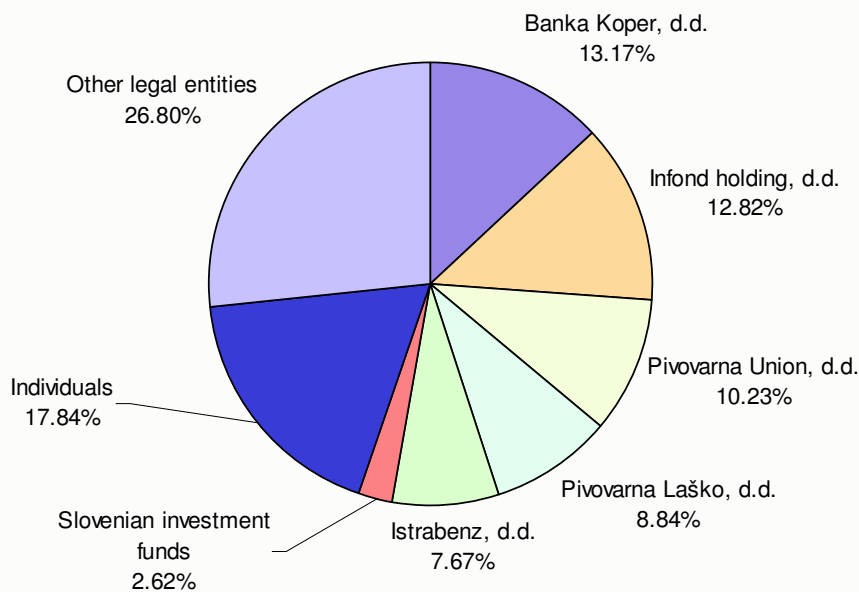
31.12.2005	30.9.2006
<b>TRADING COMPANIES IN SLOVENIA</b>	
Poslovni sistem Mercator, d.d.	Poslovni sistem Mercator, d.d.
M – SVS, d.d. (100.00 %)	M – SVS, d.d. (100.00 %)
Alpkomerc Tolmin, d.d. (97.45 %)	Alpkomerc Tolmin, d.d. (97.46 %)
Emona Maximarket, d.d. (98.95 %)	Emona Maximarket, d.d. (99.03 %)
M- Modna hiša, d.o.o. (100.00 %)	Merged with the company Poslovni sistem Mercator, d.d. (1.9.2006)
Savski otok, d.o.o. (100.00 %)	Merged with the company Poslovni sistem Mercator, d.d. (21.6.2006)
-	M.COM, d.o.o. (100.00 %)
<b>TRADING COMPANIES IN FOREIGN MARKETS</b>	
M - H, d.o.o., Hrvaška (99.85 %)	M - H, d.o.o., Hrvaška (99.86 %)
- Era Tornado, d.d., Hrvaška (100.00 %)	Merged with the company M – H, d.o.o. (26.1.2006)
- Trgohit, d.o.o., Hrvaška (100.00 %)	Merged with the company M – H, d.o.o. (28.2.2006)
M - S, d.o.o., Srbija (100.00 %)	M - S, d.o.o., Srbija (100.00 %)
M - BH, d.o.o., Bosna (100.00 %)	M - BH, d.o.o., Bosna (100.00 %)
Mercator Makedonija, d.o.o., Makedonija (90.00 %)	Mercator Makedonija, d.o.o., Makedonija (90.00 %)
<b>NON-TRADING COMPANIES</b>	
Pekarna Grosuplje, d.d. (75.13 %)	Pekarna Grosuplje, d.d. (75.13 %)
- Belpana, d.o.o. (100.00 %)	- Belpana, d.o.o. (100.00 %)
Eta, d.d. (97.33 %)	Eta, d.d. (97.33 %)
M - Emba, d.d. (69.17 %)	M - Emba, d.d. (76.80 %)
M - Optima, d.o.o. (100.00 %)	M - Optima, d.o.o. (100.00 %)
M Hotel, d.o.o. (100.00 %)	M Hotel, d.o.o. (100.00 %)

## OWNERSHIP STRUCTURE

### Ownership Structure

On September 30<sup>th</sup> 2006 the Share Register of the company Poslovni sistem Mercator, d.d. indicated 17,461 shareholders or 2,940 or 14.4 % less compared to the situation as at December 31<sup>st</sup> 2005 (20,401).

### Ownership structure of the company Poslovni sistem Mercator, d.d., as at September 30<sup>th</sup> 2006



### Major shareholders

As at September 30<sup>th</sup> 2006 the following ten major shareholders owned jointly 67.2 % of the company:

		Number of Shares	Share
1	Banka Koper, d.d.	472,915	13.17 %
2	Infond holding, d.d.	460,498	12.82 %
3	Pivovarna Union, d.d.	367,437	10.23 %
4	Pivovarna Laško, d.d.	317,498	8.84 %
5	Istrabenz, d.d.	275,411	7.67 %
6	Zvon Ena holding, d.d.	218,193	6.08 %
7	KD Group, d.d.	106,950	2.98 %
8	Pom-invest, d.d.	65,973	1.84 %
9	Poslovni sistem Mercator, d.d.	63,910	1.78 %
10	Smallcap World Cup	63,333	1.76 %

As at September 30<sup>th</sup> 2006 the share of foreign investors in the company Poslovni sistem Mercator, d.d., amounted to 8.9 %, which is a 2.3 percentage point increase compared to the year end 2005.

## COMPANY MANAGEMENT

### Supervisory Board

As at September 30<sup>th</sup> 2006 the Supervisory Board consisted of ten supervisors. Following is a chart of MELR shares owned by the members of the Supervisory Board of the company Poslovni sistem Mercator, d.d., as at September 30<sup>th</sup> 2006:

	Chairman of the Supervisory Board	Number of shares	Ownership share
1.	Robert Šega	0	0.00000 %
	<b>Members of the Board (representatives of capital)</b>		
2.	Matjaž Božič	0	0.00000 %
3.	Dušan Mohorko	0	0.00000 %
4.	Kristjan Sušinski	300	0.00835 %
5.	Mateja Vidnar	0	0.00000 %
	<b>Members of the Board (workers representatives)</b>		
6.	Ksenija Bračič	0	0.00000 %
7.	Jože Cvetek	2,000	0.05570 %
8.	Dragica Derganc	0	0.00000 %
9.	Jelka Žekar	500	0.01392 %
10.	Ivica Župetić	0	0.00000 %
	<b>TOTAL</b>	<b>2,800</b>	<b>0.07798 %</b>

On April 12<sup>th</sup> 2006, Mr. Gorazd Čuk resigned as the Deputy Chairman and the Supervisory Board member of the company Poslovni sistem Mercator, d.d.

At its 6<sup>th</sup> meeting on August 30<sup>th</sup> 2006, the Supervisory Board of the company Poslovni sistem Mercator, d.d., appointed Mr. Kristjan Sušinski as the Supervisory board vice-president, or deputy chairman.

## The Management

The Management of the company Poslovni sistem Mercator, d.d., consists of the President and three members, starting their relevant 5-year terms of office on January 1<sup>st</sup> 2006.

As at September 30<sup>th</sup> 2006, the members of the Management Board of the company Poslovni sistem Mercator, d.d., owned the following number of MELR shares:

Name and surname	Number of shares	Ownership share
Žiga Debeljak	1,100	0.03063 %
Vera Aljančič Falež	30	0.00084 %
Mateja Jesenek	1,000	0.02785 %
Peter Zavrl	60	0.00167 %
<b>TOTAL</b>	<b>2,190</b>	<b>0.06099 %</b>

## BUSINESS REPORT

### STRATEGIC POLICIES OF THE MERCATOR GROUP

#### Vision

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

#### Mission

Our business is aimed to create:

- Benefit for the customers;
- Benefit for the employees;
- Benefit for the suppliers;
- Benefit for the owners – shareholders;
- Benefit for the broad environment.

#### Corporate values

- We are bound by trust and mutual appreciation;
- Nobody understands customer requirements and desires better than us;
- Our operations are prudent and transparent in each moment and at all levels;
- We expand with solid corporate culture.

#### Strategic policies

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

#### Strategic objectives

- Growth of net revenues from trading operations in the annual average of 5% .
- Target market quotas until the year 2010:
  - Slovenia 40 %,
  - Croatia 12 %,
  - Serbia and Montenegro 10 %,
  - Bosnia and Herzegovina 5%.
- Investments: EUR 130 – 150 million annually;

→ Increase business productivity and efficiency.

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

## MARKET CIRCUMSTANCES

### **Sunday Opening Hours**

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

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

End of May 2006, representatives of unions and employers reached an agreement on Sunday working hours; henceforth, these will be regulated by industry collective labor agreement which will presumably be effective as of January 1<sup>st</sup> 2007. Retailers and unions have also agreed on higher Sunday work allowance, which will amount to 100 % with the new agreement (previously 75 %).

On November 2<sup>nd</sup> 2006 the Parliament adopted the changes and amendments to the Trade Act, based on which Sunday working hours are again permitted; the amended Act will presumably be effective as of mid November 2006.

### **Mercator's Preparations for the Adoption of Euro**

In 2006 Slovenia is actively preparing for the adoption of Euro as the national currency, which should take place in the beginning of 2007. The first stage of Slovenian adoption of Euro began on March 1<sup>st</sup> 2006, when the Act on Double Pricing (indicating prices both in Tolars and in Euros) came into force. The main purpose of this Act is to acquaint the consumers with the new currency and help them adjust to the adoption of Euro. In the first phase, the companies were required to indicate product and service prices in Tolars and Euros, according to the central parity rate; as of July 11<sup>th</sup> 2006, the prices should be indicated according to the exchange rate, which has remained unchanged compared to the central-parity rate, i.e. 1 € = SIT 239.64

The project of Euro adoption is of great importance to Mercator and we wish to be prepared for the new currency as well as possible; hence, we were additionally motivated to participate actively in the preparation of the Euro Adoption Act. The adoption of Euro will have a positive effect on Mercator financial operations, as it will presumably decrease conversion costs, unify fees for overseas and domestic payment transactions and simplify payment procedures within Slovenia. On the other hand, the project of adopting the Euro also brings additional costs that were estimated at SIT 1 billion in the course of one year. Most costs will occur in 2006 due to double price indication (in SIT and EUR), adjustment of POS cashier software, employee training etc. According to our estimate, 80 % of the costs will occur in 2006 and the remaining 20 % in 2007.

### **General Economic Conditions**

European Central Bank (ECB) increased the interest rate four times this year, causing a growth in the European inter-bank offered rate – EURIBOR. In the first nine months of 2006, EURIBOR rose by more than 0.88 percentage point, which led to an increase in variable interest rates. As another interest rate rise by the ECB is possible by the end of this year, variable interest rates could grow further.

On May 16<sup>th</sup> 2006, the European Commission and the European Central Bank published a positive convergence report regarding Slovenia's compliance with the Maastricht criteria for admission to the European Monetary Union (EMU) and adoption of Euro as the national currency. This way, Slovenia will adopt Euro as the national currency on January 1<sup>st</sup> 2007. Slovenia's admission to the European Union will bring numerous advantages and opportunities that are expected to have a favorable effect on further development of Slovenian economy.

The South European markets are increasingly important for Mercator; thus, the stabilization of macroeconomic environment and the accession of the region to European Union are of great interest for us. In May 2006, Moody's rating agency increased the country rating of Bosnia and Herzegovina by one level, from B3 to B2, especially due to progress of economic reforms.

On May 21<sup>st</sup> 2006, citizens of Montenegro held a referendum on establishing an independent country. There weren't any major incidents during the referendum, which should prove positive for the improvement and stabilization of macroeconomic circumstances in the South-eastern Europe. In Serbia, inflation remains considerable; however, the Serbian government has set ahead the goal to slash inflation to less than 10 % in 2006.

## DEVELOPMENT AND INVESTMENTS

In the period 1-9 2006 Mercator Group realized SIT 25,989 million of investments into fixed assets, which represents 64.7 % realization of the annual investment plan. The largest segment of all investments of the Mercator Group in total amount of SIT 8,079 million goes to the acquisition of Era retail outlets in Slovenia.

Country	Value (in thousands SIT)	Structure (in %)
Slovenia	15,167,694	58.4
Total investments in trading branch	14,727,867	56.7
Total investments in non-trading branch	439,827	1.7
Croatia	7,465,307	28.7
Bosnia and Herzegovina	2,105,046	8.1
Serbia	1,251,182	4.8
<b>TOTAL</b>	<b>25,989,229</b>	<b>100.0</b>

In addition to the integration of Era shops into the Mercator retail network in Slovenia, during the period January – September 2006 we opened a new supermarket in the Šentpeter garage next to the Clinical Center in Ljubljana, including two rented outlets, a Trade Center in Lesce, we furnished the Intersport outlet in BTC Novo Mesto and refurbished the supermarket in Tržič, the Konzum superette in Senovo, the Drulovka supermarket in Kranj, and the clothing outlet Modiana and Beautique drugstore in Portorož.

→ In Slovenia, we opened on June 15<sup>th</sup> a supermarket in the Šentpeter garage in Ljubljana, which also includes two outlets for supplementary services. Total area of Mercator's outlet in the garage ground floor amounts to 1,402 m<sup>2</sup>, of which the supermarket, or the so-called comfort shop, comprises 1,308 m<sup>2</sup>. The supermarket sale area includes 900 m<sup>2</sup>. Supplementary services, i.e. café and the florist, are offered in two rented outlets with a total area of 75 m<sup>2</sup>, as well as within the supermarket on the area of 21 m<sup>2</sup> with counters: a candy shop and Slovenian National Lottery. Mercator also owns the first basement level of the garage with 95 parking spots.

On September 26<sup>th</sup> 2006 we opened a Trade Center in Lesce. The center shares a larger commercial facility with Merkur. The area of the landed property that pertains to Mercator is 13,269 m<sup>2</sup>, while the relevant total area of the single storey building is 3,016 m<sup>2</sup>. Mercator also owns 250 outdoor parking spots. The offer of the Trade center comprises a 1,746 m<sup>2</sup> supermarket and eleven leased outlets that extend over a surface of 829 m<sup>2</sup>.

## TRADE CENTER LESCE



- In Croatia, we opened a refurbished Mercator Center in Samobor (opening took place on April 12<sup>th</sup> 2006). The center features all relevant Mercator standards of operation, and it includes the Intersport, hardware and electronic store and a Modiana outlet.

In Zagreb, a new Intersport outlet was opened in the town center (opening on April 12<sup>th</sup> 2006), and the expanded Intersport in Mercator Center Pula was opened on June 23<sup>rd</sup> 2006.

On August 3<sup>rd</sup> 2006 we opened a 784 m<sup>2</sup> supermarket in Novigrad. The first floor of the building will feature 11 outlets with a total area of 609 m<sup>2</sup>, with supplementary offer; the selection of tenants is still in progress. Total area of the main building located on landed property of 1,817 m<sup>2</sup> amounts to 1,784 m<sup>2</sup>. The facility also includes 82 parking spots, of which 20 are owned by Mercator, while the other ones are leased.

- In Bosnia and Herzegovina we opened on July 6<sup>th</sup> 2006 the Trade Center Mostar. It is located on a landed property of 6,015 m<sup>2</sup>. The building has a total area of 5,170 m<sup>2</sup> in two storeys. The ground floor includes a garage with 116 parking spots, while the first floor features a 1,951 m<sup>2</sup> supermarket, Intersport, Modiana with a drugstore, and a Santana coffee bar. Twelve additional leased outlets for supplementary offer extend over a total of 906 m<sup>2</sup>.

## TRADE CENTER MOSTAR



In the period at hand, we have completed the construction of Mercator Center Maribor II (Pobrežje), which was opened on October 20<sup>th</sup> 2006, and started the construction of Trade Center Cerknica, supermarket Bovec, Mercator Center Novi Sad, as well as the refurbishment of the Trade Center Nove Jarše in Ljubljana and supermarket Vema in Maribor. We have also commence the construction of a Trade Center in Bohinjska Bistrica and Mercator Center Zagreb III.

We have also acquired the following new landed property; in Slovenia: in Dragomer for a supermarket, in Sežana for a Hura! discount store, in Litija for a Trade Center; in Croatia: in eastern and western part of Zagreb, for two Mercator Centers .

## MARKETING

### Customer Relations Management

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

**As at September 30<sup>th</sup> 2006, there were 654,828 Mercator Pika card holders in Slovenia** – of these, 412,508 held blue cards, 240,103 held green cards and 2,217 held golden Pika cards. In Croatia, 112,123 Pika card holders were registered on the same day, with 94,181 holders of blue, 17,830 of green and 112 holders of golden card (green and golden card were introduced to the market on February 1<sup>st</sup> 2005). In Serbia there were 46,272 Pika card holders – of which 31,207 held the blue card, 15,035 held the green card and 30 held the golden card (green and golden card were introduced to the market on August 1<sup>st</sup> 2005), and in Bosnia and Herzegovina there were 52,684 Pika Card holders – 48,681 with blue card, 3,927 with green card and 76 with the golden card (the green and golden card were introduced on August 1<sup>st</sup> 2005). **Hence, the total number of Mercator Pika card holders amounts to 865,907.** From January 1<sup>st</sup> to the end of September 2006, the number of card holders grew by 133,221, primarily due to marketing activities focused on the Pika card, that were performed in all markets of our operation, as well as merging the Era retail network to the Mercator Group, when **12,512** holders of the "Zrno na zrno ("Bit by Bit") card agreed to sign up for the Mercator Pika card.

