

**BUSINESS REPORT OF THE MERCATOR GROUP AND
THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.,
FOR THE PERIOD 1–9, 2016**



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EXECUTIVE SUMMARY

In the period 1–9, 2016, Mercator Group generated net revenue of EUR 1.89 billion, and net operating profit of EUR 30.4 million. Sales revenue was down 3.3% relative to the equivalent period of last year, which is a result of persistently harsh market conditions in the trade industry, activities related to intensified store refurbishments, and fewer stores in Slovenia, Serbia, and Croatia. Nevertheless, Mercator Group wrapped up the period 1–9, 2016, with net profit of EUR 8.2 million. Lower operating and net profit, however, are not entirely comparable to last year, especially on account of non-recurring (one-off) business events and the effect of divestment of non-core operations (Santana and Loka, Grosuplje Bakery, M Holidays, and other divestments of non-operating assets). Following the acquisition of land in April 2016, Mercator Group launched the construction project for a new logistics and distribution centre. In July, a sale and purchase agreement for divestment of Modiana operations was successfully signed, and in September, agreement was signed on the divestment of the company Intersport ISI, d.o.o., consistently with Mercator Group's pursuit of its strategy of focusing on the core activity.

Economic conditions in all Mercator Group target markets are improving

International institutions expect the current economic growth in the euro zone to persist. To date, United Kingdom's decision to leave the EU ("the Brexit") has not yet had a material effect on the stability of the financial markets. Growth will continue to be based on household consumption growth, with further improvement in the labour market.

Based on the forecasts, Slovenian gross domestic product will grow by 2.3% in this year, fuelled by favourable developments in exports and increase in private consumption. In Mercator Group's international markets, optimistic development of macroeconomic indicators is also expected, as economic growth is forecasted to improve, or at least not to worsen, in all markets. However, high unemployment remains a problem in Mercator Group's international markets.

Revised short-term strategy already yielding results

Challenging market conditions in the trade industry and the losses resulting from the fire at our distribution centre compelled us to revise our short-term strategy in order to further improve our performance. The disaster in May 2015 when our largest fresh program distribution warehouse burnt down caused a temporary increase in distribution, logistics, and other costs of the Mercator Group. This added to the urgency to revise many processes at the company. At the same time, the company faced a more aggressive approach by the competition as seen from stepped up investment into promotion and advertising.

Hence, we introduced a number of organizational, process, and tactical changes and revised our short-term strategy which is identified in 6 steps:

- clear format positioning strategy,
- network development with further refurbishments and new store formats,
- careful and more efficient profit margin management,
- regional platform of competitive suppliers on the purchasing side,
- attainment of business performance and efficiency on a par with the best competitors in the region,
- reorganization at Mercator Group: more transparency and responsibility – new organization and spin-off of wholesale as an independent activity.

It should furthermore be noted that the company has resumed the implementation of strategy of focusing on the core activity. Thus, we successfully completed in July the negotiations and signed the agreement on the divestment of Modiana operations, and successfully signed in September the agreement on divestment of the company Intersport ISI, d.o.o.

Profitability comparable to last year's figures, adjusting for non-recurring business events and the effect of divestments

In the period 1–9, 2016, Mercator Group generated revenue of EUR 1.89 billion, which is 3.3% less than in the same period of last year. In the markets of Slovenia (3.0%) and Serbia (5.0%), lower revenue is the result of closing down of stores for refurbishments, and fewer units in non-core operations. Moreover, the decrease in revenue in Slovenia is a result of divestment of Santana and Loka, Grosuplje Bakery, and M Holidays operations. In the market of Croatia, which saw the highest decrease of revenue (8.3%), revenue is lower especially due to abandonment of the entire FMCG program as of June 2015 following consolidation across

markets within the Agrokor Group, while in Montenegro revenue rose by 9.8%. Nevertheless, Mercator Group wrapped up the period 1–9, 2016, with a net profit of EUR 8.2 million. Lower profit is largely a result of non-recurring business events, and divestment of non-core activities and other non-operating assets in 2015.

Changes in the composition of the Mercator Group

- At the end of 2015, the company Intersport H, d.o.o., was founded in Croatia, and Intersport BH, d.o.o., was founded in Bosnia and Herzegovina; at the end of April, the company Intersport S trgovina, d.o.o., was founded with its seat in Serbia, and in August 2016, the company Intersport CG, d.o.o., Montenegro, was founded. The newly founded companies are subsidiaries of the Slovenian companies Intersport ISI, d.o.o.
- In February 2016, the subsidiary M–BL, d.o.o., was successfully merged with the company Mercator–BH, d.o.o. The company M–BL, d.o.o., was thus wound up and it was deleted from the court register.
- In March 2016, a change in the company name was entered into the court register, from Platinum–F, d.o.o., to Mercator–Velpro, d.o.o. The new company was founded with the primary purpose of independent development of the wholesale segment and boosting the wholesale and logistics operations.
- In June 2016, a change in the company name was entered into the court register, from Platinum–E, d.o.o., to Mercator–Maxi, d.o.o. The company does not yet conduct any business activity.

A boost to investment activities

In the period 1–9, 2016, Mercator Group investments amounted to EUR 53.2 million, which is 12.2% more than in the equivalent period of 2015. Focus remains on retail unit refurbishments which accounted for 57.0% of total funding.

New strategic development project: construction of Mercator logistics and distribution centre

In April 2016, the agreement was signed between the company Poslovni sistem Mercator, d.d., and the company Slovenske železnice, d.o.o., on the purchase of land for the construction of a new Mercator logistics and distribution centre. The value of the transaction was EUR 17 million, and the value of the entire investment is estimated at approximately EUR 100 million. Start of construction works on the facility is anticipated for the second half of 2017, and construction is expected to be completed by the end of 2018. The purpose of construction of the logistics centre is to centralize the warehousing activity, optimize the operating costs, successfully compete with other retailers, and modernize operations.

Sale and purchase agreement on divestment of Modiana operations successfully signed in July 2016

On July 14, 2016, the company Poslovni sistem Mercator, d.d., signed an agreement with the company Montecristo SL, d.o.o., on the transfer of Modiana activities, by which Mercator continues to successfully pursue its strategy of focusing on its core activity. The subject of the sales process at hand includes apparel stores and Beautique drugstores in all markets of Mercator operations (Slovenia, Croatia, Serbia, and Bosnia and Herzegovina). The contract also includes the purchase of assets (property, plant, and equipment), transfer of employees, and transfer of operations and activities at all locations. The transaction was completed on September 30, 2016.

Sale and purchase agreement for the company Intersport ISI, d.o.o., successfully signed in September 2016

On September 14, 2016, the companies Poslovni sistem Mercator, d.d., and Enterprise Fund VII, Poland, signed a sale and purchase agreement for the company Intersport ISI, d.o.o., the parent company of the Intersport Group. In addition to the company Intersport ISI, d.o.o., the Intersport Group includes the following companies: Intersport H, d.o.o., Croatia; Intersport BH, d.o.o., Bosnia in Herzegovina; Intersport S trgovina, d.o.o., Serbia; and Intersport CG, d.o.o., Montenegro. Divestment of the Intersport Group is consistent with Mercator's new strategy of focusing on the core activity and it represents a strong partnership in supplementary offer at Mercator shopping centres. According to the agreement, the new owner will take over all employees as well as the activities at the currently existing locations. The transaction is expected to be completed by the end of 2016.

INTRODUCTION

MERCATOR GROUP PROFILE AND ORGANIZATION

Mercator Group Profile

Mercator Group is one of the largest corporate groups in Slovenia and in the entire Southeastern European region. Poslovni sistem Mercator, d.d., headquartered in the Republic of Slovenia, is the parent company of the Mercator Group.

Poslovni sistem Mercator, d.d.	
Telephone	+386 1 560 10 00
E-address	info@mercator.si
Website	www.mercatorgroup.si
Company head office	Dunajska cesta 107, 1113 Ljubljana, Slovenia
Activity	Retail in non-specialized food retail outlets (G 47.110)
Registration number	5300231000
VAT tax code	45884595
Company share capital as at September 30, 2016	EUR 254,175,051.39
Number of shares issued and paid-up as at September 30, 2016	6,090,943
Share listing	Ljubljanska borza, d.d., official market, prime market, symbol MELR

Corporate governance

In the period 1–9, 2016, the Supervisory Board of Poslovni sistem Mercator, d.d., held three regular meetings and five correspondence sessions.

At the **8th regular session held on February 5, 2016**, the Supervisory Board approved or adopted the following major resolutions:

- approved the Business Plan of the Mercator Group and the company Poslovni sistem Mercator, d.d., and the strategy for the year 2016;
- received information about the comparative analysis of the competition in the FMCG industry for the year 2014; and
- approved the implementation of the Mercator Vič project for the purchase of the warehouse and commercial facilities and the relevant land of the former company Lesnina, d.o.o., and refurbishment thereof into a Mercator centre.

At the **9th regular session held on March 31, 2016**, the Supervisory Board approved or adopted the following major resolutions:

- adopted the Annual Report of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the year 2015;
- approved the Supervisory Board report on the 2015 Annual Report audit;
- received information about the Independent Auditor's Report on the statement of relations with affiliated companies pursuant to Article 545 of the Companies Act (ZGD-1);

- approved the signing of the sales agreement for the purchase of real property near the freight railway station Ljubljana–Moste (BTC Letališka) for the construction of a Mercator logistics and distribution centre;
- received the Mercator Group Internal Audit Annual Report for the year 2015;
- appointed Igor Mamuza as Management Board member of the company Poslovni sistem Mercator, d.d., as of April 1, 2016, for the term of office lasting until September 19, 2019; and
- confirmed the revision of the investment plan for 2016.

At the **6th correspondence session held on April 22, 2016**, the Supervisory Board reduced the number of Management Board members at Poslovni sistem Mercator, d.d., by one member, following the resignation of Management Board member Igor Maroša. The company Management Board thus continues to operate with the following composition: Toni Balažič, Management Board President; and Drago Kavšek and Igor Mamuza, Management Board members. At the session, the Supervisory Board also adopted the resolution on the signing of the agreement to divest the subsidiary Investment Internacional, d.o.o.e.l., in Macedonia.

At the **7th correspondence session held on May 6, 2016**, the Supervisory Board approved the signing of the General Term Sheet between the company Poslovni sistem Mercator, d.d., and the company Numerica partnerji, družba za upravljanje, d.o.o., which pertains to real property monetization.

At the **8th correspondence session held on May 16, 2016**, the Supervisory Board was presented the operations and performance of Mercator Group and the company Poslovni sistem Mercator, d.d., in the period 1–3, 2016.

At the **9th correspondence session held on July 14, 2016**, the Supervisory Board approved or adopted the following major resolutions:

- the Supervisory Board approved the divestment of the Modiana and Beautique division in the market of Slovenia, and the Supervisory Board was presented the progress of divestment of these activities by the subsidiaries Mercator–H, d.o.o., in the market of Croatia; Mercator–BH, d.o.o., in the market of Bosnia and Herzegovina; and Mercator–S, d.o.o., in the market of Serbia, all to the buyer – the company Montecristo SL, d.o.o., Slovenia, in the manner and subject to conditions agreed with the sale and purchase agreement and the master lease agreement;
- confirmed the investment – construction of trade centre Bled at Kajuhova ulica 1–3;
- confirmed the execution and budgeted value of the investment into expansion and refurbishment of the hypermarket and a part of the common area at Mercator centre Ljubljana–Šiška, Cesta Ljubljanske brigade 33; and
- approved the amendment of the Articles of Association of the company PLATINUM–E, d.o.o., so that the company name is changed to Mercator Maxi, gostinstvo in storitve, d.o.o., and that the company activity and Supervisory Board composition also changed to a three-member Supervisory Board.

At the **10th regular session held on August 30, 2016**, the Supervisory Board approved or adopted the following major resolutions:

- the Supervisory Board was presented the Business Report for the company Poslovni sistem Mercator, d.d., and the Mercator Group for the period 1–6 2016;
- the Supervisory Board was presented the internal audit report on rebates and fees received at the company Poslovni sistem Mercator, d.d.; and
- the Supervisory Board relieved Darko Knez from the position of a member of the Supervisory Committee which is in charge of monitoring the commitments made by the company Agrokor, d.d., as specified in the Sale and Purchase Agreement for the shares of the company Poslovni sistem Mercator, d.d., and appointed a new member Damir Kuštrak, for the term until September 18, 2024.

At the **10th correspondence session held on September 13, 2016**, the Supervisory Board was presented the economic effects of divestment of the 100% share in the company Intersport ISI, d.o.o., and approved the sale of the 100% share of the company Intersport ISI, d.o.o., to the investor Enterprise Fund VII, Poland.

Mercator Group composition as at September 30, 2016

<p>MERCATOR OPERATIONS SLOVENIA</p> <p>Poslovni sistem Mercator, d.d., Slovenia Mercator - Velpro, d.o.o., Slovenia (100.0%) ¹⁾ Mercator IP, d.o.o., Slovenia (100.0%)</p> <p>MERCATOR OPERATIONS FOREIGN MARKETS</p> <p>Mercator - S, d.o.o., Serbia (100.0%) Mercator - CG, d.o.o., Montenegro (100.0%) Mercator Makedonija, d.o.o.e.l., Macedonia (100.0%) ¹⁾</p> <p>OTHER OPERATING ACTIVITIES</p> <p>Mercator - Emba, d.d., Slovenia (100.0%) M - Energija, d.o.o., Slovenia (100.0%) Mercator Maxi, d.o.o., Slovenia (100.0%) ¹⁾ Intersport ISI, d.o.o., Slovenia (100.0%): ³⁾ - Intersport BH, d.o.o., Bosnia and Herzegovina (100.0%) ²⁾ - Intersport CG, d.o.o., Montenegro (100.0%)²⁾ - Intersport H, d.o.o., Croatia (100.0%) ²⁾ - Intersport S trgovina, d.o.o., Serbia (100.0%) ²⁾</p>	<p>MERCATOR REAL ESTATE</p> <p>Mercator - H, d.o.o., Croatia (99.6%) Mercator - BH, d.o.o., Bosnia and Herzegovina (100.0%) Investment Internacional, d.o.o.e.l., Macedonia (100.0%) ¹⁾ Platinum-A, d.o.o., Slovenia (100.0%) ¹⁾ Platinum-B, d.o.o., Slovenia (100.0%) ¹⁾ Platinum-C, d.o.o., Slovenia (100.0%) ¹⁾ Platinum-D, d.o.o., Slovenia (100.0%) ¹⁾</p>
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- 1) The company does not conduct business operations.
- 2) The company is a subsidiary of company Intersport ISI, d.o.o.
- 3) Sale and purchase agreement for the company Intersport ISI, d.o.o., was signed in September 2016.

Branch Offices

As at September 30, 2016, Mercator Group companies did not have any branch offices.

Other Organizations

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

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

MERCATOR GROUP BUSINESS STRATEGY

Vision

Mercator will be the biggest, the most successful, and the most efficient retailer in the markets of Slovenia, Serbia, and Montenegro.

Mission

- Happy customers recognize Mercator as the best retailer.
- Motivated employees are the key competitive advantage.
- We enjoy trust from all stakeholders.

Strategy

We are fulfilling five key promises, or propositions, to our customers. Each proposition has a clear purpose and goals:

1. Value for money:

Day in, day out, Mercator fulfils the needs and expectations of its customers, and offers the best value for their money with innovative offer.

2. Local:

Mercator works closely with its environment and continues its local initiatives which are reflected in the most extensive network of stores that are closest to the customers.

3. The best offer:

In addition to the offer of renowned brands, Mercator's private label products offer customers solid quality and competitive pricing. Mercator introduces innovative products and adjusts the offer in each of its stores to customer needs.

4. The ultimate freshness:

Mercator offers its customers the broadest choice of innovative products that are relevant to them, with stable partnership with local and regional suppliers.

5. The best service:

With a friendly and amiable approach, Mercator employees are focused on the customers. With intensified refurbishment of its stores, Mercator offers its customers improved shopping experience in a pleasant ambiance.

MERCATOR GROUP PERFORMANCE

HIGHLIGHTS IN THE PERIOD 1–9, 2016




	1–9, 2016	1–9, 2015	Index 1–9, 2016/ 1–9, 2015
Revenue (EUR thousand)	1,884,613	1,948,311	96.7
Results from operating activities (EUR thousand)	30,359	61,230	49.6
Profit before income tax (EUR thousand)	11,387	40,118	28.4
Profit for the period (EUR thousand)	8,246	30,964	26.6
EBITDA (EUR thousand)	84,972	119,026	71.4
EBITDAR (EUR thousand)	142,813	176,840	80.8
Equity as at September 30 (EUR thousand)	641,196	653,568	98.1
Assets as at September 30 (EUR thousand)	2,222,286	2,235,385	99.4
Capital expenditure (EUR thousand)	53,187	47,401	112.2
Return on equity*	1.7%	6.6%	26.1
Return on sales	0.4%	1.6%	27.5
EBITDA / revenue	4.5%	6.1%	73.8
EBITDAR / revenue	7.6%	9.1%	83.5

* Indicator is adjusted to annual level.

