

Business Report of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period 1-6 2014

 **Mercator**
najboljši sosed že 65 let

Ljubljana, August 2014

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SUMMARY

Mercator Group revenue in the period 1-6 2014 amounted to EUR 1.3 billion, which is 4.2% less than in the equivalent period of the year before. Operating profit stood at EUR 11.8 million.

Business conditions improving, yet the purchasing power stays low

GDP is forecast to grow by 1.6% in the European Union and by 1.2% in the euro zone in 2014, and the gap between the countries with the highest economic growth and those still struggling is expected to narrow. Due to the characteristic lag between economic recovery and increase in employment, unemployment rate is only expected to start declining slowly in the medium run. Positive GDP growth was seen in all markets of Mercator operations, except for Croatia where it was negative at -0.5%. The trend of rising unemployment stopped in all markets, and consumer expectations regarding the future are more optimistic – although this was not evident yet in the first half of the year in terms of their purchasing power.

Revenue in the period 1-6 2014 lower than in the equivalent period of last year

In the period 1-6 2014, Mercator Group generated revenue of EUR 1.3 billion, which is 4.2% less than in the same period of last year. Revenue dropped in all markets of Mercator operations, except for Montenegro where it rose by as much as 6.8%. Lower revenue is mostly a result of major changes in shopping behaviour of consumers, stringent competition, withdrawal from the Bulgarian market, and closing down of some underperforming stores of the FMCG program, Modiana, and technical consumer goods program.

We refurbished more units and carried on our marketing activities

Refurbishments of our stores took place throughout the first half of 2014. Three existing stores were refurbished according to the Mercator Sosed (Neighbour) concept; special modules for customers looking to quickly buy food intended for immediate consumption were installed in 10 stores; and we launched the refurbishments of

supermarkets and hypermarkets. Activities were also focused on making the presentation of our special offer and seasonal products more attractive. We respond to the needs and desires of our customers. Therefore, we continued to offer both in Slovenia and in international markets locally sourced produce by small growers.

Investment mostly allocated for refurbishments of existing stores

Our investments in the first half of 2014 amounted to EUR 9.9 million. A major part of this sum, as much as 44.8%, was used to refurbish existing stores. In the period at hand, we divested a total of EUR 2.3 million of non-operating assets. In the second half of April, we announced a list of 50 new units intended for divestment, and contacted potential buyers.

Financial restructuring completed

Mercator Group signed with all creditor banks and lessors comprehensive contract documentation on the Group's financial restructuring, which will notably decrease its financial risks. In addition to other aspects, the financial restructuring aligned repayments with the expected cash flow, improved liquidity, and secured a higher investment rate. A major step was made towards a consolidated set of financing conditions and the basis for joint decision-making, with consolidated set of documentation.

Mercator, d.d., ownership structure stabilized

At the end of June, the company Agrokor, d.d., acquired just over 2 million of shares of the company Mercator, d.d., becoming a 53.12-percent shareholder of the company. In early July, the company Agrokor, d.d., also announced their takeover intent, followed by a takeover bid on July 31, 2014 to acquire the remaining company shares.



INTRODUCTION

MERCATOR GROUP PROFILE

Company Profile

Mercator Group is one of the largest corporate groups in Slovenia and in the entire Southeastern European region. Seven of the companies comprising the Group are headquartered in Slovenia, while eight more subsidiaries operate in the other markets of Southeastern Europe. Poslovni sistem Mercator, d.d., headquartered in Slovenia, is the parent company of the Group.

Poslovni sistem Mercator, d.d.	
Telephone	+3861 560 10 00
E-address	info@mercator.si
Website	www.mercatorgroup.si
Headquarter	Dunajska cesta 107, 1113 Ljubljana
Activity	Retail in non-specialized food retail outlets (G 47.110)
Registration number	5300231
VAT number	45884595
Company share capital as at June 30, 2014	EUR 157,128,514.53
Number of shares issued and paid-out as at June 30, 2014	3,765,361
Share listing	Ljubljanska borza, d.d., official market, prime market, symbol MELR

Corporate governance

The Supervisory Board of the company Poslovni sistem Mercator, d.d., held seven sessions in the period 1-6 2014, of which five were regular meetings and two were correspondence sessions.

At the 20th session held on January 30, 2014 the Supervisory Board was presented the progress of negotiations on the refinancing of Mercator Group debt and on the progress of sale of the majority block of Mercator, d.d., shares, and the unaudited Mercator Group results for the period 1-12, 2013. The Supervisory Board approved the disposal of the 100-percent shareholding in the company Mercator - A, sh.p.k.

At the correspondence session held on March 7, 2014 the Supervisory Board agreed that the company Mercator - S, d.o.o., sign the Restructuring Framework Agreement with some of the other financial institutions that would also sign the restructuring of the financial liabilities of the company Mercator - S, d.o.o. The Supervisory Board also agreed that other Mercator Group

companies sign the Restructuring Framework Agreement on the restructuring of their financial liabilities.

At the 21st session held on March 31, 2014, the Supervisory Board was briefed on the progress of the legal review of some transactions carried out by the previous Management Board in the period from 2007 to 2011, on the progress of the financial debt restructuring process, the sale of the majority shareholding in the company Mercator, d.d., and the status of activities of Mercator's withdrawal from the markets of Albania and Bulgaria. The Supervisory Board approved disposal of two land lots, one in Novi Beograd and another in Zagreb (location Podbrežje).

At the 22nd session held on April 25, 2014 the Supervisory Board discussed and approved the Mercator Group Annual Report for the year 2013. The Board was also orally briefed on the progress of sale of the majority block of Mercator, d.d., shares, and it adopted the report on the merger of



the company Modiana, d.o.o., to the company Mercator, d.d.

At the 23rd session held on May 20, 2014, the Supervisory Board assessed the performance of the Management Board, confirmed the criteria for determining the variable share of Management Board salaries, and the starting point for Management Board performance appraisal for the year 2014. The Board proposed to the Shareholders Assembly to appoint the auditing company Deloitte revizija, d.o.o., Dunajska cesta 165, Ljubljana, as the company auditor for 2014. The Board also adopted the report on the merger of the company M - nepremičnine, d.o.o., to the company Mercator, d.d. They were presented the contract documentation on the financial restructuring of the company Mercator, d.d., and the Mercator Group, and they confirmed the report on the compliance with the covenants and commitments with regard to the cartel charge and proceedings, pursuant to the decisions by the Competition Protection Office of the Republic of

Slovenia. The Supervisory Board also adopted the information on the activities of Mercator's withdrawal from the market of Bulgaria.

At their 24th session on May 29, 2014 the Supervisory Board confirmed the signing of the documentation for the completion of financial restructuring.

Supervisory Board member of the company Poslovni sistem Mercator, d.d., Bojan Brank, filed on June 27, 2014, his statement of resignation from the position of Supervisory Board member. On August 4, 2014, other members of the Supervisory Board, representing shareholders, Mr Matej Lahovnik, Mr Rok Rozman, Mr Boris Galić, Mr Zdenko Podlesnik and Mrs Marjeta Zevnik submitted their resignations as members of the Supervisory Board of the company. Their resignation will become effective as at August 28, 2014.

**Mercator Group composition**

As at June 30, 2014, Mercator Group included following companies:

MERCATOR GROUP**MERCATOR OPERATIONS SLOVENIA AND CROATIA****Poslovni sistem Mercator, d.d., Slovenia**

Mercator - H, d.o.o., Croatia (99.9%)
 Mercator IP, d.o.o., Slovenia (100.0%)
 M - Energija, d.o.o., Slovenia (100.0%)

OTHER OPERATING ACTIVITIES

Intersport ISI, d.o.o., Slovenia (100.0%)
 Modiana, d.o.o., Slovenia (100.0%)*
 Mercator - Emba, d.d., Slovenia (100.0%)

MERCATOR OPERATIONS SOUTHEASTERN EUROPE

Mercator - S, d.o.o., Serbia (100.0%)
 Mercator - BH, d.o.o., Bosnia and Herzegovina (100.0%)
 M - BL, d.o.o., Bosnia and Herzegovina (100.0%)
 Mercator - CG, d.o.o., Montenegro (100.0%)
 Mercator - B, e.o.o.d., Bulgaria (100.0%)*
 Mercator Makedonija, d.o.o.e.l., Macedonia (100.0%)*

MERCATOR REAL ESTATE

M - nepremičnine, d.o.o., Slovenia (100.0%)*
 Investment Internacional, d.o.o.e.l., Macedonia (100.0%)*

* The company does not conduct business operations.

** The company is in the liquidation proceedings.

*** The company was merged to the company Poslovni sistem Mercator, d.d., as at July 1, 2014.

Branch Offices

As at June 30, 2014 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 these two organizations is to provide solidarity aid to employees in social or economic distress.



MERCATOR GROUP BUSINESS STRATEGY

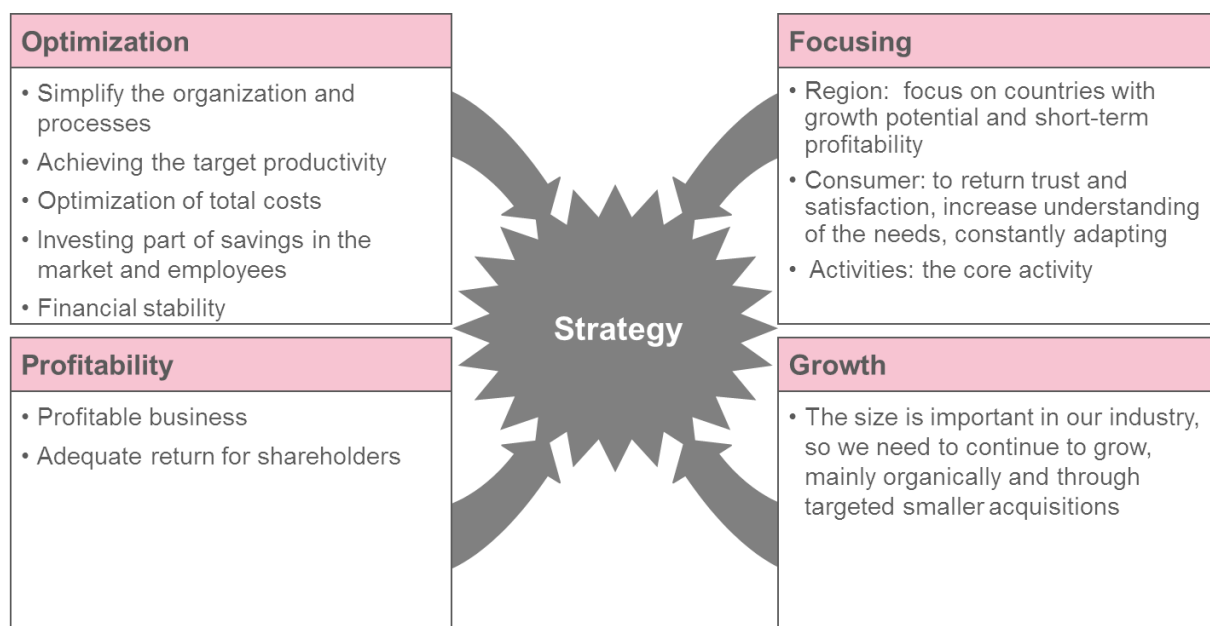
Vision

Mercator will be the largest, the most successful and the most efficient retailer in the region.

Poslanstvo

- A satisfied customer recognizes us as the best retailer that offers everything a discount store can offer, and much more.
- Employees with **smiles on their faces and sparkles in their eyes** are our key competitive advantage. They will be able to develop their potential in a stable environment.
- We are striving towards a **stable ownership structure** that will support the company development based on merit and results.
- Mercator is striving to win the **confidence of all stakeholders**.

Strategy





MERCATOR GROUP PERFORMANCE HIGHLIGHTS IN THE PERIOD 1-6 2014

	1-6 2014	1-6 2013	Index 1-6 2014/ 1-6 2013
Revenue (EUR thousand)	1,299,927	1,356,426	95.8
Results from operating activities (EUR thousand)	11,832	11,346	104.3
Profit before income tax (EUR thousand)	(13,707)	(15,067)	91.0
Profit for the financial period (EUR thousand)	(13,707)	(15,149)	90.5
EBITDA (EUR thousand)	47,266	52,709	89.7
EBITDAR (EUR thousand)	74,229	82,651	89.8
Equity as at June 30, 2014 (EUR thousand)**	500,651	653,739	76.6
Assets as at June 30, 2014 (EUR thousand)**	2,266,730	2,510,933	90.3
Capital expenditure (EUR thousand)	9,856	10,174	96.9
Return on equity	(4.7%)	(5.1%)	91.6
Return on sales	(1.1%)	(1.1%)	94.4
EBITDA / revenue	3.6%	3.9%	93.6
EBITDAR / revenue	5.7%	6.1%	93.7
Number of employees based on hours worked	21,098	22,031	92.9
Number of employees as at the end of the period	22,663	23,531	96.3

* Indicator is adjusted to annual level.

** As at June 30, 2014, buildings are valued on basis of revised accounting policies, therefore, figures are not comparable with those on June 30, 2013.



HIGHLIGHTS IN THE PERIOD 1-6 2014

Retail network development

Following are the highlights for the first half of 2014:

- we invested EUR 9,856 thousand,
- our divestments totalled at EUR 2,330 thousand,
- we added nine units or 2,820 square meters of new gross retail area in all markets of our operations.

Changes in the composition of the Mercator Group

On January 1, 2014 the activities of the company Modiana, d.o.o., Slovenia, were transferred to the company Mercator, d.d.

On January 22, 2014 the company Mercator - Optima, d.o.o., was struck from the court register. The company had operated in Slovenia and it was specialized on planning the stores and shopping centers.

In April, Mercator Group completed its withdrawal from the market of Albania. The company Poslovni sistem Mercator, d.d., divested its entire capital investment in the company Mercator - A, sh.p.k.; on April 7, 2014 it was deleted as a partner in the said company.

Changes in the ownership structure

On June 27, 2014 the company Agrokor, d.d., became the majority shareholder of the company Poslovni sistem Mercator, d.d. Agrokor acquired 2,000,278 company shares accounting for 53.12% of Mercator, d.d., share capital. The stock was sold to Agrokor by some of Mercator's major former shareholders, including Pivovarna Union, d.d., Nova Ljubljanska banka, d.d., Pivovarna Laško, d.d., Nova KBM, d.d., Gorenjska banka, d.d., Prvi faktor - faktoring, d.o.o., Belgrade, Radenska, d.d., Banka Koper, d.d., Hypo Bank, d.d., NFD 1, mešani fleksibilni podsklad - Jugovzhodna Evropa, d.o.o., Banka Celje, d.d., and NFD Holding, d.d. With this transaction, Mercator stabilized its ownership structure, which will allow it to intensify its focus on the core activity in the future.

In early July, Agrokor also announced their takeover intent, followed by a takeover bid on July 31, 2014 to acquire the remaining company shares.

Changes in corporate governance of the company Mercator, d.d.

Supervisory Board Members, representing shareholders, submitted their resignation as a members of the Supervisory Board of the company Poslovni sistem Mercator, d.d. Mr Bojan Brank resigned on June 27, 2014. On August 4, 2014, other members, Mr Matej Lahovnik, Mr Rok Rozman, Mr Boris Galić, Mr Zdenko Podlesnik and Mrs Marjeta Zevnik submitted their resignations as members of the Supervisory Board of the company effective as at August 28, 2014.

Mercator Group financial management

In June 2014, Mercator Group signed with all creditor banks and lessors comprehensive contract documentation for the Group's financial restructuring. Working with its creditors, Mercator took a big step towards a consolidated set of financing conditions and a basis for joint decision-making, with a consolidated set of documentation pursuant to the best international practice.

