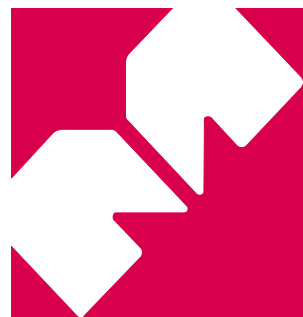
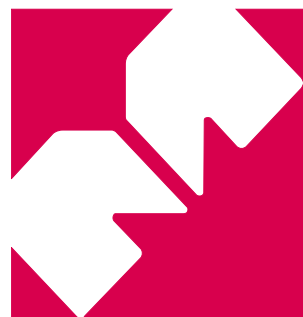


Annual Report 1998



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*Board of Management
(from left to right)
Marjan Sedej, Member
Zoran Janković, Managing Director and
Chairman of the Board of Management
Jadranka Dakič, Member
Aleš Čerin, Member*

1. Letter of the Management Board to the Shareholders

The year 1998 was a turning point for the company Poslovni sistem Mercator, d. d. and its related companies. The Mercator Group is becoming the largest and most successful trading chain in Slovenia, having a clear vision and strategy. The Mercator Group aims to become a prominent player on the competitive European market. Retail network expansion and better service make Mercator's slogan: "Mercator, the best neighbour" a reality, for our customers as well as other stakeholders.

Mercator has focused on retailing, where much progress was made in 1998. With intensified marketing efforts, new shopping centres, supermarkets, and refurbishments, we spread our retailing network, improved our service and increased our popularity. Therefore, it is not surprising that in spite of closing certain economically unjustified outlets, the total sales in the Mercator Group have increased by more than 6% in 1998, to over SIT 128 billion. At the same time productivity also increased by almost 13%.

Progress was achieved not only in sales, but also in purchasing. Organisation of commercial relationships with our business partners, selection of suitable product groups and rationalisation and concentration of supply flows have contributed to more favourable prices for consumers and to greater competitiveness. Our competitiveness was enhanced also by cost-cutting. The result is 10% growth in gross sales profit.

The goal to increase our market share, has been realised in two ways: by investing in our own retail network and by acquisition of other successful trading companies in Slovenia. We consolidated our market position in north-eastern Slovenia by acquisition of the company Klas, Maribor. In 1999 we successfully took-over the companies Goriška and Loka and consolidated our position in Goriška and in Gorenjska. The acquisition of Emona Merkur is still in progress. We financed almost one half of our investments with our own funds which demonstrate our investment potential. The successful expansion of our retailing network is bringing us closer to our goal – to become "The best neighbour" all over Slovenia.

After a bad year with a huge loss in 1997 we had very successful year in 1998. Poslovni sistem Mercator, d. d. realised over SIT 1.3 billion of net income despite an increase in depreciation. The Board of Management is aware that return on equity is still low compared to successful European traders. However we believe that we are on the right path with our vision and strategy. Our goal is to become the most important Slovene trader, effectively fulfilling the wishes and demands of our customers with a wide range, good prices, and good service.


A great contribution to our successful business was the intensified training of our employees with emphasis on employees who directly serve our customers. In the year 1998 the processes for the acquisition of the quality certificate ISO 9001 were started in the Mercator Group, which will have an influence on management effectiveness and the business process.

The business performance of non-trading companies also met our expectations. Our successful work within the Mercator Group is demonstrated by the increase in our share value on the Ljubljana Stock Exchange. It experienced an increase from 4,361 SIT to 7,299 SIT, or about 67%.

We are ready to face challenges in the coming years. Increasing foreign and domestic competition is imminent, therefore we will have to continue our efforts to improve our business efficiency. We will have to integrate newly acquired companies and work on synergy among all companies in the group.

Moreover, we are ready to take part in globalisation. Poslovni sistem Mercator, d. d. will expand its business by entering near-by markets, where we have competitive advantages over foreign companies. This expansion will enable us to further enhance profitability and consolidate our position. We aim to become truly "The best neighbour" to our customers, owners, employees and business partners.

Zoran Janković
Managing Director and Chairman
of the Board of Management



Ljubljana, 30. June, 1999

2. General data

Activity

The basic activity of the company Poslovni sistem Mercator, d. d. is retail and wholesale trade, whereas the Group Mercator also includes the trading, hotel and restaurant businesses, industrial, agricultural and service companies.

Poslovni sistem Mercator, d. d. was founded as a joint-stock company with completed ownership transformation and recorded in the register of legal entities in October, 1995; Reg. Entry No. 1/02785/00 dated 12 October, 1995. The nominal equity of the company amounted to SIT 34.72 billion, and after withdrawal of 127,600 own shares on 31 December, 1996, and 135,736 own shares on 30 June, 1996, it amounts to SIT 32.01 billion.

The total number of issued shares listed on Ljubljana Stock Exchange A list on the 31 December, 1998 was 3,208,504 ordinary registered shares. The nominal value of a share is 10,000 SIT, its average market price as at 31 December, 1998 amounted to 7,299 SIT (unified exchange rate) and its book value is 15,756 SIT.

Board of Management:

Managing Director and Chairman of the Board of Management is Zoran Janković.

Members of the Board of Management are: Aleš Čerin, Jadranka Dakič, Marjan Sedej.

Supervisory Board:

The Chairman of the Supervisory Board is Stane Valant.

Members of the Supervisory Board: Janez Bohorič, Karmen Dietner, Matjaž Gantar, Milan Gerič, Peter Tevž, Niko Trošt, Ksenija Bračič, Jože Cvetek, Dragica Derganc, Nevenka Ferenc, Katja Galof, Stane Jamnik, Jožef Kolar.

Organisation

The company Poslovni sistem Mercator, d. d. is the holding company of the Mercator Group and includes the organisational unit Mercator Trgovina Ljubljana, which carries out trade activity in the area of central Slovenia. The Mercator Group includes besides the holding company the following subsidiaries: 5 trading companies, 2 hotel and restaurant companies, 6 industrial companies, 3 agricultural companies and one service company. The organisation of the Mercator Group in 1998 may be illustrated as follows.

Organisational Scheme of the Mercator Group

Ownership of Mercator Grup d.d. in percentage

<i>Poslovni sistem Mercator, d.d. (Holding Company)</i>	Trade	<i>Mercator SVS, d.d.</i>	100%
		<i>Mercator Dolenjska, d.d.</i>	100%
		<i>Mercator Degro, d.d.</i>	100%
		<i>Mercator Modna hiša, d.d.</i>	100%
		<i>Trgoavto, d.d.</i>	51,01%
	Industry	<i>Mercator Emba, d.d.</i>	51,19%
		<i>Eta, d.d.</i>	74,79%
		<i>Zmajčkov butik, d.d.</i>	66,66%
		<i>Mesnine dežele Kranjske, d.o.o.</i>	90,56%
		<i>Pekarna Grosuplje, d.d.</i>	51,01%
		<i>Slosad, d.o.o.</i>	100%
	Agriculture	<i>Mercator KG Kočevje, d.o.o.</i>	90,94%
		<i>Mercator KŽK Kmetijstvo, d.o.o.</i>	100%
		<i>Mercator Agrokombinat, d.o.o.</i>	100%
	Hotels and Restourants	<i>Mercator Hotel Ilirija, d.o.o.</i>	100%
		<i>Mercator Sremič, d.o.o.</i>	100%
Services	<i>Mercator Optima, d.o.o.</i>	100%	

Besides the controlled companies shown on the above scheme, the company Poslovni sistem Mercator, d. d. owns a majority stake in a foreign company Intermercator GmbH., Klagenfurt. The results are not as yet included in consolidated financial statements.

The company Poslovni sistem Mercator, d. d. is the holding company of the Mercator Group, and is therefore obliged to prepare:

- financial statements for the company Poslovni sistem Mercator, d. d. and*
- financial statements for the Mercator Group.*

The financial statements of Poslovni sistem Mercator, d. d. show the business activity of organisational unit Mercator Trgovina Ljubljana, and indirectly also the business of the Mercator Group. The business results of the subsidiary companies are shown in the profit and loss statement only in the amount of net profits (among revenues from investments in other subsidiary companies) or in the amount of net loss (among long- and short-term investment write-offs), whereas, their revenues and expenses are not stated in the financial statements of the company Poslovni sistem Mercator, d. d., but are only included into the consolidated financial statements of the Mercator Group. In spite of this, the financial statements of the holding company do include some general expenses of the group which are also related to the business operations of subsidiary companies (the costs of acquisitions and mergers, marketing expenses and some other common expenses).

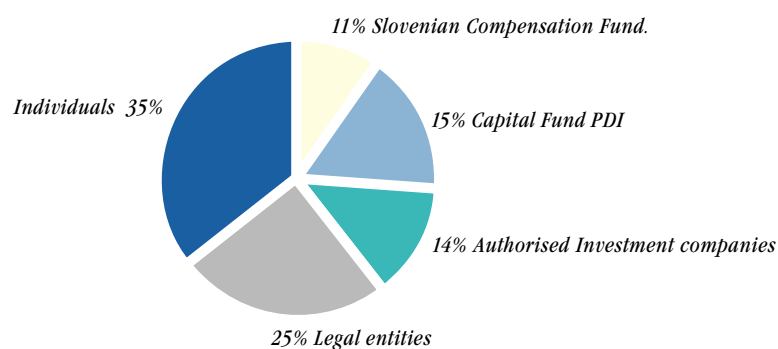
The consolidated financial statements of the Mercator Group show the consolidated financial statements of the holding and all subsidiary companies within the group from which are excluded intergroup transactions.