KEY EVENTS

Retail network development

In the period 1-9, 2016:

-  we invested EUR 53,187 into property, plant, and equipment (CAPEX);
-  we divested EUR 14,163 worth of property, plant and equipment;
-  we added 41 new units or 24,370 m² of new gross retail area in all markets of our operations.

Changes in the composition of the Mercator Group

Merger of the company M-BL, d.o.o., to the company Mercator-BH, d.o.o.

In February 2016, the subsidiary **M-BL, d.o.o.**, was successfully merged with the company **Mercator-BH, d.o.o.** The company M-BL, d.o.o., was thus wound up and it was deleted from the court register.

Focus on the core activity also through boosting wholesale operations

In 2015, Mercator substantially increased the scope and diversity of the offer in fast-moving consumer goods wholesale by acquiring the company Era Good, d.o.o. Activities to boost wholesale have continued in 2016. In March 2016, a change of the company name **Platinum-F, d.o.o.**, was entered in the court register, to **Mercator-Velpro, d.o.o.** The purpose of the new company is primarily independent development of wholesale activities and boosting our wholesale and logistics operations.

Launch of operations for the companies Intersport BH, d.o.o., Bosnia and Herzegovina; Intersport H, d.o.o., Croatia; Intersport S trgovina, d.o.o., Serbia; and Intersport CG, d.o.o., Montenegro

At the end of 2015, two companies were founded: **Intersport BH, d.o.o.**, Bosnia and Herzegovina, which started to conduct its business operations at the start of the 2016 calendar year, and **Intersport H, d.o.o.**, Croatia, which launched its business activities in March 2016. At the end of April 2016, the company **Intersport S trgovina, d.o.o.**, was founded, with registered seat in Serbia. It launched its business activity on July 1, 2016. In August 2016, the company **Intersport CG, d.o.o., Montenegro**, was entered in the court register, which started to conduct its business activity on September 1, 2016. The newly founded companies are subsidiaries of the Slovenian company Intersport ISI, d.o.o.

Founding of the company Mercator Maxi, d.o.o.

In late June 2016, a change in the company name was entered into the court register, from **Platinum-E, d.o.o.**, to **Mercator-Maxi, d.o.o.** The new company was founded with the purpose of transferring the activities of Maxi gostinstvo (HoReCa) to an independent company. The company does not yet conduct any business activity.

Sale and purchase agreement on divestment of Modiana operations successfully signed in July 2016

On July 14, 2016, the company **Poslovni sistem Mercator, d.d.**, signed an agreement with the company Montecristo SL, d.o.o., on the **transfer of the Modiana operations**. Thus, Mercator is successfully pursuing the strategy of focusing on its core activity. The subject of the sales process included all apparel retail stores and Beautique drugstores in Slovenia, Serbia, Bosnia and Herzegovina, and Croatia. The agreement also stipulates transfer of activities at all locations, acquisition of assets (property, plant, and equipment), and transfer of all employees. All current Modiana stores will remain at their current locations. The stores are to be partly refurbished, the brand portfolio will be extended, and private labels will be developed to allow pricing attuned to the needs of modern customers. As at the day of signing of the agreement, Modiana operates 47 shops in Slovenia, 22 in Croatia, and 13 in each Bosnia and Herzegovina, and Serbia. The transaction was completed on September 30, 2016.

Sale and purchase agreement for the company Intersport ISI, d.o.o., successfully signed in September 2016

On September 14, 2016, the companies **Poslovni sistem Mercator, d.d.**, and **Enterprise Fund VII**, Poland, signed a sale and purchase agreement for the company **Intersport ISI, d.o.o.**, the parent company of the Intersport Group. In addition to the company Intersport ISI, d.o.o., the Intersport Group includes the following companies: Intersport H, d.o.o., Croatia; Intersport BH, d.o.o., Bosnia in Herzegovina; Intersport S trgovina, d.o.o., Serbia; and Intersport CG, d.o.o., Montenegro. Divestment of the Intersport Group is consistent with Mercator's new strategy of focusing on the core activity and it represents a strong partnership in supplementary offer at Mercator shopping centres. According to the agreement, the new owner will take over

all employees as well as the activities at the currently existing locations. At the end of 2015, Intersport Group operated 93 stores and employed 852 people. This year, the Group was further extended with 11 new stores, 8 of which are own stores and 3 are franchise stores. Transaction value amounted to nearly EUR 34.5 million. The transaction is expected to be completed by the end of this year.

Changes in the Management Board composition at the company Poslovni sistem Mercator, d.d.

At the Supervisory Board session held in March, the Supervisory Board approved, upon proposal by the President of the Management Board Toni Balažič, the appointment of **Igor Mamuza**, previously a Senior Vice President, as the new Management Board member in charge of Mercator operations in Slovenia. **Igor Maroša**, previous Management Board member in charge of category management, procurement, wholesale, and marketing, resigned from the position of a Management Board member as of April 30, 2016, based on his statement of resignation.

Since May 1, 2016, the Management Board of Poslovni sistem Mercator, d.d., has been working in the following composition: Toni Balažič, Management Board President; and Drago Kavšek and Igor Mamuza, Management Board members.

Cooperation with local suppliers as a part of long-term strategic partnership

Mercator is working with over 2,000 Slovenian growers, farmers, and suppliers. In order to further extend cooperation with the local suppliers, an **Agreement on Long-Term Cooperation and Support to Slovenian agriculture and Cooperatives** was signed with the **Cooperative Union of Slovenia** in March 2016. Thus, Mercator is taking its cooperation with Slovenian cooperatives a step further and providing a long-term framework for it. The strategic partnership involves in-depth cooperation especially in promotion of locally grown food, new product development, and promotion and support to social enterprise activities in the field of locally grown food.

Real estate purchase agreement for the new logistics and distribution centre

In April 2016, the companies **Poslovni sistem Mercator, d.d.**, and **Slovenian Railways** (Slovenske železnice, d.o.o.) signed a real estate purchase agreement for the property on which a new Mercator logistics and distribution centre (LDC) is to be built. The property is located at the freight railway station Ljubljana–Moste (BTC Letališka). The value of the transaction is EUR 17 million, and the value of the entire investment is estimated at approximately EUR 100 million. Start of construction works is anticipated for the second half of 2017, and construction of the facility, which will span approximately 88,000 square metres complete with commercial premises, is expected to be completed by the end of 2018. The purpose of construction of the logistics centre is to centralize the warehousing activity, optimize the operating costs, successfully compete with other retailers, and modernize operations. The modern logistics and distribution centre will notably improve the service for the customer. It is one of the most important strategic development projects in Mercator's corporate history.

Opening of the refurbished centre Mercator Šiška

On July 21, 2016, the updated **Mercator Šiška** Centre was reopened. After the refurbishment, it is Mercator's flagship centre offering an all-around shopping experience on an area of 6,618 m².

Awards and other achievements

According to the Reader's Digest readers, the company Poslovni sistem Mercator, d.d., ranks **number 1 in the category of food retailers in the field of environment protection**. The company has striven for a number of years to improve the environment aspects of its operations, and for economical and rational use of energy, raw materials, and other natural resources.



The **QUDAL – Quality Medal** survey, conducted in Slovenia in June this year by the international organization Icertias of Zurich, has shown that in terms of quality when shopping for hand soap bars, Slovenians see the **Dvorec Trebnik soap** as the choice of the highest quality. We are also a medal recipient in the category of **cured meat products among private labels**.

Another recipient of the **QUDAL – Quality Medal** accolade is the **IDEA** store format in Serbia, for 2016/2017, which received the **Qudal for the retailer with the highest quality level** in the country of its operation.

At this year's **20th Business Assistant of the Year** contest, our employee Gabrijela Jež reached the **3rd place**.

In May 2016, the **6th Coaching Conference** took place at the National Council, titled Self – on the Way to Oneself and to Others, where our employee Tamara Audič from the HRM and selection department presented the first steps in introducing coaching at our company, and how we use our knowledge to develop our own human resources.

M Tehnika web store was the first in Slovenia to receive both certificates – **Certified Shop and EMOTA**, which indicate a trustworthy online retailer.

At the 54th International Fair of Agriculture and Food AGRA, the company **Mercator IP, d.o.o.**, won 3 medals of quality for its brand **Danilo&Marija**.

BUSINESS REPORT

EFFECT OF ECONOMIC CONDITIONS AND COMPETITION ON MERCATOR GROUP OPERATIONS IN THE PERIOD 1–9, 2016

Economic conditions in the markets of Mercator operations in the period 1–9, 2016¹

International institutions expect the current pace of euro zone's economic growth to continue. The decision of the United Kingdom to exit the EU (the "Brexit") has thus far not been reflected considerably in economic performance and financial market stability. According to forecasts by international institutions, GDP growth in the euro zone in the period 2016–2018 is anticipated between 1.4% and 1.6%. Growth is expected to continue to be based on household consumption growth, with further improvement in the labour market. Modest recovery of investment is also expected with higher corporate profits, the need to replace equipment, and more favourable financing terms. With expected growth of the global economy, euro zone's export growth is expected to slow down this year, and to take off again next year. Regarding our major trade partners outside the euro zone, the forecasts by international institutions point to further gradual improvement of economic growth in Croatia.

SLOVENIA

This year's gross domestic product will grow by 2.3%, fuelled by favourable developments in exports and increase in private consumption. GDP in the first half of the year was 2.5% up year-on-year, and the available activity and confidence indicators point to similar developments in the second half of the year as well. Exports remain the key factor in the growth of economic activity. As conditions in other segments of the economy have improved in recent quarters, economic recovery is getting a broader base.

Conditions in the labour market are improving materially as well. Growth of employment and salaries is picking up pace, and the household disposable income growth is higher as well, which is manifest in significant growth of household consumption.

Private spending (i.e. household consumption) growth in the first half of 2016 increased (1.9% year-on-year), and the improvement in the consumer confidence index in recent months, which is above the long-term average, indicates further strengthening in the second half of the year.

In the first half of this year, government consumption was higher 2.7% year-on-year. This year, growth is based in particular on higher compensation of employees, with growth of salaries and employment in the government sector after the expiry of some of the austerity measures.

Export growth will continue to be based on exports to the markets of EU member states, and the expected increase of growth of export demand in the period 2016–2018 will be predominantly the effect of improvement of economic activity in trade partners outside the EU, particularly in Russia.

The effect of the drop in energy prices is subsiding. This year's growth of core inflation originates in higher prices of services since the prices of non-fuel goods remain the same as last year. In the next two years, considering the assumptions regarding raw material prices, international pricing pressures will gradually intensify, which will have a direct effect on overall inflation via import prices. Indirectly, recovery of domestic

¹ Economic conditions are commented based on the following data sources: IMAD (Institute of Macroeconomic Analysis and Development of the Republic of Slovenia), EC (European Commission), national central banks of respective countries, and the Standard&Poor's rating agency.

spending and gradual closing down of the output gap could also contribute to transfer of higher raw material prices to core inflation.

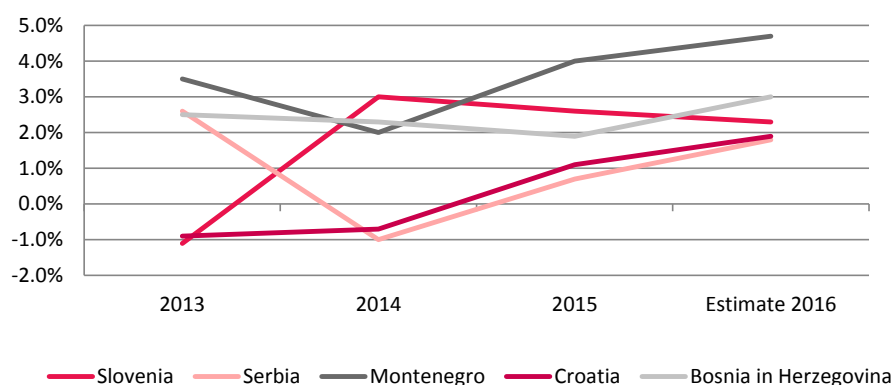
Rather than to the global environment, the risks pertain more pronouncedly as in the previous forecasts to the narrow international environment, especially regarding Brexit.

Slovenia's rating remains A (according to the Standard&Poor's rating agency) with a stable trend.

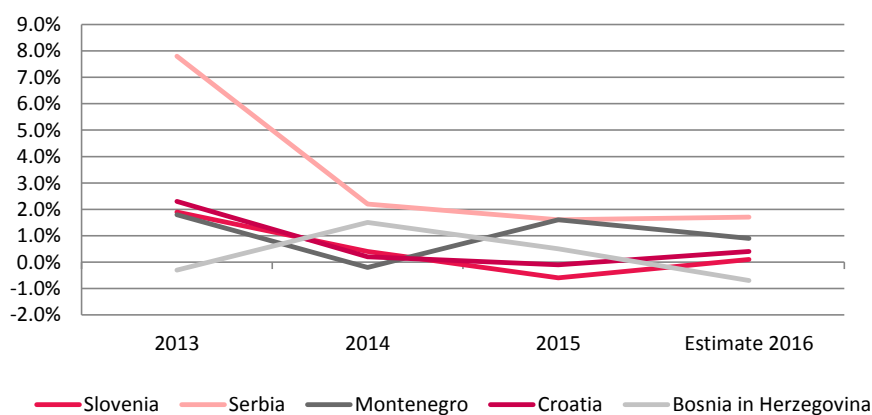
Key macroeconomic indicators in the markets of Mercator Group operations

Following is a presentation of changes in three indicators: GDP, inflation rate, and unemployment rate, since 2013. The data pertains to the countries of Mercator Group operations.

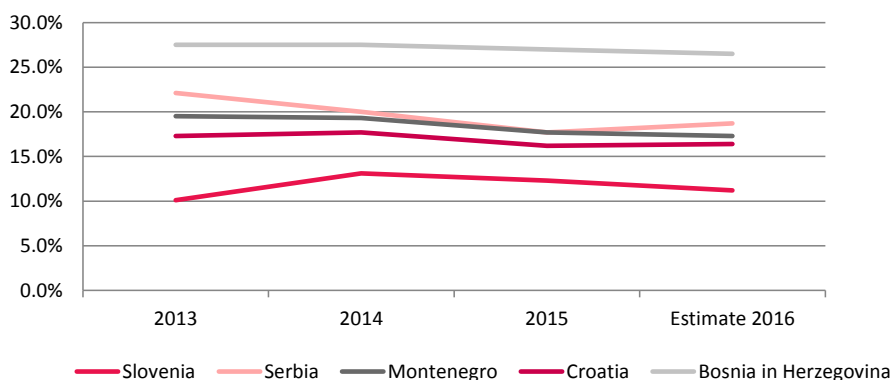
Gross domestic product growth



Inflation rate



Unemployment rate



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

In all markets of operations, the current pace of euro zone economic growth is expected to continue. Thus far, the effect of United Kingdom's decision to leave the European Union has not been reflected materially on economic performance and financial market stability (IMAD). In **Slovenia**, recovery of economic activity has had a favourable effect on hiring. Improvement in the general economic situation and conditions in the labour market has had a positive effect on consumer confidence and it has provided an impetus to private spending growth. Confidence indicators in business and among consumers remain high.

For 2016, the Institute of Macroeconomic Analysis and Development (IMAD) forecasts economic growth in Slovenia at 2.3%, which is lower than in 2015. Government investment will be the key factor of economic growth, boosting overall investment spending. In addition, growth will also be fuelled by exports and household consumption. Private spending will continue to increase as well. Increase in household consumption which started in 2014 after two years of decline, will be fuelled especially by further positive developments in the labour markets while consumer confidence remains rather high. Stronger consumer confidence in economic growth, after several years of improvement of conditions, will also contribute to further growth of household spending.

According to Nielsen data,² consumer confidence in Slovenia in the second quarter of 2016 is slightly higher than in the first quarter of 2016 and still below the European average. Seventy-one percent of respondents believe the country is in a recession. Just over 70% of respondents believe that the country will not recover from the recession in the next 12 months. Their primary concerns are security of employment, own health, and rising costs.

According to economic growth forecasts, improvement of economic conditions, or at least no worsening thereof, is also anticipated in the markets of **Serbia, Croatia, Bosnia and Herzegovina**, and **Montenegro**³. Private spending will rise while unemployment will remain high.