On June 24, 2014, following the initiative of the company Agrokor, d.d., an agreement was signed on the consent to the changes and amendments of the financial documentation on the financial restructuring of the Mercator Group, dated June 9, 2014. The agreement was made effective subject to a number of conditions, including that the company Agrokor, d.d., approve and transfer to the company Poslovni sistem Mercator, d.d., a subordinated loan of EUR 200 million, which shall be used for early repayment of a part of Mercator Group's loans to the creditor banks. The company Agrokor, d.d., transferred such subordinated loan on June 27, 2014, simultaneously with the acquisition of the majority block of shares of the company Poslovni sistem Mercator, d.d.

Agrokor, d.d., committed to vote, after the takeover procedure, in favour of the conversion of the said subordinated loan to Mercator equity, which will notably decrease the overall debt of the company Poslovni sistem Mercator, d.d.

Awards and consumer surveys

In the Trusted Brand survey conducted by the Reader's Digest magazine, Mercator was again ranked among the brands most trusted by consumers. Slovenian subscribers of the Reader's



Digest magazine were asked to choose 40 most trustworthy brands – 20 global and 20 local. Mercator was again voted a top local brand as **the most trustworthy shopping center**. According to the survey, consumers highly appreciated tradition. This year, the readers also voted for the first time the **most trustworthy brands with regard to environmental protection**; Mercator ranked among the best in this regard.



At the 13th bread, pastry, and pasta competition, organized by the Chamber of Commerce and Industry of Slovenia, Pekarna Grosuplje won 12 gold medals for **the best bakery products of excellent quality**. All products that entered the competition received top ratings. The medals are the most coveted awards in the baking industry in Slovenia.



According to the **Qudal** survey conducted by the Swiss organization ICERTIAS (International Certification Association GmbH), **Mercator is the Slovenian leader in terms of quality in the category of retail chains**. The survey was conducted in March 2014 by means of a web survey among the Slovenian population. The survey measures exclusively the perception, experience, and opinion of the customers on who truly offers the absolutely highest level of quality in the market.



Quality standard certified

The company Mercator, d.d., successfully completed the external audit of its environmental management system according to the ISO 14001 standard, which includes compliance with the relevant legislation, efficient use of resources, and prevention of pollution. **Mercator, d.d., is currently the only trade company in Slovenia, engaging in wholesale or retail of fast-moving consumer goods, to be awarded the ISO 14001 certificate.**



BUSINESS REPORT

EFFECT OF ECONOMIC AND OTHER CONDITIONS ON MERCATOR GROUP OPERATIONS IN THE PERIOD 1-6 2014

Economic conditions in the markets of Mercator operations in the period 1-6 2014¹

The European Commission is forecasting further improvement in economic conditions in the European Union relative to the previous forecasts. The economy of the European Union and the euro zone is expected to see moderate yet continuous economic recovery. According to the most recent forecasts, real GDP is expected to rise in 2014 by 1.6% in the European Union and by 1.2% in the euro zone. In 2015, GDP growth is expected at 2.0% and 1.7%, respectively. The differences in economic growth persist; however, the gap between the countries with the highest economic growth and the countries still struggling will be partially closed down. Thus, all countries of the European Union should see their economies grow in 2015.

Conditions in the labour market have been improving since 2013. However, limited economic growth and the characteristic lag between economic recovery and the increase in employment mean that few new jobs are to be expected in the medium run. Unemployment in the euro zone and in the European Union is expected to decline somewhat this year. In 2015, unemployment rate is expected at 10.1% in the European Union and at 11.4% in the euro zone. However, differences between particular countries will remain dramatic in the period to which the forecast pertains (4.8% in Austria; 26% in Greece for 2014).

Inflation rate is expected to remain low in the European Union for some time. The reasons for modest growth of the consumer price index is the drop in the prices of primary products, appreciation of the euro, weak demand, and feeble

increase in the level of competitiveness in the economically weaker countries of the European Union. According to the estimates, inflation rate is expected to increase slightly from 0.8% in the euro zone and 1% in the European Union in 2014 to 1.2% and 1.5%, respectively, in 2015.

Following the austerity measures introduced in many countries in the period 2011-2013, the fiscal policy is now more neutral. Budget deficits in 2014 are expected at 2.5% of GDP in the European Union and the euro zone. The ratio of public debt to GDP will reach nearly 90% in the European Union and 96% in the euro zone, but it is expected to start declining next year.

The European Central Bank set the interest rate for the main refinancing operations at 0.15%. As a result of such low rate, the 6-month EURIBOR also remained low and after peaking in April it hit the lowest level at the end of the period. In the period 1-6 2014, the 6-month EURIBOR averaged at 0.395%, an increase of more than 15% relative to the equivalent period of 2013. Nevertheless, average 6-month EURIBOR rate remains very low. It should be added that EURIBOR dropped to a minimum at the very end of the period, which could mean a further decrease of the average rate in the next period.

Slovenia

Except for retail revenue, economic indicators for Slovenia have improved over the year before. Real exports in the first four months of the year, after remaining at the same level in April as they were in March, averaged much higher than in the same period of the year earlier. Processing activities, although declining slightly in April, are on the rise this year and also exceed the last year's figures. Corporate expectations regarding demand in the coming months are positive as well. Construction activity grew considerably in April to nearly reach the level from three years ago. Civil engineering saw particularly strong recovery this year and building construction improved as well. Retail revenue rose slightly in April, but it has lingered at a very low level for a year. GDP rose by 1.9% in the

¹ Economic conditions are commented based on the following data sources: IMAD (Institute of Macroeconomic Analysis and Development); Bank of Slovenia; EBRD (European Bank of Reconstruction and Development); European Commission; S&P (Standard&Poor's ratings services); and statistical offices or bureaus and central banks of individual countries.



first half of 2014 relative to the same period of last year.

The growth of the number of active population has been increasing since February; the number of registered unemployed persons is slowly declining, and the average gross salary has been stagnant. Economically active population has seen modest rise since the last year's second quarter; since February this year, growth has been somewhat stronger. The number of registered unemployed persons has been decreasing since March, especially due to more hiring. At the end of June, the number of unemployed was similar to the year before and the unemployment rate is at 13.4%. Average gross salary has remained virtually unchanged in April. It only increased slightly in the public sector, especially public services, and – after stagnation in the last two quarters and due to the payments for suspended promotions – in the government sector.

In June, inflation rate was 0.8 percent. Low inflation rate was a result of seasonal changes. Monthly increase was fuelled especially by higher prices of holiday arrangements, while it was driven down by lower prices of fruits. With feeble domestic demand and absence of international price shocks, year-on-year growth remains low (0.8%), with higher prices of services driving the increase. The euro zone saw the lowest year-on-year price increase of the last five years in June (0.5%).

Slovenia's rating is at BBB+. As at May 2, 2014 interest rate on 10-year government bonds was 3.5%.

Serbia

In the period 1-6, 2013 real GDP growth was at 2.5%; in the first half of this year, it is estimated at 1.0%. Growth in this year was largely fuelled by telecommunications (5.1%), transport (2.7%), and processing (1.6%). On the other hand, GDP growth was negatively affected by construction (-7.8%), finance (-3.7%), and trade (-2.0%). Consumer price index rose by 0.1% in the period from May 2014 to June 2014, or by 1.3% year-on-year. Unemployment rate remains high at 21.0%. Average exchange rate of the Serbian dinar in the period 1-6 2014 stood at RSD 115.66 per 1 EUR, while the average rate in the equivalent period of last year was RSD 112.24 per 1 EUR. Serbia's rating remains BB- with a negative outlook.

Croatia

According to EBRD data, GDP growth was negative in Croatia at -0.5%. European Commission's forecast is pessimistic, expecting a 0.6% drop in the country's GDP in 2014. Inflation rate is expected at 1.5% in 2014, which is 0.7% lower than in 2013. Unemployment rate is at 19.0%, which is comparable to the same period of the year before. Average exchange rate of the Croatian kuna in the period 1-6 2014 stood at HRK 7.62 per 1 EUR, while the average rate in the equivalent period of last year was HRK 7.57 per 1 EUR. Croatia's rating remains BB with a negative outlook.

Bosnia and Herzegovina

GDP growth per capita is expected at 1.8% in 2014. Inflation rate in 2014 is forecast at 1.1%, with a staggeringly high unemployment rate of 43.0%. The exchange rate of the convertible mark is pegged to euro at the rate of KM 1.95583 per 1 EUR. Bosnia and Herzegovina's rating is B and the outlook is stable.

Montenegro

EBRD has revised its GDP growth forecast for Montenegro from 2.0% to 3% in 2014. The reasons are higher international demand (orders placed internationally) and major infrastructural projects. Inflation rate is forecast at 2.9% for the year 2014. Unemployment rate has declined by 3 percentage points relative to the same period of the year before to 16.0%. The official currency is the euro. Montenegro's credit rating is BB- with negative outlook.

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

Based on the estimates of higher economic growth in the first half of 2014, a slight improvement of economic conditions in all markets of Mercator's presence is expected. The drop in household consumption has continued in most markets, and unemployment rate remains high. Consumers in all markets still believe we are in a recession and they do not expect any considerable improvement in the coming year. The future is viewed with slight optimism and somewhat more positive expectations.

According to market research conducted in March 2014,² recession is not felt as acutely in everyday

² Marketing Monitor of the Slovenian Marketing Association (DMS): Consumer Survey, Spring 2014



life as before in **Slovenia**, although 80% of respondents continue to feel its effects. Consumer expectations are more positive. They are less worried about further reduction of wages or losing their jobs; and the psychological pressure of the crisis is not as heavy. The consumers insist on the changed shopping behaviour which they adopted upon the onset of the economic crisis: their shopping is more rational and planned, they prefer more inexpensive products, they are more responsive to special offers and promotions, and they buy more private label products. Their shopping is dispersed over several retailers. Instead of one major shopping session, they break it down into several smaller shopping trips, and they visit the discount retailers more often. According to Nielsen³ data, consumer confidence improved in the first quarter of 2014 relative to the previous quarter; however, it is still below the European average.

In **international markets**⁴, except for Serbia, consumer confidence has improved as well; it remains the lowest in Croatia. Job security remains the top concern of consumers in the region, due to high unemployment rates. Two out of three consumers do not see any options for new employment and over a third believes the timing is bad for shopping or spending. In Croatia, consumers increasingly turn to lower-priced private labels. In Serbia, the same shift towards cheaper brands is seen; moreover, less is spent on out-of-home entertainment.

Improvement in consumption is not expected yet. The consumers are more rational and price-sensitive. They tend to plan their shopping and they do not opt for major shopping sessions. Their rational shopping behaviour also means preference of cheaper brands and turning more often to products included in special offers. They shop less and more frequently, with lower value of each shopping cart.

SALES AND MARKETING

Sales

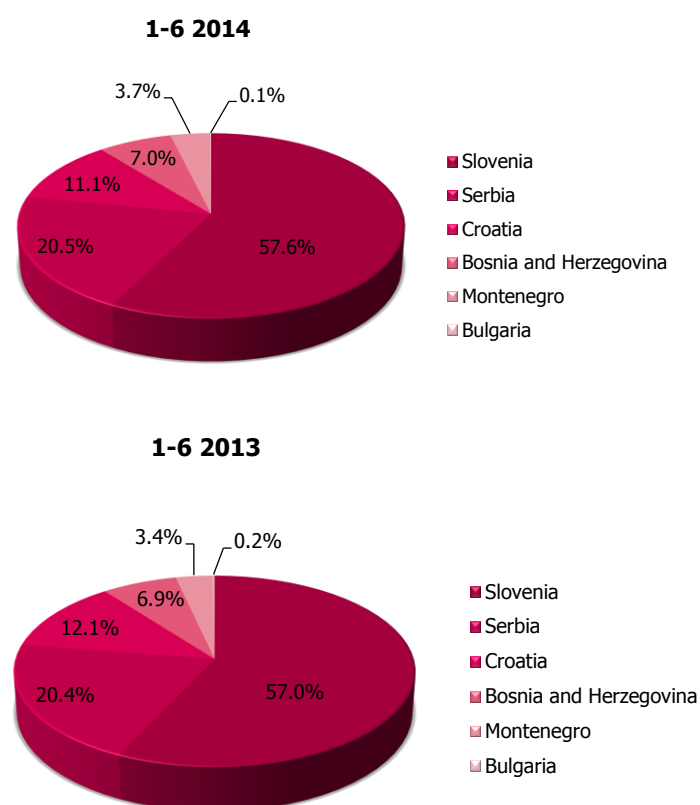
In the period 1-6 2014, Mercator Group generated EUR 1.3 billion of revenue, which is 4.2% less relative to the period 1-6 2013.

Majority of Group revenue is generated by sale of goods, material, and products, mostly retail and wholesale of trade goods.

Relative to the corresponding period of last year, revenue in Slovenian market dropped by 3.2%. A drop of revenue has been seen in foreign markets as well, except for Montenegro where the revenue has grown (6.8%).

The Group revenue is lower than in the corresponding period of last year, which is a result of several factors, including the withdrawal from the Bulgarian market and closing down of some underperforming units of the technical consumer goods and Modiana programs. The drop in revenue was also caused in part by highly stringent competition and harsh economic conditions which have already had a strong impact on the consumers' shopping behaviour.

Mercator Group net sales revenues by geographical segments:

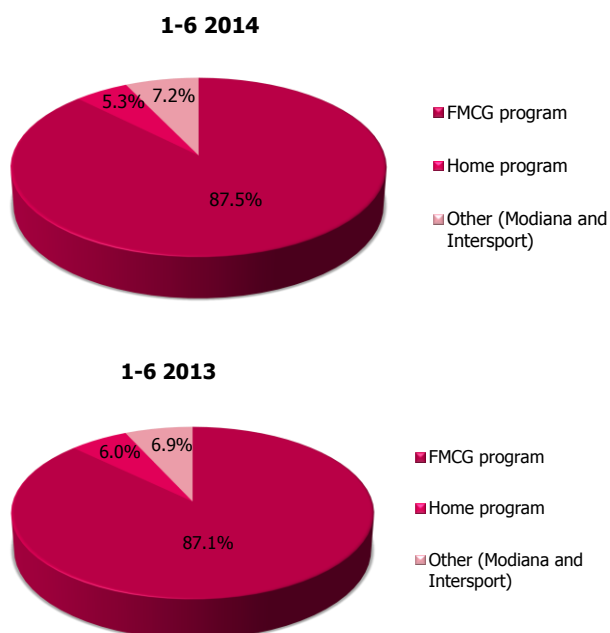


³ Adriatic consumer confidence, Quarter 1, 2014;Nielsen

⁴ Adriatic consumer confidence, Quarter 1, 2014;Nielsen



Mercator Group revenues from trade operations by programs:



In the period 1-6 2014, the majority of Mercator Group revenue resulted from sales of fast-moving consumer goods which accounted for 87.5% of the total figure; revenue from other specialized programs amounted to 12.5%. Due to the closing down of some units of the technical consumer goods program, the share of fast-moving consumer goods programs within total revenue dropped considerably. Exit from the Bulgarian market and changes in consumer behaviour are the reasons for lower FMCG sales, and for the 0.3-percent increase of the share of sales within other programs (Modiana and Intersport).

Store formats, customer segments, and category management

Store Formats

Mercator Group's retail units are present in five markets of different economic maturity. Moreover, consumer behaviour has changed dramatically in recent years as a result of a number of trends from the environment, which has increased the complexity of operations. Like most of the world's leading retailers, Mercator is seeking to adapt to these changes as much as possible by diversifying its store formats.

After years of expansion of large stores, **small box stores** are again coming to the forefront.