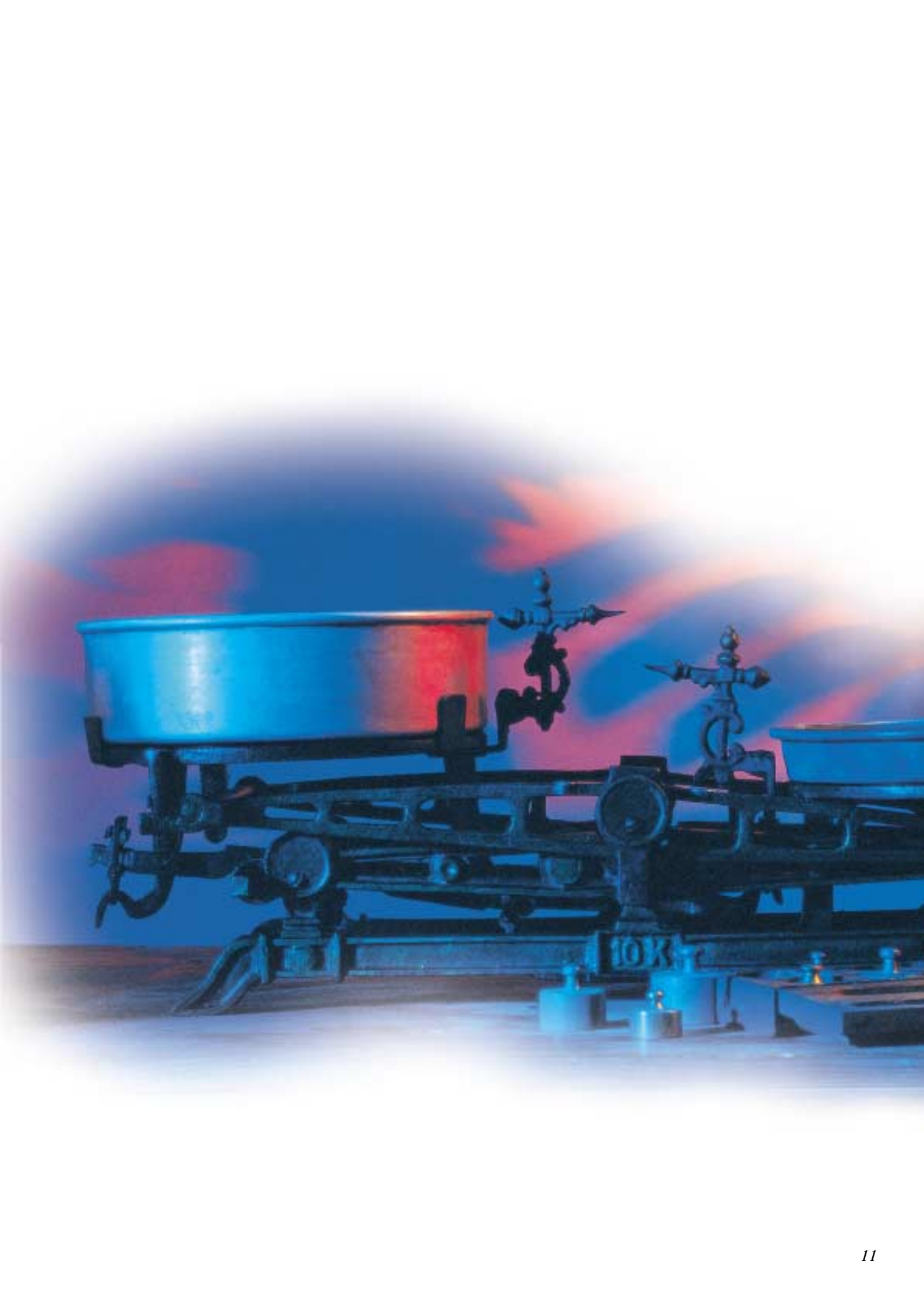
Besides investing in subsidiaries, Poslovni sistem Mercator, d. d. has long-term financial investments in associated companies.

Associated company	Ownership share - %
Associated companies – domestic	
1. Gorenjska mlekarina, d. d. Ljubljana	43
2. Spar Slovenija, d.o.o. Ljubljana	20
3. Unileasing, d.o.o. Ljubljana	20
4. Spectrum, d.o.o. Ljubljana	33
Associated companies – abroad	
5. Goimpex, s.r.l Gorica	25
6. Unimercat, GmbH Muenchen	25

The above companies are not considered as included in the Mercator Group, and therefore they are not included in consolidated statements of the Group.

Ownership Structure





3. Business Report

Important Events in 1998

The financial statements of Poslovni sistem Mercator, d. d. as well as of the Mercator Group for 1998 are not directly comparable to the previous year because of organisational changes in 1998 as well as revaluation of fixed assets in 1997. In order to ensure the comparability of the performance between 1998 and 1997 we have adjusted the following data to those changes.

Main Financial Data of the Mercator Group

	<i>in '000 of SIT</i>		
	1998 <i>(audited data)</i>	1997 <i>(comparable data)</i>	1997 <i>(audited data)</i>
Sales	128,436,900	121,017,063	121,017,063
Operating profit/loss	887,372	-559,580	-11,552,723
Profit/loss from ordinary activities	887,483	-1,609,286	-12,843,050
Net profit/net loss	1,481,054	-2,602,913	-15,207,560
Accumulation	6,619,298	1,716,317	-616
Assets	94,328,581	-	78,375,553
Equity capital	53,843,243	-	48,446,996
No. of employees	7,607	8,082	8,082

The above comparison between 1998 and 1997 data shows a successful performance by the Mercator Group in 1998:

- *increase of sales by 6.1%;*
- *increase of operating income by SIT 2.50 billion as well as net income by SIT 4.10 billion;*
- *increase of accumulation by SIT 4.10 billion; the Mercator Group considers the accumulation to be an important criteria to measure performance, with accumulation being defined as the sum of net income, depreciation and provisions for liabilities and charges;*
- *decrease of number of employees by 5.9%.*

The Mercator Group set an increase of market share as a main goal in 1998. In order to achieve the goal, we started an ambitious investment programme as well as take-overs of retailing companies. The Mercator Group invested SIT 8.64 billion during this period in restructuring and refurbishment of its retailing network as well as in new shopping centres. The Mercator Group successfully took over the company Klas, d. d. through its subsidiary M-SVS, d. d. The holding company Poslovni sistem Mercator, d. d. also bought shares in the following retailing companies: Loka, d. d., Goriška, d. d., Emona Merkur, d. d., Jestvina, d. d. and Špecerija, d. d. in the total amount of SIT 2.73 billion. In 1999 Poslovni sistem Mercator, d. d. included companies Loka, d. d. and Goriška, d. d. and thus formed the fifth and the sixth autonomous regional companies of the Mercator Group.

Accelerated investment activities as well as acquiring a share in targeted companies are the most important reasons for changes in sources of financing. The long-term liabilities of the Mercator Group have increased by SIT 1.68 billion, and short-term liabilities by SIT 8.14 billion, compared to 1997.

For the Mercator Group 1998 was successful and profitable as follows:

- *total consolidated profit was SIT 1,521 million;*
- *operating profit was SIT 887 million;*
- *profit from financing was SIT 0.11 million;*
- *profit from extraordinary activities was SIT 634 million;*
- *taxes on profit was SIT 41 million;*
- *net consolidated profit was SIT 1,481 million.*

The total profit of SIT 1,481 million is split as to SIT 1,359 million to majority owner Poslovni sistem Mercator, d. d. and the rest in the amount of SIT 122 million to minority shareholders in subsidiary companies.

Sales Revenues of the Mercator Group by Activity

Activity	in '000 of SIT			
	1998	1997	Index	Share %
Trade	111,448,043	104,061,431	107.1	86.8
Industry	10,829,708	11,114,000	97.4	8.4
Agriculture	4,683,050	4,448,639	105.3	3.7
Hotels and Restaurants	703,915	746,363	94.3	0.5
Services	772,184	646,630	119.4	0.6
Total	128,436,900	121,017,063	106.1	100.0

The Mercator Group sales revenues in the amount of SIT 128.44 billion, represent 6.1% growth compared to 1997. Revenues have increased in real terms only in service activities, while other activities experienced only nominal increase of revenues or even a decrease in nominal terms as in case of hotels, restaurants and industry. Sales revenues in trade remained in real terms at the level of 1997, due to closures of non-profitable stores as well as temporary closures of stores in the process of refurbishment. Revenues include the income of the new shopping centre in Koper, which is a part of the subsidiary Mercator Degro, d.d. since it opened in July 1998. The revenues of the later acquired company Klas, d. d. will be included in consolidated financial statements for 1999.

Profit and Loss of the Mercator Group by Activity

Activity	in '000 of SIT		
	Profit and Loss in 1998 (audited data)	Profit and Loss in 1997 (comparable data)	Profit and Loss in 1997 (audited data)
Trade	1,362,412	-2,243,095	-11,593,231
Industry	119,889	-372,999	-975,271
Agriculture	3,470	7,955	-1,781,967
Hotels and Restaurants	-18,829	-1,555	-863,872
Services	14,112	6,781	6,781
Total	1,481,054	-2,602,913	-15,207,560
- majority owner	1,359,092	-2,521,471	-15,044,072
- minority owners	121,962	-81,442	-163,488

With the exception of activities in agriculture and hotels and restaurants, other activities significantly improved their performance, compared to 1997.

Trade Performance

The Mercator Group increased its market share to 20% despite the growing competition in the Slovene market. We gained a stable position because our retail network covers almost the entire Slovenia. The Mercator Group is the first company in Slovenia to use take-overs as a way to increase its market share.

The Mercator group's trade is organised within six trading companies. We realised sales of SIT 111.45 billion in 1998, which is 7.1% increase compared to 1997. The moderate growth of Slovene trade in 1998 is the result of moderate growth of domestic demand. Retailing contributed 54% of total sales while wholesale contributed 46%. The structure of retail sales is as follows:

- 70% food grocery business;
- 18% technical and construction goods;
- 9% textiles;
- 3% furniture.

All trade companies had a profitable performance in 1998, with exception of Mercator Degro, d. d. The reason for the loss is an investment in the shopping centre Koper, which experienced high operating and financial costs in the opening period.

Non-trade Companies Performance

The processing industry is facing growing competition, the import of cheaper goods and more demanding customers, like most of industry. It is being forced to modernise its production facilities and to increase research and development in order to play a part in technological advances.

Companies M Emba, M Slosad and Mesnine dežele Kranjske performed within the framework of planned results. The most remarkable is the shift in company Mesnine dežele Kranjske (meat processing company) that improved its performance by SIT 512 million compared to 1997. We are satisfied with the performance of Eta Kamnik. The restructuring of this company is proving successful which is shown by its achieved profit of SIT 31 million.