Consumer confidence in **Serbia** is slowly but constantly improving;⁴ however, it remains below the European average. In **Croatia**, consumer confidence fell in the second quarter of 2016 relative to the first quarter of the year, by 3 percentage point. A high share of respondents – 82% in Serbia and 89% in Croatia – believes the country is in a recession. Nearly three quarters of respondents, both in Serbia and in Croatia, believe that the country will not recover from the recession in the next 12 months. Consumers in both markets are the most concerned about security of employment, health, work-life balance, and own health.

² Nielsen: Consumer Confidence Index, Q2 2016, Slovenia

³ European Economic Forecast Spring 2016, European Commission, May 2016

⁴ Nielsen: Consumer Confidence Index, Q2, 2016, Croatia & Serbia

SALES AND MARKETING

Sales

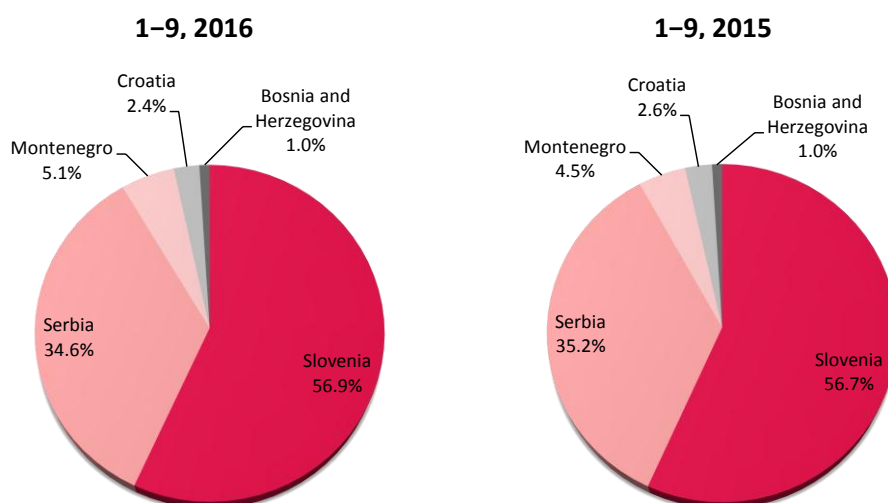
International institutions expect the current pace of economic growth in the euro zone to persist. To date, United Kingdom's decision to leave the EU ("the Brexit") has not yet had a material effect on the stability of the financial markets. According to the forecasts by the international institutions, GDP growth in the euro zone is expected between 1.4% and 1.6% in the period 2016–2018. Growth will continue to be based on growth of private spending, with further improvement of conditions in the labour market.

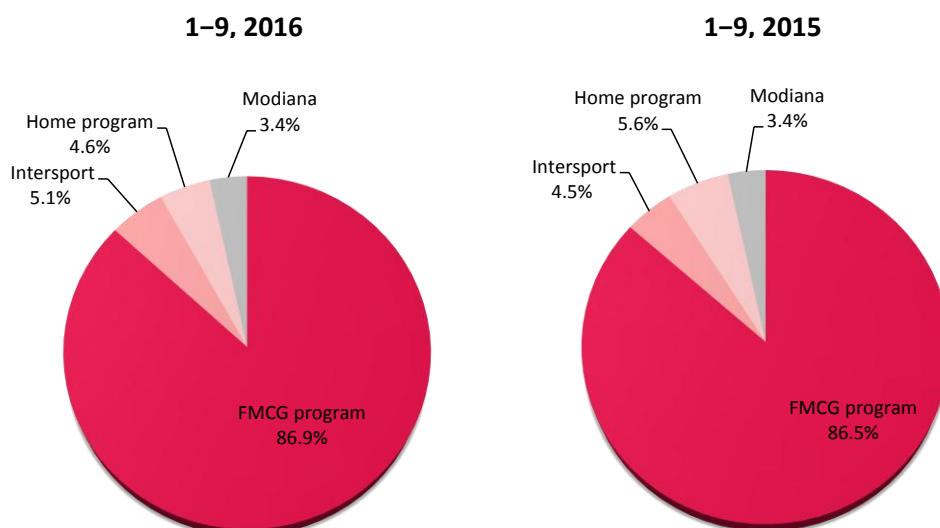
Based on the forecasts, Slovenian gross domestic product will grow by 2.3%, fuelled by favourable developments in exports and increase in private consumption. In Mercator Group's international markets, optimistic development of macroeconomic indicators is also expected, as economic growth is forecasted to improve, or at least not to worsen, in all markets. However, high unemployment remains a problem in Mercator Group's international markets.

In the period 1–9, 2016, Mercator Group generated EUR 1,885 million of net revenue, which is 3.3% percent less than in the corresponding period of 2015.

Revenue development differed across markets of Mercator Group operations. In Slovenia, revenue dropped by 3.0%. Revenue was also lower in Serbia (5.0%), Bosnia and Herzegovina (1.7%), and in Croatia (8.3%), while in Montenegro, it rose by 9.8%. Drop of revenue is a result of harsh market conditions, intensified activities of store refurbishment, and fewer units in non-core activities. Another cause for lower revenue in the market of Slovenia is the divestment of tourist service operations M Holidays, divestment of the Grosuplje Bakery (Pekarna Grosuplje), divestment of the Santana and Loka brands, and other divestment of non-operating assets in 2015. In the market of Croatia, the drop in revenue is a result of final termination of the market (FMCG) program as of June 30, 2015, due to consolidation by markets within the Agrokor Group. In the market of Montenegro where no changes regarding the consolidation took place within the Agrokor Group, revenue was higher than in the same period last year, also on account of newly opened stores in the direct vicinity of tourist resorts.

Mercator Group revenue by geographical segments:



Mercator Group revenue from trade operations by programs:

Mercator Group core activity, fast-moving consumer goods retail, generated 86.9% of the Group's total revenue in the period 1-9, 2016. The share of sales revenue from other specialized trade programs accounted for 13.1%. Compared to the equivalent period of the year before, revenue dropped at the Mercator Group level within the following programs: fast moving consumer goods, apparel (Modiana), and home products. Drop of revenue in non-core activities is mostly a result of further closing down of underperforming units. The share of Intersport revenue increased relative to the equivalent period of 2015 by 8.6%.

Store formats, customer segments, and category management**Store Formats**

Shopping – a rather simple process once – has been getting increasingly complex in recent years. The power has shifted to the customers. Today's customer is defined by rapidly changing demographic conditions, lifestyle, and technological development. The consumers have become even more demanding, more informed, and aware. They look to get the most for their money and they are less loyal to a single retailer, which further increases the complexity of the business. Pressure on the retailers is mounting to move faster and more to the digital world and the online environment as consumers are willing to spend less and less of their time on shopping. The future lies in further expansion of the number of sales channels and increasingly better integration across them.

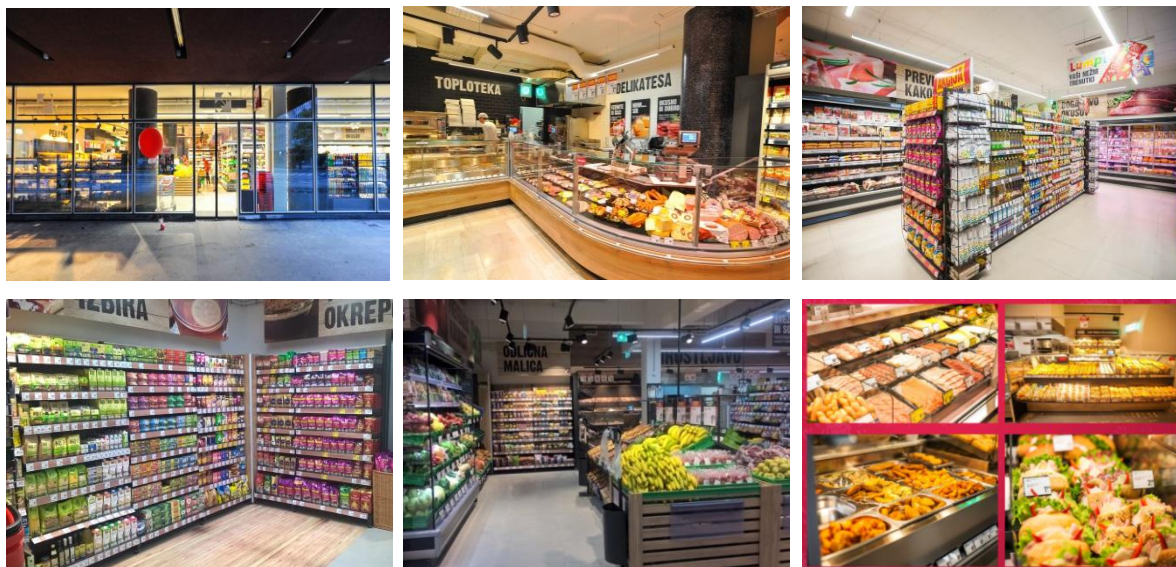
In the digital age, the customers start their shopping process long before they actually enter the store, and continue the process long after they have left it. New technology has had a key effect on retail and retailers are working with the customers to focus on improving the shopping experience.

Like most leading global retailers, Mercator is also looking to adjust accordingly as much as possible, by diversifying its store formats. They are intended to accommodate a variety of shopping needs, from major planned shopping sessions to minor daily, top-up, or occasional shopping for fast-moving consumer goods.

Mercator is looking to offer its customers a shopping environment with modern design, in as many locations as possible, with extended and richer offer of fast-moving consumer goods. Thus refurbished, Mercator stores afford customers an even more pleasant shopping environment, while category structures and new services offered are adapted to the most recent shopping trends.

Many Mercator stores have been refurbished or updated in 2016. In the period 1–9, 2016, 14 stores spanning a total gross area of 29,092 m² were refurbished (4 hypermarkets, 1 supermarket, and 9 markets); 12 stores spanning a total of 3,940 m² were partly refurbished (12 markets), and layout was updated for 21 stores

spanning a total of 19,284 m² (1 hypermarket, 2 supermarkets, and 18 markets). Before the summer season, our offer was improved and a facelift was carried out at several tourist-oriented units, both at the seaside (Portorož, Piran, Lucija), and in the Gorenjska region (Bled, Bohinj, Bohinjska Bistrica). In September, the fully refurbished store at Slovenska cesta 55 in Ljubljana was opened. The store's product mix was further adjusted to cater to the shopping needs of passers-by looking to quickly shop for a snack or lunch, and to daily shoppers residing in the vicinity of the store.



After the refurbishment in July, **hypermarket Šiška** in Ljubljana became **the most modern** hypermarket in Slovenia and the broader region. With its unique ambiance and many new features in its offer and services, Mercator Šiška is certainly setting new trends in shopping as it delivers a modern shopping experience and offers unique culinary experiences. The offer includes over 35,000 types of products, including 5,000 entirely new ones. There are many new features, in particular:

- **Offer of fresh produce:** Some fresh produce departments or sections are designed to allow the customer to look into the background of the product or food preparation. These departments or sections include the bakery (preparation, kneading, baking of the dough); pastry shop (baking and decorating the pastry); meat department (meat ageing, preparation and cutting); and the sushi bar (preparing sushi in front of the customers). The fruit and vegetable department has been extended with offer of organically grown fruit and vegetables sold in bulk; with the fruit island – so-called Vita bar – where fresh smoothies and juices are made daily. Also extended were the bakery with freshly baked pre-packed bread and pastry, including those offered in self-service counters, and the fish department, excellently stocked with fresh fish and seafood.
- **Prepared food section (called "Kuharija")** combines a broad and diverse offer of ready-made food for immediate consumption, such as vegetarian dishes and fish, past, wok dishes, preparing meat and fish according to the customer's wishes, grilled meat (pleskavica – minced meat patties), skewers, lamb (etc.). The characteristic feature of the department is modern, contemporary food preparation, with emphasis on fresh food made in front of the customer.
- **We Love Local department** combines broad offer of produce from local farms and cooperatives.
- **The world of beer** offers a diverse selection of beer from across the world.
- **Toy department, also called the Dream Factory**, has been expanded and visually upgraded to present a rich selection of toys, and a small playground (bus with a slide, Lego corner).
- **Herbal store with medical supplies and food supplements** called Sanatura.
- **New technological features** such as the M Sken (self scan) feature that allows Mercator's loyal customers quick and convenient shopping as they can scan and place select products into bags and check out at the quick check-out counter where they only pay for the select products.
- In terms of offer and appearance, the following sections and departments also stand out: **florist, located at the entrance to the hypermarket; the organic department; the wine section; the home and ambiance department; cosmetics; international food; and tobacco.**



Composition of sales units as at September 30, 2016

COUNTRY Banner	SLOVENIA		SERBIA		CROATIA	BOSNIA AND HERZEGOVINA	MONTENEGRO		MACEDONIA, ALBANIA and KOSOVO	MERCATOR GROUP		
	Mercator Number of units	Mercator Number of units	Roda Number of units	Idea Number of units	Mercator Number of units	Mercator Number of units	Mercator Number of units	Idea Number of units	Intersport Number of units	Number of units	Gross sales area	Net sales area
STORE FORMAT												
Hypermarkets	22	2	31	3	-	-	-	2	-	60	267,396	182,467
Supermarkets	109	-	3	87	-	-	-	13	-	212	223,917	147,191
Neighbour stores	339	-	-	205	-	-	-	91	-	635	247,690	147,793
Comfort stores	1	-	-	1	-	-	-	-	-	2	6,296	3,776
Convenience stores	1	-	-	-	-	-	-	-	-	1	159	83
Cash & Carry / VELPRO	14	-	-	9	-	-	-	2	-	25	80,859	36,654
Restaurants	8	-	-	-	-	-	-	-	-	8	2,070	1,379
Total FMCG program	494	2	34	305	-	-	-	108	-	943	828,388	519,343
Technical consumer goods	44	-	-	-	-	-	1	-	-	45	60,872	37,998
Clothing program and drugstores	47	13	-	-	23	13	-	-	-	96	49,375	41,585
Clothing program	41	8	-	-	23	9	-	-	-	81	47,770	40,170
Drugstores and perfumeries	6	5	-	-	-	4	-	-	-	15	1,605	1,415
Intersport	36	13	-	-	38	10	5	-	-	102	62,785	47,718
Total specialised programs	127	26	-	-	61	23	6	-	-	243	173,033	127,301
Total retail units under management	621	28	34	305	61	23	6	108	-	1,186	1,001,420	646,644
Franchise stores	213	-	-	-	-	-	-	-	9	222	52,288	35,322
TOTAL	834	28	34	305	61	23	6	108	9	1,408	1,053,708	681,965

Customer segments

The needs and desires of our customers are highly diverse. We learn about them by analyzing their shopping behaviour, either through market research or shopping data analysis. Upon this basis, we can adjust the offer and the retail area accordingly, and plan our marketing activities. All major activities are approached with a three-dimensional mindset: offer, store (place), and customer. In the 3rd quarter, we carried out several activities of adjusting the offer to respective customer segments. Some activities involved specific groups of products; others were focused on retaining customers or steering their behaviour.

Category management and procurement

Our category management and procurement activities in the period 1–9, 2016, pursued the following goals: to build a quality offer of both branded and private label products, to provide competitive prices, to include appealing offer in our sales promotion activities, to efficiently manage our store area at the level of each product or category, and to provide adequate in-store sales service.

Marketing

Our marketing activities are focused on market priorities and the dynamics of changes in the trade industry. In the period 1–9, 2016, we continued to exchange and roll out the best practices across markets. Marketing activities for the fast-moving consumer goods program are targeted at the markets of Slovenia, Serbia, and Montenegro, which is consistent with the corporate vision.

Slovenia

We are pursuing the goal of creating value for the shareholder in five key areas:

1. Pricing benefits for the consumers

Mercator is continuously pursuing the goal of offering appealing price benefits for the customers. The **My Day, Every Day** campaign involves offering attractive discounts to customers on a daily basis in a number of categories, every day of the week. In addition to campaigns from the regular catalogue, we occasionally carry out a start-of-the-week campaign called "My Start to the Week". Wednesday is normally the double Pika bonus points day for the Pika card holders, and Thursdays are always reserved for extra benefits for the retirees. At weekends, customers are offered benefits in the form of a coupon for a selected product. Through catalogues, we regularly present to the buyers attractive special offers of fast-moving consumer goods, and offers of non-food products with additional catalogues and campaigns for large formats where such offer is available. Activities are adjusted regularly in accordance with the season and customer needs. In addition to special prices and benefits, the customers are also offered prize contests and rewards for shopping.



2. Activities for the loyal Pika customers

With a pronounced focus on the consumers, we continue to develop the **benefits of the Pika card customer loyalty system**. In addition to the Pika discounts on select products and double and extra Pika bonus points which are available to all Pika card holders, additional discounts are offered to all retirees.