Moreover, **redesign of the existing retail networks**, i.e. new concepts at existing locations, is increasingly important, along with **intensive development of e-commerce** in which conventional brick-and-mortar stores take the role of pick-up points for orders placed over the internet.

In 2014, we remain focused on the revision of Mercator's most important format Mercator Neighbour ("Mercator Sosedi") according to the revised concept which puts to the forefront the adjustment to particular micro environments or to the local community and the target segments of customers and their shopping behaviour and needs.

The highlights and focus of this format are the **offer of excellent fresh produce** (depth and variety of offer) and **innovative ideas of the offered mix** that makes the customers' everyday easier:

- **importance of fresh produce** («strong fresh experience»);
- introduction or expansion of the offer of **ready-made food** to be consumed immediately (rotisserie) or after reheating («ready to heat» and «ready to cook»);
- broader offer of **pre-packed fresh products**,
- integration of the **"Minute" department** into the units at busy locations.

In the first half of this year, three Mercator stores were refurbished to fit the Mercator Sosedi concept:

- market Domžale, in Domžale,
- Tržaška neighbourhood store, in Ljubljana, and
- Na klancu neighbourhood store, in Kranj.



As a response to the shopping trends that put convenience of shopping first, we introduced the grab&go module in 10 stores with high customer



frequency. The module offers convenient products intended for immediate consumption at a single place, and it allows fast and simple checkout.

Key emphases include:

- offer of fresh produce prepared at the store;
- innovative products;
- private label (Minute);
- suitable take-away packaging.



In order to respond to the shopping trends in the market, i.e. increasing price sensitivity, increased appreciation of quality local produce, rational and conservative approach to purchases of non-FMCG products, and to provide a pleasant shopping experience for our customers, **hypermarkets and supermarkets are also being refurbished** in this year.



In this year's first quarter, the store at Kongresni trg in Ljubljana, a convenience store format, was refurbished in the first quarter of this year.

Composition of retail units as at June 30, 2014:

COUNTRY	SLOVENIA		SERBIA		CROATIA		BOSNIA AND HERZEGOVINA		MONTENEGRO		MACEDONIA*	MERCATOR GROUP			
Banner	Mercator	Mercator	Roda	Mercator	Getro	Mercator	Drvopromet	Mercator	Roda						
ACTIVITY	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Gross sales area	Net sales area	
Hypermarkets	22	2	15	12	-	5	-	-	2	-	-	58	280,206	182,084	
Supermarkets	62	-	22	19	3	13	3	-	9	-	-	131	186,067	119,226	
Neighbour stores	397	-	78	49	19	13	53	-	75	-	-	684	291,197	173,825	
Comfort stores	1	1	-	1	-	1	-	-	-	-	-	4	8,745	5,201	
Mini stores	5	-	1	-	-	-	1	-	-	-	-	7	932	528	
Cash & Carry	13	-	6	-	16	-	-	-	1	-	-	36	119,395	79,991	
Restaurants	9	10	-	-	-	2	-	-	-	-	-	23	4,899	3,200	
TOTAL FMCG program	509	13	122	81	38	34	57	0	87	-	-	941	891,258	563,846	
Technical consumer goods	52	12	-	-	-	-	-	1	-	-	-	65	88,448	57,177	
Clothing program and drugstores	54	13	-	34	-	12	-	-	-	-	-	113	56,595	47,662	
Clothing program	45	7	-	34	-	8	-	-	-	-	-	94	54,239	45,614	
Drugstores and perfumeries	9	6	-	-	-	4	-	-	-	-	-	19	2,356	2,048	
Intersport	34	11	-	28	-	9	-	2	-	-	-	84	52,457	40,154	
M holidays	12	-	-	-	-	-	-	-	-	-	-	12	242	242	
Other	3	-	-	-	-	-	-	-	-	-	-	3	374	335	
TOTAL specialised programs	155	36	0	62	0	21	0	3	0	-	-	277	197,741	145,234	
TOTAL retail units under management	664	49	122	143	38	55	57	3	87	-	-	1,218	1,089,000	709,081	
Franchise stores	232	-	94	40	-	-	-	-	-	-	-	2	368	71,053	47,164
TOTAL	896	49	216	183	38	55	57	3	87	2	1,586	1,160,053	756,245		

* In the market of Macedonia, Mercator is present with two franchise stores of the Intersport format.



Customer segments

Our customer loyalty system was revised in early 2013. The revision included designing messages for each segment separately to selectively stress the advantages of the revised system according to the segment for which the message was intended. Bonus point collection system was also revised, as was the system for using the earned bonuses. The customer loyalty system in international markets was made uniform, as it had differed considerably from one market to the other.

Category management

By active category management at Mercator, we are pursuing the following goals: to build a quality multi-level offer of both branded and private label products, to provide competitive prices for branded and private label products, 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.

In the first half of 2014, category management was focused on the following key activities:

- revised concept of promotions with "top offer", emphasis on fresh program and seasonal products for the entire retail network, and seasonal products for hypermarkets and supermarkets;
- "raised in Slovenia" – label for fresh meat produce at the store, and indicating the brands or producers of meat at the butcher's departments;
- "100-percent Slovenian milk" – labelling of fresh milk and dairy products in the stores;
- »Slovenian marketplace« – labelling the fresh fruit and vegetables produce at the store; increasing the share of Slovenian fruit and vegetables (33% more fruit and vegetables were purchased from Slovenian growers in the period 1-6 2014 than in the equivalent period of the year before);
- shrinkage or adjustment of assortment within key categories;
- varied offer of regular and special-offer seasonal products;
- more active role of sales promoters in order to improve the level of service in all fresh program departments, especially those with shop assistance service;
- training and education for all employees in the bread and pastry department, in order

to improve the knowledge of products, sales strategy, and selling skills;

- building infrastructure for more efficient assortment management.

Marketing

Our marketing activities are focused on the priorities for respective markets, and the dynamics in retail, as well as primary target customer segments. In defining our projects, we pursue the goal of creating value for the customers in the following fields:

- pricing benefits for the consumers;
- Pika customer loyalty card;
- domestic, local offer; proximity to the consumer;
- fresh and high-quality offer.

Pricing benefits for the consumers

Mercator is continuously adapting to the wishes and needs of our customers. In addition to the regular sales promotion activities conducted in January and February, we introduced several activities in March 2014 in Slovenia to improve Mercator's price competitiveness in the market. Thus, we cut the regular prices of 10,000 products; for 800 of these products by renowned brands and fresh program, we provide the lowest regular prices, subject to a money-back guarantee. We are introducing new mechanics for the customers: instead of regular Tuesday's and Thursday's 10-percent discounts, we offered our customers until the end of May 2014 double bonus points on these two days; we also added days of 10-percent discounts for shopping above EUR 30; and we carried on the double bonus points days.



In addition to the regular sales promotion activities, we launched the **weekend campaigns** in May. They take place every week from Friday to Monday and allow the shoppers to purchase the selected products at lower prices during the weekend. At the end of March, we set up Garden Centers at 11 locations across Slovenia, offering a wide selection of seedlings, seeds, decorative flowers, and garden supplies.

Our stores now also offer products labelled **MAXX** – larger packages of branded products at lower prices.



To kick-off the summer, we launched the activity **Poletje norih cen v Mercatorju** ("The summer of crazy prices at Mercator") which included a month of exceptional bonuses. Each day, customers are offered products or product categories with discounts, or discounts on a selected product.

In Slovenia, we developed activities for our customers **in cooperation with our partner companies** Zavarovalnica Triglav and the company OMV.

In Slovenia and in Croatia, offer in the first half of the year was focused more on fresh fruit and vegetables.

In the first half of 2014, the activity **To so cene** ("These are the right prices") was at the forefront in Croatia; it received weekly communication support. Weekly campaigns are prepared for the customers in the entire Mercator and Getro network in order to attract the greatest possible number of customers to the stores, and to focus on fresh and seasonal products.

In Croatia, we also carried on our weekend activities **Vikend za 5** ("Weekend for 5") and **Late Night Shopping** at Mercator centers, as well as the activity **Najnižja cena svežega mesa** ("Lowest price of fresh meat"). In April, the activity of offering well-priced products, called **Dobra cena** ("Good price"), was introduced.

In Serbia, we have carried on the regular activities related to special offers for every day of the week:

double bonus points (Monday), coupon (Tuesday), retiree discounts (Wednesday); special offer (Thursday), and weekend campaign (Friday–Sunday). For the most price-sensitive customers, we offer a range of products of the **Socially Responsible offer with the lowest prices**. The customers have also responded well to sales promotion activities at the check-out counters, which are carried out twice per week.

Since April, the Roda stores offer **10-percent discount** on the entire store assortment.



In May, the **Garancija najniže redne cene** ("Lowest Price Guarantee") was introduced for 300 products, backed by a price matching policy.



In Bosnia and Herzegovina, we are preparing joint sales promotion campaigns for customers of two store format banners: Mercator and DP marketi. Key activities are related to special offer and seasonal offer, linked purchase, coupons, and retiree discounts.

In the run-up to the football World Cup, we held a prize contest **Peljemo vas v Brazilijo** ("We'll take you to Brazil").





In Banja Luka, various special offer activities are prepared for the customers, related to weekly campaigns, Tuesday's discount coupons, retiree discounts, and special offers. The activities **Price of the day** and **Facebook coupons** were well-received among customers.



In May, a special activity was held to celebrate the 5th anniversary in Banja Luka, called **Top 200 products in a special offer**.

In Montenegro, customers are offered well-priced shopping with a variety of promotional and weekend campaigns. Good prices of selected products are also offered under the label **Attention! Low Prices**.

Pika card

Focusing on the consumer, we carry on the development of the advantages of the Pika customer loyalty system. Now, the customers can win and use their loyalty points for the entire offer; they are also offered special Pika discounts for select products; in addition, the card allows a deferral of the payment and payment in up to 24 instalments at a zero interest rate. For the segment of customers keen on shopping online, we also allow the functionality of online payment for alimentary products and technical consumer goods by Pika card.

Specially tailored offer is prepared for all customers who allow us to monitor their shopping behaviour.

Value added of the Pika card is enhanced in cooperation with **new partner companies** that offer appealing complementary offer exclusively for us and for our target segments. Thus, we presented in cooperation with the company Si.Mobil in June an exclusive offer of a free phone for the Senior Club members, and offered consumer credit at the Sberbank at favourable terms for a group of club members.

At the same time, we increased the number of Pika partners with whom our card holders are offered considerable discounts, including wellness centers, spas, language schools, adrenaline parks, rafting adventure agencies, fitness clubs etc.

Each month, special offers are prepared for the Pika card holders in all Mercator Group markets. These are presented in flyers and direct mail. Moreover, shopping is rewarded by double or triple bonus points on some days.

In Croatia, Pika card holders are offered a special Pika catalogue which brings the card holders a range of well-priced offer of various products with Pika discounts, or the possibility to trade in the bonus points for a discount. Pika card holders also received special bonus coupons in direct mail.

Since April, Pika holders in Serbia and Bosnia and Herzegovina may use the Pika card to pay for products of the entire assortment in 12 instalments with zero interest rate. Zavarovalnica Triglav also joined the Pika partner system, offering Pika card holders a special discount on insurance and addition of the bonus point to the Pika card bonus.



In Bosnia and Herzegovina, we rewarded shopping with double and triple points for the Pika card holders, and developed special offers of well-priced shopping presented in a special Pika Catalogue.

In Banja Luka, Pika card holders were offered special activities and triple Pika bonus points upon Mercator's 5th anniversary there.

In Montenegro, a special catalogue that includes over 80 products with special Pika discounts was prepared for the Pika card holders.

Domestic, local offer; proximity to the consumer

Within the project **Locally Grown**, we continue to communicate the offer of home-grown Slovenian produce. The communication is focused especially on our competitive advantages, such as the following: we are the only ones to offer meat 100%



grown and produced in Slovenia; 100% Slovenian fruit and vegetables at the "local marketplaces"; bread from our own Grosuplje Bakery is made of 100% Slovenian wheat. In addition to communicating the offer of local Slovenian produce, we also stress the importance of preserving the tradition; direct delivery allows small growers to reach our shopping aisles and shelves more easily; we promote self-sufficiency and work with the growers to develop an offer of products that are in short supply in the Slovenian market. As a part of the **Locally Grown** project we present products and offer, and cuisine of individual regions.

In May, we introduced a novel feature in our offer of fruit and vegetables. The customers may use the QR codes to find information about the producer of fruit or vegetable in our offer.



The project of local offer was successfully rolled out to other markets as well. In Croatia, local offer is presented with the activity **Taste the Home Grown**. In the spring, the focus was on the offer of fresh meat.

In Bosnia and Herzegovina, we carried on the activity **100-percent local** and **100-percent locally made**.

In Serbia, select local products are offered under the slogan **Recommending Local Products**.

In Slovenia, we highlighted Mercator's proximity to the consumers and integration into the local environment in a corporate campaign celebrating the company's 65th anniversary. Mercator brand values and Mercator were presented as the agent of change and progress that brought modern development of retail to Slovenia.



Our proximity to the environment in which we work is not seen as merely the physical proximity of our stores. We also see our proximity to the environment in terms of closeness and co-habitation with the towns we are located in and the people who live there. In order to give back to our local environment, we carried out in April the **Radi delamo dobro** ("We Like to Give Back") project in select 100 local stores across Slovenia. The project included presenting, with the help of our customers, a donation in the total amount of EUR 100,000 to 100 winning local societies. During the campaign, we received 1,100,000 customer votes in the form of red voting tokens for support to local societies. Upon the conclusion of the campaign, our store managers also presented a donation in the form of food packages to the Red Cross.



In eight Mercator centers in Croatia, **Mercator Street Soccer Tour** was held during the football World Cup, hosting teams and shopping center visitors. Moreover, a prize contest was organized for the participants.

Mercator's fifth anniversary in Banja Luka was celebrated with a special activity for the customers **"Sing a birthday song and perform as Mercator's talent"**. The importance of working with the local community and the customers was also stressed at this occasion.



Fresh and high-quality offer

Mercator private label lines offer a variety of products for all occasions, at all price segments.

In the main private label line Mercator, revision of design has been carried on. We remain focused on improving the competitiveness of our offer of products in all categories. We have developed a comprehensive market communication campaign to communicate the **affordable prices, known origin, and guaranteed quality of the Mercator private label products**.

We developed a major marketing communication campaign for Mercator and Lumpi ice cream. The dairy product category was extended with new yoghurt drinks, and advertisements and in-store promotions were prepared. Chocolates in the Mercator private label were launched, printed advertisements were developed, and points of sale were equipped or designed accordingly.



New chocolates and the range of new ice cream products were also launched in Croatia.

Our Grosuplje Bakery surprised the customers with new innovative products. To celebrate the holiday of Slovenian culture, we prepared the Prešeren bread developed in cooperation with the Slovenian ethnologist Prof Dr Janez Bogataj. In February, we

revived the tradition of Valentine's birds. We developed 100-percent whole grain spelt bread, rich in nutrient fibre, and whole grain wheat bread with linseeds.

Consumers committed to a healthy diet appreciate Mercator's Bio line. Early in the year, we revised our offer of tea and refreshed the offer of some other organic ("Bio") products.

New BIO tofu was launched; two new flavours were added to the existing product.



We continue to introduce new flavours into our assortment or bulk biscuits in order to make this offer different, better, and more season-oriented than that of the pre-packed biscuits. In January and February, we launched spelt Linzer cookies and cookies with dried fruit and nuts under the brand **From Mercator's Home Pastry Workshop**.

We also launched the revised products My Day and the Sun Joy cosmetics line.



In Bosnia and Herzegovina, we presented the Mercator private label products produced in cooperation with local producers.

In Banja Luka, we held a successful Facebook activity that involved coupons promoting the private label products. At the same time, manufactured products were also exposed.