From January 1<sup>st</sup> to September 30<sup>th</sup> the following activities were held successfully in the field of customer relations management:

- **Upon the merging of ob Era retail network to the Mercator Group**, 12,512 holders of the "Zrno na zrno" ("Bit by Bit") card exchanged their former card for the Mercator Pika card.
- **All golden Mercator Pika card** were awarded for their loyalty with a free six-month subscription to the National Geographic magazine; they were also invited to **pre-summer clearance shopping** and offered them a 30 % discount.
- **The "Double point"** campaign was performed 159 times.
- Upon the conclusion of the 14<sup>th</sup> benefit period (in MC Novo mesto) and the 15<sup>th</sup> benefit period (MC Kranj), two successful **Pika Day** events were held, including the final prize drawing and additional benefits for the customers (double points, free gifts for the customers, presentations of the Mercator Pika card, M mobil and the 'Uživajmo zdravo', or the Health & Pleasure club etc.)
- **Spreading the versatile applicability of the Mercator Pika card in the field of tourist services**; as of April 1<sup>st</sup>, Postojnska jama – turizem, d.d., was included in the Mercator Pika Card system; as of June 1<sup>st</sup> 2006, LifeClass, Hotels&Resorts, Portorož, were also included in the system; in the **field of education**, the Palatin, d.o.o., foreign language center, and IT education center Housing Co., d.o.o., Ljubljana, were also included in the system as of May 15<sup>th</sup> 2006. In the field of **leisure activities**, we have started on September 1<sup>st</sup> 2006 our cooperation with the Plesno mesto (Dance City) school of dance, Ljubljana. In Croatia, the first external partner was included in the Mercator Pika Card system – DZS Zagreb.
- **In order to increase the number of Mercator Pika debit/credit card holders**, a prize competition was carried out in the period from April 1<sup>st</sup> to May 30<sup>th</sup> 2006.
- **in order to increase the value of purchases by Mercator Pika card in the textile outlets and Beautique drugstores**, we organized a competition among the employees in the period May-July 2006, and awarded the employees of the four most successful outlets.
- In Croatia, Serbia and Bosnia and Herzegovina, intensive marketing campaigns were carried out in order to increase the number of Mercator Pika card holders. In Croatia, we have thus signed in the 100,000<sup>th</sup> Mercator Pika card holder, thus exceeding the planned number of holders for the year 2006. We have also already exceeded the planned number of card holders in Slovenian market.
- In June, we founded the 'Health & pleasure' club, intended for people of all ages, who share the idea of a healthy lifestyle. The first issue of the club's magazine "Health & pleasure" was launched in June, followed by the second volume in September; both had the circulation of 40,000 copies. The club-related content may also be viewed by the members at [www.uzivajmozdravo.si](http://www.uzivajmozdravo.si). At the end of September, the "Health & pleasure" club featured 10,307 members.

- On July 1<sup>st</sup> 2006, we completed setting up the new MERCATOR PIKA web portal, intended for all customers and Mercator Pika card holders: [www.mercatorpika.si](http://www.mercatorpika.si). The new Mercator Pika website include current events, news and campaigns.



- By launching the prepaid M mobil packages, Mercator was the first Slovenian retailer to enter the **mobile communication market**. **Prepaid M mobil suites** offered to our customers include either a prepaid M mobil suite with a telephone or the M mobil SIM card suite without a telephone. One key advantage of M mobil prepaid suites is that prices of calls to all telephone networks in Slovenia are equal; the same applies to short text messages and multimedia (image) messages. Users of M mobil prepaid suites are also offered favorable rates for GPRS data transfer. As another advantage, M mobil prepaid suites enable not only a favorable use of telephone services, but also additional discounts on the purchase of daily consumer products in Mercator.
- All users of M mobil prepaid suites may become members of the **M mobil club**. The purpose of this club is to enable the users more favorable purchases of products in all Mercator outlets, as well as with all partners of the Mercator Pika card system; as of November, the users are also additionally awarded in accordance with the value they charge to their M mobil prepaid account.
- Throughout 2006, we have performed monthly **sales promotion activities for the holders of Mercator Pika card**, in all Mercator product lines, as well as with the business partners in the Mercator Pika card system.



### Development of Private Label Lines

The Mercator private label is a permanent strategic project that is represented throughout the Mercator retail network, in all franchise stores and all Cash&Carry stores. Products of the new generic line are present both in Mercator outlets and the HURA! discount stores, as this line includes the products that are intended for the most price-sensitive customers. The fundamental characteristics of the Mercator private label products are excellent quality, favorable price and a distinctive graphical image of each product range, while the generic line follows one clearly defined goal: the lowest price in the market. The project includes products from all categories.

## In the period I-IX 2006, we continued to pursue the following goals:

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

## The Mercator private label products are developed within the following product lines:

- **Mercator products** : the range includes daily consumer products for households and offers the best price/quality ratio. At the end of September 2006, the range included 352 products. At the end of March a new comprehensive graphical image of the product range was designed and the revision of product packaging was commenced in June. Within one year, the new image will be applied to the entire product range.



- **"Popolna nega" ("Total Body Care")**: This product range includes cosmetic products for both men and women who are price-sensitive and do not pay particular attention to brands when buying cosmetic products. At September 30<sup>th</sup> 2006 the product range included 77 products.
- **M-linija ("The M-line")**: This product range includes textile products (clothing, bedclothes, textile products for kitchen etc.) for daily use, intended for price-sensitive customers. At the end of September 2006, it included 252 products.
- **Lumpi**: Lumpi is a product range for children up to 10 years of age. At the end of September 2006, a total of 311 products were included in the range. The Lumpi line follows a long-term communication strategy which is aimed both at the expansion of the product offer, as well as at the development of brand identity that incorporates attributes of educations and didactics. The central market communication activity in the beginning of September took place, as in the previous year, in cooperation with the Council for Education and Prevention of Traffic Accidents. On the first school day, all first-formers were presented with Lumpi color books; in front of Mercator Centers, a simulation testing grounds Jumnicar were set up, where children were introduced to the role of a driver in road traffic. The campaign was supported by advertising safe conduct in road traffic on billboards, road signs, printed ads, and flyers presenting the entire product range and a prize contest that triggered a considerable response.
- **"Mizica, pogrni se!" ("The Wishing Table")**: selected products of this product range should be of great help to anyone that wishes to live a full life despite the constant rush and devote their free time to family, sports and friends. These products enable a simple preparation of a quality and tasty meal. At the end of September 2006, the line included

108 products. In order to present the line more closely, several activities took place in June 2006. In the period from June 15<sup>th</sup> to 27<sup>th</sup> the special offer "Eat well and save your time!" included 26 products and a special prize competition; furthermore, presentations or tastings were held in larger Mercator outlets.

- Zdravo življenje ("Healthy Life"):** Selected products of the "Healthy life" product range follow the recommendations and contemporary findings in the field of healthy nutrition. At the end of September 2006, the range included 86 products. In March 2006, several activities were performed to raise customer awareness and thus additionally increase their trust towards the "Healthy Life" products. These activities were performed in cooperation with the Slovenian National Association for Prevention of Cardiac and Coronary Diseases which performed free cholesterol level tests, blood pressure tests and blood sugar tests; with representatives of the Health Protection Institute of the Republic of Slovenia, who educated our customers about the healthy food preparation; with Cindi Slovenia, that performed presentations of Nordic walking in Mercator Centers and informed about the possibilities to quit smoking; with the team of the nutritionist dr. Sentočnik, who advised on obesity prevention; and with the cooks Dantes and Jakob Polajžar, who prepared dishes with the "Healthy Life" products. The campaign was supported by television advertisements, ads in printed media and on the internet, by events called 'Prevention month in Mercator' taking place in all Mercator Centers; finally, a campaign flyer was printed, containing a recipe booklet.



- Generic line:** in 2006 we started to develop a new generic line of retailer brand products; the first products were offered in Mercator outlets at the end of July. These daily consumer products are intended for the most price sensitive customers who buy rationally. The aim of the line is to offer the lowest price in the market. At the end of September 2006, 11 products were included in the campaign.



- 5 na dan ("Five a Day") project:** From January 9<sup>th</sup> to February 9<sup>th</sup> 2006, we performed an extensive advertising campaign in order to boost sales of fruits and vegetables. The customers were offered a variety of presents, according to the quantity of goods purchased. The campaign was very successful, as the sales of products from fruit and vegetables category increased by 33 % in this period.

**As at September 30<sup>th</sup> 2006, Mercator retailer brand included a total of 1,201 products** (when different flavors, colors, types, sizes and fragrances are accounted for); 268 of these were developed in the period from January to September 2006. The number of products, when different flavors, colors, types, sizes and fragrances are disregarded, amounted to 852.

The products of the Mercator retailer brand are developed in all markets of the Mercator operations. In Croatia, there were 421 products with the Mercator retailer brand at the end of September 2006; in Serbia there were 382 products, and in Bosnia and Herzegovina, there were 495. The following table lists the number of products in respective retail brand product ranges in Slovenia, Croatia, Bosnia and Herzegovina and Serbia (not accounting for different tastes, colors, sizes and fragrances):

	<b>SLOVENIA</b>	<b>CROATIA</b>	<b>SERBIA</b>	<b>BH</b>
Mercator	311	139	106	156
»Mizica, pogрни se!« (‘The Wishing Table’)	106	14	9	31
Zdravo življenje (‘Healthy Life’)	75	1	5	15
Lumpi	202	141	144	153
Popolna nega (‘Total Body Care’)	55	50	53	50
M-Linija (‘The M-line’)	92	73	64	87
Generics	11	3	1	3
<b>TOTAL</b>	<b>852</b>	<b>421</b>	<b>382</b>	<b>495</b>

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

### **Sales Promotion Projects**

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

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

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

Among the long-term projects are the following:

- the project "**Permanently Low Price**" ("**Trajno nizka cena**"), which included 842 products on October 5<sup>th</sup> 2006;
- **The Exclamation Mark!**, which on October 5<sup>th</sup> 2006 comprised 240 products,
- **Slovenian Basket**, comprising:
  - o a total of 60 products in the period from **March 1<sup>st</sup> to May 31<sup>st</sup> 2006**, 55 of which were present in the household consumer product retail network, 6 in the hardware and electronics range and 4 products in the textile chain.
  - o a total of 40 products in the period from **June 1<sup>st</sup> to August 31<sup>st</sup> 2006**, 35 of which were present in the household consumer product retail network, 3 in the hardware and electronics range and 2 products in the textile chain.
  - o in the period from **September 1<sup>st</sup> to November 30<sup>th</sup> 2006** a total of 41 products, 37 of which were present in the household consumer product retail network, 4 additional products were only present in hypermarkets, two were featured in the hardware and electronics range and 1 product in Modiana outlets.

Within the short-term activities, we perform **regular campaigns and hypermarket campaigns**, with special emphasis on the projects "**Doubtlessly the best price**" ("**Brez dvoma najboljša cena**") and "**Super price**" ("**Super cena**"). In the period 1 – 9 2006, we performed 18 regular and 18 hypermarket campaigns. The former were consistently theme-oriented (e.g. "The Household Days", "The Winter Days", "Let's Tend to the Garden", "I Live a Healthy Life"). Within these fields, we also increased the presence of hardware and electronic products and seasonal products of the non-market program that we wish to offer our customers at a particularly low price.

Starting this year, we perform the **weekend campaigns** that also received ample communication support. The emphasis of weekend campaigns is on fresh program and fruit and vegetables, while other attractive products are also included. From the beginning of the year to September we carried out 32 weekend campaigns. From February to the end of September we also performed 6 "Sunday campaigns", which were aimed at reestablishing the habit of Sunday shopping with our customers after the rejection of amendments to the modified Trade Act. As of April, the campaign has been joined with the weekend campaigns.



The "**Vitamin of the Day**" campaign that takes place once a week is aimed at boosting the sales of fruit and vegetables, and particularly to motivate our customers for healthy nutrition; in the period at hand, this campaign took place 18 times. The hypermarkets and larger supermarkets also feature the "**days of fruit and vegetables**" twice a month; seven such campaigns were carried out in this period.



In May and June 2006, we carried out several **events and a prize competition, relating to the soccer world championship in Germany**; among the prizes were also 4 tickets to the championship games.

After the projects M mobil and Health & Pleasure club were launched in June and August respectively, we also started the sales promotion for the product ranges they comprise. Sales promotion takes place in the form of awarding coupons to customers, or club members.

In the period from April 10<sup>th</sup> to July 16<sup>th</sup> 2006 we carried out the **"Tognana"** project. The customers received one sticker for every purchase above SIT 2,000. A customer that collected 20 stickers (15 for the Mercator Pika card holders) received a free Tognana kitchenware set. This project was among the most successful of its kind both in Mercator and in Slovenian market so far; due to its success, it was extended to the end of October.

Planned activities were also carried out within other Mercator product lines.

In the period 1-9 2006, six regular campaigns took place in **Intersport**, as well as two clearance sales of clothes and sports equipment, the winter one in January and the summer one in July. Given the time lag in the sale of seasonal clothing and footwear, we prepared three additional sales promotion campaigns called "Customers Lead by 3:2", and another special discount of 30 % just before the summer clearance sale.

In January, we also organized a major event called "Intersport Snow Party" in Kranjska Gora, while during spring we took part in the "Hour of Soccer – Lumpi 3 on 3" events; in September, we took part in the event "Juriš na Vršič" (Storm on the Vršič).

Within the project Intersport International "The Place Where Football Starts" we prepared a special soccer related products advertisement flyer before the beginning of the Soccer World Championship; furthermore, we prepared a set of advertisements which were aired during soccer shows in national TV SLO and A Kanal ("Intersport – Where Soccer Begins", for the regular June campaign and for the "Customers Lead by 3:2" special offer). We worked with TV Slovenija and the DELO daily paper on the "Free Kick" quiz show that was advertised by both media companies.



In the same period we published several theme-oriented catalogues with exclusive brands and other products that are available only in Intersport outlet: "Running Footwear 2006", catalogues for Crazy Creek exclusive trademark of rollerblades and inline skating equipment, catalogue of trekking equipment, clothing and footwear McKINLEY 2006, "Cycling 2006"

catalogue and the Fitness catalogue with Energetics equipment in September. In Slovenia, these catalogues were sent to outlets, as well as several thousand Mercator Pika card holders (choice of Intersport customers from the Mercator Pika Card database). In the same period, we also performed required activities of our Intersport-related sponsoring project: Olympic Card with the Slovenian Olympic Committee, Kompas – Intersport Summer Clubs and some minor projects to support the alpinist and skier Davo Karničar, marathon runner Roman Kejžar and alpinist Uroš Samec.

Apart from the winter post-season clearance sale, **the textile product range** also saw in the period 1-9 2006 the following:

- special offer of interior equipment textile and the Easter special offer, where clothing for women, men and children was offered at reduced prices,
- in June, we offered lower prices on bathing suits and linked the campaign with the Beautique drugstores,
- in April and May, we performed a pilot campaign "Modiana's Advice". We presented ourselves at fashion shows that were held in Mercator Centers across Slovenia, and we presented the trademarks that we offer in special fashion shows in Maribor and Celje. By providing styling for Slovenian celebrities (Mojca Mavec, Iva Kranjc, Zvezdana Mlakar), we presented our trademarks in Slovenian magazines (Modna Jana, Jana).
- We have also published a fashion catalogue of our own trademark products called MH design, presenting the new Spring-Summer 2006 collection for women and men, and distributed it via the Ona supplement, as well as at outlets of the entire chain.

In the period at hand, we also performed numerous co-marketing activities with various suppliers (Odeja Škofja Loka, Passport, Guess, Sinequanone, Marina Yachting, Lisca, Microfila etc.) In the second part of this period we started our cooperation with Maximarket, performing two joint campaigns (discounts on bathing suits in cooperation with the Max Factor supplier, and a joint spring discount on selected major brands).

We also took part in the diplomats golf tournament in Bled, where we presented our CHERVO trademark. We also carried out the summer clothes sale.

Six regular campaigns and five co-marketing activities in cooperation with our suppliers Orbico (Max Factor), Oblak Commerce (Juvena cosmetics) and BZ Biotherm were carried out in **Beautique drugstores**. In cooperation with the Mesec magazine and the Orbico supplier we performed the first three from a series of styling makeovers. Campaigns related to the Pika card are a part of our regular activities, as are the discounts and special bonuses for purchases exceeding a particular value, and discounts or bonuses to accompany purchases of products of a particular category (15 % discount on nail polish, 10 % discount on purchases over SIT 15,000, a gift at the purchase of an anti-cellulite products etc.).

In the **Hura! Discount stores** we carried out 18 regular campaigns in the period 1 – 9 2006. These campaigns are rounded up in currently relevant themes ("Cold and Breakfast", "Valentine's Day", "Everything for Your Baby", "Easter", "Going Bicycling", "Everything for school", "Textile", "Presentation of Slovenian products and suppliers", etc.), while numerous other campaigns are carried out in cooperation with our suppliers. Regular cooperation with local TV quiz-shows "The Land of Bounty" ("Dežela zakladov"), which we sponsored, proved

very successful as well. In June we carried out a co-marketing activity with the Hejj agency, that was based on the distinctiveness of the Hura! brand, a campaign related to world soccer championship etc. In August, we emphasized our permanent offer of Slovenian products by Slovenian suppliers. Otherwise, special emphasis was laid on the offer of seasonal and hardware and electronics products that offer the best ration between price and quality. Holders of Mercator Pika card were treated to additional offer of favorable prices on selected products several times during the sales promotion campaigns. Our offer was advertised in different media ranging from radio stations, country-wide newspapers and local newspapers, to billboards and TV. Since April, we have expanded our regular flyers to 8 pages. We have also introduced a new way to indicate products that are included in the promotion campaigns or are new on our shelves.

The distinctiveness of **Mercator's hardware and electronics range** was improved this year particularly by including increasingly more electronics and hardware products in the sales promotion activities in all types of stores. Within the regular sales promotion campaigns, more emphasis is placed on the seasonal character of products and on products that offer the best price/quality ratio. We also performed four regular campaigns for specialized hardware and electronics stores and nine special offer campaigns that included the Mercator Center hardware and electronics, and Construction units (including the Adut stores).

Our activities are performed in all markets of our operation. In the period 1-9, we focused in all markets on reaching higher price competitiveness and localization of all marketing projects.