Value added of the Pika card is enhanced by extending the offer in cooperation with new partner companies that provide appealing complementary offer exclusively for us and for our target segments. For the buyers who allowed us to look into their shopping behaviour, we are also preparing customized activities via direct mail.



In the third quarter we offered the Pika card holders a new benefit – **Pika coupon for 25% discount on selected product**.

3. Homemade, local offer

The **Locally Grown** project is focused on Slovenian offer of fresh produce. We were the first in the market to offer our customers seasonal fruit in vegetables. We also stress our other advantages, such as: meat 100% raised in Slovenia; milk and dairy products from 100% Slovenian milk; and bread made of 100% Slovenian wheat.



Homemade is the best. Therefore, over 300 Mercator stores across Slovenia include, as of May this year, special stands and shelves offering exclusively authentic local produce. As we want your nearest Mercator store to be stocked with the best offer of local produce in a single place, we will label with a red heart, on dedicated shelves, the **We Love Local** ("Radi imamo domače") products. This will include offer of authentic products and products from local farms, growers, and producers. Our broad family of partners, currently comprising over 2,000 Slovenian growers, processing operations, and suppliers, has been further extended with new local suppliers, the farmers. Our offer of Slovenian products, already broader than anywhere, was extended with a varied offer of over 900 new types of genuine products from local farms.

4. Proximity to the consumers

At Mercator, we have decided to offer extra support this year to Slovenian national ski jumping team (dubbed the Eagles) and their junior teams. Until the end of the world cup we cheered for our team along with our customers, with the slogan **Jump to Mercator, Support our Jumpers!**



From February 1 to the end of the ski jumping world cup, we worked with our customers to raise funds that were donated to the national team and especially to local ski jumping clubs. Our goal was to establish a EUR 100,000 fund, of which three quarters was donated to the national team, while participating ski jumping clubs were eligible to receive the remaining quarter. Customer votes decided which club received the donation. Donation was presented at a special event immediately after the completion of the World Cup. Customers expressed their support to local ski jumping clubs by casting over 606,000 votes.



In spring this year, we again opened Mercator's gardening centres to our customers, offering a variety of seedling, fresh herbs, tree and shrub saplings, soil and fertilizers, flower pots, gardening equipment, and small and large gardening tools. The offer of vegetable seedlings included a large part of Slovenian seedlings as well as some organic seedlings. Mercator garden centres are at the following locations: MC Šiška, Domžale, Kranj Primskovo, Novo mesto Bršljin, Celje, Maribor Tabor, and Ptuj Špindlerjeva.

In addition to **store refurbishments**, we are also offering a wide range of marketing activities, depending on the scope of refurbishment and prominence of the location. For smaller refurbishments, we prepare an A5 flyer and a re-opening day campaign. For major refurbishments, we issue a more extensive flyer with many more benefits. We also prepare promotions, surprises for our customers, shopping bonuses, guerrilla advertising, local advertising, labelling, and an opening event.

For **select critical stores**, we devised an activity in June to stop the drop in revenue. We developed a local A4 flyer with three discount coupons (10% for purchases over EUR 20; 15% on purchases over EUR 50; and 20%

discount on purchases of over EUR 100), and sent it to households in the vicinity of the store for four consecutive weeks.

In May and June, some of our **Mercator centres** celebrated their anniversaries which included a lot of entertainment for the visitors and bonuses for the shoppers. The weekend of June 17–19 was the **Crazy Discount Weekend** at all Mercator centres and trade centres. In addition to exclusive discounts by our tenants, we also prepared promotional campaigns and supplier samplings or tastings, promotion of BMW automobiles, a lively verve for the children, and a party with a DJ.



Mercator Centre Šiška

There was a major clearance sale in the week before the closing. Particularly festive was the July opening of the refurbished hypermarket and the related marketing activities and prize contests.

M Sken

Implementation of the M Sken (self scan) as a new feature in the Slovenian market took place at the end of last year at the hypermarket Šmartinska. This year, the project was extended to refurbished stores (in March to hypermarket Rudnik Supernova, and in July to hypermarkets Celje and Šiška).

Upon the start of the new school year, we prepared again an attractive **Star Wars** and **Frozen** spinning top collection program. During this time, we also expanded our licensed offer of the popular Disney hero products. We organized a number of entertaining workshops for children and promoted socializing.



5. Offer of private label products

Mercator private label lines offer a variety of products for all occasions, at all price segments. In the period 1–9, 2016, we continued to communicate our **new private label lines**: dairy products **Mila**, new line of tissue paper products **Natur**, and the **Dax** line for home and household. In March, we presented our new **premium products of the Special Moments line** that allow anyone to enjoy a bit of luxury in everyday life. Also launched were the body care products **Olea and Man Extreme**. Revision of product appearance in the **central Mercator private label line** continues. Flyers and activities of the project **Jump to Mercator, support our jumpers!** promoted the sales of key alimentary categories of the Mercator line. This project also included the presentation of the organic products with a new name and assortment, **Bio Zone**, and the redesigned **Lumpi diapers**. Broad communication support across a variety of media outlets and at the stores was provided for the **Lumpi** label.



Upon the launch of the revised line of the Bio products and introduction of the Bio Zone line, we prepared an SMS competition **Choose BIO, travel to Rio**, which took place from June 16 to July 15, 2016.

To support the communication of the Mercator label, we prepared in the course of the third quarter the campaign **Thank You for Trusting the Private Label Products** and launched a catalogue with product and offer presentation, focused on products made in Slovenia.



Serbia

Marketing activities in Serbia in the period 1-9, 2016, took place separately, by respective brands or banners. Main highlights on the Roda and Idea banners are defined through key unique selling propositions (USP).

Key joint corporate projects

We joined the national campaign against children's cancer. On the International Childhood Cancer Day, all employees in retail units wore the yellow ribbons to spread the awareness of this issue.



At the business forum at the Kopaonik mountain resort in March, the company's presence included promotion of a line of local products **The Flavours of my Town**.

Moreover, retail units joined the campaign **An Hour for our Planet** which warns of the climate change on planet Earth by means of a one-hour blackout.



Corporate Superbrands: Mercator-S, d.o.o., received this prestigious award in 2016, presented to companies operating in Serbia. The award stresses the company's reputation, its corporate image, and socially responsible conduct.

Joint marketing projects

At the start of the summer, a prize contest was held to promote the sales of products in the beer category. Upon purchasing at least 500 dinar worth of products, the customers were presented a ticket. Each ticket won at least one prize, while two tickets won the first prize – a Harley Davidson motorcycle.



We further supported the campaign to expand the Special Moments private label line with twenty-one new products. The product line is offered at nine platinum IDEA stores and at Mercator hypermarkets Belgrade and Novi Sad.



Results of the GfK survey on brands have shown that the customers find **K Plus** to be the best brand. Positive results were celebrated with a marketing campaign titled **Thank You**.



At the start of the school year, September and October were a time for activities with **Star Wars** and **Frozen** Disney heroes.

In the autumn, we launched a wine catalogue and exposed our promotional offer of new wines.



IDEA

Key activities were focused on the following pricing campaigns: **Choose Healthy, Choose Fresh; This Spring Starts with Idea**; and **Belgrade, a City of new Ideas**.

The campaign **Choose Healthy, Choose Fresh** took place in January and February of 2016. It was aimed at promoting offer and reasonable prices for products in the fruit and vegetable department, especially citrus fruits, exotic fruit, and other categories. The second part of the campaign was held in June when the fruit and vegetables promotion was expanded with the Apple for Apple contest and specific workshops for raising the awareness of the importance of fruit and vegetable consumption.



The campaign **This Spring Starts with Idea** took place in March and continued in April. It was developed as a part of the Easter and May first holiday celebrations. Many activities took place during the Easter season, ranging from a contest in which every ticket won an award to an Easter visit and presents for children's homes across Serbia.

In 2016, the campaign **Belgrade, a City of New Ideas** continued. It involved a contest from December 2015 to February 2016, in which the customers chose 4 retail units in Belgrade for refurbishment.



Particular attention was also garnered by the **opening of the refurbished store Idea London**. It was attended by 70,000 people. The re-opening event included entertainment with musicians and London-themed activities, as well as a donation to the Children's Theatre for support to culture among youth.



The **IDEA** format won this year's **Qudal** award for the retailer with the highest quality level.

The new assortment includes expanded offer of bread and pastry at the **IDEA** bakery.



As a part of the campaign "**Belgrade, City of New Ideas**", many sponsorship activities were held, such as sponsoring a beer festival, the newborn baby month, Belgrade River Boat Carnival etc. The activities invite the customer to take part in collection of proposals to beautify Serbia's capital.

RODA

The following activities took place at Roda retail units in the period 1-9, 2016:

- promotion of **products made in Serbia**;
- campaign **Roda and Spring**, focused on the offer of products for gardening and promotion of products for the Easter and May First holidays;
- activities from the Super Card catalogue for technical consumer goods;
- new technological feature that allows the Super Card users (both bonus and payment cards) to shop at the retail unit in New Belgrade, from the start of 2016, by **scanning the products** and thus avoiding the line at the check-out counter.



At the start of the summer season, we worked with the most popular paper to prepare a presentation of the broadest seasonal offer. To activate the customers, we also held a photo contest with a large garden pool as the main prize.



In this year, Roda is the **sponsor of the Serbian Basketball Association**. The sponsorship includes a variety of contests that include tickets to matches as prizes. We also held the presentation ceremony for the new jerseys of the Serbian national team, and held a competition of the Serbian junior basketball league.

In the spring, we organized a major contest for our customers. Customers shopping at Roda took part in the contest called **Where Happiness is 100 Times Bigger**. The contest included giveaway of 100 refrigerators, cookers, TV sets, and washing machines, and 2,000 small domestic appliances.



Many activities this summer were also focused on socially responsible conduct. Thus, our corporate social responsibility efforts included support to the Senior Citizen's University, providing nesting grounds for the storks consistently with the Roda visual identity, and supported the event Little Dragon's Children's Games.

In the course of the third quarter, Roda took part in a number of **activities related to the local community**:

- participation in the organization of the Guinness World Record of the number of participants dancing a Serbian folk dance;
- taking part in the Pets&Friend initiative,
- participation in the contest for the best ajvar, and competition for the best fish stew,
- participation at the senior citizen's fair and support to the anniversary of Serbia's oldest elementary school.



A **refurbished Mercator Centre** was opened in **Novi Sad**. A special experience with a symphony orchestra was prepared for the opening.

Montenegro

The first half of 2016 was mostly devoted to project of re-branding of retail units from the Roda to Idea format. Marketing activities supported the re-branding process accordingly. This involved releasing the **Neighbourhood News newsletter**. The newsletter was specific for each town, presenting especially products from minor local producers. The activities also included the Cody mascot. Final events of the entire re-branding process were reopening of the largest Idea Super store in Podgorica, and a concert on the main square in Podgorica.



In the period 1–9, 2016, the following pricing activities took place in the market of Montenegro: **Weekend campaign, Super Brand Sunday, and Attention, Low Prices**. As a response to aggressive advertising from our competition, intensive advertising was launched in addition to regular catalogues. In March, a new campaign was launched with the slogan **Phenomenal April** at Idea, which includes 4 categories: Spring Cleaning, K Plus, Merry Easter, and I Like to Grill.

In September and October, key activities were related to promotion of Disney children's customer loyalty program that included offer of Disney's licensed products **Star Wars** and **Frozen**.



EMPLOYEES

In 2016, we continue the processes of restructuring and reorganization which started in 2014. The goal remains to establish more efficient work processes, reduce administration, and cut labour costs. Nevertheless, we are aware that the employees are at the heart of our operations. They contribute greatly to customer satisfaction and to success of the pursuit of Mercator's business goals.

As of February 1, 2016, the companies Poslovni sistem Mercator, d.d., and Mercator IP, d.o.o., were reorganized. As a result, most human resource management activities were focused on establishing operations according to the new organizational scheme. Another reorganization of the company Poslovni sistem Mercator, d.d., took place as of May 1, 2016.

Moreover, changes were implemented as of January 1, 2016, to the macro-organizational scheme, which also led to reassignment of employees, at the company Mercator-S, d.o.o. Employees at hypermarkets signed annexes to their employment contracts, pertaining to transition to fixed salaries. The company Mercator-S, d.o.o., was again reorganized on May 1, 2016, and on August 1, 2016.

As of March 1, 2016, new macro-organizational scheme was adopted at the company Mercator-H, d.o.o., and as of April 1, 2016, macro-level re-organization was carried out at the company Mercator-CG, d.o.o.

In the third quarter, a large part of human resource management activities were related to the transfer of the Modiana Division which was transferred to a new company as of September 30, 2016.



Hiring, caring for development, motivating, and connecting our employees

In the period at hand, Mercator Group devoted nearly 109,044 hours to training and education that involved 20,966 employees.

In July, the company **Poslovni sistem Mercator, d.d.**, sought by means of a **call for applications 25 young**, dynamic creative employees to contribute to the implementation of strategy for the years 2016/2017. Following the selection procedures that included psychological testing, an evaluation centre, interviews with employees from the human resource sector, and relevant directors, we gave the opportunity to the best among the many applicants. Young experts will be working at the project management office for a period of one year, working on projects in category management and purchasing, retail, logistics, and marketing. The first employees were hired in September and they are in the 26-day job rotation induction program that will allow them to become closely familiar with our company, the field of work, working environment, and their co-workers.



The process of **hypermarket Šiška refurbishment** that took place in the month of July also included training for improvement of sales skills and understanding of different types of personalities for the development of an excellent service. We also carried out all mandatory training. The employees of fresh produce departments took part in additional expert training in Zagreb where they exchanged knowledge on department management and tidiness in the new Mercator store concept.

Working with the Faculty of Economics in Ljubljana, we organized for the post-graduate students of the University of Ljubljana a **summer school called "Meet Your First Employer"**. Seventeen post-graduate students employed the Business Design method to identify the key challenges for the improvement of the service at Mercator. They presented their findings to the management and Mercator employees at the conclusion of the summer school.



Modelled after the **Retail Academy**, a new and first **Wholesale Academy** was developed in the course of the summer. The purpose of the Academy was to identify and arm with new knowledge the employees with the desire, potential, and competence to assume more challenging positions (deputy shop manager and shop manager) in wholesale. From a pool of 42 candidates, we selected **14 best employees** who started the first Academy module on September 23. The entire program includes **11 days of training and education**. In addition, the employees will receive support by a mentor, a coach, and a sales instructor.

After the summer break, the third generation of academy participants resumed their training in September. In September, they held workshops on leadership, held by our independent collaborator Irena Deželak. Most participants of the **3rd Retail Academy** also work with internal coaches who help the participants step out of their respective comfort zones to discover their potentials.

The workshop **Creating an Excellent Shopping Experience**, lasting 6 academic hours, has been developed as an upgrade to the two-day program of Sales Skill Development. This year, the training has already been attended by 1,312 employees. During the refurbishments, 187 employees took part in the training called "Refurbishment, Opportunity to Improve our Selling Skills", and 123 employees took part in the training "Understanding Different Types of Personalities Leads to Successful Sales".



In September, the **Stock Assistant School** started. The **14 employees** involved in the training will complete the 5-day program in late October. In addition to the workshops, participants will allocate 4 days to **training in the fresh produce departments**. To complete the program, the participants will have to draw up a **seminar paper**, with support of their personal mentors. The participants will address the topics to be coordinated between the human resource management sector and retail management. All who successfully complete the program will receive

certificates of internal training for a shop assistant.

In September, we also started the selection procedures for participants of the **4th Retail Academy**. A total of 125 employees from retail were invited for psychological testing. The best will be invited to the next selection round conducted at evaluation centres. Opportunity will be provided to all who display potential and desire to assume more challenging positions in retail. The 4th Retail Academy will start in January 2017.

As a part of our **cooperation with the IEDC Bled**, we continue the training program for our executives. In September, the program continued with a workshop on **Leadership Skill Development** and improvement of communication skills. In the next and final module, participants will think about changes and successful change management.



In early October, 7 of our employees included in the program "**Developing Key Talents for Organization Excellence**" continued their training with the 4th module titled "Personal Growth, Self-Motivation, and Stress Management" with lecturer Matej Tušak, full professor at the Faculty of Sports and psychologist for the national sports teams and top-class athletes.

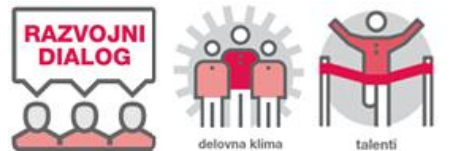
Consistently with the **initiatives** that are a part of **Mercator's strategic policies**, 761 employees have been trained for bread and pastry in this year. As a part of the **revision of competence centres**, 18 of our best meat department trainers took part in the 4-day selling skills training in Zagreb, while 8 new trainers for the fish and seafood department were trained in the same way as the meat department trainers, and they were educated on HACCP and the trade and retail legislation. The one-day course at the Slovenian Chamber of Commerce was also attended by trainers for the delicatessen departments. Shop assistants from working at these departments will start their training in October.