INVESTMENT AND RETAIL NETWORK DEVELOPMENT

In the period 1-6 2014, Mercator Group continued to pursue the real property management strategy adopted in 2013, subject to the conditions prevalent in the domestic and international financial markets. Refurbishments of existing stores were the priority activity. Thus, we launched in Slovenia new refurbishment projects according to the Neighbour (Sosed) concept, tested and implemented in 2013, wherever the right conditions were met.

There were no new construction developments in the first half 2014. Investment funds were mostly used for renovation and investment maintenance of the existing retail network.

In 2014, our goal was to divest as much non-operating assets as possible. We have developed a list of 50 new locations to be divested and announced the list in the second half of April.

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



Summary of total gross retail area as at June 30, 2014:

Gross area in m ²	Used for own operations	Leased out	Total as at June 30, 2014
Owned retail area	744,399	211,096	955,495
Leased retail area	344,974	51,298	396,272
Total retail area	1,089,373	262,395	1,351,767
Owned warehouse capacity	139,561	575	140,136
Leased warehouse capacity	38,400	6,658	45,057
Total warehouse capacity	177,960	7,233	185,193
Owned commercial facilities	23,107	2,055	25,162
Leased commercial facilities	5,811	0	5,811
Total commercial facilities	28,918	2,055	30,973
GROSS AREA UNDER MANAGEMENT	1,296,252	271,682	1,567,934
- of which owned	907,066	213,726	1,120,793
- of which leased	389,185	57,956	447,141



Investment and Divestment

In the first half of 2014 Mercator Group CAPEX amounted to EUR 9.9 million, which is 3% below the figure for the first half of last year. Of this amount, 73.6% was used for investments in Slovenia and 26.4% was used for investments in international markets.

	Capital expenditure in 1-6 2014 (in EUR thousand)	Structure (in %)
Slovenia	7,251	73.57%
Serbia	1,163	11.80%
Croatia	647	6.56%
Montenegro	573	5.81%
Bosnia and Herzegovina	222	2.25%
TOTAL	9,856	100.00%

Investment into expansion of retail area represented 11.1% of total investment; refurbishments of existing units accounted for 44.8%; remaining 44.1% was invested in logistics, IT, and non-trade activities.

In the first half of 2014, Mercator Group acquired 2,820 square meters of new gross area, mostly in Serbia and Montenegro, of which 96% was acquired by operating lease, and the remaining 4% were acquired by refurbishment of existing facilities.

In the period 1-6 2014, Mercator Group divested EUR 2,330 thousand worth of property, plant and equipment.

Summary of retail unit launches by markets

SLOVENIA

Area of new facilities: 66 m²

Number of new units: 1

Openings: Mini by Modiana in MC Koper I

Refurbishments:

Number of new units: 11

Openings: Market Kongresni trg; Supermarket Pesnica; Market Kolodvorska, Domžale; Market Lucija; Supermarket Litija, Ježa; Market Log pri Brezovici; Market Pristaniška, Koper; Hypermarket in MC Koper; Market Tržaška, Ljubljana; Market Medvoška, Medvode; Market Na Klancu, Kranj



CROATIA

Area of new facilities: 45 m²

Number of new units: 1

Openings: Mini by Modiana in MC Čakovec

SERBIA

Area of new facilities: 1,724 m²

Number of new units: 3

Openings: Superette Banovo Brdo, Belgrade; Supermarket Liman 4, Novi Sad; Santana Caffè bar, Zemun



MONTENEGRO

Area of new facilities: 985 m²

Number of new units: 4

Openings: Market Rubeža, Nikšić; Market Podgorica 3, Podgorica; Market Stari aerodrom 2, Podgorica; Market City, Podgorica



Review of retail unit openings and refurbishments following the end of the financial period

One store was newly opened in July 2014: Market Subotica 1, Subotica, Serbia (July 3, 2014).

Two more refurbished stores were re-opened in July 2014:

- Market Cigaletova, Ljubljana, Slovenia (July 1, 2014), and
- Market Brezovica, Brezovica pri Ljubljani, Slovenia (July 3, 2014).

RISK MANAGEMENT

Management of key risks in the period 1-6 2014

By timely identification of key risks to which the Mercator Group could be more severely exposed, we seek to alleviate their effect or to hedge them entirely.

Business Risks

Consumer confidence is gradually improving in Slovenia; more optimism can be perceived with regard to economic conditions in the following 12 months. In Mercator's international markets, the risk of a decline in purchasing power is still high, despite the anticipated economic growth.

Financial risks

The economy is gradually recovering as economic growth is positive in most countries. This also affects the investors and their attitude towards new investment. Mercator's operations were also positively affected by steady exchange rates of the Serbian dinar and the Croatian kuna.

Operational risks

In terms of operational risks, a lot has been done regarding environmental risk management. Several projects were carried out to provide efficient use of power and other energy sources for heating. As a part of the IT risk management, an initiative was launched within the company Mercator, d.d., to improve the efficiency of management of the changes to the central IT systems in the field of application support to material operation.

Business Risks

Business risks are related to company operations and our core activity.

Risks in the operations of trade companies increase as a result of the changes in the shopping behaviour of the consumers, and particularly due to a drop in their purchasing power. Unemployment rate, a key indicator of the purchasing power and the sense of security perceived by the consumers, has been very high in the key markets of Mercator's operations in recent years.

Risk of a decline in purchasing power

Assessment of the risk of a decline in purchasing power (size of market) due to challenging economic conditions.

The risk of a decline in purchasing power is related to the rate of economic growth, unemployment rate, increase in personal income, and changes in the prices of essentials.

Slovenia saw GDP growth in the first half of 2014. Unemployment rate is somewhat lower than at the beginning of the year, but still rather high. In April, it amounted to 13.4%. Consumer confidence is improving. The monthly consumer confidence index rose by 2 percentage points in June 2014, from -24 in May to -22 in June. Moreover, the index was 16 percentage points higher year-on-year, and 10 percent above the last year's average. The increase at the annual level was a result of more optimistic forecasts of the consumers regarding the economic conditions in Slovenia,



unemployment rate, and financial position of their households within the following 12 months. Forecasts regarding the possibilities of savings in the next 12 months did not change and they remain pessimistic. This will continue to affect the decline in consumption.

In **international markets** of Mercator's operations, gross domestic product is expected to grow moderately. Unemployment rate remains high, considerably above that in Slovenia. In Bosnia and Herzegovina and in Croatia, it is the same as in the first half of last year; in Serbia, it dropped slightly. Average salaries are notably lower than in Slovenia. Increase in wages has been low in all markets and its effect has been neutralized by the increase in the consumer prices. Private consumption is stagnant or in decline, with the exception of slight improvement expected in Montenegro. Due to the economic conditions, high unemployment, and low personal income, consumer purchasing power remains weak.

Risks in the supply process

Assessment of global and local impact on Mercator's supply processes.

In the first half of 2014, our cooperation with suppliers was transparent to allow timely identification of any problems faced by the suppliers, and prompt adjustment, which reduces the probability of delivery failures. Regular monitoring and checking of supplier solvency allowed timely redirection to new supply sources. We seek to mitigate local effects on the supply processes by managing the risks of delivery failures. They were monitored on a daily, weekly, and monthly basis and appropriate measures were adopted to curb such effects. In the first half of the year, we were focused on regional suppliers for the private label products.

Risks affecting the sales processes are mitigated by carefully thought-out sourcing policy and selection of multiple suppliers for each category. Lower upstream prices and supply terms are attained in purchases for our private label line and seasonal products, by combining our purchasing with subsidiaries in the Southeastern European markets.

Risks of sub-optimum marketing mix and effects of the competitive environment

Assessment of risk based on market conditions and Mercator's position in the Group's target markets.

Risks of sub-optimum marketing mix and effects of the competitive environment represent the risks stemming from the definition of the marketing mix which includes price, promotion, product, and place. Highly competitive environment in all markets of Mercator's operations compels us to regularly monitor our competitors with regard to every aspect of the marketing mix, and to respond promptly with the marketing mix management tactics.

In the first half of 2014, our regular and promotional retail prices were effectively managed in compliance with the adopted strategies. Additional activities were carried out regarding pricing of products that have the strongest effect on pricing perception. In order to adapt better and more quickly to the market conditions and to improve pricing perception, we introduced some new promotional activities.

We continued to establish new unified assortments that include the best-selling products at all our stores at all times. Our sales assortment is regularly monitored, expanded and updated. We were particularly active in providing the most attractive seasonal offer during major seasons and holidays. At the same time, we updated the IT and technical infrastructure for category management, which will allow more efficient and flexible operation in this field in the future. Marketing mix was also adjusted as a part of the refurbishments of neighbourhood stores.

Risks of failure to attain the planned profit margin and returns on sales promotion activities

Assessment of the risk of failure to attain the planned profit margin and returns on sales promotion activities.

The risk is managed by monitoring all key performance indicators, identifying any deviation from the planned figures, and timely adoption of corrective measures.

Key performance indicators are regularly monitored on a weekly, monthly, and cumulative



basis. In terms of management of the said risk, we are focused both on the actual profit margin (weekly level) and on the invoiced compensation (monthly level). In case of discrepancies, we adopted short-term and long-term corrective measures. Measures are adopted either at the level of a particular product, category, or assortment of a particular supplier (greater number of activities in cooperation with suppliers, more attractive packages of supplier relations etc.).

Financial risks

Financial risks represent the probability of financial loss in operating or investment activities due to certain factors.

Situation in financial markets is improving. Recovery after the recession is rather sluggish, yet it gives hope to investors, especially on the account of positive economic growth and, as a result, positive return on investment. This is also backed by expected GDP growth in most economies, gradual decrease of the unemployment rate, and new investment.

Credit risk in wholesale

Assessment of the risk that receivables from business partners resulting from deferred payment will only be settled partly or not at all.

At Mercator, we are monitoring the level and changes in the level of receivables to wholesale customers on a daily basis. Moreover, the amount of receivables is monitored at the weekly level, with emphasis on receivables overdue by more than 60 days. Monitoring of disputed receivables and receivables collected via legal proceedings is conducted on a monthly basis. In 2014, general liquidity was poor and payment defaults and delinquency were rampant, to which we responded by tightening our limit policy for customers and by intensive activities in collection of all outstanding receivables due. In February 2014, a single central system of customer credit limit management was introduced in the SAP ERP system, which allows us to easily monitor every individual customer and offers precise insight into the amount of receivables and their structure. We still work with a third-party debt collection agency and we require first-rate security from customers with a lower credit rating.

Pika card credit risk

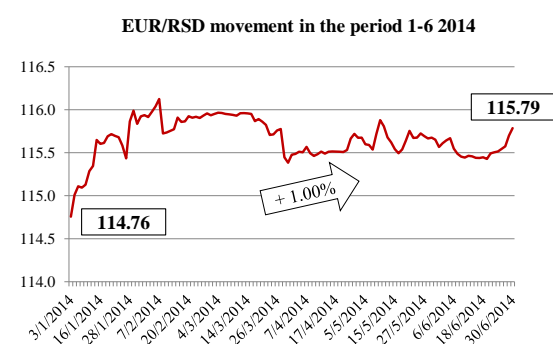
Assessment of the Pika card credit risks (possibility that receivables from customers, resulting from deferred payment, shall only be settled partly or not at all).

In the period 1-6 2014 we continued to monitor on a daily basis the receivables pertaining to Pika card purchases on instalments. We also continued to carry out the processes that have been in place for a while and which have brought positive effects on the credit risk related to the Pika card. One of the most important such processes is the collection of receivables from Pika card holders by phone, and SMS notifications or reminders. Third-party collection agency is hired for receivables that we are unable to collect in such way, not even with written notices and reminders.

Currency risk

Assessment of the loss of economic benefit due to changes in exchange rate.

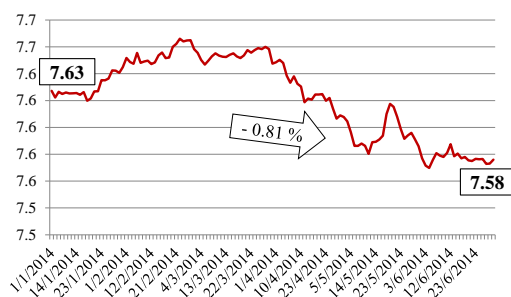
Currency risk exposure is significant especially for the companies in Croatia and Serbia. The exchange rates have been stable recently, unlike in the past when fluctuations were considerable. The Serbian dinar saw further depreciation. As at January 3, 2014, the rate was at RSD 114.76 per 1 EUR; as at June 30, 2014, the exchange rate was RSD 115.38 per 1 EUR. This means a drop in the Serbian currency relative to the euro. Average rate in the first half of 2012 was at RSD 115.66 per 1 EUR.



On the other hand, Croatian kuna appreciated as a result of seasonal effects. At the start of the period 1-6, 2014 the exchange rate was at HRK 7.63 per 1 EUR; at the end of the period at hand, it was HRK 7.58 per 1 EUR. Appreciation of the Croatian kuna in the period at hand thus amounted to 0.81%. Average exchange rate in the first half of 2014 was HRK 7.62 per 1 EUR.



EUR/HRK movement in the period 1-6 2014



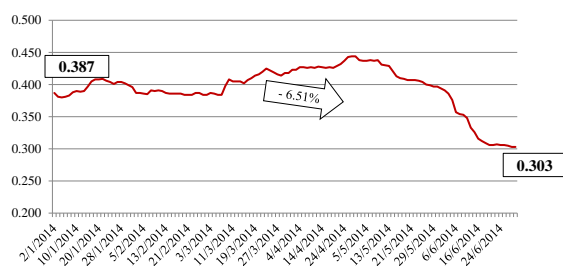
In order to hedge the currency risk, we are seeking to adapt our operations in a way that minimizes it. Additional measures have not been required to date.

Interest rate risk

EURIBOR interest rate is subject to market fluctuations and it is changing on a daily basis, which can lead to increased financing costs.

In the period 1-6 2014, variable 6M Euribor dropped from 0.387% to 0.303%. Average 6-month EURIBOR in the period 1-6 2014 was at 0.395% which is more than 20% above the rate from the last half of 2013. In case of announcement of an increase of interest rates, Mercator Group examines the possibilities of signing additional derivative financial instruments in order to hedge the interest rate risk. In order to control the interest rate risk, at least 50% of all financial liabilities used to finance non-current assets and at least 25% of total financial liabilities are hedged at any moment.

6m Euribor movement in the period 1-6 2014



Liquidity risk

Assessment of the risk that at a certain moment, the company will not have enough liquid assets to settle its current liabilities.

Active management of Mercator Group's liquidity risk is a part of the centralized cash management system. The system is based on precisely defined cash

flow planning methodology based on which every Mercator Group company plans its cash flow on a weekly level for 3 months in advance. This results in weekly updates to the short-term consolidated liquidity plan of the Mercator Group. The risk is also managed by use of standardized daily reporting systems for reports on actual cash flow in the previous day. Any discrepancy between the actual cash flow and the plan is analyzed. Coordination at different level of decision-making is centralized, meaning that every company always has the appropriate amount of cash available. Effective working capital management is also of great importance in this respect. It involves monthly monitoring of inventory, receivables, and trade payables management at individual companies.

Operational risks

Operational risks affect the ability to conduct business processes, and the cost efficiency of Mercator Group operations. Following is a list of the measures taken to alleviate these risks in the period 1-6 2014.

Operational risks in category management and procurement

Increase of tradable commodity prices

Our purchasing and sourcing activities involve close monitoring of the prices of raw materials, on which the prices of our products are heavily dependent. Conditions in the upstream milk and dairy product market in Western Europe were stabilized in the first half of 2014. Further fluctuations are expected in the autumn as a result of preparations for the abolition of the dairy quotas for the European Union in 2015. Therefore, we are closely monitoring the changes in prices for the categories of milk and dairy products, as well as the prices of products with higher milk content.

