

**BUSINESS REPORT OF THE MERCATOR GROUP AND
THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.,
FOR THE PERIOD 1–6, 2017**



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EXECUTIVE SUMMARY

In the first half of 2017, Mercator Group successfully pursued its revised business strategy. Mercator Group's profit in the first half of 2017 exceeded the figure from the same period of the year before by a factor of 2.67, amounting to EUR 10.4 million. Mercator Group EBITDA in the first half of 2017 was at EUR 58.3 million. Improved performance is also evident in higher EBITDA margin which rose by as much as 11.0% relative to the same period prior year, or by 15.0% adjusted for divested activities.

Performance improvement measures have already yielded initial results

Mercator successfully continues to execute its revised business strategy. We have introduced a new store concept; many stores were refurbished; we improved the competitiveness of our services; and we adjusted our sales assortment. We devote particular attention to the offer of fresh and local produce and products that are in the highest demand among customers. To this end, we work intensively with our local suppliers and address our customers with a comprehensive and innovative marketing approach. Successful pursuit of measures is already evident in the business performance for the first half of 2017.

Mercator Group remains focused on its core activity, and further improvement of profitability remains its key goal. Care for the consumers will remain at the focus of our activities as we look to offer them the best products and services they want and need on a daily basis, in addition to shopping environment with modern design, the greatest possible number of store locations, and expanded and enriched offer of fast-moving consumer goods.

Improved performance efficiency of the Mercator Group in the first half

In 2017, Mercator Group improved its business performance and efficiency, which is reflected by higher profit and EBITDA. Mercator Group's profit in the first half of 2017 exceeded the figure from the same period of the year before by a factor of 2.67, amounting to EUR 10.4 million; in the same period of the year before, it was at EUR 3.9 million.

Mercator Group EBITDA in the first half of 2017 was at EUR 58.3 million. In the corresponding period of the preceding year, it amounted to EUR 57.1 million including operations of divested operations, or EUR 52.0 million if the divested operations are not accounted for. Performance improvement is also evident in higher EBITDA margin which rose by 11.0% relative to the same period of the year before, or by 15.0% adjusted for divested activities. Moreover, EBITDA was higher for the company Poslovni sistem Mercator, d.d., amounting to EUR 35.2 million, or EUR 3.5 million more than in the equivalent period prior year. For this reason, EBITDA margin is higher by 17.4% relative to the same period of the year before.

The drop of revenue in respective markets was primarily a result of divestment of non-core operations of Modiana and Intersport in 2016 and closing down of some stores based on a decision of the country's regulator in Serbia.

In 2017, payment terms for our suppliers remain stable.

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

In April, Tomislav Čizmić was appointed new Management Board president; also in April, Draga Cukjati was appointed new Management Board member in charge of finance and IT. In April, Slovenian National Assembly adopted the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia. Based on the adopted Act, the government proposed Gregor Planteu for the position of the Management Board member, and the District Court of Ljubljana, consistently with its powers, appointed him extraordinary Management Board member as of May 2017. Thus, the Management Board of Poslovni sistem Mercator operates with the following composition: Tomislav Čizmić, President of the Management Board; and Management Board members Draga Cukjati, Igor Mamuza, and Gregor Planteu.

Changes in the composition of the Supervisory Board at the parent company Poslovni sistem Mercator, d.d.

As of April 25, 2017, two Supervisory Board members at the company Poslovni sistem Mercator, d.d. – Ante Todorčić as the Supervisory Board chairman and Ivan Crnjac as the Supervisory Board member – resigned from their respective positions. As of June 8, 2017, Darko Knez resigned from the position of a Supervisory Board member at the company Poslovni sistem Mercator, d.d. On June 15, 2017, the Shareholders Assembly appointed

Ante Ramljak, Vladimir Bošnjak, and Teo Vujčić as Supervisory Board members representing the interests of shareholders, for a four-year term of office. At the Supervisory Board session on June 15, 2017, Ante Ramljak was appointed new Supervisory Board chairman for the company Poslovni sistem Mercator, d.d. At the session held on June 28, 2017, members of the Works Council of Mercator, d.d., appointed Jože Lavrenčič as the new employee representative in the company Supervisory Board, as the term of the previous Supervisory Board member Veljko Tatić was to expire on November 4, 2017; in addition, they reappointed Vesna Stojanović for a new term of office.

Operating risks related to the Agrokor Group

In 2016, the companies Poslovni sistem Mercator, d.d., Mercator - H, d.o.o., and Mercator - BH, d.o.o., recognized impairments for receivables from the Agrokor Group companies that are not a part of the Mercator Group. At its extraordinary session held on April 14, 2017, the Supervisory Board instructed the Management Board to immediately examine all possibilities of settling or offsetting all mutual receivables and liabilities between the Mercator Group companies and Agrokor Group companies that are not a part of the Mercator Group as soon as possible.

In March and April of 2017, the Management Board of the company Poslovni sistem Mercator, d.d., maintained regular contact with the company creditors with regard to avoidance of a breach of long-term financing contracts which could result from the events pertaining at the time to the company's majority shareholder, and which eventually resulted in the invocation of the so-called Lex Agrokor. On April 9, 2017, the Management Board requested a waiver from the creditor banks in order to avoid a potential cross default. The waiver that the company requested pertained to the potential cross default with regard to the company Agrokor, d.d., and its restricted subsidiaries as a result of the events taking place at that time regarding the company's majority shareholder. The company Poslovni sistem Mercator, d.d., did not receive any rejections of such requests, meaning it only received positive response – waivers by the majority of the creditor banks, so that the required two-thirds majority for consent was reached.

INTRODUCTION

PROFILE AND ORGANIZATION

Mercator Group Profile

Mercator Group is one of the largest corporate groups in Slovenia and in the entire Southeastern European region. As at June 30, 2017, the company was present with ten companies in Slovenia and with six subsidiaries in other markets of the Southeastern Europe. Poslovni sistem Mercator, d.d., headquartered in the Republic of Slovenia, is the parent company of the Mercator Group.

Poslovni sistem Mercator, d.d.	
Telephone	+386 1 560 10 00
E-address	info@mercator.si
Website	www.mercatorgroup.si
Company head office	Dunajska cesta 107, 1113 Ljubljana, Slovenia
Activity	Retail in non-specialized food retail outlets (G 47.110)
Registration number	5300231
VAT tax code	45884595
Legal Entity Identifier (LEI)	549300X47J0FW574JN34
Company share capital as at June 30, 2017	EUR 254,175,051.39
Number of shares issued and paid-up as at June 30, 2017	6,090,943
Share listing	Ljubljanska borza, d.d., official market, prime market, symbol MELR

Corporate governance

In the period 1–6, 2017, the Supervisory Board of Poslovni sistem Mercator, d.d., held four regular sessions, four correspondence sessions, and one extraordinary session.

At the **12th correspondence session held on January 13, 2017**, the Supervisory Board reduced the number of Management Board members at the company Poslovni sistem Mercator, d.d., by one member, following the resignation of Management Board member Drago Kavšek. The Supervisory Board adopted the clean and consolidated copy of the Management Board Act of the company Poslovni sistem Mercator, d.d., which specifies the number of Management Board members and their respective fields of responsibility, powers and authorizations, and the conditions for appointment of the Management Board president and members.

At the **13th correspondence session held on March 30, 2016**, the Supervisory Board was presented the Annual Report on the work of the Internal Audit of Mercator Group in 2016.

At the **13th regular session held on April 5, 2017**, the Supervisory Board of Poslovni sistem Mercator, d.d., relieved Anton Balažič, based on a consensual agreement on early termination of the term of office and without any fault-based grounds or liability, from the position of the Management Board president of the company Poslovni sistem Mercator, d.d., and appointed Tomislav Čizmič as his replacement as of April 6, 2017 for a five-year term of office.

At the **14th correspondence session held on April 9, 2017**, the Supervisory Board of the company Poslovni sistem Mercator, d.d., decided to increase the number of Management Board members at the company Poslovni sistem

Mercator, d.d., by one member so that the Management Board consists of 3 members, and appointed Draga Cukjati as a new Management Board member in charge of finance and IT, with a term of office from April 18, 2017, to April 6, 2022.

At the **extraordinary session held on April 14, 2017**, convened at the request of four Supervisory Board members, the Supervisory Board of the company Poslovni sistem Mercator, d.d., was presented the report on Mercator's purchasing policy and on signing of agreements with third-party suppliers or service providers in marketing services and investments, and found based on the relevant data from all reports that no irregularities had occurred in the operations in this respect. In addition, the Supervisory Board was presented the report by the Management Board president on the current and completed Management Board activities for the protection of all interests of the company and the Mercator Group with regard to the developments at the Agrokor Group, and tasked the company Management Board to examine all possibilities to offset or settle as soon as possible all and any mutual receivables and liabilities between Mercator Group companies and Agrokor Group companies that are not a part of the Mercator Group.

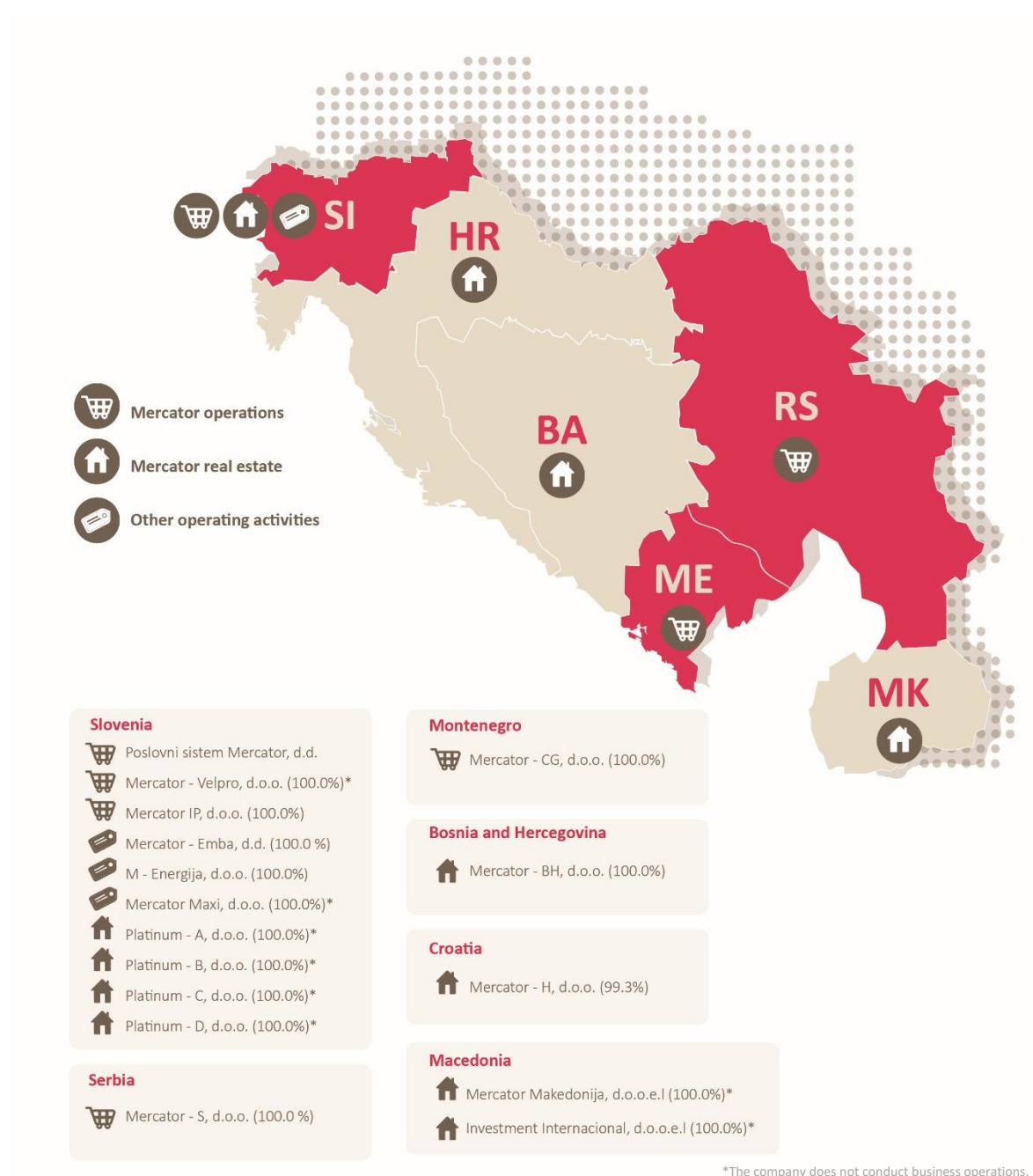
At the **14th regular session held on April 25, 2017**, the Supervisory Board of the company Poslovni sistem Mercator, d.d., adopted the Annual Report of the company Mercator, d.d., and the Mercator Group for the year 2016, approved the wording of the Supervisory Board report on the 2016 Annual Report Audit; perused the report by an independent auditor on the relations with affiliated companies in 2016, and the statement of resignation by Ante Todorić and Ivan Crnjac, by which the two resigned from the position of Supervisory Board members of the company Poslovni sistem Mercator, d.d., as of April 25, 2017; approved the agenda for the 24th regular Shareholders Assembly of the company Poslovni sistem Mercator, d.d., the resolution proposals for the appointment of the authorized auditing company for the year 2017, and appointment of new Supervisory Board members; and appointed Matej Lahovnik as a member of the Supervisory Board's Audit Committee, replacing Darko Knez.

At the **15th regular session held on May 23, 2017**, the Supervisory Board of the company Poslovni sistem Mercator, d.d., was presented the performance of the company Poslovni sistem Mercator, d.d., and the Mercator Group in the period 1–3, 2017; approved the revision of the Mercator Group plan for the year 2017; received information about the projects of Mercator nepremičnine (Mercator real estate) that the Supervisory Board had discussed and approved at the sessions in the period from September 1, 2014, to 2017, and the information about the completion of investments in the first quarter of 2017; and approved the investment proposal for the Mercator Group for the period by the end of 2017.