The five-day program of the revised **Shop Manager School** will be attended by over 500 shop managers in this year and the first half of the next year. The goal of the school is to develop shop manager competencies, and it takes place in the form of two-day modules at Hotel Ribno pri Bledu, and one one-day computer module at the company premises. By the end of September, training was completed by 235 shop managers.

In September, we also announced the **Best Shop Assistant Contest** which will involve shoppers and employees voting for their candidate. Currently, a short list of shop assistants has been drawn up. They will be evaluated in terms of their selling skills, and their leaders will also give their respective opinions. The Best Boss contest has already been completed, and the 10 best leaders will be awarded. Moreover, the committee has already selected the Mercator Award recipients. All awards will be presented at the final ceremony to be held in November.

This year, we launched the **development dialogues** with our employees in positions from the 25th pay scale category and above, working in administration. The first dialogue was dedicated to work climate, and it was attended by 241 employees. The second dialogue intended to discussion of talent is still in progress. Brief two-hour training is held before every leader dialogue.



The Health Promotion project currently includes the **Health Promoter School** attended by 70 employees who expressed their wish to promote health at the units at which they work. Respective modules took place once per month and comprise 6 academic hours each; the participants will hold five such sessions. Each Monday, the promoters receive a Health Tips newsletter which is the basis for their activities in the current week, aimed at raising the awareness among co-workers about the

importance of care for their health.

An important part of human resource management activities in 2016 is related to management of work time registration and records, with focus on process rationalization and improvement of IT support. To this end, number of training sessions was held for the employees in charge of work time registration and records.

On May 1, 2016, the companies Poslovni sistem Mercator, d.d., Intersport ISI, d.o.o., and Mercator IP, d.o.o., 439 employees were awarded their annual promotions.

In 2016, the company **Mercator IP, d.o.o.**, carried on the **N Service** implementation project, which involves activities aimed at assessing the attainment of work performance targets. Seventeen assessments were completed in the first quarter. Based on this, we obtained a grant in this year for salaries to persons with disabilities, in the amount of EUR 27,712. At the end of the third quarter, the company Mercator IP, d.o.o., had 409 employees, of which 211 were employees with some recognized category of disability. As of February 1, 2016, a new Security sector has been organized at the company.

In June, we worked with the Šentprima Institute to carry out a workshop for 20 experts who strengthened their mentorship competencies needed in their daily work as they face disability at work. Employees of the Food Safety and Internal Control Department upgraded their knowledge on quality control, and received a special certificate from the Administration of the Republic of Slovenia for Food Safety, Veterinary Sector and Plant Protection (UVHVVR) for successfully completed training on market standards of the European Union for fresh fruit and vegetables.

In August 2016, we won three awards or medals for quality for the Danilo & Marija spreads at the AGRA 2016 fair. In addition to Danilo and Marija who run the plants, the credit for the numerous awards goes to all other employees who all contribute to the excellence of the products.



In September, we took part in the recording of the show Listening to Silence ("Prisluhnimo tišini"). In the contribution to be aired on RTV Slovenia in October 2016, we present our production unit Kranjski kolaček ("Kranj Cupcake"), a pastry shop, which hires two out of a total of seven persons with hearing impairment. Responding to invitation by the Employment Agency of the Republic of Slovenia, Regional Unit Celje, Labour Office Slovenske Konjice, we took part at the event Open Door Day 2016 in September. This year's event was dedicated to hiring of persons with disabilities, and raising the awareness on the employability of this vulnerable target group.

The **Individual Performance** (IRU – Individualni radni učinak) project was implemented for the field of retail in the first quarter and for administration in the second quarter **at the company Mercator-S, d.o.o.**, and the first quarterly employee assessment has been completed. Employees take part in a number of third-party training courses, including the program Developing Key Talents for Organisation Excellence 2016, and Young Managers Program, organized by the institution IEDC Bled. In cooperation with the Berlitz language school, our employees attend the group classes, while seven employees are currently taking individual classes. Ten workshops "English Goes to Store" have been held for 52 employees in Belgrade and Novi Sad. The purpose of the workshops is to teach the retail employees the basics of English language to be able to communicate with customers from abroad.

As of August 1, 2016, the company migrated to a new human resource management IT system. Following the transition to work in HR.net, personnel for keeping the work time records had to be trained.



The goal of the **Shop Management Academy** project is to train future shop managers. It is intended for all retail employees working as shop assistants/cashiers or department managers. The program **Top shop manager for a top result**, intended for shop managers and their deputies for the IDEA brand, has been in place for over 5 years. It is one of the most successful specific training programs aimed at unifying and standardizing the business processes at all IDEA retail regions. In June, 13-day training session was held for shop managers in the East region and their deputies. In the last three months, training was held for three groups in Niš (the first group included participants of the **First Deal, the Right Move**

program, and the other group consisted of shop manager mentors in the project **Shop Manager Academy**, while the third group included younger shop managers who had taken over shops in the East region). Ten modules have been set up for the **Trading Academy** with participants selected from among category managers (4 groups of 12 participants) and trading assistants (6 groups of 12 participants). They will start training in October.

Early in 2016, the concept of **Gemification of the new employee induction process** was completed. It includes the concept of play to present the company processes to newly hired employees, thus cutting short the time new employees need to learn and adapt. In September, the induction process was carried out for a pilot group, thus obtaining required feedback for final formation of the program.

Specialized retail training for the fruit and vegetables category has also been completed. It has improved the business processes in this field. Training for 80 employees to sell meat at meat departments in all IDEA regions was completed in the first half of the year. In September, we launched in cooperation with the School of Chemistry and Food Technology ("Hemijsko-prehrambena tehnološka škola") the academy for shop assistants/butchers, which includes 2 weeks of theoretical education and 6 weeks of practical training. In Belgrade, 75 employees took part in the training for work at the bakery. As a part of the trainer network, schools for the Belgrade region were selected in the second quarter, and the schools for the regions East and West were selected in the third quarter. Selection of trainers for the regions Belgrade and Vojvodina has been completed and they started their trainer work in September. Permanent and assistant trainers were selected for the sectors Idea and Roda retail. Training on skills for on-the-job transfer of knowledge was held for all permanent trainers, and the communication mode in the trainer network was defined.

Employees from a number of fields took part in team-building workshops to strengthen the team spirit among them.

Activities of the sector of selection and development of employees included 10 individual interviews with employees who received feedback on the results of competence assessment, which were used to further define their career plans.

Potential or talent assessment was carried out for young employees in administration who have been with the company for more than 6 months and less than three years. Team-building session was organized for approximately 40 employees who met the criteria. They were given a number of different tasks based on which their competencies were assessed. Career plans and specific future activities were then specified for them.

In August, an educational video was shot titled **Standards and Procedures in the Delicatessen Departments of the Idea Retail Units** which will be one of the training methods in the training network for the delicatessen segment. In order to change the business processes, work processes in IT (administrator positions) and in retail (the position of shop manager) is being recorded. The goal of the project is to define the criteria for attainment of standards, and to define and encourage in this respect new processes and improvements.

At the company **Mercator-CG, d.o.o.**, 20 employees from retail and administration received the Employee of the Year 2015 award. On January 15, twelve university graduates started their internships according to the government expert training program. In mid-February, 20 employees completed their two-month training for new shop managers, of which 12 employees had already worked as shop managers and 8 were new. In the course of March, all employees took part in retail and administration conventions which also included training and education on re-branding of the Roda banner to Idea, and communication of this change.



In the second and third quarter, HRM activities were more intense due to hiring for seasonal work, especially in the coastal regions. Retail employees took part in the training course Service Plus ("Usluga plus ") in order to improve the quality of services at the departments.



The project "Idea Manager" is currently in progress, with the aim of training young managers to take over and manage respective business units. Four candidates with completed university degree were selected who will be trained for 6 to 9 months in a variety of fields (communication, assertiveness, leadership, etiquette, processes and procedures). Fifteen young talented employees is taking part in the training to improve their communication skills. In the third quarter,

activities were defined to improve work on the check-out counters, and training was carried out to this end. Also, the preparation of manual to serve as the guide to all cashiers has started. Decisions were adopted to reward the cashiers with the best results in active sales. In order to improve employee satisfaction, a survey was conducted on a sample of 350 employees to determine the level of satisfaction at work in terms of interpersonal relations, salaries, work conditions, training and education possibilities, promotion etc. Based on the results, an action plan was laid down to improve the level of satisfaction at work, and implementation of this plan will take place from September 2016 to May 2017.

As of March 1, 2016, the companies **Mercator - H, d.o.o.**, and **Intersport H, d.o.o.**, introduced a **new HRM IT system called HRpro**. In the first half, key activities in human resource management were related to the process of transferring the Intersport division to an independent company Intersport H, d.o.o.

The most important human resource management activities at the newly founded companies **Intersport S trgovina, d.o.o.**, and **Intersport CG, d.o.o.**, in the third quarter were related to the process of transferring the employees from the divisions to respective companies, and harmonization of internal documents.

In Slovenia, **Mercator Humanitarian Foundation** provided aid to 130 employees of Poslovni sistem Mercator, d.d., or Mercator IP, d.o.o., who were in need of help. We have paid out humanitarian aid in the total amount of EUR 62,575. We also granted social scholarships to four children of our employees, in the total amount of EUR 3,200. In Serbia, the Mercator Solidarity Foundation provided aid to 77 employees, in the total amount of EUR 20,455. In Croatia, 9 employees were provided aid in the total amount of EUR 3,556.

REAL ESTATE MANAGEMENT AND RETAIL NETWORK DEVELOPMENT

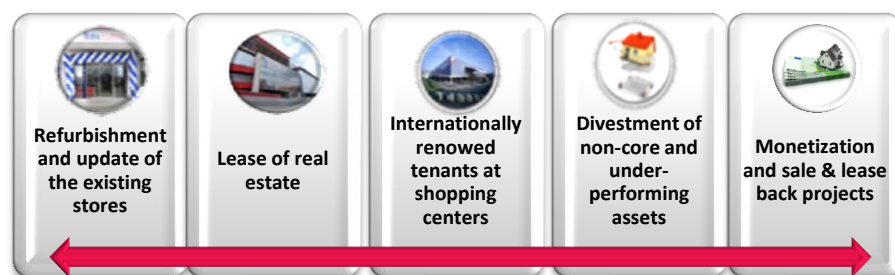
In the period 1-9, 2016, Mercator Group's priority in investment activities, consistently with the investment plan, was refurbishment of retail units and setting up new stores acquired through operating lease. Thus, we newly opened 40 new stores: 29 FMCG program stores, 9 Intersport stores, one apparel store (Benetton), one home product store; and one distribution centre.

We also sought and assessed new potential locations to expand our retail network for all Mercator programs, including a new logistics and distribution centre in Slovenia. The result of the latter process is the acquisition of the site in Ljubljana, based on the purchase agreement signed in April 2016.

There were no new construction developments in the period 1-9, 2016. Investment funds were mostly used for renovation and investment maintenance of the existing retail network, and for investment into new leased stores. Major acquisitions in Slovenia include the refurbished hypermarket in Rudnik, Ljubljana, hypermarket in Ptuj, and hypermarket and Intersport at the Mercator Center Celje. Moreover, the hypermarket at the Mercator Center Ljubljana Šiška was also refurbished. The reopened unit allows the most modern shopping trends and sets a new trend in Slovenia and the broader region.

Activities also took part in sale of non-operating assets, search for investors for sale-and-lease-back deals involving Mercator stores, and looking for investors who would build or provide retail area on behalf of Mercator and then offer it to Mercator for lease.

Following are Mercator's key goals in real estate management:



Investment and Divestment

In the period 1–9, 2016, Mercator Group's investment into property, plant, and equipment (CAPEX) amounted to EUR 53.2 million. Of this amount, 52.2% was used for investments in Slovenia and 47.8% was used for investments in international markets.

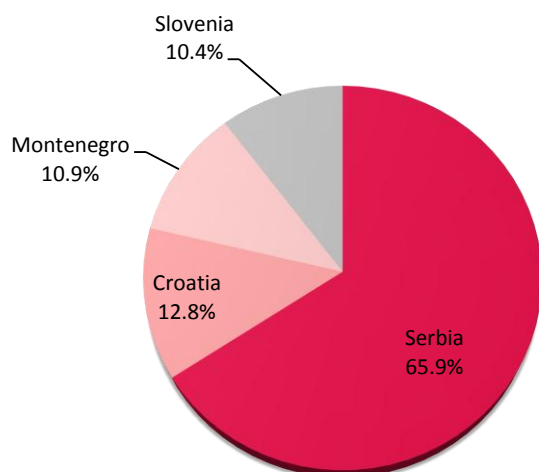
	Capital expenditure in 1–9, 2016 (in EUR 000)	Structure (in %)
Slovenia	27,739	52.16 %
Serbia	19,881	37.38 %
Croatia	2,849	5.36 %
Montenegro	2,604	4.89 %
Bosnia and Herzegovina	114	0.21 %
TOTAL	53,187	100.00 %

Investment into expansion of retail area represented 17.8% of total investment; refurbishments of existing units accounted for 57.0%; IT investments accounted for 16.2%; and the remaining 9.0% was invested in logistics and non-trade activities.

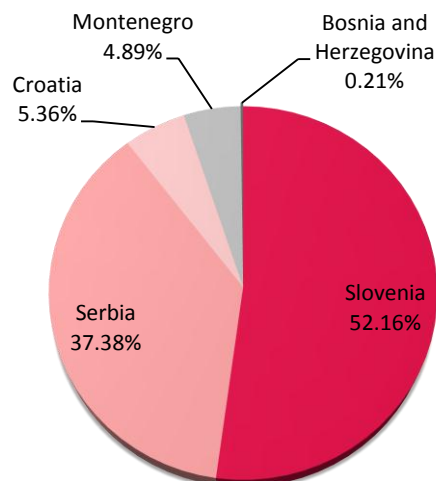
In the period 1-9, 2016, Mercator Group newly acquired 24,370 square meters of gross store area. All new gross areas, except for technical consumer goods store Nove Jarše which is a part of an already operating Mercator's own shopping centre (of which Mercator is the owner), were acquired through operating lease.

In the period 1-9, 2016, Mercator Group divested property, plant, and equipment worth EUR 14.2 million, of which EUR 13.3 million pertains to the divestment of property (real estate) and EUR 0.9 million pertains to plant and equipment.

Share of newly launched facilities by markets:



Share of investments by market:



Summary of total gross retail area as at September 30, 2016

	Gross area in square meters			TOTAL
	Used for own operations	Leased out - Konzum	Leased out - third parties	
Owned retail area	590,643	108,562	224,119	923,324
Leased retail area	410,776	75,362	118,736	604,874
Total retail area	1,001,419	183,924	342,855	1,528,198
Owned warehouse capacity	139,583	661	5,470	145,714
Leased warehouse capacity	55,591	25,982	8,237	89,810
Total warehouse capacity	195,174	26,643	13,707	235,524
Owned commercial facilities	18,211	0	1,151	19,362
Leased commercial facilities	8,270	0	0	8,270
Total commercial facilities	26,481	0	1,151	27,632
GROSS AREA UNDER MANAGEMENT	1,223,074	210,567	357,713	1,791,354
- of which owned	748,437	109,223	230,740	1,088,400
- of which leased	474,637	101,344	126,973	702,954



Summary of retail unit launches by markets in the period 1–9, 2016

SLOVENIA

Area of new facilities: 2,531 m²

Number of new units: 2

Openings: Tehnika Nove Jarše, Ljubljana; Intersport Outlet, Ljubljana

Refurbishments:

Number of refurbished units: 17 (14 FMCG program stores, 2 Intesport stores and 1 home product store)

CROATIA

Area of new facilities: 3,118 m²

Number of new units: 5

Openings: Intersport COO East Zagreb; Intersport COO Split; Intersport Mall of Split; Intersport Vinkovci, Benetton COO Split

SERBIA

Area of new facilities: 16,055 m²

Number of new units: 23

Otvoritve: Market Sivac; Market Karađorđeva, Šabac; Market Irig; Market Strahinića bana, Belgrade; Supermarket London, Belgrade; Supermarket Retail park, Subotica; Market Kneza Miloša, Kragujevac; Market Sarajevska, Belgrade; Supermarket Medijana, Niš; Supermarket Dragana Rakića, Belgrade; Supermarket Novi Banovci; Market Bogatić; Market Vojvode Stepe, Belgrade; Market Titel; Market Bujanovac; Market Makenzijeva, Belgrade; Market Ćirila i Metodija, Stara Pazova; Market Vuka Karadžića, Loznica; Market Jagodina; Market Braničevska, Belgrade; Market Zlatibor; Intesport Pančevo; distribution centre Novi Banovci

Refurbishments:

Number of refurbished units: 4

MONTENEGRO

Area of new facilities: 2,666 m²

Number of new units: 11

Openings: Market Cetinje; Market Budva 2; Market City 2, Podgorica; Market Rijeka Crnojevića, Cetinje; Market Totoši, Ulcinj; Market Igalo 2; Market Zaljevo, Ulcinj; Market Dobre vode, Ulcinj; Intersport Bar; Intersport Zelenika; Intersport Ulcinj



RISK MANAGEMENT

Risk management is an important component of management which is conducted at Mercator in compliance with the new version of the quality management system standard ISO 9001:2015, and in compliance with the environmental management system ISO 14001:2015. In May 2016, the SIQ certification institute conducted the ISO 9001 and ISO 14001 audit at Poslovni sistem Mercator, d.d. The auditors praised the risk management system in place. Risk management is a constituent part of management. Therefore, a presentation of the risk management system was held for the executives of the company Poslovni sistem Mercator, d.d., in September 2016, emphasizing their respective roles and responsibility for risk management.