Company Zmajčkov Butik performed below plan. Its net loss for 1998 was SIT 5 million, which meant a decline in results by SIT 19 billion compared to the previous year.

M Pekarna Grosuplje – the most profitable company in the Mercator Group, experienced growth in net sales but its profit was affected by investment costs due to modernisation of its facilities.

The performance of hotels and restaurants does not show a positive trend. Both companies Mercator Ilirija and Mercator Sremič are operating in a very competitive environment and therefore investment in facilities renewal is needed.

Agricultural companies are a special challenge because they are affected by state policy in agriculture. All of them were profitable in 1998, however more attention will have to be given to cost-cutting and restructuring of current activities as well as to business rationalisation.

Mercator Optima, d.o.o. was very profitable as shown by profit of SIT 14 million which grew by 108% compared to 1997.

Investments

The Mercator Group invested SIT 13.5 billion in 1998; with SIT 8.6 billion being invested in fixed assets and SIT 4.9 billion in strategic long-term capital investment. Almost 50% of funds were available from internally generated funds (net income, amortisation, provisions) in the amount of over SIT 6.6 billion.

Investments in Fixed Assets

in '000 of SIT

Type	Investment value in 1998	Share (%)
Shopping Centres	5,468,280	63.2
- Koper	2,299,533	26.6
- Maribor	452,482	5.2
- Ptuj	420,884	4.9
- Novo mesto	395,006	4.5
- Ljubljana	1,277,253	14.8
- Kranj	623,122	7.2
Supermarkets	480,793	5.6
Refurbishments	2,694,749	31.2
Total	8,643,822	100.0

We opened three shopping centres: in Koper, in Maribor, and in Ptuj in 1998. We will open two more shopping centres in 1999: one in Ljubljana and another one in Novo mesto. We will also start the development of two more shopping centres in Kranj and Nova Gorica. We refurbished 56 supermarkets and 44 smaller stores. We closed down 51 non-profitable stores.

Take-overs

In order to increase market share Poslovni sistem Mercator, d. d. started an ambitious investment programme as well as take-overs of retail companies. Poslovni sistem Mercator, d. d. successfully acquired the company Klas, d. d. Maribor. We started acquisition activities for companies Loka, d. d. Škofja Loka and Goriška, d. d. Nova Gorica, which were successfully implemented at the beginning of 1999. This means also an implementation of our main strategic goal, defined in our business plan for the period 1997 – 1999. We increased our market share and we cover the whole domestic market through our six autonomous regional trade companies. Moreover, we also acquired shares of the companies: Emona Merkur, d. d. and Jestvina, d. d. The total investment in shares of other trade companies amounted to SIT 4.9 billion in 1998.

Disposal of Financial Investments

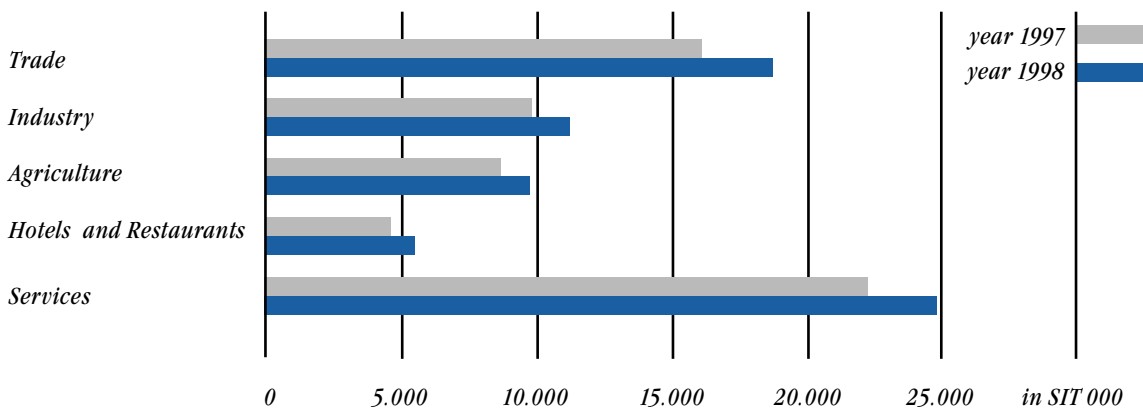
The Mercator Group acquired SIT 996 million by selling its financial investments in following companies: Zavarovalnica Mercator, d. d. and Oljarica Kranj, d. d. The company spent this money for financing investments.

Employees

<i>Company</i>	<i>1998</i>	<i>Average No. of Employees 1997</i>	<i>Indeks</i>
SALES			
<i>Mercator</i>	<i>3,013</i>	<i>3,317</i>	<i>90.8</i>
<i>Mercator SVS</i>	<i>1,108</i>	<i>1,042</i>	<i>106.3</i>
<i>Mercator Dolenjska</i>	<i>892</i>	<i>941</i>	<i>94.8</i>
<i>Mercator Degro</i>	<i>598</i>	<i>517</i>	<i>115.7</i>
<i>Mercator Modna hiša</i>	<i>130</i>	<i>115</i>	<i>113.0</i>
<i>Trgoavto</i>	<i>275</i>	<i>288</i>	<i>95.5</i>
Sales Total	6,016	6,220	96.7
INDUSTRY			
<i>Mercator Emba</i>	<i>102</i>	<i>107</i>	<i>95.3</i>
<i>Eta</i>	<i>269</i>	<i>319</i>	<i>84.3</i>
<i>Zmajčkov butik</i>	<i>155</i>	<i>150</i>	<i>103.3</i>
<i>Mesnine Dežele Kranjske</i>	<i>221</i>	<i>332</i>	<i>66.6</i>
<i>Pekarna Grosuplje</i>	<i>146</i>	<i>131</i>	<i>111.5</i>
<i>Slosad</i>	<i>45</i>	<i>86</i>	<i>52.3</i>
Industry Total	938	1,125	83.4
AGRICULTURE			
<i>Mercator Agrokombinat</i>	<i>89</i>	<i>92</i>	<i>96.7</i>
<i>Mercator KG Kočevje</i>	<i>229</i>	<i>271</i>	<i>84.5</i>
<i>Mercator KŽK Kmetijstvo</i>	<i>175</i>	<i>185</i>	<i>94.6</i>
Agriculture Total	493	548	90.0
HOTELS AND RESTAURANTS			
<i>Mercator Ilirija</i>	<i>63</i>	<i>87</i>	<i>72.4</i>
<i>Mercator Sremič</i>	<i>66</i>	<i>73</i>	<i>90.4</i>
Hotels And Restaurants Total	129	160	80.6
SERVICES			
<i>Mercator Optima</i>	<i>31</i>	<i>29</i>	<i>106.9</i>
Services Total	31	29	106.9
The Group Mercator Total	7,607	8,082	94.1

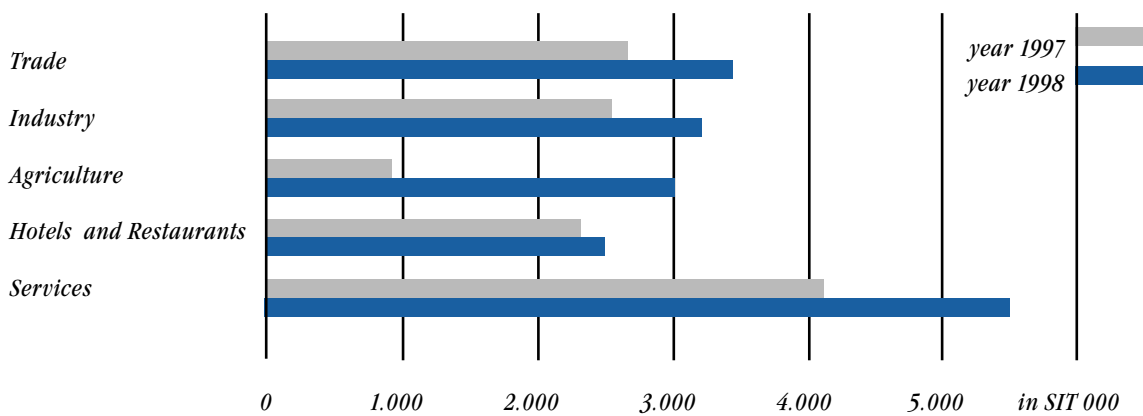
The number of employees calculated on the basis of working hours has been reduced by approx. 5.9% with regards to the previous year. The trading companies reduced their number of workers by 3.3%. In the trading companies we employed more workers in those companies which considerably increased the scope of their trading activities in 1998. In non-trading companies we employed more workers in Mercator Pekarna Grosuplje, d. d. and in Mercator Optima, d. d. as a consequence of business growth.

Productivity in activities



Productivity was improved the most in industry, agriculture and hotels and restaurants which is generally a result of workforce reductions.

Added value per employee by activities



The added value per employee, defined as the sum of accumulation and labour cost per employee, has been improved in all activities. In trade, industry and services this is the result of cost reductions as well as workforce reductions. In agriculture and hotels and restaurants the business results were not improved in 1998. The increase of added value is the result of employee numbers reduction.