Price fluctuations are also present in the purchase of fresh fruit and vegetables due to the changes in the quality of produce and yield. Stable prices are guaranteed with long-term supply agreements.

Seasonal effect

Changes in weather, temperature, natural disasters (storms, floods) have an increasing impact on the supply and sale process for all seasonal categories.



Persistence of the harsh economic situation and increased unemployment are reflected in the drop of consumer purchasing power in the segment of non-alimentary seasonal products. Our offer of seasonal products is therefore adjusted to lower demand as we diligently monitor sales and inventory of seasonal products and take required measures in a timely fashion.

Particular attention is paid to preparations for forward purchase of canned vegetables and preserves, both for branded and private label products, especially from regions hit by disastrous flooding.

The results of harsh winter in Canada and interruptions in supply of dry common beans to Europe were still felt in the second quarter of the year, resulting in an upward pressure on bean prices and on the prices of products containing a substantial share of beans.

Delivery failures

Supply failures are supervised on a daily, weekly, and monthly basis and corrective measures are adopted promptly to reduce such occurrences. New process of delivery failure monitoring, established in early 2014, allows faster adoption of suitable corrective measures.

Core activity operational risks

Failure of the refrigeration system and electrical wiring.

At Mercator, d.d., periodical tests of pressurized equipment and control of safety valves were carried out at the Zalog and Bohova sites. It is evident from the report of the certified body for periodical reviews that the suitability of pressure vessels shall be extended until the next periodic check in 2015; thus, no additional measures are currently required.

Risks resulting from damage to facilities.

Consistently with the maintenance plan, the following mandatory preventive tests were carried out at Mercator - Emba, d.o.o., in the first half of 2014:

- annual review of active fire protection (sprinkler system);
- periodic review of fire detection and alarm system. Any deficiencies found were completely remedied;

- preventive check of safety valves in the boiler room;
- periodic check of fire extinguishers and wall hydrants.

All required reports on flawless operation were obtained.

IT risks

Failure of central IT systems (SAP, GOLD, Login, e-mail etc.) and failure of business IT system terminals (personal computers, laptops).

An initiative was launched within the company Mercator, d.d., to improve the efficiency of management of the changes to the central IT systems. The initiative was sparked by opportunities identified in the field of IT and organization. Improvements will be implemented in several stages. Currently, requests for business application development in the field of material operations are being optimized, and major consolidation of requirements is being prepared in other key fields, along with improvements in their efficiency.

Initiative for optimization of incident resolution has been set up for incidents occurring at the point of sale (at check-out or on the cash register). User support department took over the first level of resolution of computer incidents from the key third-party service provider, thus establishing internal central records of incidents that were previously submitted to this service provider. Incidents on the cash registers are regularly analyzed, which should improve our understanding of and elimination of recurring computer errors. Moreover, an initiative has been established for review of the IT and telecommunications executive department processes that support the stocktaking at retail units in order to identify the weaknesses and to develop the measures for their elimination.

Activities to set up the data center building blocks under the auspices of the IT equipment operation control systems (monitoring) were carried on. The system allows early and automated identification of system errors or failures before they actually affect the operation of an IT service. When an error occurs, the system allows simpler and faster identification of the error source. Control of IT equipment reduces the operational risks as it improves the availability of the IT systems and services.

A study for the project of further implementation of IT Service Management (ITSM) principles has



been prepared. The project will include optimization of processes of IT resource, change and problem management.

New air conditioning equipment was installed in key system areas (data centers) located on Mercator, d.d., premises. The new equipment provides normal climate conditions for flawless operation of servers.

The project of replacing the main server infrastructure was launched. It includes replacement and upgrade of hardware. Key business applications like SAP, GOLD, and PSBP data warehouse will be migrated to the new infrastructure. Infrastructure upgrade will have a positive effect on the IT operational risks as it will continue to provide reliable operation of key business applications.

Environmental risks

Inefficient use of electric energy and heating fuel.

The following measures were carried out at the company Mercator, d.d., in the first half of 2014 for efficient use of energy and to improve the cost efficiency and optimize our business activities.

- Report on environmental aspects (energy sources) is prepared for the Mercator Group each month;
- By the end of May, all 51 facilities were connected within the Retail Care project, of which 50 facilities were optimized. Optimization has resulted in a decrease of power consumption for refrigeration equipment by just under 13%, which translates into savings of over 715 thousand kWh, or over EUR 66 thousand.
- Annex was signed on the installation of additional 16 combined heat and power units in 2014. By the end of June, 11 such units were installed.
- The pilot project for energy management is in progress in cooperation with the companies Enekon, d.o.o., SolveraLynx, d.d., and Maked Energea, d.o.o., which have conducted an energy audit and proposed measures to cut power consumption. The organizational measures proposed are being implemented.
- Offers were obtained for the replacement of lighting in internal and external corporate visual identity objects on 17 units.

Food safety risks

Monitoring

At the company Mercator - H, d.o.o., we terminated our cooperation with some fresh meat suppliers. Documentation on compliance and quality of meat is required from the new suppliers. Control at butcher's departments upon acceptance of meat has been intensified. Assortment is being revised and particular rotisseries are being eliminated. Conditions have been improved at the company Mercator - S, d.o.o., relative to the same period of last year. Specialist visits are organized for individual units, and additional training on good hygiene and manufacturing practices is held. Internal control is conducting intensified hygiene inspections. At Mercator - CG, d.o.o., results were improved relative to the year before, as the share of non-compliance is considerably lower. The level of personal hygiene has improved; records of cleaning, disinfection, disinfestation, and pest control are kept rigorously.

Product labelling

At Mercator - H, d.o.o., compliance of labelling is rigorously controlled upon acceptance. Improvement has been observed. At Mercator - CG, d.o.o., intensified control has been introduced at acceptance and products with non-compliant labelling are rejected.

Shelf life

There are no major improvements with regard to shelf life at Mercator - H, d.o.o. In case of discrepancies, additional training and disciplinary measures are introduced for the responsible persons. At Mercator - S, d.o.o., and Mercator - CG, d.o.o., training is held on technological procedure of shelf life control. The situation regarding the expired shelf life is improving. Internal control is strictly controlling the shelf life of products.

Store hygiene

At Mercator - BH, d.o.o., employees working at fresh program departments are trained in this respect, and the "Crash Course on Quality" training is held for all regional leaders and store managers. Regular and extraordinary internal controls are conducted. In the first half of 2014, the share of non-compliant microbiological analyses dropped by a quarter.



FINANCIAL MANAGEMENT

Net financial debt

Compared to the end of 2013, Mercator Group's finance liabilities remained at roughly the same level in the first half of 2014. The Group's net financial debt also remained unchanged, amounting to EUR 986,045 thousand as at June 30, 2014, which

is 0.9 percent more than as at the end of December 31, 2013. Maturity profile has changed as the share of non-current financial liabilities has increased and the share of current financial liabilities has decreased.

in EUR thousand	June 30, 2014	Dec. 31, 2013	Index June 30, 2014/ Dec. 31, 2013
Non-current financial liabilities	991,932	351,583	282.1
Current financial liabilities	54,539	686,225	7.9
Derivative financial instruments (liabilities)	35	1,469	2.4
Financial liabilities including derivative financial instruments	1,046,506	1,039,276	100.7
Cash and cash equivalents	18,168	18,505	98.2
Derivative financial instruments (assets)	1	16	8.0
Available-for-sale financial assets	807	820	98.4
Loans and deposits	41,485	42,609	97.4
Financial assets	60,461	61,950	97.6
NET FINANCIAL DEBT	986,045	977,326	100.9

Financing costs

In the period 1-6 2014, the 6-month EURIBOR averaged at 0.395%. At the end of the period, it was at 0.303%. Relative to the beginning of the period when the 6-month EURIBOR stood at 0.387%, this is a 6.51% decrease. Compared to the equivalent period of the year before when the 6-month EURIBOR averaged at 0.330%, this rate rose by 19.75 percentage point.

Debt to equity and financial liability ratio

As at June 30, 2014, Mercator Group attained a debt-to-equity (capital structure) ratio of 1:1.97. The ratio is a quotient between equity which includes share capital as reported in financial statements, and net financial debt.

In the period 1-6 2014, Mercator Group succeeded in improving the composition of financial liabilities by maturity (maturity profile) by completing its financial restructuring. The share of long-term financial liabilities as at June 30, 2014, amounted to 94.8% (33.9% as at December 31, 2013).

As at June 30, 2014, the ratio between variable and fixed or hedged financial liabilities at the Mercator Group amounted to 46.6% vs. 53.4%.

Financial restructuring

On June 9, 2014 Mercator Group signed with all creditor banks and lessors comprehensive contract documentation on the Mercator Group financial restructuring. The last suspensive conditions for the effectiveness thereof were met as of June 17, 2014. Financial restructuring of debt and financial lease follows the repayment plan, extended until March 2020. In addition to other aspects, the financial restructuring aligned repayments with the Group's expected cash flow, improved liquidity, and secured a higher rate of investment into Mercator Group activities. Previously, the capital structure mostly involved bilateral credit lines. Working with its creditors, Mercator took a big step towards a consolidated set of financing conditions and a basis for joint decision-making, with a consolidated set of documentation pursuant to the best international practice.



On June 24, 2014, following the initiative of the company Agrokor, d.d., an agreement was signed on the consent to the changes and amendments of the financial documentation on the financial restructuring of the Mercator Group, dated June 9, 2014. The Agreement lays down the commercial terms for Mercator Group's financial restructuring in case of a takeover by the company Agrokor, d.d. The agreement was made effective subject to a number of conditions, including that the company Agrokor, d.d., approve and transfer to the company Poslovni sistem Mercator, d.d., a subordinated loan of EUR 200 million, which shall be used for early repayment of a part of Mercator Group's loans to the creditor banks. The company

Agrokor, d.d., transferred such subordinated loan on June 27, 2014, simultaneously with the acquisition of the majority block of shares of the company Poslovni sistem Mercator, d.d. Furthermore, Agrokor, d.d., committed to vote, after the takeover procedure, in favour of the conversion of the said subordinated loan to Mercator equity, which will notably decrease the overall debt of the company Poslovni sistem Mercator, d.d.

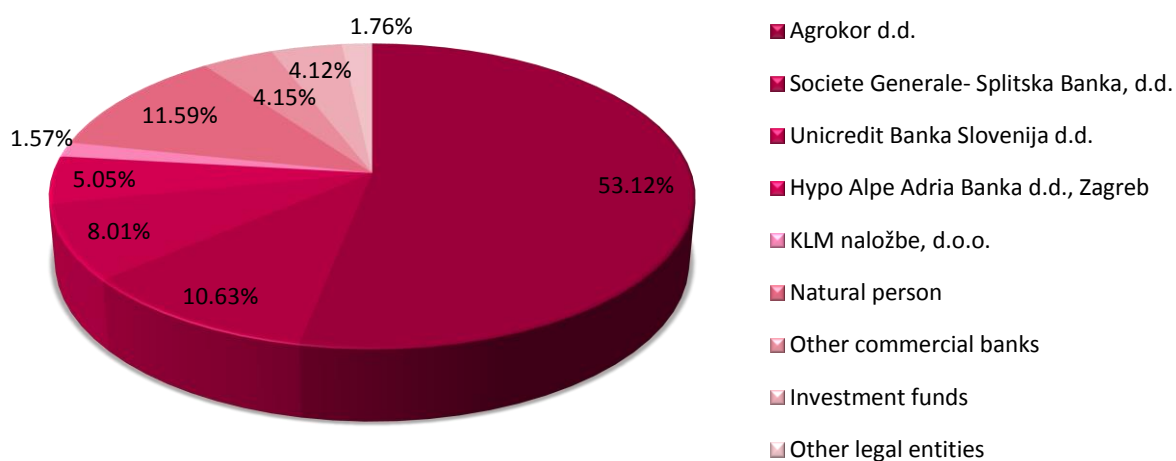


MERCATOR SHARE AND INVESTOR RELATIONS

Basic information on the share of the company Poslovni sistem Mercator, d.d., as at June 30, 2014:

Symbol	MELR
Type	Ordinary share
Listing	Prime market of Ljubljana Stock Exchange, d.d.
Share capital	EUR 157,128,514.53
Number of shares	3,765,361
Number of treasury shares	42,192
Number of shareholders	12,176

Ownership structure of the company Poslovni sistem Mercator, d.d., as at June 30, 2014:



Major Shareholders

As at June 30, 2014, the following ten largest shareholders combined owned **82.19 percent** of the company.

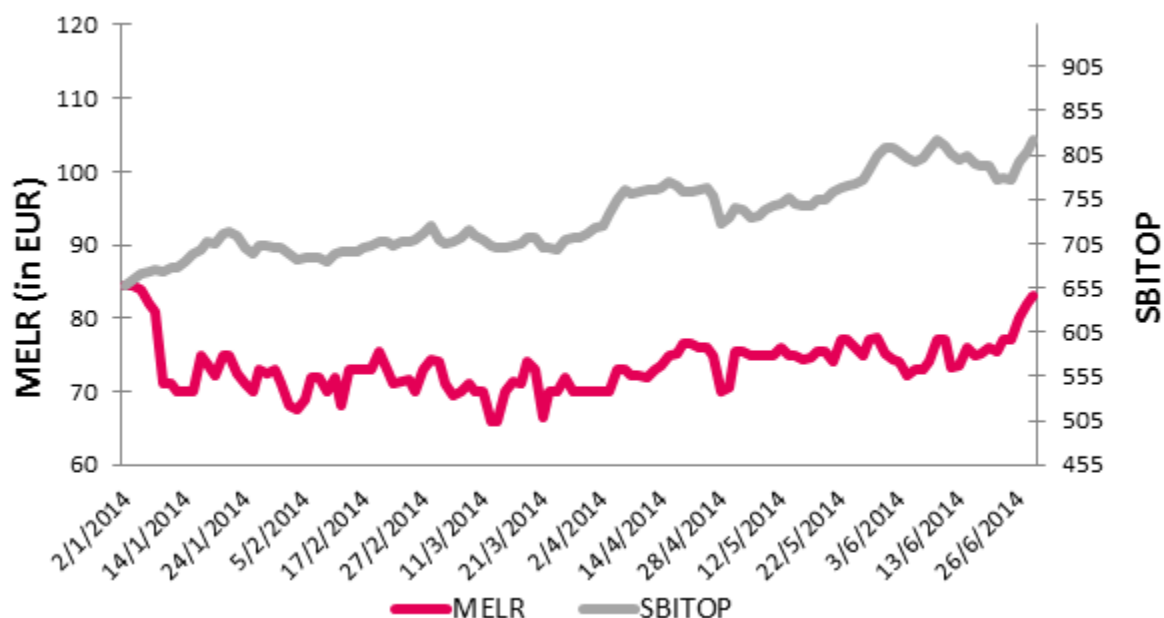
Major shareholders	Country	Number of shares	Share
1 Agrokori d.d.	Croatia	2,000,278	53.12%
2 Societe Generale - Splitska Banka d.d.	Croatia	400,302	10.63%
3 UniCredit Banka Slovenija, d.d.	Slovenia	301,437	8.01%
4 Hypo Alpe-Adria-Bank d.d.	Croatia	190,161	5.05%
5 KLM naložbe d.o.o.	Slovenia	59,190	1.57%
6 Poslovni sistem Mercator, d.d.	Slovenia	42,192	1.12%
7 Erste Group Bank AG	Austria	32,808	0.87%
8 The Bank of New York Mellon	USA	26,428	0.70%
9 Galić Josip	Croatia	21,525	0.57%
10 Privredna Banka Zagreb d.d.	Croatia	20,404	0.54%
Total		3,094,725	82.19%

Foreign shareholders

As at June 30, 2014, the share in the company Poslovni sistem Mercator, d.d., held by foreign investors amounted to **76.35 percent**, which is three times more than at the end of the second quarter of 2013.