At the **16th regular session held on June 15, 2017**, the Supervisory Board of the company Poslovni sistem Mercator, d.d., appointed Ante Ramljak as Supervisory Board chairman; appointed Vladimir Bošnjak as Audit Committee member, who thus joined Damir Kuštrak, Matej Lahovnik, and Sergeja Slapničar in the Audit Committee; and appointed a Human Resource Committee that includes Vesna Stojanović, Matej Lahovnik, and Ivica Mudrinić. In addition, the Supervisory Board was presented the performance of the Mercator Group in the period 1–5, 2017.

At the **15th correspondence session held on June 26, 2017**, the Supervisory Board of the company Poslovni sistem Mercator, d.d., received information about the new macro organization of the company Poslovni sistem Mercator, d.d.

Mercator Group composition as at June 30, 2017



*The company does not conduct business operations.

Branch Offices

As at June 30, 2017, Mercator Group companies did not have any branch offices.

Other Organizations

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

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

MERCATOR GROUP KEY OBJECTIVES

We are fulfilling the six key initiatives:

1. Revenue and profit margin

We are pursuing the goal of optimizing our prices and promotions.

2. New store concept

We are updating our retail network and introducing a new store concept.

3. Cost optimization

We are optimizing costs, through the cost control system already in place.

4. Cash flow

We are focused on optimizing our working capital management, especially inventory, and on the divestment of non-core operations and real property out of use.

5. Brand differentiation

We are strengthening our brand identity by emphasizing local offer, freshness, and quality. We offer our customers the most for their money.

6. Employees

We care for development, training and education, rewards, and motivation of our employees.

MERCATOR GROUP PERFORMANCE HIGHLIGHTS IN THE PERIOD 1–6, 2017

		Mercator Group business with discontinued operations ¹			Mercator Group - continued operations ⁴	
		1–6, 2016 adjusted ²	1–6, 2017	Index 1–6, 2017/1–6, 2016 adjusted	1–6, 2016 continued	Index 1–6, 2017/1–6, 2016 continued
INCOME STATEMENT	Revenue (in EUR 000)	1,245,316	1,146,498	92.1	1,174,989	97.6
	Results from operating activities (in EUR 000)	18,003	21,726	120.7	13,791	157.5
	Profit (loss) before income tax (in EUR 000)	5,965	13,839	232.0	1,776	779.4
	Profit (loss) for the year (in EUR 000)	3,869	10,355	267.6	9	-
	Gross cash flow from operating activities (EBITDA) (in EUR 000)	57,056	58,289	102.2	51,954	112.2
	Gross cash flow from operating activities before rental expenses (EBITDAR) (in EUR 000)	95,669	94,082	98.3	88,717	106.0
BALANCE SHEET	Total assets as at June 30 (in EUR 000)	2,218,247	2,085,735	94.0		
	Equity as at June 30 (in EUR 000)	636,680	569,213	89.4		
ABILITY TO GENERATE CASH FLOW	Return on sales	0.3%	0.9%	290.7	0.0%	-
	Return on equity ³	1.2%	3.5%	280.9	0.0%	-
	Gross cash flow from operating activities (EBITDA) / revenue	4.6%	5.1%	111.0	4.4%	115.0
	Gross cash flow from operating activities before rental expenses (EBITDAR) / revenue	7.7%	8.2%	106.8	7.6%	108.7
INVESTMENT ACTIVITIES	Capital expenditure (in EUR 000)	32,274	25,953	80.4		
EMPLOYEES	Number of employees as at the end of the period June 30	21,762	19,887	91.4		
	Number of employees based on hours worked	19,937	18,553	93.1		

¹ Modiana and Intersport operations are included.

² As the monetization project at the company Poslovni sistem Mercator, d.d., was stopped, assets available for disposal were re-classified at the end of 2016 back to non-current assets, and we resumed their depreciation and amortization. Therefore, business results for the period 1–6, 2016, are, for comparability, adjusted for the extra depreciation pertaining to the assets reclassified back to non-current assets as at the end of 2016.




³ Indicator is adjusted to the annual level.

⁴ Modiana and Intersport operations are eliminated, effects of note 2 also included.

KEY EVENTS

Retail network development

In the period 1–6, 2017:

-  we invested EUR 25,953 thousand into property, plant, and equipment (CAPEX);
-  we divested EUR 7,777 thousand worth of property, plant and equipment;
-  we added 9 new units spanning a combined total of 7,946 m² of new gross retail area, by construction of the Trade centre Bled and operating lease.

Changes in parent company governance

As of April 5, 2017, the term of office of Management Board president Anton Balažič was terminated, without any fault-based grounds or liability on the part of the Management Board president. At the same time, Tomislav Čizmič was appointed new President of the Management Board for a term of office of five years, as of April 6, 2017. The Supervisory Board appointed Draga Cukjati as the new Management Board member in charge of finance and IT. She commenced her term of office on April 18, 2017.

In April, Slovenian National Assembly adopted the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia (so-called Lex Mercator). The new Management Board member will only be in charge of transactions related to the majority owner and will not have any power or authority with regard to management of regular transactions. Based on the adopted Act, the government proposed Gregor Planteu for the position of the Management Board member, and the District Court of Ljubljana, consistently with its powers, appointed him, by the court's decision, as extraordinary Management Board member as of May 18, 2017. Thus, the Management Board of Poslovni sistem Mercator operates with the following composition: Tomislav Čizmič, President of the Management Board; and Management Board members Draga Cukjati, Igor Mamuza, and Gregor Planteu.

As of April 25, 2017, two Supervisory Board members at the company Poslovni sistem Mercator, d.d. – Ante Todorčić as the Supervisory Board chairman and Ivan Crnjac as the Supervisory Board member – resigned from their respective positions. As of June 8, 2017, Darko Knez resigned from the position of a Supervisory Board member at the company Poslovni sistem Mercator, d.d.

On June 15, 2017, the Shareholders Assembly appointed Ante Ramljak, Vladimir Bošnjak, and Teo Vujčić as Supervisory Board members representing the interests of shareholders, for a four-year term of office starting with the day of appointment at the Shareholders Assembly.

At the Supervisory Board session held on June 15, 2017, Ante Ramljak was appointed new Supervisory Board chairman for the company Poslovni sistem Mercator, d.d. At the session held on June 28, 2017, members of the Works Council of Mercator, d.d., appointed Jože Lavrenčič as the new employee representative in the company Supervisory Board, as the term of the previous Supervisory Board member Veljko Tatić was to expire on November 4, 2017. At the same session, the workers also reappointed Vesna Stojanović as the Supervisory Board member of the company Poslovni sistem Mercator, d.d., for a new term of office that started as of July 4, 2017.

At the Supervisory Board session on June 15, 2017, a resolution on the establishment of a Human Resource Committee was adopted. The Human Resource Committee includes Vesna Stojanović, Matej Lahovnik, and Ivica Mudrinić.

Changes in the parent company ownership structure

On March 10, 2017, a share sale and purchase agreement was signed between Agrokor Investment B.V. and Agrokor, d.d., pursuant to which the company Agrokor Investment B.V. sold to Agrokor, d.d., 615,384 MELR shares. Thus, the shareholding held by the company Agrokor, d.d., increased from 59.47% to 69.57%, while the shareholding held by the company Agrokor Investments B.V. decreased from 28.64% to 18.53%.

In June 2017, the company Sberbank of Russia exercised their lien over 1,128,803 shares of the company Poslovni sistem Mercator, d.d., held by the company Agrokor Investment B.V. Thus, the company Sberbank of Russia became in June 2017 an 18.53% shareholder of the company Poslovni sistem Mercator, d.d.

Events, related to the developments at the Agrokor Group

In 2016, the companies Poslovni sistem Mercator, d.d., Mercator - H, d.o.o., and Mercator - BH, d.o.o., recognized impairments for receivables from the Agrokor Group companies that are not a part of the Mercator Group. At its extraordinary session held on April 14, 2017, the Supervisory Board instructed the Management Board to immediately examine all possibilities of settling or offsetting as soon as possible all mutual receivables and liabilities between the Mercator Group companies and Agrokor Group companies that are not part of the Mercator Group.

In March and April of 2017, the Management Board of the company Poslovni sistem Mercator, d.d., maintained regular contact with the company creditors with regard to avoidance of a breach of long-term financing contracts which could result from the events pertaining at the time to the company's majority shareholder, and which eventually resulted in the invocation of the so-called Lex Agrokor. On April 9, 2017, the Management Board requested a waiver from the creditor banks in order to avoid a potential cross default. The waiver that the company requested pertained to the potential cross default with regard to the company Agrokor, d.d., and its restricted subsidiaries as a result of the events taking place at that time regarding the company's majority shareholder. The company Poslovni sistem Mercator, d.d., did not receive any rejections of such requests, meaning it only received positive response – waivers by the majority of the creditor banks, so that the required two-thirds majority required for consent was reached.

Awards and other achievements

Slovenia



Mercator brand received the **Trusted Brand 2017 award** in two categories: shopping centre and environment protection. It also received a special Trusted Brand award for its 10th victory in the shopping centres category. The survey was conducted by the market and media research institute Mediana.

The bakery section of the Chamber of Agricultural and Alimentary Companies with the Slovenian Chamber of Commerce and Industry presented the highest award to **five Mercator baking products** and **fifteen products of the Grosuplje Bakery brand** available only at Mercator. The golden awards are proof that Mercator offers superior products in its bakery and dessert department, too.



As a part of the Ljubljana Quality (LQ) project, taking place every two years in Ljubljana and the Central Slovenian Region, Ljubljana Tourism listed the **Maxim restaurant** as one of the six best-rated restaurants.



The company Mercator IP, d.o.o., received **five golden medals for products of the pastry shop Kranjski kolaček** in the 17th bakery section contest that rates the quality of bread and pastry under the auspices of the Slovenian Chamber of Commerce and Industry.

Based on the Rules and Regulations for rating the quality of milk and dairy products by the dairy interest group (GIZ) of Slovenia, Mercator UHT-treated milk scored an excellent quality score, receiving full marks – 20 out of 20.



Foreign markets

The **IDEA format** is the recipient of the **Best Buy Award** for the best price to quality ratio in **Serbia for the period 2017/2018**, according to the results of an online survey conducted by the Swiss organization Icertias.

IDEA Online in Serbia is the recipient of the **Qudal Award for superior quality**. Thus, the IDEA Online Store reaffirmed its top ranking in the online store category, and the award stands witness to the quality and focus on customer needs.

The **IDEA website in Serbia** is the recipient of a top-five award in the eMarket category as presented by PC Press, proving that the site is neat and functional.

Mercator's humanitarian activities

With the Slovenian Red Cross organization, we are collecting food for people in need at 35 major stores across Slovenia.

With the Lions Club Ljubljana Viva and Slovenian athletes, we prepared a charity auction for a signed jersey by our ski jumping champion Peter Prevc and other "eagles". The auction took place as a part of this year's campaign **I Run to Help**. The proceeds will be donated to blind and visually impaired children.

BUSINESS REPORT

EFFECT OF ECONOMIC CONDITIONS AND COMPETITION ON MERCATOR GROUP OPERATIONS IN THE PERIOD 1–6, 2017

Economic conditions in the period 1–6, 2017¹

Economic growth continued in the euro zone in the first quarter. GDP grew by 0.5%; year-on-year, it was higher by 1.7%. Domestic consumption remains the key factor of economic growth in the majority of countries. According to their spring forecast for the euro zone, the European Commission expects economic growth to be similar in this and the next year as it was last year. This year, the growth rate is forecast at 1.7%; in 2018, it is expected to be 0.1 percentage point higher. With expansionary monetary policy, high level of business and consumer confidence, and growth of global trade, the European economy will continue to be driven in particularly by household consumption and investment. The risks regarding the forecast are more balanced than they were at the start of the year. Uncertainty continues to pertain especially to the economic policy in the USA, adjustment of the Chinese economy, low profit rates in the European banking sector, and Great Britain's exit from the European Union. Positive risks are related in particular to the decrease of political uncertainty. Oil and non-energy raw material prices are lower than at the start of the year.

Slovenia

In the first quarter of 2017, economic growth, powered by an increasing amount of factors, picked up pace. Quarterly economic growth thus increased (to 1.5% deseasonalized), GDP was higher by 5.3% year-on-year. Exports remain the key motor of economic growth, driven by an increase in foreign demand and improvement in the competitive position of Slovenian companies. Closely related to exports is further growth of production in processing industries. Conditions continue to improve in most market service activities, particularly trade, traffic, and hospitality, as well as in information and communication activities. Positive conditions in the labour market, with growing employment rate and salaries, and further improvement of consumer confidence have contributed to an increase in private spending (4.0%). As the GDP growth again exceeded the euro zone average (1.7%), the three-year period of faster growth and the resulting closing of the gap relative to the average development level of the European Union continues.

