ANNUAL REPORT 2017

Mercator

moj najboljši sosed

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Legend

Non-Financial Report — The content is also included in the Non-Financial Report.

We are carrying the tradition of the best neighbour into a new era in which Mercator is "Mine. The best."

INTRODUCTION.

REPORT BY THE PRESIDENT OF MANAGEMENT BOARD

For Mercator, the year 2017 was of key importance in terms of stabilization of operations and focus on the core activity – fast moving consumer goods. Therefore, Mercator devised a new business strategy that contributed in 2017 to some key positive business developments that were reflected, along with somewhat higher consumer optimism, especially in higher core activity revenue. Hence, Mercator is operating well and growing; after all, it saw an increase in core activity revenue for the first time since 2011.

Immediately upon assuming its assignments in April 2017, the Management Board launched the measures for stabilization, improvement of efficiency of operations, intensified updates to the retail network, as well as all activities focused on the challenges brought about by the change in ownership. In just few days after assuming its term of office, the Management Board succeeded in maintaining the confidence of Mercator's creditor banks. Activities focusing on the suppliers, partners, and customers were at the fore throughout 2017. Mercator Group is independent in all key business decisions. Operations were stable; core activity revenue growth was positive; and debt of creditor banks is decreasing. A key assumption for Mercator's successful further development is deleveraging. This is also specified in Mercator's development guidelines for the period until 2021. Mercator remains a reliable business partner.

Also contributing to Mercator's stability was the appointment of a extraordinary Management Board member appointed pursuant to the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia. Regular analyses and reports compiled by the extraordinary Management Board member confirmed the diligence, economy, and credibility of Mercator's operations. The company did not sustain any loss or damage in any transaction with the majority shareholder.

An important task for Mercator, successfully completed last year, was to carry the tradition of the "best neighbour" into the new times, to consolidate its competitive edge, and to develop a new business model. In 2017, we further strengthened our solid ties with our suppliers – both large national and regional partners and smaller, yet to us very important local producers and agricultural cooperatives. For them, we specially developed promotion projects for their brands, as this is our shared and highly important point of differentiation that the customers tend to notice the most. Everything we do must ultimately result in benefit for the customers; only thus can we continue to be successful together. Above all, we fulfilled all our promises made at the start of the year and accomplished the goals we laid down for this time period.

In 2017, the Mercator Group Management Board provided all conditions for the Group's further successful operation and long-term development. Mercator Group is the largest regional retailer with major competitive advantages. With differentiation, adjustment of offer to the needs of the modern consumer and specifics of respective local and regional markets, special focus on communication overhaul and closer cooperation with the local, national, and regional suppliers, the Group has succeeded in reaching a normalized profit for the year – eliminating all one-off negative events – of EUR 6 million, and normalized gross cash flow from operating activities (EBITDA) of EUR 90.6 million, which is EUR 28.6 million more than in 2016, or index growth is 145.4 compared to 2016.

When reviewing the operations and performance in 2017, it is important to understand that real estate represents a separate business area at the Mercator Group due to its considerable scope. In terms of real estate ownership, Mercator Group is an atypical retailer, since retailers are normally not owners of real property. We are committed to observing the accounting policy, rules and International Accounting Standards. This, of course, allows us to reach the highest standards of economy and transparency of our operations. Therefore, we re-appraised our real property in 2017. It should of course be noted that appraisal of 908 properties, or real estate units, is a challenging task, and that the total value of land and buildings only decreased by 1.4%. Real estate was re-appraised by an independent consultancy, and the results were audited by external expert institutions. When reviewing the operations and performance, it should of course be taken into account that the decreased value of real estate has direct effects on the business results, while the increased value, pursuant to the international standards, is taken into account in the company's equity. From the aspect of the Group's development, increase of equity is an important foundation.

By focusing on profitability and growth, with long-term cooperation with suppliers, development of a new store concept, and investment into development of employees, we ensure that Mercator remains the store that is closest to the customers. Time and again, the customers rate Mercator highly in terms of quality of offer and friendy service, which is why many consumers have come to call it "my store". We refreshed the Mercator private label image; loyalty card Pika, voted the best customer loyalty system by the customers, celebrated its 18th birthday; we intensively refurbished and updated our stores and conducted numerous campaigns of favourable prices for our customers, and held a number of events for our communities in all markets of Mercator's operations. With volatile circumstances, challenging business conditions, and harsh competitive environment, we are solidly anchored in the awareness that Mercator is the store that offers every day a broad and quality offer, allows convenient shopping in pleasant environment, is integrated into the local and broader social life, and improves the quality of life.

Therefore, Mercator will remain focused on its core activity and successful pursuit of its revised business strategy, including cost optimization and further growth, deleveraging, differentiation of its offer, strengthening of long-term cooperation with suppliers, development of a new store concept, and investment into development of employees. We believe that with further solid operations and favourable circumstances, we will succeed in completing in the near future two major projects that we are currently planning: monetization of real estate, and construction of a new logistics and distribution centre, which will surely contribute to a new development cycle.

We shall continue to persistently improve the key performance indicators and deliver on our commitments to the customers, thus developing a new, modern Mercator. I thank everyone whose work, confidence and sympathy has contribute to Mercator's further success, and I am pleased that we will together drive the development and growth of the region's largest retailer – the Mercator Group.

President of the Management Board of the company Poslovni sistem Mercator d.d.
Tomislav Čizmić

Ljubljana, April 25, 2018

SUPERVISORY BOARD REPORT

Pursuant to the legislation and company Articles of Association, operations of the company Poslovni sistem Mercator d.d. as Mercator Group's controlling company were supervised in 2017 by a Supervisory Board which met at seven regular sessions and one extraordinary session in the course of the year. In addition, seven correspondence sessions were held in 2017.

As at December 31, 2017, the composition of the Supervisory Board was as follows: Ante Ramljak (Supervisory Board chairman), Matej Lahovnik (deputy chairman), Vladimir Bošnjak, Damir Kuštrak, Ivica Mudrinić, and Teo Vujčić as Supervisory Board members representing capital, and Matjaž Grošelj, Vesna Stojanović, and Jože Lavrenčič as members representing the employees.

The following changes took place in the Supervisory Board in the course of the year.

- On April 25, 2017, the Supervisory Board chairman Ante Todorić and Supervisory Board member Ivan Crnjac submitted their statements of resignation; on June 1, 2017, a statement of resignation was also submitted by the Supervisory Board member Darko Knez; all three were representatives of capital.
- At the 24th regular Shareholders Assembly of the company Poslovni sistem Mercator d.d., held on June 15, 2017, the following Supervisory Board members were appointed, as proposed by the majority shareholder: Ante Ramljak, Vladimir Bošnjak, and Teo Vujčić.
- On July 3, 2017, the term of office of Vesna Stojanović, employee representative in the Supervisory Board, expired. The Workers Council of the company Poslovni sistem Mercator d.d. granted her a new four-year term of office starting on July 4, 2017.
- The term of office of Veljko Tatić, employee representative in the Supervisory Board, expired on November 4, 2017. Thus, the Workers Council of the company Poslovni sistem Mercator d.d. appointed Jože Lavrenčič as the new Supervisory Board member, with a term of office starting on November 5, 2017.

Major Supervisory Board resolutions

The Supervisory Board addressed the following issues and adopted the following major resolutions:

- The Supervisory Board 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 Čizmić as his replacement as of April 6, 2017.
- The Supervisory Board increased the number of Management Board members to three members, and appointed as of April 18, 2017, Draga Cukjati as a new Management Board member to be in charge of finance and IT.
- The Supervisory Board discussed and adopted the Annual Report for the Mercator Group and the company Mercator d.d. for the year 2016, and confirmed the wording of the Supervisory Board Report on the 2016 Annual Report audit.
- The Supervisory Board approved the revision of Mercator Group's business plan for the year 2017 and approved the investment proposal for the Mercator Group by the end of 2017.
- The Supervisory Board approved that the company Mercator–BH d.o.o., Bosnia and Herzegovina, found a new company M–BL d.o.o., headquartered in Banja Luka, and approved the re-entry of Mercator's retail operations to the market of Bosnia and Herzegovina.
- The Supervisory Board was presented the report on activities to collect the receivables within the Group as reported pursuant to the Lex Agrokor, and the Report on all transactions concluded with the majority shareholder Agrokor d.d. and companies affiliated to it for the period from May 8, 2017, to August 8, 2017; and for the period from August 9, 2017 to October 31, 2017.

- The Supervisory Board adopted the Rules of Procedure for the Human Resource Committee of Mercator d.d. Supervisory Board, and Rules of Procedure for the Audit Committee of the Supervisory Board of the company Poslovni sistem Mercator d.d.
- The Supervisory Board approved the divestment of the real property MC Belgrade and lease-back of the hypermarket at MC Belgrade, complete with the key commercial terms and conditions of such sale and lease-back.
- The Supervisory Board adopted the proposal for appointment of the company auditor for the year 2017.
- The Supervisory Board approved the agenda for the 24th Shareholders Assembly (AGM) of the company Poslovni sistem Mercator d.d.
- The Supervisory Board was presented the business results of the company Poslovni sistem Mercator d.d. and the Mercator Group for the periods 1–3, 2017, 1–5, 2017, 1–6, 2017, and 1–9, 2017.
- The Supervisory Board was presented the Internal Audit Report for the year 2016.
- The Supervisory Board adopted the Mercator Group Business Plan for the year 2018 and the Mercator Group medium-run business plan.

Activities of the Audit Committee

As at December 31, 2017, the composition of the Audit Committee was as follows: Vladimir Bošnjak (Audit Committee chairman since June 15, 2017), Damir Kuštrak (deputy Audit Committee chairman), Matej Lahovnik (Audit Committee member since April 25, 2017), and Sergeja Slapničar as the independent accounting and auditing expert.

Until April 25, 2017, Ivan Crnjac was the Audit Committee chairman.

In 2017, the Audit Committee held seven session, of which five were regular meetings and two were correspondence sessions.

At their meetings, the Audit Committee addressed the following major issues:

- the Audit Committee approved the 2017 annual plan for the internal audit department;
- The Audit Committee discussed and commented the Annual Report of the company Poslovni sistem Mercator d.d. and the Mercator Group for the year 2016.
- The Audit Committee discussed the report by the independent certified auditor on the progress and findings of the second stage of the audit conducted at the company Poslovni sistem Mercator d.d. and the Mercator Group in 2016.
- The Audit Committee discussed and confirmed the offer for auditing services for the company Poslovni sistem Mercator d.d. and the Mercator Group for the year 2017 and proposed to the Supervisory Board that the auditing company Deloitte revizija d.o.o. be selected as the company auditor.
- The Audit Committee examined and proposed suggestions for improvement of the Business Reports of the company Poslovni sistem Mercator d.d. and the Mercator Group for the periods 1–3, 2017; 1–6, 2017; and 1–9, 2017.
- the Audit Committee supervised the work of Internal Audit in the period 1–12, 2017, and submitted proposals for improvements;
- The Audit Committee reviewed the medium-run Business Plan of the Mercator Group and Mercator d.d.
- The Audit Committee reviewed and commented on the business plan for the Mercator Group and the company Poslovni sistem Mercator d.d. for the year 2018.

Activities of the Human Resource Committee

The Human Resource Committee of the Supervisory Board of the company Poslovni sistem Mercator d.d. was founded on June 15, 2017, with the following membership: Matej Lahovnik, Ivica Mudrinić, and Vesna Stojanović. Matej Lahovnik was appointed Human Resource Committee chairman. The Human Resource Committee held one meeting in 2017.

Semiannual and Annual Report for 2017

The Supervisory Board was presented the non-audited Semiannual Business Report of the company Poslovni sistem Mercator, d.d., and the Mercator Group for the period 1–6, 2017, at their session held on August 30, 2017. The company announced its non-audited semiannual report pursuant to the relevant legislation and the Rules and Regulations of the Ljubljana Stock Exchange.

At its regular meeting held on April 25, 2018, the Supervisory Board discussed the audited non-consolidated and consolidated Annual Report for the year 2017, as audited by the auditing company Deloitte revizija, d.o.o., Slovenia. The Annual Report had been previously reviewed by the Audit Committee of the company Poslovni sistem Mercator d.d. at its session held on April 23, 2018. The Audit Committee session was also attended by the certified auditor who provided all and any additional explanations required by the Audit Committee. On April 23, 2018, the auditing company issued unqualified opinions on the non-consolidated and consolidated Annual Report. Supervisory Board did not have any objections to the certified auditor's report and concurred with it.

The Supervisory Board verified the Report on Relations with Affiliated Companies and the Statement prepared in this respect by the management of the company Poslovni sistem Mercator d.d. The Supervisory Board had no objections to the statement regarding relations with affiliated companies. The Supervisory Board was also presented the Independent Auditor's Report on the said statement, by which the auditor confirms and concludes that the information in the Report on Relations with Affiliated Companies is true and accurate in all material respects.

The Supervisory Board had no objections to the submitted Annual Report of the company Poslovni sistem Mercator d.d. and the Mercator Group for 2017, and confirmed it unanimously at the session held on April 25, 2018.

In 2017, Mercator Group generated net loss in the amount of EUR 184,435 thousand.

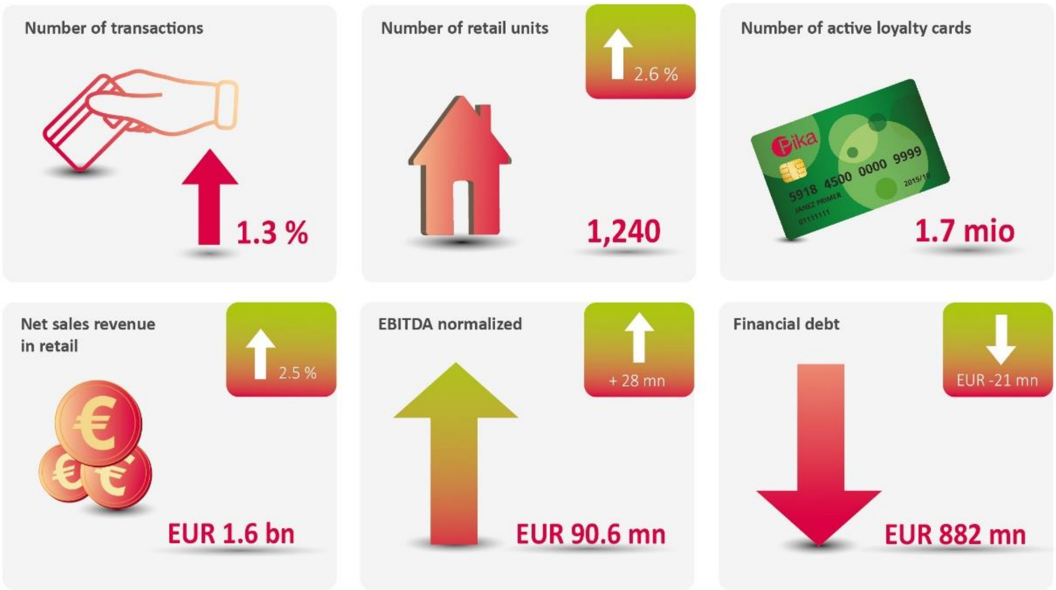
In 2017, the company Poslovni sistem Mercator d.d. generated a net loss of EUR 203,726 thousand. The company proposes to cover the net income for the year, in the amount of EUR 203,726 thousand, by debiting the share premium in the amount of EUR 201,141 thousand, and by debiting the retained earnings in the amount of EUR 2,585 thousand.

The Supervisory Board compiled this Supervisory Board report pursuant to the provisions of Article 282 of the Companies Act. The Report is intended for the Shareholders Assembly.

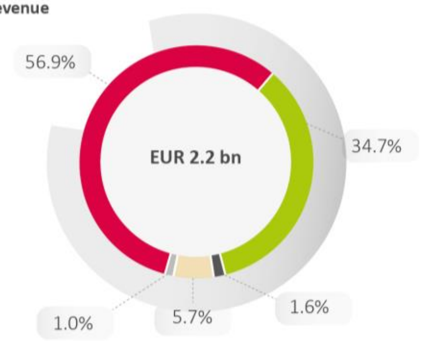
Supervisory Board Deputy Chairman
Poslovni sistem Mercator, d. d.
Lahovnik Matej

Ljubljana, April 25, 2018

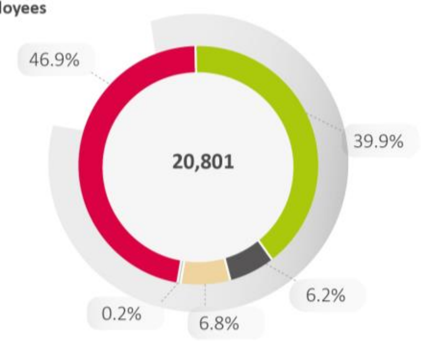
2017 HIGHLIGHTS



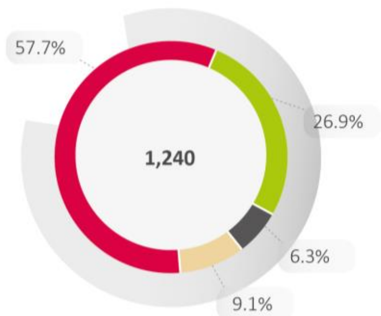
Net sales revenue



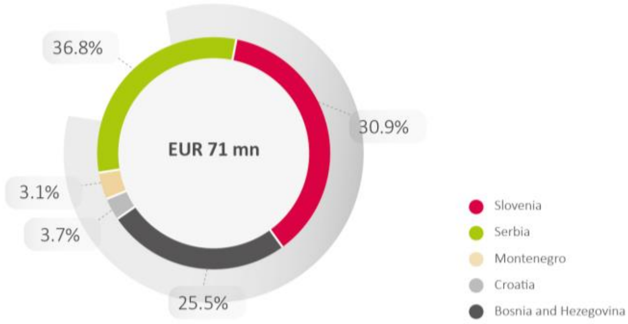
Employees



Number of retail units



Investments



PERFORMANCE HIGHLIGHTS

Key performance highlights of Mercator Group in 2017

- **Revenue growth** in the core activity of retail for the first time since 2011, and 2.5% growth recorded relative to the comparable period of the preceding year.
- Successful implementation of the operating plan for business efficiency (**Value Creation Plan**) in Slovenia, which has already shown results in terms of profit margin, new store concept, optimization of working capital management, and cost optimization.
- Generated **normalized gross cash flow from operating activities (EBITDA)** in 2017 amounts to EUR 90.6 million, which is EUR 28.3 million, or 45.3%, more than in 2016.
- In accordance with accounting policy, rules and International Accounting Standards we **re-appraised our real estate** in 2017. This resulted in a net impairment of real estate value by EUR 18.8 million, or 1.4% of total value of land and buildings. Before property revaluation, the value of land and buildings amounted to EUR 1.385 billion; after the revaluation, the value is EUR 1.366 billion. Real estate revaluation resulted in an increase of equity (fair value reserve) due to increase in value of real estate in the amount of EUR 126.9 million, while impairment of real estate value in the amount of EUR 145.8 million had a negative effect on Mercator Group's operating results.
- In 2017, Mercator Group's net loss amounted to EUR 184.4 million, which is mostly a consequence of revaluation of property.
- Successful **re-entry to the retail market of Bosnia and Herzegovina**.
- Actual **net income, adjusted for negative effects of extraordinary or one-off events,** is EUR +6.0 million; in the comparable period of the year before, it was at EUR -31.3 million. The major negative impact had the revaluation of real estate in the amount of EUR 145.8 million.
- Mercator Group **net financial debt** at the end of 2017 amounted to EUR 828.2 million, which is EUR 8.5 million less than at the end of 2016 when it amounted to EUR 836.7 million.

Performance indicators of Mercator Group

		Mercator Group business		
		restated 2016*	2017	Change 2017/ restated 2016
INCOME STATEMENT	Revenue (in EUR 000)	2,199,587	**2,152,172**	-2.2%
	Revenue from retail (in EUR 000)	1,539,561	1,577,532	2.5%
	Profit (loss) for the year (in EUR 000)	-78,063	**-184,435**	-
	Normalized profit (loss) for the year adjusted for negative effects of one-off events (in 000 EUR) **	-31,251	**6,008**	-
	Gross cash flow from operating activites (EBITDA) (in EUR 000)	33,320	**-102,662**	-
	Normalized gross cash flow from operating activites (EBITDA) (in EUR 000)**	62,353	**90,631**	45.4%
	Gross cash flow from operating activites before rental expenses (EBITDAR) (in EUR 000)	104,139	**-32,523**	-
	Normalized gross cash flow from operating activites before rental expenses (EBITDAR) (in EUR 000) **	133,172	**160,633**	20.6%
STATEMENT OF FINANCIAL POSITION	Total assets (in EUR 000)	2,122,836	**2,076,723**	-2.2%
	Equity (in EUR 000)	557,376	**478,401**	-14.2%
	Net financial debt (in EUR 000)	836,742	**828,217**	-1.0%
PRODUCTIVITY AND ABILITY TO GENERATE CASH FLOW	Productivity in retail (in EUR 000)	111.1	**113.8**	2.4%
	Value added per employee in retail per hours worked (in EUR 000)	23.5	**24.5**	4.6%
	Net financial debt / equity	1.5	**1.7**	15.3%
	Net financial debt / normalized gross cash flow from operating activities (EBITDA)	13.4	**9.1**	-31.9%
	Normalized gross cash flow from operating activites (EBITDA) / revenue	2.8%	**4.2%**	48.6%
	Normalized gross cash flow from operating activites before rental expenses (EBITDAR) / revenue	6.1%	**7.5%**	23.3%
INVESTMENT ACTIVITIES	Capital expenditure (in EUR 000)	90,426	**70,904**	-21.6%
EMPLOYEES	Number of employees as at December 31	20,354	**20,801**	2.2%
	Number of employees based on hours worked	18,646	**18,664**	0.1%
SHARE	Market value per share as at Dec. 31 (in EUR)	68.0	**20.1**	-70.5%
	Market capitalization (in 000 EUR)	414,184	**122,245**	-70.5%
	Number of companies in the Group as at Dec. 31	16	**17**	6.3%

* In 2017, the Group and the Company changed the accounting policy on consignment, discounts and allowances, and reporting of interest (changes to accounting policies are presented in more detail in the financial part of the Annual Report, in Chapter 2, Basis for Compilation, section e). For comparability, information is also presented for the year 2016.

** The normalized value does not include one-off events,presented in the section Performance analysis.

BUSINESS STRATEGY

Non-Financial Report

VISION

Mercator will be the best local retailer in every market of its operations.

MISSION

Mercator is developing the best shopping comfort and investing into value for money and quality for the customers. We contribute to the development of our social environment and we maintain a long-term link with the suppliers, while facilitating local and regional development of their brands.

STRATEGY

At the end of 2017, Mercator Group drew up a new long-term strategy and started to consistently implement it across all key processes at the Mercator Group. The strategy was developed for the period until the year 2022, and it will be executed in three stages.

PHASE 1

STABILIZATION

OPERATING PLAN FOR BUSINESS EFFICIENCY (VCP)

RE-ENTRY INTO BIH

2017

PHASE 2

OPERATING PLAN FOR BUSINESS EFFICIENCY (VCP) IN ALL MARKETS

FOCUSE ON THE CUSTOMERS

STRATEGIC AND OPPORTUNISTIC DISPOSALS

DELEVERAGING

2018/2019

PHASE 3

REFINANCING

INVESTMENT IN NEW DISTRIBUTION CENTER

EXPANSION OF STORE FOOTPRINT

OPPORTUNISTIC ACQUISITIONS

2020/2022

Operating plan for business efficiency

In 2017, we successfully implemented our operating plan for business efficiency (Value Creation Plan) in Slovenia, which includes activities for accomplishment of our operating business plan. Moreover, operating plans were adopted for efficient business operations in international markets; these will be put to action in 2018.

Activities for implementation of operating plan for business efficiency (Value Creation Plan):

1

Profitable growth
Strengthened market position with positive sales at permanent units, with a growing market share, and improved customer perception.

2

New store concept and refurbishments
Development of new store concepts and program of refurbishments or updates to the

3

Cost optimization
Cost optimization and IT upgrade of cost control system.

4

Cash flow
- Optimized working capital management
- Divestment of real property

5

Brand differentiation
Strengthening the brand identity with emphasis on digitalization and customer relationship management.

6

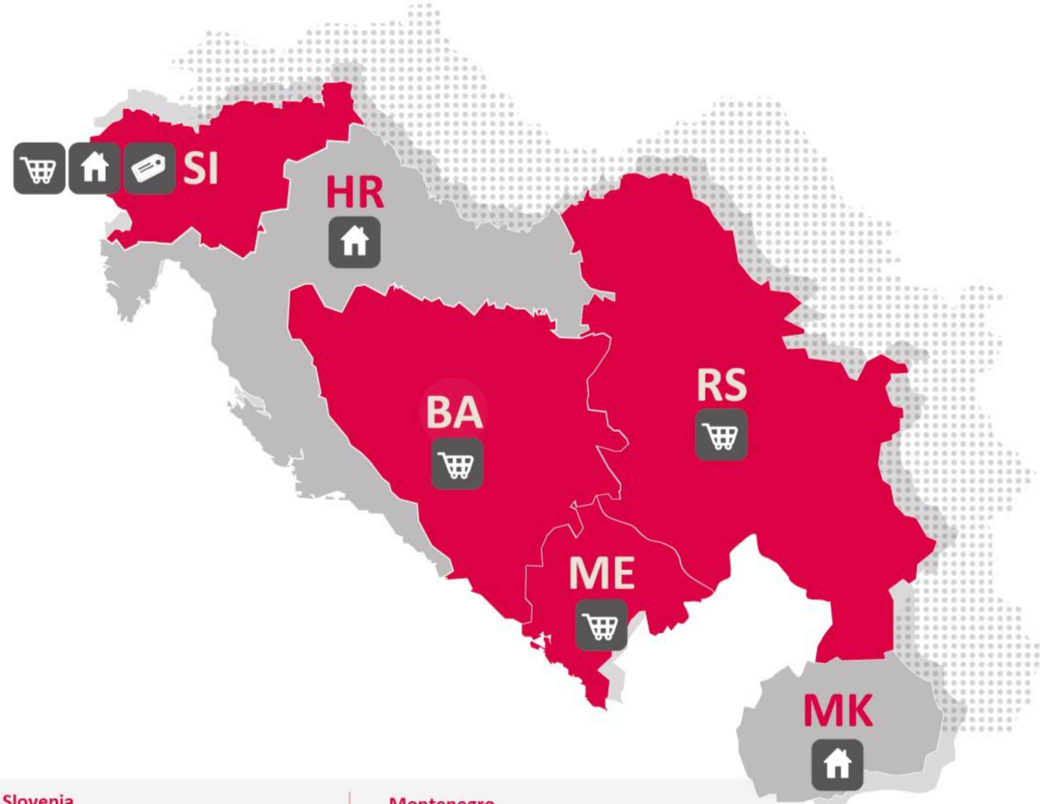
Employees
Motivation, education, and responsibility to employees.

MERCATOR GROUP PROFILE AND ORGANIZATION

Non-Financial Report

Mercator Group compositions as at December 31, 2017

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



Slovenia
- Poslovni sistem Mercator, d.d.
- Mercator-Velpro, d.o.o. (100.0%)*
- Mercator IP, d.o.o. (100.0%)
- Mercator-Emba, d.d. (100.0%)
- M-Energija, d.o.o. (100.0%)
- Mercator Maxi, d.o.o. (100.0%)*
- Platinum-A, d.o.o. (100.0%)*
- Platinum-B, d.o.o. (100.0%)*
- Platinum-C, d.o.o. (100.0%)*
- Platinum-D, d.o.o. (100.0%)*

Serbia
- Mercator-S, d.o.o. (100.0%)

Montenegro
- Mercator-CG, d.o.o. (100.0%)

Bosnia and Herzegovina
- Mercator-BH, d.o.o. (100.0%)
- M-BL, d.o.o. (100.0%)*

Croatia
- Mercator-H, d.o.o. (99.2%)

Macedonia
- Mercator Makedonija, d.o.o.e.l (100.0%)*
- Investment Internacional, d.o.o.e.l (100.0%)*

Mercator operations

Mercator real estate

Other operating activities

* The company does not conduct business operations.

Branch Offices: As at December 31, 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 foundations is to provide solidarity aid to employees in social or economic distress.

Presentation of the parent company of Mercator Group

Mercator

Company name	Poslovni sistem Mercator d.d.
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
LEI (Legal Entity Identifier)	549300X47J0FW574JN34
Company share capital as at December 31, 2017	EUR 254,175,051.39
Number of shares issued and paid-up as at December 31, 2017	6,090,943
Share listing	Ljubljanska borza, d.d., official market, prime market, symbol MELR

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Facebook *www.facebook.com/mercator*

Twitter *www.twitter.com/mercator_sl*

LinkedIn *www.linkedin.com/company/335027*

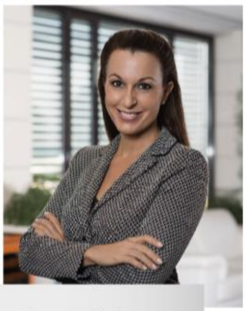
Instagram *@mercatorslovenija*

Youtube www.youtube.com/user/mercatorslo

Mercator Group organization as at December 31, 2017

The Management Board represents the company. It manages its business independently and at own responsibility. As at December 31, 2017, the Management Board of the company Mercator d.d. consisted of four members: Management Board president, two members, and the extraordinary member.

Tomislav Čizmić
President of the Management Board
Field of operation:
management of Mercator Group



Draga Cukjati
Member of the Management Board
Field of operation:
finance and informatics

Igor Mamuza
Member of the Management Board
Field of operation:
Mercator retail Slovenia

Gregor Planteu
Extraordinary member
of the Management Board
Field of operation:
field of operation in accordance with the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia

MERCATOR GROUP ACTIVITIES

Non-Financial Report

Fast-moving consumer goods

Mercator Group's core activity is fast-moving consumer goods retail, in a dense and extensive retail network in Slovenia, Serbia, Montenegro, and Bosnia and Herzegovina.

Mercator Group operates a dense and broad network of retail stores offering fast-moving consumer goods, including **40,000 different FMCG products**, to consumers in order to meet all of their desires, tastes, and needs.

A major campaign was carried out in 2017 in Slovenia called **My Brands** that looks to establish close links with our suppliers and create a shared story and new offers for our consumers. In 2018, we are planning to roll out the campaign to foreign markets as well. Our broad sales assortment is upgraded with local products within the campaign **We Love Local**. Thus, we are pursuing our vision of being the best local retailer in all markets of our operations, while also staying abreast of the shopping trends by introducing our own **offer of organic and lifestyle products**.

In the digital age, consumers start shopping before they enter the store, and the focus is on improvement of shopping experience. Thus, we offering our customers updated existing store concepts as we keep up with the shopping trends with the development of the **Organic** and **Minute** concepts. Broad market coverage is provided with **different store formats**. The largest share – 66.4% of all our FMCG stores – is accounted for by **market stores**. In recent years, we focused mainly on refurbishments of smaller market stores, continuing the tradition of coming closer to our customers in the local environment. Diversity of store formats is rounded off with hypermarkets, supermarkets, and wholesale units.

We shall continue to provide our customers a broad and quality offer of fast-moving consumer goods, which fits the needs and wishes of every individual, while also offering a quality shopping experience for the users.

Mercator real estate

Real estate is a separate business field at Mercator as the extent of our real property portfolio requires particular care and management from the aspect of environmental care and energy efficiency, and from the aspect of other improvements. Within this field, we seek to reach the optimum in managing our buildings and tenants, developing our retail network, and improving the attractiveness of our shopping centres.

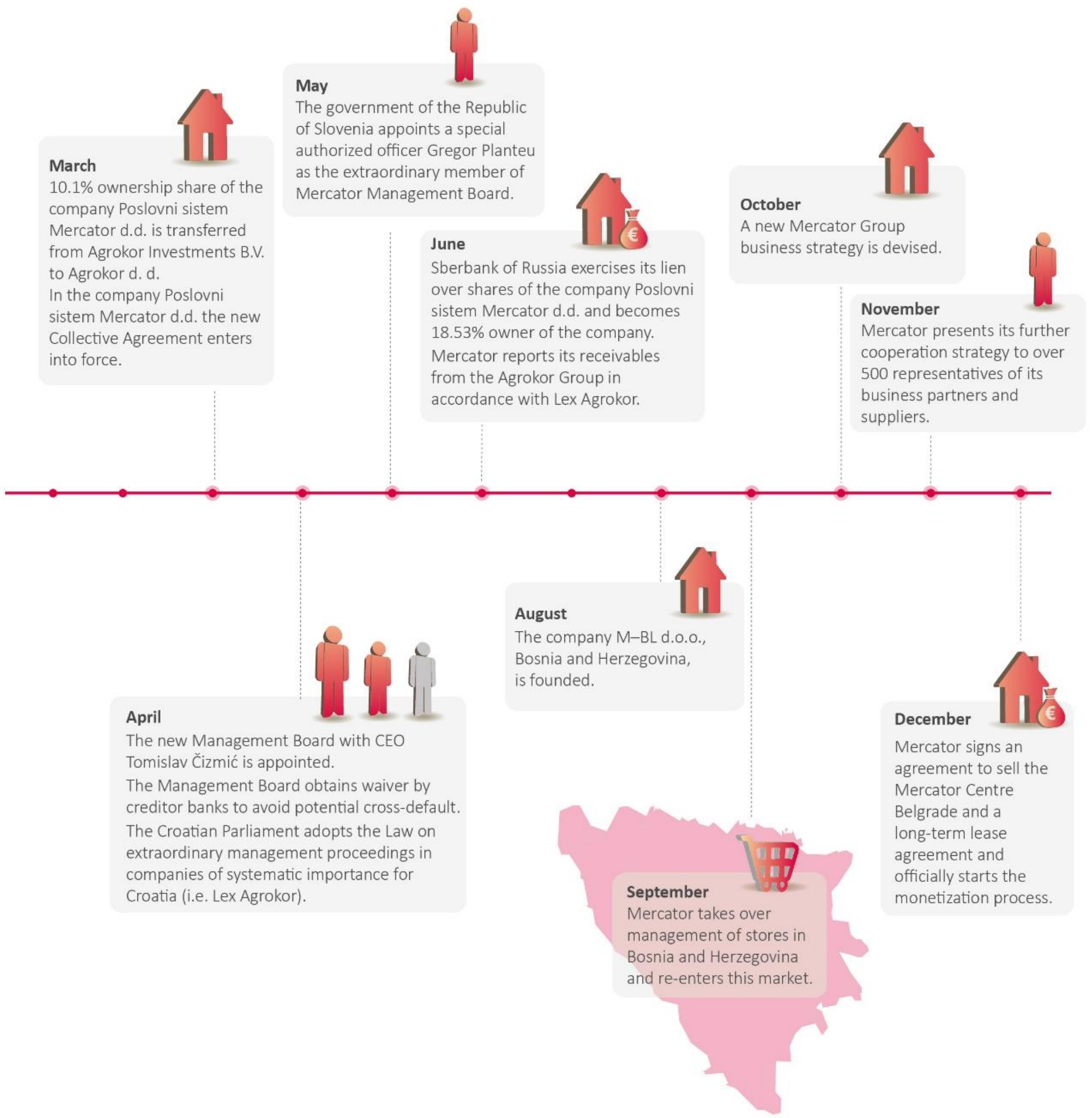
Home products

The M Tehnika (technical consumer goods) stores offer products for home and landscaping at favourable payment terms, across Slovenia. The offer includes small and major home appliances, consumer electronics, tools and accessories, construction and gardening equipment and machinery, and products for a cosy home and ambient and well-kept environment. The offer of traditional stores is rounded off with the offer of the online store M Tehnika which offers over 13,000 well-priced products, with option of payment in instalments with the Pika card and free delivery for all orders above EUR 200.

Service activities and manufacturing

Also operating as a part of the Mercator Group are two independent manufacturing companies **Mercator–Emba d.d.** and **Mercator IP d.o.o**. Production program of the company Mercator–Emba d.d. includes production of instant cocoa products, dessert toppings, cereal products, and packaging of other products. The company Mercator IP d.o.o. as a service and manufacturing company operates according to a modern concept of employment of persons with disabilities, to whom Mercator Group dedicates particular attention. Mercator Group also offers its customers other service activities like self-service petrol stations **Maxen**.

KEY EVENTS



Changes in the composition of the Mercator Group

On August 31, 2017, the company **M–BL d.o.o., Bosnia and Herzegovina**, was founded.

Changes in parent company governance

On April 5, 2017, Anton Balažič resigned from the position of the Management Board president, based on an agreement on early termination of the term of office, without any fault-based grounds or liability. At the same time, **Tomislav Čizmić** 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). 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. The new Management Board member is only in charge of transactions related to the majority owner and does not have any power or authority with regard to management of regular transactions. 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.

As of April 25, 2017, two Supervisory Board members at the company Poslovni sistem Mercator d.d. resigned from their respective positions: Ante Todorić as Supervisory Board chairman and member, and Ivan Crnjac as the Supervisory Board member. 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 same Supervisory Board session, a resolution on the establishment of a **Human Resource Committee** was adopted. The Human Resource Committee includes Vesna Stojanović, Matej Lahovnik, and Ivica Mudrinić. Two months later, the Supervisory Board of Poslovni sistem Mercator d.d. appointed at its 17th regular session Matej Lahovnik as chairman of the Human Resource Committee of Mercator d.d. Supervisory Board, and Vladimir Bošnjak as the chairman of the Audit Committee of Mercator d.d. Supervisory Board.

Changes in subsidiary management and governance

In September, **Entoni Sošić** was appointed new managing director of the company Mercator–S d. o. o., replacing his predecessor **Aleksandar Seratlić**.

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, Sberbank of Russia became, a month later, 18.53-percent shareholder of the company Poslovni sistem Mercator d.d.

Entry into the market of Bosnia and Herzegovina

Mercator re-entered the market of Bosnia and Herzegovina. Transfer of possession and establishment of retail operations took place in September 2017. Mercator's goal is to offer the local consumers a new store concept as developed by Mercator, and especially a broad assortment tailored as closely as possible to the needs and desires of the customers.

Events related to the developments at the Agrokor 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 to avoid 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 some of its 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.

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 a part of the Mercator Group.

With regard to the so-called Lex Agrokor, Mercator Group companies reported until and including June 9, 2017, a total of EUR 43,788,150 of receivables payable by the Agrokor Group companies. In January 2018, the court in Zagreb recognized and confirmed all reported receivables.

In 2017, receivables payable by the Agrokor Group companies that are not a part of the Mercator Group and headquartered in Croatia, originating in the period from January 1, 2017 to April 9, 2017, were impaired at the companies Poslovni sistem Mercator d.d. and Mercator–H d.o.o.

In September 2017, a report by the **extraordinary Management Board** member for the period from May 8, 2017, to August 8, 2017, was released, followed by another such report in December for the period from August 9, 2017, to October 31, 2017, **which indicates that all transactions signed between the company Mercator d.d. and the company Agrokor d.d. and the companies affiliated with it, complied with the principles of diligence, good management and credibility, and that the company did not sustain any loss or damage with regard to such transactions**.

Loyalty programs

Virtually every household in Slovenia is well aware of the advantages brought by the Pika customer loyalty system. In 2017, the Pika customer loyalty card celebrated its 18th birthday. For more information on Mercator Group loyalty programs, please see the chapter Marketing and Loyalty Programs.

Divestment of Mercator Center Belgrade

In December, the companies Retail Center d.o.o., Belgrade, and the company Mercator–S d.o.o. signed an agreement to sell and purchase the Mercator Center Belgrade, and a lease-back agreement for the retail part of the centre. The contract price was EUR 46 million, excluding VAT. By selling the Mercator Centre in Belgrade, Mercator successfully laid down its real estate monetization project whose main goal is deleveraging of the Mercator Group.