Risks are divided into 5 key areas, or categories:

- strategic risks,
- financial risks,
- operational risks,
- support risks, and
- compliance risks.

In total there are 561 identified risks in the Mercator Group risk register. Key risks for the Mercator Group were selected among them. A key risk for Mercator Group is a risk that meets at least one of the following criteria:

- key risks to be addressed and managed at the Mercator Group level include all risks that exceed 1% of Mercator Group EBITDA in value terms or
- a particular risk shall be deemed a key risk if such risk is the highest within a particular risk group or category that exceeds 1% of Mercator Group EBITDA.

Based on this criterion, we have identified **21 key risks** accounting for a combined total of 48% of Mercator Group EBITDA.

In the period 1–9, 2016, we therefore continued the risk management activities previously laid down. The new version of the Risk Register includes updated changes in human resources and the changes in the approach to operational risks in certain fields. As at September 30, 2016, a total of 195 measures were being examined, of which 116 have been completed (assigned the status of a completed measure).

Following is a presentation of Mercator Group's key risks, complete with a description of the activities carried out in 2016 in order to reduce the risk level.

Strategic risks

Strategic risks pertain to corporate governance and development risks which involve the question of whether we are doing the right things. We are thinking about what our customers will be like, about or competitiveness, our supply sources, our services and sales channels in the medium-run, and the related risks.

CORPORATE GOVERNANCE RISKS

Key risk category	Description of risk management operational activities
Risk of failure to reap the synergistic effects of integration (Mercator, d.d.)	The purpose of integration of the acquired/transferred operations into the Mercator Group is the pursuit of joint synergies, strategic interests, lower costs, and improvement of market position. Project approach was employed by Mercator Group for the takeover and integration of the transferred units. All Mercator Group companies continue to pursue the project for higher cost efficiency and performance improvement. We also continue to carry out other joint projects at the level of all retail units in respective markets of our operations. These projects are coordinated by the parent company Poslovni sistem Mercator, d.d.

COMPETITIVENESS AND CUSTOMER SATISFACTION RISKS

Key risk category	Description of risk management operational activities
Risk of a decline in market share resulting from new openings of our competitors (Mercator, d.d.)	Change in market share is related to a change in net retail area of Mercator and that of the competition. If our competition opens more new retail area than Mercator, this may lead to a decline in Mercator's market share. At Mercator, risks of a decline in market shares are being monitored on a monthly basis by keeping track of the changes in net sales area operated by Mercator and its competitors.

RISKS RELATED TO DEVELOPMENT OF OFFER OF GOODS AND SERVICES

Key risk categories	Description of risk management operational activities
Risk of poor price competitiveness (Mercator, d.d.)	Regular monthly price-taking service is provided by a third-party agency. Based on the results of the pricing records, regular monthly reports are prepared for the directors who introduce the relevant measures consistently with the pricing policy laid down.
Risk of sub-optimum assortment and retail area management at the micro level (Mercator, d.d.)	At the store format development and category management sectors, a database of macro retail area of retail units is being established, complete with records of the area broken down by respective categories, for the programs of accessories, delicatessen, organic, and specialized food products. The records include refrigeration equipment and sales area at the check-out counters. The category management sector also includes development of planograms for all module-based categories.

SALES CHANNELS DEVELOPMENT RISKS

Key risk category	Description of risk management operational activities
Inadequate investment into sales channel development and misalignment between stores and customer expectations (Mercator, d.d. – FMCG)	In the period 1–9, 2016, 14 stores spanning a total gross area of 29,092 m ² were comprehensively refurbished (4 hypermarkets, 1 supermarket, and 9 markets); 12 stores spanning a total of 3,940 m ² were partly refurbished (12 markets), and layout was updated for 21 stores spanning a total of 19,284 m ² (1 hypermarket, 2 supermarkets, and 18 markets). Simultaneously, refurbishment and layout update projects are being actively prepared for around 25 units, to be carried out in the last quarter of this year.

Financial risks

Financial risks pertain to financial management. They involve credit, interest rate, currency, liquidity, inflation, price, and other similar risks.

FINANCIAL RISKS

Key risk categories	Description of risk management operational activities
Credit risk related to legal persons (Mercator-S, d.o.o.)	The amount of credit limit is specified for customers paying in advance or with deferred payment. Customers are required to provide, as security or collateral, three blank bills of exchange, guarantee statements from third-party legal entities, bank guarantees, or mortgages. Receivables management is the responsibility of the receivables collection department. This department monitors the payments of such receivables on a daily basis, and prepares regular weekly reports on the receivables status. Based on such reports, the department holds weekly commercial meetings to define the measures for additional collection. Meetings are also held on a two-month basis with the company Agrokor.
Currency risk (Mercator-S, d.o.o.)	Current trend recognition and examination of macroeconomic indicators allows us to adjust our operations and minimize the currency risk in Serbia. At the start of 2016, the Serbian dinar exchange rate was at RSD 121.63 per 1 EUR; at the end of the period at hand, it was at RSD 123.29 per 1 EUR. Comparing the exchange rate at the start and the end of the period, we find that the Serbian dinar depreciated by 1.35%. Comparing the average for the period 1–9, 2016, to the period 1–9, 2015, depreciation is at 1.94%. In the period 1–9, 2015, the average exchange rate of the Serbian dinar was RSD 120.71 per 1 EUR and in the period 1–9, 2016, RSD 123.05 per 1 EUR. A part of the loans in the process of Mercator Group financial restructuring was converted into EUR, which hedged the currency risk to some degree.
Liquidity risk (Mercator-S, d.o.o.)	At the company Mercator-S, d.o.o., the stress will be on improved working capital management which in turn will mitigate the liquidity risk.
Liquidity risk (Mercator-H, d.o.o.)	Liquidity of the company Mercator-H, d.o.o., was stabilized with the following measures: <ol style="list-style-type: none"> 1. Transfer of payment transaction function to the parent company Poslovni sistem Mercator, d.d. 2. Central liquidity management for both companies via an internal revolving credit facility provided by the parent company to the company Mercator-H, d.o.o.

Operational risks

Operational risks can threaten the operations in category management and purchasing, production, logistics, retail, and wholesale.

OPERATIONAL RISKS IN CATEGORY MANAGEMENT AND PROCUREMENT

Key risk categories	Description of risk management operational activities
Seasonal effects (Mercator, d.d.)	In the third quarter of this year, we continued to carefully plan and order our seasonal products. We specified relevant dates when seasonal product sales and clearance sales started.
Increase of tradable commodity prices (Mercator, d.d.)	We stay up to date with the raw material prices on commodity exchanges, on which the prices of our products and product categories depend. Volumes and stable private label product prices are ensured via central procurement tenders.

OPERATIONAL RISKS IN WHOLESALE

Key risk category	Description of risk management operational activities
Risk of loss of franchise partners and external customers (Mercator, d.d.)	<p>Measures pertaining to franchise stores:</p> <ul style="list-style-type: none"> • Strategy implementation (repositioning, "We Love Local" projects, visual identity, training and education etc.) • Intensive processing of the current franchise customers – cooperatives, and negotiations with potential new buyers • Key risks: delivery failures, IT, investment failure (failure to execute the investments) <p>Measures regarding receivables and disputed receivables:</p> <ul style="list-style-type: none"> • Reducing the overdue receivables and improvement of receivables maturity profile – collection schedules. • Harsher payment delinquency measures – blocking the customers in case of payment delinquency, previously at 45 days, now at 30 days • Obtaining extra security from customers with a high credit limit. <p>Measures pertaining to Cash & Carry operations:</p> <ul style="list-style-type: none"> • Harsher control of compliance with the rules in the following fields: delivery to non-contract customers; pro-forma invoice records; manual discounts; packaging; control of partial stocktaking and randomly counted items etc. • Organizing regular training for shop managers and other personnel at the Cash & Carry stores.

Support risks

Support risks can threaten the progress of support processes. They pertain to employees, legal affairs, property and equipment management, IT support, and management of loss events.

HUMAN RESOURCE RISKS

Key risk category	Description of risk management operational activities
Lack of human resources (Mercator, d.d.)	<p>In the first three quarters of 2016, numerous activities were carried out to effectively provide the required human resources: active cooperation with employment agencies, regular postings of our requirements on employment portals and the website MercatorGroup.si, internal calls for applications, posting employment ads at retail units, and occasionally posting ads on social networks. Moreover, training to provide adequately trained employees is regularly carried out. Newly hired employees complete induction training which lasts at least 5 days. Training is also provided for adequately trained shop managers; currently, the third generation of the retail academy is in training. An internal call for applications was announced for re-training for skill shortage jobs. Interviews were conducted with all candidates, and two candidates were assigned to training based on them. We work regularly with high schools to invite good high school students who will be eligible employment candidates in a few years to do their mandatory practical work at Mercator. We are also a member of the Training and Education Committee with the Slovenian Chamber of Commerce.</p> <p>Development dialogues were carried out to check the climate at the company. Based on the results, we will seek to identify and employee dissatisfaction and develop improvement measures.</p>

IT RISKS

Key risk category	Description of risk management operational activities
Failure of the central information systems (SAP, GOLD, Login, Hubie, e-mail etc.) (Mercator, d.d.)	<p>In the period 1–9, 2016, many activities were related to improving the informational security of the central IT systems. Based on Agrokor's corporate rules and regulations on information security, new rules and regulations were developed and distributed for the company Poslovni sistem Mercator, d.d. Accordingly, activities were in progress in the following areas:</p> <ul style="list-style-type: none"> • adjusting the hardware to new, stricter security requirements; • upgrade and adjustment of the central system for distribution of security fixes to workstations and servers; • replacement and standardization (making uniform) the anti-virus protection on all systems; • adjusting the firewalls on the central IT system servers and on workstations accessing them; • establishing more controlled workstation connections to the network using an ID certificate; • establishing vulnerability management for workstations and servers; • regular analysis of business information systems to identify and resolve any problems related to the operation of the business IT systems; • establishing advanced central registry of changes taking place on the assets and allowing the operation of the central IT systems; • establishing advanced central records of servers and workstations. Advanced records includes, in addition to the information on assets, the key infrastructural information regarding these assets.

DAMAGE RISKS

Key risk category	Description of risk management operational activities
Earthquake and fire (Mercator, d.d.)	Property insurance was signed in late 2015. No changes are expected in this regard in this year. The same applies to fire risks.

SAFETY AND SECURITY RISKS

Key risk categories	Description of risk management operational activities
Fraud by abuse of position	In the period 1–9, 2016, the following activities continued: gathering notifications, informing the responsible persons along the management hierarchy, participation in the procedures to obtain evidence, and protection/insurance thereof, working with internal services (in particular internal control, internal audit, legal affairs office), establishing relevant IT support, development of a catalogue of educational contents for employees of the Corporate Security Sector in the field of corporate crime, pre-trial investigation proceedings, criminal law, and psychology.
Terrorism	Terrorism as a global threat requires response consistent with the security assessment of the relevant national authorities and specifics of trade. We took an active approach to monitoring the condition and treat assessment in the country; we stepped up our cooperation with the national security authorities with regard to mutual notification on potential threats; we prepared an action plan for the stakeholders in case of a threat, and occurrence or implementation of risk. We continued to inform our employees about potential threats.

Compliance risks

Compliance risks pertain to compliance with the requirements of the accounting legislation and standards, tax requirements, occupational health and safety, requirements regarding health compliance and safety of food in production and trade, and risks related to identified environmental aspects.

OCCUPATIONAL HEALTH AND SAFETY RISKS

Key risk category	Description of risk management operational activities
Inspections (Mercator-S, d.o.o.)	<p>We planned the hiring of experts on occupational health and safety, and fire safety. Two experts are now hired, of which one works in Niš and the other one in Novi Sad. The goal with regard to the identified risk was to train the employees on occupational health and safety and fire safety. Training was completed at the newly opened facilities and at the Belgrade office building. We completed the project of connecting all switchboards to the security surveillance centre. We also completed the project of connecting all fire alarm centres to the central control system (currently, works are only in progress to connect the newly opened units to the central control system).</p> <p>Inspections of work equipment for occupational health and safety by the occupational health and safety ("Varnost in zdravje pri delu - VZPD") experts and fire safety ("Varstvo pred požarom - VPP") experts are under way simultaneously with the development of risk assessment for respective buildings. Regarding regular controls of buildings and business units, the form or template for the report is still being developed; however, completion of the process with the organized control inspections and audits is planned for the second half of 2016 when certification of buildings according to the standards ISO 14001, ISO 9001, and HACCP will also be completed.</p>

FOOD SAFETY RISKS

Key risk category	Description of risk management operational activities
Design and management of facilities and equipment (Mercator, d.d.)	<p>The food safety department and internal control are actively involved in the resolution of inspection issues. They draw attention to and report any non-compliance identified during internal controls and, if requested, takes part in the process of introducing new features and in refurbishments with regard to facility and equipment layout and design, from the aspect of food safety and compliance.</p> <p>Due to restricted possibilities of implementing any measures, the field of control for "provision of facilities and equipment" will be eliminated as of 2017. Information on inspection and internal control will be made available to the real estate management sector which will be better suited to implement effective risk control measures in this field.</p> <p>The newly set up RouteMaster application is in the testing stage. The application will allow considerably better capture of non-compliance data, in terms of contents, during internal controls, (also) in the field of design and management of facilities and equipment. In July 2016, the application was first distributed to the users for testing.</p>

ENVIRONMENTAL RISKS

Key risk category	Description of risk management operational activities
Use of electric energy (Mercator, d.d.)	<p data-bbox="427 271 1394 432">Employees are informed about the measures for efficient use of energy on a quarterly basis. On a monthly basis, control of the use of energy is already in progress for respective units of the company Poslovni sistem Mercator, d.d. By upgrading the energy accounting system, we will establish faster control over the implementation of measures for efficient use of energy.</p> <p data-bbox="427 465 1394 591">Within the project of "upgrading the current energy accounting system with a more detailed targeted power consumption monitoring and implementation of measures for efficient use of energy", the goal of which is to cut energy consumption at the company Poslovni sistem Mercator, d.d., by 1% annually, the following was completed:</p> <ul data-bbox="427 600 1394 857" style="list-style-type: none"> <li data-bbox="427 600 1394 658">• energy accounting was established for all buildings of the company Poslovni sistem Mercator, d.d.; <li data-bbox="427 667 1394 824">• Efficient use of energy was implemented at 172 buildings with respect to electric energy (of 172 buildings, efficient use of energy was implemented at 51 buildings with respect to heating). By September 2016, measures were implemented at 39 buildings. By the end of November 2016, measures will have been implemented at 72 buildings. <li data-bbox="427 833 1394 857">• Savings of EUR 168,482 were made up to and including August 2016.

FINANCIAL MANAGEMENT

Stable Financial Operations

As at September 30, 2016, Mercator Group net financial debt amounted to EUR 844,047 thousand, which is 0.6% less than as at the end of 2015, and 1.0% more than as at September 30, 2015. In the last year, Mercator Group thus continued its stable financing activities and maintained a long-term sustainable maturity profile of its financial liabilities.

in EUR thousand	September 30, 2016	December 31, 2015	September 30, 2015	Index Sep. 30, 2016/ Dec. 31, 2015	Index Sep. 30, 2016/ Sep. 30, 2015
Non-current financial liabilities	755,986	758,208	827,318	99.7	91.4
Current financial liabilities	142,818	149,224	72,731	95.7	196.4
Financial liabilities	898,804	907,432	900,049	99.0	99.9
Cash and cash equivalents	15,537	18,998	33,571	81.8	46.3
Available-for-sale financial assets	471	524	999	89.9	47.1
Loans and deposits	38,749	38,669	29,535	100.2	131.2
Financial assets	54,757	58,191	64,105	94.1	85.4
NET FINANCIAL DEBT	844,047	849,241	835,944	99.4	101.0

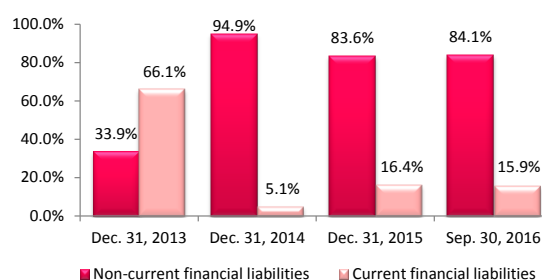
Financial costs

In the period 1–9, 2016, the 6-month EURIBOR averaged at -0.149%. At the end of the period, it was still negative at -0.203%. Compared to the equivalent period of the year before when the 6-month EURIBOR averaged at 0.075%, this rate fell by 22.41%.