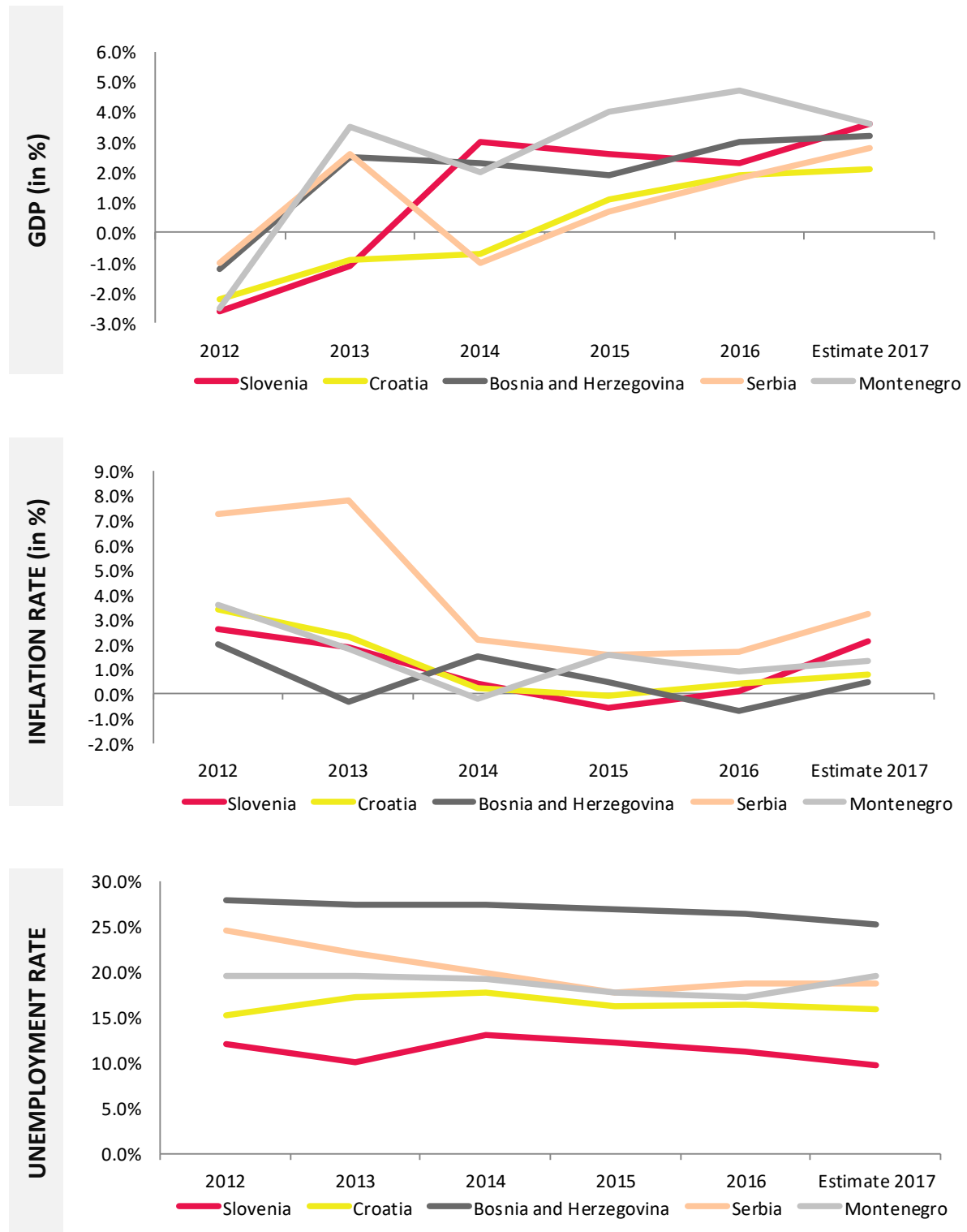
In retail, growth of food sales was added to the growth of sales of non-food and motor fuels in the first quarter. Favourable developments in retail were based on an increase in private spending and economic activity. In food retail, in which revenue stagnated until the first quarter of this year, sales growth continued at discount stores.

Year-on-year increase in the prices of services and energy continued to affect the inflation rate. Growth of service prices in some segments reflects in further improvement of private spending. Moreover, prices of services are materially affected by the year-on-year increase in the prices of utilities.

¹ Economic conditions and competition are commented based on the following data sources: UMAR (Institute of Macroeconomic Analysis and Development of the Republic of Slovenia), ECB (European central bank), FED (Federal Reserve System), EBRD (European Bank for Reconstruction and Development), S&P (Standard&Poor's ratings services), statistical offices or respective countries, IMF (International Monetary Fund), market research company Nielsen, and EC (European Commission).

Key macroeconomic indicators in the market of Mercator's operations

Following is a presentation of changes in three indicators: gross domestic product growth, inflation rate, and unemployment rate, since 2012. The data pertains to the countries of Mercator Group operations.



Credit rating by markets

	Rating ²	Outlook
Slovenia	A	positive trend
Serbia	BB-	positive trend
Croatia	BB	stable trend
Bosnia and Herzegovina	B	stable trend
Montenegro	B+	negative trend

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

In 2017 economic recovery continues in all markets of Mercator's operations. In Slovenia, recovery of economic activity had a favourable effect on the conditions in the labour market. Improvement in the general economic situation and conditions in the labour market has had a positive effect on the growth of private spending and new investment.

For 2017, the Institute of Macroeconomic Analysis and Development (UMAR) is forecasting considerable increase of economic growth to 3.6%; in the next year, it is expected around 3.2%. Significant increase of GDP growth in 2017 will be a result of the launch of public investment and increase of household consumption growth. As the conditions in the labour market improve, consumer confidence is improving as well. This has recently been reflected in particular on the purchases of the goods that saw the most pronounced stagnation during the crisis: personal vehicles, home equipment, communication and computer devices, and services related to leisure time.

According to economic growth forecasts, improvement of economic conditions is also anticipated in the markets of Serbia and Montenegro. Private spending will increase, and the rate of registered unemployment is forecast to decrease, although it will remain at a high level.

² Rating agency Standard&Poor's

SALES AND MARKETING

Sales

International institutions expect similar economic growth for the euro zone as in the previous year. Growth will be based in particular on high confidence level of businesses and consumers, while global trade will continue to be driven by private spending and an increase in investment.

Exports remain the key motor of economic growth in Slovenia, driven by an increase in foreign demand and improvement in the competitive position of Slovenian companies. Positive conditions in the labour market, with growing employment rate and salaries, and further improvement of consumer confidence have contributed to an increase in private spending. Decrease of the number of registered unemployed continues to decrease, with a high hiring rate.

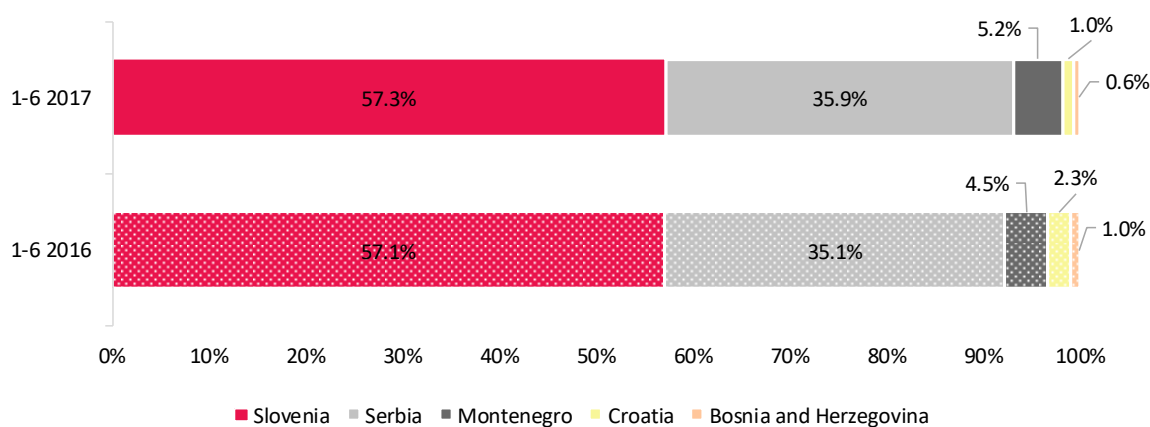
Revenue from sales of goods in the core activity of retail is higher relative to the comparable period of the prior year in Slovenia and Montenegro, while in the Serbian market the revenue is lower especially on account of closing down the units in compliance with the market regulator's decision.

In the period 1–6, 2017, Mercator Group generated revenue of EUR 1,146.5 million, which is 7.9% less than in the corresponding period of the year before, or 2.4% less comparing only the activities that have not been divested. Core activity had a positive effect on the Mercator Group revenue. In the markets of Slovenia and Montenegro, our revenue from sales of goods was higher relative to the same period last year. In the Serbian market, retail revenue was lower, especially due to closing down the units in compliance with the market regulator's decision; however, the current trends are positive.

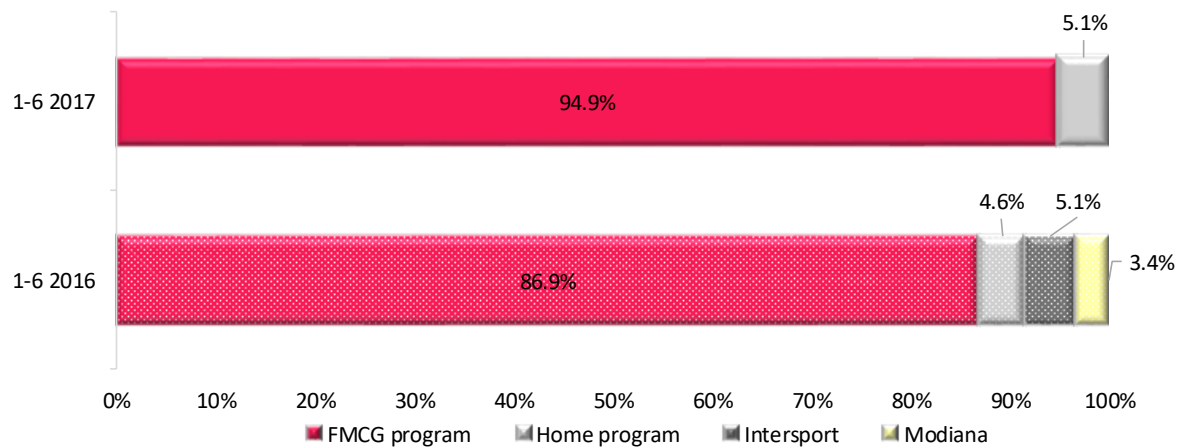
The drop of overall revenue across markets was affected especially by the divestment of non-core activities of Modiana and Intersport in 2016, as well as optimization of wholesale channels and closing down of stores in compliance with the market regulator's decision in Serbia.

Mercator Group successfully ended the period 1–6, 2017, with a net profit of EUR 10.4 million, which is EUR 6.5 million more than in 2016.

Mercator Group revenue by geographical segments:



Mercator Group revenue from trade operations by programs:



Mercator Group's core activity of fast-moving consumer goods retail generated 94.9% percent of total revenue in the period 1–6, 2017, which is more than in the equivalent period of last year, mostly as a result of the pursuit of strategy of divesting non-core operations. The share of sales revenue from specialized trade program of home products amounted to 5.1%. Compared to the same period of last year, revenue increased at the Mercator Group level in the home products program, and decreased in the fast-moving consumer goods program.

Store formats, customer segments, and category management

Store Formats

Consumer shopping behaviour has changed considerably in recent years as a result of different impacts from the environment. This tends to increase the complexity of operations. Today's customer is defined by rapidly changing demographic conditions, lifestyle, and technological development. The consumers became even more demanding, more informed, and more aware. They look to get the most for their money and they are less loyal to a single retailer, which further increases the complexity of the business. Pressure on the retailers is mounting to move faster and more to the digital world and the online environment as consumers are willing to spend less and less of their time on shopping. The future of retail lies in further expansion of the number of sales channels and increasingly better integration across them.

Like most of the world's leading retailers, Mercator is seeking to adapt to these actual changes as much as possible by **diversifying its store formats**. They are intended to accommodate a variety of shopping needs, from major planned shopping sessions to minor daily, top-up, or occasional shopping for fast-moving consumer goods.

The year 2017 will also be one of **retail network updates** according to the new concept of trade. We will continue to focus on the consumers as we wish to offer them the best goods and services. We are looking to offer our customers a shopping environment with modern design, in as many locations as possible, with extended and richer offer of fast-moving consumer goods. Refurbished Mercator stores afford customers an even more pleasant shopping environment, while category structures and new services offered are adapted to the most recent trends.



In the period 1–6, 2017, 22 units were opened or renovated in Slovenia. Sixteen units were opened or renovated in Serbia, and 5 in Montenegro.

Among the renovated units, the **supermarket Lucija in Slovenia stands out in particular, with fresh design, expanded sales area, and numerous novelties in the offer**, such as:

- **fish department,**
- **new bakery department** that also offers pizza and an expanded offer of self-service small pastry,
- **warm food counter (roisserie),**
- **a large fruit and vegetables department** that also offers a juicer for self-service preparation of fresh orange juice.

In the first half of 2017, intensive **refurbishment of hypermarkets** also took place. The refurbishments are focused on strategic adjustment of the format to new conditions in the market. Thus, the relations and ratios between respective product categories were adjusted; the assortment was optimized with more stress on fresh program. Thus, where possible, the fruit and vegetables department is placed at the entrance; most hypermarkets have new bread and pastry departments; more room is intended for product emphasis or special campaigns; and non-market (non-FMCG) departments have been refined.



In 2017, we continue with refurbishments of smaller **neighbourhood stores** as Mercator carries on the tradition of coming closer to its customer in their local environment. At neighbourhood stores, we are looking to offer our customers a modern shopping environment with a select range of products and produce with continued focus on the home-made, local, and fresh, particular in categories such as fruit and vegetables, meat, and bread, as well as other fast-moving consumer goods.



Composition of sales units as at June 30, 2017

COUNTRY	SLOVENIA	SERBIA			MONTENEGRO	MERCATOR GROUP		
	Mercator	Mercator	Roda	Idea	Idea			
STORE FORMATS	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Gross area	Net sales area
Hypermarkets	22	2	30	3	2	59	265.429	177.510
Supermarkets	110	-	3	93	15	221	234.920	154.498
Neighbour stores	335	-	-	206	92	633	246.161	147.068
Comfort stores	1	-	-	1	-	2	6.296	3.776
Mini stores	1	-	-	-	-	1	159	83
Cash & Carry / VELPRO	13	-	-	11	3	27	80.615	36.540
Total FMCG program	482	2	33	314	112	943	833.580	519.475
Restaurants	8	-	-	-	-	8	2.070	1.379
Technical consumer goods	44	-	-	-	-	44	61.459	37.799
Total specialised programs	52	-	-	-	-	52	63.529	39.178
Total retail units under management	534	2	33	314	112	995	897.109	558.653
Franchise stores	203	-	-	-	-	203	45.522	29.971
TOTAL	737	2	33	314	112	1.198	942.631	588.624

Customer segment

The needs and desires of our customers are highly diverse. We learn about them by analyzing their shopping behaviour, either through market research or shopping data analysis. Upon this basis, we can adjust the offer and the retail area accordingly, and plan our marketing activities. All major activities are approached with a three-dimensional mindset: offer, store (place), and customer. In 2017, we continue our activities for respective customer segments, with offer tailored to them as much as possible. The goal of some activities is to adjust certain groups of products, while others are focused on the activities to maintain customer loyalty or on winning their confidence and strengthening their satisfaction.