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.

M Tehnika online store is the recipient of the **Certified Shop and Emota certificate** as a trustworthy and reliable online retailer with an excellent shopping experience and over 13,000 products for home and landscaping.

For 2016/2017, **Mercator Call Centre and information desk** won the QUDAL – Number 1 award for quality in customer complaint resolution.

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.

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.

In August, the **55th International Agriculture and Food Fair** took place in Gornja Radgona. **Mercator IP** d.o.o. sent 10 products from meat, meat produce and fish product categories for assessment. All 10 products **won medals**: 5 products won gold, 3 products won silver, and 2 products won a bronze medal.

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 in a test conducted at the Faculty of Biotechnology in Ljubljana, with the best possible score, 20 out of 20.

Mercator is a proud recipient of the **Select Quality from Slovenia** certificate, awarded based on specification Select Quality for Fresh Beef, Veal, and Poultry by the IKC – Institute of Control and Certification of the University of Maribor. This sign of excellence guarantees quality, transparency and traceability of origin, and special marketing conditions.

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 Maxim restaurant also tops the list of restaurants in Ljubljana according to the Siol online portal. Moreover, readers of the Dolce Vita – magazine for life's many pleasures – rated the Maxim restaurant with a top mark of five stars.

The Marketing magazine, an expert publication, chose the **»You are what you eat«** campaign as the marketing campaign of the year 2017.

The Ministry of Labour, Family, Social Affairs and Equal Opportunities offered symbolic support to employers who help maintain the hiring of disabled persons in the open labour market. Within the »**Zmoremo« (Yes, We Can)** project, special award was presented to five employers who **hired the most persons with disabilities** in 2016, including Mercator.

In October, **M Tehnika** was presented at the 1st pan-Slovenian fair in the Dolenjska region, with more than 250 exhibitors from across Slovenia. On over 500 square meters of exhibition are, M Tehnika held a unique presentation, offering the visitors special experiences. Thus, it won the title of **the best exhibitor**.

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.

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.

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 company Mercator–S d.o.o. received an award from the National Employment Agency for the employer the most engaged in hiring persons with disabilities in 2017.

Mercator's humanitarian activities

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

Working 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.

Mercator supports our eagles – both the national ski jumping team and their young successors. In the campaign »Jump to Mercator, support our ski jumpers«, Ski jumping club Ilirija from Ljubljana won the most votes of our customers and thus won the main prize – a Ford van.

Within the **Stop** project, we garnered 2,334 likes on our Facebook page. We turned the likes into minutes that our volunteer employees spent in late September doing good deeds, helping and socializing with elderly people.

At Mercator, October is the **children's month** and a share of children's product sales is donated to the Lumpi foundation. This year, the funds from the foundation were donated to the Ljubljana Maternity Hospital for a giraffe incubator.

We also support the **Pink October** project that includes teaming up with the company Medex d.o.o. Thus, we donated 10 cents from each Medex brand products sold in October to the Europa Donna association.

In December, M-Tehnika prepared a project titled **»A step to the right solutions«** and donated cookware, small domestic appliances, and other kitchen accessories to the Janez Levec Center, Ljubljana.

Major events following the end of period at hand

Ante Ramljak resigned from the position of a Supervisory Board member at the company Poslovni sistem Mercator d.d., effective as of February 28, 2018, Teo Vujčić resigned as of April 4, 2018, and Damir Kuštrak resigned as of April 16, 2018.

CORPORATE GOVERNANCE STATEMENTS

Pursuant to Article 70, Paragraph 5 of the Companies Act (ZGD-1), Business Report of the company Poslovni sistem Mercator, d.d., also includes a Corporate Governance Statement.

Reference to the Corporate Governance Code

The governance of the company Poslovni sistem Mercator, d.d., is based on legal provisions, sound business practice, and the principles of the Corporate Governance Code.

Management and Supervisory Board of the company Poslovni sistem Mercator, d.d., hereby submit this statement of compliance with the Code, which is also a constituent part of the 2017 Annual Report. It is available at company website at www.mercatorgroup.si.

Compliance with the provisions of the Code

Management Board and Supervisory Board of the company Poslovni sistem Mercator, d.d., reviewed in 2017 the corporate governance at the company Poslovni sistem Mercator, d.d., and the Mercator Group, and the compliance thereof with the Code, and prepared a new statement which reflects the actual situation of corporate governance at the company Poslovni sistem Mercator, d.d., and the Mercator Group.

It was found that corporate governance at the company Poslovni sistem Mercator, d.d., and the Mercator Group complies with the provisions of the Code, with particular deviations explained below.

Diversity policy (Recommendation 4): The company Poslovni sistem Mercator d.d. is developing a document on diversity policy. However, diversity policy is already conducted in practice in the managerial and supervisory bodies in terms of the following aspects: gender, age, education, and professional experience.

Relations with shareholders (Recommendation 6.2): Given the fact that majority shareholder communicates its intents regarding the management policy for the investment into the publicly traded stock corporation, the company did not make additional invitations to shareholders separately to publicly disclose their management policies with regard to their investment in this publicly traded stock corporation.

Shareholders Assembly (Recommendation 8.1): The company publicly announced on its official website all information about lodging proxies for voting at particular Shareholders Assemblies; in addition, each shareholder was informed individually in this regard. However, the company did not announce on its website the information on the cost of organized lodging of voting proxies at particular Shareholders Assemblies (or general meetings). The cost or organized collection of proxy authorizations (excluding postal services) for the 24th Shareholders Assembly amounted to EUR 1,773.

Shareholders Assembly (Recommendation 8.5): In the materials for the 24th regular Shareholders Assembly and at the 24th regular Shareholders Assembly, the company Poslovni sistem Mercator d.d. disclosed the information on work experience of the proposed candidates. Moreover, the candidates submitted their written statements that there were no circumstances that would, pursuant to the provisions of the Companies Act (ZGD-1) oppose or preclude their appointment. However, no assessment of potential conflict of interests on the part of the candidates was conducted, pursuant to the criteria for independence as laid down in the Corporate Governance Code, since all candidates are employed by the majority shareholder of the company Poslovni sistem Mercator d.d.

Shareholders Assembly (Recommendation 8.6): The company does not disclose the process of recruitment, nomination and assessment of Supervisory Board candidates, since the candidates are proposed by the majority shareholder based on their own selection processes.

Supervisory Board, independence (Recommendations 9.2, 9.3, 22, 23): In the current ownership structure of the company Poslovni sistem Mercator d.d., the company Agrokor d.d. holds 69.57% of total company shares. Thus, the Supervisory Board includes more than one half of the members with close economic ties to the said shareholder.

Procedure of selecting the Supervisory Board member candidates (Recommendation 10.1): Some Supervisory Board members have not produced documentation (labour representatives and Supervisory Board members who are Croatian citizens) to prove their specialized professional or expert competencies for Supervisory Board membership. Nevertheless, they qualify for such engagement on account of their professional competencies or experience.

Statement of independence (Recommendation 11): All Supervisory Board members have signed a special statement specifying their position on meeting each of the independence criteria. The company has not released the signed statements on the company's official website since compliance with respective independence criteria is a matter of personal integrity of every Supervisory Board member.

Supervisory Board tasks and payment to the Management Board (Recommendations 12.10 and 21.1): In 2017, Management Board member receipts only included the fixed part, since most candidates assumed their respective terms of office in April 2017, while decision on the variable part of the reward to Management Board members is adopted by the Supervisory Board based on the performance in the previous year.

Supervisory Board member training (Recommendation 13.1): The Supervisory Board does not specify its annual plan for Supervisory Board and committee member training, since Supervisory Board members take part in training and education programs based on the needs of every member. The company Poslovni sistem Mercator d.d. is a member of the Slovenian Directors' Association that also offers training and education courses that are also attended by the Supervisory Board members. In 2017, education titled "Standard Knowledge and Skills for Supervisory Board Members" was carried out for the Supervisory Board and committee members.

Supervisory Board member chairman (Recommendation 15.2): At the 16th regular Supervisory Board session on June 15, 2017, a new Supervisory Board chairman was appointed due to the resignation of the previous Supervisory Board chairman. Considering the highly concentrated ownership structure of the company Poslovni sistem Mercator d.d., the extraordinary commissioner of the majority shareholder was appointed Supervisory Board chairman.

Composition and appointment of the Management Board (Recommendation 20.7): Pursuant to the adopted Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia, the District Court of Ljubljana entered ex officio into the court register the extraordinary Management Board member at the company Poslovni sistem Mercator d.d. Gregor Planteu. The duration of his contract depends on the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia.

Payment to the Management Board (Recommendation 21.3): On April 5, 2017, Anton Balažič was relieved of duty as the Management Board president, without any fault-based grounds or liability, and received severance pay of 12 monthly salaries in 2017.

Independence of Supervisory Board and committee members (Recommendation 23.5): In the course of 2017, a potential conflict of interests arose with regard to one of the Supervisory Board members, of which the Supervisory Board was promptly informed, and the office of the Supervisory Board member was terminated based on his statement of resignation.

Public disclosure of important information (Recommendation 29.9): The company released its Rules of Procedure for the Supervisory Board, Rules of Procedure for the Audit Committee, and Rules of Procedure for the Human Resource Committee on its website at www.mercatorgroup.si, in Slovenian and English. The company does not release Rules of Procedure for the Shareholders Assembly, which the company does not need, since every Shareholders Assembly (general meeting) is presided over by a renowned attorney at law, in compliance with the relevant legislation.

The composition of the Management Board and Supervisory Board, pursuant to Appendix C of the Corporate Governance Code, is presented in more detail below in this chapter, while the receipts by the Management Board and Supervisory Board are, also consistently with the Appendix C of the Corporate Governance Code, presented in more detail in the financial part of the Annual Report under section 34, Related party transactions.

The company Poslovni sistem Mercator d.d. shall continue to observe the recommendations of the Code in the future. It will look to implement as far as possible the non-binding recommendations and this to improve its corporate governance system.

Description of key characteristics of internal control and risk management at the company, with regard to the financial reporting process

Mercator Group companies compile their financial statements pursuant to the International Financial Reporting Standards (IFRS), making sure that the financial position, income, and cash flows are presented fairly and consistently with the actual effects of business events.

Internal controls include policies and procedures put into place and conducted by the Mercator Group at all levels in order to control the risks related to financial reporting. The purpose of internal controls is to provide reliability of financial reporting and compliance with the applicable laws and other internal and external regulations. The purpose of internal controls in accounting is to manage the risks pertaining principally to the following:

- credibility of accounting information based on valid and credible bookkeeping documents, and evidence of the existence of business events, complete with a clear presentation of all information relevant for correct bookkeeping of such events;
- accuracy of financial data which is appropriately reviewed before announcement; controls are conducted at several levels by comparing and aligning or harmonizing the data of analytic bookkeeping to the data in the bookkeeping documents, as well as to the data of business partners or actual physical status of assets, and bringing into line the analytical accounting and the main ledger;
- completeness and timeliness of financial information, provided by uniform accounting policies and precisely defined procedures and recording deadlines as laid down in the accounting rules and regulations of the Mercator Group, and in other internal acts of the Mercator Group companies; also important is appropriate delineation of powers and responsibilities.

The quality of financial information is ensured by the central IT system SAP.

The information system plays a vital role in the provision of quality accounting information from the aspect of the use of modern technology. Most Mercator Group companies employ SAP as the main IT system. It is fittingly integrated with other IT solutions implemented at respective companies. Operation of the SAP system and the internal controls integrated therein are checked annually in cooperation with authorized third-party service providers.

Risks occurring in financial reporting are also managed and mitigated by the following:

- good internal communication (provision of information) and notification;

- clear and concise accounting practices and their strict implementation;
- harmonized accounting policies throughout the entire Mercator Group;
- continuous improvement of organization of the accounting function at each company, as well as at the Mercator Group level;
- timely preparation, detailed treatment, and suitable concept in terms of contents and substance in statements relevant for business decision-making;
- comprehensive and extensive disclosures and explanations;
- regular internal and external audits and reviews of business processes and operations.

The above is only possible with highly professional, meticulous, and persistent employees complying with the relevant legislation and sharing Mercator's values. Therefore, we devote a lot of care to their regular education. We provide both internal and third-party professional education, as well as training to acquire the "soft" skills.

Composition of major holders of company securities as at December 31, 2017

	Major Shareholders	Country	Number of shares	Share
1	Agrokor d.d.	Croatia	4,237,376	69.57%
2	Clearstream Banking SA -fiduciary account / Sberbank of Russia	Luxembourg	1,128,945	18.53%
3	Societe Generale - Splitska Banka d.d.	Croatia	410,339	6.74%
4	Addiko bank d.d.	Croatia	173,164	2.84%
5	Zagrebačka Banka d.d.	Croatia	35,143	0.58%
6	Hrvatska poštanska banka d.d.	Croatia	21,575	0.35%
7	BNP Paribas Securutie Services S.C.A	France	1,107	0.02%
8	Fortunat Miloš	Slovenia	800	0.01%
9	Horvat Jože	Slovenia	608	0.01%
10	Verbič Tomaž	Slovenia	574	0.01%
	Total		**6,009,631**	**98.67%**

Legal transactions between the company Poslovni sistem Mercator d.d., and related companies

On May 6, 2017, the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia (ZIČUDSP) came into effect (Official Journal of the RS, 23-1204/2017; hereinafter referred to as the Act). At its session on May 8, 2017, the government of the Republic of Slovenia established that Poslovni sistem Mercator d.d. was a company of systemic importance to the Republic of Slovenia.

The Act was adopted with the following goals:

- to allow the company of systemic importance to the Republic of Slovenia, whose majority shareholder is involved in insolvency proceedings or proceedings of similar nature or contents, a normal environment for business, and prevent any negative effects on the economic, social, and financial stability of the Republic of Slovenia;
- to protect the interest of the company of systemic importance (employees, suppliers, creditors, minority shareholders) from the interests of the majority shareholder in insolvency proceedings or other proceedings of similar nature or contents;
- to provide additional control over the relation between the company of systemic importance and the majority shareholder in case of problems of the majority shareholder;

- due to increased risk, to restrict some transactions that are allowable in normal circumstances (assumption of debt, providing guarantees, material credits etc.).

Upon proposal by the government of the Republic of Slovenia, the district Court of Ljubljana appointed on May 18, 2017, **Gregor Planteu** as the extraordinary Management Board Member at the company Poslovni sistem Mercator d.d.

The extraordinary Management Board member at the company Poslovni sistem Mercator d.d.:

- is responsible exclusively for the management of transactions with the majority shareholder Agrokor d.d. and its subsidiaries;
- does not deal with regular operations of the company Poslovni sistem Mercator d.d.;
- prevent, pursuant to the Act specified above, any financial draining of the company Poslovni sistem Mercator d.d. by its majority shareholder Agrokor d.d.

Management Board members and the extraordinary Management Board Member jointly represent the company of systemic importance Poslovni sistem Mercator d.d. and adopt unanimously the decisions regarding management of all transactions related to the majority shareholder Agrokor d.d. and companies affiliated to it.

For operational execution of the Act, the Management Board of Poslovni sistem Mercator d.d. adopted an Organizational Rule for Managers and Executives of Poslovni sistem Mercator d.d. and its subsidiaries for concluding and managing any transactions in relation to the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia. This Organizational Rule specifies particularly the following:

- more precise definition of the transactions between the company Mercator d.d. with the majority shareholder Agrokor d.d. or companies affiliated to it, which are regulated pursuant to the Act;
- status of transactions effected before the Act came into force;
- obligations of Mercator Group managers and executives for which joint representation and adoption of decisions, or approval by the extraordinary Management Board member, is required in accordance with the Act.

All transactions concluded between the company Poslovni sistem Mercator d.d. and the company Agrokor d.d. conform to the principles of diligence, good management and credibility

The company Poslovni sistem Mercator d.d. shall, pursuant to the Act, **compile every three months a report on all transactions concluded with the majority shareholder Agrokor d.d. and the companies affiliated to it** and present the report to the Supervisory Board, while the extraordinary Management Board member shall present it to the Minister of Economy. The first report for the period from May 8, 2017, to August 8, 2017, was publicly released on September 7, 2017, and the second report for the period from August 9, 2017, to October 31, 2017, was released on December 1, 2017. Both reports conclude that **all transactions effected with the majority shareholder Agrokor d.d. and its subsidiaries conformed to the principles of diligence, good management and credibility, and that Poslovni sistem Mercator d.d. did not sustain any loss or damage with regard to such transactions.**

Pursuant to Article 545 of the Companies Act (ZGD-1), the company Poslovni sistem Mercator d.d. also prepared its Report on Relations with Affiliated Companies in 2017, which lists all legal transactions executed by the company in 2017 with the controlling/parent company or any company affiliated to it. The Report finds that Poslovni sistem Mercator d.d. as a subsidiary did not conclude in 2017 any legal transaction with the parent company of the Agrokor Group, which would have any harmful effects on the operations of the company Poslovni sistem Mercator d.d. Moreover, there were not any legal transactions between the parent company and its subsidiaries in this period, executed based on an obligatory instruction. Pursuant to Articles 545 and 546 of the Companies Act (ZGD-1), the parent company did not exert its influence in a way to coerce or induce the subsidiary into conducting a legal transaction disadvantageous or damaging to the subsidiary, or to do anything to its disadvantage. Moreover, the company did not perform or omit any action at the initiative or in the interest of such companies.

Audit

Pursuant to the Companies Act, audit of financial statements is mandatory for Mercator Group companies. The purpose of the audit is to increase the level of trust among the users of financial information. The auditor applies appropriate audit procedures and methods to review the financial statements and passes an opinion as to whether they are compiled in compliance with the appropriate framework of financial reporting in all relevant aspects.

External audit

At their 24th regular Shareholders Assembly, the shareholders appointed the auditing company Deloitte revizija d.o.o. as the auditor for the company Poslovni sistem Mercator d.d. The auditing company Deloitte is also in charge of auditing the Mercator Group and most of the subsidiaries.

In its work, the auditing company Deloitte revizija d.o.o. uses the latest auditing methodology that takes into account the fundamental auditing principles and other auditing rules in compliance with the International Standards on Auditing and International Statements on Auditing, while also supporting and improving the quality of the audit and contributing to its efficiency.

Internal audit

The Internal Audit service is organized in the controlling company. In terms of organization, it is within the scope of responsibilities of the Management Board member in charge of finance and IT (the CFO); in terms of function, it reports to the Audit Committee and the Supervisory Board. Mercator Group internal audit complies with the International Standards of Professional Conduct in Internal Auditing, Code of Professional Ethics for Internal Auditors, and the Code of Internal Auditing Principles.

Internal audit system is closely related to the risk management system. At Mercator Group, the fields with a higher degree of risk and the fundamental, key processes are subject to audit. From the aspect of internal audit, key processes are those with a major impact on the financial statements of companies; those that are critical for the attainment of strategic goals of particular companies and the Mercator Group; and those that are subject to disclosure requirements accounting to the International Accounting Standards or the relevant effective legislation.

In 2017, internal audit conducted 5 internal audits. The audits were conducted in purchasing and category management, retail, and in wholesale.

Corporate social responsibility is viewed by Mercator Group as a cornerstone of Mercator Group's future success. We support the culture of openness according to the highest standards of integrity and responsibility. Following an initiative by the Supervisory Board and the Audit Committee, Mercator Group companies established a whistle-blowing system called **Say it out loud** (Povejmo), which allows reporting dubious or disputable conduct. Mercator Group internal audit is in charge of this activity.

The rules in this regard were written in the document titled "Policy of Motivating Responsibility and Integrity of Conduct", available on the company website.[1] It is the goal of this policy to encourage all benevolent reports of any concerns, objections, reservations, and observations of non-transparent conduct or disputable business practices at Mercator, in order to prevent by prompt action any disputable business practices and the resulting damage to the Mercator Group before such damage is incurred, to provide all employees providing such benevolent reports protection from any retaliation (especially mobbing, harassment, or intimidation), and to additionally encourage by responsible treatment and resolution of such reports more ethical, moral, and fair conduct. In 2017, internal audit discussed 17 reports.

[1] https://www.mercatorgroup.si/en/corporate-social-responsibility/

Managerial and supervisory bodies

Company rules about appointment of Members of the Management or Supervisory bodies and amendments to the Articles of Association

Management Board and an extraordinary Management Board member. The number of Management Board members and their respective fields of work are specified in the Management Board Act adopted by the company Supervisory Board, upon proposal by the Management Board president. The three Management Board members are employed on permanent employment contracts, with the Management Board member's employment contract tied to his or her term of office. Extraordinary Management Board has a fixed term employment contract that is tied to the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia.

The fundamental function of the Supervisory Board is to supervise the management of company affairs. Pursuant to the corporate governance code, Supervisory Board member are independent in their work and decision-making. Supervisory Board members appointed by the Shareholders Assembly represent the interests of shareholders. Supervisory Board members representing the workers and elected pursuant to the Worker Participation in Management Act by the company Works Council represent the interests of all workers within the scope of powers and authority vested in the Supervisory Board.

The Shareholders Assembly decides on any changes to the Articles of Association with a three-quarter qualified majority of the share capital represented in the vote.

Shareholders Assembly and shareholder rights

The Shareholders Assembly is a corporate body in which the will of the shareholders is formed and voiced to become the will of the company. Managing the company is a shareholder's fundamental corporate right that the shareholders exercise together with other company shareholders by means of voting at the Shareholders Assembly about the issues for which the Shareholders Assembly is authorized, and by adopting resolutions to this effect.
Pursuant to the company Articles of Association, the Shareholders Assembly of Poslovni sistem Mercator d.d. shall adopt decisions as specified below.

1. In relation to the Management Board:
    - it can express a no confidence vote to the president and (or) member(s) of the Management Board;
    - decides on granting discharge from liability to the Management Board or to an individual Member of the Management Board;
    - exceptionally, it can decide on business management issues, if requested by the Management Board.
2. In relation to the Supervisory Board:
    - it elects and relieves of duty the members of the Supervisory Board representing the interests of shareholders;
    - it decides on granting discharge from liability to the Supervisory Board or to an individual member of the Management Board;
    - it decides on the amount of attendance fees or other compensation and reward for the services of Supervisory Board members.
3. In relation to the annual report and performance:
    - it decides on the adoption of the annual report if the Supervisory Board has not approved the annual report or in case the Management Board and the Supervisory Board have ceded the decision on annual report adoption to the Shareholders Assembly;
    - it decides on profit distribution according to the proposal by the Management Board and the Supervisory Board.
4. In relation to the Articles of Association:
    - it decides on changes and amendments to the Articles of Association.
5. With regard to share capital and shares:
    - it decides on measures for capital increase and decrease.

6. In relation to the status changes:
   - it decides on company dissolution and status changes (merger, affiliation, splitting up or spin off, change of company form).
7. In relation to operations auditing:
   - it decides on auditor appointment.
8. On other matters according to the law and Articles of Association.

As a rule, the company Management Board shall convene the Shareholders Assembly of Poslovni sistem Mercator d.d. once per year, in cases specified by law or company Articles of Association, and when this is beneficial to the company. The convocation of the Assembly shall be announced in the Delo daily paper, the electronic information dissemination system of the Ljubljana Stock Exchange called SEOnet, and the company website at www.mercatorgroup.si, at least 30 days prior to the Assembly date. In addition to the location and time of the Assembly, the convocation, or announcement defines the conditions for taking part in the assembly and asserting the voting right, as well as the agenda and proposed resolutions with the contents as the resolutions will be voted on.

Shareholders' voting right shall be exercised in proportion to the share of the company's share capital that they hold. Each vote-bearing no par value share shall grant the shareholder one vote. Voting right may be exercised at the Shareholders Assembly only by a shareholder who registered for attendance at the Assembly no later than at the end of the fourth day before the Assembly date, and who is registered in the central register of dematerialized securities as at the cut-off date. Each shareholder with the right to attend the Shareholders Assembly may also appoint in writing a proxy to attend the Shareholders Assembly on their behalf and exercise their voting right.

The company Poslovni sistem Mercator d.d. ensures compliance with the principles of equal treatment of all shareholders and ensures equal access to information, and encourages the shareholders to actively exercise their voting rights by organized collection of proxy voting authorizations.

On June 15, 2017, the 24th regular Shareholders Assembly took place with 76.19% of total shares with voting rights present. The Shareholders Assembly included a presentation of the 2016 Annual Report and the Supervisory Board Report on the audit results for the 2016 Annual Report. In addition, the Shareholders Assembly was informed about the receipts of the members of managerial and supervisory bodies, about the Supervisory Board assessment procedures, about the discharge from liability to the company Management Board and Supervisory Board, and on the appointment of the auditing company for the year 2017. The Shareholders Assembly appointed the auditing company Deloitte revizija d.o.o. as the company auditor for 2017. The Shareholders Assembly was informed about the resignations of three Supervisory Board members (Ante Todorić, Ivan Crnjac, and Darko Knez), and appointed three new Supervisory Board members (Ante Ramljak, Vladimir Bošnjak, and Teo Vujčić).

Minutes of the company Shareholders Assembly sessions shall be kept in the form of a notarial record, which means that compliance of the resolutions specified in the minutes with the decisions of the Shareholders Assembly has to be confirmed by the selected Notary Public.

Information on activities and composition of the Audit Committee and the Human Resource Committee

The **Audit Committee** of the Supervisory Board of the company Poslovni sistem Mercator d.d. has been in operation with varying membership since 2008. It plays an important role in the total corporate governance structure of the company Poslovni sistem Mercator d.d. and the Mercator Group. It aids the Supervisory Board in performance of its tasks, especially by monitoring and supervising the financial reporting, internal controls, risk management, and the work of internal and external auditors. The tasks and powers of the Audit Committee were defined by the Supervisory Board and laid down in the Audit Committee Rules of Procedure. These Rules of Procedure comply with the requirements of Article 280 of the Companies Act (ZGD-1). The Audit Committee reports to the Supervisory Board.

Since June 15, 2017, the Audit Committee has included the following members: Sergeja Slapničar as the independent expert, Matej Lahovnik as the deputy chairman of the Supervisory Board of Poslovni sistem Mercator d.d., and Damir Kuštrak and Vladimir Bošnjak as the Supervisory Board members at Poslovni sistem Mercator d.d. Vladimir Bošnjak is the Audit Committee chairman, and Damir Kuštrak is the deputy chairman. The activities of the Audit Committee are aimed at further improvement of performance of the supervisory function at the company.

The **Human Resource Committee** of the Supervisory Board of the company Poslovni sistem Mercator d.d. was founded on June 15, 2017, with the following membership: Matej Lahovnik, Ivica Mudrinić, and Vesna Stojanović. Matej Lahovnik was appointed Human Resource Committee chairman. The Human Resource Committee conducts its tasks and exercises its powers based on authorization granted from time to time by the Supervisory Board of the company Poslovni sistem Mercator d.d.

Information on the composition of managerial and supervisory bodies (Appendices C.1 and C.2 to the Corporate Governance Code)

Management Board

First and last name	Func.	Field of work in Management Board	First appointment to position	Completion/end of term	Gender	Nationality	Year of birth	Education	Professional profile	Membership in other supervisory bodies of non-associated companies
Anton Balažič	P	management of the Management Board	June 1, 2012	April 5, 2017	male	Slovenian	1973	BA Economics	Competencies from all segments of management or business administration	-
Tomislav Čizmić	P	management of the Management Board	April 6, 2017	April 6, 2022	male	Croatian	1973	MA Economics/MS Economics	Competencies from all segments of management or business administration	-
Draga Cukjati	M	finance and informatics	April 18, 2017	April 6, 2022	female	Slovenian	1971	BA Economics	finance, accounting, investment banking, structured and project financing, mergers and acquisitions	-
Igor Mamuza	M	Mercator retail Slovenia	April 1, 2016	April 6, 2022	male	Croatian	1973	BA Economics	retail management, sales	-
Gregor Planteu	E - M	in accordance with the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies od Systemic Importance to the Republic of Slovenia	May 24, 2017	in accordance with the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies od Systemic Importance to the Republic of Slovenia	male	Slovenian	1975	BA Economics	management, corporate finance, and financial restructuring	-

P = President M = Member E - M = Extraordinary Member

Supervisory Board

First and last name	Func.	First appointment to position	Completion/end of term	Repre-sentative	Attendance at committee sessions	Gender	Nationality	Year of birth	Education	Professional profile	Ind. pursuant to Article 23 of the Code	Occurrence of conflict of interests in the fiscal year	Membership in supervisory boards of other companies	Membership at committees	Chair / member	Attendance at committee sessions
Ante Todorić	P	August 29, 2014	April 25, 2017	C	3/5	male	Croatian	1978	MA Economics/MS Economics	management	NO	NO	Jamnica d.d., Croatia; Ledo d.d. Croatia	-	-	-
Ivan Crnjac	M	August 29, 2014	April 25, 2017	C	3/6	male	Croatian	1977	BA Economics	finance	NO	NO	Konzum d.d., Croatia	AC	P	1/1
Darko Knez	M	August 29, 2014	June 1, 2017	C	3/6	male	Croatian	1970	MA Economics and BS Mechanical Engineering	retail	NO	YES	Multiplus Card d.o.o.; Belje d.d.	-	-	-
Ante Ramljak	P	June 15, 2017		C	16/16	male	Croatian	1967	BA Economics	investment banking, mergers and acquisitions	NO	NO	Sarajevski Kiseljak d.d., Bosnia and Herzegovina	-	-	-
Matej Lahovnik	D	March 30, 2012		C	16/16	male	Slovenian	1971	PhD in management and organization	management	YES	NO	-	AC; HR	M; M	AC: 5/5; HR: 1/1
Damir Kuštrak	M	August 29, 2014		C	16/16	male	Croatian	1956	BS Construction Engineering and MA Agriculture	corporate governance, finance	YES	NO	Agrokor d.d.; Croatia	AC	M	7/7
Ivica Mudrinić	M	August 29, 2014		C	13/16	male	Croatian	1955	BS electrical engineering	competencies from all segments of management or business administration	YES	NO	Rochester Institute of Technology Croatia	HR	M	1/1
Teo Vujčić	M	June 15, 2017		C	8/10	male	Croatian	1969	PhD (doctor of sciences)	retail, finance	NO	NO	Dijamand a.d., Serbia; Ledo d.d., Zagreb; Multiplus Card d.o.o., Zagreb; PIK Vrbovec d.d., Hrvaška, Zvijezda d.d., Croatia	-	-	-
Vladimir Bošnjak	M	June 15, 2017		C	9/10	male	Croatian	1973	BA economics, MBA	investment banking, finance, mergers and acquisitions, accounting	NO	NO	Belje d.d., Croatia; Dijamant a.d., Serbia; Jamnica d.d., Croatia; Konzum d.d., Croatia; Ledo d.d.; Zvijezda d.d., Croatia	AC	P	4/4

to be continued

P = President M = Member D = Deputy chairman C= representative of Capital E = representative of Employees AC = Audit Committee HR = Human Resource Committee

continued

First and last name	Func.	First appointment to position	Completion/end of term	Repre-sentative	Attendance at committee sessions	Gender	Nationality	Year of birth	Education	Professional profile	Independence pursuant to Article 23 of the Code	Occurrence of conflict of interests in the fiscal year	Membership in supervisory boards of other companies	Membership at committees	Chair / member	Attendance at committee sessions
Veljko Tatić	M	November 4, 2013	November 4, 2017	E	11/11	male	Slovenian	1964	sales manager, VI level of education	retaila	YES	NO	-	-	-	-
Vesna Stojanović	M	July 3, 2013		E	15/16	female	Slovenian	1957	administration clerk	human resources	YES	NO	-	HR	M	1/1
Matjaž Grošelj	M	May 20, 2015		E	16/16	male	Slovenian	1969	sales manager, VI level of education	logistics	YES	NO	-	-	-	-
Jože Lavrenčič	M	November 5, 2017		E	3/3	male	Slovenian	1979	economist, VI level of education	retail	YES	NO	-	-	-	-

P = President M = Member D = Deputy chairman C= representative of Capital E = representative of Employees AC = Audit Committee HR = Human Resource Committee

External members of commissions

First and last name	Committee	Attendance at committee sessions	Gender	Nationality	Education	Year of birth	Professional profile	Membership in other supervisory bodies of non-associated companies
Sergeja Slapničar	Audit Committee	6/7	female	Slovenian	PhD in management and organization	1971	accounting and finance	NLB d.d., Slovenia – until March 2017

P = President M = Member D = Deputy chairman C= representative of Capital E = representative of Employees AC = Audit Committee HR = Human Resource Committee

Tables C.3 and C.4 are presented in the Financial part of the Annual report.

Observing the diversity policy

Non-Financial Report

The company Poslovni sistem Mercator d.d. has not adopted a dedicated document on diversity policy. However, diversity policy is conducted in practice in the managerial and supervisory bodies in terms of the following aspects: gender, age, education, and professional experience. At present, gender diversity is not entirely observed, as the company Management Board and Supervisory Board only include one female employee, respectively. In terms of other aspects of the diversity policy, the managerial and supervisory bodies have suitable composition.

Management of subsidiaries

Mercator Group consists of the parent/controlling company Poslovni sistem Mercator d.d. and its subsidiaries in which the parent company holds, directly or indirectly, the majority interest or the majority of voting rights. Parent company controls its subsidiaries within a single Management Board.

The company Poslovni sistem Mercator d.d. as the parent/controlling company of the Mercator Group operates by the principles of improving business performance in each subsidiary and the Mercator Group as a whole. The controlling company shall provide corporate governance at subsidiaries:

- through attendance at subsidiary general meetings or shareholders assemblies, and membership in supervisory boards;
- with standardization and unification of rules and procedures in respective fields or areas;
- a system of powers and authorizations is in place to delineate the responsibilities for concluding individual transactions;
- through a system of regular working meetings and TV/video conferences of the Management Board of the company Poslovni sistem Mercator d.d., along with authorized employees, with the management teams of subsidiaries, in order to review the accomplishment of results and performance in the core activity and to optimize the purchasing channels within the entire Mercator Group.

In 2017, operating plans for business efficiency (Value Creation Plans) were adopted in all markets of operations and for all subsidiaries. These plans improve the level of corporate governance and facilitate the exchange of the best practices within the Mercator Group.

Cooperation with the Financial Administration of the Republic of Slovenia

In March 2016, the Financial Administration of the Republic of Slovenia grated to the company Poslovni sistem Mercator d.d. a special status within the program for encouragement of voluntary fulfilment of obligations and settlement of liabilities, and resulting decrease in administrative burden of financial regulation. Mercator and the Financial Administration of the Republic of Slovenia (FURS) are executing the program based on the principles of transparency, cooperation, understanding, and mutual trust. The FURS grants the company fast and responsive resolution of any problems in fulfilment of its tax liabilities with willingness to cooperate. Such form of cooperation with FURS allows greater certainty regarding taxes for the company.

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We ensure stability of business and efficiency of operations with clear goals and specific responsibilities.

BUSINESS REPORT.

EFFECT OF ECONOMIC CONDITIONS AND COMPETITION ON OPERATIONS

The economy in the euro zone is growing at a rather high pace, with real growth rate at 2.2%. In 2017, the European economy performed better than expected, with higher private spending, steeper growth of economies globally, and a decline in unemployment. The growth is expected to continue in the future.

Development of modern stores, new shopping paths and channels, also results in the development of new trends. Recently, the focus has been on the following:

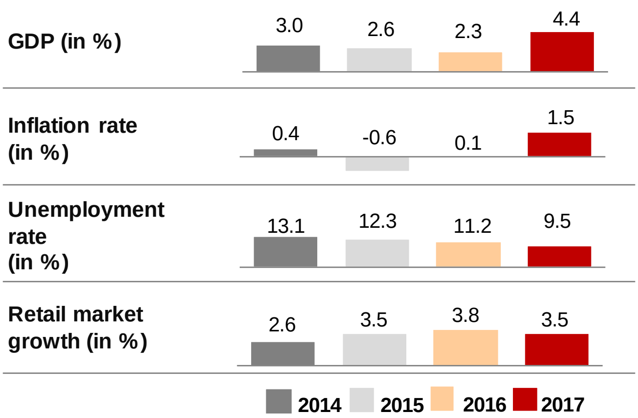
- convenience (proximity of the store, fast and simple shopping);
- broad and interesting fresh offer (expanded fresh produce departments, »food to go«, »eat in«, and »take out offer«), and
- placement of local and homemade products.

Food is becoming the main theme of communication, appearing in all digital media (blogs, websites, recipes, recommendations, opinions). **The key task of a modern retailer is to enable the customer simple shopping anytime and anywhere.**

Following is a review of gross domestic product growth, inflation rate, and unemployment rate in key markets of Mercator's operations.

Review of economic conditions and competition in the key markets of Mercator Group operations[2]

SLOVENIA



This year, exports again contributed the most to GDP growth in Slovenia. In addition, all components of domestic consumption remain higher year-on-year as well. Improved conditions in the labour market and consumer confidence have continued to fuel growth of private spending and the growth of residential property investments that started last year. Active population continues to grow in most industries and it has reached the level on a par with that of the year 2007. However, companies increasingly face a lack of suitable labour force. Contributing the most to rising inflation are the prices of energy and services; in November, the effect of food prices gained some steam. On the other hand, core inflation does not indicate major pressure on price growth. The country's rating for 2017 is A+ with a stable outlook.

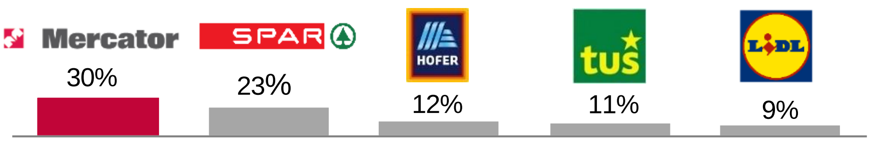
Effect of market situation on consumption: consumer confidence in Slovenia in 2017 improved and became somewhat more optimistic, which is a positive indicator affecting private spending. The biggest impact on the increased consumer confidence at the annual level came from more optimistic forecasts about the unemployment rate and improvement of financial position in households; on the other hand, expectations

[2] 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), Valicon, Euromonitor International and internal sources.

regarding savings had a negative effect on the annual change. According to Nielsen[3] data, consumer confidence in Slovenia in the second quarter of 2017 was the highest to date and closer to the European average.

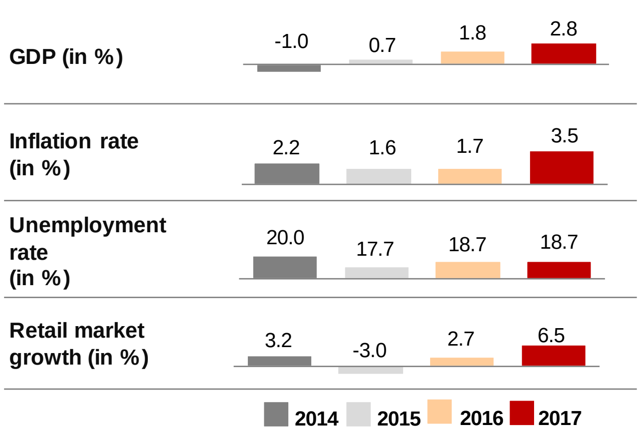
The share of respondents believing the country is in recession decreased by 24 percentage points and it stood at 47% for 2017, while in 2016 it was at 71%. Just short of 70% of respondents believe that the country will not recover from the recession in the next 12 months. Their primary concerns are security of employment and their own health.

Competitive environment: in addition to traditional retailers (Mercator, Spar, Tuš), other major retail chains (Hofer, Lidl, and Eurospin) account for a considerable market share. Retail industry is relatively stable and consolidated (top five players account for 85% of the market). Mercator maintains a leading market share.



Market share

SERBIA



Economic growth is high and expectations in the coming years are for the current conditions to persist. Inflation rate is rising while unemployment is in decline. Forecasts for the years ahead are positive. The country's rating for 2017 is BB with a stable outlook.