**Shares held by Management and Supervisory Board Members as at June 30, 2014**

	First and last name	Position	Number of shares	Share
Management Board				
1	Toni Balažič	Management Board President	0	0.0000%
2	Stanka Pejanović	Senior Vice President	0	0.0000%
3	Drago Kavšek	Senior Vice President	0	0.0000%
4	Igor Maroša	Senior Vice President	0	0.0000%
Total			0	0.0000%
Supervisory Board				
1	Matej Lahovnik	Supervisory Board Chairman	0	0.0000%
2	Rok Rozman	Deputy Supervisory Board Chairman	0	0.0000%
3	Boris Galič	Supervisory Board member	0	0.0000%
4	Zdenko Podlesnik	Supervisory Board member	0	0.0000%
5	Marjeta Zevnik	Supervisory Board member	0	0.0000%
6	Vesna Stojanović	Supervisory Board member	36	0.0010%
7	Veljko Tatić	Supervisory Board member	0	0.0000%
8	Ivan Valand	Supervisory Board member	0	0.0000%
Total			36	0.0010%

Movement of closing price per MELR share in the period 1-6 2014, compared to the movement of the SBITOP index

**Key information for the shareholders**

	June 30, 2014	June 30, 2013	Index June 30, 2014/ June 30, 2013
Number of shares registered in Court Register	3,765,361	3,765,361	100.0
Number of treasury shares	42,192	42,192	100.0
Market capitalization (in EUR)	312,524,963	425,862,329	73.4
Market value of share (in EUR)	83.00	113.10	73.4
Book value per share (in EUR)	154.06	200.29	76.9
Minimum close rate in the period (in EUR)	66.01	113.00	58.4
Maximum close rate in the period (in EUR)	84.50	140.05	60.3
Average close rate in the period (in EUR)	73.51	122.98	59.8

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

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

Dividend policy

In the year 2013, the company Mercator, d.d., realized a net loss, therefore, the payment of dividends is not planned.

Treasury shares

As at June 30, 2014 the company Poslovni sistem Mercator, d.d., held 42,192 treasury shares. In the period 1-6 2014, the company Poslovni sistem Mercator, d. d., neither acquired nor disposed of treasury shares.



SUSTAINABILITY REPORT



In all five markets of Mercator's presence, our effect on all stakeholders with whom we are directly or indirectly involved is significant. The key stakeholders we devote the most attention to are our customers, as well as our employees, suppliers, and all other stakeholders, including the broad society and nature. We are increasingly aware of the co-dependence and connections in the environments in which we operate, both locally and on a broader scale, regionally and globally.

In a highly competitive market, the key is to offer our customers a reason to continue to trust us. We

therefore continue to strive to provide the best offer of quality locally sourced products.

In the first half of 2014, we were highly active in terms of sponsorships, donations, and other types of aid to our broad society. By organizing numerous socially responsible projects, we are looking to show our understanding and offer aid to those in need, especially now, in a time of negative effects of the economic crisis.

RESPONSIBILITY TO CUSTOMERS

Care for food safety

The key medium-term goals in responsibility to customers are to provide efficient internal control over each unit and control of quality and safety of the Mercator private label and other sales assortment.

In the first half of 2014, we carried out 204 regular and 13 extraordinary controls at our stores. In order to offer safe and quality products to our consumers, we analyzed 307 specimens or samples from our private label line, conducted monitoring on 551 samples in our open departments, and carried out 79 other analyses (government control, in-house production, own imports etc.).

Introduction of new standards and environmentally friendly technologies

We continued our activities of introducing technologically more efficient refrigeration, either by replacing the store's entire refrigeration equipment or by comprehensively refurbishing the entire store. Thus, the number of stores with closed refrigeration chests and cabinets rose to 55. From the first introductions of this technology to date, we have saved over EUR 750 thousand on power consumption on refrigeration.

We added shopping carts made of recycled materials at newly built and opened hypermarkets, as well as more efficient refrigeration equipment and lighting, which led to a reduction in power consumption relative to other comparable facilities by 2%.



Marketing activities related to the offer of environmentally friendly products and services

The "Locally Grown" project has included further agreements on larger purchasing volumes for Slovenian fruit and vegetables with new suppliers. Working with the growers, we are working on increasing the rate of Slovenian self-sufficiency and development of new products. Responding to consumer expectations, new Slovenian products are increasingly added. The project is contributing to preservation of the environment, and it allows small growers to reach our aisles and shelves more quickly. Our cooperation with them is strengthened and expanded each year.

The project places great emphasis on the following:

- broad and varied offer of 100% Slovenian fruit and vegetables;
- offer of different types of bread with traditional regional characteristics; as of September 2013, all wheat used at the Grosuplje Bakery is of 100% Slovenian origin;
- highlighting the communication and our competitive advantage in the category of fresh meat; all meat included in the regular offer of our butcher's departments is 100% grown in Slovenia;
- highlighting and communicating the broad choice of milk and dairy products made of 100% Slovenian milk.

RESPONSIBILITY TO EMPLOYEES

In the first half of 2014, human resource management was focused on the processes of restructuring and reorganization aimed at the implementation of more efficient work processes, shrinking the scope of administration work, and cutting of labour costs. As of January 1, 2014 the employees of the company Modiana, d.o.o., were transferred to the parent company; as of May 4, 2014, catering units, complete with employees, were transferred to third-party acquirers. As of March 31, 2014 we closed down the technical consumer goods units (Mercator Tehnika) in Croatia; a part of the employees were transferred to the units of fast-moving consumer goods program within the company Mercator - H, d.o.o., while a part were made redundant.

At Mercator IP, d.o.o., a number of changes have taken place within the last three years regarding the activity and process organization. On February 1, 2014 we carried out a minor reorganization that brought the organizational structure of the company into line with the new situation. On June 30, 2014 the company had 211 employees with a certified category of disability, representing 51.2% of all employees.

New systematization and workplace evaluation were adopted, as well as the amended method of basic salary calculation that involves a variable part of the salary also for administrative jobs and

positions at the companies Mercator - BL, d.o.o. (as of February 1, 2014); Mercator - CG, d.o.o. (as of April 1, 2014); Mercator - S, d.o.o. (as of May 1, 2014); and Mercator - BH, d.o.o. (as of June 1, 2014).

Working with the trade union organization PPDIVUT (*Independent Trade Union of Employees in Agriculture, Food and Tobacco Industry, Water Management, HoReCa, and Trade of Bosnia and Herzegovina*), the company Mercator - BH, d.o.o., adopted on June 1, 2014 an annex to the company collective labour agreement, and received commendation and statement of appreciation from the Independent trade union PPDIVUT Sarajevo as a social partner that contributes notably to the development of industrial democracy.

The company Mercator - CG, d.o.o., was involved in the project of subsidized employment of the young in seasonal activities in the period from June 1, 2014 to September 30, 2014. Seasonal employment is also in progress at Mercator - H, d.o.o., in the regions of Istria, Kvarner, and Dalmatia.

Company reputation as an employer is promoted in the broad public with attendance at various events and by establishing links with a number of third-party stakeholders.



Number of employees

	Number of employees as at June 30, 2014	Number of employees as at December 31, 2013	Number of employees index June 30, 2014/Dec 31, 2013	Number of employees based on hours worked in the period 1-6 2014
Slovenia	11,407	11,521	99.0	10,675
Serbia	4,781	4,754	100.6	4,525
Croatia	3,221	3,381	95.3	2,912
Bosnia and Herzegovina	1,998	2,009	99.5	1,879
Montenegro	1,253	1,244	100.7	1,102
Bulgaria	3	11	27.3	2
Albania	0	2	0.0	2
TOTAL	22,663	22,922	98.9	21,098

Caring for development, motivating, and connecting our employees

In the period at hand, Mercator Group held 103,864 hours of training and education that involved 24,908 employees.

At the traditional 14th meeting of internal instructors of Mercator, d.d., taking place on May 14, 2014 at the Ljubljana Exhibition and Convention Center, the importance of knowledge, cooperation, and good mutual communication was emphasized.



In all markets, we are pursuing further the project to improve the selling skills, and we have established a *coaching* system with the participation of our internal coaches/trainers.

A team of 7 professional instructors was appointed at the parent company, to be in charge of improvement in expertise and selling skills at the retail units. We founded the Leadership Competency Center focused on the development of two programs: **Leadership training** for top

management and **store manager succession program** in retail.

At the parent company, education was held for 3,200 retail employees as a part of the project Lowest Price Guaranteed. Education was repeated for 169 groups. An adjusted version of the selling skills workshop was held for two groups of participants from the M holidays units. A moderated meeting was held for the representatives of all M holidays offices and the M holidays management, to develop jointly the proposals for improvement of services and cooperation. Illustrated manuals were developed for the training participants.



In Slovenia, we continued the successful practice of *team building* sessions on Vogel. Following the successful completion of the Lowest Price Guaranteed campaign, we held a *team building* session on Fruška Gora of 40 key employees from business functions, with creative workshops dealing with the topic of quality of service.

In order to improve the cooperation between particular business fields, the project of **internal supplier assessment** was carried out at the parent company. Thus, the business fields sought to



identify the opportunities for improvement of joint work processes and mutual communication. As many as 305 proposals were provided for improvement of work between individual fields. At Mercator - S, d.o.o., we conducted a survey among the employees in administration. Based on results, we shall identify the opportunities to improve the efficiency of our work, to improve mutual communication, and to improve leader competencies.

At Mercator - BH, d.o.o., we started to regularly visit our retail units that are underperforming in terms of business results and internal control reports. The unit is visited by a representative of the retail management, joined by employees of the employee talent development department. Their shared goal is the monitoring of teams at the unit and aid in resolution of any problems.

The company Mercator - BH, d.o.o., completed the "Quality Management Crash Course" which involves shop managers from the FMCG program and employees of the internal control. Moreover, the 3rd Trainer School and two-day training for internal auditors of the ISO 9001:2008 quality management system were completed.



Employees from Intersport ISI, d. o. o., and Mercator - Emba, d.d., retail were trained as a part of the project *Permanent Career Orientation for Employers and Employees*, co-financed by the Public Fund of the Republic of Slovenia for Development of Human Resources and Scholarships.

At the parent company, monthly evaluation of administration workers started in May. We held annual interviews with "top 100" managers. At the companies Mercator - S, d.o.o., and Mercator - CG, d.o.o., interviews were held with all key employees.

At Intersport ISI, d. o. o., five top employees in retail and the best employee in logistics are rewarded each month. Six best sales shop

assistants were also rewarded at the company Mercator - CG, d.o.o.

In the second quarter, the quarterly awards to the best shop assistants and to three stores with the biggest improvement of business results were presented for the first time at the company Mercator - S, d.o.o.



Intranet was introduced at Mercator - S, d.o.o.

At the parent company, 900 employees took part in the healthcare campaign Measurement of Arterial Circulatory System. We prepared an e-seminar Gluten-Free Life and published numerous articles dealing with healthcare and health promotion (My M, intranet). Ergonomic team worked with the Academy of Fine Arts and Design to conduct an ergonomic analysis of the job cashier.

As at June 30, 2014, Mercator Society of Sports and Culture had 275 members.

As a part of the Family-Friendly Company project, particular attention is paid to newborn babies of our employees who are presented a Lumpi package. In the first half of 2014, 111 such packages were distributed.

Employees in Slovenia who were affected by the ice storm or floods were allowed any extra day of paid leave.

In Serbia, the Mercator Solidarity Foundation provided aid in the amount of EUR 8,950 to 30 employees. Moreover, financial aid was raised for the employees who sustained damage due to flooding. In Montenegro, the Solidarity Foundation that includes 590 members helped 13 employees by providing aid in the total value of EUR 3,400. In Slovenia, Mercator Humanitarian Foundation provided aid to 58 employees of Mercator, d.d., and Mercator IP, d.o.o., who were in need of help. We have paid out humanitarian aid in the total amount of EUR 34,001. We also granted two social scholarships for children of our employees, in the total amount of EUR 1,200.



At Mercator - BH, d.o.o., Employee Solidarity Fund was established in May, following the example of Serbia and Montenegro. At Mercator - BL, d.o.o., such activities are in progress.



RESPONSIBILITY TO NATURAL ENVIRONMENT

Reducing power consumption and heating fuel

Efficient use of energy is a result of effort by all Mercator employees. Hence, all employees were notified via the intranet portal about the changes to the temperature settings and on the compliance with the instructions provided in the manual on efficient use of energy.

Report on environmental aspects (energy sources) is development each month for the Mercator Group, as well as analyses by particular units, based on which particular discrepancies are analyzed and further measures are specified.

By the end of May 2014, all 51 facilities were connected within the Retail Care project, of which 50 facilities were optimized. Optimization has resulted in a decrease of power consumption for refrigeration equipment by 12.8%, which translates into savings of just over 715 thousand kWh, or over EUR 66 thousand.

In the first half of 2014, we signed an annex on the installation of 16 additional combined heat and power (co-generation) units in the course of 2014. Twelve units were installed by the end of June, which will result in total annual power savings of over EUR 165 thousand.

Pilot energy management project is in progress in cooperation with three partners: Enekon, d.o.o., SolveraLynx, d.d., and Maked Energea, d.o.o. The partners conducted an energy audit and proposed measures to cut power consumption; the measures are already being implemented.

Cutting the use of natural resources and waste generation

Compared to the first quarter of 2014, the amount of waste packaging was reduced by 46% through optimization of waste transport. This has resulted in a **decrease of emissions into air and waste packaging processing costs in the amount of EUR 40 thousand per year.**

In order to attain the medium-term plan of reducing the amount of mixed waste by 10%, we optimized the volume of waste bins at 49 units and thereby **cut the mixed municipal waste handling costs by EUR 61 thousand per year.**

We successfully completed the external audit of our environmental management system according to the ISO 14001 standard. Mercator, d.d., is currently the only trade company in Slovenia, engaging in wholesale or retail of fast-moving consumer goods, to be awarded the ISO 14001 certificate.



RESPONSIBILITY TO SOCIAL ENVIRONMENT

Donations and sponsorships

In 2014, Mercator Group continues to pursue the tradition of response to the needs of local environments in which we operate, in keeping with our slogan of the best neighbour. In the first half of 2014, we supported **over 900 different humanitarian, cultural, educational, and sports projects**. Considering the current harsh social and economic situation in the country, our funds are primarily allocated to humanitarian projects.

Donating food surpluses for hot meals

In 2013, we were the first Slovenian retailer to join the initiative by the Ministry of Agriculture and the Environment and donated food surpluses to those in need in Celje, Maribor, and Trbovlje. Our project is pursued further and extended in 2014. Thus, volunteers of the Lions Clubs from Celje, Maribor, Trbovlje, Velenje, Koper, Domžale, Brnik, and Slovenj Gradec, and the Cenacolo Community collect food for those in need of aid every evening from 16 stores across Slovenia.



A true neighbour will help in time of need

Mercator immediately responded to the ice storm that hit most of Slovenia in early February by donations and emergency deliveries. Moreover, we immediately responded to the emergency in Serbia, Bosnia and Herzegovina, and Croatia by providing donations in the total amount of over EUR 60 thousand. In most of our stores, we worked with humanitarian organizations which are usually our choice in such activities, to install baskets to collect food and clothing. Food and clothing were also collected among administrative workers at Mercator at the Mercator, d.d., office building.