Category management and procurement

In 2017, we shall continue to actively support local supplier and promote local offer at Mercator stores. As to date, the focus will be on local fresh meat, local fruit and vegetables, and local dairy products. In addition, we shall further promote the offer of local growers and producers. We shall continue to train and educate our employees in the fresh meat departments in order to provide the maximum possible quality and convenience of offer, and especially friendly service. In the bread and pastry department, we shall continue our efforts to provide high-quality service with freshness of products and a varied offer, as well as friendly and professional service of our employees. The offer of fruit and vegetables will also be based on promotion of local produce, as well as on the quality of fruit and vegetables, and on introduction of proven market trends.

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

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

Marketing

Our marketing activities are focused on market priorities and the dynamics of changes in the trade industry. In the period 1–6, 2017, we continued to exchange and roll out the best practices across markets. Marketing activities for the fast-moving consumer goods program are targeted at the markets of Slovenia, Serbia, and Montenegro.

Slovenia

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

We provide well-priced shopping

We are pursuing the goal of offering our customers the most for their money. Therefore, we offer our customers many products and special prices every day. We provide further benefits to our loyal customers who can double their savings with the Pika card, receive immediate Pika discounts and bonus points. Thursdays are still reserved for retirees who can shop with an extra 10% discount on all products. Our loyal customers can also enjoy the benefit of a 25-percent Pika discount on the selected product, which is easily implemented with the Pika card on the cashier, on a monthly basis we are conducting the activity of double Pika points, allowing our customers to reach a certain benefit threshold sooner. Occasionally, we also offer a 10-percent discount on all products.



Our main tool of communication with the customers is the catalogue which we use to inform our customers on a weekly level about new special offers and quality products at favourable prices, novelties and specificities. Occasionally, we also issue additional catalogues in which we present the offer of non-food seasonal categories.

With Pika, our customers save more

Advantages of the Pika customer loyalty system are now known to virtually every household in Slovenia. The customers can win and use their loyalty points for the entire offer. They are also offered **immediate Pika discounts for select products**. In addition, the card allows them to **defer the payment or to pay in up to 24 instalments at a zero interest rate**. Pika card affords the customers a number of benefits when shopping in Mercator's sales network and at partner companies. In addition to the Pika discounts on select products from the flyers, and double and triple Pika card bonus points which are available to all Pika card holders, additional discounts were offered in the first half of 2017 to all retirees who show their retiree card at the check-out counter.



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 Mercator Pika card. In addition we offer exclusive discounts and surprises for our customers. For the buyers who allowed us to look into their shopping behaviour, we also prepare customized offer. Golden Pika card holders also receive the Golden Letters with golden benefits.

In January, we successfully carried out the "vignette" activity in which customers who purchased the annual highway toll vignette received a coupon for 55 Pika points. Moreover, they were offered to pay in five instalments.

KitchenAid

In April 2017, we launched an interactive customer loyalty program KitchenAid in which we offered our customers top-class KitchenAid cookware with a discount of up to 71%. The program will last until July 31. Customers who have purchased any piece of cookware are also eligible for the main award – a KitchenAid kitchen robot. For customers who do not have a Pika card, we activated an additional activity as of June 12, offering them a 50-percent discount on KitchenAid products whenever their checkout total is EUR 30 or more. Over 17,000 pieces of KitchenAid cookware were sold by mid-June.



We Love Local

In the We Love Local project, we seek to **develop a strategic partnership with cooperatives and small local growers**, and we are looking to further improve our cooperation. To this end, we are organizing events that promote cooperation between respective suppliers, and participation and support to activities that improve recognition. One such example is the We Love Local Academy, closing with a fair at Mercator Šiška. The project included visits to 9 places across Slovenia, sharing our knowledge and opening the door to many local suppliers. At the fair, we offer the 29 suppliers who applied for the project the option to sell, promote, and connect.



Monthly project themes are supported with local cuisine, with a modern twist. To this end, we enlisted the help of the master chefs Tejani. With their video recipes, adjusted to the weekly offer from the We Love Local flyer, they are increasing the interest and recognition in the digital channels. At the same time, we are pursuing the goal of bringing local food and local growers closer to our younger customers. The focus is on products, especially those from our new suppliers.

The campaign also includes our sponsorship of the popular Slovenian TV show "Slovenski pozdrav", and the Slovenian Polka and Waltz Festival that also draws large crowds of visitors. As a part of the Magic Day, we hosted our youngest customers at the We Love Local farm. Working with Zavarovalnica Triglav (insurance company), we addressed the fans of Slovenian mountains; and we worked with Slovenian ski jumpers, musicians, and many other famous faces. We also took part in the selection of the best products or growers – Agrobiznis.

Mine. The best. Mercator

This spring, Mercator introduced a new communication campaign in Slovenia. It includes a **thorough revision of the strategy and refreshment of the tone of communication**. Mercator is looking to come closer to the new generations of customers, to consolidate the recognition of the communication platform, and to rejuvenate the Mercator brand identity. We are betting on freshness and quality, local origin, a cosmopolitan offer, and the best value for money. In addition, an **increasing number of Mercator stores are thoroughly updated or renovated**, and in the new campaign, especially the TV ad, **the main roles are played by our employees**: young, inquisitive, playful. Not only for the customers; they have an ear for many other things, including good music.

Creative solutions have been employed to update the store equipment as they moved to be among customers and employees, while their interactive character made ideal content for digital and social networks



where especially the young intensively liked and shared the music, while employees and customers identified their "best neighbours", the employees starring in the ads.

Thus, Mercator used many elements to come closer to the younger, dynamic audience, as we are aware that the somewhat older and senior population has traditionally been the most loyal to Mercator. For the young, Mercator developed not only an energetic spring campaign with appealing ads and music; rather, the **offer and shopping paths** have been adjusted to them as well. Enriched offer of new products, online store, My M mobile application, lively activity in the social networks, and a range of other elements rounds off the convincing and inviting shopping experience at Mercator for the younger generations.

Fresh category campaign

In the first half of 2017, our umbrella campaign Mercator also included a fresh category campaign with a key emphasis on the offer of quality and fresh produce. The campaign included the offer of fresh meat, fruit and vegetables, and the dairy category in which the offer was focused on the products by our Mercator private label. The goal of the campaign was to present all aspects of our quality offer to the customers. Thus, we inform customers about the advantages of purchasing the Mercator private label products in flier, we also presented the story of our own meat products or pre-packed meat and quality control by the National Veterinary Institute, and several stories of our suppliers.

At the end of May, we also launched a fruit and vegetable campaign in which we worked with the suppliers to inform the customers about the Global GAP certificate and offer of organic produce. Working with the Austrian laboratory Imprint Analytics, we carried out an origin test for the select fruits and vegetables. In this way, we checked whether the origin of the produce by our growers was indeed Slovenian. We also prepared two special reports for meat and for fruit and vegetables, presenting how all stakeholders in a supply chain work together to deliver freshness and quality.



In addition to fresh categories, particular attention was paid to the wine category. Since April, we have been conducting a campaign to improve the wine drinking culture in Slovenia. In addition to the Wine of the Month activity in which renowned wine experts recommend a certain type of wine, we also prepared a special wine guide for our stores to provide further information to our customers.

Offer of private label products

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

In the first quarter, we conducted several activities related to our private labels. We presented an annual supply of **Lumpi diapers** to all children born on January 1, 2017, in Slovenia, which their mothers were very grateful for. This also resulted in Facebook communication in which mothers shared their experience with Lumpi diapers with us and others.

Our care for healthy diet of children was also manifest in organization of **Bio Zone** workshops with **Alenka Košir** at Mercator Šiška. Thus, we continued to communicate our Bio Zone product line. Bio Zone products were also promoted as a part of the "Žogarija" (Ball Game) project that encourages the young to do sports and to choose a healthy diet. This also included a My Food, Natural is the Best contest. At the end of June, we launched a refreshment campaign for the Bio Zone brand recall. This year, it was upgraded with interesting recipes based on the Bio Zone products, in cooperation with Alenka Košir, as well as with an interesting prize competition in which customers can win participation in workshops with Alenka Košir.





In February we received **golden medals from the Slovenian Chamber of Commerce and Industry for select pastries and biscuits of our Mercator line**. In March, we prepared an extensive **campaign for Mercator's dairy products** as we launched new product design and emphasized their Slovenian origin. **In June, we upgraded our dairy product campaign with communication of labels for top quality awarded to Mercator dairy products** at the tests conducted by the Faculty of Biotechnology. The campaign included a TV ad, many activities on social networks, giving out free samples of yoghurt for our customers to help them learn about the quality of the products etc.

Serbia

The following joint marketing activities took place in the Serbian market in the period 1–6, 2017:

- The **Beer Rituals** campaign – taking place from May 25 to June 30, it included a catalogue presenting our current offer of beer, and how to pour, taste, and rate beer. We also presented the brewing machine to our customers.
- The **"Genije za režiје"** campaign – in addition to doing their daily shopping, Idea customers can now pay their monthly bills from the companies SBB, VIP Mobile and Telekom Serbia. To date, the service is possible at 74 Idea stores, at all Roda stores, and at all Mercator hypermarkets across Serbia.
- The **Humanitarian Weekend** campaign – working with the "Bodi human" (Be Humane) Foundation, the company Mercator - S, d.o.o., organized the Humanitarian Weekend campaign at 339 Idea, Roda, and Mercator units. On the weekend of May 20 and 21, one dinar from each checkout was donated to the said campaign. The campaign raised 500,000 Serbian dinars in only two days.
- The campaign **Five Minutes to Get a Job** – the company Mercator - S, d.o.o., started a hiring project in which anyone interested can take part in a 5-minute job interview, which brings them a step closer to getting a job at an Idea, Roda, or Mercator unit anywhere in Serbia.



In the period 1–6, 2017, marketing activities also took part separately, by brands.

IDEA

For the second consecutive year, a workshop took place in January and February at four Belgrade municipalities as a part of the **Choose healthy, choose fresh** campaign. The workshop was intended for children and it focused on the importance of a healthy lifestyle and diet. Participation is upgraded by Idea and the Belgrade Marathon who signed a new three-year exclusive partnership agreement. Thus, Idea was once again a sponsor of the Belgrade Marathon attended by over 20,000 spectators.



In the early months of this year, one of our first stores opened in Serbia, the **Idea Centre Immo**, was refurbished. Only a month after its opening, we opened a new store in the BIG Fashion Shopping Centre in Belgrade, as well as an all new playground.

For customers across Serbia, we organized a contest **Idea rewards with 1,000 bicycles** in which we gave away the said number of bicycles to the lucky winners.



The campaign **Belgrade, the City of your IDEAs** was launched in June. Eleven ideas were selected based on 500,000 votes, which will contribute to beautification of Belgrade. The first idea already put to action was called The People of Belgrade Read. It included promotion of culture through poetry with young poets reciting at 80 public transit stations or stops.

RODA

Through the campaign **Where Happiness is 1,000 Times Bigger**, we organized a prize contest in January and presented the last 400 out of a total of 1,000 TV sets to lucky prize winners.



Moreover, we continued our activities of cooperating with the **Serbian Basketball Association** and together pursued the goal of development and promotion of basketball in the entire Serbia. This involved a number of trips in May.



With its Super Card, Roda prepared a customer loyalty program called **The Dreams Offer** in order to make it easier for parents to shop for baby equipment. The customers collect stickers for a 50-percent discount on the select products of the Chicco baby equipment range.

Renovated Roda stores – after several weeks of works, Roda Dragon reopened with an entirely new ambient. In the process of refurbishment, particular attention was paid to specialized customers who are now offered a broader assortment of the Rial brand products. In June, retail units Roda Čačak, Roda Sremska Mitrovica and Roda Požarevac were renovated, too.



In order to offer a true shopping experience, the **Mercator Days** campaign took place for two weeks at the Mercator centre Belgrade and Novi Sad, which included a presentation of the breadth and exclusive selection of the most renowned brands.



Scan in an instant – Since Mercator customers appreciate simplicity, modern technology, and speed, we have already implemented the innovative service "Sken za tren" (Scan in an instant) at Mercator hypermarket in Belgrade and Novi Sad. The service allows the customers to scan their products and monitor the list and total amount, as well as savings.

Montenegro

In addition to the regular pricing activities, the campaigns The Flavours of my Town and VIP were the two key campaigns in the first three months of the year. In our pricing activities, we successfully launched regular bi-weekly catalogues, and two theme-oriented catalogues: Our Brands / Private Labels, and Beauty and Care.

As we seek to deliver the best quality, freshness, and a varied assortment, we held the **fruit and vegetables** campaign through 5 themes: citruses, exotic fruits, detox, vitamins, and salad. During the campaign, a giveaway was held under the slogan **Buy Oranges and Travel to Spain** which involved giving away 2 trips to Spain, 3 iPhones 7, and 100 fruit coupons.



Particular attention was paid to the introduction of new lines of local products through the campaign **The Flavours of My Town**, launched in mid-March. This is a new campaign involving sale of local Montenegrin products at retail stores, in cooperation with 11 local producers. It is the goal of the campaign to make sure the consumers perceive Idea as a retailer worthy of their consumer's confidence, and a retailer offering quality traditional products. Within the campaign, customers can choose from a range of healthy products prepared based on traditional production recipes. Thus, the products include local prosciutto, baklava, olive oil, wine etc.



In addition to regular pricing activities, we also launched at the end of March the campaign Phenomenal April which lasted until the start of May and included 3 parts: spring cleaning, merry Easter, and I love grilling. The goal of the campaign was to keep the existing customers and win over new ones.