4. Financial Statements of Poslovni sistem Mercator, d. d.

Audited Financial Statements

Balance Sheet of Poslovni sistem Mercator, d. d. as at 31 December, 1998

	<i>in '000 of SIT</i>	
	<i>31.12.1998</i>	<i>31.12.1997</i>
ASSETS		
FIXED ASSETS	58,597,314	50,671,787
<i>Intangible fixed assets</i>	<i>146,997</i>	<i>752,043</i>
<i>Tangible fixed assets</i>	<i>23,695,878</i>	<i>24,926,769</i>
<i>Long-term investments</i>	<i>34,740,846</i>	<i>24,611,370</i>
<i>Equity adjustments</i>	<i>13,593</i>	<i>381,605</i>
CURRENT ASSETS	13,941,641	13,520,575
<i>Inventories</i>	<i>6,027,003</i>	<i>6,153,959</i>
<i>Long-term operating receivables</i>	<i>19,999</i>	<i>157,629</i>
<i>Short-term operating receivables</i>	<i>6,657,560</i>	<i>5,084,156</i>
<i>Short-term investments</i>	<i>954,372</i>	<i>1,638,715</i>
<i>Cash</i>	<i>163,593</i>	<i>196,124</i>
<i>Deferred expenses and accrued revenues</i>	<i>119,114</i>	<i>289,992</i>
TOTAL ASSETS	72,538,955	64,192,362
LIABILITIES		
CAPITAL	50,552,878	45,586,581
<i>Basic capital</i>	<i>32,085,040</i>	<i>32,085,040</i>
<i>Paid-in surplus capital</i>	<i>139,213</i>	
<i>Reserves</i>	<i>5,019,922</i>	<i>4,989,231</i>
<i>Net profit or losses from previous periods</i>	<i>-15,848,516</i>	<i>-849,636</i>
<i>Capital revaluation adjustments</i>	<i>27,810,589</i>	<i>24,387,004</i>
<i>Undistributed current net profit or loss</i>	<i>1,346,630</i>	<i>-15,025,058</i>
PROVISIONS FOR LIABILITIES AND CHARGES	0	
LONG-TERM FINANCIAL LIABILITIES	3,363,971	2,807,570
LONG-TERM OPERATING LIABILITIES	3,811	65,113
SHORT-TERM FINANCIAL LIABILITIES	10,104,712	5,575,798
SHORT-TERM OPERATING LIABILITIES	7,604,580	9,738,454
ACCRUED EXPENSES AND DEFERRED REVENUES	909,003	418,846
TOTAL LIABILITIES	72,538,955	64,192,362
NON BALANCE SHEET ITEMS	14,127,254	10,682,245

Profit and Loss Statement of Poslovni sistem Mercator, d. d. for the Period from 1 January to 31 December, 1998

	<i>in '000 of SIT</i>		
	<i>1998 (audited data)</i>	<i>1997 (comparable data)</i>	<i>1997 (after revaluation)</i>
<i>NET SALES</i>	<i>66,496,079</i>	<i>62,825,884</i>	<i>69,214,495</i>
<i>Sale of products on domestic market</i>	<i>92,638</i>	<i>65,339</i>	<i>105,516</i>
<i>Sale of products on foreign markets</i>	<i>111</i>	<i>0</i>	<i>28,696</i>
<i>Sale of services on domestic market</i>	<i>2,059,806</i>	<i>2,113,052</i>	<i>2,280,026</i>
<i>Sale of services on foreign markets</i>	<i>70,024</i>	<i>143,997</i>	<i>147,843</i>
<i>Sale of goods on domestic market</i>	<i>64,115,510</i>	<i>60,264,574</i>	<i>66,371,921</i>
<i>Sale of goods on foreign markets</i>	<i>95,676</i>	<i>160,609</i>	<i>163,193</i>
<i>Sale of materials</i>	<i>3,201</i>	<i>701</i>	<i>701</i>
<i>Sale of capitalised own products</i>	<i>59,113</i>	<i>77,612</i>	<i>116,599</i>
<i>COSTS OF GOODS SOLD</i>	<i>-50,969,585</i>	<i>-48,161,765</i>	<i>-53,420,312</i>
<i>Production costs</i>	<i>-82,311</i>	<i>-70,645</i>	<i>-191,942</i>
<i>Purchase value of goods and materials sold</i>	<i>-50,887,274</i>	<i>-48,091,120</i>	<i>-53,228,370</i>
<i>GROSS PROFIT FROM SALES</i>	<i>15,526,494</i>	<i>14,664,119</i>	<i>15,794,183</i>
<i>Administrative expenses</i>	<i>-2,712,894</i>	<i>-6,655,604</i>	<i>-9,168,315</i>
<i>Selling expenses</i>	<i>-12,690,000</i>	<i>-8,620,754</i>	<i>-13,950,619</i>
<i>Other operating revenues</i>	<i>10</i>	<i>541</i>	<i>19,632</i>
<i>OPERATING PROFIT/LOSS</i>	<i>123,610</i>	<i>-611,698</i>	<i>-7,305,119</i>
<i>Revenues from investments in Slovenia and abroad</i>	<i>826,593</i>	<i>940,006</i>	<i>328,535</i>
<i>Interest revenues and other financial revenues</i>	<i>2,117,164</i>	<i>1,211,721</i>	<i>1,211,721</i>
<i>Long and short-term investment write-offs</i>	<i>-443,283</i>	<i>-1,157,585</i>	<i>-6,107,961</i>
<i>Interest expenses and other financial expenses</i>	<i>-1,381,308</i>	<i>-1,680,754</i>	<i>-1,680,753</i>
<i>PROFIT/LOSS FROM ORDINARY ACTIVITIES</i>	<i>1,242,776</i>	<i>-1,298,310</i>	<i>-13,553,577</i>
<i>Extraordinary revenues</i>	<i>560,204</i>	<i>1,095,229</i>	<i>1,095,050</i>
<i>Extraordinary expenses</i>	<i>-456,350</i>	<i>-2,324,494</i>	<i>-2,566,531</i>
<i>TOTAL PROFIT/LOSS</i>	<i>1,346,630</i>	<i>-2,527,575</i>	<i>-15,025,058</i>
<i>Taxes on income</i>			
<i>NET PROFIT/LOSS</i>	<i>1,346,630</i>	<i>-2,527,575</i>	<i>-15,025,058</i>
<i>Accumulation¹</i>	<i>3,710,211</i>	<i>-579,330</i>	<i>-7,427,968</i>

¹ We define accumulation as the sum of net income, depreciation and provision for liabilities and charges

Cash Flow Statement for the Year ended 31 December, 1998

	<i>in '000 of SIT</i>	
<i>Cash flow</i>	<i>1998</i>	<i>1997</i>
<i>REVALUATION, OPENING BALANCE OF CASH AND CASH EQUIVALENTS ON 1 JAN.</i>	<i>210,833</i>	<i>312,301</i>
<i>Revenues from sales</i>	<i>70,000,050</i>	<i>71,869,433</i>
<i>Expenses without depreciation and provisions for liabilities and charges</i>	<i>-66,189,838</i>	<i>-78,043,741</i>
<i>NON-ADJUSTED NET INFLOWS FROM OPERATING ACTIVITIES</i>	<i>4,021,045</i>	<i>-5,862,007</i>
<i>Decrease in operating liabilities</i>	<i>-2,930,444</i>	<i>-2,823,017</i>
<i>Decrease in operating receivables</i>	<i>0</i>	<i>2,527,578</i>
<i>Increase in operating receivables</i>	<i>-1,042,640</i>	<i>0</i>
<i>Increase in accrued expenses and deferred revenues</i>	<i>458,744</i>	<i>398,199</i>
<i>Decrease in deferred expenses and accrued revenues</i>	<i>192,627</i>	<i>557,976</i>
<i>Decrease in inventories</i>	<i>588,503</i>	<i>529,312</i>
<i>ADJUSTED NET INFLOWS FROM OPERATING ACTIVITIES</i>	<i>1,287,835</i>	<i>-4,671,959</i>
<i>Offset increase in intangible long-term assets</i>	<i>0</i>	<i>-14,915</i>
<i>Offset decrease in intangible long-term assets</i>	<i>661,449</i>	<i>0</i>
<i>Offset increase in tangible fixed assets</i>	<i>0</i>	<i>-4,459,605</i>
<i>Offset decrease in tangible fixed assets</i>	<i>636,817</i>	<i>0</i>
<i>Offset increase in long-term investments</i>	<i>-7,886,991</i>	<i>0</i>
<i>Offset decrease in long-term investments</i>	<i>0</i>	<i>8,656,933</i>
<i>Offset increase in short-term investments</i>	<i>0</i>	<i>-1,048,440</i>
<i>Offset decrease in short-term investments</i>	<i>807,248</i>	<i>0</i>
<i>NET OUTFLOWS FROM OPERATING ACTIVITIES</i>	<i>-4,493,642</i>	<i>-1,537,986</i>
<i>Increase in capital</i>	<i>200,674</i>	<i>0</i>
<i>Decrease in capital</i>	<i>0</i>	<i>-1,434,786</i>
<i>Offset increase in long-term financial liabilities</i>	<i>345,833</i>	<i>1,269,268</i>
<i>Offset increase in short-term financial liabilities</i>	<i>4,110,728</i>	<i>1,899,628</i>
<i>CLOSING BALANCE OF CASH AND CASH EQUIVALENTS</i>	<i>163,593</i>	<i>196,124</i>

Notes to the Financial Statements

Notes to the Balance Sheet

Intangible Fixed Assets

	<i>in '000 of SIT</i>	
<i>Net value</i>	<i>31.12.1998</i>	<i>31.12.1997</i>
<i>Goodwill</i>	0	593,242
<i>Deferred costs</i>	12,523	47,238
<i>Substantive rights</i>	26,433	6,594
<i>Other items (software licence, deferred costs of rent)</i>	108,041	104,970
Total	146,997	752,044

The goodwill which was formed in the process of ownership transformation in Poslovni sistem Mercator, d. d. was finally amortised in 1998.

Tangible Fixed Assets

	<i>in '000 of SIT</i>	
<i>Net value</i>	<i>31.12.1998</i>	<i>31.12.1997</i>
<i>Land</i>	2,622,800	2,675,549
<i>Buildings</i>	13,517,961	14,321,511
<i>Store equipment</i>	2,029,168	2,011,495
<i>Other equipment</i>	1,251,345	1,329,102
<i>Farms</i>	0	15,876
<i>Other tangible assets</i>	19,098	15,510
<i>Tangible fixed assets under construction or in process</i>	3,070,151	4,416,092
<i>Advances for tangible fixed assets</i>	1,185,356	141,634
Total	23,695,879	24,926,769

Gross fixed assets increased mostly because of investments in the amount of SIT 4.11 billion as follows:

- SIT 1.90 billion was invested in shopping centres;
- SIT 1.74 billion was invested in supermarkets and refurbishment;
- SIT 0.47 billion were other investments.

The rest of increase in fixed assets in the amount of SIT 1.03 billion is due to revaluation.

In total net fixed assets decreased compared to 1997 because of disposal, write-offs and transfer of fixed assets to subsidiaries in the amount of SIT 4.75 billion, and depreciation of SIT 1.62 billion.