Debt to equity and financial liability ratio

As at September 30, 2016, Mercator Group attained a debt-to-equity (capital structure) ratio of 1:1.3. The ratio is a quotient between equity and net financial debt.

As at September 30, 2016, the share of Mercator Group's non-current financial assets was at 84.1%, which is consistent with a sustainable maturity profile of financial liabilities.



Available liquidity lines as at September 30, 2016

As at September 30, 2016, Mercator Group had access to the following liquidity lines:

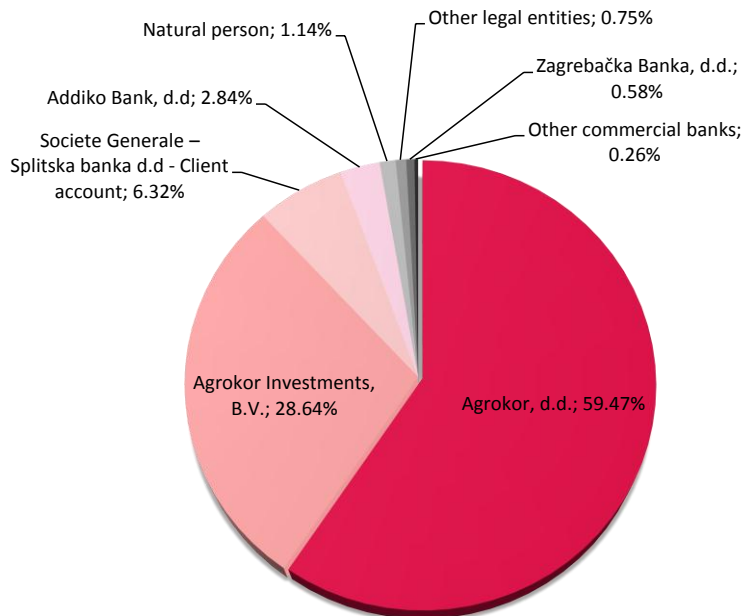
in EUR thousand	September 30, 2016
Cash and cash equivalents	15,537
Standby revolving credit lines	67,946
TOTAL	83,483

MERCATOR SHARE AND INVESTOR RELATIONS

Basic information on the share of the company Poslovni sistem Mercator, d.d., as at September 30, 2016

Code / Symbol	MELR
Type	Common share
Listing	Prime market of Ljubljana borza, d.d.
Share capital	EUR 254,175,051.39
Number of shares	6,090,943
Number of treasury shares	42,192
Number of shareholders	2,276

Ownership structure of the company Poslovni sistem Mercator, d.d., as at September 30, 2016



Major Shareholders

As at September 30, 2016 the following ten largest shareholders held a combined share of **98.43%** of the company.

Major shareholders	Country	Number of shares	Share
1 Agrokor, d.d.	Croatia	3,621,992	59.47%
2 Agrokor Investments B.V.	Netherlands	1,744,187	28.64%
3 Societe Generale - Splitska banka, d.d., - Client account	Croatia	385,172	6.32%
4 Addiko Bank, d.d.	Croatia	173,264	2.84%
5 Zagrebačka Banka, d.d.	Croatia	35,393	0.58%
6 Galić Josip	Croatia	21,525	0.35%
7 Erste Group Bank AG	Austria	8,987	0.14%
8 Posojilnica bank Egen	Austria	2,910	0.05%
9 Banque Pictet and CIE SA	Switzerland	1,107	0.02%
10 Societe Generale - Splitska banka d.d.- Ucits client account	Croatia	953	0.02%
TOTAL		5,995,490	98.43%

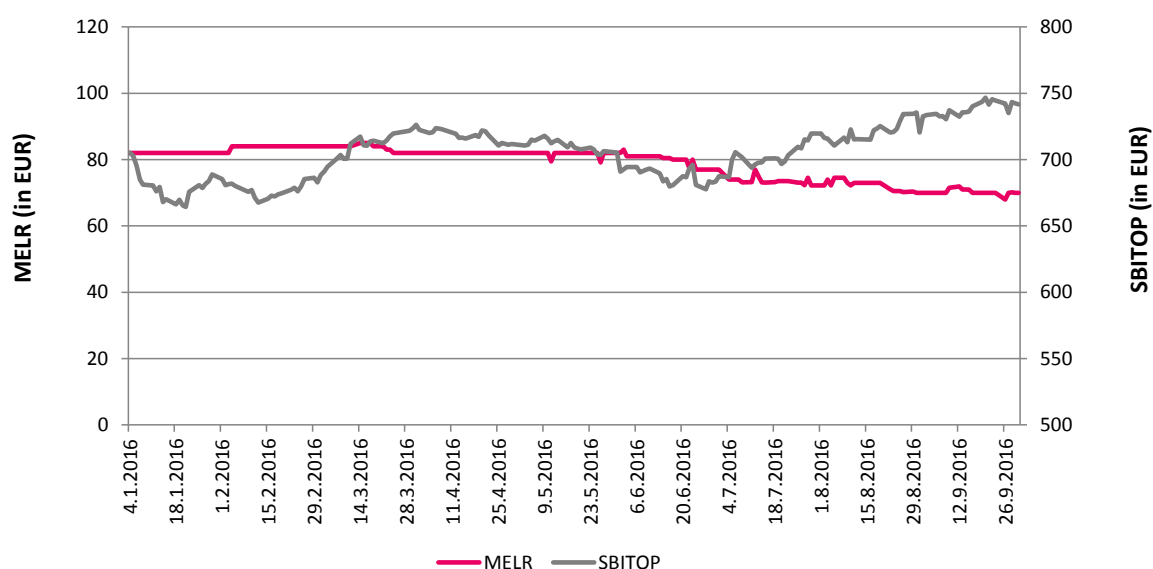
Shares held by Management and Supervisory Board Members as at September 30, 2016

Management Board and Supervisory Board Members did not own shares of the company Poslovni sistem Mercator, d.d., as at September 30, 2016.

Foreign shareholders

As at September 30, 2016, the share in the company Poslovni sistem Mercator, d.d., held by foreign investors amounted to **98.50%**, which is 0.03 percentage point more than in equivalent period of the year before.

Movement of closing price per MELR share in the period 1–9, 2016, compared to the movement of the SBITOP index



Key information for the shareholders

	September 30, 2016	September 30, 2015	Index Sep. 30, 2016/ Sep. 30, 2015
Number of shares entered into the court register	6,090,943	6,090,943	100.0
Number of treasury shares	42,192	42,192	100.0
Market capitalization (in EUR)	426,366,010	487,275,440	87.5
Market price per share (in EUR)	70,00	80,00	87.5
Share book value (in EUR)	106,31	111,34	95.5
Minimum close rate in the period (in EUR)	68,00	70,13	97.0
Maximum close rate in the period (in EUR)	85,00	86,00	98.8
Average close rate in the period (in EUR)	78,65	77,04	102.1
Earnings per share (in EUR)*	2,65	7,6	35.0

* The indicator is adjusted to the annual level.

Market capitalization is calculated by multiplying the number of shares entered into the court register as at September 30, with market price per share as at September 30.

Share book value is calculated as the ratio between the value of the equity of the company Poslovni sistem Mercator, d.d., as at September 30, and the weighted average number of ordinary shares in the period at hand, excluding treasury shares.

Earnings per share is calculated as the ratio between net profit of the company Poslovni sistem Mercator, d.d., and weighted average number of ordinary shares in the period at hand, excluding the treasury shares.

Dividend policy

The company Poslovni sistem Mercator, d.d., does not plan dividend payment for 2016.

Treasury shares

As at September 30, 2016, the company Poslovni sistem Mercator, d.d., held 42,192 treasury shares. In the period 1–9, 2016, the company Poslovni sistem Mercator, d.d., neither acquired nor disposed of treasury shares.

Investors

The company Poslovni sistem Mercator, d.d., communicates important information and major changes in company operations or performance to all stakeholders regularly and in a timely fashion. Such information is conveyed via the website at www.mercatorgroup.si, and the Ljubljana Stock Exchange electronic information dissemination system SEOnet where Mercator is publishing releases in Slovenian and English.

Shareholders holding shares of the same class are treated equally by Mercator. Furthermore, they are motivated to actively and responsibly assert their rights.

FINANCIAL REPORT

ACCOUNTING POLICIES

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d. d., for the period 1–9, 2016, are drawn up in compliance with the International Financial Reporting Standards and they are unaudited.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

Poslovni sistem Mercator, d.d. (hereinafter referred to as Mercator, d.d.), is a company headquartered in Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. Condensed consolidated financial statements for the period 1–9, 2016, include the company Mercator, d.d., and its subsidiaries, as follows:

- in Slovenia: Intersport ISI, d.o.o., Mercator–Emba, d.d., Mercator IP, d.o.o., M–Energija, d.o.o.,
- abroad: Mercator–H, d.o.o., Croatia; Mercator–S, d.o.o., Serbia; Mercator–BH, d.o.o., Bosnia and Herzegovina; Mercator–CG, d.o.o., Montenegro; Mercator Macedonia, d.o.o.e.l., Macedonia; Investment Internacional, d.o.o.e.l., Macedonia, Intersport H, d.o.o., Croatia, Intersport BH, d.o.o., Bosnia and Herzegovina; Intersport S trgovina, d.o.o., Serbia and Intersport CG, d.o.o., Montenegro.

(hereinafter jointly referred to as the "Mercator Group"). Mercator Group's predominant operating activity is retail and wholesale of fast-moving consumer goods.

Condensed consolidated statement of financial position

EUR thousand	September 30, 2016	December 31, 2015	Index Sep. 30, 2016/ Dec. 31, 2015
ASSETS			
Non-current assets			
Property, plant and equipment	1,354,349	1,371,405	98.8
Investment property	3,262	3,352	97.3
Intangible assets	22,210	19,538	113.7
Deferred tax assets	16,073	18,057	89.0
Loans and deposits	34,126	30,604	111.5
Available-for-sale financial assets	471	524	89.9
	1,430,491	1,443,480	99.1
Current assets			
Disposal groups	217,487	217,482	100.0
Inventories	275,838	280,853	98.2
Trade and other receivables	277,154	256,189	108.2
Current tax assets	1,156	656	176.2
Loans and deposits	4,623	8,065	57.3
Cash and cash equivalents	15,537	18,998	81.8
	791,795	782,243	101.2
Total assets	2,222,286	2,225,723	99.8
EQUITY			
Share capital	254,175	254,175	100.0
Share premium	286,772	286,772	100.0
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	41,686	41,686	100.0
Fair value reserve	108,977	108,865	100.1
Retained earnings	35,288	15,365	229.7
Profit (loss) for the period	8,273	20,245	40.9
Currency translation reserve	(90,944)	(89,668)	101.4
Total equity attributable to equity owners of the company	640,992	634,205	101.1
Non-controlling interests	204	228	89.5
Total equity	641,196	634,433	101.1
LIABILITIES			
Non-current liabilities			
Trade and other payables	46,155	38,352	120.3
Borrowings and other financial liabilities	755,986	758,208	99.7
Deferred tax liabilities	29,616	29,947	98.9
Provisions	25,076	25,918	96.8
	856,833	852,425	100.5
Current liabilities			
Trade and other payables	580,061	588,117	98.6
Current tax liabilities	1,378	1,524	90.4
Borrowings and other financial liabilities	142,818	149,224	95.7
	724,257	738,865	98.0
Total liabilities	1,581,090	1,591,290	99.4
Total equity and liabilities	2,222,286	2,225,723	99.8

Condensed consolidated income statement

EUR thousand	1–9, 2016	1–9, 2015*	Index 1–9, 2016/ 1–9, 2015
Revenue	1,884,613	1,948,311	96.7
Cost of goods sold and selling costs	(1,808,912)	(1,861,175)	97.2
Administrative expenses	(58,381)	(60,860)	95.9
Other income	13,039	34,954	37.3
Results from operating activities	30,359	61,230	49.6
Finance income	4,616	2,995	154.1
Finance expenses	(23,588)	(24,107)	97.8
Net finance expenses	(18,972)	(21,112)	89.9
Profit (loss) before tax	11,387	40,118	28.4
Tax expense	(3,141)	(9,154)	34.3
Profit (loss) for the period	8,246	30,964	26.6
Profit (loss) for the period attributable to:			
Owners of the parent company	8,273	31,046	26.6
Non-controlling interests	(27)	(82)	33.0

* Data is not entirely comparable due to some non-recurring (one-off) business events and effect of divestments of non-core operations and assets (Santana and Loka, Grosuplje Bakery, M Holidays, and other divestments of non-operating assets).

Condensed consolidated statement of comprehensive income

EUR thousand	1–9, 2016	1–9, 2015	Index 1–9, 2016/ 1–9, 2015
Profit (loss) for the period	8,246	30,964	26.6
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss	(1,483)	926	-
Foreign currency translation differences - foreign operations	(1,272)	926	-
Deferred tax	112	-	-
Other changes	(323)	-	-
Other comprehensive income for the period	(1,483)	926	-
Total comprehensive income for the period	6,763	31,890	21.2
Total comprehensive income for the period attributable to:			
Owners of the parent company	6,787	31,971	21.2
Non-controlling interests	(24)	(81)	29.6

Condensed consolidated statement of changes in equity

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings (loss)	Profit (loss) for the year	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance at January 1, 2015	254,175	286,772	(3,235)	41,686	115,411	(53,485)	69,353	(89,215)	621,462	215	621,677
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	31,046	-	31,046	(82)	30,964
Other comprehensive income	-	-	-	-	(187)	187	-	925	925	1	926
Total comprehensive income for the period	-	-	-	-	(187)	187	31,046	925	31,971	(81)	31,891
Transactions with owners of the parent company directly recognized in equity											
Contributions by and distributions to owners											
Change of share in subsidiary	-	-	-	-	-	(118)	-	-	(118)	118	-
Total transactions with owners of the parent company	-	-	-	-	-	(118)	-	-	(118)	118	-
Transfer of loss of the previous year to retained earnings	-	-	-	-	-	69,353	(69,353)	-	-	-	-
Balance at September 30, 2015	254,175	286,772	(3,235)	41,686	115,224	15,938	31,046	(88,290)	653,315	252	653,568

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings (loss)	Profit (loss) for the year	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance at January 1, 2016	254,175	286,772	(3,235)	41,686	108,865	15,365	20,245	(89,668)	634,205	228	634,433
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	8,273	-	8,273	(27)	8,246
Other comprehensive income	-	-	-	-	112	(322)	-	(1,276)	(1,486)	3	(1,483)
Total comprehensive income for the period	-	-	-	-	112	(322)	8,273	(1,276)	6,787	(24)	6,763
Transfer of profit (loss) of the previous year to retained earnings	-	-	-	-	-	20,245	(20,245)	-	-	-	-
Balance at September 30, 2016	254,175	286,772	(3,235)	41,686	108,977	35,288	8,273	(90,944)	640,992	204	641,196

Condensed consolidated cash flow statement

EUR thousand	1–9, 2016	1–9, 2015	Index 1–9, 2016/ 1–9, 2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Gross cash flows from operating activities	79,622	115,359	69.0
Change in inventories	5,015	(6,048)	-
Change in trade and other receivables	(21,465)	(22,622)	94.9
Change in trade and other payables	1,872	(83,283)	-
	65,044	3,406	1.909.7
Interest paid	(22,191)	(22,464)	98.8
Income tax paid	(2,443)	(4,326)	56.5
Net cash from (used in) operating activities	40,410	(23,384)	-
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of subsidiaries and business operations, net of cash acquired	-	(845)	-
Acquisition of property, plant and equipment and investment property	(45,610)	(41,134)	110.9
Acquisition of intangible assets	(7,577)	(6,267)	120.9
Acquisition of available-for-sale financial assets	-	(119)	-
Loans and bank deposits made	(80)	(1,276)	6.3
Proceeds from sale of property, plant and equipment, investment property and intangible assets	14,163	18,963	74.7
Proceeds from sale of available-for-sale financial assets	2,500	1,200	208.3
Interest received	1,151	1,726	66.7
Dividends received	281	50	562.0
Net cash used in investing activities	(35,172)	(27,702)	127.0
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds (repayment) in borrowings	(8,628)	50,412	-
Net cash from (used in) financing activities	(8,628)	50,412	-
Net (decrease) increase in cash and cash equivalents	(3,390)	(674)	503.0
Cash and cash equivalents at the beginning of the year	18,998	34,224	55.5
Effect of exchange rate fluctuations on cash and cash equivalents held	(71)	21	-
Cash and cash equivalents as at the end of the period	15,537	33,571	46.3

Notes to Mercator Group condensed consolidated financial statements

Notes to condensed consolidated income statement

Revenue

In the period 1–9, 2016, Mercator Group generated EUR 1,884,613 thousand of revenue, which is 3.3% more relative to the period 1–9, 2015. In the markets of Slovenia and Serbia, lower revenue is mostly the result of fewer units in non-core operations. The drop in revenue is partly also a result of divestment of non-core operations (M Holidays, Santana and Loka brands, Pekarna Grosuplje). In the market of Croatia, which suffered the highest decrease of revenue, revenue is lower especially due to abandonment of the entire FMCG program as of June 2015 following consolidation across markets within the Agrokor Group.