As of May 1, we launched a new customer loyalty program called **Super Card**. Super Card is a customer loyalty program that includes several partners, all of which rewards customer's shopping.



In April, we opened the **first Idea store in Šavnik**. In the first 2 days, we presented more than 1,000 presents to our customers, offered a 10% discount for every purchase, and gave away every 50th purchase.

EMPLOYEES

In 2017, we continue the processes of restructuring and reorganization, started in 2014. The goal remains to establish a more efficient work processes. We are aware that the employees are at the heart of our operations. They contribute greatly to customer satisfaction and to success of the pursuit of Mercator's business goals.

As of January 1, 2017, new organizational structure came into effect at the company **Mercator IP, d.o.o.**, at both macro and micro level. It allows faster and more efficient changes in organizational and work processes, and improved transparency of entire company operations.

Changes of macro and micro organization also took place at the company **Mercator - S, d.o.o.**, as of February 1, 2017, and again as of June 1, 2017, consistently with the relevant work processes and human resource changes.

As of March 15, 2017, a new Collective Labour Agreement came into effect at the company **Poslovni sistem Mercator, d.d.**, which introduces alignment with the Employment Relationships Act (ZDR-1) and the industry collective labour agreement.

As of June 1, 2017, macro organizational structure at the company **Mercator - CG, d.o.o.**, was changed.

Number of employees

	Number of employees as at June 30, 2017	Number of employees as at December 31, 2016	Index number of employees June 30, 2017/ December 31, 2016	Number of employees based on hours worked in the period 1–6, 2017
Slovenia	9,963	10,019	99.4	9,092
Serbia	8,357	8,830	94.6	8,061
Montenegro	1,511	1,436	105.2	1,340
Croatia	35	49	71.4	41
Bosnia in Herzegovina	21	20	105.0	19
TOTAL	19,887	20,354	97.7	18,553

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

In the period at hand, Mercator Group devoted nearly 65,456 hours to training and education that involved 14,434 employees.

The company **Poslovni sistem Mercator, d.d.**, is one of the first Slovenian companies to have introduced **internal coaching** in a systematic way, offering its employees who expressed the willingness to participate the possibility to work as coaches. Internal coaching supports the succession programs in retail and wholesale, and the individuals who express their wish for internal coaching.

Today, the group of active internal coaches includes 17 individuals. To date, five coaches received a certificate from the International Coach Federation; this year, three more employees joined them.





We completed the **School for Shop Managers and their Deputies in Wholesale**. 27 participants took part in five modules of 40 academic hours. They acquired skills and knowledge of the key aspects of Cash&Carry unit operation – wholesale strategy, mandatory training, hiring and working hours management, internal control, assortments, special campaigns, and sales orientation. In addition to the 4 theoretical modules, one day was dedicated to expand the computer skills and knowledge for work with the GOLD system, program support, and back office. This training allowed the employees in key positions in

retail to perform their challenging and responsible work even more successfully and efficiently.

In June, the project **Career Challenge** was completed with a festive certificate award ceremony that was also attended by Mercator's top management. The project included education as a part of the Management Academy and Business Academy for the employees who have shown potential to take on more challenging work assignments in the future. Training for a total of 34 participants took place in cooperation with the Business Excellence Centre at the Faculty of Economics in Ljubljana. It consisted of 8 modules at which the candidates addressed respective issues relevant for Mercator's further development. At the final module, participants worked together to present to the Management Board their vision of Mercator in the future.



In the **Mystery Shopper survey** for the first quarter, awards were presented to the units with excellent results. They were divided based on three criteria. Thus, awards were presented to 81 units with a high overall score (over 90%); to 8 units that improved their overall score by 10% or more; and to 12 units who maintained their overall score between 85% and 90%.

In order to strengthen our cooperation and find potential candidates to be hired at our meat departments, we held open door days at our meat departments before the end of the school year. On Monday, June 5, we hosted school principals and organizers of the mandatory practical training from five Slovenian high schools who offer the butchery training program. The purpose of the meeting was to transfer sound practices and retail trends from Mercator to schools, and to strengthen cooperation. In the first part, we presented to the guests the Mercator meat department strategy, and emphasized the advantages of working in retail, and the opportunities for their students. In the second part of their visit, we took them on a tour of Hypermarket Šiška, with particular focus on the meat department. **Meeting with the high school principals** was followed by an open door day for **5 high school junior (2nd year) students** at the Biotechnology Centre Ljubljana, with similar contents, emphasizing the opportunities for young employees at Mercator and a tour of the meat preparation, ageing, and packing plants and the meat department.



The week from May 29 to June 4, 2017, was dedicated to **mental health**. At this occasion, we issued a booklet "Protect and Boost Your Mental Health", which was presented to all employees.

Managers and health promoters were encouraged to talk about the aspects of mental health at their respective units. Every day of the week, we posted some news on the intranet and introduced "healthcare hours" to encourage the employees to care for their own mental health. Thus, we encouraged thinking about and awareness of the urgency of taking care of our own mental health



and of the fact that our behaviour and conduct can affect the mental health of others.

As of January 1, 2017, a new activity of Permanent Stocktaking Committee was introduced at the company **Mercator IP, d.o.o.** A group of nine employees is managing and conducting the stock taking of fixed assets (property, plant, and equipment), which will relieve the employees in retail and maintenance of considerable workload in the long run.



At the 17th bakery section contest that rates the quality of bread and pastry under the auspices of the Slovenian Chamber of Commerce and Industry, we received on February 7, 2017, five golden medals for products of the pastry shop "Kranjski kolaček". The highest score was awarded to Mercator private label products (cremeschnitte, coconut cubes, blueberry surprise cake, Linzer cookies) and the Special Moments label products (biscuits with white milk filling, biscuits with hazelnut filling). Mercator cremeschnitte (a custard cream dessert) remains our

most recognizable product.

At the end of May, we took part in the traditional, 14th symposium of Flour Production (Milling) and Bakery in Portorož. This year's topic at the symposium was food safety in flour milling, bakery, and pastry baking. At the event, we presented our pastry products made every day at the "Kranjski kolaček" pastry workshop in Naklo.



In the second quarter of 2017, we worked with the Slovenian Chamber of Commerce and Industry to certify the study programs for all vocations in the food industry in which we are encountering the greatest dearth of suitable human resources.

In May, seven employees completed several-day training to mentor the high school students in their practical training programs. In early June we worked with the company CRI Celje, which also deals with rehabilitation of disabled persons, and conducted a workshop at which 22 experts honed their mentorship competencies that they require on a daily basis when handling disability in the workplace.

At the end of the second quarter, the company Mercator IP, d.o.o., had 407 employees, of which 210, or 51.6%, were employees with a recognized category of disability.

In March, we started a **Training Academy** at the company **Mercator - S, d.o.o.** This is a program of assessment and implementation of required knowledge in trade or retail. In the first module, the employees upgraded their knowledge of the applications Hubie and Excel and their skills in development of analyses and reports; at the second module, they upgraded their knowledge of finance and marketing.

The project **Shop Manager Academy** is intended for all employees in retail working as sales assistant / cashier and head of department or section, who were identified as talent for promotion to the position of shop manager deputy shop manager. The program consists of two weeks of specialized training, three days of soft skill training, and six weeks of practical work in retail units under the supervision of a shop manager – mentor.

The goal of the program **Academy for Meat Department Sales Assistants** is to re-train in a structured and systematic way the interested employees working in various departments for the job of a butcher which they can then independently perform. This two-month program is held in cooperation with the Technical School for Chemistry and Food Industry and it includes education and training, examination, and grading. The mentors are our best butchers who share their knowledge with their colleagues.

Case study competition (CSC) is an interactive two-day competition organized by the Alumni Club IEDC Bled, in which teams from different companies show their talent and creativity in a limited period of time, through teamwork in analysis and resolution of a realistic business situation. This year's CSC took place on March 22 and 23, 2017, in Belgrade. The six-member team of young managers performed very well in the search for the best business solution, competing against other participating companies such as Coca Cola Hellenic Serbia, Delhaize, GGE, Hemofarm, and Triglav Osiguranje.



We have standardized the procedures of the coaching network program in retail, and completed the development of the FMS application through which the entire communication will take place within the network. We started the pilot project that includes 6 days of training at school before the start of work at the employee's unit, in April in the Belgrade region. At other regions, implementation is planned as of August 1, 2017.

A proposal for the model **Retail Management Program (RMP)** has been developed in order to implement the required skills in the business field of retail and logistics. Target participants include shop managers, heads of retail areas, and regional directors. The program will consist of several modules and a target group of participants will be defined for each module.

We continue the concept of **new employee induction process** which includes uses play (or games) to present the company processes to newly hired employees in administration, thus cutting short the time new employees need to learn and adapt.

The project of disabled persons hiring included creating a new job sales assistant, with working environment adjusted to the special needs of individuals with disability.

We have started the project of **mobile hiring** for jobs in retail (sales assistant, cashier). To date, the processes have been carried out in locations with higher fluctuation in Belgrade and Novi Sad. To this end, we set up outdoor mobile offices near our stores and at city outdoor swimming pools, distributed flyers to passers-by, and immediately held interviews with any interested candidates.



Hiring of seasonal workers increased in the units on the seaside in May and June at the company **Mercator - CG, d.o.o.**

In February, the Employee Talent Development Department held training for regional leaders and shop managers at all Idea business units, titled **Human Resources in Retail**. In order to improve the leadership skills, participants in training discussed the contents related to work satisfaction, management, leadership and communication etc. which they will use in their daily work.



Employee training was also carried out as a part of the Flavours of My Town project which may be one of the most important campaigns to date. This involves a new line of local Montenegrin products The Flavours of my Town. In order for all employees to be ambassadors of the project and to work together in the spirit of the project, all managers of our stores were informed about the project and the products. Gift packages were presented to them, containing the products from this line, so that they would convey their hands-on impressions to their co-workers, or sample the products together with them.

During the month of April, we conducted training for 250 employees as we introduced a new Super Card that replaced the Pika card. Training participants included shop managers and selected cashiers who took part in the theoretical and practical training.



One of the constant activities is the monitoring of newly hired employees. It is aimed at cutting short the time they take to adjust to the work at the company, and to identify promising talent in administration and retail. In the period from March to May, we monitored 44 employees during their first month on the job, and conducted interviews with them and their superiors. In order to make hiring more successful and effective, we are currently developing a systematization and update to the procedures for the entire hiring and human resource recruitment process.

At the end of March, the company **Mercator - Emba, d.d.**, joined twenty-five other alimentary companies in the public tender KOC Food for co-financing of training and education in the next two years. The project is managed

by the Chamber of Commerce of the Pomurje Region, working with the Chamber of Agricultural and Alimentary Companies. The project will include setting up an industry-wide competence centre or model, and co-financing for training and education that will contribute to improvement of competencies specified for respective job profiles.

In the first quarter in Slovenia, the **Mercator Humanitarian Foundation** provided aid to 59 employees of the companies Poslovni sistem Mercator, d.d., and Mercator IP, d.o.o., who were in need of help. We paid out humanitarian aid in the total amount of EUR 36,155. In Serbia, we provided humanitarian aid to 44 employees, in the total amount of EUR 13,814; in Montenegro, 28 employees received total aid of EUR 6,500; and in Croatia, one employee received aid of EUR 1,004.

REAL ESTATE MANAGEMENT AND RETAIL NETWORK DEVELOPMENT

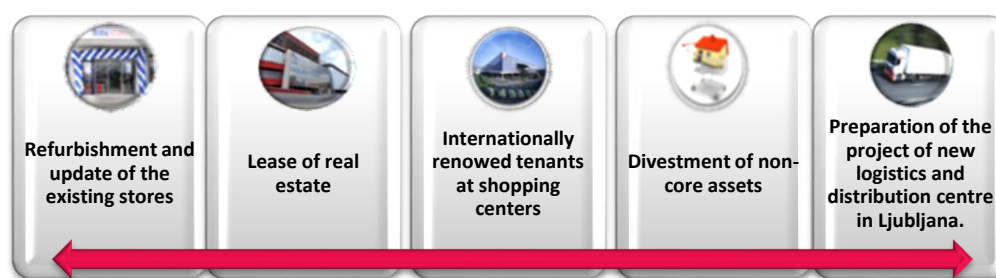
In the period 1-6, 2017, Mercator Group's priority in investment activities, consistently with the investment plan, was refurbishment of retail units and setting up new stores acquired through operating lease. The exception in this case is the Trade Centre Bled, for which construction started in September last year, and it was opened in March 2017. In the first half of 2017, we opened 9 new FMCG stores.

We also searched for and evaluated new potential locations to extend Mercator's retail network.

In the period 1-6, 2017, Mercator's greatest acquisition is the newly constructed Trade Centre Bled with a supermarket and additional premises to be leased out to third parties. There was no other own real estate development. Remaining investment funds were mostly used for renovation, acquisition of additional equipment, and investment maintenance of the existing retail network, and for investment into new leased stores.

Activities also took place with regard to divestment of non-core or non-operating assets, as well as with the investors willing to build or acquire retail area to suit Mercator's needs and then offer these facilities to Mercator on a lease.

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



Investment and Divestment

In the period 1-6, 2017, Mercator Group's investment into property, plant, and equipment (CAPEX) amounted to EUR 26.0 million. Of this amount, 38.8% was used for investments in Slovenia and 61.2% was used for investments in international markets.

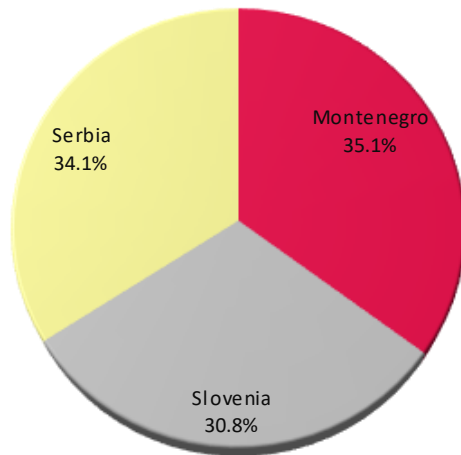
	Capital expenditure in 1-6, 2017 (in EUR 000)	Structure (in %)
Serbia	11,868	45.7%
Slovenia	10,063	38.8%
Bosnia and Herzegovina	1,932	7.5%
Montenegro	1,668	6.4%
Croatia	422	1.6%
TOTAL	25,953	100.0%

Investment into expansion of retail area represented 20.3% of total investment; refurbishments of existing units accounted for 61.3%; IT investments accounted for 10.0%; investments into distribution centers accounted for 5.6% and the remaining 2.8% was invested in non-trade activities.