Long-term Financial Investments

in '000 of SIT

	31.12.1998	31.12.1997
Long-term investments in subsidiaries	26,974,566	22,268,033
Long-term investments in other associated companies	738,362	1,550,016
Other long-term investments	2,836,697	73,895
Long-term loans to subsidiaries	3,993,107	295,928
Long-term loans to associated companies	-174,779	5,725
Long-term loans to others	372,893	417,773
Total	34,740,846	24,611,370

Long-term financial investments contribute 47.9% to assets. This means 41.2% increase which is mostly the result of long-term investments in other companies as well as long-term loans to subsidiaries.

Our investments in associated companies are reduced due to sell-off shares in companies Oljarica, d. d. and Zavarovalnica Mercator, d. d.

Long-term Financial Investments in Slovenia and Abroad

in '000 of SIT

Company	Share in company capital (%) 31.12.1998	31.12.1998	31.12.1997
Mercator SVS	100	8,010,053	6,962,875
Mercator Dolenjska	100	4,052,248	1,408,351
Mercator Degro	100	2,716,362	2,630,334
Mercator Modna hiša	100	532,728	464,742
Trgoavto	51.01	1,084,026	1,004,253
Trade total		16,395,417	12,470,555
Mercator Emba	51.19	776,332	707,807
Eta	74.79	1,378,153	1,260,423
Zmajčkov butik	66.66	393,849	369,724
Mesnina dežele Kranjske	90.56	394,621	422,978
Mercator Pekarna Grosuplje	51.01	580,473	498,466
Mercator Slosad	100	39,241	31,251
Industry total		3,562,669	3,290,649
Mercator Agrokombinat	100	1,187,788	1,104,526
Mercator KG Kočevje	90.94	2,369,720	2,203,315
Mercator KŽK Kmetijstvo	100	1,704,241	1,552,997
Agriculture total		5,261,749	4,860,838

<i>Mercator Hotel Ilirija</i>	100	888,438	810,605
<i>Mercator Sremič</i>	100	558,874	553,247
Hotels and Restaurants total		1,447,312	1,363,852
<i>Mercator Optima</i>	100	216,117	192,693
Services total		216,117	192,693
<i>Subsidiaries Abroad</i>		91,302	89,446
LONG-TERM INVESTMENTS IN SUBSIDIARIES TOTAL		26,974,566	22,268,033
<i>Gorenjska mlekarina</i>	43	385,954	392,430
<i>Oljarica</i>		0	599,526
<i>Zavarovalnica Mercator</i>		0	226,532
<i>Spar Slovenija</i>	20	172,762	160,709
<i>Spectrum</i>	33	89,682	83,425
<i>Unileasing</i>	20	15,442	14,365
LONG-TERM INVESTMENTS IN ASSOCIATED COMP. SLOVENIA		663,840	1,476,987
<i>Goimpex, Italija</i>	25	2,190	2,162
<i>Unimercat, Nemčija</i>	25	72,332	70,867
LONG-TERM INVESTMENTS IN ASSOCIATED COMPANIES ABROAD		74,522	73,029
LONG-TERM INVESTMENTS IN ASSOCIATED COMPANIES TOTAL		738,362	1,550,016
LONG-TERM INVESTMENTS IN OTHER COMPANIES		2,836,697	73,895
LONG-TERM INVESTMENTS IN SLOVENIA TOTAL		30,383,801	23,729,469
LONG-TERM INVESTMENTS ABROAD TOTAL		165,824	162,475
LONG-TERM INVESTMENTS TOTAL		30,549,625	23,891,944

The investment into a subsidiary company abroad refers to Intermercator GmbH., Klagenfurt. Its value has increased as a result of exchange rate differences. In 1998 the company showed the profit in the amount of SIT 6.11 million, but the stated profit will only be brought into the 1999 statement.

The investments to other companies were increased by SIT 2.76 billion due to share investments in 1998.

Besides the investments in shares there are also long-term granted loans and deposits among the long-term financial investments. Compared to the previous year the investments were almost 6 fold. The reason for such a big increase is the loan granted to the company Mercator Degro, due to a property title transfer (Mercator Centre Koper) and by this also transfer of financial liabilities to this company.

Capital Correction

In 1998 the company Poslovni sistem Mercator, d. d. bought 101,730 thousand of its own shares in the amount of SIT 524 million, and sold 187,234 own shares in the amount of SIT 1.06 billion. As of 31 December, 1998 the company still has 2000 shares in the amount of SIT 13.59 million in its possession.

Inventory

Inventories of raw materials and trade goods as at 31 December, 1998, amount to SIT 6.03 billion. The greatest part - 96.6 % refers to the inventory of commercial goods. The average inventory in 1998 amounts to SIT 5.72 billion, the inventory turnover coefficient is 13, which means that in 1998 the inventory turned over in 28 days in the average, which is almost the same as in the previous year.

Long-term Operating Receivables

The long-term operating receivables amount to SIT 19.99 million. Compared to the previous year receivables from the subsidiary companies were reduced by SIT 139.93 million. This reduction is a valuation adjustment.

Short-term Operating Receivables

Short-term operating receivables amounted to SIT 6.66 billion on 31 December, 1998. They increased by 31% compared to the previous year. Their share in current assets amounted to 47.7% which is an increase of 10.2%. The largest share of short-term operating receivables is represented by receivables from the subsidiaries, associated and other companies (74.6%). As at 31 December, 1998 the operating receivables increased by approx. 9% which is mainly the result of increase in scope of sales with deferred payment in wholesale activity. The high increase in other receivables at the end of 1998 arises from SIT 1.16 billion to acquire shares of the companies Jestvina, d. d. and Emona Merkur, d. d. (series B, C, D). In bookkeeping these shares are to be disclosed as short-term receivables until the expiration of a deferred condition, when they will be transferred to long-term investments.

Short-term Financial Investments

Short-term investments were disclosed in the amount of SIT 954 million and in comparison with the previous year they are diminished by SIT 684 million. The reduction refers mainly to short-term loans granted to subsidiary and associated companies not present in the year 1998.

Equity

	<i>in '000 of SIT</i>	
	<i>31.12.1998</i>	<i>31.12.1997</i>
<i>Nominal capital</i>	<i>32,085,040</i>	<i>32,085,040</i>
<i>Paid-in surplus capital</i>	<i>139,213</i>	<i>0</i>
<i>Reserves</i>	<i>5,019,922</i>	<i>4,989,231</i>
<i>Net profit or loss from previous years</i>	<i>-15,848,516</i>	<i>-849,636</i>
<i>Capital revaluation adjustments</i>	<i>27,810,589</i>	<i>24,387,004</i>
<i>Undistributed current net profit or loss</i>	<i>1,346,630</i>	<i>-15,025,058</i>
<i>Total</i>	<i>50,552,878</i>	<i>45,586,581</i>

Paid-in surplus capital in the sum of SIT 139 million represents the profit from buyouts and sales of own shares in the year 1998.

Reserves in the amount of SIT 5.02 billion represent the legal reserves in the value of SIT 4.47 billion and own shares fund in the amount of SIT 547 million, which was formed according to the General Meeting resolution on 20 June, 1997 from the retained profits from the years until 1996. The fund volume was not changed in 1998.

The average market share price as at 31 December, 1998 amounted to SIT 7,299 and the book value was SIT 15,756 SIT.

Long-term Financial Liabilities

Long-term financial liabilities as at 31.12.1998 amounted in total to SIT 3.36 billion. Compared to 1997 they increased by 20%. The main change is termination of the agreement with the European Bank for Reconstruction and Development. After unsuccessful negotiations with the EBRD in the first half of 1998, the agreement was concluded with EBRD, that is with an international bank consortium in the beginning of September on a final termination of co-operation with EBRD and on principal and interest redemption and repayment of other expenses up to 31 October, 1998 included. The EBRD loan was replaced by a long-term foreign exchange loan of two domestic banks for the period of 5 years.

Long-term Operating Liabilities

The greatest part of long-term operating liabilities was settled by the company. A smaller part in the amount of SIT 23.58 million was transferred to short-term liabilities, so that the position as at 31 December, 1998 amounted to SIT 3.81 million and refers to long-term commodity loans.



S. BREVETTI VAN BERKEL
MILANO

Berkel



Berkel

Short-term Financial Liabilities

	<i>in '000 of SIT</i>		
	<i>31.12.1998</i>	<i>Structure (%)</i>	<i>31.12.1997</i>
<i>Short-term loans from subsidiaries</i>	1,084,772	10.8	1,071,299
<i>Other short-term loans</i>	168,006	1.7	364,299
<i>Short-term loans from associated enterprises</i>	1,376,544	13.6	3,707,089
<i>Short-term bank loans</i>	6,435,822	63.7	0
<i>Current portion of long-term loans</i>	953,959	9.4	294,514
<i>Issued short-term securities</i>	85,609	0.9	138,597
Total	10,104,712	100.0	5,575,798

Short-term financial liabilities increased in comparison with 1997 by 81.2%. The largest share refers to loans with banks.

Short-term Operating Liabilities

The short-term operating liabilities amount to SIT 7.60 billion. 62% out of these refer to liabilities to the suppliers outside the Mercator Group. A greater part among short-term operating liabilities on the date 31 December, 1998 is the liability to the State under a decree of the tax authorities RS No. II-219/98 in connection to taxes on profits for the period between 1994-1996. To avoid penalty charges the tax liability was paid in March 1999 in the amount of SIT 994 million. The company appealed against this decree, but the final decision of the tax authorities has not yet been received.

Non Balance Sheet Items

The value of non balance sheet items amounts to SIT 14.13 billion. The largest share (62%) refers to mortgages (Mercator trgovina Ljubljana and headquarter building on Dunajska 107 street), and to the guarantees given.

Notes to the Profit and Loss Statement

Net Sales

	in '000 of SIT			
	1998 (audited data)	Structure (%)	1997 (comparable data)	1997 (audited data)
Sales of goods	62,045,573	93.3	58,257,658	64,406,576
- wholesale	24,485,199	36.8	21,563,272	21,563,272
- retail	37,560,374	56.5	36,694,386	42,843,304
Internal gross margin	2,227,926	3.4	2,245,838	2,245,838
Sales of services	2,222,580	3.3	2,322,388	2,562,081
Total	66,496,079	100.0	62,825,884	69,214,495

The net sales amount to SIT 66.49 billion and if compared to the year 1997 they are increased by 5.8%. Goods sales profits which represent 97% of all revenues have increased in comparison with the same period of 1997 by 6.2%. Revenues of services have diminished by 4.3% and represent only 3.3% of all sales revenue.