**SERBIA:** In the period 1-9 2006 we focused primarily on improving the price competitiveness and the choice of special offer products. All long-term sales promotion projects are in progress, as well as the short-term projects. Nine hypermarket campaigns were carried out in the market program and the Weekend campaigns were launched as well. Special attention was paid to consistent selection of products in campaigns in Čačak and Belgrade. At the same time, we carried out all sales promotion projects in other programs. In this period we carried out nine regular campaigns in Intersport, seasonal discount in textile products, footwear and equipment, and completed three special offer campaigns for Mercator Pika holders. Within the textile product range we carried out a clearance sale, a special campaign for the Mercator Pika card holders, presented the new collections spring/summer 2006 and fall/winter 2006, carried out two co-marketing activities with Sinequanone and organized two fashion shows. In Beautique drugstores we carried out seven regular campaigns and one campaign for the Mercator Pika card holders. Distinctiveness of the hardware and electronics program was improved by including these products in the hypermarket campaigns. We carried out nine regular campaigns and one campaign for the Mercator Pika card holders.

**CROATIA:** In the Croatian market we carried out all sales promotion activities in line with the plan. The goal of all the activities was to boost sales and fortify the perception of our costumers that they get the most for their money at our outlets. We are creating a perception that customers are offered versatile quality products at favorable prices, and the best service. We carried out 13 regular campaigns, 16 weekend campaigns, summer campaigns called

"Thirsty" for beverages, regional radio campaigns, co-marketing activities with suppliers, and long-term sales promotion projects.

**BOSNIA AND HERZEGOVINA:** We carried out all activities in line with our plan in this field; at the same time, due to increasing competition in particular locations, they were combined with particular local activities. We carried out regular campaigns, weekend campaigns (started on June 19<sup>th</sup> 2006), co-marketing activities with suppliers, and the Price of the Day campaigns. We also started the preparatory activities for the Tognana project. In the period from January to September we carried out 16 regular campaigns, nine campaigns of special Pika discounts, and nine weekend theme oriented campaigns. In line with our orientation towards the boosting the sales and increasing the number of customers, we started to carry out the campaign "To!" ("Yes!"). We carried out six campaigns of Special Pika Discounts in Beautique, three campaigns of Special Pika Discounts in Modiana and three campaigns of Special Pika Discounts in Intersport. At the same time, we started to cooperate with several companies on the Pika card project and prepared a special offer of Pika discounts for our customers.

### Structure of Retail Units

The composition of retail units of the Mercator Group according to store types and individual product ranges as at September 30<sup>th</sup> 2006:

ACTIVITY	No. of units	Net sales area in m <sup>2</sup>	Gross sales area in m <sup>2</sup>
Hypermarkets	32	87,466	135,133
Supermarkets	139	104,054	163,538
Superettes	338	78,991	140,980
Self-service stores	122	10,649	19,022
Cash & Carry	9	10,471	13,385
Hura! discounts	12	6,419	8,990
<b>Total FMCG programme</b>	<b>652</b>	<b>298,051</b>	<b>481,048</b>
<b>Tehnickal programme</b>	<b>138</b>	<b>85,206</b>	<b>161,759</b>
Tehnickal programme	95	53,816	119,932
Furniture programme	43	31,390	41,827
<b>Clothing programme</b>	<b>146</b>	<b>50,680</b>	<b>60,776</b>
Clothing programme	124	48,449	57,934
Drug stores and perfumeries	22	2,231	2,842
<b>Intersport</b>	<b>42</b>	<b>15,697</b>	<b>20,392</b>
<b>Restaurants</b>	<b>63</b>	<b>16,906</b>	<b>25,975</b>
<b>Other</b>	<b>2</b>	<b>46</b>	<b>63</b>
<b>Total specialised programmes</b>	<b>391</b>	<b>168,536</b>	<b>268,964</b>
<b>TOTAL</b>	<b>1,043</b>	<b>466,587</b>	<b>750,012</b>
Franchise stores	195	24,955	39,285
<b>TOTAL with franchise stores</b>	<b>1,238</b>	<b>491,542</b>	<b>789,297</b>

## PRODUCT CATEGORY MANAGEMENT AND SUPPLIER RELATIONS

### Product Category Management

In the period 1-9 2006, the first phase of the Product Category Management (PCM) project took place in Mercator, which included the evaluation of all product categories and selecting 41 categories that represent 37.5 % of the entire value of Mercator sales in Slovenia. The evaluation of these 41 categories and consideration of top-line savings (sales growth) and the more traditional bottom-line improvements (reduction in purchase price) led to an estimate of the savings that exceed those that were planned at first.

Based on the results from the first phase of the category management project (potential savings, simplicity and duration of execution and strategic importance), we selected six pilot product categories (fruit, vegetables, bread and pastry, chocolate, hair care products and laundry detergents) on which the savings will be shown; subsequently, the concepts applied will be transferred to other categories in the following phases of the PCM project.

In the second phase of the category management project we tackled the definition of measures for improved execution of pilot categories. By September 30<sup>th</sup> 2006 we prepared the first measures and saving estimates for categories chocolate and hair care products; by the end of the year, the same will have been completed for the categories laundry detergents, fruit, vegetables, and bread and pastry.

Improvement measures for categories are tied to the customer decision tree (CDT) for each category. Based on this concept we have analyzed the assortment and estimated the potential measures in the field of assortment optimization, prices, promotion and positioning on the shelves.

We have also focused on supplier negotiations that have started end of September and will last until the end of 2006. Fact-based negotiation principles were integrated into our negotiation strategy, and negotiation scenarios were prepared.

### Purchasing of Trade Goods and Supplier Relations

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

In the purchasing area, we emphasized the first nine months of the year 2006 close collaboration with suppliers, preparation and implementation of new sales promotion projects and quality improvement of the existing ones. We also initiated the activities on the new line

of the Mercator brand name, and accelerated the activities of introducing the brand names in foreign markets.

In this period the project of new line of generic products was brought to the first phase of implementation. First products were placed on the shelves at the end of July 2006; by the end of the year, the majority of planned products should have been launched.

The Mercator private label project has the status of the leading project within Mercator's sales promotion activities in all markets of our operations. Thus we are actively involved in expanding this project in foreign markets as well; however, there are several circumstances that hinder its implementation quite significantly (customs duties for goods from Slovenia, fresh programs require inclusion of local suppliers etc.).

Apart from the standard sales promotion projects, we also introduced two special projects in the beginning of the year: the weekend special, lasting from Thursday to Monday, and the "Tognano" campaign – collection of bonus points in order to obtain a present. Both projects have proven very effective and have had a considerable impact on retail sales. Due to outstanding success of the Tognano project which pushed the demand for products beyond even the most optimistically expected volumes, we extended the prize collection period for customers who had obtained sufficient bonus points, to the end of October.

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

## SALES

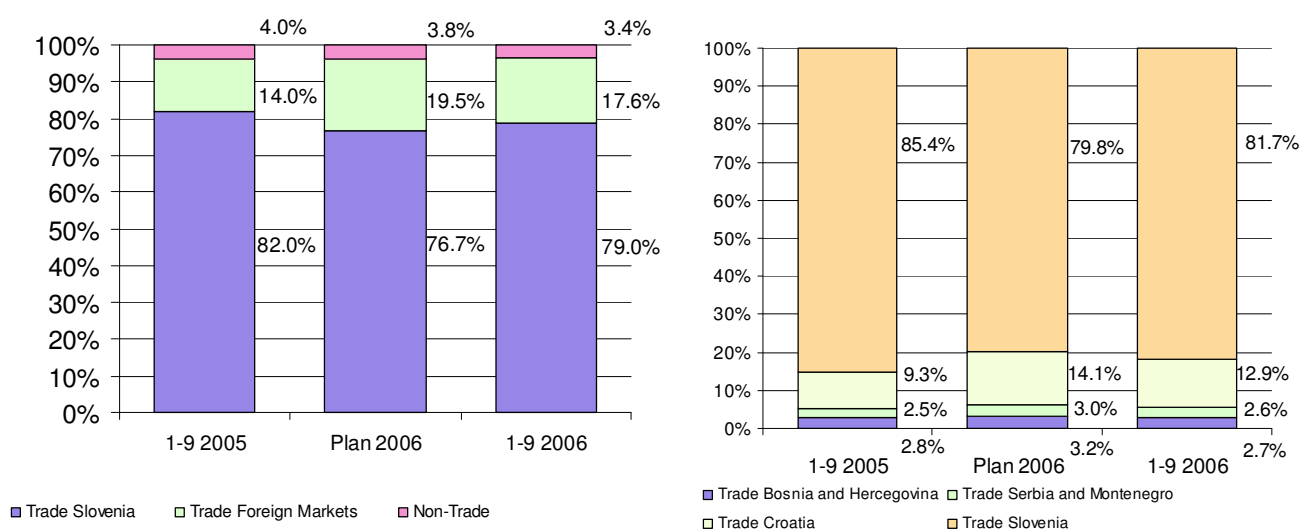
### Mercator Group

In the period 1-9 2006 the Mercator Group realized SIT 351.3 billion of net revenues from sales, which is 18.0 % more than the comparable period last year and amounts to 75.5 % of planned net revenues from sales for the year 2006

In the trading sector the Mercator Group realized 96.6 % of net revenues from sales, of which 81.7 % in Slovenia and 18.3 % abroad.

In the non-trading sector, net revenues from sales were increased in the period 1-9 2006 by 0.1 %.

## Net revenues from sales of Mercator Group by sectors



Trading companies in Slovenia saw a 13.9 % nominal increase in net revenues from sales in the period 1-9 2006 compared to the same last year period, mostly resulting from the acquisition of Era's retail units, opening of new retail outlets, and increase in revenues resulting from aggressive marketing activities.

In the period 1-9 2006 in Slovenia, in the acquired Era's trading operations we realized SIT 15.6 billion of net revenues from sales, representing 91.4 % of the periodic plan of net revenues from sales. We are therefore carrying out numerous activities for the increase in productivity and implementation of Mercator standards of operations.

Trading companies abroad recorded 49.5 % nominal increase in net revenues from sales in the period 1-9 2006 compared to the same last year period, which is mostly the consequence of acquisition of the company Era Tornado, d.o.o., and Trgohit, d.o.o., at the end of the year 2005, and the successful operations of existing and newly opened Mercator shops.

In the period 1-9 2006, we realized SIT 11.2 billion of net revenues from sales in the acquired Era's trading operations in Croatia, representing 71.2 % of the periodic plan of net revenues from sales. In the company Mercator – H d.o.o., we are therefore carrying out numerous activities for the increase of revenues and productivity, and implementation of Mercator standards of operations.

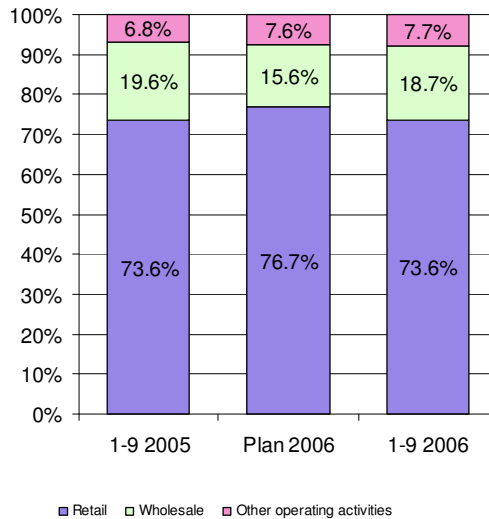
**Without the revenues realized within the acquired Era's outlets in Croatia and in Slovenia, net revenues from sales of the Mercator Group for the period 1-9 2006 would have amounted to SIT 324.5 billion, which would represent 9.0 % growth compared to the same period in 2005.**

**Net revenues from trade operations in Slovenia, when revenue from the acquired Era units in Slovenia is omitted, amount to SIT 269.5 billion in the period I-IX 2006, representing a 7.7 % growth over the same period in 2005.**

## Poslovni sistem Mercator, d.d.

In the period 1-9 2006 the company Poslovni sistem Mercator, d.d., realized SIT 251.3 billion of net revenues from sales, which is 19.9 % more than the comparable period last year and amounts to 77.7 % of planned net revenues from sales for the year 2006.

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



## LOGISTICS

Below are the activities carried out in the period 1-9 2006 in the area of logistics – apart from providing quality supply:

### → Integration and consolidation of warehouses

- As a part of the Era, d.d., logistics consolidation, 27 workers were relocated to the Ljubljana warehouse.
- The division and physical relocation of programs between warehouses Postojna and Novo Celje was carried out; this way, we were able to cancel the lease of two warehouses for hardware and electronics.
- Warehouses of Agro oprema, Hura! discount stores and textile were taken over and merged into the logistics structure.
- We integrated the distribution of refrigerated goods by MDK and Perutnine Ptuj, and frozen products from Ljubljanske mlekarne.
- Within available warehouses capacity, additional areas were equipped at the locations Slovenčeva and Zalog refrigerated warehouse.
- At the Novo Celje location, preparatory works (laying the asphalt) were completed to provide additional warehousing capacity.
- Intersport tolar warehouse was relocated from Slovenčeva to Naklo; thus, the entire Intersport program was moved to a single location. Capacity previously occupied by Intersport products will now be used for 'ekonomat'.

- Activities for consolidation (merging) of the Ptuj distribution center into the logistics structure are in progress.
- Within the project of upgrade and unification of information support to logistics operations, a pickup request system for transport route planning support (PRS) was implemented at the Slovenčeva location. An upgrade to the WMS information system is also being implemented, base on paperless operation.
- Strategic project of logistics infrastructure optimization

Analysis of logistics infrastructure optimization in Slovenia has been completed. Based on economic viability indicators, a scenario of long-term logistics infrastructure optimization was selected, which comprises construction of a modern logistics center in Želodnik near Domžale, including a modular construction of a warehouse in the period 2009 – 2011. In the interim period, logistics will operate in a maximum of eight locations. Drafts for redesigning the warehouses at Slovenčeva, Novo Celje and Bohova Maribor have been prepared. A project of redesigning the Levec warehouse into a Cash&Carry has also been completed, with the redesign scheduled to be completed in March 2007.

Activities to set-up and standardize logistics operations in foreign markets are also under way.

## HUMAN RESOURCES

### Human Resource Management

The following milestones highlighted the human resource management in Mercator in the period from January to September 2006:

- employees from the companies Alpkomerc Tolmin, d.d., Era, d.d., Mercator – Modna hiša, d.o.o., and Emona Maximarket, d.d., were transferred to the parent company Poslovni sistem Mercator, d.d.;
- employees from acquired companies Era Tornado, d.o.o., Samobor, and Era Trgohit, d.o.o., Čakovec, were transferred to the subsidiary Mercator-H, d.o.o.;
- we commenced the human resource management activities, related to transferring the employees from the company Mercator-SVS, d.d.;
- we have implemented the reorganization of the parent company, which included restructuring the management scheme, performing an audit of the expert service micro-organization, and granted promotions for a total of 178 employees;
- we allocated additional human resources to trade companies abroad by appointing a procurator for marketing and sales;
- we started the project of terminating the employment agreement with disabled employees for whom we are unable to provide an appropriate workplace, in line with the adopted legislations and the pertaining executive acts;
- we started the project of reducing health-related absenteeism, with emphasis on short-term sick-leaves;

- on June 14<sup>th</sup> 2006, we signed with the representative trade unions an Annex to the collective labor agreement of the company Mercator, d.d., which stipulates the following:
  - provisions and clauses of the Employment Relationship Act shall be applied in cases of malfeasance and liability for damage,
  - bonus payments for work on a program or a project are implemented,
  - in line with the collective labor agreement of Mercator, d.d., any employee may be entitled to a material (monetary) bonus for a calendar year in case of exceptional contribution to employer's success;
- we have appointed a workgroup that will prepare the changes and amendments to the labor compensation system, while taking into consideration the new industry-wide collective labor agreement, which will presumably become effective as of January 1<sup>st</sup> 2007<sup>2</sup>.

### Overview of Employees in the Mercator Group

As at September 30<sup>th</sup> 2006, the Mercator Group had a total of 17,399 employees, of which 11,433 were employed by the company Poslovni sistem Mercator, d.d. Compared to the situation at the end of 2005, the number of employees in the Group rose by 1,027 (by 6.3 %), which implies a 98.6 % realization of the plan for 2006. The number of employees in trade operations increased primarily due to opening of new retail units and due to taking over the employees of the acquired companies outside the Group.<sup>3</sup> Number of employees in the non-trade part of the group fell by 46.

	No. of employees based on hours worked in 1-9 2006	Number of employees based as at 31 December 2005	Number of employees based as at 30 September 2006	Planned number of employees based as at 31 December 2006	Index 30.9.2006/plan 31.12.2006
Poslovni sistem Mercator, d.d.	10,716	9,458	11,433	11,480	99.6
M - SVS, d.d.	1,573	1,491	1,594	1,673	95.3
Alpkomerc Tolmin, d.d.	17	152	6	-	-
Emona Maximarket, d.d.	141	394	11	-	-
M - Modna hiša, d.o.o.	0	544	-	-	-
<b>Total Trade - Slovenia</b>	<b>12,447</b>	<b>12,039</b>	<b>13,044</b>	<b>13,153</b>	<b>99.2</b>
M - H, d.o.o.	2,336	1,842	2,525	2,603	97.0
Era Tornado, d.o.o.	-	636	-	-	-
Trgohit, d.o.o.	-	42	-	-	-
M - S, d.o.o.	525	565	539	616	87.5
M - BH, d.o.o.	515	506	595	554	107.4
<b>Total Trade - Foreign Market</b>	<b>3,376</b>	<b>3,591</b>	<b>3,659</b>	<b>3,773</b>	<b>97.0</b>
<b>Total Trade</b>	<b>15,823</b>	<b>15,630</b>	<b>16,703</b>	<b>16,926</b>	<b>98.7</b>
Pekarna Grosuplje, d.d.	247	241	243	244	99.6
Belpana, d.o.o.	0	0	0	0	-
Eta, d.d.	243	272	238	261	91.2
M - Emba, d.d.	124	125	125	125	100.0
M - Optima, d.o.o.	37	39	38	42	90.5
M Hotel, d.o.o.	59	65	52	45	115.6
<b>Total Non-Trade</b>	<b>710</b>	<b>742</b>	<b>696</b>	<b>717</b>	<b>97.1</b>
<b>Mercator Group</b>	<b>16,533</b>	<b>16,372</b>	<b>17,399</b>	<b>17,643</b>	<b>98.6</b>

In the period from January to September 2006, Mercator Group signed 2,444 new employees; 1,471 employees terminated their employment agreements, while 1,689 employees were relocated between the companies within the group.