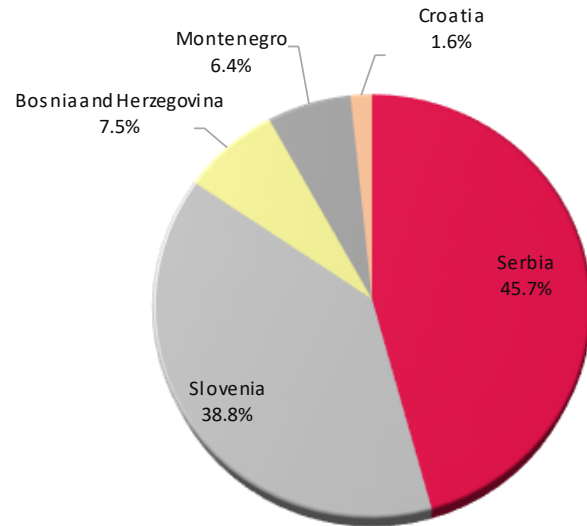
In the period 1–6, 2017, Mercator Group newly acquired 7,946 square meters of gross store area, of which 976 square meters was intended to be leased out to third party service providers. All new gross area, except for Trade Centre Bled, was acquired by operating lease.

In the period 1–6, 2017, Mercator Group divested property, plant, and equipment worth EUR 7.8 million, of which EUR 7.2 million pertains to the divestment of property (real estate) and EUR 0.6 million pertains to plant and equipment.

Share of newly launched facilities by markets:



Share of investments by market:



Summary of total gross retail area as at June 30, 2017:

	Gross area in square meters			TOTAL
	Used for own operations	Leased out-Konzum	Leased out-third parties	
Owned retail area	516,556	108,562	305,304	930,422
Leased retail area	380,552	73,975	115,025	569,552
Total retail area	897,108	182,537	420,329	1,499,974
Owned warehouse capacity	130,578	661	16,072	147,311
Leased warehouse capacity	55,321	25,982	17,165	98,468
Total warehouse capacity	185,899	26,643	33,237	245,779
Owned commercial facilities	19,067	0	2,110	21,177
Leased commercial facilities	7,311	0	346	7,657
Total commercial facilities	26,378	0	2,456	28,834
GROSS AREA UNDER MANAGEMENT	1,109,385	209,180	456,022	1,774,587
- of which owned	666,201	109,223	323,486	1,098,910
- of which leased	443,184	99,957	132,536	675,677

Summary of retail unit launches by markets in the period 1–6, 2017**SLOVENIA****Area of new facilities:** 2,451 m²Number of new units: 1Openings: Trgovski center Bled**Refurbishments:**Number of refurbished units: 21**SERBIA****Area of new facilities:** 2,706 m²Number of new units: 3Openings: Market Juriša Gagarina, Belgrade; Supermarket Super Višnjička, Belgrade; Market Mis Irbijeva, Belgrade**Refurbishments:**Number of refurbished units: 13**MONTENEGRO****Area of new facilities:** 2,789 m²Number of new units: 5Openings: Supermarket Idea Gold, Podgorica; Market Idea Trešnica, Podgorica; Market Idea Rafailovići, Budva; Market Idea Spuž, Podgorica; Market Idea Šavnik

RISK MANAGEMENT

Risk management is an important component of management which is conducted at Mercator in compliance with the new version of the quality management system standard ISO 9001:2015, and in compliance with the environmental management system ISO 14001:2015. In May 2016, the SIQ certification institute conducted the ISO 9001 and ISO 14001 audit at Poslovni sistem Mercator, d.d. The auditors praised the risk management system in place.

Risks are divided into 5 areas, or categories:

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

In total there are 509 identified risks in the Mercator Group risk register. Key risks for the Mercator Group were selected among them. A key risk for Mercator Group is a risk that meets at least one of the following criteria:

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

Strategic risks

Strategic risks pertain to development and implementation of the company strategy, stability of ownership, integration processes, management or governance of the company, compliance with the ethics code, flow of information, company reputation, sustainability of operations etc. These risks pertain to the questions of what will our customers, procurement sources, services, and sales channels be like in the medium run. Strategic risks pertain to occurrence of loss as a result of flawed business decisions, vision, mission, or values.

Key strategic risks include the following risk categories:

- **corporate governance risks** in which the risk of the laying down the right strategy and its execution is the most recognizable;
- **risk of competitiveness and customer satisfaction**, with the risk of a drop in market share as a result of new store openings by the competition being the most recognizable; and
- **risks of development of the offer of goods and services**, among which the risk of poor price competitiveness related to pricing management is the most recognizable, as inefficient price management can lead to loss of revenue, profit margin, and poorer consumer perception.

Financial risks

Financial risks pertain to financial management. They involve credit, interest rate, currency, liquidity, inflation, price, and other similar risks. The most important among these are the **credit risks** that are managed via a central credit limit system, sending notices for late payments, monthly receivables monitoring, contacting the customers regarding payments etc.

Operational risks

Operational risks can threaten the operations in category management and purchasing, production, logistics, retail, and wholesale. Key operational risks include the following two risk categories:

- **risk of category management and procurement**, with regard to which the risks of an increase in tradable commodity prices and seasonal effects are the most pronounced. With regard to the latter, we carefully plan our ordering of seasonal products and follow the weather forecasts, analyze our sales in the preceding year and the challenges of the current year,
- **risks of wholesale operations in which the** risk of loss of franchise partners and third-party customers is the most pronounced.

Support risks

Key support risks include the following risk categories:

- **human resource risks** which involve in particular the risks of lack of human resources,
- **legal risks**,
- **risks of real property and equipment management** which includes renovations and updates to our units,
- **IT risks**, with regard to which the key risk is the risk of central IT system failure (SAP, GOLD, Login, Hubie, e-mail etc. and
- **loss risks** pertaining to potential earthquakes and fires.

Compliance risks

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

Key compliance risks include **environmental risks** in which employees are informed on a quarterly basis on the measures for efficient use of energy; in addition, control of the use of energy is already in place on a monthly level for respective units of the company Poslovni sistem Mercator, d.d.

FINANCIAL MANAGEMENT

Stable Financial Operations

As at June 30, 2017, Mercator Group net financial debt amounted to EUR 814,247 thousand, which is 1.1% more than as at the end of 2016, and 4.9% less than as at June 30, 2016. In the last year, Mercator Group continued its stable financing activities.

in EUR 000	June 30, 2016	December 31, 2016	June 30, 2017	Index June 30, 2017/ December 31, 2016	Index June 30, 2017/ June 30, 2016
Non-current financial liabilities	756,657	738,354	764,347	103.5	101.0
Current financial liabilities	156,281	133,241	89,170	66.9	57.1
Financial liabilities	912,938	871,595	853,517	97.9	93.5
Cash and cash equivalents	19,175	26,318	9,237	35.1	48.2
Available-for-sale financial assets	473	462	463	100.2	97.9
Loans and deposits	36,960	39,495	29,570	74.9	80.0
Financial assets	56,608	66,275	39,270	59.3	69.4
Net financial debt	856,330	805,320	814,247	101.1	95.1

Financing costs

In the period 1–6, 2017, the 6-month EURIBOR averaged at -0.247%. At the end of the period, it was at -0.271%. Compared to the equivalent period of the year before when the 6-month EURIBOR averaged at -0.127%, this rate fell by 0.12 percentage point.

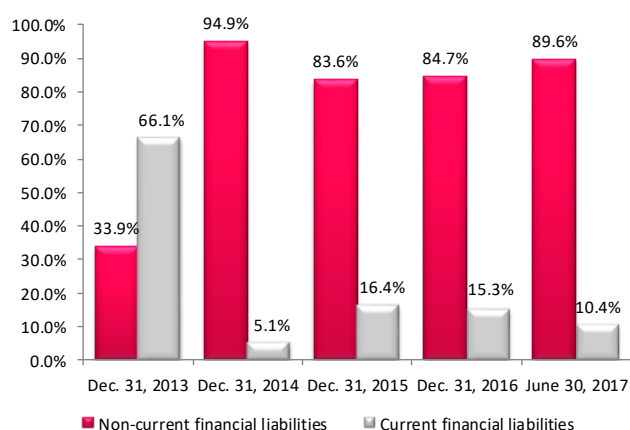
Security of bank loans

Restructuring of Mercator Group's financial liabilities included securing such liabilities with mortgages on Mercator's own real property, with financial investments into subsidiaries, receivables, inventories, and funds/deposits in bank accounts.

Debt to equity and financial liability ratio

As at June 30, 2017, Mercator Group attained a debt-to-equity (capital structure) ratio of 1:1.4. The ratio is a quotient between equity and net financial debt.

As at June 30, 2017, the share of Mercator Group's non-current financial assets was at 89.6%, which is consistent with a sustainable maturity profile of financial liabilities.



Available liquidity lines as at June 30, 2017

As at June 30, 2017, Mercator Group had access to the following liquidity lines:

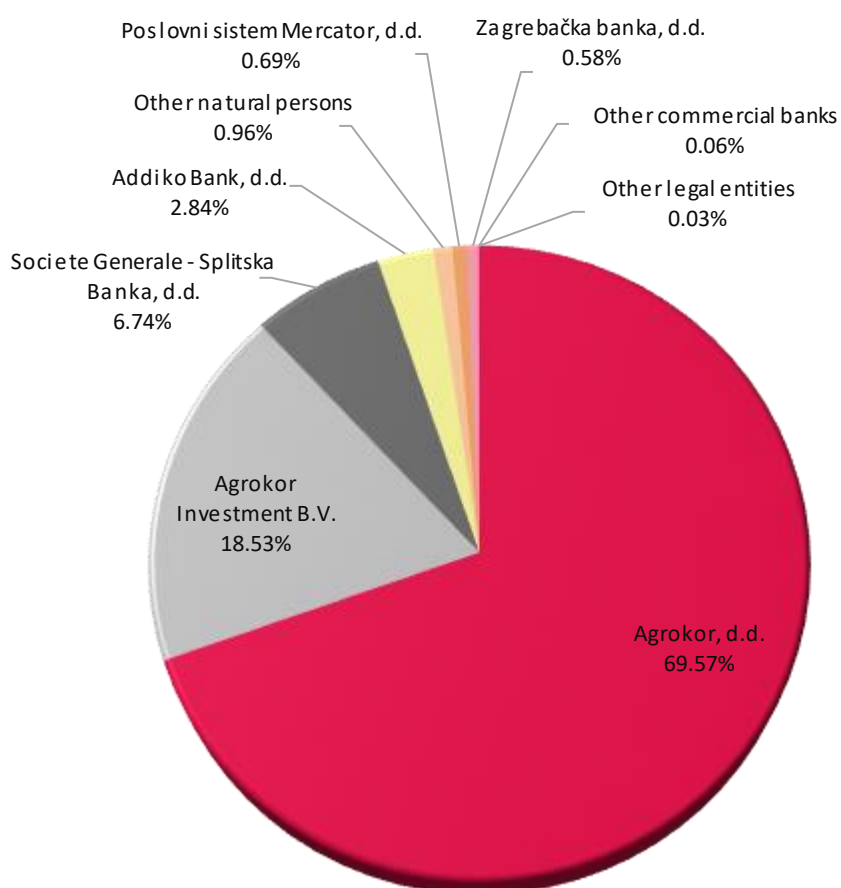
in EUR 000	June 30, 2017
Cash and cash equivalents	9,237
Standby revolving credit lines	47,575
Total	56,812

MERCATOR SHARE AND INVESTOR RELATIONS

Basic information on the share of the company Poslovni sistem Mercator, d.d., as at June 30, 2017:

Code / Symbol	MELR
Type	Common share
Listing	Prime market of Ljubljana borza, d.d.
Share capital	EUR 254,175,051.39
Number of shares	6,090,943
Number of treasury shares	42,192
Number of shareholders	1,646

Ownership structure of the company Poslovni sistem Mercator, d.d., as at June 30, 2017:



Major Shareholders

As at June 30, 2017 the following ten largest shareholders held a combined share of 98.67% of the company.