Effect of market situation on consumption: Consumer confidence in Serbia is slowly but constantly improving; however, it remains below the European average. A high share of respondents – as many as 78% – believe the country is in a recession. Just short of 70% of respondents in Serbia believe that the country will not recover from the recession in the next 12 months. Consumers' primary concerns include security of employment, health, and financial standing. According to the survey, 44% of respondents will save on out-of-home entertainment; somewhat fewer will save on clothes and by opting for cheaper brands. The consumers are rational and price-sensitive. They tend to plan their shopping and avoid major shopping sessions. They shop less and more frequently, with lower value of each shopping cart.

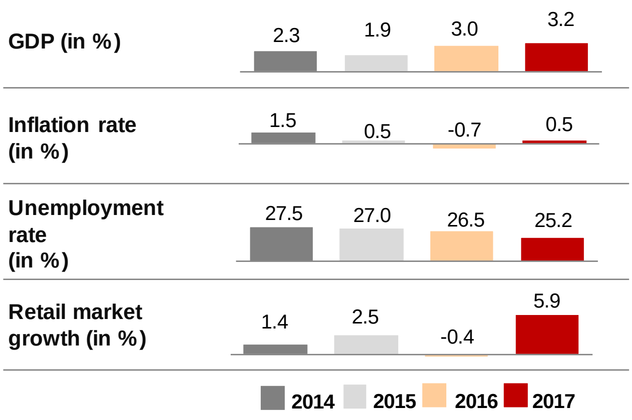
Competition: Trade is relatively less consolidated as traditional retail (smaller independent retailers) are still predominant. Mercator's competition includes international retailers (Delhaize, Metro) and domestic retail chains (DIS, Univerexport, Vero, Aman and Gomex).

Market share

BOSNIA AND HERZEGOVINA

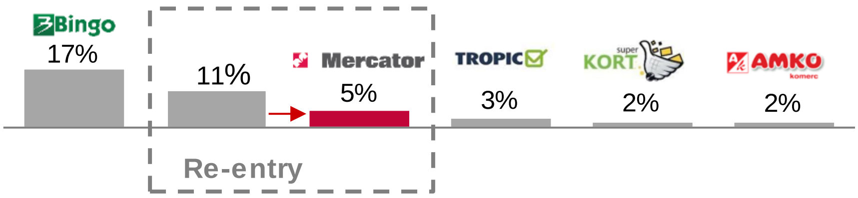
GDP growth in 2017 was high. Growth of private spending is increasing while unemployment rate is decreasing. Inflation rate remains at the same level throughout the year. The country's rating for 2017 is B with a stable outlook.

[3] Nielsen: Consumer Confidence Index, Q2 2017, Slovenia



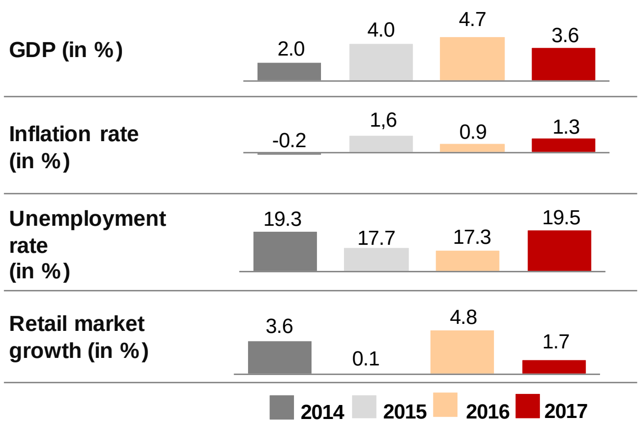
Effect of market situation on consumption: in 2017, economic growth rate was positive in Bosnia and Herzegovina, while unemployment rate remains high. Average salary in Bosnia and Herzegovina in 2017 was among the lowest salaries compared to other countries in the region.

Competition: The market of Bosnia and Herzegovina is highly diversified. Retail chains Konzum, Mercator, and Bingo operate their networks across the entire country, while other retailers only cover specific parts of it. The largest retailers in Bosnia and Herzegovina include Bingo, Konzum, and Mercator; they are followed by smaller retailers (Tropic, Amako and Imex). None of the major European retailers are present in Bosnia and Herzegovina. After resuming retail operations in 2017, Mercator has 5% market share.



Market share

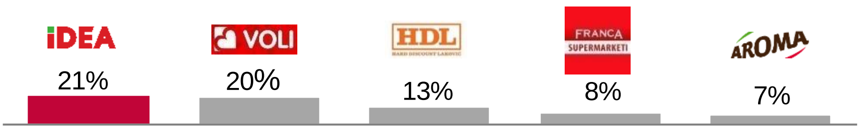
MONTENEGRO



Growth is positive in Montenegro as well. Inflation rate remains moderate. In the years ahead, economic growth will be based on investment as the main motor of the economy. The country's rating for 2017 is B+ with a negative outlook.

Effect of market situation on consumption: average salary in Montenegro in 2017 is the lowest among the countries of the region.

Competition: the Montenegrin market is the least consolidated (top 5 retailers account for 69% of the market) of all markets in the region, with traditional retail accounting for a considerable share. In 2017, most retailers expanded their sales network: Mercator, Voli Trade, Domaća trgovina, Laković, and Franca.



Market share

STORE FORMATS AND CATEGORY MANAGEMENT

Store formats

Today's customers are defined by rapidly changing demographic conditions, lifestyle, and technological development. The consumers have become 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. Since customers are willing to spend less and less of their time for shopping, they expect ever more extensive and faster shift of retail into the digital world and the online environment. The future of retail lies in further expansion of the number of sales channels and increasingly better integration across them.

Mercator responds to the current market conditions by **constantly developing new store concepts** and 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.

We were **intensively refurbishing our retail network** in 2017. In Slovenia, **101 units** were either refurbished, rearrangements, or newly opened. The 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. Stores were also rearrangements and newly opened in the markets of **Montenegro and Serbia**. A total of **34 units** were opened and rearrangements in **Montenegro**, along with **48 units** in **Serbia.**

Also in 2017, **Mercator re-entered the market of Bosnia and Herzegovina**. Thus, Mercator managed **78 stores** at the end of 2017, including the modern hypermarkets Ložionička in Sarajevo and Borik in Banja Luka. In September and October, the units taken over were **re-branded both in terms of internal and external visual identity**.

In Slovenia in the first half of 2017, intensive **refurbishment of hypermarkets** took place. The refurbishments were 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.

In 2017, we continued with refurbishments of **market stores**, as Mercator carries on the tradition of coming closer to its customer in their local environment. In December, the stores in **Kranjska Gora** and **Bovec** were thoroughly refurbished, with the following highlights in the offer: **grab&go department**, **new packaging unit, hot**

bar, and **a larger fruit and vegetables department.** Last year, major emphasis was also placed on refurbishments of the existing **supermarkets** that represent an upgrade to the market stores, featuring a broader and especially deeper offer of FMCG.



Composition of sales units as at December 31, 2017

COUNTRY	SLOVENIA	SERBIA			MONTE-NEGRO	BOSNIA AND HERZ.	MERCATOR GROUP		
	Mercator	Mercator	Roda	Idea	Idea	Mercator			
STORE FORMATS	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Number of units	Gross sales area (m²)	Net sales area (m²)
Hypermarkets	22	2	32	1	2	5	**64**	**289,225**	**192,504**
Supermarkets	111	-	3	97	15	24	**250**	**272,789**	**179,702**
Markets	333	3	-	189	93	49	**667**	**256,483**	**153,798**
Cash & Carry/VELPRO	13	-	-	6	3	-	**22**	**63,750**	**35,366**
Restaurants	8	-	-	-	-	-	**8**	**2,070**	**1,379**
Total FMCG program	**487**	**5**	**35**	**293**	**113**	**78**	**1.011**	**884,317**	**562,749**
Technical consumer goods	44	-	-	-	-	-	**44**	**62,866**	**38,404**
Total specialised programs	44	-	-	-	-	-	**44**	**62,866**	**38,404**
Total units under management	**531**	**5**	**35**	**293**	**113**	**78**	**1.055**	**947,183**	**601,153**
Franchise stores	185	-	-	-	-	-	**185**	**37,982**	**25,051**
TOTAL	**716**	**5**	**35**	**293**	**113**	**78**	**1.240**	**985,165**	**626,204**

Category management

Category management activities in 2017 in **Slovenia** were focused on accomplishing the following goals:

- build a quality multilevel offer or products under renowned brands and various private labels (campaigns "My Brands" and "We Love Local");
- offer competitive prices for branded and private label products;
- efficiently manage the store area at a level of particular products or product or categories, and the store as a whole;
- adjust the assortment to particular characteristics of respective micro locations;
- ensure attractive offer in sales promotion activities, with focus on optimization;
- provide appropriate sales service in our stores (at the point of sales).

In the market of **Serbia**, the following activities took place in 2017.

- Redefinition of categories and alignment with the unique selling proposition of each store format.
- Training and education of employees to make sure the category managers can use the category management process in 2018 as the basis for planning and monitoring of turnover and activities by respective categories.
- Sales assortment was carefully examined and reviewed, with particular focus on expansion of its width and reduction of its depth; moreover, the process and dynamics of procurement and changes to the category module, by respective categories, were redefined.
- Regarding positioning, in order to make orientation at our stores easier for our customers and to improve their shopping experience, we started preparing a review of planograms (some findings were already taken into account in refurbishments in the last quarter of 2017; we shall adopt the decisions on potential refurbishments at other retail units based on the results).
- With regard to service, we launched employee training for the meat, bakery, deli, hot bar, and fruit and vegetables departments in order to improve our service and general customer satisfaction with their shopping.
- Regarding price and promotion, we sought to provide competitive regular prices and promotions of products that attract the consumers, considering the high price sensitivity of the average Serbian consumer.

In **Montenegro**, the following activities were carried out in category management in 2017:

- optimization of offer consistently with the development of respective groups of brands;
- price competitiveness of brands and higher participation of suppliers;
- optimization of retail activities, consistently with the development of the Super Card;
- efficient retail area management.

In the market of **Bosnia and Herzegovina**, the following activities have taken place since September 2017 when Mercator resumed its retail operations:

- establishing cooperation with suppliers and signing of the annex to agreements with Konzum d.o.o., Sarajevo;
- providing the assortment and goods delivery, and returning the assortment that was active at Konzum before the crisis;
- expanding the offer and returning the variety of products available to the customers before consolidation across markets within the Agrokor Group in 2014;
- introduction to the Mercator private label assortment;
- introduction to new brands in order to offer our customers quality products and value for money;
- maintain the price position, including adapting the prices and adjusting the assortment for the market of the Republic of Srpska.

MARKETING AND LOYALTY PROGRAMS

Loyalty programs and brands by countries*

	Loyalty program	Brand
SLOVENIA Active card holders: **675 thousand**		Mercator M Tehnika MAXEN MAXIMALNA ENERGIJA
SERBIA Active card holders: **620 thousand**		Mercator iDEA RODA
MONTENEGRO Active card holders: **60 thousand**		iDEA
BOSNIA AND HERZEGOVINA Active card holders: **340 thousand**		Mercator

*An active cardholder is one who has made at least 1 purchase in the last 12 months.

Marketing

Our marketing activities are focused on market priorities and the dynamics of changes in the trade industry.

We are pursuing four key fields:

- value for money,
- fresh categories,
- homemade/local,
- the best shopping experience.

In 2017, we communicated the brand in a new, more youthful way
Mercator brand refreshment

This spring, Mercator introduced a new communication campaign in Slovenia: "Are you? You are what you eat." It includes a thorough revision of the strategy and refreshment of the tone of communication. The goals of the campaign include the following:

- come closer to new generations of customers;
- unify the identity and recognition of the communication platforms, and
- make the Mercator brand identity younger.

Mercator is the **retailer with the longest retail tradition in Slovenia.**
Due to the extensive network of stores across Slovenia, including smaller towns and villages, it traditionally has a higher market share in the segment of mature and older consumers. **Competition is the most stringent in the segment of young consumers and young families (aged 18 to 38)**. Thus, Mercator's key marketing goal for the future of the brand is a **turn to the young**. In addition to store refurbishment, the revised communication platform is focused primarily on the younger target audience, with a **refreshed tone of communication.**

We bet on the following **breakthrough elements:**

- personal identification of consumers with food, under the slogan "**You are what you eat**";
- refreshed **visual system** (with major emphasis on photos);
- selection of **music** in foreign language, atypical for Mercator (***No Roots* by Alice Merton**);
- hiring a top class **director** of music videos and dance films.

In addition, the three pillars of unique selling proposition were assigned their recognizable and distinctive verbal constants:

- Fresh offer and quality — ***Daily fresh, always fresh***
- Offer of local products — ***From here and from everywhere***
- Value for money — ***Good price, even better price***

With the campaign, Mercator increased its market share in the segment of young consumers aged 18 to 38 by 14 percent, increased the margin over the competition, and retained the position of the leading retailer in the segment of young consumers and young families. When we approached the fundamental rejuvenation of our communication, the song No Roots by then hardly known singer Alice Merton played a decisive role. Today, the song has 75 million views on YouTube and it is (according to the national radio station Val 202) the second most frequently played foreign song.

1. VALUE FOR MONEY

My Brands

The campaign **My Brands** left an impression on the year 2017. In the food industry, Slovenia has many renowned brands whose products have become an important part of Slovenian "brandscape". Thus, we launched an initiative to connect with the suppliers and to offer them more than just a shelf or aisle in the store. The purpose of synergistic collaboration with the umbrella project My Brands is to connect with the suppliers of Slovenian brands. To date, the initiative has been joined by over 50 partner food brands.

In a small market with very strong presence of international competition, maintaining the leading position is not an easy task. Thus, many domestic brands face many challenges – like Mercator does. Slovenia has many renowned brands in the food industry, which have succeeded in keeping the leading market position and maintaining their quality and reputation. Both Mercator and Slovenian food brands are looking to stay popular. The purpose of synergistic collaboration with the umbrella project My Brands is to connect the suppliers not only at the level of a shared special offer, but also to connect in creation of joint marketing stories and new offers for the consumers. In the campaign, Mercator exposes the most appreciated domestic brands and their suppliers as its premium partners. Simple and efficient. Their products are particularly exposed at Mercator stores, they enjoy extra attention with advertisements, and adjusted presence in digital media. In 2018, the "My Brands" story is expanding to the broader region.

We provide well-priced shopping

Convenience, rationality, and quality are important factors affecting the consumers' choices. Key target tasks are therefore geared towards **improving the perception of pricing** and **value for money**, and towards **making the offer more appealing** in order to retain the existing customers and to attract new ones.

Mercator is continuously pursuing the goal of offering the most appealing price benefits for the customers. Each week, we offer appealing discounts in our special campaign catalogue for products from a variety of categories. We do our best to be competitive every day in as many products as possible, which is also evident in the **"Znižano"** (Discount) project.

We also introduced the **"Recommended"** project. This tag points to the products with the best price-to-quality ratio, and to products with prices that are set as competitive retail prices as at the day of price survey. Thus, we are looking to offer our consumer particularly well-priced shopping for their favourite products.

In 2017, **Mercator re-entered the market of Bosnia and Herzegovina** where the customers could browse through five regular catalogues in the last three months. Moreover, they were able to choose products from theme-oriented catalogues presenting particular segments: toys, technical consumer goods, home and holidays, and wine. In the catalogue, the customers found a coupon for a 20-percent discount that they could redeem as they pleased. At the same time, we introduced the activity of Thursdays as retiree days when our customers in retirement were offered a 10-percent discount.

With Pika, our customers save more

Mercator is building consumer trust with a range of short-term loyalty programs that include collecting stickers for discounts or redeeming points for discounts. Thus, the updated Pony bicycles, KitchenAid cookware, and Tefal innovative products were exclusively offered in 2017.

Customer segmentation

The needs and desires of our customers are highly diverse. We learn about them by analyzing their shopping behaviour, through market research, and 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.

Following are the most important segmentation levels:
- loyalty, where our customers are monitored according to the frequency of visits and spending, and we prepare particular activities for them; and
- age – life cycle; in this respect, we placed more emphasis in 2017 on the younger generation.

In 2017, we **stepped up the scope** of our activities to adjust the offer to different customer segments. Some activities are aimed at certain product categories, while others are based on retaining the loyalty of our customers and affect their behaviour, e.g. keeping the customers during refurbishments of our stores. Particular attention was paid to customer notification at stores, via coupons received at check-out. For customers keen on shopping online, we will continue to allow the functionality of online payment for alimentary products and technical consumer goods using the Mercator Pika card, and we shall continue to upgrade the Pika customer loyalty system.

Pika card

Pika allows customers a range of benefits both in Mercator's retail network and in partner companies, including deferred payment and payments in up to 24 instalments and zero interest rate. Pika card holders are offered additional discounts and benefits.

18 years of Pika card in Slovenia

In September, **Pika celebrated its 18th birthday**. The customers can make use of its advantages using the "Moj M" (My M) app on their mobile phone. In the month of Pika birthday celebration, we presented the Pika benefits, added now benefits, and surprised with Pika rewards, because "**The bottom line: it's cheaper with Pika**".

1. **Offer adjusted to the desires of the customers:** A new feature called 123 Pika coupons. Every time, the customer receives a coupon with offer adjusted to the purchasing desires and actual purchases.
2. **Actual statements by our loyal customers:** In the TV advertisement, we combined true statements by three actual loyal Pika card users.
3. **Pika spreads the happiness across Slovenia:** We wanted to spread happiness across Slovenia; therefore, the Pika wheel of fortune hit the road.
4. **Pika comes alive from a poster and surprises the commuters waiting at Bavarski dvor:** We set up a "live poster" in the centre of Ljubljana, from which our lovely girl Pika came to life from the poster and invited the commuters waiting at the bus stop to her birthday celebration in Šiška.
5. **Birthday celebration in Šiška:** Pika card's birthday was celebrated at the Hypermarket Šiška.

In the run-up to Christmas, we prepared a special **Pika magazine with a unique scented cover** and over 40 holiday recipes.

Super Card in Serbia

The Super Card is the only and the largest multi loyalty program in Serbia. It includes over 17 partners, more than 1,100 stores, and over 620 thousand active users.

In 2017, was highlight the campaign titled "The Dream Offer" ("Ponuda snova") by which Roda and Super card offered well-priced shopping of children's equipment during Easter holidays, targeted at parents. The customers collected stickers for a 50-percent discount on select Chicco products. Another campaign that attracted a lot of attention of our customers was "To Babies with Love, to You at a Discount", organized by Mercator and Super Card during New Year's holidays. With the Super Card, users could earn a 40-percent discount on select Peg-Perego and Kids products, and other equipment for children.

In December, we organized major sweepstakes "Let the Super Card Support You for a Year" at the IDEA and Roda stores and the Mercator hypermarkets. A total of 365,000 SMS were sent for participation in the sweepstakes.

Super Card Montenegro

In Montenegro, we successfully completed the migration of Pika card to Super card in May 2017. The Super Card is a reward program that includes several partners. In addition to all other benefits, Super Card holders can fund as many as 1,000 products at "super prices" every day at IDEA stores. The Super Card project is the first in the region to be implemented entirely online, while retaining the user experience of the Pika card.

In addition to the Super Card, the users were presented three key chains (or key fobs), allowing all family members to collect the points. To improved user experience related to the Pika card, customers were also offered other benefits including daily discounts related to the use of the Super Card, and benefits offered by the partners and had previously not been included in the Pika card.

Pika card in Bosnia and Herzegovina

In Bosnia and Herzegovina, we continue to reward the customers within the Pika card brand, which remains a member of the PikaSuperCard loyalty program. Customers collect points at 1 point per 2 KM of purchase, and thus qualify for quarterly cash-back rewards. There is also the benefits booklets offering additional benefits for Mercator customers, including discounts on certain categories or products. Regular promotional materials also offer discounts to customers who are Pika card holders.

2. FRESH CATEGORIES

Freshness and quality

In 2017, we also conducted a **fresh category** campaign. The campaign included the offer of fresh meat, fruit, and vegetables, bread and pastry, and dairy products.

In July, we became the first and only retailer to receive the **"Select Quality for Fresh Chicken Meat"** certificate. In September, we also received the certificate for **beef and veal**. 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. Five Mercator **baking products** and fifteen products of the "Pekarna Grosuplje" bakery brand available only at Mercator stores received gold medals of the bakery section with the Slovenian Chamber of Commerce and Industry.

In **Serbia**, we prepared in 2017 as a part of the IDEA format the project "**Choose healthy and take fresh**". In addition to special campaign activities and the image campaign, IDEA highlighted, depending on the season, the key categories of fruit that was launched in the market by IDEA. One such case was the "Cardinal" grapes that IDEA was the first to present in its assortment and for which special communication was prepared, and, 26 tons of this fruit were sold. As a part of the campaign titled "Choose healthy and take fresh", IDEA started in January and February, for the second consecutive year, and initiative that involved workshops for children at four Belgrade municipalities, teaching them about the importance of healthy food.

In **Montenegro**, we used the campaign titled "**Choose healthy, take fresh**" to position ourselves as a popular destination for daily purchases of fruit and vegetables, and we rewarded our customers with generous prizes from the sweepstakes.

OURS. THE BEST

OURS, THE BEST is Mercator's corporate signature for all types of support to sports – professional, amateur, youth, and starter. Mercator is strategically investing in several segments of sports: winter Olympic team, ski jumpers, national football team, largest football clubs in the country Olimpija and Maribor, and the Ljubljana Marathon.

3. LOCAL

We Love Local

Remaining at the heart of care for the domestic customer in 2017 were the products labelled with the red heart **"We Love Local"**. In Slovenia, the project includes 20 agricultural cooperatives and over 100 small suppliers with more than 1, 000 types of local products. Under the umbrella slogan "Good People behind Good Food", we present the local growers whose knowledge, hard work, and a good measure of innovativeness were combined to create quality products.

Our goal is to further improve our cooperation. We are looking to contribute to this goal by organizing events that allow cooperation between respective suppliers, and by support 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.

Promotion of domestic products in foreign markets

One of the most recognizable campaign in Serbia is the supply of domestic products. We want to offer our customers the best home products at a lower price. In addition to regular promotions of home-made products, with special emphasis on the brand "Tastes of my place", special action activities are also carried out. Customers have the opportunity to buy products that are available only in IDEA, Roda and Mercator stores.

In Montenegro, we worked with the local producers to develop a range of local products **"The Tastes of My Town"** ("Ukusi kraja moga"), which pay homage to traditional recipes. At the end of the year, the offer included 55 such products, and we kept our customers up to date about the producers and the way their products are made.

4. THE BEST SHOPPING EXPERIENCE

We provide a pleasant shopping experience

In the spring of 2017, we again opened **Mercator's gardening centres** to our customers, offering a variety of seedlings, fresh herbs, tree and shrub saplings, soil and fertilizers, flower pots, gardening equipment, and small and large gardening tools. The offer of vegetable seedlings included a large part of Slovenian seedlings as well as some organic seedlings. Mercator garden centres are at the following locations: Šiška, Domžale, Kranj Primskovo, Novo mesto Bršljin, Celje, Maribor Tabor, and Ptuj Špindlerjeva.

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

In December, we treated the visitors at our major centres to free gift wrapping service and a visit by **Saint Nicholas and Santa Claus**, and Santa Claus fulfilled the wishes of customers at Mercator Centre Maribor Tabor and Mercator Centre Šiška by bringing their gifts to their homes.

In September 2017, we celebrated the birthday of Šiška and titled the month-long series of events and experience "**My September, the best in Šiška**". We developed unique sweepstakes for our customers with the slogan "every ticket wins", and we gave away 100 Pony bicycles as the main prize. In addition, we prepared special theme-oriented experiences every weekend including the following: Weekend of Illusion and Magic, the Tastes and Rhythms of Primorska, Weekend of Good Shopping: Celebrities Shop with You, and Explosion of Flavours, the best when Pika celebrates.

In **Serbia**, we worked with the Belgrade marathon to prepare the sweepstakes **IDEA** rewards you with 1,000 bicycles, and carried out the project "Who lives in Belgrade, also creates." For the third consecutive year, we carried out as a part of the project "We Love Holidays Because We Love Each Other" the humanitarian caravan that involved our employees visiting over 40 institutions and giving way more than 4,000 presents to children. We teamed up with the Basketball Club Crvena Zvezda in the campaign "Zvezda plus IDEA" to organize promotional activities for strengthening our K Plus brand.

In Serbia, **Roda** organized the sweepstakes "Where happiness is a thousand times bigger." The "Dream Offer" campaign, targeted at parents, offered children's equipment, and we prepared the fourth ajvar cooking competition that included 3,000 contestants.

We organized special events at Mercator Centres in Belgrade and Novi Sad, holding the campaign "Days at Mercator" every two weeks, leading our customers through special theme-oriented campaigns, displaying the breadth of our assortment, and preparing many sweepstakes in this respect. We also prepared the customer loyalty program "To Babies with Love" in which our customers could win 40% of discount on the purchase of children's equipment. In 2017, we updated our fruit and vegetables departments, as well as our healthy food departments.

In **Bosnia and Herzegovina**, Mercator prepared a special shopping experience for its customers at the Mercator Centre Ložionička in Sarajevo and Mercator Centre Borik in Banja Luka were they could enjoy the Tastes of Coffee, Days of Beer and Sausages, and Days of Wine and Chocolate. Moreover, the customers could learn about the domestic food producers as a part of the "Domestic Brand Days", and shop at very favourable prices during "late night shopping" sessions. A Wine Festival was also held, and we organized holiday culinary workshops and meeting with the Father Frost (Dedek Mraz).

In **Montenegro**, we prepared the project Days of Italy in which we presented Italian products and held sweepstakes in which every ticket won a prize. We also presented a rich offer of products from Serbia, Croatia, Slovenia, and Bosnia and Herzegovina, and gave away a Fiat 500 to our customers. In 2017, we again sponsored the Montenegro Basketball Association and organized the online contest "500 balls for future aces". We are also very proud of our New Year's campaign in which our employees distributed gifts to children at paediatric hospitals.

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New shopping technologies

Mercator Web Store

- Creating a profile and linking it to social networks.
- Review of both traditional and online transactions.
- Advanced analytics for improved user experience.

Tik Tak

- Already used by 50% of the customers, where available.
- Investment into new self-service check-out devices (small easy-to-use terminals).

M Scan

- Increased use of product scanning devices at major stores.
- According to statistics, shopping cart size is doubled where this technology is available.
- In 2017, the innovative service "Sken za tren" for the first time in Montenegro.

M Scan Mobile

- Leading smart scanning using a mobile app in the market.
- Allows the use of the mScan app for Android and iOS at all stores.

Moj M application

- Introduction of Pika payments with an application based on a QR code and the NFC protocol (contactless payment).
- In 2017, was started the project of launching a digital wallet with the goal of implementing it in 2018.

Development of new technologies

In 2018, we will add new digital services to the MY M application. Customers and users will have access in a single place to a review of operations with the Pika card, and they will be able to use digital services that Mercator offers to its customers.

Offer of private label products

We are extending the quality and scope of offer with our private label line, as the introduction of private labels affords some control over the supply chain and targeted management of private label categories in a way that allows offering the customers the best quality products at reasonable prices.

Throughout 2017, Mercator promoted its own Mercator line of dairy products. We also highlighted product quality with the fall campaign for the Minute products, with emphasis on convenience and quality.

In 2017, we continued to promote our line of organic products called **Bio Zone** with the aid of the blogger Alenka Košir who provided tips and recipes for maintaining a healthy lifestyle and a balanced diet. This autumn during the Ljubljana Marathon, we also included other segments from our comprehensive offer of products for an active and healthy lifestyle in the promotion of the Bio Zone products, rather than only the products of the Bio label. This involved lactose-free and gluten-free products, and vegetarian nutrition, on a special flyer, TV advertisements, and promotion at events.

We also impressed the mothers as we presented the babies born on January 1, 2017, a year-long supply of Lumpi diapers, and continued to monitor the satisfaction of children and mothers with the products throughout the year via our Facebook profile and in flyers. The donation also saw positive response in the media. At the end of the year, we launched a novelty in our line: Lumpi organic baby food.

We carried out two humanitarian activities focusing on pets: one in the spring with Buddy and Kitty food products in digital channels, and one in the autumn when we worked with the company Mars on a sales promotion project for our pet food, which included donating the pet food to shelters.

We shall continue to pursue the trends set by today's lifestyle: **contemporary offer** for consumers who have increasingly less time for preparation of quality meals at home or who spend ever more time away from home; **more own offer of organic and lifestyle products** (gluten-free, vegetarian); and **more products for a healthier lifestyle** (products with less sugar, trans-fat-free etc.).

REAL ESTATE MANAGEMENT

In 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 two exceptions in this case are the Trade Centre Bled for which construction started in September 2016 and it was opened in March 2017, and the Supermarket Blok 63 in Belgrade, opened in September 2017. In 2017, we opened a total of 21 new FMCG stores (1 in Slovenia, 12 in Serbia and 8 in Montenegro) and 2 distribution centers. In September 2017, we took over Mercator's former stores and one distribution centre from Konzum Sarajevo.

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

As a part of the shopping centre monetization project, we completed in 2017 in Serbia the sale of Mercator Centre Belgrade, with a lease-back of the hypermarket.

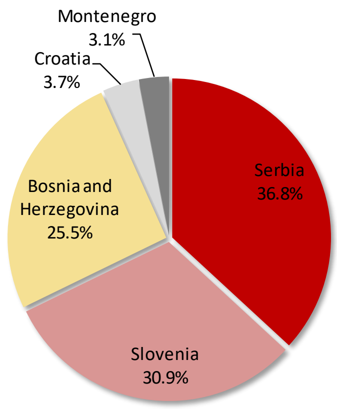
Following are Mercator's key goals in real estate management:

Investment and Divestment

In 2017, Mercator Group investment into property, plant, and equipment (CAPEX) amounted to EUR 70.9 million. Of this amount, 30.9% was used for investments in Slovenia and 69.1% was used for investments in international markets.

Investments by markets

	Capital expenditure in 2017 (in EUR 000)	Structure (in %)
Serbia	26,101	36.8%
Slovenia	21,924	30.9%
Bosnia and Herzegovina	18,045	25.5%
Croatia	2,598	3.7%
Montenegro	2,235	3.1%
TOTAL	**70,904**	**100.0%**

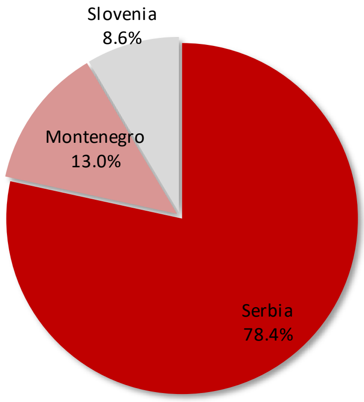


Investment into expansion of retail area represented 15.7% of total investment; refurbishments of existing units accounted for 63.6%; IT investments accounted for 8.1%; investments into distribution centres accounted for 8.0%; and the remaining 4.6% was invested in non-trade activities.

In 2017, Mercator Group newly acquired 28,629 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 and Supermarket Blok 63, Belgrade, was acquired by operating lease.

In 2017, Mercator Group divested property, plant, and equipment worth EUR 64.8 million, of which EUR 46 million pertains to the divestment of MC Belgrade in Serbia.

Newly opened sales ared by markets



Summary of total gross retail area as at December 31, 2017

	Gross retail area (in m^2)		
	Used for own operations	Leased out	TOTAL
Owned retail area	541,754	409,060	950,814
Leased retail area	405,429	153,610	559,039
Total retail area	**947,183**	**562,670**	**1,509,853**
Owned warehouse capacity	138,935	16763	155,698
Leased warehouse capacity	66,237	40,009	106,246
Total warehouse capacity	**205,172**	**56,772**	**261,944**
Owned commercial facilities	18,415	2954	21,369
Leased commercial facilities	7,870	346	8,216
Total commercial facilities	**26,285**	**3300**	**29,585**
Gross area under management	**1,178,640**	**622,742**	**1,801,382**
- of which owned	699,104	428,777	1,127,881
- of which leased	479,536	193,965	673,501

Summary of retail units and logistics distribution centers launches by markets in 2017

SLOVENIA

Area of new facilities: 2,451 m^2

Number of new units: 1

Openings: Trgovski center Bled

Refurbishments/rearrangements:

Number of units: 100

SERBIA

Area of new facilities 22,448 m^2 (retail units 12,324 m^2, logistics distribution centre: 11,661 m^2)

Number of new units: 12 retail units, 2 LDC

Otvoritve:

Market Jurija Gagarina, Belgrade; Supermarket Višnjička, Belgrade; Market Mis Irbijeva, Belgrade; Market Petefi Šandora, Subotica; Market Goce Delčeva, Belgrade; Market Dorčol, Belgrade; Supermarket Blok 63, Belgrade; Market Lazarevac; Market Organic, Kralja Petra, Belgrade; Market Organic, Patrijarha Varnave, Belgrade; Market Organic, Svetogorska, Belgrade; Supermarket Pirot; LDC Ugrinovci; LDC Čačak

Refurbishments/rearrangements:

Number of units: 36

MONTENEGRO

Area of new facilities 3,729 m^2

Number of new units: 8

Otvoritve: Supermarket Idea Gold, Podgorica; Market Idea Trešnica, Podgorica; Market Idea Rafailovići, Budva; Market Idea Spuž, Podgorica; Market Idea Šavnik; Market Idea Zagorič 3, Podgorica; Market Idea Zagorič 4, Podgorica; Market Zabjelo 2, Podgorica

Refurbishments/rearrangements:

Number of units: 26

BOSNIA AND HERZEGOVINA

Mercator re-entered the Bosnian market. In September 2017 we took over from Konzum Sarajevo ex-Mercator retail units and one distribution center. In September and Oktober rebranding of these units took place including both interior and exterior design.

PERFORMANCE ANALYSIS IN 2017

Following is a performance analysis for 2017 for the Mercator Group, the parent company Poslovni sistem Mercator, d.d., and respective markets of Mercator Group's operations. The data for 2016 is presented on comparable basis. Since Mercator Group revised its accounting policy in 2017, the effects of such revision are, for comparability, also presented for 2016, It should be taken into account when reading and interpreting the analysis that the parent company has a double role in the Mercator Group: it is the controlling company that holds the ownership shares in Mercator Group's subsidiaries; at the same time, it is an operating company carrying out all trade and other activities in Slovenia.

Normalized gross cash flow from operating activities (EBITDA) amounted to EUR 90,631 thousand in 2017, which is EUR 28,279 thousand more than in 2016.

Adjusting for the negative effect of extraordinary events, Mercator Group generated in 2017 a business result of EUR 6,008 thousand, while the result for 2016, also adjusted for negative effect of extraordinary events, was at EUR -31,251 thousand.

Review of write-offs, legislation amendments and accounting policies in 2016 and 2017

Impairment of receivables from companies within the Agrokor Group

In 2016, all receivables payable by Agrokor Group companies that are not a part of the Mercator Group were impaired. At the company Poslovni sistem Mercator d.d., receivables were impaired by EUR 6,782 thousand; at the company Mercator–H d.o.o. by EUR 26,710 thousand; and at the company Mercator–BH d.o.o. by EUR 12,520 thousand. Total impairments of receivables payable by Agrokor Group companies that are not a part of the Mercator Group amounted to EUR 46,012 thousand.

In 2017, all receivables payable by Agrokor Group companies that are not a part of the Mercator Group and headquartered in Croatia, originating between January 1, 2017, and April 9, 2017, were impaired. At the company Poslovni sistem Mercator d.d., receivables were impaired by EUR 2,283 thousand; at the company Mercator–H d.o.o., they were impaired by EUR 5,155 thousand, total in the amount of 7,438 thousand EUR.

With regard to the so-called Lex Agrokor, Mercator Group companies reported until and including June 9, 2017, a total of EUR 43,788,150 of receivables payable by the Agrokor Group companies. In January 2018, the court in Zagreb recognized and confirmed all reported receivables.

Impairment of land and real estate

Consistently with the accounting policy of the Mercator Group, which requires that real estate be re-appraised every 3 years, and the International Accounting Standards, the Company and the Group launched the appraisals of their real property. Pursuant to requirements of the IAS 36 Impairment of Assets, and the estimate that there were indicators for impairment of entire real estate, an appraisal of all real estate as at December 31, 2017, was conducted. Since the result of real estate appraisals indicated both the need for impairment of real estate, as well as that some properties were undervalued in the financial statements. The Group changed its accounting policy for valuation of buildings from the cost model to the revaluation model, pursuant to IAS 16 Property, Plant and Equipment. Pursuant to IAS 40 Investment Property, the accounting policy on disclosing the value of investment property was also changed. Thus, as of January 1, 2017, investment property is no longer appraised according to the cost model, but rather according to the revaluation model. The approach of reporting the value of real estate in financial statements was revised in particular in order to represents a true and fair view of the financial situation.

Real estate appraisal was conducted by a certified real estate appraiser. The final report was reviewed by two independent institutions who confirmed the findings of the original report.

The result of the real estate revaluation is a downward adjustment in the real estate value in the statement of financial position in this respect by an amount of EUR 18,835 thousand. Impairments had a negative effect on Mercator Group's results in the amount of EUR 145,773 thousand, while the increases in value in the amount of EUR 126,938 thousand resulted in an increase of equity (fair value reserve).

Change of accounting policy of the Mercator Group

In 2017, the Group and the Company changed the accounting policy on consignment, discounts and allowances, and reporting of interest (changes to accounting policies are presented in more detail in the financial part of the Annual Report, in Chapter 2, Basis for Compilation, section e).

Review of extraordinary events 2017

Mercator Group financial statements were negatively affected by the revaluation of land and buildings in the amount of EUR 18,835 thousand. Impairments had a negative effect on Mercator Group's results in the amount of EUR 145,773 thousand, while the increases in value in the amount of EUR 126,938 thousand resulted in an increase of equity (fair value reserve). Also affecting the business results were other extraordinary business events summarized in the table below.

in mn EUR	2017
Net adjustments of short-term assets	-53.5
Net adjustments of long-term assets	-145.8
Net other one-off events	+5.9
Total impacts	**-193.3**

Performance analysis of Mercator Group

For 2016, adjusted business results are presented, which means:

- without Intersport and Modiana operations (already shown in 2016);
- with effects of the revised accounting policy regarding revenue reporting in light of closer alignment with the IFRS 15 (net consignment and reducing the cost of goods sold by the amount of discounts and allowances).

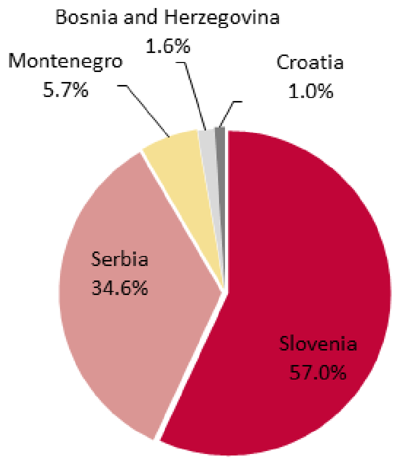
Revenue

In 2017, Mercator Group **sales revenue** amounted to **EUR 2,152.2 million**, which is 2.2% less than in the comparable period of the preceding year 2016. Revenue development differed across markets. Slovenia and Serbia remain the most important markets for the Mercator Group. In 2017, Mercator re-entered the market of Bosnia and Herzegovina. Transfer of possession and establishment of retail operations took place in September 2017.