Gross Profit

The gross profit from sales (the difference between sales and purchase value of the goods) thus amounts to SIT 15.53 billion, which is by 5.9% more than the previous year.

Costs Structure

	in '000 of SIT			
Type of cost	1998 (audited data)	Structure (%)	1997 (comparable data)	1997 (audited data)
Costs of materials	1,333,930	8.6	1,328,912	1,504,000
Costs of services	3,230,006	21.6	3,325,251	3,542,064
Working capital adjustment	329,583	3.0	450,908	457,061
Depreciation	2,363,581	12.6	1,948,245	8,635,615
Labour costs	7,792,641	52.2	7,992,512	8,774,799
Other costs	353,153	2.0	301,175	389,515
Total	15,402,894	100.0	15,347,003	23,303,054

Almost all costs by types (costs of materials, services, working capital adjustment, labour) are nominally lower than in 1997. Only the cost of depreciation increased. Without consideration of depreciation due to revaluation in the year 1997, these costs increased by 21%, which is the result of investments and increased amortisation rates.

Revenues from Financing

	<i>in '000 of SIT</i>			
	<i>1998 (audited data)</i>	<i>Structure (%)</i>	<i>1997 (comparable data)</i>	<i>1997 (audited data)</i>
<i>Revenues from investments in subsidiaries</i>	773,111	26.3	749,827	138,356
<i>Revenues from investments in other associated companies</i> 46,088		1.6	187,971	187,971
<i>Revenues from other investments</i>	7,394	0.2	2,208	2,208
<i>Interests revenues</i>	759,757	25.8	431,745	431,745
<i>Financial discounts revenues</i>	690,099	23.4	544,731	544,731
<i>Other revenues from investments</i>	177,434	6.0	127,384	127,384
<i>Foreign exchange gain</i>	231,418	7.9	107,861	107,861
<i>Revaluation surplus</i>	258,456	8.8	0	0
Total	2,943,757	100.0	2,151,727	1,540,256

In the revenues arising from participation in profits of subsidiary companies the profits of subsidiary companies in which Poslovni sistem Mercator, d. d. holds majority share, are incorporated, and comprise together with the holding company the Mercator Group, whereas the losses of these companies are included into the Profit and loss statement in the line: long-term and short-term financial investment write-offs. The revenues from participation in profits of the associated and other companies refer to participation in profits of companies in which Poslovni sistem Mercator, d. d. has minority financial interests.

Revenues and Expenses from Participation in Financial Investments

in '000 of SIT

Company	Profit and loss in 1998 (audited data)	Profit and loss in 1997 (comparable data)	Profit and loss in 1997 (audited data)
Mercator SVS	435,354	322,471	-917,239
Mercator Dolenjska	111,093	75,942	-267,867
Mercator Degro	-119,742	89,697	-478,357
Mercator Modna hiša	36,350	29,944	-26,386
Trgoavto	47,858	35,068	35,068
Trade total	510,913	553,122	-1,654,781
Mercator Emba	15,439	14,409	14,409
Eta	23,198	26,261	-107,045
Zmajčkov butik	-3,604	13,423	13,422
Mesnine dežele Kranjske	-60,080	-523,744	-955,524
Mercator Pekarna Grosuplje	63,668	76,049	38,865
Mercator Slosad	5,646	20,603	20,602
Industry total	44,267	-372,999	-975,271
Mercator Agrokombinat	423	7,292	-318,406
Mercator KG Kočevje	1,156	186	-1,179,995
Mercator KŽK Kmetijstvo	1,776	477	-283,567
Agriculture total	3,355	7,955	-1,781,968
Mercator Hotel Ilirija	17,038	22,015	-532,144
Mercator Sremič	-35,867	-23,570	-331,728
Hotels and restaurants total	-18,829	-1,555	-863,872
Mercator Optima	14,112	6,781	6,781
Services total	14,112	6,781	6,781
Affiliated companies abroad	0	0	0
LONG-TERM INVESTMENTS IN SUBSIDIARIES	553,818	193,304	-5,269,111

<i>Gorenjska mlekarina</i>	16,788	0	0
<i>Oljarica</i>	10,355	18,281	18,281
<i>Zavarovalnica Mercator</i>	0	7,991	7,991
<i>M - banka</i>	0	15,845	15,845
<i>Spar Slovenija</i>	18,945	144,843	144,843
<i>Spectrum</i>	0	0	0
<i>Unileasing</i>		1,011	1,011
LONG-TERM INVESTMENTS IN ASSOCIATED COMP. IN SLOVENIA	46,088	187,971	187,971
<i>Goimpex, Italija</i>	0	0	0
<i>Unimercat, Nemčija</i>	0	0	0
LONG-TERM INVESTMENTS IN ASSOCIATED COMP. ABROAD	0	9,208	9,209
TOTAL LONG-TERM INVESTMENTS IN ASSOCIATED COMP.	46,088	197,179	197,180
LONG-TERM INVESTMENTS IN OTHER COMP. IN SLOVENIA	7,394	2,208	2,208
TOTAL LONG-TERM INVESTMENTS IN SLOVENIA	607,300	383,483	-5,078,932
TOTAL LONG-TERM INVESTMENTS ABROAD	0	9,208	9,209
TOTAL LONG-TERM INVESTMENTS	607,300	392,691	-5,069,723

Financial Expenses

in '000 of SIT

	1998 (audited data)	Structure (%)	1997 (comparable data)	1997 (audited data)
<i>Investment write-offs</i>	443,283	24.3	1,157,585	6,107,961
<i>Interest expenses</i>	1,017,064	55.7	1,205,526	1,205,526
<i>Financial discounts expenses</i>	13,920	0.8	19,152	19,152
<i>Foreign exchange loss</i>	350,324	19.2	422,835	422,835
<i>Revaluation deficit</i>	0	0.0	33,240	33,240
Total	1,824,591	100.0	2,838,338	7,788,714

In financial expenses the key expenses are interest expenses, which were reduced by 16% as the result of favourable movements on financial markets and active restructuring of borrowings.

Extraordinary Revenues and Expenses

Extraordinary revenues include as follows:

- 44% recovered bad debt;
- 28% profit from fixed assets sales;
- 15% revenues generated in previous years;
- 13% other revenues.

Extraordinary expenses include as follows:

- 49.3% reimburse expenses due to denationalisation;
- 4.6% expenses transferred from previous years;
- 9% other expenses.

The Auditor's Report

We have audited the Balance Sheet of the company Poslovni sistem Mercator, d. d. as at 31 December, 1998, the relevant Profit and loss statement and The cash flow statement for the business year ended on the same date. We also studied the business report for 1998 presented by the management. The management of the company is responsible for the above mentioned financial statements. Our responsibility is to express an opinion on these financial statements.

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

In our opinion, the financial statements mentioned in the first paragraph in all respects give a true and fair view of the financial position of Poslovni sistem Mercator, d. d. as at 31 December, 1998 and of the results and cash flow for the year ending on the same date, in accordance with Slovene Accounting Standards.

PricewaterhouseCoopers d.d.

Ljubljana

PRICEWATERHOUSECOOPERS

d.d., Ljubljana
2

Chartered auditor

Vida Lebar



Director

Jure Šager



Ljubljana, 15 April, 1999



5. Audited Financial Statements of the Mercator Group

Consolidated Balance Sheet of the Mercator Group as at 31 December, 1998

	<i>in '000 of SIT</i>	
<i>Type of assets/liabilities</i>	<i>31.12.1998</i>	<i>31.12.1997</i>
FIXED ASSETS	63,215,122	51,615,917
<i>Intangible fixed assets</i>	<i>334,720</i>	<i>950,947</i>
<i>Tangible fixed assets</i>	<i>56,256,619</i>	<i>47,550,213</i>
<i>Long-term investments</i>	<i>6,610,190</i>	<i>2,733,152</i>
<i>Equity adjustments</i>	<i>13,593</i>	<i>381,605</i>
CURRENT ASSETS	31,113,459	26,759,636
<i>Inventories</i>	<i>16,483,012</i>	<i>14,264,296</i>
<i>Short-term operating receivables</i>	<i>11,099,033</i>	<i>9,020,197</i>
<i>Short-term investments</i>	<i>2,299,038</i>	<i>2,476,371</i>
<i>Cash</i>	<i>1,091,510</i>	<i>687,455</i>
<i>Deferred expenses and accrued revenues</i>	<i>140,866</i>	<i>311,317</i>
TOTAL ASSETS	94,328,581	78,375,553
LIABILITIES		
<i>Capital</i>	<i>53,843,243</i>	<i>48,446,996</i>
<i>Provisions for liabilities and charges</i>	<i>1,282,730</i>	<i>1,081,486</i>
<i>Long-term financial liabilities</i>	<i>5,093,245</i>	<i>3,414,660</i>
<i>Long-term operating liabilities</i>	<i>31,128</i>	<i>90,246</i>
<i>Short-term financial liabilities</i>	<i>15,687,029</i>	<i>7,541,807</i>
<i>Short-term operating liabilities</i>	<i>17,096,324</i>	<i>17,208,411</i>
<i>Accrued expenses and deferred revenues</i>	<i>1,294,882</i>	<i>591,947</i>
TOTAL LIABILITIES	94,328,581	78,375,553

Consolidated Profit and Loss Statement of the Mercator Group for the Period from 1 January to 31 December, 1998