	Country	Number of shares	Share
1 Agrokori, d.d.	Croatia	4,237,376	69.57%
2 Agrokori Investments B.V.	Netherlands	1,128,803	18.53%
3 Societe Generale - Splitska Banka, d.d.	Croatia	410,339	6.74%
4 Addiko bank, d.d. - fiduciary account	Croatia	173,164	2.84%
5 Zagrebačka Banka, d.d. - fiduciary account	Croatia	35,393	0.58%
6 Galić Josip	Croatia	21,525	0.35%
7 Banque Pictet and CIE SA - fiduciary account	Switzerland	1,107	0.02%
8 Splitska banka d.d.- Ucits - client account	Croatia	953	0.02%
9 Horvat Jože	Slovenia	770	0.01%
10 Fortunat Miloš	Slovenia	575	0.01%
Total		6,010,005	98.67 %

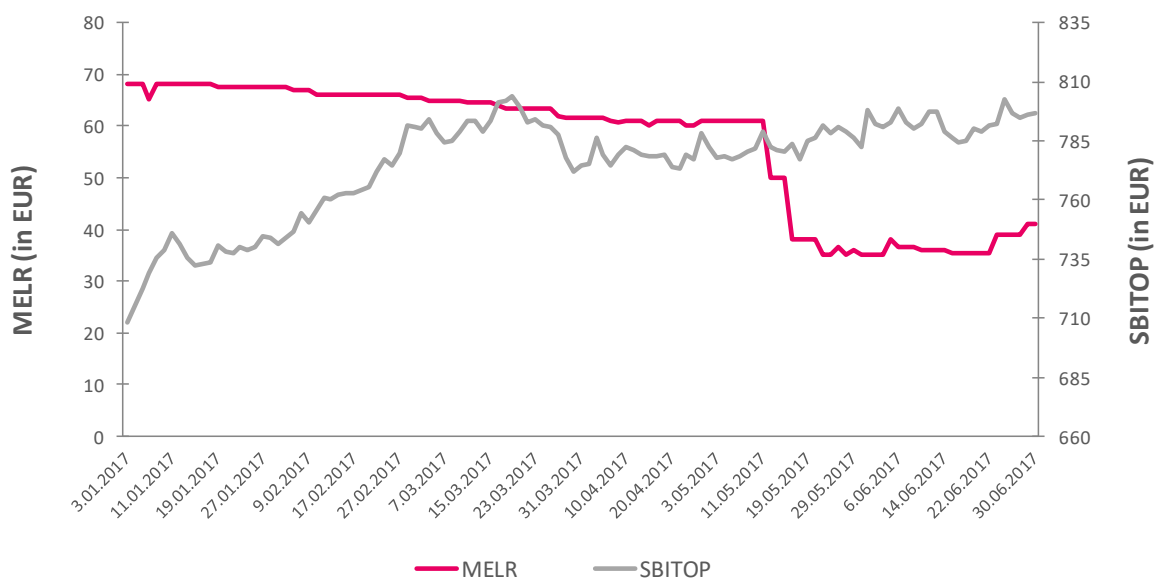
Shares held by Management and Supervisory Board Members as at June 30, 2017

Management Board and Supervisory Board Members did not own shares of the company Poslovni sistem Mercator, d.d., as at June 30, 2017.

Foreign shareholders

As at June 30, 2017, the share in the company Poslovni sistem Mercator, d.d., held by foreign investors amounted to **98.71%**, which is 0.11 percentage point more than the year before.

Movement of closing price per MELR share in the period 1–6, 2017, compared to the movement of the SBITOP index



Key information for the shareholders³

	June 30, 2016 Adjusted ³	June 30, 2017	Index June 30, 2017/ June 30, 2016 adjusted
Number of shares registered in Court Register	6,090,943	6,090,943	100.0
Number of treasury shares	42,192	42,192	100.0
Market capitalization (in EUR)	469,063,520	249,728,663	53.2
Market value of share (in EUR)	77.01	41.00	53.2
Book value per share (in EUR)	105.47	92.75	87.9
Minimum close rate in the period (in EUR)	77.01	35.00	45.4
Maximum close rate in the period (in EUR)	85.00	68.00	80.0
Average close rate in the period (in EUR)	82.13	56.54	68.8
Earnings per share (in EUR) ⁴	2.28	3.14	137.4

³ As the monetization project at the company Poslovni sistem Mercator, d.d., was stopped, assets available for disposal were re-classified at the end of 2016 back to non-current assets, and we resumed their depreciation and amortization. Therefore, business results for the period 1–6, 2016, are, for comparability, adjusted for the extra depreciation pertaining to the assets reclassified back to non-current assets as at the end of 2016.

⁴ The indicator is adjusted to the annual level.

Dividend policy

The company Poslovni sistem Mercator, d.d., does not plan dividend payment for 2017.

Treasury shares

As at June 30, 2017, the company Poslovni sistem Mercator, d.d., held 42,192 treasury shares. In the period 1–6, 2017, the company Poslovni sistem Mercator, d.d., neither acquired nor disposed of treasury shares.

Investors

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

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

³ Market capitalization is calculated by multiplying the number of shares entered into the court register as at June 30, with market price per share as at June 30.

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

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

FINANCIAL REPORT

ACCOUNTING POLICIES

All financial statements of the Mercator Group and the company Poslovni sistem Mercator, d.d., for the period 1–6, 2017, are drawn up in compliance with the International Financial Reporting Standards and they are unaudited.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF THE MERCATOR GROUP

Poslovni sistem Mercator, d.d. (hereinafter referred to as Mercator, d.d.), is a company headquartered in Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. Condensed consolidated financial statements for the period 1–6, 2017, include the company Poslovni sistem Mercator, d.d., and its subsidiaries, as follows:

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

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

Condensed consolidated statement of financial position

EUR thousand	June 30, 2017	December 31, 2016	Index Jun. 30, 2017/ Dec. 31, 2016
ASSETS			
Non-current assets			
Property, plant and equipment	1,562,212	1,569,905	99.5
Investment property	10,052	9,899	101.5
Intangible assets	21,925	21,963	99.8
Deferred tax assets	20,520	23,529	87.2
Loans and deposits	27,785	31,385	88.5
Available-for-sale financial assets	463	462	100.2
	1,642,958	1,657,143	99.1
Current assets			
Inventories	206,998	224,328	92.3
Trade and other receivables	223,695	205,707	108.7
Current tax assets	1,062	1,230	86.3
Loans and deposits	1,785	8,110	22.0
Cash and cash equivalents	9,237	26,318	35.1
	442,777	465,693	95.1
Total assets	2,085,735	2,122,836	98.3
EQUITY			
Share capital	254,175	254,175	100.0
Share premium	207,523	286,772	72.4
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	41,685	41,686	100.0
Fair value reserve	104,148	104,541	99.6
Retained earnings	44,752	37,515	119.3
Profit (loss) for the period	10,363	(72,463)	-
Currency translation reserve	(90,298)	(91,720)	98.4
Total equity attributable to equity owners of the company	569,113	557,270	102.1
Non-controlling interests	100	106	94.0
Total equity	569,213	557,376	102.1
LIABILITIES			
Non-current liabilities			
Trade and other payables	49,896	45,183	110.4
Borrowings and other financial liabilities	764,347	738,354	103.5
Deferred tax liabilities	31,196	31,356	99.5
Provisions	26,145	26,818	97.5
	871,584	841,711	103.5
Current liabilities			
Trade and other payables	555,459	590,021	94.1
Current tax liabilities	309	488	63.3
Borrowings and other financial liabilities	89,170	133,241	66.9
	644,938	723,750	89.1
Total liabilities	1,516,522	1,565,460	96.9
Total equity and liabilities	2,085,735	2,122,836	98.3

Condensed consolidated income statement

EUR thousand	1-6, 2017	1-6, 2016 adjusted*	1-6, 2016 continued**	Index 1-6, 2017/ 1-6, 2016 adjusted	Index 1-6, 2017/ 1-6, 2016 continued
Revenue	1,146,498	1,245,316	1,174,989	92.1	97.6
Cost of goods sold and selling costs	(1,094,954)	(1,197,113)	(1,132,389)	91.5	96.7
Administrative expenses	(37,425)	(39,960)	(37,950)	93.7	98.6
Other income	7,607	9,760	9,141	77.9	83.2
Results from operating activities	21,726	18,003	13,791	120.7	157.5
Finance income	8,051	3,613	3,484	222.8	231.1
Finance expenses	(15,938)	(15,651)	(15,499)	101.8	102.8
Net finance expenses	(7,887)	(12,038)	(12,015)	65.5	65.6
Profit (loss) before tax	13,839	5,965	1,776	232.0	779.4
Tax expense	(3,484)	(2,096)	(1,767)	166.2	197.2
Profit (loss) for the period	10,355	3,869	9	267.6	119.905.4
Profit (loss) for the period attributable to:					
Owners of the parent company	10,363	3,882	-	267.0	-
Non-controlling interests	(8)	(13)	-	64.2	-

* As the monetization project at the company Poslovni sistem Mercator, d.d., was stopped, assets available for disposal were re-classified at the end of 2016 back to non-current assets, and we resumed their depreciation and amortization. Therefore, business results for the period 1-6, 2016, are, for comparability with 2017, adjusted for the extra depreciation pertaining to the assets reclassified back to non-current assets as at the end of 2016.

** Revenue from sales of continued operations include also revenue from internal rents, that Mercator Group received from Intersport during the period when it was legal entity, in 2016 amounted to EUR 2,173 thousand.

Condensed consolidated statement of comprehensive income

EUR thousand	1-6, 2017	1-6, 2016 adjusted	Index 1-6, 2017/ 1-6, 2016 adjusted
Profit (loss) for the period	10,355	3,869	267.6
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss	-	-	-
Items that may be reclassified subsequently to profit or loss	1,484	(1,621)	-
Foreign currency translation differences - foreign operations	1,425	(1,410)	-
Deferred tax	60	112	53.5
Other changes	-	(323)	-
Other comprehensive income for the period	1,484	(1,621)	-
Total comprehensive income for the period	11,839	2,248	526.7
Total comprehensive income for the period attributable to:			
Owners of the parent company	11,844	2,259	524.4
Non-controlling interests	(7)	(11)	65.9

Condensed consolidated statement of changes in equity

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings (loss)	Profit (loss) for the year	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance as at January 1, 2016	254,175	286,772	(3,235)	41,686	108,865	15,365	20,245	(89,668)	634,205	228	634,433
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	3,882	-	3,882	(13)	3,869
Other comprehensive income	-	-	-	-	112	(322)	-	(1,413)	(1,623)	2	(1,621)
Total comprehensive income for the period	-	-	-	-	112	(322)	3,882	(1,413)	2,259	(11)	2,248
Transactions with owners directly recognized in equity	-	-	-	-	-	-	-	-	-	-	-
Transfer of profit for previous year to retained earnings	-	-	-	-	-	20,245	(20,245)	-	-	-	-
Balance as at June 30, 2016 (adjusted)	254,175	286,772	(3,235)	41,686	108,977	35,288	3,882	(91,081)	636,464	217	636,681

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings (loss)	Profit (loss) for the year	Currency translation reserve	Total equity attributable to owners of the parent company	Non-controlling interests	Total equity
Balance as at January 1, 2017	254,175	286,772	(3,235)	41,685	104,541	37,514	(72,463)	(91,720)	557,269	107	557,376
Total comprehensive income for the period											
Profit (loss) for the period	-	-	-	-	-	-	10,363	-	10,363	(9)	10,354
Other comprehensive income	-	-	-	-	(394)	453	-	1,422	1,481	2	1,483
Total comprehensive income for the period	-	-	-	-	(394)	453	10,363	1,422	11,844	(7)	11,837
Transactions with owners directly recognized in equity	-	-	-	-	-	-	-	-	-	-	-
Transfer of profit for previous year to retained earnings	-	-	-	-	-	6,786	72,463	-	79,249	-	79,249
Distribution of profit for the year pursuant to the Management Board decision	-	(79,249)	-	-	-	-	-	-	(79,249)	-	(79,249)
Balance as at June 30, 2017	254,175	207,523	(3,235)	41,685	104,148	44,752	10,363	(90,298)	569,113	100	569,213

Condensed consolidated cash flow statement

EUR thousand	1-6, 2017	1-6, 2016	Index 1-6, 2017/ 1-6, 2016
Cash flows from operating activities			
Gross cash flows from operating activities	55,546	52,594	105.6
Change in inventories	17,330	12,749	135.9
Change in trade and other receivables	(17,820)	(24,630)	72.4
Change in trade and other payables	(30,938)	(11,952)	258.8
	24,118	28,761	83.9
Interest paid	(15,215)	(14,675)	103.7
Income tax paid	(309)	(2,048)	15.1
Net cash from (used in) operating activities	8,594	12,038	71.4
Cash flows from investing activities			
Acquisition of property, plant and equipment and investment property	(24,189)	(26,779)	90.3
Acquisition of intangible assets	(1,764)	(5,494)	32.1
Loans and bank deposits made	-	-	-
Proceeds from sale of property, plant and equipment and investment property	7,777	12,453	62.5
Proceeds from sale of intangible assets	-	1	-
Loans and bank deposits made	9,925	1,709	580.7
Proceeds from sale of available-for-sale financial assets	-	149	-
Interest received	592	669	88.5
Net cash used in investing activities	(7,659)	(17,293)	44.3
Cash flows from financing activities			
Proceeds (repayment) in borrowings	(18,078)	5,506	-
Net cash from (used in) financing activities	(18,078)	5,506	-
Net (decrease) increase in cash and cash equivalents	(17,143)	251	-
Cash and cash equivalents at the beginning of the year	26,318	18,998	138.5
Effect of exchange rate fluctuations on cash and cash equivalents held	62	(74)	-
			-
Cash and cash equivalents as at the end of the period	9,237	19,175	48.2

Notes to Mercator Group condensed consolidated financial statements

Notes to condensed consolidated income statement

Revenue

In the period 1–6, 2017, Mercator Group generated EUR 1,146.5 million of revenue, which is 7.9% decrease compared with the period 1–6, 2016 or 2.4% less comparing only the activities that have not been divested. Core activity had a positive effect on the Mercator Group revenue. In the markets of Slovenia and Montenegro, our revenue from sales of goods was higher relative to the same period last year. In the Serbian market, retail revenue was lower, especially due to closing down the units in compliance with the market regulator's decision; however, the current trends are positive.

The drop of overall revenue across markets was affected especially by the divestment of non-core activities of Modiana and Intersport in 2016, as well as optimization of wholesale channels and closing down of stores in compliance with the market regulator's decision in Serbia.

Cost of goods sold and selling costs

Mercator Group cost of goods sold and selling costs which include the cost of goods sold, production costs, selling and other expenses, amounted to EUR 1,094,954 thousand in the period 1–6, 2017, which is a 8.5% decrease compared with the same period of the previous year.

Administrative expenses

Mercator Group's administrative expenses in the period 1–6, 2017, amounted to EUR 37,425 thousand, which is 6.3% decrease compared with the equivalent period of the previous year.

Total expenses by nature amounted to EUR 293,279 thousand in the period 1–6, 2017, which is 5.8% decrease compared with the equivalent period of the previous year.

Result from operating activities

In the period 1–6, 2017, Mercator Group's result from operating activities reached EUR 21,726 thousand, which is 20.7% more compared with the equivalent period of the previous year.

Net finance expenses

Net finance expenses in the period 1–6 2017, amounted to EUR 7,887 thousand, while they amounted to EUR 12,083 thousand in the previous year, which is mostly a result of positive currency translation differences.