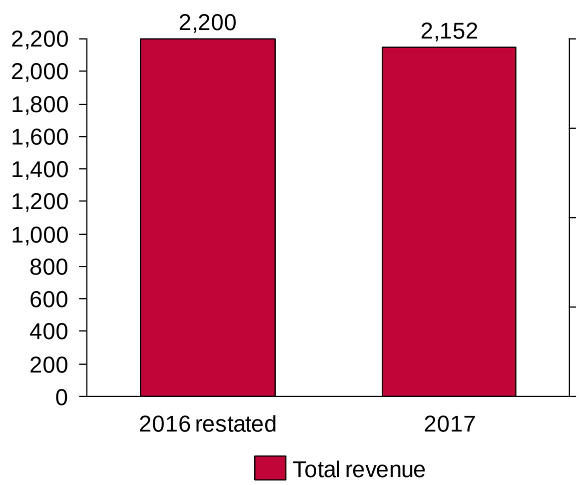
Revenue by markets

Revenue (in 000 EUR)	2016 restated	2017	Change 2017/ 2016 restated
	consolidated	consolidated	
Slovenia	1,245,159	1,225,000	-1.6%
Serbia	801,043	745,907	-6.9%
Montenegro	114,452	123,304	7.7%
Bosnia and Herzegovina	15,175	35,413	133.4%
Croatia	23,758	22,549	-5.1%
Total	**2,199,587**	**2,152,172**	**-2.2%**

Revenue by markets in 2017(in %)



Total revenue (in EUR mn) in 2016 and 2017



In the market of **Slovenia**, we saw a drop of revenue in 2017 by 1.6%, as a result of lower revenue in wholesale due to a decrease in transit and decrease in sales in the program Agro equipment. Revenue also decreased in **Serbia** (by 6.9%), especially on account of closing down of some stores in compliance with the decision by the market regulator in Serbia, and lower actual revenue from wholesale operations due to decrease in transit and closing down of unprofitable Velpro centres. We also saw lower revenue in **Croatia** (by 5.1%) as a result of disposing of inventories in accordance with the contract for the sale of non-core business in 2016, while our revenue in **Bosnia and Herzegovina** increased by 133.4% due to re-establishment of retail operations in this market. We also saw revenue growth in the market of Montenegro, in the amount of 7.7%.

Retail revenue

After successful completion of divestment processes for non-core operations in 2015 and 2016, Mercator Group, consistently with the newly devised strategy, recorded growth of revenue from sale of goods in its core activity of retail.

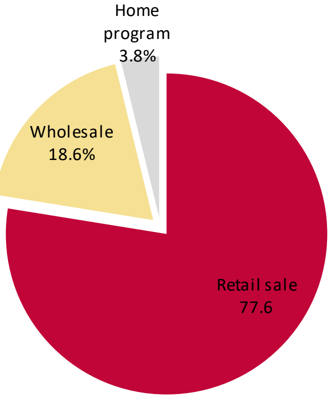
At the Mercator Group level, revenue in core activity of retail increased for the first time since 2011 relative to the comparable period of the preceding year, topping the last year's figure by 2.5%.

Revenue from retail is higher relative to the comparable period of the prior year in **Slovenia (+1.7%)** and **Montenegro (+7.3%)**, while in the **Serbian market, revenue remained on a comparable level**, especially on account of closing down of the units in compliance with the market regulator's decision. After re-entering the market of Bosnia and Herzegovina in September 2017, Mercator Group revenue from core activity of retail increased in this market as well.

Sales structure in by programs

Sales structure (in %)	2016 restated	2017
Retail sale	74.1%	77.6%
Wholesale	22.2%	18.6%
Home program	3.7%	3.8%
Total revenue in retail, wholesale and home programs	**100.0%**	**100.0%**

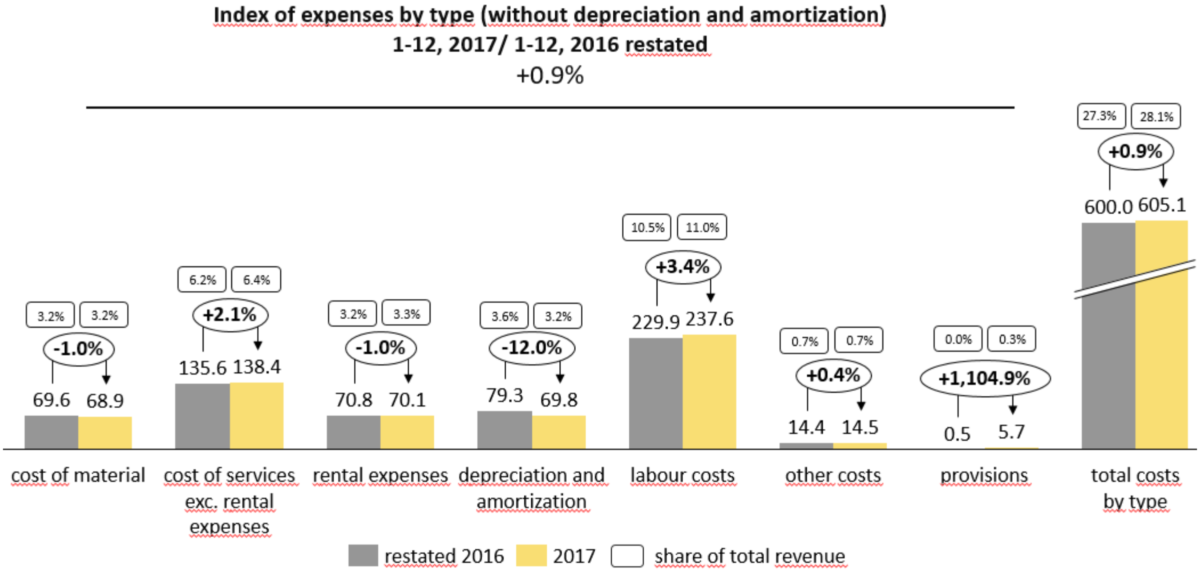
Revenue by programs in 2017 (in %)



The structure of revenue by respective programs did not change significantly in 2017. FMCG retail continues to account for the highest share of revenue with 77.6%. Relative to the year before, this share in comparison to other programs increased by 3.5 percentage points. In 2017, wholesale revenue declined as a result of events and developments regarding the Agrokor Group, drop of revenue in transit and decrease of revenue in program Agro equipment . The share of sales revenue from other specialized trade programs accounted for 3.8% in 2017.

Operating costs
Total costs, including cost (purchase value) of goods sold, revaluation adjustments, and other Mercator Group operating expenses, increased in 2017 relative to 2016 by 3.2%, mainly due to the impairment of property value, and they amounted to EUR 2,350,495 thousand.

Expenses by type in 2016 and 2017 (in mn EUR)



Costs of material in 2017 amounted to EUR 68,905 thousand, which is on a par with the year before, as it is lower by 1.0%.

Cost of services for the entire Mercator Group in the period 1–12, 2017, remained at a level similar to the figure for the comparable period of the preceding year; it amounted to EUR 208,570 thousand, while in the comparable period of the preceding year, it was at EUR 206,436 thousand.

Labour costs in the period 1–12, 2017, at the level of the entire Mercator Group increased by 3.4% relative to the comparable period of the preceding year. In 2017, they amounted to EUR 237,645 thousand. Labour costs increased in Bosnia and Herzegovina where Mercator was transformed in September 2017 from a real estate company back to a retail company. In Serbia, labour costs increased due to inclusion of meal allowance costs in the salary, and in Slovenia they increased due to variable rewards to employees in retail.

Depreciation and amortization at the level of the entire Mercator Group decreased from EUR 79,329 thousand in the period 1–12, 2016, to EUR 69,846 thousand, or by 12.0%. Lower depreciation and amortization are a result of changes in the accounting policy on revaluation of investment property and depreciation rates for property, plant, and equipment (fixed assets).

Other costs by natural categories, which include e.g. environment protection expenses, donations, membership fees etc., amounted to EUR 14,477 thousand in the period 1–12, 2017, which is comparable to the figure for the period 1–12, 2016, which amounted to EUR 14,415 thousand.

In the period 1-12 of 2017, the cost of provisions amounted to EUR 5,740 thousand and relates to provisions formed for claims and provisions for termination benefits on retirement.

Results from operating activities, financial result and result for the period

In 2017, Mercator Group's **result from operating activities** was negative at EUR –172,508 thousand; however, the information is not comparable to the year before due to extraordinary events presented at the start of this chapter.

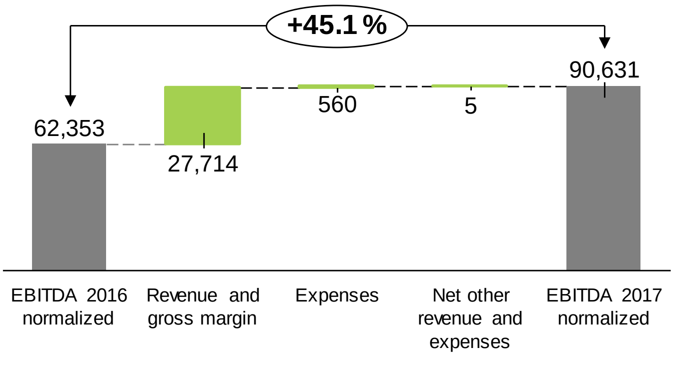
In 2017, **net finance expenses** for the Mercator Group amounted to EUR 30,071 thousand, which is 18.7% less than in the year before. The largest share of finance expenses pertains to net regular interest expenses at EUR 30,227 thousand, which is EUR 1,271 thousand lower than in the year before. Net currency translation differences account for the largest change in net finance expenses, with EUR 5,483 thousand in the period 1–12, 2017, or EUR 4,475 thousand more than in the preceding year, mainly due to exchange rate differences in Serbia and Croatia.

In 2017, Mercator Group's result, or net income, excluding the negative effect of extraordinary events, was EUR 6,008 thousand (2016: EUR -31,251 thousand). Including the extraordinary events (impairment of land and buildings, impairment of receivables etc.), Mercator Group's result for 2017 is EUR -184,435 thousand (2016: EUR -78,063 thousand).

Gross cash flow from operating activities (EBITDA) and gross cash flow from operating activities before rental expenses (EBITDAR)

Normalized gross cash flow from operating activities (EBITDA) amounted to EUR 90,631 thousand in 2017, which is EUR 28,278 thousand more than in 2016. The change in normalized EBITDA was affected by business events presented in the table below.

Normalized gross cash flow from operating activities (EBITDA) in 2016 and 2017 (EUR thousand)



In 2017, Mercator Group generated EUR 90.6 million of normalized EBITDA, which is EUR 28.3 million more than in the comparable period of the year before.

Normalized gross cash flow from operating activities before rent (EBITDAR) amounted to EUR 160,633 thousand in 2017, which is EUR 27,461 thousand more than in the preceding year.

Assets

Mercator Group's assets as at December 31, 2017, amounted to EUR 2,076,723 thousand, which is 2.2% less than at the end of 2016.

Non-current assets as at December 31, 2017, amounted to EUR 1,491,988 thousand, which is 10.0% less than at the end of 2016, mostly due to revaluation adjustment to land and buildings at the end of 2017, and the changes in accounting (or bookkeeping) policies on assets intended for monetization, as assets in the amount of EUR 117,146 thousand were re-classified from non-current assets to current assets. The value of property, plant, and equipment (fixed assets) accounts for the highest share of non-current assets, with 95.5%.

in EUR 000	December 31, 2016	December 31, 2017	Change 2017/2016	Share in total assets 2017
Tangible and intangible assets	1,601,767	1,424,185	-11.1%	68.6%
Loans and depozits	31,385	24,147	-23.1%	1.2%
Deffered tax assets and available-for sale financial assets	23,990	43,655	82.0%	2.1%
Non-current assets	**1,657,143**	**1,491,988**	**-10.0%**	**71.8%**
Assets for disposal	0	117,146	-	5.6%
Inventories	224,328	210,233	-6.3%	10.1%
Receivables	206,937	228,412	10.4%	11.0%
Loans and depozits	8,110	4,833	-40.4%	0.2%
Cash and cash equivalents	26,318	24,112	-8.4%	1.2%
Current assets	**465,694**	**584,736**	**25.6%**	**28.2%**
Total assets	**2,122,836**	**2,076,723**	**-2.2%**	**100.0%**

Mercator Group current assets as at December 31, 2017, amounted to EUR 584,736 thousand, which is 25.6% more than at the end of 2016. The increase pertains mostly to transfer of assets intended for monetization, which were re-classified as current assets at the end of 2017. Trade and other receivables (39.1%) represent the largest share of total current assets, followed by inventory (36.0%).

Equity and liabilities

Changes in equity in 2017 for the Mercator Group relate to:

- decrease in equity for loss in the amount of EUR 184,435 thousand in 2017,
- increase in equity due to the revaluation of land and buildings in the amount of EUR 126,370 thousand,
- decrease in equity due to the impact of deferred taxes in the amount of EUR 20,747 thousand,
- increase in equity due to foreign exchange translation differences in the foreign subsidiaries in the amount of EUR 7,704 thousand,
- increase in equity due to other changes in the amount of EUR 7,868 thousand.

in EUR 000	December 31, 2016	December 31, 2017	Change 2017/2016	Share in total equity and liabilities 2017
Equity	**557,376**	**478,401**	**-14.2%**	**23.0%**
Trade, other payables and deferred tax liabilities	45,117	58,708	30.1%	2.8%
Financial liabilities	769,776	765,309	-0.6%	36.9%
Provisions	26,818	29,683	10.7%	1.4%
Non-current liabilities	841,711	853,701	1.4%	41.1%
Trade, other payables and deferred tax liabilities	590,509	628,231	6.4%	30.3%
Financial liabilities	133,241	116,391	-12.6%	5.6%
Current liabilities	723,750	744,622	2.9%	35.9%
Total liabilities	**1,565,461**	**1,598,322**	**2.1%**	**77.0%**
Total equity and liabilities	**2,122,836**	**2,076,723**	**-2.2%**	**100.0%**

Mercator Group's borrowings and other financial liabilities as at December 31, 2017, amounted to EUR 881,700 thousand, which is EUR 21,317 thousand less than at the end of 2016. Net financial debt of the Mercator Group as at December 31, 2017, amounted to EUR 828,217 thousand, which is EUR 8,525 thousand lower than a year earlier.

Trade and other payables as at December 31, 2017, amounted to EUR 686,939 thousand, which is 8.1% more than at the end of 2016.

Provisions as at December 31, 2017, amounted to EUR 29,683 thousand, which is 10.7% more than at the end of 2016.

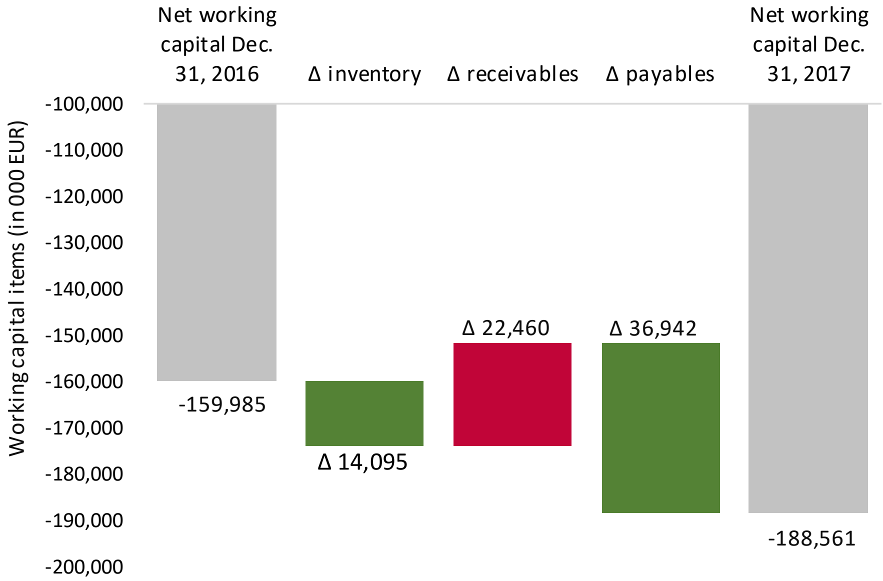
Coverage of non-current assets and net financial debt/ normalized EBITDA

	31. 12. 2016	31. 12. 2017
Coverage of non-current assets with non-current liabilities	84.4%	89.3%
Net financial debt/EBITDA normalized	13.4	9.1

As at December 31, 2017, long-term coverage of non-current assets with non-current liabilities at the Mercator Group amounted to 89.3%, which is 4.9 percentage points more than as at the end of 2016. The ratio between financial debt and normalized EBITDA in 2017 amounted to 9.1, which is an improvement over the preceding year when the indicator was at 13.4.

Changes in working capital

At the end of 2017, the Group's working capital structure was more favourable than a year earlier.



Inventories decreased in 2017 relative to 2016 on account of efficient optimization and inventory management. Innovative approaches to optimization of trade goods inventories through introduction of cutting-edge inventory replenishment methods allowed us to keep our trade goods inventory levels at the lowest point in recent years throughout the year. At the same time, we successfully improved the supply of goods from all categories of the defined sales assortment to our stores.

Trade receivables increased in 2017 relative to 2016 by EUR 22,460 thousand. The increase mostly pertains to the market of Serbia where we saw a one-off increase in receivables as a result of divestment of Mercator Centre Belgrade at the end of 2017. In the market of Bosnia and Herzegovina, receivables also increased on account of re-establishment of retail operations.

Trade payables increased by EUR 36,942 thousand relative to the comparable period of the preceding year. In the Slovenian market, trade payables decreased, while in Serbia, Croatia, and Bosnia and Herzegovina, they increased. Increase in trade payables in the market of Bosnia and Herzegovina is a result of re-entry into this market in 2017. In 2017, payment terms and conditions with our suppliers remain stable and mostly unchanged.

OPERATIONS AND PERFORMANCE PLANS FOR 2018

After successful re-entry to Bosnian market in 2017 increase in revenue is expected to the amount of EUR 2.4 billion in 2018 and to EUR 2.5 billion in 2021. Mercator Group remains focused on its core activity, and improvement of profitability remains its key goal.

Higher revenue budget in 2018 relating to 2017

Mercator Group revenue in 2018 is budgeted at EUR 2.4 billion. By 2021, revenue will increase by 3% to EUR 2.5 billion. The focus of the Mercator Group remains on the core business, its key goal remains improvement of profitability.

EUR 37.7 million earmarked for investment in 2018

In 2018, Mercator Group investment will amount to EUR 37.7 million, of which 47.0% will be used for expansion of new retail area; 20.2% will be used for updates and investment maintenance of the existing retail units; 16.7% will be dedicated to IT investments; 5.1% to logistics investments; and 11.0% will be invested in non-trade operations. Investments in Slovenia will account for 64.5% of total investment funds.

Divestment of business assets under way

In 2018, Mercator Group will actively continue the procedures to divest its business assets. This will involve several steps. Divestment proceeds will mostly be allocated to deleveraging.

Improvement in performance with focus on satisfying the needs of consumers will continue in the future

In defining and conducting our marketing activities, focusing on satisfying the needs of modern consumers and offering well-priced shopping remain the key policies. Key target tasks are therefore geared towards improving Mercator's pricing perception. We offer our customers a wide assortment of genuine and local products. We pay particular attention to design and orderliness of our stores, and we implement new technologies and services. The new strategy has already had a positive effect on our operations, which is also reflected in improved performance. The performance improvement trend will continue in the future.

RISK MANAGEMENT

Non-Financial Report

Macroeconomic conditions in the markets of Mercator Group operations are improving; however, external effects from the environment, and internal challenges to Mercator Group operations and performance persist.

At Mercator Group, we are aware of the importance of identifying the potential new risks and preparation and implementation of measures to mitigate or hedge the identified risks to the lowest possible level. With systematic analysis, we have identified and assessed the risks and opportunities that can occur in every process of Mercator Group operations. Based on the criteria laid down, we have determined the material risks to respective companies and the entire Mercator Group. All major risks have already been addressed from the aspect of conducted activities and from the aspect of planned activities. Specific measures were proposed, the implementation of which will be monitored in 2018.

RISK MONITORING AND MANAGEMENT SYSTEM

Consistently with the Mercator Group Risk Management Rules of Procedure that specify the requirements, activities, and responsibilities regarding risk management at Mercator Group companies, we actively managed in 2017 the risks of the company Poslovni sistem Mercator d.d. and the Mercator Group. We held 3 Risk Management Council sessions, kept the Mercator Group Risk Register up to date, proposed 173 risk mitigation or hedging measures and monitored their implementation, held training and education for management, and conducted the risk analysis for the Mercator Group for the year 2018.
Upon recommendation from the external audit of the quality management system ISO 9001:2015, presented in May 2017, we included opportunity management into the risk management process. By identifying opportunities, we are also focusing on the circumstances regarding future business events that can positively affect the operating performance or accomplishment of the goals laid down.

For Mercator Group, material risks and opportunities at the level of the entire Group level are divided into 5 key areas: strategic, financial, operational, support, and compliance risks. Following is a presentation of the key areas of risks and opportunities for the Mercator Group, and of the expected changes with regard to these risks and opportunities in 2018 relative to 2017.

Key areas of Mercator Group's risks and opportunities

STRATEGIC risks and opportunities	**Strategic field** includes risks and opportunities pertaining to devising and executing the company strategy, stability of ownership, and company reputation. These risks and opportunities pertain to the questions of what our customers, procurement sources, services, and sales channels will be like in the medium run.
FINANCIAL risks and opportunities	**Financial field** includes risks and opportunities pertaining to financial management. They involve credit, interest rate, currency, liquidity, inflation, price, and other similar risks.
OPERATIONAL risks and opportunities	**Operational field** includes risks and opportunities that can threaten the operations in category management and purchasing, production, logistics, retail, and wholesale.

SUPPORT risks and opportunities	**Support field** includes risks and opportunities pertaining to employees, legal affairs, property and equipment management, IT support, and management of loss events.
COMPLIANCE risks and opportunities	The **field of compliance** includes risks and opportunities pertaining 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

Based on the analysis of risks and opportunities for 2018, we find that the Mercator Group will be the most exposed in 2018 to support, financial, and strategic risks. With regard to all groups of risks, we find that among all companies of the Mercator Group, the company Poslovni sistem Mercator d.d. as the controlling and largest company within the Group has the highest exposure.

Following is a presentation of major risks within respective fields, complete with planned activities for their mitigation or hedging in 2018.

Relevance of respective risks for the Mercator Group is indicated with one of the following symbols:

Low risk Moderate risk High risk

STRATEGIC FIELD	
Risk description	**Activities planned in 2018**
CORPORATE RISK: Correct definition and implementation of strategy	
Correct definition and effective execution of strategy are the foundation for successful operations and performance of the entire Mercator Group.	At the end of 2017, Mercator Group drew up a new long-term strategy and started to consistently implement it across all key processes at the company. The strategy was developed in cooperation with the consultant McKinsey & Company, and it was communicated in 3 stages until 2022. Mercator Group strategy is presented in more detail under chapter Business Strategy in the introduction to the Annual Report.

CORPORATE RISK: Risk pertaining to the operations of the Agrokor Group	
 In early 2017, uncertainty regarding future operations and performance of the company Agrokor d.d. and its subsidiaries, except for Mercator Group, became evident, resulting from multiple downgrades of credit rating of the company Agrokor d.d., changes in the so-called Lex Agrokor, and start of financial restructuring procedures.	▶ In 2017, control over the status of outstanding receivables to companies within the Agrokor Group was introduced. Receivables as at December 31, 2017, originating after April 9, 2017, amounted to EUR 6.8 million, while new business liabilities amounted to EUR 35.6 million. This means that the ratio improved, since receivables from Agrokokor Group, which are not part of Mercator Group, amounted to EUR 49.3 million, and payables amounted to EUR 40.1 million in 2016. ▶ Risk araising from complience with commitments from financial/loan agreements including cross-default for 2017 is in more detail presented in Financial part of Annual report, in chapter 30. Financial instruments, subchapter Operational risk. Mercator Group will continue to meet regularly with all its creditors in 2018. ▶ Pursuant to the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia (ZIČUDSP), the extraordinary Management Board Member Gregor Planteu is in charge of developing a Report on all transactions effected with the majority shareholder Agrokor d.d. and companies affiliated to it.

CORPORATE RISK: Compliance of corporate risk with the legislation	
 In the last few years, the corporate governance structure of the company Poslovni sistem Mercator d.d. was centralized and not entirely aligned with the legislation in respective countries of Mercator Group operations, Corporate Governance Code, and sound business practices.	In 2017, corporate governance was redefined at Mercator, and corporate governance at subsidiaries was tightened. The controlling company provides corporate governance at subsidiaries: ▶ by taking part in shareholders assemblies and with membership in Supervisory Boards of subsidiaries; ▶ with standardization and unification of rules and procedures in respective fields or areas; ▶ through a system for issuing permits, specifying the responsibilities for executing particular transactions; ▶ through a system of regular working meetings, video/ TV conferences of the Management Board of the company Poslovni sistem Mercator d.d., along with authorized employees, with the management teams of subsidiaries, in order to review the accomplishment of results and performance in the core activity and to optimize the purchasing channels within the entire Mercator Group.

RISK OF COMPETITIVENESS AND SALES PROCESS DEVELOPMENT: Risk of a decline in market share and poor price competitiveness	
 Today's customer is defined by rapidly changing demographic conditions, fast-paced lifestyle, and technological development. We are focusing on the needs and desires of the customers, and we place the customer at the centre of our decisions.	▶ Monthly monitoring of changes in the market share and sales performance, and adjustment of the assortment and marketing campaigns based on the results. ▶ Opening of new stores and refurbishments of existing ones consistently with the 2018 plan; further search for new potential locations. ▶ Developing a new pricing strategy.

FINANCIAL FIELD	
Risk description	**Activities planned in 2018**
FINANCIAL RISK: Credit risk	
 Credit risk is the risk that the company will sustain financial loss if a party to an agreement defers a payment and later does not settle its obligations in full or not at all. Key credit risks can originate in the wholesale operations, and sale of goods to Pika card holders. Risks related to the Pika card have been transferred to a third-party financial institution.	In 2018, we shall continue with the following activities: ▶ regular monitoring of exposure to each individual external customer, and monitoring of credit limits; ▶ preparing weekly reports on trade receivables and holding monthly meetings of the receivables task force; ▶ operating a system to block the sales to critical customers from the aspect of overdue receivables, bankruptcies, deletions of striking, liquidations, and lawsuits.
FINANCIAL RISK: Liquidity risk	
 Liquidity risk is the risk that Mercator Group will, in the course of its business, see problems with settling its current liabilities. At Mercator Group, we are monitoring on a daily basis the actual cash flow, and we coordinate the cash flows in a centralized manner at various levels of decision-making to make sure individual companies always have available a suitable amount of cash for repayment of their respective liabilities.	▶ Optimization of working capital management, especially better management of trade goods inventories and faster collection of overdue outstanding receivables. ▶ Care for control and procedures for investment approvals. Investments that improve the free cash flow sooner shall be preferred; ▶ as at the end of December, 2017 Mercator signed an agreement for selling Mercator Center Belgrade and a long-term rental agreement, with wich the implementation of monetization project started. Disposal of non-core real estate and monetization project are of key importance for future sustainable financial structure.
FINANCIAL RISK: Risk of sustainable financial structure	
 Sustainable financial structure and confidence of creditors and other stakeholders is a prerequisite for further successful Mercator Group operations and performance. As at December 31, 2017, Mercator Group's net financial debt amounted to EUR 828.2 million, which is 1.0% less than as at the end of 2016. Mercator Group has to observe the covenants specified in agreements with creditor banks. Most loans were granted with a variable interest rate Euribor that was negative in 2017 (according to the relevant agreements, in case of a negative Euribor, interest shall be calculated based on an assumption that Euribor is at 0%). In 2018 Euribor is expected to remain at the same level until the end of the year.	▶ In 2018, we shall communicate with the key stakeholders and keep them informed about Mercator's condition, and continue to execute our deleveraging strategy and our plan to divest the non-operating assets. ▶ If a significant increase in Euribor is seen in the future, we shall also examine the options of interest risk hedging.

OPERATIONAL FIELD	
Risk description	**Activities planned in 2018**
WHOLESALE RISK: Risk of loss of franchise partners and external customers	
 Wholesale is one of the more important Mercator Group operating activities. Risk of loss of franchise partners and external customers is assessed as a key risk due to potentially critical customer receivables and entry of new franchisors.	In 2018, our activities will be targeted at the following: ▶ audit of sales and payment terms, separately by customer segments; ▶ winning new customers in the segment of franchises, retailers, wholesalers, public tenders, and HoReCa – focus on leased establishments and lost (former) customers; ▶ refurbishments of franchise stores.

SUPPORT FIELD	
Risk description	**Activities planned in 2018**
IT RISK: Failure of IT systems and protection of personal data	
 IT system failure can cause loss of information, preclude efficient operations, and result in penalties imposed by the relevant authorities, as well as affect the company's reputation. The new regulation EU 2016–679 (GDPR) regulating the management of personal data at the organization will increase the IT risk due to more stringent security requirements, as the legislation requires stricter control over transfer of personal data between respective systems, and management thereof.	In 2018, our activities in IT will be focused on the following: ▶ regular monitoring of the needs and diligent assessment of priorities regarding the changes to the IT systems; ▶ regular cooperation between IT and the business operations in development and implementation of new developments in hardware and software; ▶ testing the operation at the IT and the user side before migration to a production environment in case of all refurbishments, replacements or upgrades; ▶ adapting the mechanisms for fast and efficient integration of third-party experts into the elimination of non-compliance in projects that increase the IT risks. Due to the new Regulation (GDPR), activities will be focused on the upgrade of tools and procedures for safe transfer of data outside Mercator, storage of traces of personal data processing, pseudonymization of personal data and elimination of personal data from applications where it is not necessary; we shall also upgrade the support for ensuring individuals' rights to access and transfer their personal data.
HUMAN RESOURCE RISK: Lack of human resources	
 We are aware that our employees contribute the most to customer satisfaction and, in turn, to accomplishment of Mercator's business goals. Lack of human resources in operations, such as retail, logistics etc., and retention of competent human resources at the company, account for the biggest risk. If suitable human resources are not available, work processes cannot take place correctly, which in turn could lead to lower sales and damage to reputation.	In 2018, our activities will be targeted at the following: ▶ development of own human resources with in-house training and education and employee development programs; ▶ revision of values and culture; ▶ strengthening leadership competencies of our leaders; ▶ implementing succession programs in retail; ▶ continuing our projects in non-cash rewards to employees and fostering connections between employees.

FIELD OF COMPLIANCE	
Risk description	**Activities planned in 2018**
ENVIRONMENTAL RISK: Use of electric energy	
 We are aware we are operating in a region with a highly diverse and rich natural environment. All our efforts and actions in improvement of processes at our company are targeted at preservation of natural environment in which we operate. Environmental risk of electric energy consumption is related to inefficient use of electric energy due to suboptimal design of business processes and technologies employed.	▶ We shall continue to inform the employees on a quarterly basis about the efficient use of energy. ▶ We shall upgrade the existing energy accounting system with a more detailed targeted monitoring of energy consumption.

FINANCIAL MANAGEMENT

Stable financial operations

As at December 31, 2017, Mercator Group net financial debt amounted to EUR 828,217 thousand, which is 1.0 percent less than as at the end of 2016.

v 000 EUR	Dec. 31, 2016	Dec. 31, 2017	Change Dec. 31, 2017/ Dec. 31, 2016
Non-current borrowings and other financial liabilities	769,776	765,309	-0.6%
Current borrowings and other financial liabilities	133,241	116,391	-12.6%
Financial liabilities	**903,017**	**881,700**	**-2.4%**
Cash and cash equivalents	26,318	24,112	-8.4%
Available-for-sale financial assets	462	391	-15.3%
Loans and deposits	39,495	28,980	-26.6%
Financial assets	**66,275**	**53,483**	**-19.3%**
Net financial debt *	**836,742**	**828,217**	**-1.0%**

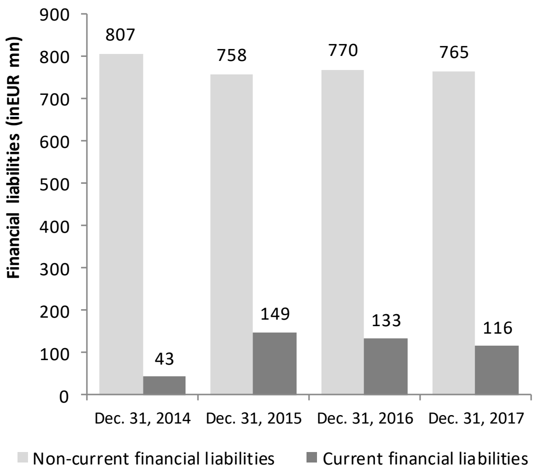
*At the end of 2017, consistently with the revised accounting policy, the interest that is due for payment when the loan is due (PIK interest) in the amount of EUR 36,887 thousand was re-classified from long-term operating liabilities to long-term financial liabilities. At the end of 2016, this interest amounted to EUR 31,421 thousand.

Financing costs

In the period 1–12, 2017, the 6-month EURIBOR averaged at -0.260%. Compared to the equivalent period of the year before when the 6-month EURIBOR averaged at -0.165%.

Debt to equity and financial liability ratio

As at December 31, 2017, Mercator Group attained a debt-to-equity (capital structure) ratio of 1:1.73. The ratio is a quotient between equity and net financial debt.



In recent years, Mercator Group succeeded in improving the composition of financial liabilities by maturity (maturity profile) by completing its financial restructuring. The share of non-current financial liabilities in total financial liabilities as at December 31, 2017 amounted to 86.8% (85.3% as at December 31, 2016). A considerable part of current financial liabilities is of non-current nature as the creditors are committed to revolving or renewing the loans until their final maturity, based on the Master Restructuring Agreement (MRA). The final maturity of the WGD is in 2021, and the final maturity of the Serbian deal is 2020.
Following the restructuring of the company Mercator, d.d., all financial liabilities of the company are variable and tied to the EURIBOR.

Available liquidity lines as at December 31, 2017

As at December 31, 2017, Mercator Group had access to the following liquidity lines:

in EUR thousand	Dec. 31, 2017
Cash and cash equivalents	24,112
Standby revolving credit lines	15,224
Total	39,336

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.

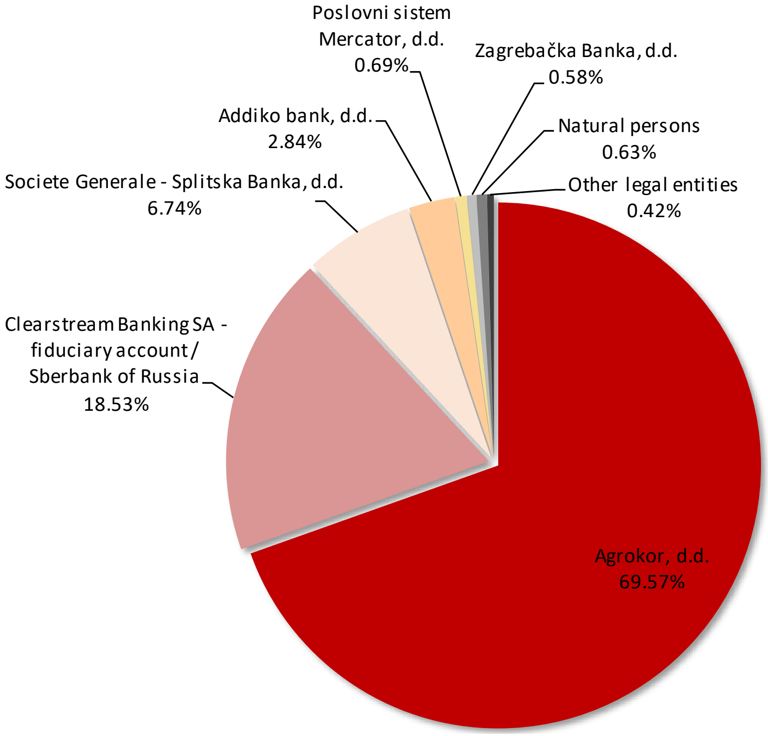
MERCATOR SHARE AND INVESTOR RELATIONS

Mercator share and ownership structure

Basic information on the share of the company Poslovni sistem Mercator, d.d., as at December 31, 2017:

Code/Symbol	MELR
Type	Common share
Listing	Prime market of Ljubljanska 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	1,637

Ownership structure of the company Poslovni sistem Mercator, d.d., as at December 31, 2017:



Major Shareholders

As at December 31, 2017 the following ten largest shareholders held a combined share of **98.67%** of the company. More detailed information about the largest shareholders is presented under the chapter on Corporate Governance Statement.

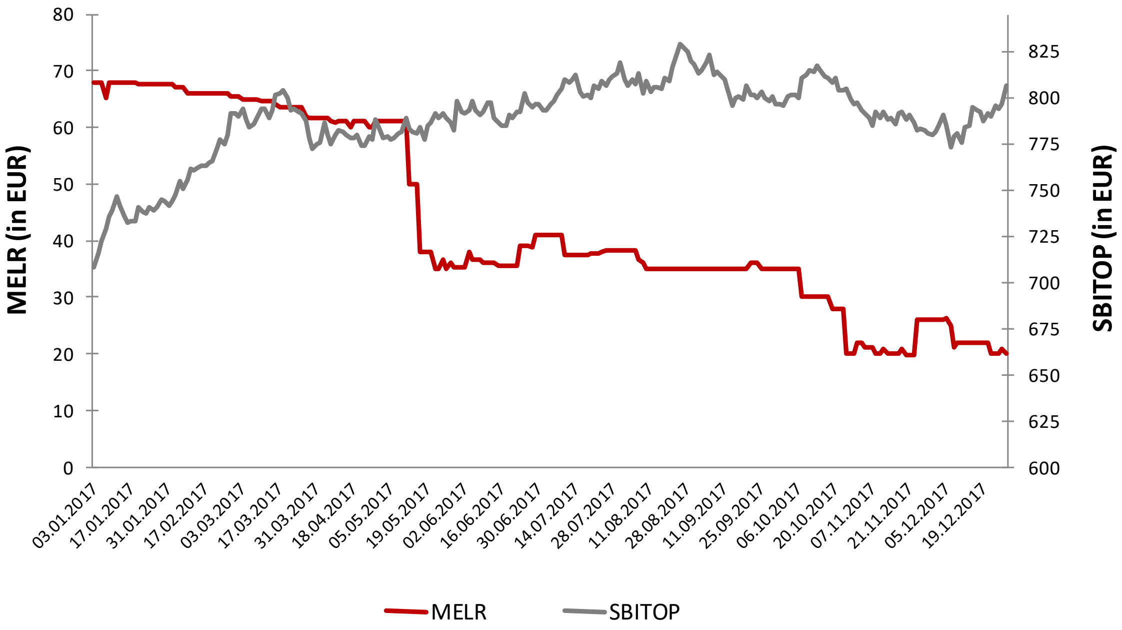
Shares held by Management and Supervisory Board Members as at December 31, 2017

Management Board and Supervisory Board Members did not own shares of the company Poslovni sistem Mercator, d.d., as at December 31, 2017.

Foreign shareholders

As at December 31, 2017, the share in the company Poslovni sistem Mercator, d.d., held by foreign investors amounted to **98.68%**, which is 0.08 percentage point more than at the end of 2016.

Movement of closing price per MELR share in the period 1-12 2017, compared to the movement of the SBITOP index



Key information for the shareholders [4]

	Dec. 31, 2016	Dec. 31, 2017	Change Dec. 31, 2017/ Dec. 31, 2016
Number of shares registered in Court Register	6,090,943	**6,090,943**	0.0%
Number of treasury shares	42,192	**42,192**	0.0%
Market capitalization (in EUR)	414,184,124	**122,245,226**	-70.5%
Market value of share (in EUR)	68.0	**20.1**	-70.5%
Book value per share (in EUR)	91.1	**70.0**	-23.2%
Minimum close rate in the period (in EUR)	67.0	**19.6**	-70.8%
Maximum close rate in the period (in EUR)	85.0	**68.0**	-20.0%
Average close rate in the period (in EUR)	76.4	**43.4**	-43.2%
Earnings per share (in EUR)*	-13.0	**-33.7**	-
Price/earnings ratio (P/E)	-5.7	**-0.7**	-
Capital gains yield (in %)	-17.1	**-70.5**	-

Dividend policy

Dividends will not be paid in 2018.