	<i>in '000 of SIT</i>		
<i>Revenues and/or Expenses</i>	<i>1998 (audited data)</i>	<i>1997 (comparable data)</i>	<i>1997 (audited data)</i>
<i>NET SALES REVENUES</i>	<i>128,436,900</i>	<i>121,017,063</i>	<i>121,017,063</i>
<i>Revenues from sale of products and services</i>	<i>13,905,402</i>	<i>12,598,030</i>	<i>12,598,030</i>
<i>Revenues from sale of goods</i>	<i>111,934,247</i>	<i>108,005,317</i>	<i>108,005,317</i>
<i>Revenues from sale of capitalised own products</i>	<i>2,597,251</i>	<i>413,716</i>	<i>413,716</i>
<i>COSTS OF GOODS SOLD</i>	<i>-97,428,647</i>	<i>-92,983,643</i>	<i>-92,983,643</i>
<i>Production costs</i>	<i>-11,972,147</i>	<i>-11,447,447</i>	<i>-11,447,447</i>
<i>Purchase value of goods and material sold</i>	<i>-85,456,500</i>	<i>-81,536,196</i>	<i>-81,536,196</i>
<i>GROSS PROFIT FROM SALES</i>	<i>31,008,253</i>	<i>28,033,420</i>	<i>28,033,420</i>
<i>Administrative and selling expenses</i>	<i>-30,198,559</i>	<i>-28,657,309</i>	<i>-39,650,452</i>
<i>Other operating revenues</i>	<i>77,678</i>	<i>64,309</i>	<i>64,309</i>
<i>OPERATING PROFIT/LOSS</i>	<i>887,372</i>	<i>-559,580</i>	<i>-11,552,723</i>
<i>Revenues from investments</i>	<i>2,624,246</i>	<i>2,127,444</i>	<i>2,061,831</i>
<i>Interest expenses and other financial expenses</i>	<i>-2,624,135</i>	<i>-3,177,150</i>	<i>-3,352,158</i>
<i>PROFIT/LOSS FROM ORDINARY ACTIVITIES</i>	<i>887,483</i>	<i>-1,609,286</i>	<i>-12,843,050</i>
<i>Extraordinary revenues</i>	<i>1,440,936</i>	<i>1,811,071</i>	<i>1,800,792</i>
<i>Extraordinary expenses</i>	<i>-806,777</i>	<i>-2,688,591</i>	<i>-4,049,196</i>
<i>TOTAL PROFIT/LOSS</i>	<i>1,521,642</i>	<i>-2,486,806</i>	<i>-15,091,454</i>
<i>Taxes on profit</i>	<i>40,588</i>	<i>116,107</i>	<i>116,106</i>
<i>Other taxes</i>			
<i>NET PROFIT/LOSS FOR THE FINANCIAL YEAR</i>	<i>1,481,054</i>	<i>-2,602,913</i>	<i>-15,207,560</i>
<i>Profit/loss of majority owner</i>	<i>1,359,092</i>	<i>-2,521,471</i>	<i>-15,044,072</i>
<i>Profit/loss of minority owner</i>	<i>121,962</i>	<i>-81,442</i>	<i>-163,488</i>
<i>Accumulation</i>	<i>6,619,298</i>	<i>1,716,317</i>	<i>-616</i>

*Consolidated Cash Flow Statement for the Mercator Group for the Year ended
31 December, 1998*

	<i>in '000 of SIT</i>	
	<i>1998</i>	<i>1997</i>
<i>Cash flow</i>		
<i>Revaluation, Opening balance of cash and cash equivalents on 1 Jan.</i>	<i>739,014</i>	<i>989,274</i>
<i>Revenues</i>	<i>132,579,760</i>	<i>124,943,995</i>
<i>Expenses without depreciation and provisions for liabilities and charges</i>	<i>-126,352,031</i>	<i>-124,828,505</i>
<i>Taxes on profit</i>	<i>-40,588</i>	<i>-116,106</i>
NON-ADJUSTED NET INFLOWS FROM OPERATING ACTIVITIES	<i>6,926,155</i>	<i>988,658</i>
	<i>-1,468,604</i>	<i>-2,391,886</i>
<i>Change in operating liabilities</i>	<i>-1,402,321</i>	<i>2,198,826</i>
<i>Change in accrued expenses and deferred revenues</i>	<i>658,539</i>	<i>416,154</i>
<i>Change in deferred expenses and accrued revenues</i>	<i>193,800</i>	<i>578,128</i>
<i>Change in inventories</i>	<i>-1,148,894</i>	<i>690,113</i>
ADJUSTED NET INFLOWS FROM OPERATING ACTIVITIES	<i>3,758,675</i>	<i>2,479,993</i>
<i>Change in intangible long-term assets</i>	<i>-25,116</i>	<i>578,544</i>
<i>Change in tangible fixed assets</i>	<i>-9,133,563</i>	<i>-5,348,019</i>
<i>Change in long-term financial investments</i>	<i>-3,672,052</i>	<i>2,330,292</i>
<i>Change in short-term financial investments</i>	<i>363,061</i>	<i>-873,744</i>
NET OUTFLOWS FROM OPERATIONS AND INVESTMENT ACTIVITIES	<i>-8,708,995</i>	<i>-832,934</i>
<i>Change in capital</i>	<i>678,300</i>	<i>-688,857</i>
<i>Change in provisions for liabilities and charges</i>	<i>120,133</i>	<i>-249,199</i>
<i>Change in long-term financial liabilities</i>	<i>1,422,486</i>	<i>758,094</i>
<i>Change in long-term financial liabilities</i>	<i>7,579,586</i>	<i>1,700,351</i>
CLOSING BALANCE OF CASH	<i>1,091,510</i>	<i>687,455</i>



Notes to the Consolidated Financial Statements

When preparing the consolidated financial statements the following principles have been taken into consideration :

- The consolidated financial statements are prepared in accordance with provisions of the Slovene and international standards.*
- The accounts receivable and liabilities between the companies in the group have been excluded from the consolidated statement.*
- The profit arising from goods and service sales within the group is excluded from the consolidated financial statement. The profit from tangible fixed assets sales between the companies within the group is also excluded.*
- All the revenues and expenses between the subsidiary companies and between the subsidiary and holding companies have been excluded from the consolidated financial statement.*

Net Revenues from Sales

Net revenues in the Mercator Group were increased by approximately 6.1% in comparison to the year 1997 and amount to approx. SIT 128.43 billion.

The Administrative and Selling Expenses

The administrative and selling expenses have increased by 5.4% in nominal terms mostly because of increased costs of depreciation. Depreciation costs went up by 21.6% in nominal terms due to investments and higher depreciation rates.

The Profit from Ordinary Activities

The Mercator Group concluded its business year 1998 with profit from ordinary activities in the amount of SIT 887 million. However this data is not comparable to the year 1997 due to revaluation. With regards to the comparable data from 1997, the profit from regular operation in 1998 was nominally increased by approx. SIT 2.5 billion.

Net Profit

The Mercator Group concluded the business year 1998 with the net profit in the amount of SIT 1.48 billion. The net profit of the majority owner the company Poslovni sistem Mercator, d. d. amounted to SIT 1.36 billion however, due to financial revaluation in 1997 this data is not comparable to the financial result of 1997, when the net loss of the majority owner of the Mercator Group amounted to SIT 15.04 billion. If we use the comparable data for 1997, the financial result of the majority owner was nominally increased by more than SIT 3.8 billion in 1998.

Revaluation of Certain Real Estate

Following the auditor's report for the year 1997, the General Meeting of Poslovni sistem Mercator's shareholders held in November 1997, entrusted the administration to implement a revaluation of real estate worth above SIT 500 million, with the newly established fair market values had to be included into financial statements for the year 1998. The revaluations have shown that there were no major deviations between book values and the new valuations in the group, and for this reason the new values of real estate were not recorded in the financial statements for the year 1998.

The auditor's report

We have audited the Balance sheet of the Mercator Group as at 31 December, 1998, the relevant Profit and loss statement and The cash flow statement for the business year ended on the same date. We also studied the business report for 1998 presented by the management. The management of the company is responsible for the above mentioned financial statements. Our responsibility is to express an opinion on these financial statements.

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

In our opinion, the financial statements mentioned in the first paragraph in all respects give a true and fair view of the financial position of the Mercator Group as at 31 December, 1998 and of the results and cash flow for the year ending on the same date, in accordance with Slovene Accounting Standards.

PricewaterhouseCoopers d.d.

Ljubljana

PRICEWATERHOUSECOOPERS 

d.d., Ljubljana
2

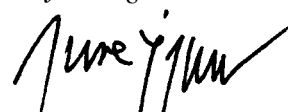
Chartered Auditor

Vida Lebar



Director

Jure Šager



Ljubljana, 15 April 1999

6. Audited Consolidated Financial Statements According to International Accounting Standards

Consolidated Balance Sheet of the Mercator Group as at 31 December, 1998

	<i>in ' 000 SIT</i>	
	<i>1998</i>	<i>1997</i>
ASSETS		
FIXED ASSETS	48,119,150	38,791,787
<i>Intangible fixed assets</i>	<i>308,334</i>	<i>791,779</i>
<i>Tangible fixed assets</i>	<i>41,946,664</i>	<i>35,808,987</i>
<i>Long term investments</i>	<i>5,864,152</i>	<i>2,191,021</i>
CURRENT ASSETS		
<i>Inventories</i>	<i>16,272,718</i>	<i>14,165,363</i>
<i>Trade receivables</i>	<i>11,072,660</i>	<i>9,020,197</i>
<i>Short term loans</i>	<i>2,325,411</i>	<i>2,476,368</i>
<i>Cash and cash equivalents</i>	<i>1,091,510</i>	<i>687,455</i>
<i>Prepaid expenses</i>	<i>140,866</i>	<i>311,317</i>
TOTAL ASSETS	79,022,315	65,452,487
EQUITY AND LIABILITIES		
<i>Equity</i>	<i>37,729,304</i>	<i>34,469,595</i>
<i>Share capital</i>	<i>32,085,040</i>	<i>32,085,040</i>
<i>Share premium</i>	<i>105,714</i>	
<i>Retained earnings</i>	<i>496,623</i>	<i>(2,223,072)</i>
<i>Treasury shares</i>	<i>(13,593)</i>	<i>(381,604)</i>
<i>Revaluation and other reserves</i>	<i>5,055,520</i>	<i>4,989,231</i>

<i>Minority interest</i>	1,842,805	1,742,582
<i>Non – current liabilities</i>	5,371,971	3,899,090
<i>Provisions</i>	247,598	395,033
<i>Long term borrowings</i>	5,124,373	3,504,057
<i>Current liabilities</i>	34,078,235	25,341,220
<i>Trade and other payables</i>	17,060,546	17,207,720
<i>Short term borrowings</i>	15,722,807	7,541,551
<i>Accrued costs and expenses</i>	1,294,882	591,949
TOTAL EQUITY AND LIABILITIES	79,022,315	65,452,487