Profit before income tax

In the period 1–6, 2017, Mercator Group's profit before income tax amounted to EUR 13,839 thousand.

Profit for the financial period

Mercator Group net profit for the period 1–6, 2017, amounts to EUR 10,355 thousand, which is EUR 6,486 thousand more compared with the equivalent period of the previous year.

EBITDA

Mercator Group EBITDA in the period 1–6, 2017, amounted to EUR 58,289 thousand which is 2.2% more than in the same period of the previous year.

EBITDAR

EBITDAR for the period 1–6, 2017, amounted to EUR 94,082 thousand which is 1.6% less than in the same period of the previous year.

Notes to condensed consolidated statement of financial position

Assets

Mercator Group assets as at June 30, 2017, amounted to EUR 2,085,735 thousand, which is EUR 37,102 thousand less than at the end of 2016.

As at June 30, 2017, the value of Mercator Group's non-current assets amounted to EUR 1,642,957 thousand, which is EUR 14,185 thousand less than as at December 31, 2016. Fixed assets represent the largest share of non-current assets at 97.0% (EUR 1,594,190 thousand), which is EUR 7,577 thousand less than as at the end of 2016.

As at June 30, 2017, the value of Mercator Group's current assets amounted to EUR 442,777 thousand, which is EUR 22,916 thousand less than as at the end of 2016. Trade and other receivables represent the largest portion of total current assets (50.5%), followed by inventories (46.7%).

Equity and liabilities

As at June 30, 2017, Mercator Group total equity amounted to EUR 569,213 thousand, which is EUR 11,837 thousand more than as at the end of 2016. The change pertains to net profit in the amount of EUR 10,355 thousand, and other comprehensive income amounting to EUR 1,483 thousand.

As at June 30, 2017, total financial liabilities amounted to EUR 853,518 thousand, which is EUR 18,078 thousand less than as at the end of 2016. Net financial debt of the Mercator Group, calculated as the difference between Mercator Group financial liabilities and financial assets, amounted to EUR 814,247 thousand as at June 30, 2017 (December 31, 2016: EUR 805,320 thousand). The share of long-term financial liabilities as at June 30, 2017, was at 89.6% (84.7% as at December 31, 2016).

As at June 30, 2017, provisions amounted to EUR 26,145 thousand. Compared to the end of 2016, provisions have decreased by EUR 673 thousand.

Trade and other payables as at June 30, 2017, amounted to EUR 605,355 thousand, which is EUR 29,849 thousand less than at the end of 2016, especially on account of current trade and other payables.

As at June 30, 2017, coverage of non-current assets with non-current liabilities at the Mercator Group was at 87.7%, which is by 3.3 percentage point more than as at the end of 2016.

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

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

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

Condensed statement of financial position

EUR thousand	June 30, 2017	December 31, 2016	Index Jun. 30, 2017/ Dec. 31, 2016
ASSETS			
Non-current assets			
Property, plant and equipment	855,954	867,726	98.6
Investment property	3,197	3,237	98.8
Intangible assets	13,501	13,455	100.3
Deferred tax assets	18,049	21,218	85.1
Trade and other receivables	373	25,664	1.5
Loans and deposits	161,745	125,202	129.2
Equity investments in Group companies	270,758	270,758	100.0
Available-for-sale financial assets	296	296	100.0
	1,323,871	1,327,554	99.7
Current assets			
Inventories	114,790	121,783	94.3
Trade and other receivables	83,440	78,786	105.9
Current tax assets	-	300	-
Loans and deposits	969	999	97.0
Cash and cash equivalents	4,291	13,344	32.2
	203,490	215,212	94.6
Total assets	1,527,361	1,542,766	99.0
			-
EQUITY			
Share capital	254,175	254,175	100.0
Share premium	207,523	286,772	72.4
Treasury shares	(3,235)	(3,235)	100.0
Revenue reserves	16,624	16,624	100.0
Fair value reserve	75,803	76,196	99.5
Retained earnings	659	(1,802)	-
Profit (loss) for the period	9,495	(77,447)	-
Total equity	561,044	551,283	101.8
LIABILITIES			
Non-current liabilities			
Trade and other payables	30,616	27,198	112.6
Borrowings and other financial liabilities	522,824	508,047	102.9
Deferred tax liabilities	24,991	25,229	99.1
Provisions	22,567	23,041	97.9
	600,998	583,514	103.0
Current liabilities			
Trade and other payables	293,102	315,082	93.0
Current tax liabilities	-	-	-
Borrowings and other financial liabilities	72,217	92,886	77.7
	365,319	407,968	89.5
Total liabilities	966,317	991,483	97.5
Total equity and liabilities	1,527,361	1,542,766	99.0

Condensed income statement

EUR thousand	1-6, 2017	1-6, 2016 adjusted*	1-6, 2016 continued	Index 1-6, 2017/ 1-6, 2016 adjusted	Index 1-6, 2017/ 1-6, 2016 continued
Revenue	637,276	672,874	655,279	94.7	97.3
Cost of goods sold and selling costs	(604,951)	(645,930)	(630,060)	93.7	96.0
Administrative expenses	(18,167)	(18,595)	(17,911)	97.7	101.4
Other income	4,841	4,824	4,794	100.4	101.0
Result from operating activities	18,999	13,173	12,102	144.2	157.0
Finance income	3,007	5,082	5,082	59.2	59.2
Finance expenses	(9,314)	(9,888)	(9,888)	94.2	94.2
Net finance expenses	(6,307)	(4,806)	(4,807)	131.2	131.2
Profit (loss) before tax	12,692	8,367	7,296	151.7	174.0
Tax expense	(3,197)	(1,456)	(1,456)	219.6	219.6
Profit (loss) for the period	9,495	6,911	5,840	137.4	162.6

* As the monetization project at the company Poslovni sistem Mercator, d.d., was stopped, assets available for disposal were re-classified at the end of 2016 back to non-current assets, and we resumed their depreciation and amortization. Therefore, business results for the period 1-6, 2016, are, for comparability, adjusted for the extra depreciation pertaining to the assets reclassified back to non-current assets as at the end of 2016.

Condensed statement of comprehensive income

EUR thousand	1-6, 2017	1-6, 2016 adjusted	Index 1-6, 2017/ 1-6, 2016 adjusted
Profit (loss) for the period	9,495	6,911	137.4
Other comprehensive income			
Items that will not be reclassified subsequently to profit or loss	266	-	-
Deferred taxes	266	-	-
Items that may be reclassified subsequently to profit or loss	-	-	-
Other comprehensive income for the period	266	-	-
Total comprehensive income for the period	9,761	6,911	141.2

Condensed statement of changes in equity

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Total equity
Balance as at January 1, 2016	254,175	286,772	(3,235)	16,624	79,869	619	(3,800)	631,024
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	6,911	6,911
Other comprehensive income	-	-	-	-	(1,252)	1,252	-	-
Total comprehensive income for the period	-	-	-	-	(1,252)	1,252	6,911	6,911
Transactions with owners directly recognized in equity	-	-	-	-	-	-	-	-
Transfer of profit for previous year to retained earnings	-	-	-	-	-	(3,800)	3,800	-
Balance as at June 30, 2016 (adjusted)	254,175	286,772	(3,235)	16,624	78,617	(1,929)	6,911	637,935

EUR thousand	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Total equity
Balance as at January 1, 2017	254,175	286,772	(3,235)	16,624	76,196	(1,802)	(77,447)	551,283
Total comprehensive income for the period								
Profit (loss) for the period	-	-	-	-	-	-	9,495	9,495
Other comprehensive income	-	-	-	-	(393)	659	-	266
Total comprehensive income for the period	-	-	-	-	(393)	659	9,495	9,761
Transactions with owners directly recognized in equity	-	-	-	-	-	-	-	-
Distribution of profit for the year pursuant to the Shareholders Assembly decision	-	(79,249)	-	-	-	1,802	77,447	-
Balance as at June 30, 2017	254,175	207,523	(3,235)	16,624	75,803	658	9,495	561,044

Condensed cash flow statement

EUR thousand	1-6, 2017	1-6, 2016	Index 1-6, 2017/ 1-6, 2016
Cash flows from operating activities			
Gross cash flows from operating activities	32,509	28,583	113.7
Change in inventories	6,993	2,456	284.7
Change in trade and other receivables	(4,354)	(20,062)	21.7
Change in trade and other payables	(19,036)	9,117	-
	16,112	20,094	80.2
Net foreign exchange gains from financing activities	(6)	12	-
Interest paid	(8,571)	(9,888)	86.7
Income tax paid	-	-	-
Net cash from (used in) operating activities	7,535	10,218	73.7
Cash flows from investing activities			
Acquisition of subsidiaries and business operations, net of cash acquired	-	(2,000)	-
Acquisition of property, plant and equipment and investment property	(8,406)	(8,294)	101.4
Acquisition of intangible assets	(1,211)	(4,298)	28.2
Loans and bank deposits made	(11,222)	(1,356)	827.6
Proceeds from sale of property, plant and equipment and investment property	7,355	5,668	129.8
Proceeds from sale of available-for-sale financial assets	-	149	-
Interest received	2,788	2,060	135.3
Dividend received	-	2,005	-
Net cash used in investing activities	(10,696)	(6,066)	176.3
Cash flows from financing activities			
Net repayment in borrowings	(5,891)	(2,144)	274.8
Net cash from (used in) financing activities	(5,891)	(2,144)	274.8
Net (decrease) increase in cash and cash equivalents	(9,052)	2,008	-
Cash and cash equivalents at the beginning of the year	13,344	10,046	132.8
Cash and cash equivalents as at the end of the period	4,291	12,054	35.6

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

Notes to condensed income statement

Revenue

In the period 1–6, 2017, the company Poslovni sistem Mercator, d.d., generated EUR 637,276 thousand of revenue, which is 5.3% less relative to the period 1–6, 2016. Core activity had a positive effect on the company Poslovni sistem Mercator, d.d. Revenue from sales of goods was higher relative to the same period last year. The drop of overall revenue was affected especially by the divestment of non-core activities of Modiana in 2016 and as well as optimization of wholesale channels.

Cost of goods sold and selling costs

Costs of sales of the company Poslovni sistem Mercator, d.d., which include the cost of goods sold, selling costs, and other expenses, amounted to EUR 604,951 thousand in the period 1–6, 2017, which is a 6.3% decrease on the same period of last year.

Administrative expenses

The company's administrative expenses in the period 1–6, 2017, amounted to EUR 18,167 thousand, which is 2.3% less than in the equivalent period last year. Expenses decreased primarily due to divestment of Modiana and Intersport operations in the second half of 2016.

Total expenses by nature amounted to EUR 159,888 thousand in the period 1–6, 2017, which is 5.0 percent less than in the equivalent period of last year.

Results from operating activities

In the period 1–6 2017, results from operating activities of the company Poslovni sistem Mercator, d.d., reached EUR 18,999 thousand, which is 44.2% more than in the same period of last year.

Net finance expenses

Net finance expenses in the period 1–6 2017, amounted to EUR 6,307 thousand, while they amounted to EUR 4,806 thousand in the previous year.

Profit before income tax

The company's profit before income tax for the period 1–6, 2017, amounted to EUR 12,692 thousand, which is EUR 4,325 more than in the same period of 2016.

Profit for the financial period

The company's net profit for the period 1–6, 2017, amounted to EUR 9,495 thousand, which is 2,584 thousand more than in the equivalent period of last year.

EBITDA

EBITDA of the company Poslovni sistem Mercator, d.d., in the period 1–6, 2017, amounted to EUR 35,226 thousand which is 11.2% more than in the comparable period of last year.

EBITDAR

EBITDAR of the company Poslovni sistem Mercator, d.d., in the period 1–6, 2017, amounted to EUR 39,879 thousand which is 7.9% more than in the comparable period of last year.

Notes to condensed statement of financial position

Assets

Assets of the company Poslovni sistem Mercator, d.d., as at June 30, 2017, amounted to EUR 1,527,361 thousand, which is EUR 15,405 thousand less than at the end of 2016.

As at June 30, 2017, the value of the company's non-current assets amounted to EUR 1,323,871 thousand, which is EUR 3,683 thousand less than as at December 31, 2016. Property, plant, and equipment represent the largest share of non-current assets at 65.9% (EUR 872,652 thousand), which is EUR 11,766 thousand less than at the end of 2016.

As at June 30, 2017, the value of company current assets amounted to EUR 203,490 thousand, which is EUR 11,722 thousand less than at the end of 2016. The decrease pertains largely to inventories, and cash and cash equivalents. Inventories account for the largest share of current assets with 56.4%, while trade and other receivables account for 41.0%.

Equity and liabilities

As at June 30, 2017, total equity of the company Poslovni sistem Mercator, d.d., amounted to EUR 561,044 thousand, which is EUR 9,761 thousand, or 1.8%, more than as at the end of 2016. The increase is primarily a result of net profit in the period 1–6, 2017.

As at June 30, 2017, total financial liabilities amounted to EUR 595,041 thousand, which is EUR 5,892 thousand less than as at the end of 2016.

As at June 30, 2017, provisions amounted to EUR 22,567 thousand. Compared to the end of 2016, provisions decreased by EUR 474 thousand.

Trade and other payables as at June 30, 2017, amounted to EUR 323,718 thousand, which is EUR 18,562 thousand less than at the end of 2016, especially on account of current trade and other payables.

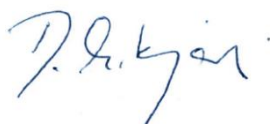
MANAGEMENT RESPONSIBILITY STATEMENT

The Management Board of the company Poslovni sistem Mercator, d.d., hereby confirms that the summary of the financial report of the company Poslovni sistem Mercator, d.d., and the Mercator Group for the period ended on June 30, 2017, 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 net 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.

Ljubljana, August 16, 2017



Tomislav Čizmić
President of the Management Board



Draga Cukjati
Member of the Management Board



Igor Mamuza
Member of the Management Board



Gregor Planteu
Extraordinary Member of the Management Board