Cost of goods sold and selling and marketing costs

Mercator Group costs of sales which include the cost of goods sold, production costs, selling and marketing costs, and other expenses, amounted to EUR 1,808,912 thousand in the period 1–9, 2016, which is a 2.8% decrease on the same period of last year.

Cost of goods sold was lower by 2.9% relative to last year's comparable period.

Administrative expenses

Mercator Group's administrative expenses in the period 1–9, 2016, amounted to EUR 58,381 thousand, which is 4.1% less than in the equivalent period last year.

Total expenses, consisting of selling and marketing costs, production costs (included in costs of sales), and administrative expenses amounted to EUR 467,307 thousand in the period 1–9, 2016, a decrease of 2.0% over the last year's figure for such period.

Results from operating activities

In the period 1–9, 2016, Mercator Group's results from operating activities reached EUR 30,359 thousand, which is 50.4% less than in the comparable period of last year.

Net finance expenses

Net finance expenses are lower by EUR 2,140 thousand relative to the last year's comparable period, which is mostly a result of lower currency translation differences.

Profit before income tax

In the period 1–9, 2016, Mercator Group's profit before income tax was at EUR 11,387 thousand.

Profit for the financial period

Mercator Group's net profit for the period 1–9, 2016, amounted to EUR 8,246 thousand.

EBITDA

Mercator Group EBITDA in the period 1–9, 2016, amounted to EUR 84,972 thousand which is 28.6% less than in the comparable period of last year.

EBITDAR

EBITDAR for the period 1–9, 2016, amounted to EUR 142,813 thousand which is 19.2% less than in the comparable period of last year.

Notes to condensed consolidated statement of financial position

Assets

Mercator Group assets as at September 30, 2016, amounted to EUR 2,222,286 thousand, which is EUR 3,437 thousand less than at the end of 2015, mostly due to lower property, plant, and equipment, and inventories, while trade receivables increased.

As at September 30, 2016, the value of Mercator Group's non-current assets amounted to EUR 1,430,491 thousand, which is EUR 12,989 thousand less than as at December 31, 2015. The largest share of non-current assets (96.5% or EUR 1,379,821 thousand) is represented by property, plant, and equipment, the value of which was EUR 14,474 thousand lower than as at the end of 2015.

As at September 30, 2016, the value of Mercator Group current assets amounted to EUR 791,795 thousand, which is EUR 9,552 thousand more than at the end of 2015. Trade and other receivables represent the largest portion of total current assets (35.0%), followed by inventories (34.8%).

Equity and liabilities

As at September 30, 2016, Mercator Group share capital amounted to EUR 641,196 thousand, which is EUR 6,763 thousand more than as at the end of 2015. The increase pertains to the net profit of EUR 8,246 thousand, negative currency translation differences in the amount of EUR 1,272 thousand, and deferred taxes and other changes in the amount of EUR -211 thousand.

As at September 30, 2016, total financial liabilities amount to EUR 898,804 thousand, which is EUR 8,628 thousand less than as at the end of 2015. Net financial debt of the Mercator Group, calculated as the difference between Mercator Group financial liabilities and financial assets, amounted to EUR 844,047 thousand as at September 30, 2016 (December 31, 2015: EUR 849,241 thousand). The share of long-term financial liabilities as at September 30, 2016, was at 84.1% (83.6% as at December 31, 2015).

As at September 30, 2016, provisions amounted to EUR 25,076 thousand. Compared to the end of 2015, provisions decreased by EUR 842 thousand, mostly due to reversal/drawing of provisions for severance packages and rewards for loyal service.

Trade and other payables as at September 30, 2016, amounted to EUR 626,216 thousand, which is EUR 253 thousand less than at the end of 2015.

As at September 30, 2016, long-term coverage of non-current assets with non-current liabilities at the Mercator Group amounts to 104.7%, which is 1.7 percentage points more than as at the end of 2015.

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

Mercator, d.d., is a company headquartered in Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. The company Mercator, d.d., is the parent/controlling company of a group of associated companies headquartered in Slovenia, Serbia, Croatia, Bosnia and Herzegovina, Montenegro, and Macedonia.

The company has a double role: it is predominantly engaged in fast-moving consumer goods retail and wholesale; however, it also performs various group-related corporate tasks for the companies included in the Mercator Group. Hence, employing the financial statements of the company Poslovni sistem Mercator, d.d., for economic analysis of Mercator Group's operation is inappropriate. For such analysis, it is more sensible to apply above all the consolidated financial statements that present an account of the performance of the Mercator Group as a uniform business entity.

Condensed statement of financial position

EUR thousand	September 30, 2016	December 31, 2015	Index Sep. 30, 2016/ Dec. 31, 2015
ASSETS			
Non-current assets			
Property, plant and equipment	638,464	643,311	99.2
Investment property	3,262	3,351	97.3
Intangible assets	12,911	10,844	119.1
Deferred tax assets	14,772	16,748	88.2
Trade and other receivables	419	419	100.0
Loans and deposits	5,349	7,057	75.8
Investment into equity of subsidiaries	351,545	352,045	99.9
Available-for-sale financial assets	296	352	84.1
	1,027,018	1,034,127	99.3
Current assets			
Disposal groups	217,487	217,482	100.0
Inventories	131,188	130,404	100.6
Trade and other receivables	117,955	105,229	112.1
Current tax assets	218	-	-
Loans and deposits	119,590	110,608	108.1
Cash and cash equivalents	5,430	10,046	54.1
	591,868	573,769	103.2
Total assets	1,618,886	1,607,896	100.7
EQUITY			
Share capital	254,175	254,175	100.0
Share premium	286,772	286,772	100.0
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	16,624	16,624	100.0
Fair value reserve	78,509	79,869	98.3
Retained earnings	(1,821)	619	-
Profit (loss) for the period	12,017	(3,800)	-
Equity	643,041	631,024	101.9
LIABILITIES			
Non-current liabilities			
Trade and other payables	23,994	17,715	135.4
Borrowings and other financial liabilities	516,872	526,865	98.1
Deferred tax liabilities	22,555	22,779	99.0
Provisions	21,275	22,162	96.0
	584,696	589,521	99.2
Current liabilities			
Trade and other payables	291,546	293,323	99.4
Current tax liabilities	241	327	73.7
Borrowings and other financial liabilities	99,362	93,701	106.0
	391,149	387,351	101.0
Total liabilities	975,845	976,872	99.9
Total equity and liabilities	1,618,886	1,607,896	100.7

Condensed income statement

EUR thousand	1–9, 2016	1–9, 2015*	Index 1–9, 2016/ 1–9, 2015
Revenue	1,014,485	1,048,265	96.8
Cost of goods sold and selling costs	(970,632)	(992,991)	97.7
Administrative expenses	(27,918)	(30,930)	90.3
Other income	6,111	25,800	23.7
Results from operating activities	22,046	50,144	44.0
Finance income	6,820	7,201	94.7
Finance expenses	(14,856)	(16,853)	88.2
Net finance expense	(8,036)	(9,652)	83.3
Profit (loss) before tax	14,010	40,492	34.6
Tax expense	(1,993)	(6,201)	32.1
Profit (loss) for the period	12,017	34,291	35.0

*Data is not entirely comparable due to some non-recurring (one-off) business events and effect of divestments of non-core operations and assets (Santana and Loka, Grosuplje Bakery, M Holidays, and other divestments of non-operating assets).

Condensed statement of comprehensive income

EUR thousand	1–9, 2016	1–9, 2015	Index 1–9, 2016/ 1–9, 2015
Profit for the period	12,017	34,291	35.0
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss	-	-	-
Items that may be reclassified subsequently to profit or loss	-	(1)	-
Corporate income tax on items that may be reclassified subsequently to profit or loss	-	(1)	-
Other comprehensive income for the period	-	(1)	-
Total comprehensive income for the period	12,017	34,290	35.0

Condensed statement of changes in equity

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Profit (loss) for the period	Total equity
Balance at January 1, 2015	254,175	286,772	(3,235)	16,624	84,865	-	-	639,201
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	34,291	34,291
Other comprehensive income	-	-	-	-	(188)	187	-	(1)
Total comprehensive income for the period	-	-	-	-	(188)	187	34,291	34,290
Total transactions with owners of the parent company	-	-	-	-	-	-	-	-
Balance at September 30, 2015	254,175	286,772	(3,235)	16,624	84,677	187	34,291	673,491

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Profit (loss) for the period	Total equity
Balance at January 1, 2016	254,175	286,772	(3,235)	16,624	79,869	619	(3,800)	631,024
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	12,017	12,017
Other comprehensive income	-	-	-	-	(1,360)	1,360	-	-
Total comprehensive income for the period	-	-	-	-	(1,360)	1,360	12,017	12,017
Total transactions with owners of the parent company	-	-	-	-	-	-	-	-
Transfer of profit (loss) of the previous year to retained earnings	-	-	-	-	-	(3,800)	3,800	-
Balance at September 30, 2016	254,175	286,772	(3,235)	16,624	78,509	(1,821)	12,017	643,041

Condensed cash flow statement

EUR thousand	1–9, 2016	1–9, 2015	Index 1–9, 2016/ 1–9, 2015
CASH FLOWS FROM OPERATING ACTIVITIES			
Gross cash flows from operating activities	41,718	75,839	55.0
Change in inventories	(783)	(3,214)	24.4
Change in trade and other receivables	(11,743)	(11,405)	103.0
Change in trade and other payables	3,685	(35,333)	(10.4)
	32,877	25,887	127.0
Net exchange rate differences from financing	16	1	1,600.0
Interest paid	(13,520)	(16,854)	80.2
Income tax paid	(327)	(1,383)	23.6
Net cash from (used in) operating activities	19,046	7,651	248.9
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of subsidiaries and business operations, net of cash acquired	(2,000)	(845)	236.7
Acquisition of property, plant and equipment and investment property	(21,675)	(22,679)	95.6
Acquisition of intangible assets	(5,289)	(3,053)	173.2
Acquisition of available-for-sale financial assets	-	(119)	-
Loans and bank deposits made	(7,274)	(25,998)	28.0
Proceeds from sale of subsidiaries, net of cash disposed of	2,500	-	-
Proceeds from sale of property, plant and equipment and investment property	7,822	14,334	54.6
Proceeds from sale of intangible assets	-	14	-
Proceeds from sale of available-for-sale financial assets	149	1,200	12.4
Interest received	4,156	3,091	134.5
Dividends received	2,282	1,801	126.7
Net cash used in investing activities	(19,329)	(32,254)	59.9
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds (repayment) in borrowings	(4,333)	31,164	-
Net cash from (used in) financing activities	(4,333)	31,164	-
Net (decrease) increase in cash and cash equivalents	(4,616)	6,561	-
Cash and cash equivalents at the beginning of the year	10,046	18,571	54.1
Cash and cash equivalents as at the end of the period	5,430	25,132	21.6

Notes to condensed financial statements of the company Poslovni sistem Mercator, d.d.

Notes to condensed income statement

Revenue

In the period 1–9, 2016, the company Poslovni sistem Mercator, d.d., generated EUR 1,014,485 thousand of revenue, which is 3.2% less relative to the period 1–9, 2015. Majority of company revenue is generated by sales of goods, material, and products, mostly retail and wholesale of trade goods.

Cost of goods sold and selling and marketing costs

Costs of sales of the company Poslovni sistem Mercator, d.d., which include the cost of goods sold, selling and marketing costs, and other expenses, amounted to EUR 970,632 thousand in the period 1–9, 2016, which is a 2.3% decrease on the same period of last year.

Administrative expenses

The company's administrative expenses in the period 1–9, 2016, amounted to EUR 27,918 thousand, which is 9.7% less than in the equivalent period last year. This is a result of cost optimization and rationalization in the course of 2015 and in 2016.

Total expenses, consisting of selling and marketing costs (included in costs of sales), and administrative expenses amounted to EUR 250,762 thousand in the period 1–9, 2016, a decrease of 3.6% on the last year's figure for such period.

Results from operating activities

In the period 1–9 2019, results from operating activities of the company Poslovni sistem Mercator, d.d., reached EUR 22,046 thousand, which is 56.0% less than in the equivalent period of the last year.

Net finance expenses

Net finance expenses are lower by EUR 1,616 thousand relative to the last year's comparable period, which is mostly a result of somewhat lower finance expenses in 2016.

Profit before income tax

The company's profit before income tax for the period 1–9, 2016, amounts to EUR 14,010 thousand, which is EUR 26,482 thousand less than in the comparable period of 2015.

Profit for the financial period

The company's net profit for the period 1–9, 2016, amounted to EUR 12,017 thousand.

EBITDA

EBITDA of the company Poslovni sistem Mercator, d.d., in the period 1–9, 2016, amounted to EUR 45,125 thousand which is 42.1% less than in the comparable period of last year.

EBITDAR

EBITDAR of the company Poslovni sistem Mercator, d.d., in the period 1–9, 2016, amounted to EUR 52,972 thousand which is 38.5% less than in the comparable period of last year.

Notes to condensed statement of financial position

Assets

Assets of the company Poslovni sistem Mercator, d.d., as at September 30, 2016, amounted to EUR 1,618,886 thousand, which is EUR 10,990 thousand more than at the end of 2015.

As at September 30, 2016, the value of the company's non-current assets amounted to EUR 1,027,018 thousand, which is EUR 7,109 thousand less than as at December 31, 2015. The decrease in non-current assets is largely a result of lower value of property, plant, and equipment. Property, plant, and equipment represent the largest share of non-current assets at 63.7% (EUR 654,637 thousand), which is EUR 2,869 thousand less than as at the end of 2015.

As at September 30, 2016, the value of company's current assets amounted to EUR 591,868 thousand, which is EUR 18,099 thousand more than as at the end of 2015. The increase pertains especially to trade and other receivables. Assets available for disposal (36.7%) and inventories (22.2%) account for the largest share of current assets. Loans and deposits account for 20.2%, and trade and other receivables account for 19.9% of current assets.

Equity and liabilities

As at September 30, 2016, share capital of the company Poslovni sistem Mercator, d.d., amounted to EUR 643,041 thousand, which is EUR 12,017 thousand, or 1.9%, more than as at the end of 2015. The increase is a result of net profit in the period 1–9, 2016.

As at September 30, 2016, total financial liabilities amount to EUR 616,234 thousand, which is EUR 4,332 thousand less than as at the end of 2015. The decrease is predominantly a result of lower non-current financial liabilities.

As at September 30, 2016, provisions amounted to EUR 21,275 thousand. Compared to the end of 2015, provisions decreased by EUR 887 thousand.

Trade and other payables as at September 30, 2016 amounted to EUR 315,540 thousand, which is EUR 4,502 thousand more than at the end of 2015, especially on account of non-current trade and other payables.

MANAGEMENT RESPONSIBILITY STATEMENT

The Management Board of the company Poslovni sistem Mercator, d.d., hereby confirms that the summary of the financial report of the company Poslovni sistem Mercator, d.d., and the Mercator Group for the period ended on September 30, 2016, to their best knowledge, is compiled in compliance with the International Financial Reporting Standards and that it presents a true and fair account of assets and liabilities, financial position, and the income of the company Poslovni sistem Mercator, d.d., and other companies included in the consolidated statements. The Management Board also declares that the transactions between associated entities within the Mercator Group were conducted based on the signed sale and purchase agreements, according to arm's length principle.

Poslovni sistem Mercator, d.d.
Management Board

Ljubljana, October 24, 2016