<sup>2</sup> The part of the industry wide collective labor agreement that pertains to the Sunday working hours will become effective as of November 1st 2006.

<sup>3</sup> The newly opened outlets are MC Mostar, TC novigrad, TC Lesce, SM Šempeter and some smaller stores, as well as the retail activity of the company Era Velenje, d.d.

In the same period in 2006, the company Poslovni sistem Mercator, d.d., signed 2,632 new employees, of which 972 were transferred from subsidiaries, while 1,660 were newly employed.<sup>4</sup> One employee was transferred to another company within the Mercator Group and 656 employees terminated their employment agreements. 1,358 employees were relocated among the organization units within the parent company, with most relocations taking place as a measure of the reorganization project.

## **Demographic and Educational Structure of Employees**

### Mercator Group

As at September 30<sup>th</sup> 2006, Mercator Group was the employer of 1,571 employees in the first educational group (employees with I – III level education), which represents 9.03 % of all employees; the second group (employees with IV and V level education) featured 14,810 employees or 85.12 %, and the third group (VI or higher level education) included 1,018 employees or 5.85 %. Average level of education (measured on a scale from 1 – I level education – to 8 – VIII or higher level) as at September 30<sup>th</sup> 2006 amounted to 4.3.

Compared to the same reference date in 2005, the share of employees in the first group fell by 1.03 percentage point, the share of the second group rose by 0.95 percentage point and the third group rose by 0.09 percentage point.

### Poslovni sistem Mercator, d.d.

As at September 30<sup>th</sup> 2006, the company Poslovni sistem Mercator, d.d., was the employer of 1,137 employees in the first educational group (employees with I – III level education), which represents 9.94 % of all employees; the second group (employees with IV and V level education) comprised 9,657 employees or 84.47 %, and the third group (VI or higher level education) included 639 employees or 5.59 %. Average level of education (measured on a scale from 1 – I level education – to 8 – VIII or higher level) in the parent company as at September 30<sup>th</sup> 2006 amounted to 4.20.

Compared to the same reference date in 2005, the share of employees in the first group fell by 0.32 percentage point, the share of the second group rose by 0.15 percentage point and the third group fell by 0.16 percentage point.

## **Absenteeism**

The total of sick leave hours from January to September 2006 in the Mercator Group amounts to 1,436,010 hours, of which 715,356 were charged to the group member companies and 720,654 hours to the Health Insurance companies. The absenteeism rate in the Mercator Group amounts to 5.31 %, which is 0.64 percentage points less than in the same period of 2005 (when the total absenteeism rate amounted to 5.95%).

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<sup>4</sup> This figure also includes 1,075 employees that were transferred from retail units of Era Velenje, d.d., which was previously not a part of the Group.

The company Poslovni sistem Mercator, d.d., saw a total of 1,049,041 sick leave hours in the period from January to September 2006, of which 508,731 were charged to the company and 540,310 to the Health Insurance Institute of the Republic of Slovenia. The absenteeism rate in the parent company amounts to 6.09 %, which is 0.94 percentage points less than in the same period of 2005 (when it amounted to 7.03 %).

The activities of health-related absenteeism management included conducting systematic interviews with 20 % of the employees in each organizational unit of Poslovni sistem Mercator, d.d., who have the highest sick leave rate. The objective of these interviews was the identification of causes of (especially short-term) sick leave and possibly devising improvement measures on the individual level, in order to cut the short-term sick leave rate by 5 % annually. In the future, we intend to conduct interviews with employees who had the highest number of sick-leave hours in 2005 and 2006.

### **Training and Education**

From January to September 2006, various forms of training and education were attended by a total of 17,408 participants (compared to 16,524 in the same period of 2005), of which 11,840 were from the parent company Poslovni sistem Mercator, d.d. (11,547 in the same period of 2005). In total, the Mercator Group carried out 124,061 hours of training and education (which is 18.6 % more than in the same period of 2005), or an average of 7.13 hours per employee, which is 0.51 hour more than in the same period of 2005. The parent company, Poslovni sistem Mercator, d.d., carried out 11,840 hours of training and education (or 2.5 % more than in the same period of 2005), which is 7.39 average hours of education and training per employee.

Apart from functional education and training the Group also supervised 105 apprentices, 328 employees who took up extra studies, paid scholarships to 36 high school and college students, trained 22 apprentices in our retail and manufacturing units and enabled 735 practical training programs for students of secondary trade schools, as well as other students and scholarship receivers.

Apprentices, scholarship receivers and students carrying out compulsory practical work were trained by 409 mentors (in the same period of 2005 there were 371 mentors), performing a total of 160,158 mentor hours, which is 5.2 % more than in the same period in 2005.

### **Employee Motivation**

In this year the project of employee satisfaction monitoring has been redesigned. Surveys were conducted in September, **by written questionnaires**, in order to enable a higher **level of anonymity** (in previous years, the survey was conducted by telephone). **All employees** from the trade companies of the Mercator Group were invited to take part. The response level was 33%. Figures indicate this year's Mercator results in Slovenia and in Croatia,

compared to last year's results, and in comparison with the results of the organizational climate survey (hereinafter referred to as SiOK) from 2005.<sup>5</sup>

The data shows the highest level of employee satisfaction in 2006 in Mercator-H, d.o.o., followed by results from Slovenian trade companies of the Mercator Group.<sup>6</sup> This year's figures, given the higher level of anonymity compared to previous years, are expected. On average, they are 0,1 lower than satisfaction levels in last year.

The results were compared to the average satisfaction levels in trade industry in Slovenia and the average levels in all Slovenian companies, included in SiOK in 2005.<sup>7</sup> We observe that on average, satisfaction ratings given by our employees are higher than average SiOK ratings for trade industry and Slovenia in 2005.

Mercator prizes, money prizes, gold coins for 30<sup>th</sup> or 40<sup>th</sup> anniversary of employment in Mercator and awards for active participation in the realization of internal education and training, with the possibility to obtain the internal lecturer certificate, are all designed to provide additional motivation to the employees.

In April, new regulations became effective, on awarding the employees for participation in company projects. Project awards are an additional way of material stimulation which is intended for the most successful workers engaged in particular projects.

## ORGANIZATION AND QUALITY

In the period 1-9 2006, the following activities were carried out in the field of organization and quality:

### Rationalization of operations to increase business efficiency

Activities performed in the period 1-9 2006:

- we set up and approved new organization of the parent company Mercator, d.d., and the macro-organization of retail companies in foreign markets, as well as transferred the activity of the companies Mercator-Modna hiša, d.o.o., and Emona Maximarket, d.d.;
- preparations for the takeover of retail and wholesale activities of the company Mercator SVS, d.d., as of November 1<sup>st</sup> 2006.
- we prepared new standards to define minimum and correctional number of associates in retail units from type small superette to large hypermarket.
- we started the implementation of the SAP module to support human resource management for keeping the register of organizational units and entering the master data into the SAP CO.
- we complemented and published new catalog of work posts in the parent company;

<sup>5</sup> Results for Mercator-BH and Mercator-S for 2006 are not shown, as they cannot be compared to 2005 figures, since the organizational climate survey was not conducted.

<sup>6</sup> Poslovni sistem Mercator, d.d. and Mercator-SVS, d.d., together.

<sup>7</sup> in 2006, the survey Slovenian organizational climate (SiOK) has not been conducted yet.

- we designed a model of the sub-process Operational execution of procurement (purchasing) and logistical account verification based on the business plan. We set up the operation of the Aris 7.0 software platform for modeling processes and prepared organizational regulations on flowcharts design;
- we managed the work post register, in which there were 17 work post changes among the total of 240 systemized work posts in the period at hand;
- we managed the collection of Mercator Standards, to which 121 new or revised documents were added in the period at hand, for a total of 709 valid documents;
- within the project office, we monitored the progress of projects and corrective and preventive measures.

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

Activities performed in the period 1-9 2006:

- execution of the General Optimization of Operations Project in the Mercator Group:
  - We prepared detailed report regarding the accomplishment and the results of the General Optimization of Operations Project in the Mercator Group for the year 2005,
  - we set up and approved new organization of the General Optimization of Operations Project in the Mercator Group, and published a new updated version of the Rules and Regulations;
  - we defined priority tasks within the Project, redefined schedules of activities, and approved the methods of monitoring and confirming the results of measures via the internal revision, and compiled the Rules of Proceedings for the internal review of the Project;
  - we monitored the compliance of project progress with respective plans;
- Realization of the General Optimization of Operations Project in the Mercator Group:
  - we conducted the preliminary activities for the setting up of new organization of the parent company and companies abroad;
  - we compiled a list of activities prepared the report on the results regarding the optimization of organization processes in the year 2005;
  - We completed the "Application Setting Renewal, ERP choice" project. The project report included a corroboration of the proposal for the control of product movements in the Mercator Group to be carried out with the aid of the G.O.L.D. program tool;
  - we prepared the plan and carried out the project for the integration of the company Mercator SVS, d.d., to the parent company;
  - we prepared the plan and carried out the merger of subsidiaries Mercator – Modna hiša, d.o.o., and Emona Maximarket, d.d., to the parent company;
  - we took part in preparing the methodology of HR solution which is a part of any measure, and started to prepare the required human resource related solutions;
  - in cooperation with the retail management, human resources and legal sector, we analyzed and prepared a proposal of viable organization forms and employment of temporary labor force in the outlets. A pool of temporary labor force will enable

- rational allocation of labor force in the outlet, in line with the requirements within the labor-intensive intervals in a particular day.
- for the category of persons with challenged work abilities, we compiled a status report and conducted interviews with all disabled employees regarding the requirements and restrictions to be observed by Mercator in the work place. We started preparing the disability management plan.
  - we prepared the proposals for organizational-process changes related to the implementation of the SAP system for the field of procurement of non-trade goods and services, and carried out the process of linking particular functional areas in the sense of establishing rules that enable rational and efficient work;
  - we set up the conditions and commenced the implementation of:
    - o IT solutions for automatic ordering in outlets,
    - o IT system to support warehouse operation,
    - o IT solutions for transport route planning.
  - identified, defined and documented measures that will allow total savings of EUR 42.5 million after the implementation. Measures and savings are related to the fields of retail, logistics, support processes, trade goods inventories and procurement (purchase) of non-trade goods and services.

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

Activities performed in the period 1-9 2006:

- o we issued the following company Rules and Regulations: Good Sanitary Habits applying the HACCP principles for the retail operations; Comprehensive Policy of Data and Information Protection; Quality Management Rules and Regulations for trading companies, members of the Mercator Group. Particular activities in the field of environmental protection are also in progress;
- o we carried out the supervisory activities for our operation according to management review requirements in all trade companies of the Mercator Group;
- o in the company Mercator - S, d.o.o., the SIQ assessment company evaluated the business operation system in line with the requirements of the ISO 9001 standard; corrective measures have been launched;
- o we performed the 6<sup>th</sup> regular external ISO 9001 renewal assessment in the company Poslovni sistem Mercator, d.d. Corrective measures have been launched and the SIQ report has been submitted. Regular external assessments in companies Mercator SVS, d.d., and Mercator-H, d.o.o., have also been successfully executed.
- o we designed the internal assessment plan for 2006; process owners and heads of assessed units also took part in this process. On the notice board, we opened the folder Operation assessment, where all employees may review the records from internal and external assessments. in line with the plan, the first part of Internal Assessment 2006 was carried out in September, on which the changes to the process of integrating the assessment results into systemic corrective measures are tested;

- we monitored the system for managing inconsistencies, recommendations and praises (IRP) – a total of 167 IRPs, 89 % solved, 66 % positively accepted. Active monitoring of unsolved IRP and management support contributed to considerable improvement in the IRP solving indicators in the second half of the year.

#### Preventing disagreements of goods, and performance of inconsistent business processes by preventive internal control actions

Activities performed in the period 1-9 2006:

- 472 regular and 44 extraordinary controls.
- had 1,042 inspection reviews and received 2,166 documents thereof.
- performed 49 trainings with the topic of compulsory legislation and Mercator Standards, 11 trainings focused on internal control to secure healthy food based on the DHN standards and HACCP system principles for the Mercator Group staff, and 26 trainings on implementation of DHN for staff in the meat and delicacies department;
- we monitored the compulsory legislation that deals with the flow of trade goods and services. The list of compulsory legislation is updated every month and made electronically available to users. 349 changes were documented in the period at hand.

### ENVIRONMENT PROTECTION ACTIVITY

Concept of sustainable development, corporate accountability and the relations between the company and all stakeholders involved, are constantly gaining relevance. Therefore, setting up a comprehensive and systematic environment protection activity based on the idea of sustainable development and related activities may be one of the ways to improve Mercator's competitiveness and to retain the leading position among the trade companies in Slovenia.

In the first three quarters of 2006, the following activities were included among those that are aimed at reducing the consumption of raw materials and energy in the trade companies of the Mercator Group:

- As of January 2006, we are in compliance with all requirements of the legislation on waste electric and electronic equipment treatment. In trade companies of the Mercator Group we informed our customers regarding the possibility of free disposal and took over from them 77 tons of waste electric and electronic equipment that will subsequently be recycled. Apart from operative activities, we are currently engaged primarily in the issue of water tax.
- In the final phase of the Organic Waste Treatment project in trade companies of the Mercator Group, we strive towards rationalization of the entire organic waste treatment process, which includes rationalization of logistics, record keeping and work in retail.
- In order to rationalize the costs of communal waste treatment at selected test locations, we are compiling a status report and preparing records that will enable the

standardization of communal waste treatment in trade companies of the Mercator Group.

- Separate collection of waste office paper and used cartridges and toners is implemented into all commercial buildings of the Mercator Group trade companies.
- We are also preparing the project of efficient use of electric and thermal energy, which involves preparing an overview of power consumption by particular consumption points, analyzing the consumption and suggesting corrective measures for its reduction, as well as collecting data on facility specification, which will serve as a basis for certifying.
- With the opening of electric power and gas market in 2007, Mercator will have the option to buy power or fuel from any supplier in the EU. The basis of price negotiation is knowledge of energy consumption and technical data on consumer locations. Thus, we started to collect and sort technical data on consumer locations and data on consumption of all types of energy (power, fuels and thermal energy), that are the basis for operation of any facility.
- With regard to opening of the electric power market and selection of a new electric power supplier for 2007, we have obtained all required technical data on electric power consumer locations and data on consumption of electric power for individual consumer locations. We are also preparing an instruction manual that will enable to continuously keep track of and monitor technical and contractual changes for particular consumer locations.
- We have also started to collect information on technical characteristic of consumer locations and consumption of fuels or thermal energy, required for heating of buildings.
- As a part of educational activities on the subject, we are publishing a series of popular-scientific articles on environment protection.

In the first three quarters of 2006, all companies invested great effort to improve the environmental aspects of their operation and to rationalize their consumption of energy, raw materials and other natural resources.

## INFORMATION TECHNOLOGY

The activities performed in the period 1-9 2006 included the renewal of the following key areas of operations:

- **adoption of Euro**
- **strategic project of redesigning the information system**
  - The project of redesigning the information system for support functions is now in its third phase, which is Realization, which is scheduled to be completed by October 31<sup>st</sup> 2006. At the interim milestone (completion of system settings) an external audit was performed by SAP; the risk level was assessed as low. Project is in progress in line with the time schedule. After the preparation we have compiled a business plan that now determines the implementation process.

- Intensive work will continue in the following months, as the preparations start for the startup on January 1<sup>st</sup> 2007.
- Within the project of redesigning the information system for material operation we have carried out the following activities:
    - analysis and the choice of the comprehensive IT solution for the field of retail, wholesale, procurement and logistics. G.O.L.D. by the Aldata Solutions company was selected and agreement on cooperation was signed.
    - Project organization was set up: project team was appointed and project structure was established.
    - Draft of the business model is being compiled through workshops. We have carried out more than twenty workshops that were attended by over 50 co-workers from various areas of material operation.
  - Master Data Management project which is aimed at establishing central management of retail outlet operation, is being executed in accordance with the plan. In the period from the project commencement (February 2006) to the end of September, 270 of a total of 554 market program outlets and 60 hardware and electronics were completely connected to the central records / registers.
- **IT support for General Operation Optimization Projects of the Mercator Group**
    - We have expanded the IT support for automatic preparation of order proposal (currently, 195 outlets are included, managed by Mikropis);
    - We designed IT support for keeping records on consumer credits, granted to Mercator Pika card holders.
  - **IT support for management and decision-making**
    - All retail units that were integrated into the common procurement during the period at hand were also included in the material operation data warehouse.
    - We designed a scenario of completion and supplementation of IT support for business partners for the requirements of transition to SAP.
    - In cooperation with an external service provider, AC Nielsen, we designed IT support based on data, compiled in the data warehouse, for the analysis of weekly retail results.
    - In cooperation with an external service provider GFK Gral Iteo we have designed information support based on data, collected in the material operation data warehouse, for the analysis of monthly results of the selected hardware and electronics stores.
    - In July 2006, we included all outlets of the Croatian company (126 units) in the material operation data warehouse.
    - We compiled reports for the category management program that are the basis for negotiations with suppliers (signing annual agreements).
  - **IT support for warehouse operation and logistics**
    - we designed the IT support for the informational calculation of EUR prices;
    - we unified the IT support in the units acquired from Era, d.d.;
    - we unified the IT support in distribution centers Postojna and Goriška;

- we unified the IT support for Cash&Carry in Liminjan and Nova Gorica (total of 7 C&Cs).
  - we designed the IT support for paperless operation (WMS project) and carried out the pilot implementation in the Slovenčeva Distribution Center.
  - we designed the IT support for transport route planning (RPS project) into which the SSA product was integrated, and carried out the pilot implementation in the Slovenčeva Distribution Center.
- **IT support to retail**
    - we continued to decrease the number of POS contractors,
    - we established the electronic sale of MOBI cards in additional 90 retail units
    - we continued to develop and upgrade the IT support in line with marketing campaigns (Pika discounts, "YES" coupons).
- **IT support to facilities and security**
    - We upgraded the existing hardware, in order to enable handling of increased quantity of data for the data warehouse.
    - We started the refurbishment of system premises at Dunajska and Slovenčeva.
    - We started the redesign of the Local Area Network at Dunajska and Slovenčeva.
    - We prepared the infrastructure for new applications in M-Rodič, d.o.o.
    - We selected a new telecommunication service provider for Mercator-H, d.o.o.
- **IT support for common operations and electronic transactions**
    - We designed IT support for the Mercator web portal and the "Health & Pleasure" club, including the links to background systems (data warehouse for material operation, PIKA transaction system, Lotus Notes);
    - We expanded electronic confirmation of cost invoices.
    - We invited 35 new suppliers into the computer aided data exchange system (currently, 169 suppliers are included).