We like to do good deeds

In April 2014, a pan-Slovenian donation activity "We Like to do Good Deeds" took place at 100 minor Mercator stores. Three hundred local societies and organizations from around Slovenia competed for a donation of a total of EUR 100 thousand. The winners were chosen in cooperation with our customers. After each check-out, the customers voted for their favourite organization to be awarded a donation of EUR 1,000 for a project of local importance. Over 1.1 million votes were cast in the course of the campaign. We are particularly glad to see strong bonds established between Mercator and individual local communities in the weeks of intensive cooperation. Customers, as well as organizations, societies, institutes etc., unanimously praised the activity in which we again proved ourselves as a neighbour who is attentive to the needs, wishes, and initiatives of loyal customers from the local environment in which we operate.

At the final event of the project We Like to do Good Deeds, we donated 300 packages of food and other essential products to the Red Cross of Slovenia.





A good deed feels food

Working with Radio Ognjišče, we collect on the 20th day of each month in 2014 at one of our stores goods for eight families in social distress. In addition to several carts of collected goods, we also provide each family with a Mercator gift card. Thus, our customers contributed 49 carts worth of goods in the first six months – or six days.



Humanitarian activities

In addition to aid to numerous societies and individuals, our humanitarian activities also included donations to the Friends of the Youth Association Moste Polje for families in social distress, the Palčica (Tinker Bell) Safe house in Grosuplje, and the Safe House in Pilštanj. We donated 5 tons of fruit and vegetables to homes for juvenile orphans in Croatia.

Sports

In the field of sports, we sponsored the finals of the ski jumping world cup finals Planica 2014. We also pride on long-standing sponsorship cooperation with the Slovenian Olympic Committee, the Slovenian Ski Association, team handball club Krim Mercator, football club Maribor, Basketball Club Maribor, wheelchair basketball team of the Ljubljana Region Society of Paraplegics, wheelchair table tennis player Mateja Pintar, stand-up paddle surfer Manca Notar, and whitewater kayaker Nejc Žnidaršič. This year, we again supported the hike along the Wire of occupied Ljubljana, and the international bicycle race "Dirka po Sloveniji" (Tour of Slovenia).



Culture

In the first half of 2014, we sponsored the "kurentovanje" carnival in Ptuj and the Golden Subscription of the Cankarjev dom cultural center.

Education

In the first half of 2014, we supported as a general sponsor the national competition in sales techniques which took place at the High School of Trade and Commerce in Maribor, and the competitions in logic, chemistry, IT, and biology, organized by the Association of Technical Culture of Slovenia. Under the auspices of the World Slovenian Congress, we supported the project of including the Slovenian scientists from top universities in the world into the domestic environment, in order to promote the transfer of knowledge to the benefit of Slovenia.





RESPONSIBILITY TO SUPPLIERS

Inclusion of suppliers into expansion of Slovenian and local offer for our customers

At Mercator, we work with domestic suppliers to offer our customers as much locally grown produce as possible. We are working with more than 100 local suppliers of fruit and vegetables, with all major cooperatives, and with small growers. The amounts purchased from all of the above are increasing.

100% Slovenian fruit and vegetables

After a mild winter, Slovenian season of vegetables and fruit started somewhat earlier. By March this year, we offered exclusively Slovenian cabbage in our stores; for a long period of time, we also offered Slovenian potatoes. Working with suppliers from the Slovenian coastal region, we held a promotion of Slovenian kale in March. In May, we worked with Slovenian growers to carry out a sales promotion campaign with Slovenian summercrisp lettuce. Pursuant to the planned purchase amounts, we offered an abundance of Slovenian strawberries at reasonable prices.

Flyers distributed to our customers include the section **Iz domačih krajev ("From the Home Country")** which regularly presents Slovenian growers and their produce. As a part of the campaign "The Tastes of Gorenjska" we presented the vegetable farm Burger and the sauerkraut producer with an own brand Jerin, from Voklo. The "Tastes of Primorska" campaign included presentation of the specific character of the Slovenian Istria. We were the first in Slovenia to offer black truffles to our consumers. We presented each individual grower to the customers. Selected growers were also presented at Mercator marketplaces by photos. The buyers can obtain all information on these growers using

their mobile devices by scanning the QR codes on the labels for each grower.

Increasing number of growers also offer organic produce. Thus, the customers are offered an increasingly broad range of Slovenian organic products, mostly in cooperation with the Agricultural Cooperative Agraria from Koper, but also other individual growers. Working with the Agraria Cooperative, we were the first to offer cherry tomatoes raised in seaside greenhouses of the seedling center Purissima.

Locally grown fresh meat

In the first half of 2014, we carried on our continuous sourcing of fresh pork, beef, veal, and poultry raised in Slovenia from our top ten Slovenian suppliers. By including the meat grown in Slovenia in to our regular offer, we are ensuring traceability and better quality of meat from the aspect of attainment of healthcare/medical standards and increasing the share of self-sufficiency.

100% Slovenian milk

Slovenian milk is comparable to the milk from the European countries renowned for quality milk. Shorter routes from farms to dairy plants allow the milk to stay fresher and less damaged or modified. By offering our consumers milk and dairy products made of 100-percent Slovenian milk, we are offering what they recognize as safe products of high quality. Thus, we are carrying on our efforts to promote the production and consumption of locally produced food. Twelve Slovenian suppliers of milk and dairy products, joined by the largest Slovenian dairy company, have committed to deliver selected milk and dairy products made of 100-percent Slovenian milk.





OUR RESPONSIBILITY AND CARE FOR QUALITY

Maintenance, implementation, and certification of international quality management systems

Efficient management of business processes is provided through compliance with the requirements of the international quality management systems. There are **12** certified management systems maintained by the Mercator Group.

Four external audits were completed in the period 1-6 2014: SQMS - Supplier Quality Management System at Mercator - Emba, d.d.; ISO 9001 and ISO 14001 at Mercator, d.d.; and ISO 9001 at Mercator - H, d.o.o.

Documentation management

Internal rules of operations and documented good practices of the Mercator Group are maintained in the Mercator Standards collection which is easily available to all employees via intranet. As at June

30, 2014 Mercator Standards Collection included **2,948 documents**. In the period 1-6 2014, we published **240** new or revised documents; **194** documents were archived.

Continuous improvement system

The continuous improvement system was supported by a new application for the management of non-compliance, recommendations and commendations (praises), and corrective and preventive measures. The application is intended for all Mercator Group companies. Thus, all records are kept in a single place, which allows for efficient process management.

In the period 1-6 2014, **657** measures were processed by the application, of which **238** were resolved. 92% of proposing entities were happy with the solutions for the measure; **75%** of all measures were resolved by the deadline.



FINANCIAL REPORT

ACCOUNTING POLICIES

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d. d., for the period 1-6 2014 have been prepared in compliance with 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 1-6 2014 include the company Mercator, d.d., and its subsidiaries, as follows:

- in Slovenia: Intersport ISI, d.o.o., Modiana, d.o.o., Mercator - Emba, d.d., Mercator IP, d.o.o., M - nepremičnine, 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, M - BL,

d.o.o., Bosnia and Herzegovina, Mercator - CG, d.o.o., Montenegro, Mercator Makedonia, d.o.o.e.l., Macedonia, Investment Internacional, d.o.o.e.l., Macedonia, and Mercator - B, e.o.o.d., Bulgaria;

(hereinafter 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	June 30, 2014	Dec.31, 2013	Index June 30, 2014/ Dec. 31, 2013
ASSETS			
Non-current assets			
Property, plant and equipment	1,675,985	1,704,182	98.3
Investment property	2,574	2,791	92.2
Intangible assets	17,348	17,407	99.7
Deferred tax assets	16,873	17,530	96.3
Loans and deposits	31,352	32,284	97.1
Available-for-sale financial assets	807	820	98.4
	1,744,939	1,775,014	98.3
Current assets			
Inventories	239,728	264,798	90.5
Trade and other receivables	253,448	234,927	107.9
Current tax assets	312	256	121.9
Loans and deposits	10,133	10,325	98.1
Derivative financial instruments	1	16	6.3
Cash and cash equivalents	18,168	18,505	98.2
	521,790	528,827	98.7
Total assets	2,266,729	2,303,841	98.4
EQUITY			
Share capital	157,129	157,129	100.0
Share premium	198,872	198,872	100.0
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	146,656	146,656	100.0
Fair value reserve	141,424	140,587	100.6
Retained loss	(44,700)	(63,887)	70.0
Profit (loss) for the period	(13,696)	18,695	-
Currency translation reserve	(81,889)	(80,623)	101.6
Total equity attributable to equity owners of the Company	500,561	514,194	97.3
Non-controlling interests	90	100	90.0
Total equity	500,651	514,294	97.3
LIABILITIES			
Non-current liabilities			
Trade and other payables	1,031	850	121.3
Financial liabilities	991,932	351,583	282.1
Deferred tax liabilities	37,384	37,455	99.8
Provisions	21,847	25,047	87.2
	1,052,194	414,935	253.6
Current liabilities			
Trade and other payables	658,737	686,507	96.0
Current tax liabilities	573	411	139.4
Financial liabilities	54,539	686,225	7.9
Derivative financial instruments	35	1,469	2.4
	713,884	1,374,612	51.9
Total liabilities	1,766,078	1,789,547	98.7
Total equity and liabilities	2,266,729	2,303,841	98.4

**Condensed consolidated income statement**

EUR thousand	1-6 2014	Plan 2014	1-6 2013	Index 1-6 2014/ 1-6 2013	Index 1-6 2014/ Plan 2014
Revenue	1,299,927	2,672,342	1,356,426	95.8	48.6
Cost of goods sold and selling costs	(1,263,615)	(2,554,993)	(1,308,405)	96.6	49.5
Administrative expenses	(36,376)	(93,875)	(47,294)	76.9	38.7
Other income	11,895	11,410	10,619	112.0	104.3
Results from operating activities	11,831	34,884	11,346	104.3	33.9
Finance income	2,434	3,241	2,306	105.6	75.1
Finance expenses	(27,972)	(37,114)	(28,720)	97.4	75.4
Net finance expense	(25,538)	(33,873)	(26,414)	96.7	75.4
Profit (loss) before tax	(13,707)	1,011	(15,067)	91.0	-
Tax expense	-	(672)	(82)	-	-
Profit (loss) for the period	(13,707)	339	(15,149)	90.5	-
Profit (loss) for the period attributable to:					
Owners of the parent company	(13,696)	359	(15,135)	90.5	-
Non-controlling interests	(11)	(20)	(14)	78.6	55.0

Condensed consolidated statement of comprehensive income

EUR thousand	1-6 2014	1-6 2013	Index 1-6 2014/ 1-6 2013
Profit (loss) for the period	(13,707)	(15,149)	90.5
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss	64	5,639	1.1
Foreign currency translation differences - foreign operations	(1,265)	3,325	-
Net gains/losses recognized in revaluation surplus in relation to cash flow hedges (effective hedging)	1,419	2,011	70.6
Deferred tax	(90)	303	-
Other comprehensive income for the period	64	5,639	1.1
Total comprehensive income for the period	(13,643)	(9,510)	143.5
Total comprehensive income for the period attributable to:			
Owners of the parent company	(13,633)	(9,498)	143.5
Non-controlling interests	(10)	(12)	83.3



Condensed consolidated 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	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance at January 1, 2013	157,129	198,872	(3,235)	197,045	240,762	(21,714)	(26,953)	(78,819)	663,087	162	663,249
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	(15,135)	-	(15,135)	(14)	(15,149)
Other comprehensive income	-	-	-	-	(954)	3,268	-	3,323	5,637	2	5,639
Total comprehensive income for the period	-	-	-	-	(954)	3,268	(15,135)	3,323	(9,498)	(12)	(9,510)
Transfer of profit (loss) of the previous year to retained earnings	-	-	-	-	-	(26,953)	26,953	-	-	-	-
Balance at June 30, 2013	157,129	198,872	(3,235)	197,045	239,808	(45,399)	(15,135)	(75,496)	653,589	150	653,739

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Profit (loss) for the period	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance at January 1, 2014	157,129	198,872	(3,235)	146,656	140,587	(63,887)	18,695	(80,623)	514,194	100	514,294
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	(13,696)	-	(13,696)	(11)	(13,707)
Other comprehensive income	-	-	-	-	837	492	-	(1,266)	63	1	64
Total comprehensive income for the period	-	-	-	-	837	492	(13,696)	(1,266)	(13,633)	(10)	(13,643)
Transfer of profit (loss) of the previous year to retained earnings	-	-	-	-	-	18,695	(18,695)	-	-	-	-
Balance at June 30, 2014	157,129	198,872	(3,235)	146,656	141,424	(44,700)	(13,696)	(81,889)	500,561	90	500,651

**Condensed consolidated statement of cash flows**

EUR thousand	1-6 2014	1-6 2013	Index 1-6 2014/ 1-6 2013
Cash flows from operating activities			
Gross cash flows from operating activities	44,883	48,859	91.9
Change in inventories	25,071	23,457	106.9
Change in trade and other receivables	(18,578)	(39,886)	46.6
Change in trade and other payables	(31,343)	6,826	-
	20,033	39,257	51.0
Interest paid	(21,252)	(24,371)	87.2
Income tax paid	-	(501)	-
Net cash from operating activities	(1,219)	14,385	-
Cash flows from investing activities			
Acquisition of property, plant and equipment and investment property	(7,694)	(7,545)	102.0
Acquisition of intangible assets	(2,162)	(2,629)	82.2
Transaction costs related to loans	(3,281)	-	-
Proceeds from sale of subsidiaries, net of cash disposed of	550	-	-
Proceeds from sale of property, plant and equipment and investment property	2,330	2,980	78.2
Proceeds from sale of available-for-sale financial assets	68	9	760.6
Interest received	1,386	1,482	93.5
Loans and deposits repayments received	1,124	536	209.8
Net cash used in investing activities	(7,679)	(5,167)	148.6
Cash flows from financing activities			
Increase (repayment) in borrowings	8,664	(10,384)	-
Dividends paid	(1)	(6)	16.7
Net cash from (used in) financing activities	8,663	(10,390)	-
Net (decrease) increase in cash and cash equivalents	(235)	(1,172)	20.1
Cash and cash equivalents at the beginning of the year	18,505	38,012	48.7
Effect of exchange rate fluctuations on cash and cash equivalents held	(102)	159	-
Cash and cash equivalents as at the end of the period	18,168	36,999	49.1



Notes to condensed consolidated interim financial statements

Notes to condensed consolidated income statement

Revenue

In the period 1-6 2014, Mercator Group generated EUR 1,299,927 thousand of revenue, which is 4.2% less relative to the period 1-6 2013. Revenue dropped by 3.2% in Slovenia and by 5.5% in foreign markets. In Slovenia, the largest drop in revenue relative to the equivalent period of last year was seen in home product program and textile/apparel program. Sales also dropped in FMCG retail by 3.1%, while wholesale revenue increased. In foreign markets, change in revenue differs by countries. Revenue rose in Montenegro, and declined in Croatia, Serbia, and Bosnia and Herzegovina.

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 1,263,615 thousand in the period 1-6 2014, which is a 3.4-percent decrease on the same period of last year.

Cost of goods sold was lower by 3.9% relative to last year. The amount of early payment discounts was lower by EUR 589 thousand in the period 1-6 2014.

Administrative expenses

Mercator Group's administrative expenses in the period 1-6 2014 amounted to EUR 36,376 thousand, which is 23.1 percent less than in the equivalent period last year.

The Management Board of Mercator, d.d., continued the extensive efforts to rationalize all types of costs in the first half of 2014. As much as EUR 13.4 million was saved in the period at hand.