Treasury shares

As at December 31, 2017, the company Poslovni sistem Mercator, d.d., held the same amount of treasury shares as on the last day of the preceding year, i.e. 42,192. In the period 1-12 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.

4 **Market capitalization** is calculated by multiplying the number of shares entered into the court register as at December 31 with market price per share as at December 31.
Net return on equity (ordinary 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.
Share book value is calculated as the ratio between the value of the equity of the company Poslovni sistem Mercator d.d. as at December 31, and the weighted average number of ordinary shares in the period at hand, excluding treasury shares.
P/E (price-to-earnings) ratio is calculated as the ratio between market price per share as at December 31 and net Mercator Group profit per share.
Capital gain is calculated as the ratio between market price per share as at December 31 of the current year, and market price per share as at December 31 of the previous year.

Mercator Group's dynamic pulse is characterized by a high level of expertise and responsibility towards, the customers, suppliers, and the environment.

NON-FINANCIAL REPORT.

Pursuant to the Directive 2014/95/EU of the of the European Parliament and of the Council dated December 2014, Guidelines on non-financial reporting (2017/C 215/01), and pursuant to Article 70.c of the Companies Act (ZGD-1 No. 15/17 dated March 31, 2017), the company Poslovni sistem Mercator d.d. includes into its business report a Non-Financial Statement.

NON-FINANCIAL STATEMENT

Mercator Group conceives of sustainable development as balanced activity in particular fields of social responsibility, environment protection, and economic sustainability. For socially responsible and sustainable operation, Mercator has laid down goals to create a healthy and safe future for people and the environment.

Sustainability projects are carried out in the field of energy efficiency and preservation of natural resources. We work in a constructive manner with our suppliers to guarantee safety and quality of products for our customers. We also provide information to our customers and raise their awareness. We provide neat and safe working conditions for our employees and contribute to the development of our local environment. We are highly attentive to both the most important social issues and individuals. Our operations are transparent and compliant with the highest business standards, and we treat all stakeholders equally.

The Management Board of the company Poslovni sistem Mercator d.d. issues the statement on the compliance of non-financial reporting pursuant to the provisions of Article 70.c of the Companies Act (ZGD-1) for the fiscal year 2017. Mercator Group's non-financial operations are presented later in this chapter.

Ljubljana, April 20, 2018

Tomislav Čizmić
President of the Management Board

Draga Cukjati
Member of the Management Board

Igor Mamuza
Member of the Management Board

Gregor Planteu
Extraordinary Management Board Member

NON-FINANCIAL REPORTING

Mercator is fostering economic and social development of the local environment in which it operates as it generates broader economic and social effects, provides a pleasant and neat environment for the consumers and employees, and constantly improves the quality of the goods and services it offers. We are aware that only socially responsible operations will lead to greater business success, competitiveness, and productivity.

Business model and governance

Mercator Group's core activity is fast-moving consumer goods retail, in a dense and extensive retail network in Slovenia, Serbia, Montenegro, and Bosnia and Herzegovina.

Mercator Group's business model is presented in more detail in the Business Report within this Annual report, under the following chapters:

- Business Strategy,
- Presentation and Organization which presents Mercator Group composition and governance of the parent company,
- all Mercator Group activities are presented in more detail in the chapter Operating Activities.

Approach to governance and the corporate governance systems are presented in more detail based on the Corporate Governance Code for Listed Companies in the Corporate Governance Policy of the company Mercator d.d. and the Mercator Group, which is publicly available at the company website at www.mercatorgroup.si and in the public information dissemination system SEOnet.

References to non-financial reporting in the Business Report of this Annual report is indicated with the following sign: Non-financial Report

Presentation of Mercator Group's key policies

Mercator's relevance in the broad social environment goes beyond the role of a retailer. Its influence and activities reach into other important fields of social life as well and therefore, we are looking to involve and integrate all our stakeholders into our processes as we follow eight policies.

Mercator Group policies

Diversity policy is presented in more detail in the Corporate Governance Statement in the Business Report part of this Annual Report, while other policies and results thereof, as well as the non-financial indicators are presented in more detail later in this chapter. Mercator Group's key risks are described and presented in the chapter Risk Management in the Business Report part of the Annual Report.

Responsibility **TO EMPLOYEES AND RESPECT FOR HUMAN RIGHTS.**

EMPLOYEE POLICY *and respect for human rights*

Employee policy and respect for human rights

Employees are at the core of our operations as they are the key to customer satisfaction and thereby to the attainment of Mercator's business goals. Therefore, our activities in human resource management activities are focused on the following:

- **improving the efficiency of the attainment of our goals** (optimum usage of the available resources, competencies, and potentials according to the possibilities and situation in the market);
- **the employees are our competitive advantage** (quality of service based on integrity and friendly, respectful, and professional communication with the customers);
- strategic human resource management goals are changing in compliance with the changes in the labour market, consistently with the business policies of the management, regional needs, and characteristics and possibilities or operational implementation at the local level.

At Mercator, communication with the employees takes place in several ways, including meetings, interviews and discussion, and regular notifications on internal websites and in our in-house newsletters.

Our key goal is to have competent, satisfied, and motivated employees.

Regardless of the changes in the business environment (internal and external), Mercator Group complies with the norms laid down by the applicable legislation and restricts any forms of discrimination. We hereby declare that free assembly and association and collective bargaining is not restricted at Mercator Group companies, and that there is no child or forced labour at our companies.

Employees at the Mercator Group

In 2017, we continued the processes of reorganization which had started in 2014. The goal remains to establish a more efficient work processes. The focus remains on our core activity.

Changes in organizational structures in 2017

As of February 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, July 1, 2017, August 1, 2017, and December 1, 2017.

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. Moreover, Annex No. 2 to the Collective Labour Agreement for the Retail Industry came into effect in 2017, which specifies a higher hourly rate for overtime above 170 completed overtime hours, and new Lowest Base Salaries for respective tariff rates. There was a change in the macro and micro organizational structure at our parent company as of August 1, 2017.

As of June 1, 2017, macro organizational structure at the company Mercator–CG d.o.o. was changed; as of July 1, 2017, such change was also introduced at Mercator–H d.o.o.

Retail operations were re-established at Mercator–BH d.o.o. Therefore, a new macro organizational scheme was adopted as of September 1, 2017, along with adoption of changes and amendments to internal acts like the Rules of Procedure and Rules and Regulations on job organization and systematization at Mercator–BH d.o.o.

Information about the employees

The following information about our employees pertain to either December 31, 2017, or to the period 1–12, 2017.

Number of employees

As at December 31, 2017, Mercator Group had 20,801 employees, of which 11,039 were employed in markets outside Slovenia. Relative to the last day of 2016, total number of employees increased by 2.2%. The number of employees increased in Bosnia and Herzegovina as a result of re-establishment of retail operations in this market. In other countries, the number of employees decreased relative to the year before.

Market	Number of employees as at December 31, 2017	Number of employees as at December 31, 2016	Index number of employees Dec 31, 2017 / Dec 31, 2016	Number of employees based on hours worked in the period Jan-Dec 2017
Slovenia	9,762	10,019	97.4	9,027
Serbia	8,301	8,830	94.0	7,877
Montenegro	1,420	1,436	98.9	1,362
Croatia	38	49	77.6	39
Bosnia and Herzegovina	1,280	20	6,400.0	358
TOTAL	20,801	20,354	102.2	18,664

Share of employees by type of employment contract

As at December 31, 2017, the company Mercator–CG d.o.o. had the largest share of employees on fixed-term (temporary) employment contracts. At the Mercator Group level, the share of fixed-term employment contracts decreased from 20.4% as at December 31, 2016, to 15.9% as at the last day of 2017.

Market	Individual contract (in %)	Standard contract (in %)	Permanent contract (in %)	Contract for a fixed period (in %)
Slovenia	0.7	99.3	96.9	3.1
Serbia	0.8	99.2	71.0	29.0
Montenegro	0.1	99.9	67.3	32.7
Croatia	7.9	92.1	97.4	2.6
Bosnia and Herzegovina	0.3	99.7	89.8	10.2
TOTAL	0.6	99.4	84.1	15.9

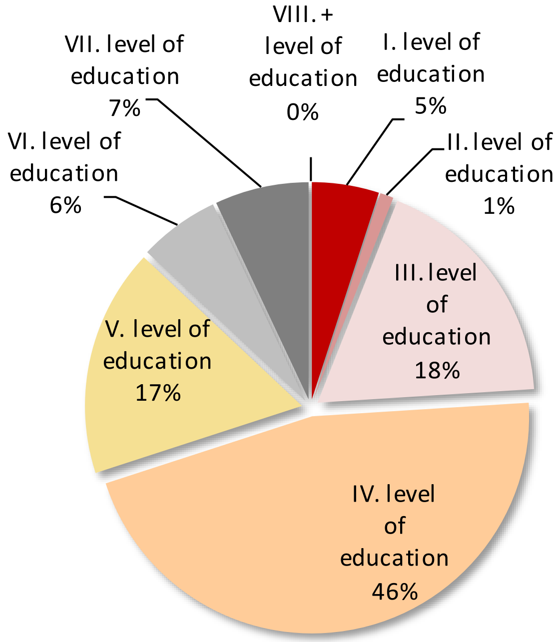
Employees with disabilities

The number of employees with disabilities increased in 2017 relative to the end of 2016 by 0.4 percentage point. Companies in Slovenia (Poslovni sistem Mercator d.d. and Mercator IP d.o.o.) had the highest number of employees with disabilities as at December 31, 2017, with 824.

Market	Employees with disabilities on Dec 31, 2017	Employees with disabilities on Dec 31, 2017 (in %)	Employees with disabilities on Dec 31, 2016 (in %)
Slovenia	829	8.5	8.1
Serbia	164	2.0	1.2
Montenegro	1	0.1	0.1
Croatia	0	0.0	10.2
Bosnia and Herzegovina	40	3.1	0.0
TOTAL	1,034	5.0	4.6

Actual level of education

The largest share of Mercator Group employees have IV level of education (9,625 employees), which reflects our core activity of retail.



Employees by gender

Mercator employs more female than male employees: 71.4% of employees are women and 28.6% are men.

Year	Number of employees	Employees - men (in %)	Employees - woman (in %)
2017	20,801	28.6	71.4
2016	20,354	30.3	69.7

External fluctuation

A total of 4,889 new employees were hired at Mercator Group companies in 2017. We terminated the employment of 5,707 employees.

The highest rate of external fluctuation in 2017 was seen in Croatia, on account of departures. During the peak season, hiring was increased in particular in the coastal regions (Slovenia, Montenegro).

Market	Number of new employment (excluding transfers between affiliated companies) in 2017	Number of new employment (excluding transfers between affiliated companies) in 2016	External turnover (in %)
Slovenia	1,161	1,420	12.7
Serbia	2,889	3,425	29.2
Montenegro	791	807	36.2
Croatia	1	24	48.0
Bosnia and Herzegovina	53	25	34.2
TOTAL	4,895	5,701	22.6

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

In 2017, Mercator Group devoted a total of 108,749 hours to training and education that involved 19,430 employees. This figure, however, does not represent unique participants as some employees took part in multiple training and education courses. The number of employees taking part in a variety of training and education courses was lower than in the year before, but the average duration of training and education courses was longer. Investment into employee training and education amounted to EUR 378,355.

Description of human resource management activities in Slovenia

At the company **Poslovni sistem Mercator d.d.** we provide the **training mandatory by law** throughout the year, including occupational health and safety, fire safety, HACCP, first aid, forklift truck operator course, responsible person training, driver training, and other contents. A total of 449 events were held in 2017, attended by 5,146 employees.

For employees in retail, we held **expert training** for work in the meat department, hot bar, deli department, bakery department, florist department, and garden centres. A total of 55 workshops were held in 2017, attended by 716 employees.

Selling skills development intended to improve the sales focus includes a variety of forms of training, including conventional selling skills workshops titled "Creating an Excellent Shopping Experience", visits of selling instructors at our retail units, and selling skills workshops upon refurbishments of our FMCG stores. In 2017, a combined total of 1,854 employees attended all forms of selling skills training. We carried out 189 training events.

In 2017, **teambuilding workshops on Vogel** took place in the spring and autumn. Over 250 participants at 15 workshops involved our employees from retail, wholesale, Mercator IP d.o.o., internal coaches and employees from the human resources sector. Workshops took place in the relaxed Alpine atmosphere.

Modelled after the Shop Manager School, the **Deputy Shop Manager School** was launched in mid-September. This year, 140 participants enrolled in the training, while other deputy shop managers will attend the school in 2018. The purpose of the school is to boost key competences of the employees working as deputy shop managers. The program involves 5 days of training in which participants will learn about the topics related to motivation, positive attitude, processes, material operations projects, new developments in retail, business performance (or economics), trade legislation and HACCP, environment protection, and computer knowledge related to GOLD.

In November, the succession program included the completion of the **4th Retail Academy**. 32 participants from all parts of Slovenia were trained from January on at 11 workshops, and developed their competencies with the assistance of internal coaching. Some of them have already been given the opportunity to assume more complex jobs, while others are still waiting to take this step.

At the same time, we completed in December the **selection** of participants of the **5th Retail Academy**. The selection process which involved psychological testing and an assessment centre, included over 250 candidates, of which 63 were selected for the program. Thus, the Retail Academy will include three groups of participants in 2018. Moreover, participants of the Retail Management School completed their training in November. This form of training is also a part of the succession program and it is intended for employees in whom potential has been recognized for them to take over the most complex and demanding positions in retail.

The **Logistics Management School** that includes 62 employees is in its second half. Until the end of the year, the participants took part in training courses titled:

- SDI – motivational value systems;
- Improving personal flexibility for successful stress management, parts I and II;
- Team coaching – leaders helping each other.

Before the end of the training, the logistics managers will take part in three more workshops (Communication in a Multicultural Environment, Group Coaching – Improvements, and Organization). All participants will also be offered an internal coach to support the development of their competencies.

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. In 2017, 17 internal coaches held 348 coaching sessions. In 2017, an internal coach was assigned to 78 of our employees.

In November, we announced in the cosy atmosphere of the Avsenik Home the employees whose commitment and diligence led to excellent results last year. **Awards and special acknowledgements** were presented to 15 best freshness ambassadors, 5 internal instructors, 15 best stores, 10 best bosses, 33 best sales assistants, and 18 Mercator Award recipients.

By the end of November, the leaders held the **4th development dialogue** with key employees in administration, **this time discussing the topic of learning**.

At the end of the year, we worked with a renowned Slovenian actor starring as a Mercator shop assistant in a popular Slovenian TV series, to invite potential candidates for the job of a sales assistant to attend the **Mercator Career Day**. The event was intended to present the company, to personally present the candidates, including a brief interview, and to create opportunities for cooperation in the future. Career day took place in December at our training and education centre in Ljubljana.

The project **"Earn an Award with your Candidate"** took place from July to November. In the project, Mercator employees and agency workers propose candidates for hiring, which is aimed at improving our odds for recruiting scarce (excess-demand) human resources. For each person proposed as a candidate by a Mercator employee or agency worker, who is actually newly hired at our company based on our human resource management procedures, we paid out to the employee who proposed the candidate a gross bonus of EUR 100 to the salary, and EUR 100 of e-vouchers on the employee's Pika card, after the newly hired employee successfully completed the trial period.

Before the start of the new school year, we held an **Open Door Day** for the children of employees from Ljubljana and its surroundings, and offered a relaxed day off at the company where their parents work. Thus, 53 children learned what it meant to "**work at a store**", and we also kept them amused with **singing hours** led by our employee, by **learning to cook**, by working out in the **dance and movement workshops**, and by **developing their creativity**.

In December, we organized a magical event. **Our employees' children** aged up to 7 were **visited by Santa Claus** with over 2,200 presents. The event was attended by approximately 800 children. For all other children aged up to 7, the Santa Claus' presents were sent to their parents' workplace.

The **Health Promotion Project** involved presenting to the retail management the Report with Recommendations for Decrease of Absenteeism, and the Report on Activities to Preserve the Employees' Health, prepared for their respective units by health promoters from large formats. Moreover, we carried out the project "Work Safety Week: a Week without Cuts". We shot 5 short educational videos on safe work at the retail unit, which will be used for employee training and for our activities for encouraging and promoting safety at work. We also organized vaccination against seasonal flu. In this year, we announced on our portal 36 health tips and celebrated 7 world days directly or indirectly related to the health and healthy lifestyle.

PROMOCIJA ZDRAVJA

At the Days of Vocational and Employment Rehabilitation in September 2017, the company Poslovni sistem Mercator d.d. was awarded the plaque and the right to use the promotional logo **"Disabled-friendly company"**. We received the award, presented by the Ministry of Labour, Family, Social Affairs and Equal Opportunities, as one of the largest employers of persons with disabilities in the country.

At the companies Poslovni sistem Mercator d.d., M–Energija d.o.o., and Mercator IP d.o.o., the survey **Measuring Employee Commitment and Satisfaction** was conducted. Based on the results, we will prepare a range of measures to improve employee commitment. Moreover, activities are being prepared to revise the organizational culture.

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 included 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. As a part of the public tender, the company is entitled to reimbursement of 60% of the net price of training and education. Thus, it already deceived funding in the amount of EUR 1,800 in 2017.

In November, we adopted the revised Rules and Regulations on Job Systematization that updated both the titles and job descriptions, and matched the jobs to relevant tariff rates. At the same time, we signed with the company trade union a company collective labour agreement that includes the existing practice in employment relationship regulation, and additionally defines employee rewards and promotions.

On May 30, 2017, the company **Mercator IP d.o.o.** 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 (»Kranj Cupcake«) pastry workshop in Naklo. The design of our exhibition area, deemed most beautiful at the symposium, was the work of our employees from the decoration and design team.

In 2017, we worked with the Slovenian Chamber of Commerce and Industry (SCCI) to verify the learning programs for all food-related vocations with regard to which we are facing the direst scarcity of suitable human resources. We also held 3 meetings with key employees in manufacturing and service activities in order to advance the knowledge of respective areas of work and to promote mutual cooperation.

In the second half of 2017, we completed two major investments in production activities. In Naklo, we completed a new dispatch unit and additional manufacturing facility; in Slovenske Konjice we completed the project of setting up a new facility for preparation of sandwiches and salads.

At the end of the fourth quarter of 2017, the company Mercator IP d.o.o. had 417 employees, of which 218, or 52.28%, were employees with a recognized category of disability.

Description of human resource management activities in Serbia

At the company Mercator–S d.o.o., three modules of the **Trading Academy** were held in 2017, i.e. the program of evaluation and development of trading skills and knowledge (i.e. category management and procurement). In each module, a knowledge test was made, and the program was accessed by the participants.

The goal of the **Shop Manager Academy** is to train future shop managers. The project 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. In 2017, the training has already been attended by 17 participants.

The goal of the **"Meat Department Academy"** is to retrain the interested employees, in a structured and systematic manner, for the position of sales assistant/butcher. The program consists of training and education, knowledge test, and assessment. The mentors are our best butchers who share their knowledge with their colleagues. In 2017, the training was attended by 18 employees.

"Case study competition" 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.

The purpose of the training campaign **English Goes to Store** is to teach the retail employees the basics of English language to be able to communicate with customers from abroad. The training involved 65 employees from retail units in the Centre of Belgrade.

Every retail employee takes part in training within the coaching network in retail, whose goal is to train every newly hired retail employee for work in a certain department. After a six-day training at one of the training centres, the employee starts working at a retail unit. The coaching network includes 249 coaches covering 14 segments. We shot educational videos for meat, fruit, and vegetable departments and for cash register operation, which are used for specialized training.

Based on research of the market offer and our needs, new tools were tested and implemented for external and internal selection of candidates, standardized for our market. In order to assess intellectual capabilities and personality dimensions, we also introduced an assessment centre used especially for talent management.

In 2017, we hired around 60 persons with disabilities. Consistently with the needs and requirements of employees with disabilities, we adjusted the workplace and created the job sales assistant. We received an award from the **National Employment Agency** for the employer the most engaged in hiring persons with disabilities in 2017.

Description of human resource management activities in Montenegro

In February, the Employee Talent Development Department at the company **Mercator–CG d.o.o.** 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.

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.

In the summer months from June to September, there was considerably more hiring to cover the needs of seasonal work at units in the coastal region, as over 200 seasonal employees did seasonal work at 50 retail units.

We launched an **employee satisfaction survey**. Groups consisting of employees from a variety of retail segments discussed the factors of employee satisfaction and dissatisfaction, incentives for improved satisfaction, training and education, and business unit management. The results are used to devise a strategy for promoting care for the employees and putting in place mechanisms that improve the rate of satisfaction. Based on the analysis of data, the development of the plan for 2018 is in progress.

In October, the campaign "**Living in the Spirit of Corporate Values**" started, whose purpose is to promote corporate culture and values. The headquarters building was redesigned to present the story of the company and our values, and the modern design of the business environment allows pleasant work and living. In Podgorica, Nikšić, Bar, Herceg Novi, and Bijelo Polje, the first "Idea" trees were planted in the yards of elementary schools. In the spirit of social responsibilities, the employees donated their blood. In November, we launched major project "**We are Here for You**" to show our consumers with integrity and a lot of respect that they matter to us. We carried out workshops for administration employees to answer the questions about our mission, vision, and culture in general. By promoting openness, creativity, and proactivity, we gained notable insight into how corporate culture is perceived by our employees. Also in the spirit of the campaign, we surprised the employees with a manual "Corporate Culture for Every Day" in which the employees can find guidelines for successful daily conduct and operation.

Description of human resource management activities in Bosnia and Herzegovina

At the company Mercator–BH d.o.o., the biggest human resource management challenge since the month of July included the activities of taking over the retail units from the company Konzum BH d.o.o., and restoration of retail operations in the market of Bosnia and Herzegovina, preparation of organizational scheme, and internal company acts. In the period from September 7, 2017, to September 30, 2017, we thus re-established operations at retail units. This involved taking over 1,150 employees in retail, 10 employees at the logistics and distribution centre, and 58 employees in administration from the company Konzum BH d.o.o., and 17 employees from the company Velpro d.o.o. New employment contracts were signed with all employees, pursuant to the relevant legislation. At the same time, candidates were selected, with support from the parent company HR sector, tor the administrative positions for respective sectors or departments.

In October and November, the Management Board of Mercator–BH d.o.o. held meetings with all trade union organizations, and established social dialogue that will continue next year.

In September, we launched activities to replace the currently existing human resource management IT system STATUS with the system HR.net, and moved the HR data to the new system.

In December 2017, just over 670 children of our employees received New Year's packages. Moreover, all employees received presents as well. All employees from administrative departments took part in wrapping the presents. Moreover, administrative employees came to assist their co-workers in retail in the last week of 2017, helping them restock the shelves for a total of 370 hours.

Description of humanitarian foundation activities

In Slovenia, the **Mercator Humanitarian Foundation** provided aid to 101 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 65,168. In Serbia, humanitarian aid was provided to 98 employees, in the total amount of EUR 27,128. In Croatia, 1 employee was provided aid in the total amount of EUR 1,005; and in Montenegro, 42 employees received total aid of EUR 9,900.

Responsibility TO CUSTOMERS.

CUSTOMER RELATIONS *policy*

Customer Relations Policy

It is Mercator's goal not to only attract customers, but also to retain them and to increase their loyalty. Therefore, we are committed to quality as we look to provide the highest level of service to the customers at our stores. To this end, we also prepared commitments to customers by respective markets.

Marketing activities related to the offer of local products

The project Locally Grown was upgraded with the project **We Love Local**. Special stands as well as aisles were set up at Mercator stores, offering exclusively genuine local products. For easier recognition, the stands are labelled with red hearts with the sign "We Love Local. The stands offer genuine produce and products from local farmers, growers, and producers.

Customer complaints

Received customer complaints are an important source of information and data based on which we can improve our offer and services. We carefully consider every complaint or proposal we receive, and we seek to observe it as closely as possible. Thus, we eliminate any deficiencies and improve our offer and our services.

All customer complaints, regardless of who received the complaint and how it was presented (phone, e-mail etc.), are collected at our Contact Centre. We coordinate their resolution and provide feedback on the solution as needed. We analyze the received complaints and develop proposals for improvements and measures for their pursuit.

Care for food safety

Key medium-term goals in the field of responsibility to customers include providing control over safety, compliance, and quality of our private label products; efficient internal control over each unit; and control of safety and quality of food in open departments.

In order to offer the consumer safe, compliant, and quality products, the companies Poslovni sistem Mercator d.d., Slovenia, and Mercator–S d.o.o., Serbia, conducted the following activities in 2017:

- we conducted continuous quantity and quality control on acceptance of fresh food at the central warehouses (e.g. fresh fruit and vegetables, fresh meat etc.);
- a total of 2,444 private label product samples were analyzed in our own laboratory and by third-party institutions;
- we conducted monitoring on 3,183 food samples and swabs from our open departments;
- we monitored 329 other samples (fresh fruit and vegetables safety, fruit and vegetable origin control, monitoring in the Seal of Quality project, monitoring of other brands, and samples from our own imports);
- we recorded 296 samples as a part of national monitoring;
- we carried out 1,473 regular and at least 60 extraordinary internal controls at our sales units;
- we recorded at least 106 workshops on internal controls based on the principles of the HACCP system for responsible persons in retail;
- we successfully completed the audit for marketing organic food, and newly acquired the "Select Quality" certificate for sale of poultry, beef, and veal;
- we held at least 21 tours of the manufacturing plants where our private label products are produced.

In addition to establishing and implementing our own work procedures at Mercator, we strictly comply with national and European legislation and we actively work with the Slovenian Chamber of Commerce and relevant Ministries in the development of new legislation or in making changes to the currently effective national and European legislation.

Responsibility TO NATURAL ENVIRONMENT.

ENVIRONMENTAL
policy

Environmental policy

Consistently with the adopted ambitious package on circular economy by the European Commission, Mercator Group seeks to make the transition to the circular economy in which resources are used in a more sustainable way. Our measures, like the increase in the volume of recycled waste, and reuse of products and raw materials, contribute to "closing the loop" of product life cycles, and bring benefits for the environment and for the company. The measures improve the usage of raw materials, products and waste, which in turn increases the energy savings and reduces greenhouse gas emissions. This is consistent with our commitments laid down in the Mercator d.d. Environmental Policy, that we shall strive to prevent and reduce pollution and negative effects on the environment throughout the entire life cycle of our products and services, especially with regard to generation of waste and emissions, and use of raw materials and energy. In addition, we have also committed to include environment protection into our development strategy and business plans.

Environmental management system

Environmental aspects have been managed in a systematic manner at the company Poslovni sistem Mercator d.d. and Mercator–S d.o.o. since 2009 or 2012, respectively, which is also confirmed by the certificate for the environmental management system in compliance with the requirements of the international standard ISO 14001:2004. Poslovni sistem Mercator d.d. is the only trade company in Slovenia, engaging in wholesale and retail of fast-moving consumer goods, to be awarded the ISO 14001 certificate.

We used our system for internal communication with the employees whose work has considerable environmental impact, for the following:

- In 2017, we launched the training on environment protection as a part of the Deputy Store Manager School for retail employees at the stores of Poslovni sistem Mercator d.d.; the training will continue in 2018.
- We updated the Environment Protection portal which is intended for all employees of the company Poslovni sistem Mercator d.d.
- We Prepared and standardized the technological procedure of hazardous waste management, and the Rules and Regulations for waste management at the locations/facilities of the company Poslovni sistem Mercator d.d., for persons responsible for operations.

In order to raise the awareness of our consumers that the waste packaging of their products can be recycled and reused as a new product, which in turn protects the natural resources and raw materials, the company Poslovni sistem Mercator d.d. teamed up with product suppliers with whom we will carry out a new circular economy project in 2018.

Audits

External audits

- At the company Poslovni sistem Mercator d.d., internal audit of the environmental management system according to the ISO 14001:2004 standard was carried out.
- At Mercator–S d.o.o., the audit company Quality Austria conducted an external audit of the environment management system according to the ISO 14001:2004 standard.

Internal audits

At the company Poslovni sistem Mercator d.d., internal audit of the environmental management system according to the ISO 14001 standard was carried out; some cases of non-compliance were identified and remedied.

Cooperation with the government authorities

As a member of the Sustainable Development and Environment Protection Council, the company Poslovni sistem Mercator d.d. is active within the Ministry of the Environment and Spatial Planning; we are also active as members of the Environment Committee with the Slovenian Chamber of Commerce; and as members of the Environment and Spatial Planning Committee within the American Chamber of Commerce.

As a member of the Slovenian Chamber of Commerce (Trgovinska zbornica Slovenije), Mercator d.d. actively took part in 2017 in the pilot project of the Statistical Office of the Republic of Slovenia regarding generation and management of waste food in Slovenia. The purpose of the project was to establish the methodology for monitoring data on waste food in Slovenia.

Environment protection expenses

At Poslovni sistem Mercator d.d., more than EUR 634,869 was allocated in 2017 for environment protection investments. In addition, current environment protection expenses exceeded EUR 4,173,421, while revenue from environment protection activities amounted to EUR 925,156.

Awards and special achievements

In 2017, Mercator d.d. won the top spot in the Trusted Brand 2017 survey in the environment protection category.

Energy efficiency

In the period 1–12, 2017, the following applies to the 5 companies of the Mercator Group:

- cost of energy amounted to EUR 42.237 million; specific energy cost was EUR 3.5 per square meter;
- carbon dioxide emissions from fuel and energy consumed amounted to 306.419 tons of CO2; specific emission was 161kg of CO^2/m2;
- Electric energy consumption amounted to 491.957 GWh; specific power consumption stood at 256 kWh/m^2.

Slovenia

At the company Poslovni sistem Mercator d.d., we are aware of the importance of energy efficiency. Therefore, we made it our goal to reduce energy consumption by 1% annually. In order to optimize our energy savings, we carried out the following activities:

- Energy accounting was established for all buildings of the company Poslovni sistem Mercator d.d.
- Efficient use of electric energy (power) was launched at 491 of our buildings.
- Efficient use of thermal energy (heating) was launched at 214 of our buildings.
- By the end of 2017, all measures on all buildings involved were completed.

The employees are informed on a quarterly basis on the measures for efficient use of energy. Each month, we control the consumption of energy at respective units of the company Poslovni sistem Mercator d.d.

In 2018, we shall continue to inform the employees on a quarterly basis about the efficient use of energy. We are also planning to upgrade the existing energy accounting system with a more detailed targeted monitoring of energy consumption. Measures for efficient use of energy will be implemented with the aid of our contractual partner Maked Energea. Efficient use of energy will include restoration of boiler rooms and installation of energy-efficient equipment at some facilities. In addition to restoration of boiler rooms, we are also planning to replace the lighting fixtures on buildings and outdoor areas with energy-efficient LED lighting.

Serbia

The following energy efficiency projects were carried out at Mercator–S d. o. o. in 2017:

- Retail Food Service project that included 24 buildings;
- launch of three projects to replace the heating system;
- compensation for energy waste on 13 buildings (in the next period energy waste compensation measures will be carried out on 50 more buildings).

At Mercator–S d.o.o., energy consumption is expected to decrease by at least 1% per year in the coming years. To this end, we are planning to implement the ISO 50001 Energy Management System Standard to contribute to decrease of energy consumption throughout the company. Employees will be informed on the importance of energy efficiency measures.

Montenegro

To improve the efficiency of energy use, the company Mercator–CG d.o.o. issued in 2017 its guidelines for rational use of electric energy at retail units, which are included in the internal rules and regulations.

Bosnia and Herzegovina

At Mercator–BH d.o.o., the following measures for efficient use of energy were conducted in 2017:

- signing of an agreement with Elektroprivreda BH on additional decrease of electric energy for devices with 10 kV voltage, resulting in economic savings of 10%;
- gradual implementation of LED lighting.

The following activities for efficient use of energy will be conducted in 2018:

- rational use of energy for lighting and refrigeration – control over managers at centres and managers at smaller units or buildings;
- further introduction of LED lighting;
- control of heating and cooling in buildings; adjusting the use to the weather with continuous visits and temperature control;
- looking for the best offer for supply of heating oil;
- monthly control over the use of energy.

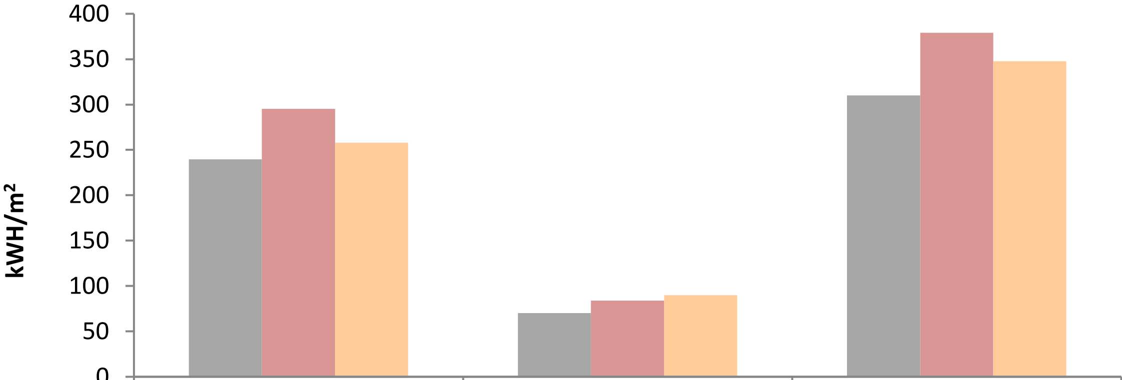
Croatia

For the company Mercator–H d.o.o., no plan for efficient use of energy was made in 2017. However, it is important to emphasize the fact that Mercator's buildings in Croatia were managed until July 1, 2017, by Konzum; thereafter, these buildings were again managed by Mercator.

In the Croatian market, the following measures for efficient use of energy will be conducted in 2018:

- implementing the guidelines consistently with the Manual for Efficient Use of Energy at our stores;
- replacement of less energy-efficient devices with more energy-efficient ones.

Use of specific total final energy for the Mercator Group in the years 2015–2017



	Electricity	Heating	TOTAL
2015	240	70	310
2016	295	84	379
2017	258	90	348

Sustainable logistics and merchandise supply

Operations of the field of logistics in 2017 was, even more than in previous years, **focused on providing availability of trade goods, or merchandise, at the stores (on the shelves)** while **decreasing the level of trade goods inventories** both at warehouses and at the stores. Innovative approaches to optimization of trade goods inventories through introduction of cutting-edge inventory replenishment methods allowed us to keep our trade goods inventory levels at the lowest point in recent years throughout the year. At the same time, we successfully improved the supply of goods from all categories of the defined sales assortment to our stores, and reached the best results in store stock in December in the last two years since we have been systematically measuring the presence (inventory and shelf stock) of products from the defined sales assortment.

In 2017, we also increased the number of products and level of distribution from the warehouse or central supply.

In 2017, we also increased the number of products and level of distribution from the warehouse or central supply. Re-routing of products and the material flows related to such products to central supply greatly simplifies our operating processes, as it reduces the number of goods deliveries to stores, and the related operating and administrative processes in ordering and acceptance of goods. By increasing the share of central supply, we are also improving control of the stock and inventory of trade goods; as the volumes increase, logistics processes of trade goods supply are also optimized. Re-routing of material flows from direct distribution to warehouse distribution is a lengthy process that will continue in the coming years. Maximum volume of central distribution will be provided with the logistics capacity that we will acquire in Slovenia with the construction of the new central distribution centre.

In 2017, we continued to partially revise the IT support to logistics processes and introduce new IT solutions in logistics. Thus, we will continue to provide more efficient supply of goods, better stock at stores, and lower level of trade goods inventories.

Other environmental aspects

Waste and raw materials

Slovenia

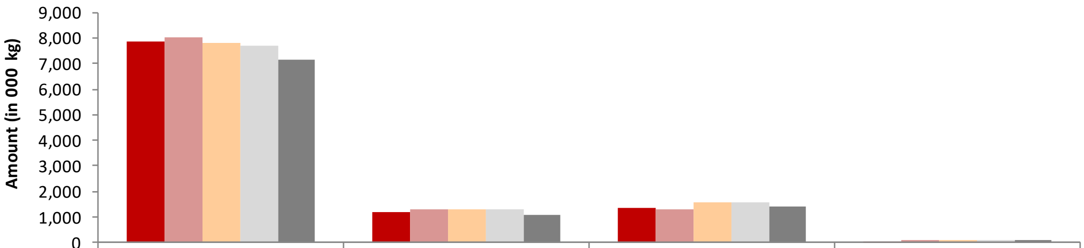
In Slovenia, the following activities of waste and raw materials management were carried out in 2017:

- In order to attain the medium-term plan of reducing the amount of mixed waste by 10%, we optimized at the company Poslovni sistem Mercator d.d. the volume of waste bins at 11 units and provided more suitable waste bins for small waste packaging and biological waste, thus increasing the share of separately collected waste and cutting the mixed municipal waste handling costs.
- At 34 refurbished retail units of Mercator d.d., we installed waste bins for separate waste collection for our customers.

- We actively controlled the separate waste packaging collection and sorting at the units of the company Poslovni sistem Mercator d.d. in order to improve the quality of separately collected waste packaging, we optimized the handling of small waste packaging at our stores.
- We emptied the archives at the company Poslovni sistem Mercator d.d., submitted all separately collected paper documentation to the authorized waste collection centre, and donated the funds for the collected paper documentation to Mercator Humanitarian Foundation.
- The company Poslovni sistem Mercator d.d. worked with the Reuse Centre (Center za ponovno uporabo, CPU) and supplied them with damaged products, and we donated sample ceramic tiles from discontinued programs to the High School of Construction in Maribor for use in practical training.
- At the M Tehnika units, we worked with the company ZEOS that manages waste electric and electronic equipment and joined the project "**E-Waste Management**", with the slogan E-cycle to promote sorting of e-waste and waste batteries.
- At Mercator **IP d.o.o.**, we trained and educated the newly employed on correct waste disposal.