## FINANCIAL OPERATION

Due to growth of operating activities volume and the realization of investment activities plan in Slovenia, and particularly in new markets, financial liabilities, including liabilities from financial leasing, continued to increase in the first nine months of 2006. On September 15<sup>th</sup> 2006, Mercator signed an agreement with the International Financial Corporation (IFC) for a long-term loan of EUR 40 million. These funds will be used for general corporate purposes in Serbia and Bosnia and Herzegovina, among other for financing Mercator investments in those countries. This loan by the IFC is the first step within a broader financial package from IFC, agreed upon for a middle term, and which will most probably also include cooperation of other banks through syndication processes.

At the end of the third quarter of 2006, the Mercator Group reached the capital composition of 1 : 1.3 (this ratio was 1 : 1.23 at the end of the year 2005) between equity which includes balance sheet share capital and long-term provisions, and debt capital which includes financial liabilities.

At the end of the third quarter of 2006, the long-term financing rate in the Mercator Group amounted to 84.9 %, which means that this indicator has declined compared to the end of 2005 (87.1 %)

At the end of the third quarter of 2006, the total financial liabilities of the Mercator Group amounted to SIT 180.1 billion. Long-term financial liabilities represented 56.0 % of all financial liabilities, with the short-term liabilities representing the remaining 44.0 %. Due to growth of variable interest rates, Mercator decided to protect its financial liability portfolio in the amount of EUR 350 million by employing standard interest rate swap (IRS) and zero-cost collars (ZCC). Thus on September 30<sup>th</sup> 2006, financial liabilities at variable interest rate accounted for 36 %, while liabilities with fixed or protected interest rate represented the remaining 64 % of total liabilities. This way, exposure of the Mercator Group to interest rate risks was greatly diminished.

## SHAREHOLDER RELATIONS

### Key Information for the Shareholders

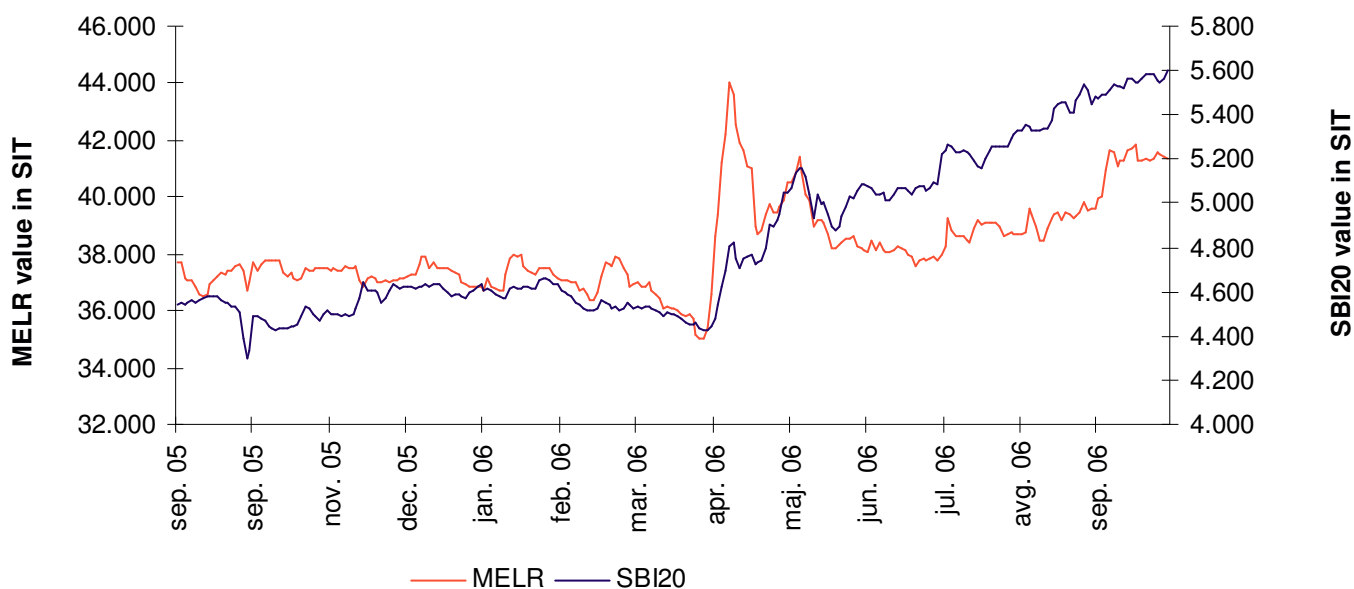
Share capital of the company Poslovni sistem Mercator, d.d., as at September 30<sup>th</sup> 2006, was divided into 3,590,844 shares that are listed and traded at the Ljubljana Stock Exchange. Nominal value per share amounts to SIT 10,000.

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

Shareholder Information	30 September 2006
Number of shares	3,590,844
Market capitalisation (in SIT 000)	148,458,238
Market value per share (in SIT)	41,344
Book value per share (in SIT)	36,191
Annual low (in SIT)	35,003
Annual high (in SIT)	44,020
Weighted average market price, excluding block and cross trades (in SIT)	40,701
Earnings per share (in SIT)	1,493

## Price per Share Movement

The following chart shows the movement of average price per MELR share in the period 1-9 2006, compared to the movement of the SBI20 index:



## Dividend Policy

Company shareholders discussed the rate of dividend for the year 2005 at the 12<sup>th</sup> regular annual meeting of the Shareholder's Assembly, called for May 17<sup>th</sup> 2006. The Management and the Supervisory Board of the company proposed to the Assembly the payment of dividends in gross amount of SIT 600 per share, which was confirmed and adopted by the Assembly. Poslovni sistem Mercator, d.d., started the payment of dividend to shareholders on June 16<sup>th</sup> 2006.

## Capital Increase

The process of capital increase of the company Poslovni sistem Mercator, d.d. was completed on January 31<sup>st</sup> 2006. On July 19<sup>th</sup> 2005 the Management and the Supervisory Board of the company Poslovni sistem Mercator, d.d., approved the resolution regarding the increase of registered capital of the company by the issuance of up to 641,700 ordinary shares with nominal value of SIT 10,000 and market value of SIT 38,000 (this price was valid until October 31<sup>st</sup> 2005, and after that date it was increased for accrued interest by the 5 % annual interest rate). The entire emission of new shares was offered to the well informed investors known beforehand in the non-public procedure: half of the entire emission of new shares was offered to the Slovenian Capital Fund, Slovenian Compensation Fund, and the KD Group, d.d., while the remaining half was offered to the company KLM, d.d. Until the conclusion date of the capital increase process, that is until January 31<sup>st</sup>, 2006 the companies participating in the capital increase process paid-in 382,340 ordinary shares with

nominal value of SIT 10,000.00. The total paid-in amount for new shares is SIT 14,615,147,723.50.

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

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

On April 24<sup>th</sup> 2006 the company Poslovni sistem Mercator, d.d., received the approval by the National Securities Market Agency for organized trading with newly issued shares, and on April 26<sup>th</sup> 2006 the approval by the Ljubljana Stock Exchange related to the extension of enlistment of the newly issued stock by the company Poslovni sistem Mercator, d.d. On May 3<sup>rd</sup> 2006 all newly issued stock in the process of capital increase was entered in the Central Register of dematerialized securities (KDD, Central Securities Clearing Corporation), and on May 5<sup>th</sup> 2006 all newly issued stock was enlisted in the stock market quotation.

## RISK MANAGEMENT

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

In Mercator all risks have been monitored and controlled within three major groups: business risks, financial risks, and operational risks; we are constantly updating the risk register that we have set up and we are evaluating the exposure to particular types of risk.

It is our estimate that the exposure to interest rate financial risks has decreased due to the increase in the share of financial liabilities with protected interest rate.

In the period 1-9 2006, the exposure of the Mercator Group to other types of risks has not considerably changed compared to the year 2005.

## COMMUNICATION WITH STAKEHOLDERS

### Communication with Customers

In the year 2006 we continue the development of the Mesec magazine in Slovenia and in Croatia. In the first half of 2006, the first three issues were published, Mesec April, Mesec June and Mesec September. One more issue is planned to be published by the end of this year.



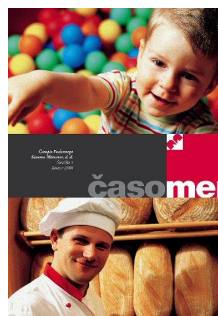
Every month, we treat our customers to eMesec (<http://mesec.mercator.si>) which offers additional content such as news on the offer in Mercator retail units, announcements of events, advice etc.

In June 2006, we founded the "Health & Pleasure" club, intended for people of all ages, who share the idea of a healthy lifestyle. The first two volumes of the club's magazine "Health & Pleasure" with the circulation of 40,000 each were launched. The club also has its web page at [www.uzivajmozdravo.si](http://www.uzivajmozdravo.si), where members may access all information, advice and other club benefits.



### Communication with Employees

The Mercator internal magazine has been renamed into Časomer ('The Time Keeper'). Časomer's contents was upgraded and its design was improved. Nine volumes were published, containing accounts of the most important events in Mercator and concerning it.



In January 2006 at the venue of the Restaurant Maxim we presented 17 prizes for the Best Shop Assistant according to the customers' selection. In September, we started the contest for the Best Shop Assistant in 2006.

In June 2006, a festivity was held to present 27 Mercator employees from across Slovenia were their diplomas of Operative Merchandising Mentor for hardware stores.

In June 2006, sixth traditional meeting of internal lecturers, trainers, tutors and mentors was held. Several certificates were presented to new internal lecturers, as well as awards for

contribution in the field of internal education and training, and bonus awards to employees that were most successful in this field in the previous year.

In April 2006, Kodeljevo sports park hosted 28<sup>th</sup> traditional Mercator sports games.

On June 10<sup>th</sup> 2006, the traditional Mercator Day was held in Velenje. The huge Mercator family of 22,500 employees and their family members gathered by the Velenje lake. Apart from daytrips and sports, Mercator employees were entertained by guest musicians from the countries where Mercator operates. The youngsters enjoyed the children's park and the company of children entertainers. Employees who have shown outstanding performance were presented with the Mercator awards; for the year 2005, 13 employees received this award.

In September we presented the awards to the most tidy and well decorated fresh program sections in the year 2005. The contest was organized for the seventh time. In 2005, 152 units took part in the contest, 144 in Slovenia and 8 in foreign markets; the latter were graded for the first time in 2005. Together, 52 units received the award, with some units receiving awards for multiple sections.

### **Communication with Financial Community**

In the period 1-9 2006 our efforts were aimed at the continued professional communication with shareholders and the rest of the financial community. Using the Ljubljana Stock Exchange electronic information system SEO-net we regularly informed the shareholders and other members of the financial community with business results, plans, and other important events of our business operations.

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

In the period 1-9 2006, Mercator took part in two meetings within the presentation, organized by the Ljubljana Stock Exchange, of Slovenian capital market to foreign potential investors. The meetings that were held in Frankfurt (June 1<sup>st</sup> 2006) and Vienna (September 12<sup>th</sup> 2006) also feature presentations from other Slovenian companies from the first quotation.

### **Communication with the Social Community**

In the period 1-9 2006, we have continued to prove our integration into the social community by numerous donor campaigns and general our concern for socially accountable action.

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

In January we donated SIT 2 million to the Clinical Center in Ljubljana for the acquisition of the CT device for the diagnostic procedures of oncology patients.

Within the humanitarian action Vsi smo bili otroci (We Were All Children) at the conclusion of the third consecutive winter season in March we financed holidays on snow for 100 children from socially deprived families.

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

As a part of the M-book project (M knjiga), we organized a musical competition called Odpete knjige ('Books Sung Out'), which combined reading and music, thus stimulating the imagination in a very constructive manner. The finals of the competition took place on Friday, June 30th 2006, when the best were selected in front of the Mercator Center Ljubljana. CD "Books Sung Out" will be recorded by five youngsters from four different places in Slovenia. All five winners of the competition will have to be quite diligent during their summer holidays, as they will record their first CD by the beginning of autumn and the new school year; the CD will be available to rap music fans in Mercator's outlets. The final event took place along with the meeting of **Slovenian Traveling Libraries**; among the twelve libraries that presented themselves in front of the MC Ljubljana, the visitors chose the best looking one.

From April to June, we worked with the company Media Šport Marketing to organize 14 events called "Play ball – Lumpi 3 on 3" (Lumpi 3 na 3 – Žogarija); the events took place in front of Mercator Centers in Slovenia, while one event was held in Croatia, Serbia and Bosnia and Herzegovina respectively. The events were attended by children aged up to ten years, and they were sorted into five categories. There were around 1,500 participants and about 8,500 spectators. At the end of the competition, the winners in respective categories received the 'Play Ball – Lumpi 3 on 3' awards and handy prizes.

We also worked with the Slovenian Olympic Committee to organize the "Mini Olympics with Lumpi" events as a part of the Committee's Mini Olympics series. Children were awarded Lumpi Certificates and Lumpi Frisbees. Mini Olympics with Lumpi took place in Maribor, Novo mesto, Ljutomer and Celje.

At the beginning of the school year, the educational campaign Lumpi's safe way to school was held for the third time. The campaign is aimed to prevent road accidents and to ensure safety for our children on their way to school.

At the Ptuj general hospital, we helped construct a wooden house called "The Shop"; at the TRC Jezero in Velenje we provided aid for the renovation of the children's playground; children from the Children's Home in Zagreb were pleased with the clothes and footwear that was donated from the Intersport product range. Mercator H was the sponsor of the 10<sup>th</sup> Croatian radio festival and a theatre performance about Nikola Tesla by the Ulikses (Ulysses) theatre.

Extensive floods in Serbia left a lot of families without their homes; the company Mercator-S, d.o.o., helped two families. The company Poslovni sistem Mercator, d.d., offered financial aid to a family in Domžale and awarded the children with scholarships. The company Mercator-BH, d.o.o., was also actively involved in humanitarian and donor campaigns in the first half of this year; among other projects, it donated funds to the "National Canteen" and to Red Cross of the Sarajevo Center municipality; it also sponsored BC Bosna and, for the third time in a row, the international cycling competition in Tuzla.

The company Mercator-H, d.o.o., donated funds and goods to day care center in Čakovec, financially and socially deprived families in Džakovo, amateur theatre in Metkovič, and it sponsored the BC Zadar.

At the beginning of the Sarajevo Film Festival, Mercator BH as the sponsor donated a range of ecologically grown products to the Shelter for the Elderly.

Mercator also sponsored the meeting of charity volunteers who are active in the **Skupaj** ('Together') institution whose efforts are aimed at securing a better future for children, and peace and stability in the areas that were struck by war, armed conflict, terrorist attacks, natural and other disasters.

### **Communication with Business Partners**

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

### **Communication with Media**

In the period 1-9 2006 we actively responded to numerous questions from the press and continued the intensive communication of Mercator's strategic policies. In May 2006, the meeting of Shareholders Assembly took place, and it was accompanied by publishing the 2005 Annual Report of the Mercator Group and the company Poslovni sistem Mercator, d.d. In the second half of the year, we communicated intensively in regard to strategic partnership that we entered into in the field of trade operations, with the Rodić M&B Holding, as well as the opening of the new Trade Center in Mostar, commencement of construction in Novi Sad, opening of the new Trade Center in Lesce and refurbishment of some of our outlets. Topics that were of most interest to the media during the summer and the beginning of fall, were operations in foreign markets, especially in Croatia, adoption of Euro and potential related price increases, autumn negotiations with the suppliers, launching the new Mercator M mobil offer, Mercator Pika card, founding the new Chamber of Commerce and the new collective labor agreement that also includes the provisions on the Sunday working hours.

## FINANCIAL STATEMENTS

### ACCOUNTING POLICIES

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

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period 1-9 2006 have not been audited.

In accordance with the International Financial Reporting Standards the financial statements of the Mercator Group and the Poslovni sistem Mercator, d.d. for the period I-IX 2005 have been adjusted for the effects resulting from merger of companies Era Tornado, d.o.o., and Trgohit, d.o.o., into the Mercator Group on Sept. 19<sup>th</sup> 2005. The effect of merging particular companies is disclosed in accordance with the IFRS 3, while the effect of purchasing properties related to the Shopping Center Samobor are disclosed in accordance with the IAS 36 and IAS 16. Major portion of the impact is represented by an impairment of goodwill in the amount of SIT 2.6 billion, and an impairment of property, plant and equipment in the amount of SIT 1.5 billion, while other changes in the aggregate amount of SIT 1.2 billion relate to loss from operations, generated by the companies Era Tornado, d.o.o., and Trgohit, d.o.o., mostly from adjustments in working capital.

### CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

In addition to the parent company Poslovni sistem Mercator, d.d., consolidated financial statements of the Mercator Group comprise 13 subsidiaries in which the parent company directly or indirectly holds the controlling ownership share, as follows:

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

## Consolidated Income Statement

in SIT 000

	Type of revenue / expense / cost	1-9 2005 (adjusted)	Plan 2006	1-9 2006	Index	Index
1	2	3	4	5	6=5/3	7=5/4
<b>A.</b>	<b>Net sales revenues</b>	<b>297,796,288</b>	<b>465,362,411</b>	<b>351,286,461</b>	<b>118.0</b>	<b>75.5</b>
1.	Revenues from products sold	4,734,607	6,905,448	4,745,152	100.2	68.7
2.	Revenues from services sold	17,821,190	29,503,462	22,794,750	127.9	77.3
3.	Revenues from goods and material sold	275,240,490	428,953,501	323,746,559	117.6	75.5
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-216,018,870</b>	<b>-337,447,864</b>	<b>-254,091,920</b>	<b>117.6</b>	<b>75.3</b>
1.	Production costs	-8,205,188	-11,271,325	-7,441,230	90.7	66.0
2.	Purchase value of goods and material sold	-210,165,574	-331,234,775	-250,023,584	119.0	75.5
3.	Received cassasconts	3,721,225	5,080,806	3,847,022	103.4	75.7
4.	Other expenses	-1,369,333	-22,569	-474,127	34.6	2,100.8
<b>C.</b>	<b>GROSS PROFIT/LOSS</b>	<b>81,777,418</b>	<b>127,914,547</b>	<b>97,194,541</b>	<b>118.9</b>	<b>76.0</b>
D.	Selling and marketing costs	-59,131,950	-90,400,677	-71,564,122	121.0	79.2
E.	Administrative expenses	-19,794,175	-24,364,691	-16,752,499	84.6	68.8
F.	Other gains - net	2,323,903	1,584,628	2,083,767	89.7	131.5
<b>G.</b>	<b>OPERATING PROFIT/LOSS</b>	<b>5,175,195</b>	<b>14,733,808</b>	<b>10,961,687</b>	<b>211.8</b>	<b>74.4</b>
H.	Financial revenue	2,843,159	1,067,158	2,348,231	82.6	220.0
I.	Financial costs	-4,334,785	-6,658,111	-6,195,792	142.9	93.1
<b>J.</b>	<b>PROFIT/LOSS BEFORE INCOME TAX</b>	<b>3,683,569</b>	<b>9,142,855</b>	<b>7,114,126</b>	<b>193.1</b>	<b>77.8</b>
K.	Income tax expense	-1,155,098	-3,557,636	-1,932,194	167.3	54.3
L.	Deferred tax	0	550,000	-68,398	-	-
<b>M.</b>	<b>PROFIT/LOSS FOR THE FINANCIAL PERIOD</b>	<b>2,528,471</b>	<b>6,135,219</b>	<b>5,113,534</b>	<b>202.2</b>	<b>83.3</b>
N.	Profit/loss attributable to equity holders of the Company	2,464,137	5,993,020	5,030,166	204.1	83.9
O.	Profit/loss attributable to minority interest	64,335	142,198	83,368	129.6	58.6
<b>P.</b>	<b>GROSS CASH FLOW FROM OPERATING ACTIVITIES*</b>	<b>18,819,118</b>	<b>30,015,815</b>	<b>22,555,787</b>	<b>119.9</b>	<b>75.1</b>
<b>R.</b>	<b>COMPERABLE OPERATING PROFIT/LOSS*</b>	<b>8,301,031</b>	<b>14,538,671</b>	<b>10,124,945</b>	<b>122.0</b>	<b>69.6</b>
<b>S.</b>	<b>COMPARABLE PROFIT/LOSS BEFORE INCOME TAX*</b>	<b>5,319,871</b>	<b>8,790,704</b>	<b>6,314,766</b>	<b>118.7</b>	<b>71.8</b>
<b>T.</b>	<b>COMPARABLE PROFIT/LOSS FOR THE FINANCIAL PERIOD*</b>	<b>3,755,698</b>	<b>5,871,106</b>	<b>4,514,014</b>	<b>120.2</b>	<b>76.9</b>

\*Calculations of particular items are displayed in the section Notes to the Consolidated Financial Statements.

## Consolidated Balance Sheet

in SIT 000

1	Type of assets / liabilities	31.12.2005	Plan 31.12.2006	30.9.2006	Structure 30.9.2006	Index	Index
	2	3	4	5	6	7=5/3	8=5/4
	<b>ASSETS</b>						
	<b>A. NON-CURRENT ASSETS</b>	<b>281,200,346</b>	<b>303,233,915</b>	<b>292,341,011</b>	<b>76.5%</b>	<b>104.0</b>	<b>96.4</b>
I.	Property, plant and equipment	275,551,749	297,754,831	287,573,158	75.2%	104.4	96.6
II.	Intangible assets	2,425,106	2,223,320	2,300,700	0.6%	94.9	103.5
III.	Deferred income tax assets	683,504	1,240,121	654,235	0.2%	95.7	52.8
IV.	Derivative financial instruments	27,770	30,000	28,269	0.0%	101.8	94.2
V.	Trade and other receivables	2,512,217	1,985,643	1,784,649	0.5%	71.0	89.9
	<b>B. CURRENT ASSETS</b>	<b>86,178,549</b>	<b>84,986,865</b>	<b>90,052,751</b>	<b>23.5%</b>	<b>104.5</b>	<b>106.0</b>
I.	Inventories	43,109,610	43,602,447	47,689,660	12.5%	110.6	109.4
II.	Trade and other receivables	38,390,093	37,599,412	38,931,869	10.2%	101.4	103.5
III.	Other financial assets at fair value through profit and loss	718,042	270,407	232,199	0.1%	32.3	85.9
IV.	Cash and cash equivalents	3,960,805	3,514,599	3,199,022	0.8%	80.8	91.0
	<b>TOTAL ASSETS</b>	<b>367,378,895</b>	<b>388,220,780</b>	<b>382,393,762</b>	<b>100.0%</b>	<b>104.1</b>	<b>98.5</b>
	<b>A. EQUITY</b>	<b>132,048,107</b>	<b>139,959,237</b>	<b>135,003,037</b>	<b>35.3%</b>	<b>102.2</b>	<b>96.5</b>
	<b>Majority interest equity</b>	<b>130,622,020</b>	<b>138,620,676</b>	<b>133,478,428</b>	<b>34.9%</b>	<b>102.2</b>	<b>96.3</b>
I.	Share capital	41,153,268	46,068,546	46,145,117	12.1%	112.1	100.2
II.	Other reserves	14,208,756	13,453,689	12,765,511	3.3%	89.8	94.9
III.	Retained earnings	75,259,996	79,098,441	74,567,800	19.5%	99.1	94.3
	<b>Minority interest</b>	<b>1,426,087</b>	<b>1,338,561</b>	<b>1,524,609</b>	<b>0.4%</b>	<b>106.9</b>	<b>113.9</b>
	<b>LIABILITIES</b>						
	<b>B. NON-CURRENT LIABILITIES</b>	<b>110,854,659</b>	<b>114,133,565</b>	<b>109,991,975</b>	<b>28.8%</b>	<b>99.2</b>	<b>96.4</b>
I.	Borrowings	106,239,658	109,904,945	100,860,695	26.4%	94.9	91.8
II.	Derivative financial instruments	0	0	151,516	-	-	-
III.	Deferred income tax liabilities	386,430	0	4,656,688	1.2%	1,205.1	-
IV.	Retirement benefit obligations	4,228,571	4,228,620	4,323,076	1.1%	102.2	102.2
	<b>C. CURRENT LIABILITIES</b>	<b>124,476,129</b>	<b>134,127,978</b>	<b>137,398,750</b>	<b>35.9%</b>	<b>110.4</b>	<b>102.4</b>
I.	Trade and other payables	60,693,939	66,753,353	54,840,853	14.3%	90.4	82.2
II.	Borrowings	60,382,752	63,975,187	79,281,981	20.7%	131.3	123.9
III.	Provisions for other liabilities and charges	3,399,438	3,399,438	3,275,916	0.9%	96.4	96.4
	<b>TOTAL LIABILITIES</b>	<b>235,330,788</b>	<b>248,261,543</b>	<b>247,390,725</b>	<b>64.7%</b>	<b>105.1</b>	<b>99.6</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>367,378,895</b>	<b>388,220,780</b>	<b>382,393,762</b>	<b>100.0%</b>	<b>104.1</b>	<b>98.5</b>

## Consolidated Cash-Flow Statement

in SIT 000

	Cash flows	Plan 2006	1-9 2006
1	2	3	4
<b>A</b>	<b>Cash flows from operating activities</b>		
	<b>Gross cash flow from operating activities before change in working capital</b>	<b>30,015,815</b>	<b>22,555,787</b>
	<b>Changes in working capital</b>		
1	Trade and other receivables	-790,681	-337,892
2	Inventories	492,837	-4,580,051
3	Trade and other payables	5,342,939	-5,916,702
	<b>Cash generated from operations</b>	<b>35,060,911</b>	<b>11,721,142</b>
4	Interest paid	-5,797,824	-5,839,603
5	Income tax paid	-3,557,636	-2,000,592
<b>I</b>	<b>Net cash generated from operating activities</b>	<b>25,705,451</b>	<b>3,880,948</b>
<b>B</b>	<b>Cash flows from investing activities</b>		
1	Purchases of property, plant and equipment (PPE)	-39,225,584	-25,605,789
2	Proceeds from sale of PPE	3,243,115	2,455,095
3	Purchases of intangible assets	-955,312	-383,439
4	Proceeds from sale of intangible assets	20,152	3,502
5	Movement of non-current investments	0	68,159
6	Purchase of current investments	0	-206,301
7	Loans made	6,667	-2,596
8	Loan repayments received	0	73,011
9	Proceeds from sale of current investments	304,089	578,081
10	Interest received	474,857	2,029,423
<b>II</b>	<b>Net cash used in investing activities</b>	<b>-36,132,016</b>	<b>-20,990,854</b>
<b>C</b>	<b>Cash flows from financing activities</b>		
1	Proceeds from issuance of shares	4,915,295	4,915,295
2	Proceeds/repayments from borrowings	7,270,197	13,520,266
3	Dividends paid to Company's shareholders	-2,154,506	-2,098,455
<b>III</b>	<b>Net cash used in financing activities</b>	<b>10,030,985</b>	<b>16,337,106</b>
<b>1</b>	<b>Net increase/decrease in cash</b>	<b>-395,580</b>	<b>-772,800</b>
2	Cash at beginning of the financial period	3,960,805	3,960,805
3	Exchange gains/losses on cash	-50,626	11,018
<b>IV</b>	<b>Cash at end of the financial period</b>	<b>3,514,599</b>	<b>3,199,023</b>

## Consolidated Statement of Changes in Equity

in SIT 000

	I. Share capital	II. Other reserves	III. Retained earnings	Minority interest	Total
<b>Balance as at 1 January 2006</b>	<b>41,153,268</b>	<b>14,208,756</b>	<b>75,259,996</b>	<b>1,426,087</b>	<b>132,048,107</b>
Restatement:					
Deferred income tax liabilities	0	-1,837,055	-2,471,342	0	-4,308,397
<b>Balance as at 1 January 2006 (adjusted)</b>	<b>41,153,268</b>	<b>12,371,701</b>	<b>72,788,654</b>	<b>1,426,087</b>	<b>127,739,710</b>
Profit/loss for the financial period	0	0	5,030,166	83,368	5,113,534
Issue of share capital	4,915,295	0	0	0	4,915,295
Treasury shares	76,554	0	0	0	76,554
Dividend paid	0	0	-2,113,661	0	-2,113,661
Cash flow hedge net of tax	0	-151,017	0	0	-151,017
Currency translation differences	0	74,388	0	0	74,388
Change in share capital of existing subsidiaries	0	0	0	15,154	15,154
Revaluation of PP&E to fair value	0	565,290	-1,904,056	0	-1,338,766
Deferred tax	0	-94,851	0	0	-94,851
Other changes	0	0	766,697	0	766,697
<b>Balance as at 30 September 2006</b>	<b>46,145,117</b>	<b>12,765,511</b>	<b>74,567,800</b>	<b>1,524,609</b>	<b>135,003,037</b>

## Notes to the Consolidated Financial Statements

### NOTES TO THE CONSOLIDATED INCOME STATEMENT

- Net sales revenues**

Net sales revenues for the relevant period amounted to SIT 351,286 million and arrived at 75.5 % of planned net sales revenues for the year 2006, and exceed the figures from the comparable period last year by 18.0 %, which is considerably the consequence of taking over the retail units from the company Era Velenje, d.d., by the companies Poslovni sistem Mercator, d.d., and Mercator – SVS, d.d., in January, as well as the takeover of companies Era Tornado, d.o.o., and Trgohit, d.o.o., at the end of the year 2005. Revenues resulting from the sale of goods and materials take 92.2 % of net revenues, while the remaining 7.8 % originates from revenues from sales of products and services.

Without revenues originating from the acquired Era outlets in Slovenia and in Croatia, Mercator Group would have realized SIT 324.5 billion in the period 1-9 2006, which would represent a 9.0 % increase compared to the same period in the year 2005.

- Cost of goods sold**

Costs associated with sold products including production costs, purchase value of sold goods and materials and other operating expenditures in the relevant period amounted to SIT 254,092 million, and exceed the same category by 17.6 % compared to the last year figures, which is mostly the consequence of increased extent of operations.

- **Gross profit**

Gross profit for the period 1 - 9 2006 amounted to SIT 97,195 million, which is an 18.9 % increase compared to the period 1 - 9 2005 and represents 76.0 % of the 2006 plan.

- **Selling costs and administrative expenses**

Selling costs and administrative expenses amounted to SIT 88,317 million and exceed the figures for the comparable period last year for 11.9 %, representing 77.0 % of the 2006 plan.

#### Expenditures by nature

in SIT 000

	Type of Cost	1-9 2005 (adjusted)	Plan 2006	1-9 2006	Structure 1- 9 2006	Index
1	2	3	4	5	6	7=5/4
1	Costs of material	10,756,295	16,502,337	12,078,367	3.5%	73.2
2	Costs of services	19,454,774	31,778,417	24,791,524	7.2%	78.0
3	Depreciation	10,518,088	15,477,144	12,430,841	3.6%	80.3
4	Labour costs	39,912,865	60,063,896	44,509,173	13.0%	74.1
5	Other expenses	7,858,622	2,237,468	2,422,075	0.7%	108.3
6	Costs of goods sold	206,444,351	326,153,969	246,176,562	71.9%	75.5
7	<b>TOTAL COSTS</b>	<b>294,944,995</b>	<b>452,213,231</b>	<b>342,408,541</b>	<b>100.0%</b>	<b>75.7</b>

Cost of material amounted to SIT 12,078 million, and recorded 12.3 % increase compared to the same period last year, which is largely the consequence of increases in the costs of energy.

Cost of services amounted to SIT 24,792 million and recorded a 27.4 % increase compared to the same period last year. Increase is mostly the consequence of integration of the company Era operations in Slovenia and in Croatia, the project of dual price tagging required by the expected introduction of Euro, and due to certain intensified marketing activities.

Labor costs are increasing in line with the increase in the number of employees.

- **Other revenues from operations**

Other revenues from operations amounted to SIT 2,084 million, of which SIT 835 million is related to profit from the sale of property, plant and equipment, with the majority in the sum of SIT 279 million being related to proceeds from the sale of the Kanin hotel in Bovec, while other revenues from operations (compensations, donations, subsidies, written-off due claims) amounted to SIT 1,249 million.

- **Operating profit**

Operating profit for the period 1 - 9 2006 amounts to SIT 10,962 million and represents 74.4% of the 2006 plan.

- **Financial revenues**

Financial revenues amounted to SIT 2,348 million, which is SIT 495 million less than in the period 1-9 2005, when profit from the sale of Sava, d.d., shares amounted to SIT 1.5 billion.

- **Financial expenditures**

Financial expenditures for the relevant period amount to SIT 6,196 million, of which major portion includes expenditures from interest paid and financial lease. Compared to the same period last year they represent 42.9 % increase, mostly resulting from increases in interest rates and higher financial liabilities.

- **Profit for the period**

In the period 1 - 9 2006 the Mercator Group realized SIT 5,114 million of net profit, representing 83.3 % of net profit planned for the year 2006. Profit for the current year is not entirely comparable to the last year figures, because both categories had had certain one-off and/or extraordinary accounting items, of which the most important are impairment of goodwill and property of Era companies in Croatia in the year 2005 amounting to SIT 4.1 billion, and proceeds from the sale of Sava, d.d. securities in the year 2005 amounting to SIT 1.5 billion. Comparable profit whose calculation is disclosed below, amounted to SIT 4,514 million, and represents 20.2 % increase over last year.

- **Gross cash flow from operations**

Gross cash flow from operations of the Mercator Group for the relevant period amounted to SIT 22,556 million, which is 19.9 % more compared to the period 1- 9 2005, arriving at 75.1 % of the 2006 plan.

The calculation is indicated in the following chart:

in SIT 000

Cash flows	1-9 2005	Plan 2006	1-9 2006	Index 1 - 9 2006/1 - 9 2005	Index 1 - 9 2006/Plan 2006
Profit/loss for the financial period	2,528,471	6,135,219	5,113,534	202.2	83.3
Income tax	1,155,098	3,007,636	2,000,592	173.2	66.5
Depreciation of property, plant and equipment	10,518,088	15,477,144	12,430,841	118.2	80.3
Impairment of goodwill	2,629,408	0	0	-	-
Impairment of property, plant and equipment	1,458,721	0	153,466	10.5	-
Net gains from sale of property, plant and equipment	-660,083	-352,151	-706,372	107.0	200.6
Net movement of provisions	-17,933	0	-123,522	688.8	-
Net gains from sales of financial assets	-1,487,204	0	-122,932	8.3	-
Negative goodwill recognised directly in profit and loss statement	-286,608	0	0	-	-
Net interest paid	2,981,160	5,747,967	3,810,179	127.8	66.3
<b>Gross cash flow from operating activities</b>	<b>18,819,118</b>	<b>30,015,815</b>	<b>22,555,787</b>	<b>119.9</b>	<b>75.1</b>

In the period 1 – 9 2006 the Mercator Group realized 75.1 % of the planned gross cash flow from operating activities for the entire year 2006.

- **Comparable profit / loss**

Since business results of the Mercator Group for the years 2006 and 2005 have been importantly influenced by the one-off and/or extraordinary accounting situations, the comparable categories of profit disclosed below exclude the impact of such one-off and/or extraordinary accounting situations.

Comparable profit from operations for the period 1-9 2006 amounted to SIT 10,125 million, which is 22.0 % increase compared to the same period last year.

Comparable profit before taxes amounts to SIT 6,315 million, which is 18.7 % more than compared to the same period last year and represents 71.8 % of the 2006 plan.