Total expenses, consisting of selling and marketing costs, production costs (included in costs of goods sold and selling and marketing costs), and administrative expenses amounted to EUR 312,509 thousand in the period 1-6 2014, an decrease of 5.8% on the last year's figure for such period. All categories of costs were decreased. Costs of material were slashed by 9.5%. Contributing the most to the decrease are costs of raw materials and energy costs. Service costs, excluding rents, dropped by 2.5%. The greatest decrease was seen in transport and telecommunication costs,

maintenance costs, insurance premiums, and costs of cleaning and security. Labour costs were cut by 3.7% in the period 1-6 2014 relative to the last year's comparable period.

Results from operating activities

In the period 1-6 2014, Mercator Group's results from operating activities reached EUR 11,831 thousand.

Net finance expenses

Net finance expenses are lower by EUR 876 thousand relative to the last year's equivalent period, which is mostly the result of lower interest expense and lower revaluation adjustments related to receivables.

Profit before income tax

In the period 1-6 2014, Mercator Group's profit before income tax was negative at EUR -13,707 thousand.

Profit for the financial period

Mercator Group's net loss for the period 1-6 2014 amounts to EUR -13,707 thousand.

EBITDA

Mercator Group EBITDA in the period 1-6 2014 amounts to EUR 47,266 thousand which is 10.3% less than in the equivalent period of last year.

EBITDAR

EBITDAR amounts to EUR 74,229 thousand for the period 1-6 2014, which is 10.2% lower than in the equivalent period of last year.



Notes to condensed consolidated statement of financial position

Assets

Mercator Group assets as at June 30, 2014 amounted to EUR 2,266,729 thousand, which is EUR 37,112 thousand less than at the end of 2013, mostly due to lower inventories and lower property, plant, and equipment.

As at June 30, 2014 the value of Mercator Group non-current assets amounted to EUR 1,744,939 thousand, which is EUR 30,075 thousand less than as at December 31, 2013. The largest share of non-current assets, 97.2% (EUR 1,695,907 thousand) is represented by property, plant, and equipment, the value of which was EUR 28,473 thousand lower than as at the end of 2013 as a result of lower investment which was lower than depreciation.

As at June 30, 2014, Mercator Group current assets amounted to EUR 521,790 thousand, which is EUR 7,037 thousand less than at the end of 2013. Trade and other receivables represent the largest portion of total current assets (48.6%), followed by inventories (45.9%). Regarding the inventory, the Group continues to pursue the policy of efficient management; as a result, the inventory in the period 1-6 2014 dropped by EUR 25,070 thousand.

Equity and liabilities

As at June 30, 2014, Mercator Group equity amounted to EUR 500,651 thousand, which is EUR 13,643 thousand, or 2.7%, less than as at the end of 2013. The decrease pertains to the loss of EUR -13,707 thousand, negative currency translation differences in the amount of EUR -1,265 thousand, positive change in fair value of risk hedging instruments in the amount of EUR 1,419 thousand, and deferred taxes in the amount of EUR -90 thousand.

As at June 30, 2014 total financial liabilities amounted to EUR 1,046,471 thousand, which is EUR 8,663 thousand more than as at the end of

2013. Net financial debt of the Mercator Group, calculated as the difference between financial liabilities and financial assets, amounted to EUR 986,045 thousand as at June 30, 2014 (December 31, 2013: EUR 977,327 thousand).

As at June 30, 2014, provisions amounted to EUR 21,847 thousand. Compared to the end of 2013, provisions decreased by EUR 3,200 thousand, mostly due to reversal/drawing of provisions for legal claims.

Trade and other payables as at June 30, 2014 amounted to EUR 659,768 thousand, which is EUR 27,589 thousand less than at the end of 2013. The decrease in trade payables is a result of year-on-year dynamics in the trade industry.

As at June 30, 2014, long-term coverage of non-current assets with non-current liabilities at the Mercator Group amounts to 89.0%, which is 36.6 percentage points more than as at the end of 2013, as a result of the financial restructuring.



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 company of a group of associated companies in Slovenia, Serbia, Croatia, Bosnia and Herzegovina, Montenegro, Bulgaria, 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.

Due to the merger of the company M - Tehnika, d.d., and acquisition of activities of the company Modiana, d.o.o., the financial statements of the company Poslovni sistem Mercator, d.d., are not comparable between the relevant periods.

**Condensed statement of financial position**

EUR thousand	June 30, 2014	Dec. 31, 2013	Index June 30, 2014/ Dec. 31, 2013
ASSETS			
Non-current assets			
Property, plant and equipment	923,263	935,671	98.7
Investment property	2,574	2,791	92.2
Intangible assets	9,310	9,289	100.2
Deferred tax assets	15,787	16,003	98.7
Loans and deposits	10,541	354	2,977.7
Investment into equity of subsidiaries	485,689	485,179	100.1
Available-for-sale financial assets	707	720	98.2
	1,447,871	1,450,007	99.9
Current assets			
Inventories	117,013	110,447	105.9
Trade and other receivables	155,143	154,814	100.2
Current tax assets	5	24	20.8
Loans and deposits	62,684	13,282	471.9
Derivative financial instruments	1	16	6.3
Cash and cash equivalents	8,954	6,018	148.8
	343,800	284,601	120.8
Total assets	1,791,671	1,734,608	103.3
EQUITY			
Share capital	157,129	157,129	100.0
Share premium	198,872	198,872	100.0
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	121,595	121,595	100.0
Fair value reserve	104,262	103,426	100.8
Retained earnings	437	-	-
Profit (loss) for the period	(5,486)	-	-
Equity	573,574	577,787	99.3
LIABILITIES			
Non-current liabilities			
Trade and other payables	760	1,006	75.5
Financial liabilities	746,593	242,007	308.5
Deferred tax liabilities	26,910	26,980	99.7
Provisions	17,700	25,136	70.4
	791,963	295,129	268.3
Current liabilities			
Trade and other payables	370,726	363,281	102.0
Current tax liabilities	-	-	-
Financial liabilities	55,373	496,942	11.1
Derivative financial instruments	35	1,469	2.4
	426,134	861,692	49.5
Total liabilities	1,218,097	1,156,821	105.3
Total equity and liabilities	1,791,671	1,734,608	103.3



Condensed income statement

EUR thousand	1-6 2014	Plan 2014	1-6 2013	Index 1-6 2014/ 1-6 2013	Index 1-6 2014/ Plan 2014
Revenue	716,821	1,445,168	682,370	105.0	49.6
Cost of goods sold and selling costs	(690,905)	(1,364,648)	(643,564)	107.4	50.6
Administrative expenses	(19,539)	(49,950)	(23,938)	81.6	39.1
Other income	2,993	4,215	3,868	77.4	71.0
Results from operating activities	9,370	34,785	18,736	50.0	26.9
Finance income	4,265	4,816	2,790	152.9	88.6
Finance expenses	(19,121)	(27,722)	(18,178)	105.2	69.0
Net finance expense	(14,856)	(22,906)	(15,388)	96.5	64.9
Profit (loss) before tax	(5,486)	11,879	3,348	(163.9)	(46.2)
Tax expense	-	-	(27)	-	-
Profit (loss) for the period	(5,486)	11,879	3,321	(165.2)	(46.2)

Condensed statement of comprehensive income

EUR thousand	1-6 2014	1-6 2013	Index 1-6 2014/ 1-6 2013
Profit (loss) for the period	(5,486)	3,321	(165.2)
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss	-	-	-
Items that may be reclassified subsequently to profit or loss	1,273	2,159	59.0
Net gains/losses recognized in revaluation surplus in relation to cash flow hedges	1,419	2,011	70.6
Corporate income tax on items that may be reclassified subsequently to profit or loss	(146)	148	(98.6)
Other comprehensive income for the period	1,273	2,159	59.0
Total comprehensive income for the period	(4,213)	5,480	(76.9)



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, 2013	157,129	198,872	(3,235)	171,984	215,494	-	-	740,244
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	3,321	3,321
Other comprehensive income	-	-	-	-	(398)	2,557	-	2,159
Total comprehensive income for the period	-	-	-	-	(398)	2,557	3,321	5,480
Transactions with owners of the parent company directly recognized in equity								
Contributions by and distributions to owners								
Dividends to equity holders	-	-	-	-	-	-	-	-
Transfer of profit (loss) of the previous year to retained earnings	-	-	-	-	-	-	-	-
Balance at June 30, 2013	157,129	198,872	(3,235)	171,984	215,096	2,557	3,321	745,724

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, 2014	157,129	198,872	(3,235)	121,595	103,426	-	-	577,787
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	(5,486)	(5,486)
Other comprehensive income	-	-	-	-	836	437	-	1,273
Total comprehensive income for the period	-	-	-	-	836	437	(5,486)	(4,213)
Total transactions with owners	-	-	-	-	-	-	-	-
Balance at June 30, 2014	157,129	198,872	(3,235)	121,595	104,262	437	(5,486)	573,574

**Condensed statement of cash flows**

EUR thousand			Index 1-6 2014/ 1-6 2013
	1-6 2014	1-6 2013	
Cash flows from operating activities			
Gross cash flows from operating activities	26,132	37,689	69.3
Change in inventories	(6,568)	(15,956)	41.2
Change in trade and other receivables	(310)	(42,405)	0.7
Change in trade and other payables	(298)	39,740	(0.7)
	18,956	19,068	99.4
Net exchange rate differences from financing	(3)	(2)	150.0
Interest paid	(15,462)	(16,872)	91.6
Income tax paid	-	-	-
Net cash from operating activities	3,491	2,194	159.1
Cash flows from investing activities			
Acquisition of subsidiaries and business operations, net of cash acquired	(510)	(27,963)	1.8
Acquisition of property, plant and equipment and investment property	(5,251)	(1,344)	390.7
Acquisition of intangible assets	(1,720)	(2,049)	83.9
Loans and bank deposits made	(59,588)	-	-
Expenses for transaction costs related to loans	(3,281)	-	-
Disposal of subsidiaries, net of cash disposed of	551	73	754.8
Proceeds from sale of property, plant and equipment and investment property	2,243	1,693	132.5
Proceeds from sale of intangible assets	-	-	-
Proceeds from sale of available-for-sale financial assets	68	-	-
Interest received	3,917	2,382	164.4
Loans and deposits repayments received	-	34,253	-
Net cash from (used in) investing activities	(63,571)	7,045	(902.4)
Cash flows from financing activities			
Increase (repayment) in borrowings	63,017	(6,408)	(983.4)
Dividends paid	(1)	(6)	16.7
Net cash from (used in) financing activities	63,016	(6,414)	(982.5)
Net (decrease) increase in cash and cash equivalents	2,936	2,825	103.9
Cash and cash equivalents at the beginning of the year	6,018	11,611	51.8
Cash and cash equivalents as at the end of the period	8,954	14,436	62.0



Notes to interim financial statements

Due to the merger of the company M - Tehnika, d.d., and acquisition of activities of the company Modiana, d.o.o., the financial statements of the company Poslovni sistem Mercator, d.d., are not comparable between the relevant periods.

Notes to condensed consolidated income statement

Revenue

In the period 1-6 2014, the company Mercator, d.d., generated EUR 716,821 thousand of revenue, which is 5.0 percent more relative to the period 1-6 2013. 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

Mercator, d.d., costs of sales which include the cost of goods sold, selling and marketing costs, and other expenses, amounted to EUR 690,905 thousand in the period 1-6 2014, which is a 7.4-percent increase over the same period of last year.

Relative to the last year's equivalent period, cost of goods sold rose by 6.1%, while other expenses increased by 435.5% in the period 1-6 2014.

Administrative expenses

Company's administrative expenses in the period 1-6 2014 amounted to EUR 19,539 thousand, which is 18.4 percent less than in the equivalent period last year.

Total expenses, consisting of selling and marketing costs (included in costs of sales), and administrative expenses amounted to EUR 177,577 thousand in the first half of 2014, an increase of 6.3% on the last year's figure for such period. The highest increase was seen in labour costs which rose by 12.2%. The increase of expenses is a result of the merger of the company M-Tehnika, d.d., and acquisition of the activities of the company Modiana, d.o.o.

Results from operating activities

In the period 1-6 2014, results from operating activities of the company Mercator, d.d., reached EUR 9,370 thousand, which is 50.0% less than in the equivalent period of the last year. The decline in results from operating activities in this year is

especially a result of the negative effects of the economic situation on the consumption.

Net finance expenses

Net finance expenses are lower by EUR 532 thousand relative to the last year's equivalent period, which is mostly a result of lower short-term financial revenue from loans granted.

Profit (loss) before income tax

The company's profit (loss) before income tax for the period 1-6 2014 amounts to EUR -5,486 thousand, which is EUR 8,834 thousand less than in the comparable period of last year.

Profit (loss) for the financial period

The company's net loss for the period 1-6 2014 amounts to EUR -5,486 thousand.

EBITDA

Mercator, d.d., EBITDA in the period 1-6 2014 amounts to EUR 27,339 thousand which is 28.9% lower than in the equivalent period of last year, for the same reasons that are listed with regard to lower results from operating activities.

EBITDAR

Mercator, d.d., EBITDAR in the period 1-6 2014 amounts to EUR 33,318 thousand which is 25.3% lower than in the equivalent period of last year.

Notes to condensed consolidated statement of financial position

Assets

Mercator, d.d., assets as at June 30, 2014 amounted to EUR 1,791,671 thousand, which is EUR 57,063 thousand more than at the end of 2013, mostly due to higher loans granted and deposits to companies within the Group. The increase is consistent with the agreement on Mercator Group financial restructuring.

As at June 30, 2014, the value of company's non-current assets amounted to EUR 1,447,871 thousand, which is EUR 2,136 thousand less than as at December 31, 2013. Property, plant, and equipment represent the largest share of non-current assets at 64.6% (EUR 935,147 thousand), which is EUR 12,604 thousand less than the estimate for the end of 2013. The decrease in property, plant, and equipment is a result of lower investment which was exceeded by the depreciation and amortisation expense.



As at June 30, 2014, the value of the company's current assets amounts to EUR 343,800 thousand, which is EUR 59,199 thousand more than as the end of 2013. The increase is related predominantly to loans granted to subsidiaries. Trade and other receivables represent the largest portion of total current assets (45.1%), followed by inventories (34.0%). In the first quarter of 2014, the company continued intensive implementation of the measures for efficient working capital management. As at June 30, 2014, inventory is higher than as at the end of last year by EUR 6,566 thousand, which is a result of the takeover of the company Modiana, d.o.o.

Equity and liabilities

As at June 30, 2014, equity of the company Poslovni sistem Mercator, d.d., amounted to EUR 573,574 thousand, which is EUR 4,213 thousand, or 0.7%, less than as at the end of 2013. The decrease is mostly an effect of the negative results in the first quarter of 2014 in the amount of EUR -5,486 thousand. The change in equity was also affected by the change in the value of derivative financial instruments in the amount of EUR 1,419 thousand, and deferred tax in the amount of EUR -146 thousand.

As at June 30, 2014 total financial liabilities amounted to EUR 801,966 thousand, which is EUR 63,017 thousand more than as at the end of 2013. The increase in financial liabilities is a result of the agreement on Mercator Group's financial restructuring. Thus, long-term financial liabilities rose by EUR 504,586 thousand relative to the end of 2013.

As at June 30, 2014, provisions amounted to EUR 17,700 thousand. Compared to the end of 2013, provisions decreased by EUR 7,436 thousand, mostly due to partial reversal of provisions upon exit from the market of Albania.

Trade and other payables as at June 30, 2014 amounted to EUR 371,486 thousand, which is EUR 7,199 thousand more than at the end of 2013. The increase in trade payables is a result of year-on-year dynamics in the trade industry, and the transfer of activities of the company Modiana, d.o.o.

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 June 30, 2014, 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, August 26, 2014