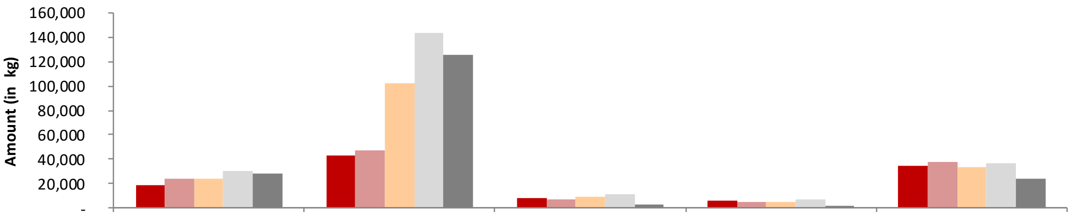
Information on volumes, specific volumes, and types of generated waste packaging, waste electric and electronic equipment, and biological waste for the company Poslovni sistem Mercator d.d. for the period 2013–2017

Waste packaging



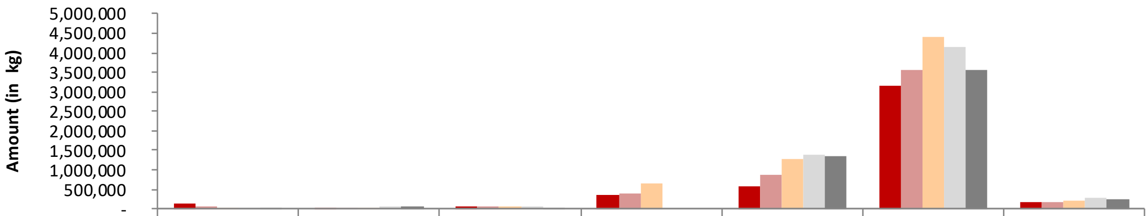
	paper and cardboard packaging	plastic packaging	wood packaging	other
2013	7,860	1,170	1,330	45
2014	8,022	1,272	1,312	81
2015	7,804	1,320	1,554	83
2016	7,687	1,280	1,566	74
2017	7,174	1,064	1,420	74

Waste EE equipment



	HZA	VGA and MGA	TV, monitors	lamps	PBA
2013	18,460	42,790	7,880	6,351	34,541
2014	24,640	47,660	6,850	5,452	38,034
2015	24,130	102,502	9,890	5,547	33,184
2016	30,940	143,260	11,450	7,104	36,654
2017	27,950	124,935	2,550	2,543	24,455

Organic waste



	kitchen waste	oil and fat	fat	bread and dough	category 3 ABPs	fruits and vegatable	animal tissue
2013	147,478	20,046	55,811	356,743	565,178	3,139,626	168,665
2014	78,360	23,090	47,475	390,057	869,160	3,551,387	181,675
2015	36,418	30,493	50,165	650,340	1,295,890	4,405,487	209,289
2016	36,163	55,687	47,094	-	1,377,716	4,144,285	292,892
2017	37,828	66,142	36,471	-	1,347,955	3,554,147	261,328

Foreign markets

In the markets of Montenegro, Serbia, and Bosnia and Herzegovina, the following activities of waste and raw materials management were carried out in 2017:

- In Montenegro, legislation on waste management has not yet been prepared. Thus, the company **Mercator–CG d.o.o.** works in this respect with the companies authorized for collection of particular types of waste.
- Waste management at the company **Mercator–S d. o. o.** is regulated by internal documents that are in compliance with the legislation of the Republic of Serbia. All types of hazardous and non-hazardous waste generated during regular operation are managed at the company level.
- At **Mercator–BH d.o.o.**, all types of waste generated as a result of our operations are managed consistently with the legislative requirements. At the Ložionička Hypermarket in Sarajevo, we set up a waste electric and electronic equipment bin intended for customers and other residents.

Water and wastewater

Slovenia

We completed two monitoring boreholes at the Zalog distribution centre to monitor the level of groundwater pumped for cooling of goods at the distribution centre. All pumped water returns to the watercourse unpolluted. Nevertheless, the monitoring boreholes have improved our control over the effect that the pumping of water for the needs of the distribution centre has on the groundwater.

Foreign markets

Since oily water and precipitation present a hazard for pollution of watercourses at the company Mercator–S d. o. o., oil skimming devices have been installed at major units and distribution centres. Total number of skimming devices in 2017 was 39, and they are cleaned in compliance with the internal instructions. No deviations were recorded for the measured parameters in 2017.

Out of respect to the natural environment, Mercator Group not only complies with the requirements of the environmental legislation, but also conducts a range of other activities to prevent or mitigated negative impact on the environment. In order to reduce environmental impact, we conducted various activities for managing the environment aspects in 2017.

Emissions into atmosphere and ozone depleting substances

Slovenia

In Slovenia, the following activities related to emissions into atmosphere and ozone depleting substances were carried out in 2017:

- On newly constructed units and refurbished buildings at the company Poslovni sistem Mercator d.d., we replaced and updated at 11 locations the equipment in the cooling equipment engine room and replaced the freezers on three buildings. All newly installed equipment and devices are more environmentally friendly.

- We installed heat pumps on two Mercator d.d. units and thus cut the emissions into atmosphere and use of fossil fuels for heating at these locations.
- We also installed systems for recuperating the waste heat from cooling equipment at two units, thus cutting emissions into atmosphere and use of fossil fuels for hot water heating.
- In order to optimize transport routes and cut emissions into air and use of motor fuels, we established at the company Poslovni sistem Mercator d.d. a new method for separate collection of waste printing toners. Using our internal mail service, waste printer toners are now only collected at two collection points where they are then collected by an authorized waste management company.
- At Poslovni sistem Mercator d.d., we updated a part of the vehicle fleet and replaced 4 old freight vehicles with new freight vehicles fitted with a Euro 6 motors with lower environmental impact.

Foreign markets

At Mercator–S d. o. o., emissions into atmosphere from stationary sources were measured in 2017 at the start and at the end of the heating season at 20 commercial buildings with boiler rooms in which heat is generated from wood pellets or natural gas. Emissions into atmosphere from mobile sources (personal and freight vehicles) are measured once per year during regular vehicle inspections (MOT tests). Measured parameters were within the reference limits.

Hazardous substances and preparations

In 2017, the period of double labelling for chemicals as per CLP Regulation EC No. 1272/2008 on classification, labelling, and packaging of hazardous chemicals, ended. At the company Poslovni sistem Mercator d.d., we conducted all necessary activities to make sure only classification as per CLP is used.

Noise

At 21 locations of the company Poslovni sistem Mercator d.d. in which the critical values of noise indicators were exceeded, we restored the sources of such noise and thus eliminated the excess noise at these locations. In newly constructed buildings and refurbished buildings at the company Poslovni sistem Mercator d.d., we are removing the refrigeration equipment, compressors, and condenser units for freezers and replacing them with freezer chests with built-in motor, which do not cause noise emissions into the environment.

States of emergency

We standardized the equipment for response in case of a spill of a hazardous chemical at all units of the company Poslovni sistem Mercator d.d. Thus, we provided correct and safe treatment of hazardous chemicals at our stores and reduced the risk of negative effects on the natural environment in case of a hazardous chemical spill.

Responsibility TO SOCIAL ENVIRONMENT.

POLICY OF RESPONSIBILITY *to social environment*

Policy of responsibility to social environment

As a socially responsible company, we are looking to contribute to the development of local and regional environment and to improve the quality of people's lives. Sponsorships and donations, and participation in socially beneficial campaigns are an important part Mercator Group's comprehensive socially responsible conduct. Therefore, we support and enable humanitarian, sports, cultural, scientific, educational, and other projects.

Slovenia

In 2017, Mercator continues to pursue the tradition of prompt response to the needs of local environments in which we operate, in keeping with our slogan of **the best neighbour**. We respond to all applications submitted by societies, organizations, clubs, and individuals. In 2017, these numbered over 2,000 and included support to over 600 different humanitarian, cultural, educational, and sports projects.

Donating food for hot meals

In 2017, we continued the Donated Food project. Thus, volunteers of the Lions Clubs from Celje, Maribor, Trbovlje, Velenje, Koper, Brnik, Novo mesto and Slovenj Gradec, and the "Pod strehco" institute from Ljubljana collect food every evening from 18 stores across Slovenia.

Collecting food in cooperation with the Red Cross of Slovenia

In 2017, we teamed up with the Slovenian Red Cross to actively collect food and other necessities every third Saturday at our major shopping centres. Thus, more than 77,000 products were donated at 230 stores.

Working with Zavarovalnica Triglav insurance company in the project Clean up the Mountains

Working with the Zavarovalnica Triglav insurance company, Mercator Mountaineering Society, and Slovenian athletes, we combined fun and benefit and picked up litter on Rašica, under Storžič, and Kamniška Bistrica.

Humanitarian activities

In addition to aid to numerous societies and individuals, our humanitarian activities also included donations to the Friends of the Youth Association Moste Polje for families in social distress, the Palčica (Thumbelina) Safe house in Grosuplje, and the Safe House in Pilštanj. In October we donated 3.5 tons of bead within the Drobtinica (Breadcrumb) project, organized each year by the Slovenian Red Cross organization.

National competition in sales techniques

The 2017 National Competition in sales techniques took place at the High School of Trade and Commerce in Slovenska Bistrica. Over 100 high school students from across Slovenia competed. Mercator has been supporting the event as a sponsor since 2006.

Supporting a variety of conferences

In 2017, we sponsored the following conferences: Sales summit, Slovenian Marketing Conference, BledCom Conference, Bled Strategic Forum, HR Breakfast »Talent Recruitment and Management«, Sales and Marketing on the Shelves, Trade and Retail Conference, Sarajevo Summit, Corporate Governance Conference, Eurocities General Assembly, Portorož Business Conference

At the end of 2017 we organized the **Mercator Business Conference** entitled »Opportunities of the Future« for our partners, which was attended by almost 500 representatives of Mercator's suppliers and other business partners. President of the Management Board Tomislav Čizmić presented the strategy of cooperation with suppliers, which affects not only on the future of Mercator, but also on the future of all partners. We are aware that suppliers are those who significantly co-create the offer and make the competitive advantage.

We are sponsoring the following sports associations, clubs, and athletes:

In Mercator we support the champions, including our eagle – Ski Association of Slovenia and as well young persons. Ski jumping club Ilirija from Ljubljana collect the most votes from our customers in the campaign Jump into Mercator, support the jumpers, and earn the main prize - the Ford van.

Ice Hockey Federation of Slovenia

Ski Association of Slovenia (women's and men's national team)

Football Association of Slovenia

Football club Olimpija

Football club Maribor

Handball club Krim Mercator

Handball club Celje Pivovarna Laško

Wheelchair basketball team – Society of Paraplegics of the Ljubljana Region

Nejc Žnidarčič

Manca Notar

We are sponsoring mass sports events

Hike Along the Barbed Wire

Ljubljana Marathon and the Lumpi Run

Žogarija – Ball Game festival

Serbia

Humanitarne aktivnosti

IDEA builds a Kodi Park in Karaburma – Working with the Palilula Municipality and the company Energoprojekt, IDEA supported the construction of a children's playground where they can spend their leisure time, play, and socialize with their peers.

Open Heart Street campaign – IDEA is proud to take part for the fifth consecutive year in the event with many entertaining activities.

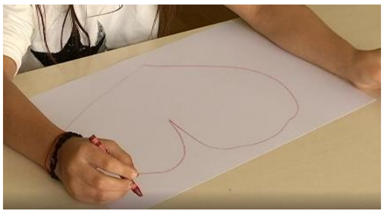
Children's Month – Within the project Children's Month, IDEA donated over 350 infant packages to families from Niš.

Humanitarian New Year's concert in Niš – For the 6th consecutive year, IDEA organized a humanitarian New Year's concert, the proceeds from which were donated to the Niš Children's Cultural Centre.

Karavana IDEA – As a part of the campaign called "We Love Holidays because we Love Each Other", over 2,000 employees of Mercator–S d. o. o. visited over 40 institutions and hospitals across Serbia and donated over 4,000 packages.

On September 1, 2017, **Roda** presented two personal computers and over 200 books to first-graders in Kragujevac, pointing out the importance of education for the youngest.

Humanitarian Weekend – The Company Mercator–S d.o.o. worked with the Be Humane Foundation to organized at all IDEA, RODA, and Mercator units the project Humanitarian Weekend. From May 20 to 21, one Serbian dinar from each checkout was donated to the said foundation.



Humanitarian Campaign by Roda and Serbian National Radio and TV – Roda and »Radio televizija Srbije« (Serbian National Radio and TV) visited 7 orphanages in Belgrade and is surroundings and donated sweets, snacks, school supplies, and clothing to the children there.

We support a variety of conferences

FMCG conference in Serbia

Webiz conference

Marketing Communication Festival KAKTUS, and the »Forum komunikacionih lidera IZAZOV« (CHALLENGE Communication Leaders' Forum)

We are sponsoring sports associations, clubs, and athletes

Roda and the Basketball Federation of Serbia – Partnership between Mercator–S d. o. o., and the Basketball Federation of Serbia was the most visible during the 2017 European Basketball Championships when several marketing activities were organized.

In the Campaign "Zvezda Plus IDEA", in cooperation with the Basketball Club Crvena Zvezda, the brands IDEA and K plus were promoted via promotional activities.

YUBAC Basketball Camp

Roda Children's League of Serbia

RODA

Cooperation between Roda and Kragujevac Basketball Club Radnički

Roda 3x3

Cooperation between the Belgrade Marathon and the IDEA brand

Montenegro

At the company Mercator–CG d.o.o., we are looking to be present in the daily lives of the citizens, consistently with the slogan "With you through your life".

Humanitarian activities

In 2017, IDEA again supported the »Dnevnica« show in which a former star performs various works and collects funds for a selected distressed family from her town. Due to its humanitarian note and aid to fellow humans, this is one of the top-rated shows in Montenegro.

Donating TV sets to the Institute for Sick Children

We pay particular attention to the youngest. In 2017, IDEA donated 11 TV sets, and some social games, to the Paediatrics Ward.

IDEA Karavana (Caravan)

The IDEA New Year's caravan 2017 visited all children's hospitals in Montenegro. Our employees, the Santa Clause, and the Kodi mascot surprised over 300 children.

Be responsible, plant an IDEA tree

As a part of the social responsibility month, over 100 employees at IDEA planted trees and arranged the landscaping on the yards of 6 selected elementary schools at five Montenegrin towns.

Sponsoring the National Basketball Team

IDEA is the proud sponsor of the Montenegrin National Basketball Team. The Men's National Team qualified for the European Championships, while the U16 National Team provided the biggest surprise by winning silver at the European Championships.

Anti-corruption policy

Consistently with the Articles of Association of the company Poslovni sistem Mercator d.d., a document titled Binding Guidelines for Provision of Compliance of Operations was prepared, defining the fundamental principles and rules applying to the employees in their mutual relations and in relations to customers and third parties with whom they collaborate during their work. At Mercator Group, we are therefore raising the awareness of all employees on the importance of compliant and fair conduct, and prevention of non-compliance in everyday practice. We have also established a mechanism for disclosure of disputable practices (whistleblowing system) at the company, called "Say It Out Loud". The purpose of the "Say It Out Loud" mechanism is to make sure that any disputable practices and irregularities are identified, resolved, and eliminated in the earliest stage, within the company. Mercator Group internal audit is in charge of this activity. The rules in this regard were written in the document titled "Policy of Motivating Responsibility and Integrity of Conduct", available on the company website.

Responsibility TO SUPPLIERS.

SUPPLIER RELATIONS *policy*

Supplier relations policy

Long-term partnership relations with suppliers of branded products and products under Mercator private labels are a key element in the corporate sustainable responsibility. Transparent transactions and joint efforts allow us to establish an environmentally friendly supply chain as we work with our suppliers. It is Mercator Group's goal to establish such relationships and rules with suppliers who will provide stable and, given the scope, most favourable supply sources for trade and non-trade goods and services in the long run.

Supplier commitments, monitoring and control

Mercator Group signs annual, biannual, or triennial contracts on supply of goods with the suppliers. General Terms and Conditions of the company Poslovni sistem Mercator d.d., which define the terms and conditions of cooperation in supply of fast-moving consumer goods, are a constituent part of every such contract. By signing the contract, the suppliers confirm that they are fully aware of the General Terms and Conditions and that they fully agree with them.

Special chapter of General Terms and Conditions is dedicated to quality, safety, labelling, and traceability. By signing a special statement, suppliers of fruit and vegetables commit to providing appropriate and safe products, while suppliers of other food products sign a written Statement of Product Safety, Quality, and Compliance for food and materials in contact with food.

Supplier control is carried out by the internal control and food safety department. Findings of our in-house control are supplemented with the data provided by national control of product safety and quality. In case of non-compliance, we work with the suppliers to implement corrective measures.

Assessment and selection of suppliers

Assessment of suppliers is aimed at providing constant quality, safety, and traceability of products in order to promote and foster the health of customers in compliance with the contractual provisions, relevant legislation, and Mercator's special requirements.

Assessment of current FMCG suppliers takes place once per year, before new procurement contracts are signed. Criteria according to which a supplier is evaluated depends on the clauses and provisions from the core contract; they are divided into two sets: commercial criteria and criteria of quality. Criteria of quality refer to any non-compliance in the process of supply of goods, and non-compliance of products.

Based on overall supplier assessment, we specify their suitability. Contracts for the current year may be signed with suitable suppliers, or cooperation with them may be continued. We negotiate corrective measures and implementation deadlines with other suppliers. No agreements are signed with inadequate suppliers, except for exceptional cases when they meet the quality criteria and no alternative sources are available.

Moreover, supplier assessment is conducted in all markets of the Mercator Group, which is the basis for determining the suitability of suppliers for cooperation with Mercator in respective markets.

Inclusion of suppliers

Inclusion of suppliers into expansion of local offer

In **Slovenia**, we work with local suppliers to offer our customers as much locally grown produce as possible. Inclusion of products by local suppliers allow cutting supply and transport routes and thus reduce carbon dioxide emissions. By offering the best from the local environment, we are encouraging innovation and supporting Slovenian farmers and growers. In 2017, we additionally developed the project and offer as a part of the activity **We Love Local**.

In other markets of Mercator Group operations, the activities concerning the local offer is also important. Many activities are conducted, such as "The Best from Serbia", "The Flavours of My Town" etc.

Inclusion of suppliers into the project My Brands

The campaign **My Brands** left an impression on the year 2017. **Slovenia** as many renowned brands in the food industry, which have succeeded in keeping the leading market position and maintaining their quality and reputation. Therefore, they have an important place on Mercator's shelves. Products of these brands have become important parts of the Slovenian brand landscape; therefore, we launched the initiative for their collaboration and offered them more than just a shelf in our aisles. The purpose of synergistic collaboration with the umbrella project My Brands is to connect the suppliers not only at the level of a shared special offer, but rather to connect in creation of joint marketing stories and new offers for the consumers. During this time, the initiative was joined by over 50 partner food brands. The partners recognized the great potential of a shared appearance that systematically exposes the most reputable brands both at the stores and in advertising activities.

Responsibility TO QUALITY.

QUALITY
policy

Quality Policy

The quality policy specifies the method of operation that ensures long-term satisfaction for our customers by offering superior level of offer of products and services. Thus, we are providing successful operation and growth of the company that represents a solid base for development of employees, owners, and other relevant stakeholders. The management and all employees at Mercator are committed to meet the needs and requirements of our customers and to continuously improve the efficiency of our management system.

Management of certified management systems

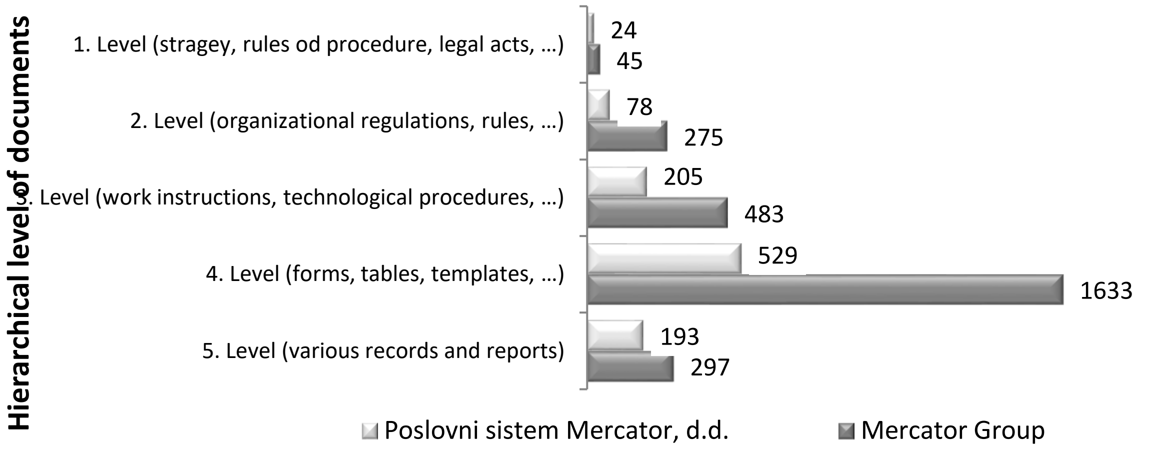
There are 15 certified management systems maintained at Mercator Group companies. In 2017, the company Poslovni sistem Mercator d.d. acquired a new certificate Select Quality for Beef and Poultry; while the systems IFS and SQMS were re-certified at Mercator–Emba, d.d.

Management Qualitiy System	Poslovni sistem Mercator, d. d.	Mercator–S, d. o. o.	Mercator IP, d. o. o.	Mercator–Emba, d. d.	Mercator–CG, d. o. o.
ISO 9001 – Quality Management Systems	✓	✓		✓	
ISO 14001 – Environmental System	✓	✓			
HACCP – Food safety		✓			✓
IFS - International Food Standard				✓	
SQMS - Supplier Quality Management System				✓	
AEO – Supplier Food Standard	✓				
Family Friendly Company	✓		✓		
Organic production	✓				
Selected quality - beef and poultry meat	✓				
UTZ – Production of cocoa products based on sustainable principles				✓	

Management of knowledge and information

The rules of operations in effect at the Mercator Group are defined in internal documents available to all employees. Thus, the company provides better communication and improved flow of knowledge and information. The users may browse or search for documents related to their role in the business process, and provide proposals for improvements. Document contents are regularly revised and updated based on good practices and proposals for changes. Documents are monitored in a variety of ways, most frequently by companies, functions, and hierarchy.

Number of valid documents in the Mercator Standards Collection as at December 31, 2017



Source: Mercator Standards Collection

As at December 31, 2017, there were **2,733** valid documents in the Mercator Standards Collection for the Mercator Group. In 2017, we published **710** new or revised documents; **127** documents were archived (removed from use).

Control of operations

Processes and goods are controlled in various stages of the business process in order to provide their compliance with the legislation, effective standards, and specified requirements.

External control at Mercator Group is provided by inspection authorities, external auditors who ensure compliance with the relevant legislation and other requirements binding for Mercator. In addition to external control, we also conduct various forms of **internal control**. Compliance of operations is reviewed with internal controls, monitoring, internal audit, accounting and tax supervision and control, internal system audits, and controls of security, occupational health and safety and fire safety. Internal control includes checking the quality of goods, documentation, and conducting business processes in compliance with the requirements of respective forms of internal control, Mercator standards, and good practices. Employees in charge of activities and process administrators control respective processes and systematically measure and monitor process performance based on the indicators and the goals laid down. Findings of such controls are, in turn, the basis for action.

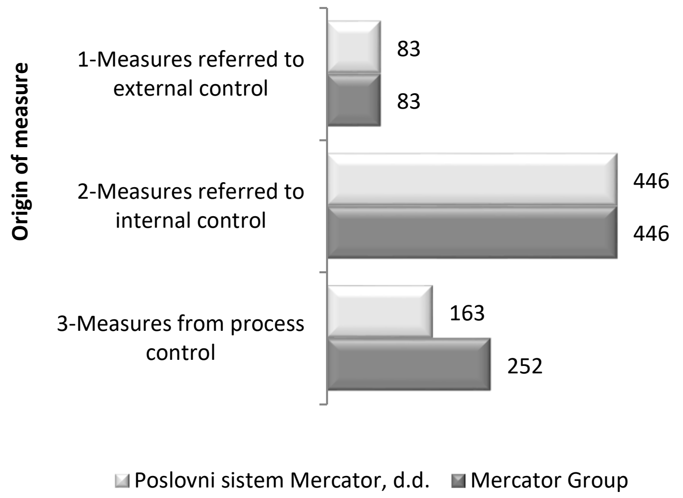
Management of the continuous improvement system

Errors that may appear in the operations process are eliminated or corrected, while implementation of measures eliminates the causes of non-compliance; thus, we are continuously improving our operations.

Continuous improvement process is consistent with the company strategy, based on the findings of councils, control of operations, customer and employee satisfaction analyses, risk management, non-compliance system, recommendations and commendations, and improvement proposals provided by the employees. The system has information support for faster and more transparent resolution of reports. Analyses are used to identify major discrepancies and to introduce corrective measures based on our findings.

Respective management systems have been combined into an integrated management system whose basic requirements are implemented at all Mercator Group companies, regardless of whether certified management systems are in place there or not. The management system is being continuously developed and expanded, and systemic monitoring of key indicators allows us to efficiently manage the processes and to improve and transfer of good practices between Mercator Group companies.

Number of measures implemented in 2017, by origin of report



Source: internal application

In the non-compliance, recommendations, commendations, and measures management application, we addressed in 2017 at the Mercator Group level a total of **781** measures. This figure, however, only accounts for a part of all measures implemented to improve our operations, as the use of the non-compliance, recommendations, commendations, and measures management application has not been implemented in all areas of control and at all Mercator Group companies, which will be the goal of our efforts in the future.

We are focused on our core activity; we invest into a competitive and up-to-date offer.

FINANCIAL REPORT.

Management Responsibility Statement

The company's Management Board is responsible for preparation of the Annual Report for the company Poslovni sistem Mercator, d.d., and the Mercator Group for the year 2017, and of the financial statements which, to the best knowledge of the Management Board, present truly and fairly the development and operating results of the company and its financial position, including the description of significant risk types the company or any other company included in the consolidation are exposed to as a whole.

The Management Board confirms to have consistently applied the appropriate accounting policies in compiling the financial statements and to have made the accounting estimates according to the principle of fair value, prudence and good management, and that the financial statements give a true and fair view of the company's property and operating results for the year 2017.

The Management Board is also responsible for appropriate accounting, the adoption of adequate measures for protection of property and other assets, and confirms that the financial statements, together with notes, have been prepared on the basis of the going concern assumption and in line with the applicable legislation and the International Financial Reporting Standards as adopted by the EU.

The Management Board approves and confirms the Annual Report of the company Poslovni sistem Mercator, d.d., and the Mercator Group for financial year 2017.

Ljubljana, April 20, 2018

Tomislav Čizmić
President of the Management Board

Draga Cukjati
Member of the Management Board

Igor Mamuza
Member of the Management Board

Gregor Planteu
Extraordinary Management Board Member

FINANCIAL STATEMENT OF THE MERCATOR GROUP AND THE COMPANY POSLOVNI SISTEM MERCATOR D.D.

Consolidated statement of financial position of the Mercator Group and statement of financial position of the company Poslovni sistem Mercator d.d.

in EUR thousand	Note	Mercator Group 2017	Mercator Group 2016 restated	Poslovni sistem Mercator d.d. 2017	Poslovni sistem Mercator d.d. 2016 restated
ASSETS					
Non-current assets					
Property, plant and equipment	14	1,159,237	1,569,905	736,152	867,726
Investment property	16	244,316	9,899	4,838	3,237
Intangible assets	15	20,632	21,963	12,573	13,455
Deferred tax assets	19	42,920	23,529	40,184	21,218
Trade and other receivables	22	344	-	422	25,664
Loans/deposits given	23	24,147	31,385	99,220	125,202
Available-for-sale financial assets	18	391	462	259	296
Capital investments in Group companies	17			190,798	270,758
		1,491,988	**1,657,143**	**1,084,445**	**1,327,554**
Current assets					
Assets held for sale	20	117,146	-	95,203	-
Inventories	21	210,233	224,328	104,950	121,783
Trade and other receivables	22	228,168	205,707	71,239	78,786
Current tax assets	19	244	1,230	-	300
Loans/deposits given	23	4,833	8,110	27,180	999
Cash and cash equivalents	24	24,112	26,318	11,635	13,344
		584,736	**465,694**	**310,208**	**215,212**
Total assets		**2,076,723**	**2,122,836**	**1,394,652**	**1,542,766**
EQUITY	25				
Nominal capital		254,175	254,175	254,175	254,175
Capital surplus		207,523	286,772	207,523	286,772
Own shares		(3,235)	(3,235)	(3,235)	(3,235)
Revenue reserves		42,830	41,685	16,624	16,624
Fair value reserve		200,181	104,541	149,214	76,196
Retained net profit or loss		45,102	37,515	2,584	(1,802)
Net profit/loss for the period		(184,284)	(72,463)	(203,726)	(77,447)
Currency translation reserve		(84,029)	(91,720)		
Equity attributable to the controlling company owners		**478,261**	**557,269**		
Non-controlling interests		**140**	**106**		
Equity		**478,401**	**557,376**	**423,159**	**551,283**
LIABILITIES					
Non-current liabilities					
Trade and other payables	29	7,174	13,762	1,012	2,552
Loans received and other financial liabilities	27	765,309	769,776	539,291	532,693
Deferred tax liabilities	19	51,534	31,356	40,684	25,229
Provisions	28	29,683	26,818	25,377	23,041
		853,701	**841,711**	**606,365**	**583,514**
Current liabilities					
Trade and other payables	29	626,963	590,021	303,621	315,082
Current tax liabilities	19	1,268	488	-	-
Loans received and other financial liabilities	27	116,391	133,241	61,507	92,886
		744,622	**723,750**	**365,128**	**407,968**
Total liabilities		**1,598,322**	**1,565,461**	**971,493**	**991,483**
Equity and liabilities		**2,076,723**	**2,122,836**	**1,394,652**	**1,542,766**

The accompanying notes are an integral part of consolidated and financial statements and should be read in conjunction with them. The adjustments for 2016 and the effects of changes on the consolidated and financial statements are presented in greater detail under 2. e).

Consolidated income statement of the Mercator Group and income statement of the company Poslovni sistem Mercator d.d.

		Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	Note	2017	2016 restated	2017	2016 restated
Sales revenue	9	2,152,172	2,199,587	1,186,622	1,209,952
Cost of goods sold and selling costs	11	(2,116,036)	(2,197,076)	(1,141,334)	(1,182,373)
Administrative expenses	11	(87,387)	(81,102)	(47,239)	(39,539)
Impairment of property, plant and equipment and intangible assets	11	(147,072)	-	(98,033)	-
Other operating revenue	10	25,815	32,582	12,867	8,242
Results from operating activities		**(172,508)**	**(46,009)**	**(87,117)**	**(3,718)**
Finance revenue	13	6,626	1,980	6,054	12,740
Finance expenses	13	(36,696)	(38,968)	(142,155)	(91,728)
Net finance expense		**(30,071)**	**(36,988)**	**(136,101)**	**(78,988)**
Profit or loss before tax		**(202,579)**	**(82,997)**	**(223,217)**	**(82,706)**
Tax	19	18,144	4,934	19,491	3,992
Net profit/loss for the year from continued operations		**(184,435)**	**(78,063)**	**(203,726)**	**(78,714)**
Discontinued operations (Modiana and Intersport)		**-**	**5,328**	**-**	**1,267**
Net profit/loss for the year		**(184,435)**	**(72,735)**	**(203,726)**	**(77,447)**
Net profit/loss for the year attributable to:					
Owners of the controlling company		(184.284)	(72.463)		
Non-controlling interests		(151)	(272)		
Net profit (loss) per share in EUR	26	(30.5)	(12.9)	(33.7)	(13.0)

The accompanying notes are an integral part of consolidated and financial statements and should be read in conjunction with them. The adjustments for 2016 and the effects of changes on the consolidated and financial statements are presented in greater detail under 2. e).

Consolidated statement of other comprehensive income of the Mercator Group and statement of other comprehensive income of the company Poslovni sistem Mercator d.d.

in EUR thousand	Note	Mercator Group 2017	Mercator Group 2016	Poslovni sistem Mercator d.d. 2017	Poslovni sistem Mercator d.d. 2016
Net profit/loss for the year		(184,435)	(72,735)	(203,726)	(77,447)
Other comprehensive income:					
Items subsequently not reclassified to profit or loss		**97,751**	**(2,611)**	**75,594**	**(2,370)**
Net gains/losses recognized in revaluation surplus in relation to property, plant and equipment	14	126,464	-	91,695	-
Provisions for termination benefits		(231)	(294)	(191)	(322)
Other changes		(7,741)	(1,109)	68	-
Deferred tax for items subsequently not reclassified to profit or loss	19	(20,742)	(1,208)	(15,978)	(2,047)
Items that may be reclassified subsequently to profit or loss		**7,709**	**(2,452)**	**8**	**75**
Foreign currency translation differences		7,704	(2,047)	-	-
Net gains/losses on available-for-sale financial assets recognized in revaluation surplus		10	(404)	10	-
Gains/losses recognized in revaluation surplus	19	10	(0)	10	-
Transfer of gains/losses from revaluation surplus to profit or loss	25	-	(404)	-	-
Net gains/losses recognized in revaluation surplus in relation to cash flow hedges (successful hedging)		-	-	-	-
Deferred tax for items that may be reclassified subsequently to profit or loss	19	(5)	(0)	(2)	75
Other comprehensive income for the year		**105,460**	**(5,063)**	**75,602**	**(2,295)**
Total comprehensive income for the year		**(78,975)**	**(77,797)**	**(128,124)**	**(79,742)**

Total comprehensive income for the year attributable to:		
Owners of the controlling company	(79,009)	(77,676)
Non-controlling interests	33	(122)

The accompanying notes are an integral part of consolidated and financial statements and should be read in conjunction with them.

Consolidated statement of changes in equity of the Mercator Group

		Mercator Group										
in EUR thousand	Note	Nominal capital	Capital surplus	Own shares	Revenue reserves	Fair value reserve	Retained net profit or loss	Net profit or loss for the period	Currency translation reserve	Equity attributable to the controlling company owners	Non-controlling interests	Total equity
As at January 1, 2016		**254,175**	**286,772**	**(3,235)**	**41,686**	**108,865**	**15,365**	**20,245**	**(89,668)**	**634,204**	**228**	**634,432**
Total comprehensive income for the year												
Net profit/loss for the year		-	-	-	-	-	-	(72,463)	-	(72,463)	(272)	(72,735)
Deffered taxes		-	-	-	-	(2,938)	1,814	-	-	(1,124)	-	(1,124)
Adjustment of income tax		-	-	-	-	-	(84)	-	-	(84)	-	(84)
Transfer of fair value upon sale of property, plant and equipment		-	-	-	-	-	(404)	-	-	(404)	-	(404)
Expenses from previous years - retained earnings		-	-	-	-	-	(263)	-	-	(263)	-	(263)
Foreign exchange differences		-	-	-	-	-	-	-	(2,052)	(2,052)	5	(2,047)
Provisions for termination benefits		-	-	-	-	(539)	245	-	-	(294)	-	(294)
Other changes		-	-	-	-	(846)	(146)	-	-	(992)	145	(846)
Other comprehensive income		**-**	**-**	**-**	**-**	**(4,323)**	**1,162**	**-**	**(2,052)**	**(5,213)**	**150**	**(5,063)**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**(4,323)**	**1,162**	**(72,463)**	**(2,052)**	**(77,676)**	**(122)**	**(77,798)**
Transactions with owners directly recognized in equity												
Contributions by and distributions to owners												
Transfer of net profit for the previous year to retained earnings		-	-	-	-	-	742	-	-	742	-	742
Distribution of profit pursuant to the Management Board decision		-	-	-	-	-	20,245	(20,245)	-	-	-	-
Total transactions with owners		**-**	**-**	**-**	**-**	**-**	**20,987**	**(20,245)**	**-**	**742**	**-**	**742**
Balance as at December 31, 2016		**254,175**	**286,772**	**(3,235)**	**41,686**	**104,541**	**37,514**	**(72,463)**	**(91,720)**	**557,270**	**106**	**557,376**

							Mercator Group						
in EUR thousand	Note	Nominal capital	Capital surplus	Own shares	Revenue reserves	Fair value reserve	Retained net profit or loss	Net profit or loss for the period	Currency translation reserve	Equity attributable to the controlling company owners	Non-controlling interests	Total equity
As at January 1, 2017		**254,175**	**286,772**	**(3,235)**	**41,686**	**104,541**	**37,514**	**(72,463)**	**(91,720)**	**557,270**	**106**	**557,376**
Total comprehensive income for the year												
Net profit/loss for the year		-	-	-	-	-	-	(184,284)	-	(184,284)	(151)	(184,435)
Revaluation of land and buildings		-	-	-	-	126,370	93	-	-	126,464	-	126,464
Change in fair value of available-for-sale financial assets		-	-	-	-	10	-	-	-	10	-	10
Adjustment of income tax		-	-	-	-	(23,018)	2,272	-	-	(20,747)	-	(20,747)
Foreign exchange differences		-	-	-	-	-	-	-	7,691	7,691	13	7,704
Provisions for termination benefits		-	-	-	-	(481)	251	-	-	(231)	-	(231)
Other changes		-	-	-	-	(7,181)	(731)	-	-	(7,912)	171	(7,741)
Other comprehensive income		-	-	-	-	95,700	1,885	-	7,691	105,276	184	105,460
Total comprehensive income for the year		-	-	-	-	95,700	1,885	(184,284)	7,691	(79,009)	33	(78,975)
Transactions with owners directly recognized in equity												
Contributions by and distributions to owners												
Transfer of net profit for the previous year to retained earnings		-	-	-	-	-	(72,463)	72,463	-	-	-	-
Allocation of profit for the year pursuant to the Management Board decision	25	-	(79,249)	-	1,144	(60)	78,165	-	-	-	-	-
Total transactions with owners		-	**(79,249)**	-	**1,144**	**(60)**	**5,702**	**72,463**	-	-	-	-
Balance as at December 31, 2017		**254,175**	**207,523**	**(3,235)**	**42,830**	**200,181**	**45,101**	**(184,284)**	**(84,029)**	**478,261**	**140**	**478,400**

Consolidated statement of changes in equity of the company Poslovni sistem Mercator d.d.

		Poslovni sistem Mercator d.d.							
in EUR thousand	Note	Nominal capital	Capital surplus	Own shares	Revenue reserves	Fair value reserve	Retained net profit or loss	Net profit or loss for the period	Total equity
As at January 1, 2016		**254,175**	**286,772**	**(3,235)**	**16,624**	**79,869**	**620**	**(3,800)**	631,025
Total comprehensive income for the year									
Net profit/loss for the year		-	-	-	-	-	-	(77,447)	(77,447)
Deffered taxes		-	-	-	-	(3,348)	1,376	-	(1,972)
Provisions for termination benefits		-	-	-	-	(324)	2	-	(322)
Other comprehensive income		**-**	**-**	**-**	**-**	**(3,673)**	**1,378**	**-**	**(2,294)**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**(3,673)**	**1,378**	**(77,447)**	**(79,742)**
Transactions with owners directly recognized in equity									
Contributions by and distributions to owners									
Transfer of net profit for the previous year to retained earnings		-	-	-	-	-	(3,800)	3,800	-
Total transactions with owners		**-**	**-**	**-**	**-**	**-**	**(3,800)**	**3,800**	**-**
Balance as at December 31, 2016		**254,175**	**286,772**	**(3,235)**	**16,624**	**76,196**	**(1,802)**	**(77,447)**	**551,283**

in EUR thousand	Note	Nominal capital	Capital surplus	Own shares	Revenue reserves	Fair value reserve	Retained net profit or loss	Net profit or loss for the period	Total equity
					Poslovni sistem Mercator d.d.				
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 year									
Net profit/loss for the year		-	-	-	-	-	-	(203,726)	(203,726)
Revaluation of land and buildings		-	-	-	-	91,695	-	-	91,695
Change in fair value of available-for-sale financial assets		-	-	-	-	10	-	-	10
Adjustment of income tax		-	-	-	-	(18,252)	2,272	-	(15,980)
Provisions for termination benefits		-	-	-	-	(436)	245	-	(191)
Other changes		-	-	-	-	-	68	-	68
Other comprehensive income		**-**	**-**	**-**	**-**	**73,018**	**2,584**	**-**	**75,602**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**73,018**	**2,584**	**(203,726)**	**(128,124)**
Transactions with owners directly recognized in equity									
Contributions by and distributions to owners									
Transfer of net profit for the previous year to retained earnings		-	-	-	-	-	(77,447)	77,447	-
Allocation of reserves for the year pursuant to the Management Board decision	25	-	-	-	-	-	1,802	-	1,802
Coverage of losses pursuant to the Management Board decision		-	(79,249)	-	-	-	77,447	-	(1,802)
Total transactions with owners		**-**	**(79,249)**	**-**	**-**	**-**	**1,802**	**77,447**	**(0)**
Balance as at December 31, 2017		**254,175**	**207,523**	**(3,235)**	**16,624**	**149,214**	**2,584**	**(203,726)**	**423,159**

The accompanying notes are an integral part of consolidated and financial statements and should be read in conjunction with them.