Comparable profit for the relevant period 1-9 2006 amounted to SIT 4,514 million, which is 20.2 % increase compared to the same period last year, and account for 76.9 % of the 2006 plan.

Comparable profit for the relevant period compared to the original profit for the relevant period excluded the impairment in goodwill, impairment of property, plant and equipment, net proceeds from the sale of property, plant and equipment, net proceeds from the sale of financial assets, recognized negative goodwill and changes in the amount of provisions.

The calculation of comparable profit categories is indicated in the following chart:

in SIT 000

	1-9 2005	Plan 2006	1-9 2006	Index 1-9 2006/1-9 2005	Index 1-9 2006/Plan 2006
Gross cash flow from operating activities	18,819,118	30,015,815	22,555,787	119.9	75.1
Depreciation	-10,518,087	-15,477,144	-12,430,841	118.2	80.3
<b>Comparable operating profit/loss</b>	<b>8,301,031</b>	<b>14,538,671</b>	<b>10,124,945</b>	<b>122.0</b>	<b>69.6</b>
Net interest paid	-2,981,160	-5,747,967	-3,810,179	127.8	66.3
<b>Comparable profit/loss before income tax</b>	<b>5,319,871</b>	<b>8,790,704</b>	<b>6,314,766</b>	<b>118.7</b>	<b>71.8</b>
Adjusted income tax	-1,564,174	-2,919,598	-1,800,752	115.1	61.7
<b>Comparable profit/loss for the financial period</b>	<b>3,755,698</b>	<b>5,871,106</b>	<b>4,514,014</b>	<b>120.2</b>	<b>76.9</b>

Tax on profit has been adjusted for tax on one-off and/or extraordinary impacts on taxable amount applying the 25 % marginal tax rate.

## NOTES TO THE CONSOLIDATED BALANCE SHEET

### • **Property, plant and equipment**

The value of property, plant and equipment as at September 30<sup>th</sup> 2006 amounted to SIT 289,874 million and represents an increase of SIT 11,897 million compared to the situation as at December 31<sup>st</sup> 2005. The change largely originates from:

- investments in total amount of SIT 25,989 million;
- depreciation in the amount of SIT 12,431 million;
- disposal of non-operating (redundant) assets in the amount of SIT 1,752 million;
- impairment of Era facilities in the amount of SIT 1,904 million;
- impairment of Mercator – S, d.o.o., Srbija facilities in the amount of SIT 153 million,
- increase in value of Era facilities in the amount of SIT 565 million;
- exchange rate differences in the amount of SIT 443 million;
- other net increases in value, in the amount of SIT 1,140 million.

Impairment of property, plant and equipment in the amount of SIT 1,904 million for the difference between cost and fair value of particular real estate property is related to property, plant and equipment whose acquisition had been agreed upon with the company Era, d.d. in the year 2005. Since the identified impairments originate from the contractual deal entered into in the year 2005, in accordance with the IAS 8 the impairment was disclosed as change in the calculated capital (decrease in other reserves from capital) in the year 2006.

### • **Derivative financial instruments**

As at Sept. 30, 2006 the amount of derivative financial instruments with positive fair value is SIT 28 million, which is SIT 0.5 million more than the balance on Dec. 31, 2005. The value of derivative financial instruments with negative fair value amounts to SIT 152 million.

### • **Long term financial investments**

Long term financial investments as at Sept. 30, 2005 amounted to SIT 1,785 million and indicate SIT 727 million decrease compared to the figure on Dec. 31, 2005

### • **Inventories**

Stock of raw materials and trade goods on Sept. 30, 2006 amounted to SIT 47,690 million and represent 53.0% in the structure of current assets. Compared to the position at the beginning of the year the volume of inventories increased for SIT 4,580 million, mostly due to the takeover of Era, d.d. retail units and the opening of new retail outlets.

- **Trade and other receivables**

As at September 30<sup>th</sup> 2006 the trade and other receivables amounted to SIT 38,932 million and recorded an increase of SIT 542 million compared to the balance at the beginning of the year.

- **Other financial assets at fair value**

Other financial assets at fair value include mostly current loans approved and deposits which at Sept. 30, 2006 amounted to 232 million, and compared to the beginning of the year 2006 decreased for SIT 486 million.

- **Equity**

in SIT 000

	<b>31 December 2005</b>	<b>30 September 2006</b>
Majority interest equity	130,622,020	133,478,428
Minority interest	1,426,087	1,524,609
<b>Total</b>	<b>132,048,107</b>	<b>135,003,037</b>

In the period 1-9 2006 the majority interest recorded an increase of SIT 2,856 million. Changes are related to the:

- increase in the amount of SIT 4,915 million from capital increase of the parent company by the KD Group, d.d., and the company KLM, d.d.;
- increase resulting from realized net profit for the period 1-9 2006 in the amount of SIT 5,030 million;
- capital increase in the amount of SIT 767 million due to tax refund to the company Poslovni sistem Mercator, d.d., from the differences in the previous years;
- capital increase in the amount of SIT 565 million due to the increase in value of Era facilities in Slovenia;
- capital increase in the amount of SIT 74 million due to differences in exchange rates for the translation of financial statements of foreign companies to the base currency;
- reduction of capital in the amount of SIT 1,904 million, due to impairment of Era facilities in Slovenia;
- reduction of liabilities resulting from allocation of deferred taxes, in the amount of SIT 4,308 million, as at January 1<sup>st</sup> 2006;
- reduction of revaluation capital adjustment due to allocation of deferred tax liabilities in the amount of SIT 95 million.
- reduction of capital due to the payment of dividends in the amount of SIT 2,114 million;
- reduction of capital for changes in fair value of derivative financial instruments in the amount of SIT 151 million,
- increase in capital for deposited own stock with the National Clearing Agency (KDD, d.d.) for the performance of merger of companies, in the amount of 77 million.

Reduction in capital related to other reserve from capital in the amount of SIT 1.904 million includes identified impairment in the value of fixed assets in the amount of difference between cost and fair value of particular real estate property agreed with the company Era d.d. in the year 2005. In accordance with the IAS 8 this was disclosed as recalculation of capital. Value increment for the Era, d.d. facilities in Slovenia was identified as increase in revaluation adjustment of capital in line with the assessment of the certified appraiser.

- **Borrowings**

Non-current borrowings as at September 30<sup>th</sup> 2006 amounted to SIT 100,861 million and recorded a decrease of SIT 5,379 million compared to the beginning of the year.

Current borrowings as at September 30<sup>th</sup> 2006 amounted to SIT 79,282 million and recorded an increase of SIT 18,899 million compared to the beginning of the year. The largest portion of short term liabilities from financing originates from current borrowings from commercial banks. Increase in short term financial liabilities is largely the consequence of movements in working capital.

Compared to the beginning of the year the maturity of borrowings has changed, so that the Non-current borrowings represent 56.0 %, and current borrowings 44.0 % of the overall structure of borrowings.

The composition of borrowings by currency includes 87.4 % of borrowings in EUR, 11.8 % are borrowings in SIT and 0.8 % borrowings are in other currencies.

The share of borrowings in total borrowings by applying variable interest rate amounts to 36 %, and by applying fixed or hedged interest rate it amounts to 64 %.

- **Retirement benefit obligations**

As at September 30<sup>th</sup> 2006 the retirement benefit obligations amounted to SIT 4,323 million, representing SIT 95 million increase compared to the beginning of the year. Retirement obligations / liabilities include liabilities for retirement indemnity payments and jubilee awards; they are considered pursuant accounting standard IAS 19.

- **Trade and other payables**

Operational and other liabilities amounted on Sept. 30, 2006 to SIT 54,841 million, and compared to the beginning of the year indicate decrease of SIT 5,853 million. The reduction is largely the consequence of changes in the inter-year purchasing dynamics and reduction of liabilities related to investments.

During a recent case, Slovenian law practitioners adopted the view that normative and tariff part of the collective labor agreement for trade industry related to commuting refund are not in line with each other; as a result, employees are receiving more benefits than stipulated. Mercator has already taken steps to protect its interest. Since probability and amount of any

liabilities of Slovenian companies of the Mercator Group, related to these proceedings, cannot be estimated, they are not included among the potential liabilities.

- **Provisions**

As at September 31<sup>st</sup> 2006 the balance of provisions amounted to SIT 3,276 million. Compared to the balance at the beginning of the year the provisions recorded a reduction of SIT 124 million.

### Financial indicators

	Mercator Group		
	1-9 2005 (adjusted)	Plan 2006	1-9 2006
<b>Indicators of Profitability</b>			
Return on Equity	3.0%	4.6%	5.2%
Return on Sales	0.8%	1.3%	1.5%
<b>Indicators of Financial Structure</b>			
Borrowings / Equity	1.41	1.24	1.33
Equity and Long-term Provisions to Total Liabilities	34.3%	36.9%	36.2%
Borrowings to Total Liabilities	46.9%	44.8%	47.1%
Trade and Other Payables to Total Liabilities	15.9%	17.2%	14.3%
<b>Indicators of Operating Efficiency and Productivity</b>			
Labor Costs per work hours (in SIT 000)	3,602	3,653	3,590
Sales / Labor Costs	7.5	7.7	7.9
Revenues per Employee per work hours (in SIT 000)	26,878	28,300	28,330
Value Added per Employee per work hours (in SIT 000)	5,301	5,478	5,409
Gross Cash Flow from Operating Activities / Sales	6.3%	6.4%	6.4%
Total Costs without Depreciation / Sales	23.0%	21.3%	21.6%
Invested Capital (in billion SIT)	237	307	307
Gross Cash Flow from Operating Activities / Invested Capital	10.6%	9.8%	9.8%

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

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

To provide comparability of company operations for the period 1-9 2006 with the operations in the same period last year, the Financial Statements of the company Poslovni sistem Mercator, d.d., for the period 1-9 2005 have been adjusted to suit the requirements of the International Financial Reporting Standards.

**The statements of the company Poslovni system Mercator, d.d., are considerably affected by unique or extraordinary accounting events. Any economic analysis should be based on the consolidated financial statements of the Mercator Group.**

### Income statement

in SIT 000

1	2	3	4	5	6=5/3	7=5/4
	Type of revenue / expense / cost	1-9 2005 (adjusted)	Plan 2006	1-9 2006	Index	Index
<b>A.</b>	<b>Net sales revenues</b>	<b>209,551,147</b>	<b>323,231,216</b>	<b>251,252,458</b>	<b>119.9</b>	<b>77.7</b>
1.	Revenues from products sold	285,677	271,290	469,256	164.3	173.0
2.	Revenues from services sold	14,196,073	24,853,804	19,106,579	134.6	76.9
3.	Revenues from goods and material sold	195,069,397	298,106,122	231,676,623	118.8	77.7
<b>B.</b>	<b>COST OF GOODS SOLD</b>	<b>-152,769,095</b>	<b>-233,657,595</b>	<b>-182,301,683</b>	<b>119.3</b>	<b>78.0</b>
1.	Production costs	-111,065	-402,416	-117,751	106.0	29.3
2.	Purchase value of goods and material sold	-152,577,080	-233,255,179	-182,142,631	119.4	78.1
3.	Other expenses	-80,950	0	-41,301	51.0	-
<b>C.</b>	<b>GROSS PROFIT/LOSS</b>	<b>56,782,052</b>	<b>89,573,621</b>	<b>68,950,775</b>	<b>121.4</b>	<b>77.0</b>
Č.	Selling and marketing costs	-46,718,073	-57,626,225	-48,125,114	103.0	83.5
D.	Administrative expenses	-2,656,241	-20,495,804	-12,788,448	481.4	62.4
E.	Other gains - net	1,192,773	6,395,308	886,410	74.3	13.9
<b>F.</b>	<b>OPERATING PROFIT/LOSS</b>	<b>8,600,511</b>	<b>17,846,899</b>	<b>8,923,623</b>	<b>103.8</b>	<b>50.0</b>
G.	Financial revenue	2,048,521	749,477	1,883,494	91.9	251.3
H.	Financial costs	-7,944,015	-4,541,637	-3,970,098	50.0	87.4
<b>I.</b>	<b>PROFIT/LOSS BEFORE INCOME TAX</b>	<b>2,705,017</b>	<b>14,054,739</b>	<b>6,837,019</b>	<b>252.8</b>	<b>48.6</b>
J.	Income tax expense	-856,410	-2,991,385	-1,422,541	166.1	47.6
K.	Deferred tax	0	500,000	-52,802	-	-
<b>L.</b>	<b>PROFIT/LOSS FOR THE FINANCIAL PERIOD</b>	<b>1,848,607</b>	<b>11,563,354</b>	<b>5,361,676</b>	<b>290.0</b>	<b>46.4</b>
M.	Number of employees based on hours worked	9,198	10,585	10,716	116.5	101.2

## Balance Sheet

in SIT 000

	Type of assets / liabilities	31.12.2005	Plan 31.12.2006	30.9.2006	Structure 30.9.2006	Index 7=5/3	Index 8=5/4
1	2	3	4	5	6	7=5/3	8=5/4
	<b>ASSETS</b>						
	<b>A. NON-CURRENT ASSETS</b>	<b>237,643,490</b>	<b>257,498,346</b>	<b>249,429,528</b>	<b>78.9%</b>	<b>105.0</b>	<b>96.9</b>
I.	Property, plant and equipment	142,300,926	166,705,168	152,957,254	48.4%	107.5	91.8
II.	Intangible assets	950,877	2,153,764	1,246,411	0.4%	131.1	57.9
III.	Deferred income tax assets	550,502	600,000	551,893	0.2%	100.3	92.0
IV.	Derivative financial instruments	27,770	30,000	28,269	0.0%	101.8	94.2
V.	Trade and other receivables	93,813,415	88,009,414	94,645,701	30.0%	100.9	107.5
	<b>B. CURRENT ASSETS</b>	<b>62,672,466</b>	<b>69,180,476</b>	<b>66,521,759</b>	<b>21.1%</b>	<b>106.1</b>	<b>96.2</b>
I.	Inventories	25,471,684	26,846,939	30,897,126	9.8%	121.3	115.1
II.	Trade and other receivables	33,922,497	39,028,405	33,820,973	10.7%	99.7	86.7
III.	Other financial assets at fair value through profit and loss	1,459,168	1,465,237	386,170	0.1%	26.5	26.4
IV.	Cash and cash equivalents	1,819,117	1,839,896	1,417,490	0.4%	77.9	77.0
	<b>TOTAL ASSETS</b>	<b>300,315,956</b>	<b>326,678,822</b>	<b>315,951,287</b>	<b>100.0%</b>	<b>105.2</b>	<b>96.7</b>
	<b>A. EQUITY</b>	<b>123,998,458</b>	<b>138,322,600</b>	<b>129,954,744</b>	<b>41.1%</b>	<b>104.8</b>	<b>94.0</b>
I.	Share capital	41,187,421	34,657,465	46,179,270	14.6%	112.1	133.2
II.	Other reserves	21,114,436	14,680,560	19,824,460	6.3%	93.9	135.0
III.	Retained earnings	61,696,601	88,984,576	63,951,014	20.2%	103.7	71.9
	<b>LIABILITIES</b>						
	<b>B. NON-CURRENT LIABILITIES</b>	<b>79,898,160</b>	<b>88,945,126</b>	<b>78,513,674</b>	<b>24.8%</b>	<b>98.3</b>	<b>88.3</b>
I.	Borrowings	74,763,870	85,576,511	72,511,352	23.0%	97.0	84.7
II.	Derivative financial instruments	0	0	151,516	-	-	-
III.	Deferred income tax liabilities	2,153,528	0	2,689,118	0.9%	124.9	-
IV.	Retirement benefit obligations	2,980,762	3,368,615	3,161,688	1.0%	106.1	93.9
	<b>D. CURRENT LIABILITIES</b>	<b>96,419,338</b>	<b>99,411,096</b>	<b>107,482,869</b>	<b>34.0%</b>	<b>111.5</b>	<b>108.1</b>
I.	Trade and other payables	51,089,602	45,505,608	36,767,000	11.6%	72.0	80.8
II.	Borrowings	42,803,688	51,379,441	68,297,642	21.6%	159.6	132.9
III.	Provisions for other liabilities and charges	2,526,048	2,526,048	2,418,227	0.8%	95.7	95.7
	<b>TOTAL LIABILITIES</b>	<b>176,317,498</b>	<b>188,356,222</b>	<b>185,996,543</b>	<b>58.9%</b>	<b>105.5</b>	<b>98.7</b>
	<b>TOTAL EQUITY AND LIABILITIES</b>	<b>300,315,956</b>	<b>326,678,823</b>	<b>315,951,287</b>	<b>100.0%</b>	<b>105.2</b>	<b>96.7</b>

## Cash-Flow Statement

in SIT 000

	<b>Cash flows</b>	<b>Plan 2006</b>	<b>1-9 2006</b>
1	Cash generated from operations	5,500,361	-2,732,923
2	Interest received	749,476	983,610
3	Interest paid	-4,521,637	-3,953,728
4	Income tax paid	-2,991,385	-1,422,541
	<b>Net cash generated from operating activities</b>	<b>-1,263,185</b>	<b>-7,125,582</b>
	<b>Cash flows from investing activities</b>		
1	Purchases of subsidiaries	-1,490,985	-3,847,396
2	Purchases of property, plant and equipment (PPE)	-19,542,066	-12,033,226
3	Purchases of intangible assets	-1,200,000	-102,414
4	Movement of non-current investments	0	-699,639
5	Loans made	0	-68,800
6	Proceeds from sale of subsidiaries	0	0
7	Proceeds from sale of PPE	1,670,972	1,194,052
8	Proceeds from sale of intangible assets	0	0
9	Proceeds from sale of current investments	1,250,975	1,025,186
10	Dividend received	0	0
11	Loan repayments received	405,059	72,900
	<b>Net cash used in investing activities</b>	<b>-18,906,045</b>	<b>-14,459,337</b>
	<b>Cash flows from financing activities</b>		
1	Proceeds from issuance of shares	4,915,295	4,915,295
2	Proceeds/repayments from borrowings	17,429,220	18,366,452
3	Dividend paid to Company's shareholders	-2,154,506	-2,098,455
	<b>Net cash used in financing activities</b>	<b>20,190,009</b>	<b>21,183,292</b>
	Net increase/decrease in cash	20,779	-401,627
	Cash at beginning of the financial period	1,819,117	1,819,117
	Net increase/decrease in cash	20,779	-401,627
	Cash at end of the financial period	1,839,896	1,417,490

## Statement of Changes in Equity

in SIT 000

	I. Share capital	II. Other reserves	III. Retained earnings	Total
<b>Balance as at 31 December 2005</b>	<b>41,187,421</b>	<b>21,114,436</b>	<b>61,696,601</b>	<b>123,998,458</b>
Profit/loss for the financial period	0	0	5,361,676	5,361,676
Revaluation of PP&E to fair value	0	-709,716	-1,760,299	-2,470,015
Treasury shares	76,554	0	0	76,554
Dividend paid	0	0	-2,113,661	-2,113,661
Cash flow hedge net of tax	0	-151,017	0	-151,017
Currency translation differences	0	-429,243	0	-429,243
Issue of share capital	4,915,295	0	0	4,915,295
Other changes	0	0	766,697	766,697
<b>Balance as at 30 September 2006</b>	<b>46,179,270</b>	<b>19,824,460</b>	<b>63,951,014</b>	<b>129,954,744</b>

## Notes to the Financial Statements

### NOTES TO THE INCOME STATEMENT

- **Net sales revenues**

Net sales revenues for the period 1-9 2006 amounted to SIT 251,252 million, which is an increase over the comparable period last year by 19.9 %, and represents 77.7 % of planned net sales revenues for the year 2006.