Consolidated Profit and Loss Statement of the Mercator Group for the period from 1 January to 31 December, 1998

	1998	1997
<i>Sales</i>	128,436,900	121,081,372
<i>Cost of sales</i>	(97,218,353)	(92,777,923)
<i>Gross profit</i>	31,218,547	28,303,449
<i>Other operating income</i>	1,518,614	1,800,792
<i>Administrative expenses</i>	(5,256,264)	(4,448,172)
<i>Selling expenses</i>	(23,321,000)	(22,922,092)
<i>Other operating expenses</i>	(806,777)	(4,049,196)
<i>Operating profit/loss</i>	3,353,120	(1,315,219)
<i>Financial revenues</i>	2,326,274	2,185,011
<i>Financial expenses</i>	(2,708,225)	(3,341,301)
<i>Net profit/loss before tax</i>	2,971,169	(2,471,509)
<i>Tax</i>	(40,588)	(1,002,807)
<i>Group profit/loss</i>	2,930,581	(3,474,316)
<i>Minority interest</i>	(121,962)	200,203
<i>Net profit/loss</i>	2,808,619	(3,274,113)

Consolidated Cash Flow Statements for Mercator for the year ended 31 December, 1998

	<i>In ' 000 SIT</i>	
<i>Cash flow</i>	<i>1998</i>	<i>1997</i>
I. Cash flows from operations		
<i>Profit/loss before taxes</i>	2,971,169	(2,471,509)
<i>Depreciation</i>	3,362,424	2,876,250
<i>Devaluation</i>	156,197	1,243,825
<i>Financial revenues</i>	(2,077,996)	(1,748,008)
<i>Financial expenses</i>	2,303,750	2,176,347
<i>Operating profit before working capital changes</i>	6,715,544	2,076,905
<i>Change in receivables</i>	(1,882,012)	726,598
<i>Change in inventories</i>	(2,107,355)	(495,885)
<i>Change in current liabilities</i>	8,737,015	1,681,530
<i>Cash generated from operations</i>	11,463,192	3,989,148
<i>Interest, financial discounts and foreign exchange differences paid</i>	(2,285,422)	(2,168,259)
<i>Taxes on profit Paid</i>	(40,588)	(89,297)
<i>Net cash from operating activities</i>	9,137,182	1,731,592
II. Cash flows from investment activities		
<i>Purchase of equity interest</i>	(3,673,131)	1,786,770
<i>Purchase of fixed assets</i>	(9,016,656)	(6,717,802)
<i>Proceeds from sale of equipment</i>	42,885	1,313,674
<i>Interest, financial discounts and foreign exchange differences received</i>	2,051,028	1,533,238
<i>Dividends received</i>	84,184	214,770
<i>Decrease of long term provisions</i>	(147,435)	(186,573)
<i>Net cash from investment activities</i>	(10,659,125)	(2,055,923)
III. Cash flows from financing activities		
<i>Proceeds from long term borrowings</i>	1,620,316	781,562
<i>Finance lease liabilities paid</i>	-	(423,125)
<i>Changes in equity</i>	-	(361,101)
<i>Change of purchase treasury shares</i>	368,014	155,453
<i>Dividend paid</i>	(62,332)	(45,275)
<i>Net cash used for financing activities</i>	1,925,998	107,514
IV. Net decrease in cash and cash equivalents (I.+II.+III.)	404,055	(216,817)
V. Opening balance of cash and cash equivalents	687,455	904,272
VI. Closing balance of cash and cash equivalents	1,091,510	687,455

7. Letter of the Supervisory Board

Dear Shareholders ,

The business year 1998 was successful, after some years of unsatisfactory business by Poslovni sistem Mercator, d. d. The negative trends of recent years have been stopped and we have been establishing the first more important results both regarding the profitability of business operations and the rise of commercial effectiveness and recognition of the company on the market.

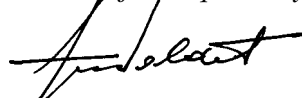
In 1998 for the company's business operations new turning points were set, which will essentially determine its further development. In accordance with the accepted strategic development plans, Poslovni sistem Mercator d. d. has started the processes for the required integration of the Slovene food and other trade, which not only contribute to a reduction of expenses and increase of economic efficiency and competitiveness of the business, but simultaneously also has a positive influence on other parts of the Slovene economy. We have formed also new, internationally comparable quality standards in the business operations and the process of internal restructuring has been intensified. By opening new shopping centres in Koper and Ptuj, the company has shown to its rivals that it is capable of competing successfully also with foreign companies on the Slovene market.

An increase in market share was the basic goal of the previous business year, but this does not mean that other important targets have been neglected. There was a great intensification of selling those investments and assets which are of no real importance in realisation of the development strategy of Poslovni sistem Mercator, d. d. The same is true for the process of a gradual business consolidation of certain subsidiary companies which were facing big production and financial problems in previous years. We carried out a revaluation of the company's assets, as in the process of company ownership transformation they were unfortunately overvalued, and thus had a negative effect on the structure of the company's balance sheet. This made it impossible to carry out sensible international comparisons of the company's competitiveness. Since the long-term goal of the company's development is to become an internationally competitive company, I feel convinced, that the one-and-a-half-year-long process will be finished at the shareholder's General Meeting.

The achievements of the business year 1998 could be further discussed, but that is more the purpose of the report as a whole. I would only like to add, the year 1998 will not be easily improved upon numerous criteria, including the 67% annual rise of share price on the Ljubljana Stock Exchange. The year 1998 is certainly a year of a positive turnaround in the company's business operation effectiveness which will give real results in the years to come.

On behalf of the supervisory Board, I would like to express the gratitude to the company's business partners, and especially to all the employees and the management for everything the company achieved in the year 1998, as with their work, endeavours and a vision they greatly contributed to a successful fulfilment of all the goals, determined in the business plan of the company for the year 1998.

Stanislav Valant,
Chairman of the Supervisory Board



Ljubljana, 30. June, 1999

Companies in the Mercator Group

31.12.1998

TRADE

Poslovni sistem Mercator, d.d., Dunajska cesta 107,
1113 Ljubljana

Mercator SVS, d.d., Rogozniška 8, 2250 Ptuj

- **Mercator Klas, d.d.**, Ptujška cesta 9, 2000 Maribor

Mercator Dolenjska, d.d., Livada 8, 8000 Novo mesto

Mercator Degro, d.d., Obala 144, 6320 Portorož

Trgoavto, d.d., Pristaniška 40 a, 6000 Koper

Mercator Modna hiša, d.o.o., Partizanska 3-5, 2000
Maribor

INDUSTRY

Mercator Emba, d.d., Slovenčeva 21, 1000
Ljubljana

ETA, d.d., Kajuhova pot 4, 1240 Kamnik

Zmajčkov butik, d.d., Koprška 100, 1000 Ljubljana

Mesnine dežele Kranjske, d.o.o., Mesarska 1, 1000
Ljubljana

Pekarna Grosuplje, d.d., Gasilska 1, 1290 Grosuplje

Slosad, d.o.o., Bohova 1, 2311 Hoče pri Mariboru

AGRICULTURE

Mercator Agrokombinat, d.o.o., Cesta krških žrtev
145, 8270 Krško

Mercator Kmetijsko gospodarstvo Kočevje, d.o.o.,
Kolodvorska 25, 1330 Kočevje

Mercator KŽK Kmetijstvo, Kranj, d.o.o., Begunjska
5, 4000 Kranj

HOTELS AND RESTAURANTS

Mercator Hotel Ilirija, d.o.o., Trg prekomorskih
brigad 4, 1000 Ljubljana

Mercator Sremič, d.o.o., Trg Matije Gubca 3, 8270
Krško

SERVICE ACTIVITY

Mercator Optima, d.o.o., Dunajska 105, 1113
Ljubljana

30.6.1999

TRADE

Poslovni sistem Mercator, d.d., Dunajska cesta 107,
1113 Ljubljana

Mercator SVS, d.d., Rogozniška 8, 2250 Ptuj

- **Mercator Klas, d.d.**, Ptujška cesta 9, 2000 Maribor

- **Jelša, d.d.**, Aškerčev trg 3, 3240 Šmarje pri Jelšah

- **Planika, d.d.**, Trg svobode 12, 2310, Slovenska Bistrica

Mercator Dolenjska, d.d., Livada 8, 8000 Novo mesto

Mercator Degro, d.d., Obala 144, 6320 Portorož

Goriška, d.d., Gregorčičeva 19, 5000 Nova Gorica

Mercator Gorenjska, d.d., Kidričeva 54, 4220, Škofja
Loka

Trgoavto, d.d., Pristaniška 40 a, 6000 Koper

Mercator Modna hiša, d.o.o., Partizanska 3-5, 2000
Maribor

INDUSTRY

Mercator Emba, d.d., Slovenčeva 21, 1000 Ljubljana

ETA, d.d., Kajuhova pot 4, 1240 Kamnik

Mesnine dežele Kranjske, d.o.o., Mesarska 1, 1000
Ljubljana

Pekarna Grosuplje, d.d., Gasilska 1, 1290 Grosuplje

Slosad, d.o.o., Bohova 1, 2311 Hoče pri Mariboru

AGRICULTURE

Mercator Agrokombinat, d.o.o., Cesta krških žrtev
145, 8270 Krško

Mercator Kmetijsko gospodarstvo Kočevje, d.o.o.,
Kolodvorska 25, 1330 Kočevje

Mercator KŽK Kmetijstvo, Kranj, d.o.o.,
Begunjska 5, 4000 Kranj

HOTELS AND RESTAURANTS

Mercator Hotel Ilirija, d.o.o., Trg prekomorskih
brigad 4, 1000 Ljubljana

Mercator Sremič, d.o.o., Trg Matije Gubca 3, 8270
Krško

SERVICE ACTIVITY

Mercator Optima, d.o.o., Dunajska 105, 1113
Ljubljana

Balances belongs to Tehniški muzej Slovenije (Slovenian technical Museum)

Production: Poslovni sistem Mercator in Studio A4, design: Bojana Fajmut, photos: Franci Virant, print: Camera and Čuk-graf