Proposal for allocation of accumulated loss of the company Poslovni sistem Mercator d.d. (category compliant with Companies Act–1)

Identified accumulated loss for 2017 comprises the following[5]:

Proposal on allocation of accumulated profi/loss	Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**
Net profit/loss for the year	(203,726)	(77,447)
Retained net profit or loss	2,585	(1,802)
Accumulated loss for the year	**(201,141)**	**(79,249)**

The Company proposes that the accumulated loss in the amount of EUR 203,726 thousand is covered by the capital surplus in the amount of EUR 201,141 thousand and by the retained profit in the amount of EUR 2,585 thousand.

[5] The Company allocated the accumulated loss in accordance with Article 230 of the Companies Act.

Consolidated cash flow statement of the Mercator Group and cash flow statement of the company Poslovni sistem Mercator d.d.

in EUR thousand	Note	Mercator Group 2017	Mercator Group 2016	Poslovni sistem Mercator d.d. 2017	Poslovni sistem Mercator d.d. 2016
Cash flows from operating activities					
Net profit/loss for the year		**(184,435)**	**(72,735)**	**(203,726)**	**(77,447)**
Adjustments:					
Tax	19	(18,144)	(4,255)	(19,491)	(3,992)
Depreciation and amortization	14, 15, 16	69,846	80,911	32,752	37,282
Impairment of property, plant and equipment, intangible assets and investment property	14,15, 16	147,072	-	98,033	(2,000)
Other impairments of non-financial assets	11	9,575	-	6,259	-
Net impairment of receivables from affiliated companies in the Agrokor Group		-	46,012	-	6,782
Gains or losses on disposal of property, plant and equipment	10,11	(9,967)	(3,708)	(3,805)	-
Gains or losses on disposal of subsidiaries	13	-	3,488	-	-
Dividends received, impairments and disposals of available-for-sale financial assets	13	(824)	(443)	-	(6,886)
Gains or loses on investments in subsidiaries	17	47	-	115,627	69,287
Change in provisions	11	5,740	900	4,833	-
Net financial income (expenses)	13	1,288	1,974	5,585	1,531
Net foreign exchange differences	13	(5,483)	(936)	(52)	(8)
Interest income	13	(824)	(1,558)	(5,402)	(5,491)
Interest expenses	13	35,050	34,590	20,632	20,554
Other changes		933		(1,287)	
		49,874	**84,240**	**49,957**	**39,613**
Change in inventories		9,775	19,813	12,310	8,621
Change in trade and other receivables		15,788	(15,694)	30,006	(5,884)
Change in trade and other payables, and provisions		26,259	43,761	(11,097)	31,556
		101,695	**132,120**	**81,175**	**73,906**
Interest expenses		(29,584)	(34,590)	(16,417)	(20,554)
Tax paid	19	(1,876)	94	-	-
Cash from operating activities		**70,235**	**97,624**	**64,759**	**53,351**
Cash flows from investing activities					
Acquisition of subsidiaries and business operations, net of cash acquired, recapitalization of companies		-	-	(35,620)	(2,000)
Acquisition of property, plant and equipment, investment property and intangible assets	14, 15, 16	(70,904)	(90,438)	(20,383)	(56,612)
Acquisition of available-for-sale financial assets	18	(70)	(5)	(37)	-
Proceeds from disposal of subsidiaries, net of cash disposals		-	16,510	-	16,510
Proceeds from sale of property, plant and equipment, investment property and intangible assets		19,331	18,600	14,948	11,818
Proceeds from sale of available-for-sale financial assets	18	-	149	-	149
Interest income	13	824	1,558	5,402	5,491
Dividends received	13	8	12	290	2,282
Loans and deposits repayments received	23	10,515	7,413	(199)	(8,536)
Cash flow from investing activities		**(40,295)**	**(46,201)**	**(35,598)**	**(30,898)**
Cash flows from financing activities					
Repayment of long-term loans received		(67,069)	(44,686)	(58,910)	(209,171)
Long-term loans received		34,570	611	28,041	190,015
Dividends paid		-	-	-	-
Cash from financing activities		**(32,499)**	**(44,075)**	**(30,869)**	**(19,156)**
Net increase/decrease in cash and cash equivalents		**(2,560)**	**7,348**	**(1,708)**	**3,297**
Cash and cash equivalents at beginning of the year		26,318	18,998	13,344	10,046
Effect of exchange rate fluctuations on cash and cash equivalents		354	(28)	-	-
Cash and cash equivalents at end of the year	24	**24,112**	**26,318**	**11,635**	**13,343**

The accompanying notes are an integral part of consolidated and financial statements and should be read in conjunction with them.

Notes to consolidated financial statements of the Mercator Group and financial statements of the company Poslovni sistem Mercator d.d.

1. REPORTING COMPANY

Poslovni sistem Mercator, d.d. (**hereinafter referred to as the Company**), is a company headquartered in Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. The company Mercator, d. d. is the controlling company of a group of associated companies in Slovenia, Serbia, Croatia, Bosnia and Herzegovina, Montenegro and Macedonia. The role of the Company is two-fold: its activities mainly comprise trading activities at the Company level and various corporate governance tasks for the companies in the Mercator Group (**hereinafter referred to as the Group**). The consolidated financial statements of the Mercator Group as at and for year ended December 31, 2017 comprise the company Mercator, d.d., and its subsidiaries. The company Mercator, d.d., is a subsidiary of the company Agrokor, d.d., therefore, the Mercator Group is consolidated within the Agrokor Group. The consolidated financial statements of the Agrokor Group are available at the registered office of Agrokor, d.d., Trg Dražena Petrovića 3, Zagreb, Croatia. Mercator Group's core and predominant activity is retail and wholesale of fast-moving consumer goods and home products.

2. BASIS FOR PREPARATION

a) Statement of compliance

Consolidated financial statements of the Group and the Company have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU, and in compliance with the provisions of the Slovenian Companies Act.

The management of the company approved the financial statements on April 20, 2018

b) Basis of measurement

Consolidated financial statements of the Group and the Company have been prepared on the historical cost basis, except for the items listed below:

- available-for-sale financial assets, which are measured at fair value;
- land and building, which are measured using the revaluation model.

Methods used for fair value measurement are described in Note 5.

c) Functional and presentation currency

The consolidated financial statements of the Group and the Company attached herewith are presented in EUR, i.e. in the functional currency of the Company. All financial information figures presented in EUR are rounded to one thousand units.

d) Use of estimates and judgments

Preparation of financial statements in compliance with the IFRS requires the company management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

The estimates and assumptions are reviewed regularly. Adjustments of accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information on significant assessments regarding uncertainty and critical judgments, which were prepared by the management in the process of accounting policies execution and which affect the amounts in the financial statement the most, is given below.

i. Goodwill

Upon acquisition, goodwill is allocated to groups of cash-generating units represented by clusters of comparable entities, such as Mercator centers, hypermarkets, supermarkets, and smaller units. Recoverable amount of a cash-generating unit is specified based on the calculations of value in use or fair value less the selling costs. Calculations include projections of cash flows based on the business plans adopted by the Management Board for the following year and on the expected operating results in the coming medium-term period, based on the assumptions and policies specified in the medium-term business plan for each company and therefore the Group as a whole. The Management Board has prepared projections based on the historical business performance) and expectations with regard to the future development of the Company and thr market environment. The discount rate applied is based on market rates adjusted to reflect the specific risks related to the business units.

ii. Property, plant and equipment

The Group and the Company measure land and buildings using the revaluation model and equipment using the cost model as described in section 3(f)(i). The estimated useful life of property, plant and equipment is disclosed in section 3(f)(iv).

iii. Accounting for borrowing costs

In respect of borrowing costs relating to qualifying assets, the Group and the Company, pursuant to IAS 23 Borrowing Costs (2007), capitalize borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Capitalization of interest expense is performed for major investments whose construction and preparation for use lasts more than 6 months. In 2017, no investment meets the above criteria for capitalization of borrowing expenses.

iv. Available-for-sale financial assets

Long-term financial investments of the Group and the Company into equity of other companies, classified as available-for-sale financial assets, also include such assets that could not be appraised at fair value. Shares of these companies are not listed on the stock exchange. Fair values of these assets cannot be reliably measured; therefore, they are valued at historical cost less impairment loss.

v. Trade and other receivables

Allowances for receivables are based on pending legal proceedings and experience from previous periods. The estimate is based on the assumption that receivables will be paid in the amount recognized.

Receivables with quality collateral are excluded from the allowance calculation. Adjustments of short-term trade receivables and receivables from Pika card transactions are created according to the age of receivables and the possibility of their repayment (individually). Thus, the value of short-term trade receivables and relevant default interest is adjusted by 50%, if the receivable is overdue by 61 to 74 days; 75%, if the receivable is overdue by 75 to 89 days; and by 100%, if the receivable is overdue by 90 days or more. Short-term receivables from Pika card holders are adjusted by 100% if the receivables are overdue by 90 days or more.

Disputed receivables (lawsuit, bankruptcy, compulsory composition) are adjusted by 100%.
Adjustments to other receivables are created individually.

vi. Inventories

Carrying amounts of inventories do not materially exceed their realizable value. Value adjustments of inventories are based on previous years' experience:

- inventories acquired a year before the current year are adjusted by 50% of their cost;
- inventories acquired two years or more before the current year are adjusted by 80% of their cost.

In the future, the Group and the Company do not expect any events that would significantly influence the accounting estimates.

vii. Provisions

Carrying amounts of provisions are measured as the present value of the expenditures expected to be required for the settlement of liabilities. Estimates are given by experts, or the values are based on original documentation. The outcome and the date of resolution of legal proceedings, which were the basis for recognition of provisions, are uncertain.

Provisions for termination benefits and long-service awards refer to estimated payments of termination benefits upon retirement and jubilee benefits as a result of long service, as at the balance sheet date, discounted to present value. They are recognized on the basis of actuarial calculation, approved by the parent company's Management Board. Actuarial calculation is based on the assumptions and estimates applicable at the time of the calculation, which may differ in the future from the actual assumptions at the time due to changes. This refers mostly to determining discount rate and estimating staff turnover, mortality and salary growth. Due to the actuarial calculation complexity and long-term features of items, the liabilities for post-employment benefits are susceptible to changes in the mentioned estimates.

In the future, the Group and the Company do not expect any events that would significantly influence the accounting estimates.

viii. Deffered taxes

Deferred taxes are calculated based on temporary differences applying the balance sheet liability method, using the tax rate applicable in the next financial period. If the tax rate changes, deferred tax assets and liabilities will change accordingly.

The Mercator Groups and the Mercator Company recognize deferred tax assets for the carry forward of unused tax losses and unused tax credit only in cases when it is likely that future taxable income will be available against which the unused tax losses and unused tax credits can be charged. The basis for estimate is the medium-term business plan of the Mercator Group and Company.

In the future, the Group and the Company do not expect any events that would significantly influence the accounting estimates.

e) Changes in accounting estimates and accounting policies

i. Change in accounting estimate

In 2017, the Group and the Company changed the estimated useful life of buildings and long-term intangible assets. The change was introduced with the aim of unifying useful life of grups of assets. On buildings, the Group and the Company assessed their useful life for 40 years and for intangible long-term assets to 10 years. The change is also consistent with tax recognized depreciation rates.

The impact of the change at the Group due to the changed estimated useful life is EUR 4,760 thousand and at the Company EUR 4,200 thousand.

ii. Changes in accounting policy and disclosures in the financial statements

In 2017, the Group and the Company changed the accounting policy of interest that mature on the final maturity of loans (PIK interest) and transferred them from long-term trade and other payables to long-term financial liabilities.

In 2017 and for the comparable period, the Group and the Company show consignment by using the net method and have changed the accounting policy of managing the consignment from using the gross method as in the previous period.

In the year 2017, the Group and the Company changed the accounting policies for recognizing variable considerations, which until then were part of the revenues,. With the change in accounting policy, they reduce the purchase value of the goods sold accordingly.

The reason for the changes is a more accurate presentation of business performance indicators in the trade industry and is in line with best practices in the European Union market, and therefore gives users of financial statements more comparable information.

Impact of changes in accounting policy on the statement of financial position and profit or loss of the Group and the Company in 2016

Statement of financial position

	Mercator Group			
In EUR thousand	2016 without changes	Effect of change in accounting treatment of PIK interest	Total adjustments	2016 after changes
LIABILITIES				
Non-current liabilities				
Trade and other payables	45,183	(31,421)	(31,421)	13,762
Loans received and other financial liabilities	738,354	31,421	31,421	769,775
Deferred tax liabilities	31,356	-	-	31,356
Provisions	26,818	-	-	26,818
	841,710	-	-	841,710

	Poslovni sistem Mercator d.d.			
In EUR thousand	2016 without changes	Effect of change in accounting treatment of PIK interest	Total adjustments	2016 after changes
LIABILITIES				
Non-current liabilities				
Trade and other payables	27,198	(24,646)	(24,646)	2,552
Loans received and other financial liabilities	508,047	24,646	24,646	532,693
Deferred tax liabilities	25,229	-	-	25,229
Provisions	23,041	-	-	23,041
	583,514	-	-	583,514

Income statement

In EUR thousand	Mercator Group				
	2016 without changes	Effect of change in accounting treatment of consignment	Effect of changes in accounting treatment of variable considerations	Total adjustments	2016 after changes
Sales revenue	2,374,538	(77,114)	(97,836)	(174,950)	**2,199,588**
Cost of goods sold and selling costs	(2,372,026)	77,114	97,836	174,950	**(2,197,076)**
Administrative expenses	(81,102)	-	-	-	**(81,102)**
Impairment of property, plant and equipment and intangible assets	-	-	-	-	**-**
Other operating revenue	32,582	-	-	-	**32,582**
Results from operating activities	**(46,008)**	**-**	**-**	**-**	**(46,008)**

In EUR thousand	Poslovni sistem Mercator d.d.				
	2016 without changes	Effect of change in accounting treatment of consignment	Effect of changes in accounting treatment of variable considerations	Total adjustments	2016 after changes
Sales revenue	1,321,092	(77,114)	(34,026)	(111,140)	**1,209,952**
Cost of goods sold and selling costs	(1,293,513)	77,114	34,026	111,140	**(1,182,373)**
Administrative expenses	(39,539)			-	**(39,539)**
Impairment of property, plant and equipment and intangible assets	-			-	**-**
Other operating revenue	8,242			-	**8,242**
Results from operating activities	**(3,718)**	**-**	**-**	**-**	**(3,718)**

In 2017, the Group and the Company also changed the real estate valuation policy described under 3. f).

3. Relevant accounting policies

The accounting policies defined below have been applied consistently to all periods presented in these consolidated financial statements for all Group and Company entities.

a) Basis of consolidation

i. Business combinations

Business combinations are accounted for based on the acquisition method as at the day of the combination, which equals the day of acquisition or when the Group gains control. Control is the power to make decisions on financial and business policies of a company or a business entity in order to gain benefits from its activities. In order to assess its control, the Group takes into account the criteria of currently exercisable potential voting rights.

With regard to acquisitions, the Group measures or evaluates the goodwill as at the day of acquisition, as follows:

- at fair value of the transferred acquisition price; plus

- recognized value of any non-controlling interest in the acquired company (The non-controlling interest can be initially measured either at fair value or at proportional share in acquired assets and liabilities valuated as at the date of acquisition. The Group decides on the method upon each acquisition); plus
- fair value of existing shares in equity of the acquired company, if the business combination is carried out gradually; less
- net recognized value (fair value, unless IFRS requires differently) of acquired assets and liabilities as at the day of the acquisition.

If the difference is negative, it is recognized as surplus (income) in the income statement.

The transferred acquisition proceeds do not include amounts of settlements regarding previously existing relations. These amounts are normally recognized in the income statement.
Acquisition costs, except for costs related to issue of equity or debt instruments related to the business combination, are recognized in the income statement as they are incurred.

Contingent liabilities regarding business combinations are recognized at fair value as at the day of acquisition. If a contingent liability is classified in equity it does not have to be remeasured; the payment is recognized within equity. Subsequent changes in the fair value of contingent liability are recognized in the income statement.

ii. Subsidiaries

Subsidiaries are companies controlled by the Group. Controlling exists when the Group is able to decide on financial and business policies of a company in order to obtain benefits from its operations. In assessing control, existence and effect of potential voting rights that are currently exercisable or exchangeable are taken into account. Financial statements of subsidiaries are included in consolidated financial statements from the date when the controlling begins to the date when it stops. The accounting policies of subsidiaries have been changed if necessary or aligned with the policies adopted by the Group.

iii. Acquisition of non-controlling interests

Acquisitions of non-controlling interests are accounted for as transactions of shareholders who operate as owners; therefore, goodwill is not recognized. Changes in non-controlling interest arising from transactions that do not include loss of control are based on proportionate share of net assets of the subsidiary or on fair value of the non-controlling interest. If the purchase price for acquisition of non-controlling interest differs from its carrying amount, the difference is recognized in equity.

iv. Loss of control

After loss of control, the Group derecognizes assets and liabilities of the subsidiary, non-controlling interest, and derecognizes other components of equity that pertain to the subsidiary. Any surplus or deficit resulting from loss of control is recognized in the income statement. If the Group retains a share in the previously controlled subsidiary, such share is valued at fair value as at the day of loss of control and the difference is recognized in the income statement. Subsequently, such share is recognized in equity as investment in an associate (at equity method) or as available-for-sale financial asset, depending on the extent of retained influence.

v. Transactions excluded from consolidation

Balances, revenues and expenses, gains and losses arising from intra-group transactions are eliminated from consolidated financial statements. Unrealised losses are excluded in the same way as profits, provided that there is no evidence of impairment.

b) Foreign currency

i. Foreign currency transactions

Transactions expressed in a foreign currency are translated into the relevant functional currency of the Group companies at the exchange rate applicable on the date of transaction. Cash and liabilities denominated in a foreign currency as at the balance sheet date are converted into functional currency at the exchange rate applicable at the date. Positive or negative foreign exchange differences are differences between amortized cost in the functional currency at the beginning of the period, which is adjusted by the amount of effective interest and payments during the period, as well as amortized cost in foreign currency converted at the exchange rate at the end of the period. Non-cash assets and liabilities expressed in a foreign currency and measured at fair value are converted into the functional currency at the exchange rate on the date when the amount of fair value is determined. Currency translation differences are recognized in the income statement, except for differences arising on recalculation of equity instruments classified as available-for-sale financial assets (except for the case of impairment when all currency translation differences recognized in other comprehensive income are re-classified to the income statement), for non-financial liabilities designated as hedges (if such hedges are effective), or for cash flow hedges (if such hedges are effective), which are recognized directly in equity.

ii. Foreign operations

Assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated to euro at exchange rates effective as at the balance sheet date. Revenue and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated to euro at average exchange rates in the period.

Foreign exchange differences arising from translation are recognized directly in other comprehensive income and are recognized in translation reserve within equity. From the day of transition to the IFRS, these changes are recognized in the translation reserve. Upon a partial or full disposal of a foreign operation, the relevant amount in the foreign currency translation reserve (FCTR) is transferred to the income statement.

In case of a subsidiary that is not fully owned, a pro rata share of currency translation reserve is allocated to non-controlling interest. When a company abroad (foreign operation) is disposed of in a way that it is no longer controlled and that significant influence or joint control no longer exists, corresponding accrued amount in the currency translation reserve is transferred to profit or loss, or re-classified as revenue or expense resulting from disposal. If the Group only disposes of a part of its stake in a subsidiary that includes a foreign company, and still maintains control, the appropriate pro rata share of accumulated amount is reclassified to non-controlling interest.

c) Financial instruments

i. Non-derivative financial instruments

Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables and loans given.

Initially, the Group and the Company recognize loans and receivables and deposits on the day of their occurrence. Other financial assets (including assets designated at fair value through profit or loss) are initially recognized on the exchange date or when the Group and the Company become parties under contractual provisions of the instrument.

The Group and the Company derecognize financial assets when contractual rights to cash flows from this asset are discontinued or when the rights to contractual cash flows from the financial asset are transferred on the basis of a transaction in which all risks and benefits from the ownership of the financial asset are transferred. Any share in the transferred financial asset that is created or transferred by the Group and the Company is recognized as individual asset or liability.

Financial assets and liabilities are offset and the net amount is disclosed in the balance sheet if and only if the Group and the Company have legal right to settle the net amount or to realize the asset and at the same time settle its liability.

Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. At initial recognition, loans and receivables are disclosed at fair value increased by direct costs of transaction. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method, decreased by loss due to impairment. Loans and receivables include cash and cash equivalents, loans to other companies and bank deposits, trade and other receivables, and long-term deposits for rent payment. Long-term deposits for rent payment are considered in terms of content (financing lessors) and represent long-term financial receivables. They are discounted with market or contractual discount rates. Discount rate represents the basis for accounting of financial revenues in the entire period for which the rent was paid.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified into the above categories. Available-for-sale financial assets include investments into shares and interests in companies. After the initial recognition, these investments are measured at fair value, increased by the transaction cost, also taking into account the changes in fair value. Impairment losses and foreign exchange differences on available-for-sale equity instruments are recognized in other comprehensive income and disclosed in equity or in fair value reserve. At derecognition of investment, cumulative gains and losses are transferred to profit or loss. Available-for-sale financial assets also include equity securities.

ii. Non-derivative financial liabilities

Initially, the Group and the Company recognize issued debt securities and subordinate debt as at the date of their occurrence. All other financial liabilities are initially recognized on the trade date when the Group and the Company become contractual parties in relation to the instrument.

The Group and the Company derecognize financial liabilities in case the obligations stipulated in the contract have been fulfilled, annulled or time-barred.

Financial assets and liabilities are offset and the amount is recognized in the balance sheet if and only if the Group and the Company have the official enforceable right to offset recognized amounts and intends to pay net amount or it is legally entitled to offset amounts and has the intention to pay net amount or realize the asset and at the same time settle its liability.

The Group and the Company recognize non-derivative financial instruments as other financial liabilities. Such financial liabilities are initially carried at fair value increased by the costs that are directly attributable to the transaction. After the initial recognition, financial liabilities are measured at amortized cost using the effective interest method.

Other financial liabilities comprise loans and trade and other payables.

d) Cash and cash equivalents

Cash and cash equivalents comprise cash on transaction accounts, cash on hand and deposits with maturity of up to 3 months.

e) Share capital

Ordinary shares

Ordinary shares are an integral part of share capital. Additional costs directly attributable to issuing of ordinary shares and share options are disclosed as decrease in equity, net of effects on the equity.

Repurchase of own shares (treasury shares)

When share capital recognized as equity is repurchased, the amount of consideration paid, which includes directly attributable costs and excludes any tax effects, is recognized as a change in equity. Repurchased shares are classified as treasury shares and are deducted from equity. When treasury shares are sold or reissued subsequently, the amount received is recognized as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to share premium.

f) Property, plant and equipment

i. Reporting and measurement

Equipment is measured using the cost model. Equipment is carried at cost less accumulated depreciation and any accumulated impairment losses.

The cost includes costs that are directly attributable to the acquisition of assets. Borrowing cost regarding acquisition or construction of relevant property, plant, or equipment are capitalized if they are related to the acquisition of a major asset and if construction or preparation for use lasts over 6 months. In 2017, the Group and the Company did not carry out any investments that would meet the described criteria. Costs of property, plant and equipment manufactured within the Group include the costs of material, direct labor costs, and other costs that can be directly attributable to the asset's preparation for its intended use, costs of decomposition and removal of property, plant and equipment and reconstruction of the site where the item of assets was located, as well as capitalized borrowing costs.

Gains and losses on disposal of an item of property and plant (except equipment) are determined by comparing the proceeds from disposal of an item of property and plant with the net value recognized in other income/expenses in the income statement. When revalued assets are sold or depreciated, an appropriate amount included in the fair value reserve is transferred to retained earnings.

For valuation of land, the Group and the Company use the revaluation model. As at December 31, 2017 the Group and the Company changed their accounting policy of valuation of buildings from cost meodel to revaluation model. The fair values reported are based on periodical, but not less than three-year appraisals by an external independent appraiser. Fair value of buildings and land is estimated in compliance with the International Valuation Standards (IVS 2013) and Slovenian business and financial standard No. 2: Valuation/appraisal of real estate (OG RS, no. 106/13, December 18, 2013). To appraise the market value, the possibilities and suitability of all three methods are always examined considering the use of property and availability of information. These three methods are income method (discounted cash flow method), comparable sales (method of direct comparability of sales or transactions), and historical cost (the cost method). If the carrying amount of the asset is increased due to revaluation, the increase must be recognized directly in equity as revaluation surplus. The increase must be recognized in profit or loss (income statement), if it eliminates a revaluation decrease of the same asset, which had previously been recognized in profit or loss. If the carrying amount of assets is decreased as a result of revaluation, then the decrease must be recognized in profit or loss. Decrease is charged directly to equity under the revaluation surplus item, up to the amount of credit in the revaluation surplus for the same asset. When an asset is disposed of the fair value reserve for such asset is transferred directly to retained earnings.

a) Estimation of property fair value

In line with the Accounting Rules, the Group and the Company periodically, at least every three years, review the fair value of its land. The appraisal was last carried out as at the end of 2017 by a certified appraiser pursuant to the International Valuation Standards and in relation to the International Financial Reporting Standards.

b) Assessment of useful lives of property and equipment

In the Group the Company, fixed assets are depreciated by the straight line depreciation method, using the depreciation rates that reflect estimated useful lives of different assets in each company of the Mercator Group. Useful life and remaining value of property, plant and equipment is appraised annually by an internal committee of experts or external independent certified appraisers based on events that indicate the need for revaluation of a particular asset.

ii. Reclassification to investment property

The Group and the Company may reclassify property used by the owner to investment property. Investment property is appraised using the revaluation model. Only independent buildings entirely rented out are classified as investment property. If only a part of a building is leased, it is not classified as investment property, as it cannot be sold separately, and because the other important part of the building is being used for performance of in-house service activity or production of goods.

iii. Subsequent costs

The cost of replacing a part of a piece of property, plant and equipment is recognized in the carrying amount of the asset if it is likely that future economic benefits relating to a part of that asset will flow to the Group and the Company and its fair value can be measured reliably. The carrying amount of the replaced part is derecognized. All other costs (e.g. regular maintenance) are recognized in profit or loss as expenses, as soon as they are incurred.

iv. Depreciation

Depreciation is calculated on a straight-line basis, taking into account the useful life of each individual asset of property, plant and equipment. Leased assets in the form of finance lease are depreciated by taking into account the lease term and their useful lives, unless it is reasonably certain that the Group and the Company will obtain ownership by the end of the lease term. Land is not subject to depreciation.

The estimated useful lives for current and comparable periods are as follows:

	2017	2016
Buildings	40 years	20-50 years
Plant and equipment	2-18 years	2-18 years

Useful lives and residual values are again reviewed on the reporting date.

g) Intangible assets

i. Goodwill

Goodwill generated upon acquisition of subsidiaries or activities is recognized under intangible assets.

Other intangible assets
Other intangible assets acquired by the Group and the Company and with limited useful lives are measured at cost, less accumulated amortization and accumulated impairment losses.

ii. Subsequent costs

Subsequent costs in relation to intangible assets are capitalized only in cases when they increase future economic benefits arising from the asset to which the costs relate. All other costs, including internally generated brands, are recognized in profit or loss as expenses as soon as they are incurred.

iii. Amortization

Amortization is calculated on a straight-line basis, taking into account useful lives of intangible assets. Amortization begins when an asset is available for use. The estimated useful lives for current and comparable periods are as follows:

	2017	2016
Brands/labels	unlimited	unlimited
Software and licenses	10 years	5-10 years

Value of brands/labels is tested for impairment annually on the balance sheet date.

h) Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services, or for administrative purposes.

Only independent buildings entirely rented out are classified as investment property. If only a part of a building is leased, it is not classified as investment property, as it cannot be sold separately, and because the other important part of the facility is being for performance of in-house service activity or production of goods (e.g. a hypermarket in a shopping center). Investment property is measured using the revaluation model according to IAS 40.

When the use of property changes so that it has to be reclassified under property, plant and equipment, the reclassification is carried out based on its fair value.

i) Leased assets

Leases for which the Group and the Company assume all substantial risks and benefits of ownership are classified as finance leases. Upon initial recognition, the leased asset is posted in the amount equal to the lower of either fair value or the present value of the sum of minimum lease payments. Subsequently, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other leases are considered operating leases. Assets in operating lease are not posted in the balance sheet of the Group and the Company.

j) Assets held for sale or disposal group

Assets held for sale or disposal group, which includes assets and liabilities the largest share of which is expected to be repaid through sale, are classified as held for sale. Right before the classification under assets held for sale, these assets or disposal group are remeasured. Accordingly, a long-term asset or disposal group is recognized at the lower of carrying amount or fair value less costs to sell. Impairment loss upon reclassification of assets as held for sale and subsequent loss or gain upon remeasurement are disclosed in profit or loss. Gains are not recognized if in excess of the cumulative impairment loss. When intangible assets and property, plant and equipment are reclassified under held for sale or distribution, they are no longer amortized/depreciated.

k) Inventories

Inventories are carried at the lower of historical cost and net realisable value.

Methods of accounting for the cost of inventories and related expenses:

- FIFO method for merchandise,
- method of weighted average purchase prices for raw materials and packaging; cost of inventory includes purchase value, cost of production, transformation, and other costs incurred in bringing them to the current location and in the current condition; with both finished products and work in progress, the costs also include the relevant part of indirect production cost upon normal use of means of production.

Net realizable value is equal to the estimated selling price in the ordinary course of business, less the estimated costs of completion and sales. The estimation of net realizable value of inventory is conducted at least once a year, upon the preparation of the Group’s and the Company's annual financial statements.

Write-offs and partial write-offs of damaged, expired and useless inventories are regularly performed during the year on specific items. At the end of the year, inventories are impaired as at December 31 by groups of related or connected items depending on their age or obsolescence. They are impaired on the basis of previous years' experience.

l) Impairment of assets

i. Non-derivative financial instruments

For each financial asset that is not recognized at its fair value through profit or loss, an assessment is made on the reporting date to determine whether there is objective evidence of impairment of the asset. Financial asset is deemed impaired if there is objective evidence indicating that after the initial recognition of the asset, there was, due to one or a number of events, a decrease of expected future cash flows from this asset which can be reliably measured.

Objective evidence of financial assets impairment (including equity securities) can be the following: non-fulfilment or breach by a debtor; restructuring of an amount owed to the Group and the Company subject to the Group's and the Company's consent; indications of bankruptcy of a debtor; deteriorated solvency of borrowers or securities issuers in the Group and the Company and economic conditions that correlate with the disappearance of an active market for such security. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost can also be an objective evidence of impairment. The Group's and the Company's equity securities are impaired if the stock market price of a security is continuously below its acquisition price for at least 6 months, or if the stock market price of the investment is more than 20% lower than its acquisition price.

Loans and receivables

The Group and the Company assess the evidence of impairment for loans and receivables at individual and collective (grouped) level. All significant receivables are individually measured for specific impairment. All individual significant loans and receivables found not to be specifically impaired are collectively assessed for any impairment that has been incurred, but has not yet been identified. Loans and receivables that are not individually significant are collectively assessed for impairment by grouping together loans and receivables with similar risk characteristics, except for receivables with quality insurance.

In assessing collective impairment, the Group and the Company use historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether actual losses arising from current economic and credit conditions can be greater or smaller than suggested by historical trends.

Impairment loss in connection with the financial asset carried at amortized cost is calculated as the difference between the carrying amount of that asset and expected future cash flows, including the expected future cash flow from insurance, discounted at historical effective interest rate. Losses are recognized in profit or loss and disclosed in the account of allowance for loans and receivables. Interest on the impaired asset thus continues to be recognized. When subsequent events (e.g. repayment by a debtor) cause the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Available-for-sale financial assets

Impairment losses on available-for-sale financial assets are recognized by transferring the loss disclosed in the fair value reserve to profit or loss. The amount of accumulated loss that is reclassified from equity to profit or loss is the difference between the cost and the current fair value, less any impairment loss recognized previously in profit or loss.

Impairment loss recognized in the income statement for an investment in an equity instrument classified as available-for-sale cannot be reversed trough profit or loss. Subsequent recovery in fair value of impaired available-for-sale equity security is recognized in the other comprehensive income for the period.

ii. Non-financial assets

On each reporting date, the Group and the Company review the residual carrying amount of their non-financial assets, inventories and deferred tax assets in order to establish the existence of any signs of impairment. If such signs exist, the recoverable amount of the asset is estimated. Impairment of goodwill and intangible assets that have indefinite useful lives and are not yet available for use is estimated on each reporting date. Impairment of a cash-generating unit is recognized when its carrying amount exceeds its recoverable amount.

The recoverable amount of an asset or cash-generating unit is the higher of the two: value in use or fair value less costs of sale. When determining the value of an asset in use, the expected future cash flows are discounted to their current value by using the discount rate before tax that reflects regular market assessments of the time value of money and risks that typically occur in relation to the asset. For the purpose of impairment test, the assets that cannot be individually tested are classified in the smallest possible group of assets that generate cash flows from further use and are mostly independent from receipts of other assets and groups of assets (cash-generating unit). For the purpose of goodwill impairment test, the cash-generating units (CGUs) that goodwill is allocated to, are subject to a special testing (i.e. segment ceiling test); CGUs to which goodwill has been allocated are aggregated, so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to cash-generating units or groups of units that are expected to benefit from synergies of the combination.

The corporate assets of the Group and the Company do not generate separate cash inflows and are used by more than one CGU. The assets of the Group and the Company are reasonably and consistently allocated to individual CGUs. Their impairment is tested within the scope of testing for impairment of those CGUs to which a relevant Group asset is allocated.

Impairment is disclosed in the income statement. Impairment loss recognized in respect of cash-generating units is allocated first to reduce the carrying amount of the goodwill allocated to the unit (or group of units), and then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).

Impairment loss in respect of goodwill is not reversed. In relation to other assets, the Group and the Company evaluate and determine impairment losses in the previous periods at the end of reporting period and establishes whether the loss has decreased or no longer exists. Loss due to impairment is reversed in case there has been a change in assessments, on the basis of which the Group and the Company define the recoverable amount of the asset. The impairment loss is reversed to the amount up to which the asset’s increased carrying amount does not exceed the carrying amount that would have been determined net of depreciation had no impairment loss been recognised for the asset in prior periods.

m) Employee benefits

i. Other long-term employee benefits – provisions for termination benefits and long-service awards

In the balance sheet, the Group and the Company recognized provisions deriving from future liabilities to employees for long-service awards, calculated in compliance with the collective labor agreement for this industry, and the mandatory retirement benefits as stipulated by the relevant act. There are no other existing pension liabilities. Provisions are created in the amount of estimated payment of termination benefits and long-service awards, discounted as at the reporting date, for the employees in those countries where such payments are required by the local legislation. The calculation is based on the cost of termination pay upon retirement and of all long-service awards expected to be paid until retirement. Provisions are made using the projected unit credit method. Labor costs and interest expense are recognized in the income statement, while recalculated post-employment benefits or unrealized actuarial gains or losses are recognized in other comprehensive income.

ii. Termination benefits

Termination benefits are recognized as an expense when the Group and the Company are demonstrably committed to either terminate employment before the normal retirement date, or to offer payment of termination benefits to encourage voluntary redundancy, namely, as the result of an existing detailed formal plan for employment termination, and when the Group and the Company do not have a realistic possibility of withdrawal. Termination benefits for voluntary redundancies are recognized as an expense if the Group and the Company have made an offer that would promote voluntary redundancy, if it is probable that the offer will be accepted and if the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting date, the Group and the Company discount them to their present value.

iii. Short-term employee benefits

Liabilities for short-term employee benefits are measured without discounting and are recorded under expenses when the work of an employee related to a certain short-term benefit is performed.

A liability is recognized in the amount expected to be paid as short-term receipts payable within 12 months after the expiry period for the service provided, or as profit split program if the Group and the Company have a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

n) Provisions

A provision is recognized when the Group and the have has legal or constructive obligations as a result of a past event that may be reliably measured and when it is probable that an outflow of economic benefits will be required to settle the liability. The Group and the Company determine provisions by discounting the expected future cash flows at a pre-tax discount rate reflecting the existing estimates of the time value of cash and, if needed, the risks specific to a liability.

o) Revenue

i. Revenue from sales of goods, products and materials

Revenue from sales of goods, products and material is recognized at fair value of the received repayment or a relevant receivable, decreased by repayments, rebates for further sale and quantity discounts. Revenue is recognized when all relevant risks and benefits from ownership of assets have been transferred to the buyer, when certainty of recovery of consideration, the associated costs and possibility of return of goods, products and material, exist, when the Group and the Company stop with further decision-making on quantities sold and when the amount of revenue can be measured reliably.

Transfer of risks and benefits depends on separate provisions of the purchase contract. In case of wholesale, transfer is usually carried out when the goods have been delivered to the buyer's warehouse, but in the event of some international deliveries transfer is carried out when the goods have been loaded on a means of transport.

ii. Customer loyalty program

The Group and the Company issue credit and debit cards Pika to its customers for collecting bonus points at purchases. Bonus periods last six months. The first annual bonus period lasts from February 1 to July 31, the second bonus period from August 1 to January 31 of the following year. During the bonus period, customers collect bonus points. Depending on the amount of purchases and consequently the number of collected points, they can earn a 2 to 6-percent discount. During the year, the Group and the Company allocate potential discounts on the basis of collected points, whereas revenue from unrealized bonus points is allocated based on experience from previous bonus periods. Despite the fact that the second bonus period ends on January 31 of the following year, the Group and the Company in this way ensure that recorded revenues match expenditures that were necessary for their realization.

iii. Revenue from services rendered

Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the reporting date. The stage of completion is estimated by the review of the work carried out.

iv. Rental income

Rental income is recognized in profit or loss on a straight-line basis over the lease term. Any related discounts and benefits are recognized as an integral part of total rental income.

p) Government grants

Initially, all government grants are recognized as deferred revenue in the financial statements where an acceptable assurance exists that the Group and the Company will receive the grants and fulfil the conditions relating to them. Government grants for covering costs are recognized consistently as revenue in the periods when the relevant costs are incurred. Government grants related to assets are disclosed in the income statement consistently, under other operating revenue during the useful life of an individual asset.

q) Leases

Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Any related discounts and benefits received are recognized as an integral part of total lease expense.

Interest paid for finance lease is recognized under finance expenses and allocated to periods of the lease term, in order to achieve a constant interest rate on the remaining balance of the liability in each period.

<u>Determining whether an arrangement includes a lease</u>
At inception of an arrangement, the Group and the Company determine whether the arrangement represents or includes a lease. The arrangement is deemed to include a lease if the following criteria are met:

- a specific asset is the subject of a lease if the fulfilment of the arrangement depends on the use of that specified asset; and
- the arrangement transfers the right to use the asset.

At inception or reassessment of the arrangement, the Group and the Company separate payments and other consideration required by such arrangement to lease payments and to other elements, based on their relative fair values. If the Group and the Company conclude that payments cannot be divided reliably, the asset and liability from finance lease are recognized at an amount equal to the fair value of the asset defined as the lease subject. Subsequently, the liability is reduced as payments are made and an imputed finance charge on the liability is recognized by using the Group's and the Company's incremental borrowing rate of interest.

r) Finance income and expenses

Finance income comprises interest on investments (including available-for-sale financial assets), dividend income, gains on the disposal of available-for-sale financial assets, gains on revaluation of fair value of interest in an acquired company that the Group and the Company had held in the acquired company before the acquisition, and gains on hedging instruments that are recognized in the income statement. Interest income is recognized as it arises, using the effective interest method. Dividend income is recognized in the income statement as at the day when the shareholder's right to payment is exercised; for companies listed on the stock market, this is, as a rule, the day when the right to current dividend ceases to be related to the share.

Finance expenses comprise costs of borrowings, unwinding of the discount on provisions and contingencies, losses from disposal and impairment of available-for-sale financial assets, dividend on preferred shares reported in liabilities, and reclassification of amounts previously recognized as other comprehensive income. Borrowing costs that do not pertain directly to acquisition, construction, or production of an asset under construction are recognized in the income statement using the effective interest method.