Revenues resulting from the sale of goods and materials amounted to SIT 231,677 million, which is 36,607 million or 18.8 % more compared to the same period last year. Net increase is largely the consequence of:

- Increase in revenues of Mercator Centers in Ljubljana, Koper, Kranj – Primskovo, Nova Gorica, Celje, Kamnik, Domžale, Slovenj Gradec, Kranj – Savski otok, Novo mesto, Jesenice, Ravne and in Trebnje;
- Revenues of the Novo Mesto I hypermarket, taken over from the company Era, d.d., in January 2006;
- Revenues of market program outlets taken over from the company Alpkomerc Tolmin, d.d., and Era, d.d., which were integrated in the parent company operations in January 2006, in addition to revenues in the newly opened FMCG units;
- Revenues from retail units, acquired from the company Emona Maximarket, d.d., as of April 1<sup>st</sup> 2006.
- Increase in revenues by the hardware store outlets, mostly due to newly opened units and units acquired from the company Era, d.d., Intersport outlets and Hura! discount shops, newly opened units of Beautique drugstores; and
- Increase in revenues of wholesale units.

Revenues from sales of products and services amounted to SIT 19,576 million, which is a 35.2 % increase compared to the same last year period, representing 77.9 % of planned revenues from sales of products and services for the year 2006.

- **Cost of goods sold**

Expenses associated with sold products including production costs, cost value of sold goods and materials and other operating expenditures in the relevant period amounted to SIT 182,302 million, and exceed the same category for 19.3 % compared to the last year figures, which is mostly the consequence of increased extent of operations.

- **Gross profit**

Gross profit for the period 1 - 9 2006 amounted to SIT 68,951 million, representing 77,0 % of the 2006 plan.

- **Selling costs and administrative expenses**

Selling costs and administrative expenses amounted to SIT 60,914 million and exceed the figures for the comparable period last year for 23.4 %, representing 78.0 % of the 2006 plan. Net increase of expenses largely originates from the integration of existing expenditures of the merged companies Alpkomerc, d.d., Emona Maximarket, d.d., and the acquired units of the company Era, d.d., as well as expenditures of some newly opened units.

#### Expenditures by nature

in 000 SIT

	Type of Cost	1-9 2005	Plan 2006	1-9 2006	Index	Index
1	2	3	4	5	6=5/3	7=5/4
1.	Costs of Material	3,712,987	6,106,875	4,575,796	123.2	74.9
2.	Costs of Services	12,306,788	19,954,128	16,747,729	136.1	83.9
3.	Depreciation	5,413,387	8,036,084	6,776,364	125.2	84.3
4.	Provisions for other liabilities and charges	0	0	0	-	-
5.	Labour costs	26,867,925	41,813,374	31,408,580	116.9	75.1
6.	Other Expenses	1,073,226	2,211,570	1,405,094	130.9	63.5
7.	Costs of Goods Sold	152,769,095	233,657,595	182,301,683	119.3	78.0
8.	<b>TOTAL COSTS</b>	<b>202,143,408</b>	<b>311,779,626</b>	<b>243,215,246</b>	<b>120.3</b>	<b>78.0</b>

Cost of material amounted to SIT 4,576 million, and recorded 23.2 % increase compared to the same period last year, which is largely the consequence of increases in costs of energy, heating, spare parts and components for the maintenance of property, plant and equipment and other material costs. The increase is largely the consequence of takeovers of the companies Era, d.d., Emona Maximarket, d.d. and Alpkomerc Tolmin, d.d.

Cost of services amounted to SIT 16,748 million and recorded a 36.1 % increase compared to the same period last year. This increase is mostly the consequence of:

- the project of dual price tagging required by the expected introduction of Euro, and due to certain intensified marketing activities.

- increase of sales promotion costs related to the "Tognana" project;
- integration of the company Era operations in Slovenia, and the integration of companies Emona Maximarket, d.d. and Alpkomerc Tolmin, d.d. into the parent company, and
- increase in costs of transportation, banking, intellectual and other services.

Expenditures from general activities include also losses originating from disposal of fixed assets in the amount of SIT 91 million, and adjustments of current assets in the amount of SIT 633 million, largely related to the adjustments in the value of receivables.

- **Other revenues from operations**

Other revenues from operations amounted to SIT 886 million, of which SIT 296 million is related to the proceeds from disposal of property, plant and equipment, SIT 155 million to the decrease in negative goodwill arising from merger of company M – Modna hiša, d.d., SIT 110 million to received compensations from other sources, SIT 103 million to collected written-off receivables, SIT 88 million to revenues from insurance premium compensations, and the remaining portion to other revenues from operations.

- **Operating profit**

Operating profit for the period 1 - 9 2006 amounted to SIT 8,924 million, representing 50.0 % of planned net profit figure for the year 2006. Considerable portion of the planned operating profit for the year 2006 is represented by the planned decrease of negative goodwill resulting from mergers of companies M – Modna hiša, d.o.o., Alpkomerc, d.d., and Emona Maximarket, d.d. in the amount of SIT 5.2 billion, which is expected to be realized during the last quarter of the year 2006, following the entry of these companies into the Court Register.

- **Financial revenues**

Financial revenues for the period 1 - 9 2006 amounted to SIT 1,883 million, of which the amount of SIT 754 million is related to the revaluation adjustment in the investments of Poslovni sistem Mercator, d.d. into the company Savski otok, d.o.o. when this company was merged, and the remaining financial revenues are mostly related to revenues from late payment interests from current operational receivables.

Compared to the same period last year financial revenues have decreased for SIT 165 million. In the same period last year, financial revenues were increased as the result of proceeds from the disposal of Sava, d.d. stock in the amount of SIT 1,487 million.

## Financial expenditures

Financial expenditures for the period 1-9 2006 amounted to SIT 3,970 million and largely include expenditures from interest paid to commercial banks. In the same period last year financial expenditures amounted to SIT 7,944 million, already adjusted for the impact of takeovers of the companies Era Tornado, d.o.o., in Trgohit, d.o.o., in the amount of SIT 5,334 million. The amount also comprises loss of the company M – H, d.o.o., for the increase in goodwill and impairment of real estate property in the amount of SIT 4.1 billion, as well as the loss created by the companies in Croatia, namely Era Tornado, d.o.o., and Trgohit, d.o.o., mostly related to the current assets write-offs in aggregate amount of SIT 1.2 billion.

- **Profit for the period**

In the period 1-9 2006 the company realized SIT 5,362 million of profit. The profit in this year is not comparable to last year's figure, since both were affected significantly by unique or extraordinary accounting occurrences. Planned profit for 2006 also includes revenues from compensating for the negative goodwill upon the merger of subsidiaries, in the amount of SIT 5.2 billion.

## NOTES TO THE BALANCE SHEET

- **Property, plant and equipment**

The value of property, plant and equipment as at September 30<sup>th</sup> 2006 amounted to SIT 154,204 million which is an increase of SIT 10,952 million compared to the situation at the beginning of the year; it represents 48.8 % in the overall composition of fixed assets. The change largely originates from:

- investments in total amount of SIT 12,136 million;
- assets acquired with the merger of companies Savski otok, d.o.o. and Modna hiša, d.o.o., in the amount of SIT 8.274 million,
- depreciation in the amount of SIT 6,776 million;
- divestment of non-operating (redundant) assets in the amount of SIT 818 million;
- other net reductions in the amount of SIT 1,864 million, mostly related to impairment of real-estate acquired from the company Era, d.d.

Impairment of property, plant and equipment in the amount of SIT 1,902 million for the difference between cost and fair value of particular real estate property is related to property, plant and equipment whose acquisition had been agreed upon with the company Era, d.d. in the year 2005. Since the identified impairments originate from the contractual deal entered into in the year 2005, in accordance with the IAS 8 the impairment was disclosed as change in the calculated capital (decrease in other reserves from capital) in the year 2006.

- **Derivative financial instruments**

As at Sept. 30, 2006 the amount of derivative financial instruments allocated for hedging cash flow against risk is SIT 28 million, which is approximately at the same level as the balance on Dec. 31, 2005.

- **Long term financial investments**

Long term financial investments, including long term approved loans and deposits as at Sept. 30, 2005 amounted to SIT 94,646 million, and are related mostly to ownership shares of associated undertakings within the Mercator Group in Slovenia and abroad. Compared to the balance at the beginning of the year long term financial investments indicate SIT 832 million increase. In the period 1-9 2006 the company increased capital of the companies Mercator – H, d.o.o., and Mercator – S, d.o.o., in total amount of SIT 3,846 million. Reduction of long term financial investments for the relevant period is mostly the consequence of merger of the companies Modna hiša, d.o.o., and Savski otok, d.o.o., into the company Poslovni sistem Mercator, d.d.

- **Inventories**

As at September 30<sup>th</sup> 2006 the value of raw materials, general material, and trading goods in stock amounted to SIT 30,897 million, and in the structure of current assets represented 46.4 %. Compared to the balance at the beginning of the year the extent of inventories recorded an increase of SIT 5,425 million or 21.3 % which is largely the consequence of taking over the operations of the company Alpkomerc Tolmin, d.d., Mercator – Modna hiša, d.o.o., Emona Maximarket, d.d., and the acquisition of Era, d.d., retail network.

- **Trade and other receivables**

As at September 30<sup>th</sup> 2006 the trade and other receivables amounted to SIT 33,821 million and recorded a reduction of SIT 102 million or 0.3 % compared to the balance at the beginning of the year.

- **Other financial assets at fair value**

Other financial assets of the company include among other the current financial investments and short term approved loans and deposits which as at September 30<sup>th</sup> 2006 amounted to SIT 386 million which is SIT 1,073 million less compared to the balance at the beginning of the year 2006. The reduction is largely the consequence of repaid short term lending to the companies Mercator - SVS, d.d., Emona Maximarket, d.d., and Eta, d.d.

## Equity

in SIT 000

	31 December 2005	30 September 2006
Share capital	41,187,421	46,179,270
Other reserves	21,114,436	19,824,460
Retained earnings	61,696,601	63,951,014
<b>Total</b>	<b>123,998,458</b>	<b>129,954,744</b>

Changes in equity in the period 1-9 2006 are related to the:

- increase in the amount of SIT 4,915 million from capital increase of the parent company by the KD Group, d.d. (SIT 4,115 million), and the company KLM, d.d., (SIT 800 million);
- increase resulting from realized net profit for the period 1-9 2006 in the amount of SIT 5,362 million;
- reduction of capital due to the payment of dividends in the amount of SIT 2,114 million;
- reduction of capital due to the change in fair value of the derivative financial instruments in the amount of SIT 151 million.
- net reduction of capital in the amount of SIT 1,716 million, for special capital revaluation, due to impairment of fixed assets acquired from the company Era, d.d.;
- reduction of capital in the amount of SIT 754 million, related to the revaluation adjustment in the investments of Poslovni sistem Mercator, d.d. into the company Savski otok, d.o.o. when this company was merged.
- increase of capital related to the returned tax on profit levied for the preceding year in the amount of SIT 767 million,
- increase of capital in the amount of SIT 77 million related to the deposition of treasury shares with the National Clearing Agency (KDD, d.d.) for the takeover of the companies Emona Maximarket, d.d., Alpkomerc, d.d., and M - SVS, d.d.,
- reduction in capital related to rate differences in long term financial investments in the amount of SIT 429 million.

On Dec. 31, 2005 the company Poslovni sistem Mercator, d.d. owned 68,076 treasury shares, with allocated relevant provisions for own stock in the amount of SIT 1,250,975 thousand. In September 2006 the company Poslovni sistem Mercator, d.d. deposited with the KDD, d.d. treasury shares in the amount of SIT 76,554 thousand to satisfy its liabilities towards minority stockholders related to the merger of companies Emona Maximarket, d.d., Alpkomerc, d.d., and M - SVS, d.d.

### • Borrowings

As at September 30<sup>th</sup> 2006 the borrowings amounted to SIT 140,809 million, which is an increase of SIT 23,241 million compared to the beginning of the year 2006. Increase is

largely the consequence of new borrowing with domestic and foreign commercial banks and other companies.

Compared to the beginning of the year the maturity of borrowings has changed considerably, so that the non-current borrowings represent 51.5 %, and current borrowings 48.5 % of the overall structure of borrowings (as at Dec. 31, 2005 the relationship between non-current and current term borrowings was 63.6 : 36.4).

- **Retirement benefit obligations**

As at Sept. 30, 2006 the retirement liabilities amounted to SIT 3,162 million, which is SIT 181 million more than at the year beginning and is mostly related to the merger of the company M – Modna hiša, d.o.o.

- **Trade and other payables**

As at September 30<sup>th</sup> 2006 trade and other payables amounted to SIT 36,767 million representing a reduction of SIT 14,323 million compared to the beginning of the year. Reduction is largely the consequence of repaid liabilities from the purchase of property.

- **Provisions**

As at September 30<sup>th</sup> 2006 the balance of provisions amounted to SIT 2,418 million. Compared to the balance at the beginning of the year the provisions recorded a reduction of SIT 108 million. Changes are related to:

Increase of provisions for other purposes	+	52 million
Reduction of provisions from the disbursement of provisions	-	160 million
<b>Total changes</b>	<b>=</b>	<b>108 million</b>

## Financial indicators

	Poslovni sistem Merctor, d.d.		
	1-9 2005 (adjusted)	Plan 2006	1-9 2006
Indicators of Profitability			
Return on Equity	2.4%	9.2%	5.8%
Return on Sales	0.9%	3.6%	2.1%
Indicators of Financial Structure			
Borrowings / Equity	1.12	0.99	1.08
Equity and Long-term Provisions to Total Liabilities	44.9%	43.1%	41.9%
Borrowings to Total Liabilities	48.8%	41.9%	44.6%
Trade and Other Payables to Total Liabilities	6.1%	13.9%	11.6%
Indicators of Operating Efficiency and Productivity			
Labor Costs per work hours (in SIT 000)	3,895	3,950	3,908
Sales / Labor Costs	7.8	7.7	8.0
Revenues per Employee per work hours (in SIT 000)	30,377	30,537	31,262
Value Added per Employee per work hours (in SIT 000)	5,851	5,902	5,806
Gross Cash Flow from Operating Activities / Sales	6.4%	6.4%	6.1%
Total Costs without Depreciation / Sales	21.0%	21.7%	21.6%
Invested Capital (in billion SIT)	187	249	249
Gross Cash Flow from Operating Activities / Invested Capital	9.6%	8.3%	8.2%

## EVENTS FOLLOWING THE BALANCE SHEET DATE

Business operations of the Mercator Group and the company Poslovni sistem Mercator, d.d. after the conclusion of the accounting period 1 - 9 2006 have been distinguished by the following major events:

- ✓ On October 19, 2006, the Holding Rodić M&B and Mercator, d.d. signed an agreement for the acquisition of ownership share in the company M-Rodić, d.o.o., Novi Sad. Mercator, d.d. thus became 76 % owner of the company M–Rodić, d.o.o., while the remaining 24% share is retained by the Holding Rodić M&B, and in accordance with the agreement Mercator will buy this remaining share in the years 2008 (12 %) and 2009 (12 %). Price for the 76 % ownership share of the company M – Rodić, d.o.o. amounted to EUR 116 million, of which EUR 30 million will be paid in Mercator, d.d. shares, and the remaining portion with the acceptance of seller's financial liabilities and/or in cash. The company Mercator, d.d. will issue new stock from the approved capital increase, and shares will be valued at average market value at the Ljubljana Stock Exchange in the last calendar year prior the conclusion of the relevant transaction. The issuance price of 174,517 new shares therefore equals to SIT 41,194.77 (171.90 EUR), which is an average market price of the share for September 2006.
- ✓ On October 20, 2006 we opened Mercator Center Maribor II in Slovenia (Pobrežje); this is the second large Mercator shopping center in Maribor area. Total surface of the facility is 7,058 m<sup>2</sup>. In addition to the hypermarket where the system of sorting product groups in the sales area already follows the new sales concept, the center also includes the range of products offered by the specialized shops like Intersport, Modiana with the drugstore, and 17 other retail outlets leased to selected lessees.
- ✓ On October 20, 2006 the Supervisory Board on its correspondence session approved the resolution by the Management Board related to the issuance of 174,517 ordinary shares to the bearer of the company Poslovni sistem Mercator, d.d. at selling price of SIT 41,194.77 per share, relevant to the approved capital increase for the purpose of strategic association with the company M – Rodić, d.o.o.
- ✓ On October 30, 2006 mergers of companies Alpkomerc, d.d., Emona Maximarket, d.d. and M – SVS, d.d. to the company Poslovni sistem Mercator, d.d. were entered in the Court Register.