Gains and losses from translation between currencies are recognized at net value as finance income or expenses.

s) Corporate income tax

Corporate income tax on income or loss for the financial year comprises current and deferred tax. Income tax is recognized in the income statement, except to the extent that it relates to items disclosed directly in equity or other comprehensive income, in which case it is recognized in equity or in other comprehensive income.

v. Current tax

Current tax is the expected tax payable on the taxable profit for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous business years.

vi. Deferred tax

Deferred tax is disclosed using the balance sheet liability method, taking into account temporary differences between the carrying amounts of assets and liabilities used for the purpose of financial and tax reporting. The following temporary differences are not considered:

- the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit,
- temporary differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not be reversed in the foreseeable future,
- taxable temporary differences upon initial recognition of goodwill.

Deferred tax liabilities are recognized in the amount expected to be paid upon reversal of temporary differences, based on the laws that have been enacted or substantively enacted as at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realize the assets and settle the liabilities simultaneously.

As a rule, deferred tax assets are recognized to the extent it is probable that future taxable profit will be available against which a deferred tax asset can be used in the future. Deferred tax assets are decreased by the amount for which it is no longer probable that tax breaks associated with the asset can be utilised in the future.

t) Earnings per share

The Group and the Company calculate basic earnings per share by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Since the Group and the Company do not have any dilutive potential ordinary shares (e.g. preference shares or convertible bonds), diluted earnings per share equal the basic earnings per share.

4. Use of new and revised International Financial Reporting Standards (IFRS)

Initial application of new amendments to the existing Standards and Interpretation effective for current financial period

The following amendments to the existing standards and new interpretation issued by the International Accounting Standards Board (IASB) and adopted by the EU are effective for current financial period:

- **Amendments to IAS 7 "Statement of Cash Flows"** – Disclosure Initiative – adopted by EU on November 6, 2017 (effective for annual periods beginning on or after January 1, 2017),
- **Amendments to IAS 12 "Income Taxes"** – Recognition of Deferred Tax Assets for Unrealised Losses – adopted by EU on November 6, 2017 (effective for annual periods beginning on or after January 1, 2017).

The adoption of these amendments to the existing standards has not led to any changes in the accounting policies of the Group and the Company.

Standards and amendments to the existing standards issued by the IASB and adopted by the EU but not yet effective

At the date of authorization of these financial statements the following amendments to the existing standards issued by the IASB and adopted by the EU were in issue but not yet effective:

- **IFRS 9 "Financial Instruments"** – adopted by the EU on November 22, 2016 (effective for annual periods beginning on or after January 1, 2018),
- **IFRS 15 "Revenue from Contracts with Customers"** and amendments to IFRS 15 "Effective date of IFRS 15" – adopted by the EU on September 22, 2016 (effective for annual periods beginning on or after January 1, 2018),
- **Amendments to IFRS 15 "Revenue from Contracts with Customers"** – clarifications to IFRS 15 Revenue from Contracts with Customers – adopted by the EU on October 31, 2017 (effective for annual periods beginning on or after January 1, 2018),

- **IFRS 16 "Leases"** – adopted by the EU on October 31, 2017 (effective for annual periods beginning on or after January 1, 2019),
- **Amendments to IFRS 4 "Insurance Contracts"** – applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts – adopted by the EU on November 3, 2017 (effective for annual periods beginning on or after January 1, 2018 or when IFRS 9 "Financial Instruments" is applied for the first time).

New standards and amendments to the existing standards issued by the IASB but not yet adopted by the EU
At present, IFRS as adopted by the EU do not significantly differ from the regulations adopted by the International Accounting Standards Board (IASB) except from the following new standards and amendments to the existing standards, which as at December 31, 2017 (the effective dates stated below are for IFRS in full) were not endorsed for use in the EU:

- **IFRS 14 "Regulatory Deferral Accounts"** (effective for annual periods beginning on or after January 1, 2016) – the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard,
- **IFRS 17 "Insurance Contracts"** (effective for annual periods beginning on or after January 1, 2021),
- **Amendments to IFRS 2 "Share-based Payment"** – Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after January 1, 2018),
- **Amendments to IFRS 9 "Financial Instruments"** – Prepayment Features with Negative Compensation (effective for annual periods beginning on or after January 1, 2019),
- **Amendments to IFRS 10 "Consolidated Financial Statements" and IAS 28 "Investments in Associates and Joint Ventures"** – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture and further amendments (effective date was deferred indefinitely until the research project on the equity method has been concluded),
- **Amendments to IAS 28 "Investments in Associates and Joint Ventures"** – Long-term Interests in Associates and Joint Ventures (effective for annual periods beginning on or after January 1, 2019),
- **Amendments to IAS 40 "Investment Property"** – Transfers of Investment Property (effective for annual periods beginning on or after January 1, 2018),
- **Amendments to various standards "Improvements to IFRSs (cycle 2014-2016)"** resulting from the annual improvement project of IFRS (IFRS 1, IFRS 12 and IAS 28) primarily with a view to removing inconsistencies and clarifying wording (amendments to IFRS 12 are to be applied for annual periods beginning on or after January 1, 2017 and amendments to IFRS 1 and IAS 28 are to be applied for annual periods beginning on or after January 1, 2018),
- **Amendments to various standards due to "Improvements to IFRSs (cycle 2015-2017)"** resulting from the annual improvement project of IFRS (IFRS 3, IFRS 11, IAS 12 and IAS 23) primarily with a view to removing inconsistencies and clarifying wording (effective for annual periods beginning on or after January 1, 2019),
- **IFRIC 22 "Foreign Currency Transactions and Advance Consideration"** (effective for annual periods beginning on or after January 1, 2018),
- **IFRIC 23 "Uncertainty over Income Tax Treatments"** (effective for annual periods beginning on or after January 1, 2019).

The Group and the Company anticipate that the adoption of **IFRS 9, IFRS 15 and IFRS 16** will have an impact on the financial statements of Group and the Company. The estimated impact of IFRS 9 and IFRS 15 on the statements is clarified as follows:

- **IFRS 9 – Financial Instruments:** The financial statements of the Group and the Company will be affected by impairment of receivables, which will be calculated using the expected loss model for outstanding receivables, as well. Considering the relatively conservative creation of allowances in accordance with the current accounting policy in the Company and the Group, the impact on the financial statements will be minimal – we estimate it to several hundred thousand EUR.
- **IFRS 15 – Revenue from Contracts with Customers:** The Group and the Company will see an impact on the financial statements deriving from the transfer of service variable considerations to the cost of the goods sold and from the changed method of accounting for consignments (from gross to net).

The implementation of the other new standards and amendments to the existing standards will not have a material impact on the financial statements of the Group and the Company in the period of initial application. Group and Company are in the process of estimation of impact of the standard IFRS 16.

Hedge accounting regarding the portfolio of financial assets and liabilities, whose principles have not been adopted yet by the EU, is still unregulated.

According to the Group's and the Company's estimates, the application of hedge accounting for the portfolio of financial assets or liabilities pursuant to **IAS 39: 'Financial Instruments: Recognition and measurement'** would not significantly impact the financial statements, if applied as at the balance sheet date.

5. Fair value determination

The Group and the Company determined the fair value of individual groups of assets for the purposes of measuring or reporting in compliance with the methods described below. Where additional interpretations relating to assumptions for measurement of fair value are needed, they are stated in the breakdowns of individual items of assets or liabilities of the Group and the Company.

a) Property, plant and equipment

Fair value of property, plant and equipment from business combinations equals their market value at which a willing buyer and a willing seller would trade the property as at the day of the appraisal of value in a transaction between non-associated and independent parties after reasonable marketing, with both parties taking part in the trade being informed, prudent, and without force or coercion. Description of the determination of property fair value is available in Note 3 (f) Property, plant and equipment.

b) Intangible assets

The fair value of patents and trademarks acquired through business combinations is based on estimated discounted royalty payments which will no longer be necessary thanks to the ownership of a patent or trademark. The fair value of other intangible assets is based on the current value of expected future cash flows projected to arise from use and potential sale of such assets.

c) Investment property

The fair values in business or strategic combinations are based on market values, being the estimated amount for which a property could be exchanged on the date of the valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

If the current prices in an active market cannot be determined, the property investment value is measured based on the aggregate value of cash flows expected to be received from renting out the property. Yield reflecting specific risks is included in the calculation of the property value based on discounted net cash flows on annual basis.

Where appropriate, the property appraisal should be based on consideration of the following: the type of tenants currently residing in or responsible for meeting lease commitments or likely to become its tenants after the real estate is rented out, and overall picture of their credit rating; the allocation of maintenance and insurance responsibilities between the Group, the Company and the lessee; and the remaining life of the investment property. When in reviewing or renewing the lease contract it is expected that subsequent increase in rent will occur due to restoring its original condition, it is deemed that all notices, and when appropriate counter-notices, have been served validly and on time.

d) Inventories

The fair value of inventories acquired in business combinations is determined based on their estimated selling price in ordinary course of business, less the estimated costs of completion and sale, and a reasonable profit margin considering the work required to complete and sell the inventories.

e) Investments in equity and debt securities

The fair value of financial assets and liabilities at fair value through profit or loss and available-for-sale financial assets in business or strategic combinations is determined by reference to their quoted bid price as at the reporting date or, if not available, by using one of valuation methods according to IFRS standards. Valuation methods which can be employed include market multiples and discounted cash flow analysis using expected future cash flows and a market-related discount rate.

f) Trade and other receivables

The fair value of trade and other receivables, excluding construction work in progress, in business combinations is estimated as the present value of future cash flows, discounted at the market rate of interest as at the reporting date.

g) Non-derivative financial liabilities

The fair value of bonds for the disclosure purposes is calculated based on the most recently available market value of bonds in the stock market, prior to the reporting date. Fair values of other non-derivative financial liabilities are not determined, as their carrying amount represents a reasonable approximation of fair value.

6. Tax policy

a) Slovenia

Tax statements (financial statements for tax authorities) of the company Poslovni sistem Mercator d.d., and the companies of the Mercator Group in Slovenia, are prepared in accordance with the International Financial Reporting Standards and the Corporate Income Tax Act.

Corporate income tax rate is at 19%.

Pursuant to the Corporate Income Tax Act, a company's tax base is the profit as the surplus of revenues over expenses, where the basic criteria for recognition in a tax statement are still the revenues and expenses as shown in the income statement, defined pursuant to the legislation or accounting standards.

When calculating corporate income tax, the following tax reliefs can be exercised:
- relief for investments in research and development,
- relief for employment of disabled people of 50% or 70% of the disabled's salaries,
- relief for carrying out practical training within professional training,
- relief for voluntary supplementary pension insurance,
- relief for donations,
- relief for investments in equipment and intangible assets of 40%,
- relief for employment of unemployed under 26 or over 55.

In 2017, the companies recognized and reversed deferred income tax related to the following items:
- differences between operating and tax depreciation and amortisation,
- differences in allowances for receivables,
- differences in value of provisions,
- tax losses,
- revaluation of goodwill,

- fixed assets the value of which does not exceed EUR 500 and the useful life of which is longer than one year,
- revaluation of available-for-sale financial assets,
- unused tax breaks,
- revaluation of fixed assets to a higher value,
- impairment of investment into equity of subsidiaries.

Each company has to provide documentation on transfer prices; general documentation may be common to a group of related entities as a whole.

b) Serbia

Tax statements of the company Mercator-S d.o.o. are prepared in compliance with the International Financial Reporting Standards and the relevant Corporate Income Tax Act ('Zakon o porezu na dobit pravnih lica').

Corporate income tax rate is at 15%.

When calculating corporate income tax, the following tax reliefs can be exercised:

- relief for investing in fixed assets in the amount exceeding one billion RSD, and employment of 100 new permanent employees who had not been employed at any of its related parties.

In 2017, the company recognized and reversed deferred income taxes in relation to the following:

- differences between operating and tax depreciation and amortisation,
- differences in inventories adjustments,
- differences in value of provisions,
- revaluation of fixed assets to a higher value,
- tax losses,
- tax reliefs,
- accounted for, outstanding government revenue.

The company is obliged to prepare transfer pricing documentation.

c) Croatia

Tax statements of the company Mercator-H d.o.o. are prepared in compliance with the International Financial Reporting Standards and the relevant Corporate Income Tax Act ('Zakon o porezu na dobit').

Taxable base is the profit calculated according to the accounting principles, from which tax recognized costs are subtracted, or to which non-recognized costs are added.

Corporate income tax rate is at 18%.

In 2017, the company recognized deferred taxes liabilities arising from revaluation to a higher value (appreciation) of fixed assets.

The company is obliged to prepare transfer pricing documentation.

d) Bosnia and Herzegovina

Tax statements of the company Mercator-BH, d.o.o. are prepared in compliance with the International Financial Reporting Standards and the relevant Corporate Income Tax Act ('Zakon o porezu na dobit').

Corporate income tax rate is at 10%.

In the assessment of corporate income tax, companies in Bosnia and Herzegovina may exercise the following tax reliefs:

- relief for investments in production on the territory of Bosnia and Herzegovina,
- relief for hiring new employees for a period of at least 12 months.

In 2017, the company disclosed deferred taxes arising from differences between business and tax deductible depreciation, revaluation of fixed assets and tax losses.

e) Montenegro

Tax statements of the company Mercator-CG d.o.o. are prepared in compliance with the International Financial Reporting Standards and the relevant Corporate Income Tax Act ('Zakon o porezu na dobit pravnih lica').

Corporate income tax rate is at 9%.

In 2017, the company recognized deferred tax liabilities arising from differences between business and tax deductible depreciation.

7. Business segments

Mercator Group

For the requirements of reporting by business segments, the Mercator Group defined business segments by the countries where the Group carries out its activities. Operating results of a segment are regularly reviewed by a manager who adopts decisions in order to provide basis for adoption of decisions on resources that need to be allocated to certain segment, and who evaluates the performance of operations.
In 2017, the Mercator Group was operating in five countries:

- Slovenia, where the headquarters of the parent company is located, which is also the largest business unit of the Group. Fields of operation in Slovenia include the following: trade (retail and wholesale), food production, and other non-trade activities,
- Serbia, Croatia, Bosnia and Herzegovina and Montenegro.

For selling goods, products and services between the segments market prices are used. Revenues from any individual customer do not reach 10% of total sales revenues of the Group.

in EUR thousand	Mercator Group											
	Slovenia		Serbia		Croatia		Bosnia and Herzegovina		Montenegro		Total	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Assets	**1,434,096**	**1,323,649**	**541,278**	**528,675**	**294,030**	**287,281**	**119,495**	**104,093**	**64,249**	**63,639**	**2,453,147**	**2,307,337**
Inter-segment eliminations	*318,428*	*159,481*	*40,203*	*773*	*80*	*5*	*10,176*	*16,901*	*7,488*	*7,340*	*376,375*	*184,501*
Consolidated total assets											***2,076,724***	***2,122,836***
Liabilities	**987,705**	**1,007,860**	**419,285**	**400,072**	**259,605**	**272,506**	**58,508**	**40,587**	**29,265**	**28,936**	**1,754,368**	**1,749,961**
Inter-segment eliminations	*26,240*	*36,171*	*1,842*	*1,528*	*127,684*	*146,114*	*227*	*23*	*52*	*664*	*156,045*	*184,501*
Consolidated total liabilities											***1,598,322***	***1,565,460***
Sales revenue	**1,241,729**	**1,264,894**	**746,567**	**802,161**	**22,686**	**23,950**	**36,041**	**18,375**	**124,041**	**114,857**	**2,171,064**	**2,224,237**
Inter-segment eliminations	*17,343*	*19,735*	*660*	*1,118*	*129*	*192*	*22*	*3,200*	*737*	*406*	*18,891*	*24,650*
Consolidated total sales revenue											*2,152,172*	*2,199,587*
Interest income	**5,608**	**5,511**	**105**	**523**	**11**	**21**	**602**	**606**	**254**	**(264)**	**6,580**	**6,397**
Inter-segment eliminations	*(4,995)*	*(4,785)*		*-*		*-*	*(509)*	*(489)*	*(253)*	*263*	*(5,757)*	*(5,010)*
Consolidated total interest income											*824*	*1,386*
Interest expense	**(20,837)**	**(20,683)**	**(10,836)**	**(10,237)**	**(7,794)**	**(7,504)**	**(1,208)**	**(1,213)**	**(132)**	**(137)**	**(40,807)**	**(39,775)**
Inter-segment eliminations	*1,100*	*1,438*		*-*	*4,656*	*3,995*		*-*		*-*	*5,756*	*5,433*
Consolidated total interest expense											*(35,051)*	*(34,342)*

As at December 31, 2017, the Group included the following companies (figures in EUR thousand and are based on audited reporting packages by companies reporting to the parent company):

Poslovni sistem Mercator d.d.	
Slovenia	
equity	423,159
financial liabilities	600,798
net operating profit or loss	(203,726)
net sales revenue	1,186,622
no. of employees	9,227

Mercator - S d.o.o.	100.0%
Serbia	
equity	121,992
financial liabilities	152,518
net operating profit or loss	(56,451)
net sales revenue	746,567
no, of employees	8,301

Mercator - H d.o.o.	99.3%
Croatia	
equity	34,424
financial liabilities	34,817
net operating profit or loss	(40,711)
net sales revenue	22,686
no, of employees	38

Mercator - CG d.o.o.	100.0%
Montenegro	
equity	34,984
financial liabilities	3,036
net operating profit or loss	332
net sales revenue	124,041
no. of employees	1,420

Mercator - BH d.o.o.	100.0%
Bosnia and Herzegovina	
equity	60,987
financial liabilities	36,889
net operating profit or loss	(3,315)
net sales revenue	36,041
no. of employees	1,280

M Energija d.o.o.	100.0%
Slovenia	
equity	(1,828)
financial liabilities	4,416
net operating profit or loss	(4,570)
net sales revenue	22,858
no. of employees	7

Mercator - Emba d.d.	100.0%
Slovenia	
equity	17,369
financial liabilities	1
net operating profit or loss	1,859
net sales revenue	18,159
no. of employees	111

Mercator IP d.o.o.	100.0%
Slovenia	
equity	7,691
financial liabilities	-
net operating profit or loss	1,788
net sales revenue	14,090
no. of employees	417

The consolidated financial statements also include companies Platinum - A d.o.o., Platinum - B d.o.o., Platinum - C d.o.o., Platinum - D d.o.o., Mercator - Velpro d.o.o., Mercator Maxi d.o.o., Mercator Humanitarian Foundation, Mercator Makedonia d.o.o.e.l., Investment Internacional d.o.o.e.l., which do not carry out business activities.

Poslovni sistem Mercator d.d.

In 2017 the Company operated as a single economic entity with business and geographical segments. As a result, for 2017, the Company does not display business information either by business or geographical segments, but geographical segments are displayed for the entire Group at a consolidated level.

8. Business mergers and reorganisation of the Group

On August 31, 2017, the company M - BL d.o.o. was established on the market of Bosnia and Herzegovina, which did not carry out business activities in 2017.

In September 2017 Mercator re-entered the market of Bosnia and Herzegovina, it took over the former Mercator stores and one distribution center from Konzum d.o.o., Sarajevo. The re-entry was based on positive experiences from the period when Mercator managed stores in Bosnia and Herzegovina. Integration after Mercator's takeover caused a decrease in turnover and thus directly affected the business efficiency of retail activity on this market. At the takeover, Mercator bought equipment and inventories in stores at a market price, while at the same time it did not took over any obligations from Konzum.

9. Revenue

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016 restated	2017	2016 restated
Sales of goods	2,060,308	2,111,325	1,136,103	1,143,326
Sales of services	83,654	84,174	37,767	70,925
Sales of products	16,172	15,681	16,172	-
Sales of materials	468	453	103	-
Expenses for discounts granted	(8,430)	(12,045)	(3,523)	(4,298)
Total	**2,152,172**	**2,199,587**	**1,186,622**	**1,209,952**

Due to the introduction of the new IFRS 15 standard as of January 1, 2018, the Mercator Group changed the accounting policy already in 2017 and in accordance with the IAS 18 standard, applied the accounting treatment of consignment by using the net method. Change in the method of accounting treatment of consignment to using net method in 2017 had an impact on the decrease of revenues from sales of goods in the amount of EUR 65,770 thousand (which is at the same time equal as decrease at the company Mercator d.d.) and on the increase in revenues from sales of services in the amount of EUR 3,630 thousand (which is at the same time equal to the increase at the company Mercator d.d.). Due to the comparability between periods, the adjustment was also made in the treatment of revenues for 2016.

In 2017, the policy of accounting treatment of variable considerations was changed in a way that they were included in the reduction of the cost of goods sold, as permitted by IAS 18. The change in the accounting policy of the Mercator Group had an impact in 2017 on the decrease of sales revenues due to the decrease of service variable considerations in the amount of EUR 99,789 thousand, transferred by the Group to the cost of goods sold. At the company Poslovni sistem Mercator d.d. the change in the policy of accounting treatment of rebates affected the decrease of service variable considerations in the amount of EUR 39,306 thousand. Due to the comparability of data between periods, the adjustment was also made in the rteatment of revenues for 2016.

10. Other operating revenue

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Profit from sales of property, plant and equipment	9,967	5,009	3,805	2,825
Reversal of real estate impairment	-	-	-	-
Revenue from reversal of provisions	6,120	3,389	3,903	1,384
Other operating revenue	9,728	24,184	5,159	4,033
Total	**25,815**	**32,582**	**12,867**	**8,242**

Mercator Group

Profit from the sale of property, plant and equipment in the amount of EUR 9,967 thousand (2016: EUR 5,009 thousand) refer mostly to the sale of Mercator Center Belgrade in Serbia.

Revenue from the reversal and utilization of provisions in the amount of EUR 6,120 thousand (2016: EUR 3,389 thousand) refer to the use of assigned assets for disability contributions, legal proceedings and reversal of provisions for termination benefits and jubilee benefits.

Among other operating revenue in the amount of EUR 9,728 thousand (2016: EUR 24,184 thousand), the Group discloses income from indemnitiess based on insurance premiums and other indemnities in the amount of EUR 1,859 thousand, revenue from employment disability benefits in the amount of EUR 795 thousand and other business revenue in the amount of EUR 7,074 thousand.

Poslovni sistem Mercator d.d.

Profit from the sale of property, plant and equipment amounted to EUR 3,805 thousand in 2017 (2016: EUR 2,825 thousand).

Revenue from the reversal of provisions include drawing of provisions for the improvement of working conditions for the disabled in the amount of EUR 850 thousand (2016: EUR 785 thousand), reversal of provisions for jubilee benefits in the amount of EUR 1,550 thousand (2016: EUR 120 thousand), EUR 100 thousand (2016: EUR 405 thousand) from the reversal of provisions for termination benefits and from the reversal of provisions for lawsuits in the amount of EUR 1,403 thousand (2016: EUR 73 thousand).

Among other other operating revenue the Company discloses income from indemnities based on insurance premiums and other indemnities in the amount of EUR 718 thousand (2016: EUR 781 thousand), revenue from employment disability benefits in the amount of 795 thousand EUR (2016: EUR 742 thousand) and other operating revenue in the amount of EUR 3,646 thousand (2016: EUR 2,509 thousand).

11. Expenses by type

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016 restated	2017	2016 restated
Depreciation of property, plant and equipment	66,275	73,506	30,536	32,573
Amortisation of intangible assets	3,570	5,723	2,214	4,247
Depreciation of investment property	1	100	1	100
Labor costs	237,645	229,935	165,058	162,532
Costs of material	68,905	69,569	26,359	27,746
Costs of services excluding rents	138,430	135,617	89,458	92,014
Lease payments	70,140	70,820	9,202	9,612
Provisioning	5,740	476	4,833	-
Other costs	14,477	14,415	8,671	9,028
Other impairments of non-financial assets	9,575	-	6,259	746
Impairment of property, plant and equipment and intangible assets	147,072	1,509	98,033	-
Change in the value of inventories	(27)	(178)	-	-
Other operating expenses	9,505	49,327	6,213	7,154
Cost of goods sold	1,579,188	1,627,359	839,767	876,160
Total cost of goods sold, selling costs and administrative expenses	**2,350,496**	**2,278,178**	**1,286,606**	**1,221,912**
- of which expenses by type	**605,156**	**599,983**	**336,333**	**337,852**

Mercator Group

Costs of goods sold and selling costs in the amount of EUR 2,116,036 thousand (2016: EUR 2,197,076 thousand) mostly relate to the cost of goods sold in the amount of EUR 1,579,188 thousand (2016: 1,627,359 thousand), production costs in the amount of EUR 22,056 thousand (2016: EUR 20,708 thousand) and selling costs and other operating expenses in the amount of EUR 514,792 thousand (2016: EUR 549,009 thousand).

Administrative expenses amounted to EUR 77,813 thousand in 2017 (2016: EUR 81,102 thousand).

The cost of goods sold is reduced by rebates and received discounts. It is increased by revaluation of inventories and and write-downs of damaged, expired and obsolete inventory and deficits. Due to the changed policy of treatment of variable considerations, in the manner that all rebates are included in the reduction of the cost of goods sold and treatment of consignment by the net method, the cost of the goods sold in 2017 at the Group level is lower by EUR 161,930 thousand. Due to the comparability of data between periods, changes are also taken into account in the business report for 2016, which had an impact on the decrease in the cost of goods sold in the amount of EUR 174,950 thousand.

Provisions in the amount of EUR 5,740 thousand were created in connection with legal actions and termination benefits upon retirement.

Impairment of property, plant, equipment and intangible assets relates to impairment of property in accordance with the accounting policy of the Mercator Group, rules and International Accounting Standards.

Among the costs of services the Group in 2017 shows audit costs for auditing the annual report in the amount of EUR 144 thousand. To the same audit firms EUR 5 thousand were paid in the year 2017 for other assurance services and EUR 55 thousand for other non-audit services.

Poslovni sistem Mercator d.d.

Costs of goods sold and selling costs in the amount of EUR 1,141,334 thousand (2016: EUR 1,182,373 thousand) mostly relate to the cost of goods sold in the amount of EUR 839,767 thousand (2016: EUR 876,160 thousand), selling costs and other operating expenses in the amount of EUR 301,567 thousand (2016: EUR 306,213 thousand).

Administrative expenses amounted to EUR 40,980 thousand in 2017 (2016: EUR 39,539 thousand).

The total amount of all remuneration of employees of the Company employed under a contract, that is not subject to the tariff part of the collective agreement, excluding the members of the management, amounted to EUR 5,202 thousand in 2017.

Provisions in the amount of EUR 4,833 thousand were created in connection with legal actions and termination benefits upon retirement.

Among the costs of services the Company in 2017 shows audit costs for auditing the annual report in the amount of EUR 78 thousand. To the same audit firm EUR 5 thousand were paid in the year 2017 for other assurance services and EUR 55 thousand for other non-audit services.

Cost of goods sold is reduced by rebates and received discounts. It is increased by revaluation of inventories and and write-downs of damaged, expired and obsolete inventory and deficits. Due to the changed policy of treatment of variable considerations, in the manner that all rebates are included in the reduction of the cost of goods sold and treatment of consignment by the net method, the cost of goods sold in 2017 at the Company is lower by EUR 101,446 thousand. Due to the comparability of data between periods, changes are also taken into account in the business report for 2016, which had an impact on the decrease in the cost of goods sold in the amount of EUR 111,140 thousand.

12. Labor costs

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Salaries	172,301	165,082	114,127	111,466
Pension insurance costs	21,493	19,553	13,250	12,972
Health insurance costs	9,572	10,645	8,444	8,227
Other labour costs	34,278	34,655	29,237	29,867
Total	**237,645**	**229,935**	**165,058**	**162,532**
Number of employees as at 31/12	20,801	20,354	9,227	9,498

Mercator Group

Labor costs at the Group level in 2017 amounted to EUR 237,645 thousand (2016: EUR 229,935 thousand).

Among other labor costs, which amounted to EUR 34,278 thousand (2016: EUR 34,655 thousand) in 2017, the Group classifies reimbursement of meal allowances during work, reimbursement of commute allowances, annual leave allowances and other labour costs.

Poslovni sistem Mercator d.d.

Labor costs at the Company in 2017 amounted to EUR 165,058 thousand (2016: EUR 162,532 thousand).

Among other labor costs, which amounted to EUR 29,237 thousand (2016: EUR 29,867 thousand) in 2017, the Company includes reimbursement of meal allowances during work, reimbursement of commute allowances, annual leave allowances and other labour costs.

13. Finance income and expenses

in EUR thousand	Mercator Group		Poslovni sistemi Mercator d.d.	
	2017	2016	2017	2016
Interest income	824	1,386	5,402	5,491
Gains on disposal of available-for-sale financial investments	-	92	-	4,604
Net exchange rate differences from operations	5,483	1,008	52	8
Dividends received	8	12	290	2,282
Other financial income	311	489	310	362
Finance revenue	**6,626**	**2,987**	**6,054**	**12,747**
Interest expenses	(35,050)	(34,342)	(20,632)	(20,554)
Losses on disposal and impairment of available-for-sale financial assets and write-offs from revaluation of financial investments	(47)	(3,741)	(115,627)	(69,287)
Other finance expenses	(1,599)	(1,893)	(5,896)	(1,893)
Finance expenses	**(36,696)**	**(39,976)**	**(142,155)**	**(91,734)**
Net finance expense recognized in the income statement	**(30,071)**	**(36,989)**	**(136,101)**	**(78,987)**

Mercator Group

The largest share of the finance expenses of the Mercator Group represent interest expenses, which amounted to EUR 35,050 thousand in 2017 (2016: EUR 34,342 thousand).

Poslovni sistem Mercator d.d.

The largest part of finance expenses of the Company represent write-offs from the revaluation of financial investments, which in 2017 include the impairment of investments in the companies Mercator-H d.o.o., Mercator - S d. o. o., M - Energija d. o. o., Mercator Macedonia d. o. o. e. l., Investment Internacional, d.o.o.e.l.

The second largest part represent interest expenses, which amounted to EUR 20,632 thousand in 2017 (2016: 20,554).

14. Property, plant and equipment

			Mercator Group		
in EUR thousand	Land	Buildings	Equipment and other assets	FA being acquired	Total
As at January 1, 2016					
Cost	435,541	1,262,609	404,128	31,825	2,134,102
Revaluation	-	(491,134)	(271,364)	(199)	(762,697)
Carrying amount	**435,541**	**771,474**	**132,764**	**31,626**	**1,371,405**
Year ended December 31, 2016					
Opening carrying amount	**435,541**	**771,474**	**132,764**	**31,626**	**1,371,405**
Effect of foreign exchange differences	(67)	(1,725)	(921)	(194)	(2,907)
Investments	-	-	-	81,301	81,301
Transfers*	68,843	191,683	33,880	(83,911)	210,495
Disposals	(8,531)	(2,536)	(3,817)	(555)	(15,439)
Depreciation	-	(46,893)	(28,023)	(34)	(74,951)
Appreciation or impairment	-	-	-	-	-
Other changes	-	-	-	-	-
Closing carrying amount	**495,786**	**912,003**	**133,882**	**28,233**	**1,569,905**
Balance as at December 31, 2016					
Cost	495,786	1,524,164	397,373	28,572	2,445,895
Revaluation	-	(612,161)	(263,490)	(339)	(875,990)
Carrying amount	**495,786**	**912,003**	**133,882**	**28,233**	**1,569,905**
Year ended December 31, 2017					
Opening carrying amount	**495,786**	**912,003**	**133,882**	**28,233**	**1,569,905**
Effect of foreign exchange differences	3,295	8,462	2,311	288	14,357
Investments	-	1,212	14,190	51,789	67,190
Transfers*	(37,753)	(79,393)	-	-	(117,146)
Disposals	(20,242)	(25,757)	(2,436)	(70)	(48,504)
Depreciation	-	(40,140)	(26,134)	-	(66,274)
Appreciation or impairment	(77,232)	47,928	-	-	(29,303)
Other changes	(31,692)	(151,546)	19,074	(66,823)	(230,987)
Closing carrying amount	**332,163**	**672,770**	**140,887**	**13,418**	**1,159,237**
Balance as at December 31, 2017					
Cost	333,011	1,219,677	414,787	14,070	1,981,545
Revaluation	(848)	(546,907)	(273,900)	(652)	(822,308)
Carrying amount	**332,163**	**672,770**	**140,887**	**13,418**	**1,159,237**

*Attributable to transfer of assets held for sale to long term assets and other transfers between groups.

	Poslovni sistemi Mercator d.d.				
in EUR thousand	Land	Buildings	Equipment and other assets	FA being acquired	Total
As at January 1, 2016					
Cost	241,037	624,195	237,404	19,244	1,121,880
Revaluation	-	(296,221)	(182,348)	-	(478,569)
Carrying amount	**241,037**	**327,974**	**55,056**	**19,244**	**643,311**
Year ended December 31, 2016					
Opening carrying amount	**241,037**	**327,974**	**55,056**	**19,244**	643,311
Investments	-	-	-	49,549	49,549
Transfers*	68,158	180,771	17,900	(49,328)	217,502
Disposals	(3,622)	(3,831)	(2,265)	(42)	(9,761)
Depreciation	-	(20,952)	(11,924)	-	(32,876)
Appreciation or impairment	-	-	-	-	-
Other changes	-	-	-	-	-
Closing carrying amount	**305,574**	**483,963**	**58,767**	**19,423**	**867,726**
Balance as at December 31, 2016					
Cost	305,574	879,842	232,558	19,423	1,437,396
Revaluation	-	(395,879)	(173,791)	-	(569,670)
Carrying amount	**305,574**	**483,963**	**58,767**	**19,423**	867,726
Year ended December 31, 2017					
Opening carrying amount	**305,574**	**483,963**	**58,767**	**19,423**	867,726
Investments	-	-	-	17,753	17,753
Transfers*	(35,913)	(59,290)	-	-	(95,203)
Disposals	(6,959)	(2,734)	(1,452)	-	(11,144)
Depreciation	-	(21,428)	(9,108)	-	(30,536)
Appreciation or impairment	(56,894)	49,104	-	-	(7,790)
Other changes	32,298	(12,943)	7,027	(31,037)	(4,654)
Closing carrying amount	**238,106**	**436,673**	**55,234**	**6,139**	**736,152**
Balance as at December 31, 2017					
Cost	238,106	871,187	229,544	6,139	1,344,976
Revaluation	-	(434,515)	(174,309)	-	(608,824)
Carrying amount	**238,106**	**436,673**	**55,234**	**6,139**	**736,152**

*Attributable to transfer of assets held for sale to long term assets and other transfers between groups.

Investments in property, plant and equipment shown in the context of investments refer to:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Purchase of land, buildings and equipment	11,173	12,817	2,396	21,897
Refurbishment of existing retail and wholesale units	45,079	63,264	9,006	24,009
Other	10,938	5,220	6,351	3,643
Total	**67,190**	**81,301**	**17,753**	**49,549**

Decreases in property, plant and equipment relate to:	Mercator Group		Poslovni sistem Mercator, d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Real estate sales	45,999	7,427	9,692	7,427
Sale of equipment	2,436	1,962	1,452	1,962
Write-offs	70	372	0	372
Total	**48,504**	**9,761**	**11,144**	**9,761**

Mercator Group

Investments in property, plant and equipment shown among investments amounted to EUR 67,190 thousand. Disposals of property, plant and equipment in the amount of EUR 48,504 thousand refer to the sale of Mercator Center Belgrade in Serbia at the end of 2017, thus starting the project of monetization of real estate.

In accordance with the Mercator Group's accounting policy, rules and International Accounting Standards, the valuation of real estate as at December 31, 2017 was carried out by an independent certified real estate appraiser. The final report was verified by the two independent appraisers that confirmed the findings of the first report. The consequence of the valuation of real estate is lower net value of real estate in the statement of financial position by EUR 29,303 thousand.

Poslovni sistem Mercator d.d.

In 2017, investments in property, plant and equipment amounted to EUR 17,753 thousand, while disposals of property, plant and equipment amounted to EUR 11,144 thousand.

If land was disclosed at historical cost, the amounts would be as follows:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Cost	311,719	358,742	198,351	201,991

The carrying amount of property, plant and equipment under financial leases amounts to:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Cost	170,731	242,359	102,748	113,637

The carrying amount of property, plant and equipment under financial leases amounts to EUR 170,731 thousand for the Group (2016: EUR 242,359 thousand) and EUR 102,748 thousand for the Company (2016: EUR 113,637 thousand) and refers almost entirely to land and buildings.

Pledeged property as at 31 December 2016:	**Mercator Group**		**Poslovni sistem Mercator d.d.**	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Cost	495,511	560,776	285,058	309,955

As at December 31, 2017, the Group's pledged property amounted to EUR 495,511 thousand (2016: EUR 560,776 thousand), and the Company's pledged property amounted to EUR 285,058 thousand (2016: EUR 309,955 thousand).

15. Intangible assets

	Mercator Group			Poslovni sistem Mercator d.d.		
in EUR thousand	Goodwill	Trademarks, material rights and licenses	Total	Goodwill	Trademarks, material rights and licenses	Total
As at January 1, 2016						
Cost	1,664	65,783	67,446	1,200	40,165	41,365
Revaluation	-	(47,909)	(47,909)	-	(30,522)	(30,522)
Carrying amount	**1,664**	**17,873**	**19,537**	**1,200**	**9,644**	**10,844**
Year ended December 31, 2016						
Opening carrying amount	**1,664**	**17,873**	19,537	**1,200**	**9,644**	10,844
Effect of foreign exchange differences	5	(13)	(8)	-	-	-
Investments	-	9,137	9,137	-	7,063	7,063
Disposals	-	(1,055)	(1,055)	-	(62)	(62)
Transfers*	-	(970)	(970)	-	(84)	(84)
Impairment	-	1,182	1,182	-	-	-
Depreciation	-	(5,861)	(5,861)	-	(4,306)	(4,306)
Closing carrying amount	**1,669**	**20,294**	**21,963**	**1,200**	**12,255**	**13,455**
Balance as at December 31, 2016						
Cost	1,669	72,646	74,315	1,200	46,659	47,859
Revaluation and impairment	-	(52,352)	(52,352)	-	(34,404)	(34,404)
Carrying amount	**1,669**	**20,294**	**21,963**	**1,200**	**12,255**	**13,455**
Year ended December 31, 2017						
Opening carrying amount	**1,669**	**20,294**	21,963	**1,200**	**12,255**	13,455
Effect of foreign exchange differences	18	292	309	-	-	-
Investments	-	3,713	3,713	-	2,630	2,630
Transfers	-	2	2	-	2	2
Impairment	(1,686)	(99)	(1,785)	(1,200)	(99)	(1,299)
Depreciation	-	(3,570)	(3,570)	-	(2,214)	(2,214)
Closing carrying amount	**-**	**20,632**	**20,632**	**-**	**12,573**	**12,573**
Balance as at December 31, 2017						
Cost	1,669	76,412	78,081	1,200	48,680	49,880
Revaluation and impairment	(1,669)	(55,780)	(57,449)	(1,200)	(36,107)	(37,307)
Carrying amount	**-**	**20,632**	**20,632**	**-**	**12,573**	**12,573**

Allocation and changes in goodwill are presented in the table below:	Mercator Group				
in EUR thousand	Dec. 31, 2015	Foreign exchange differences	Increases in 2016	Impairment in 2016	Dec. 31, 2016
Hypermarkets	-	-	-	-	-
Supermarkets	464	5	-	-	469
Markets	-	-	-	-	-
Other stores	1,200	-	-	-	1,200
Total	**1,664**	**5**	**-**	**-**	**1,669**

in EUR thousand	Dec. 31, 2016	Foreign exchange differences	Increases in 2017	Impairment in 2017	Dec. 31, 2017
Hypermarkets	-	-	-	-	-
Supermarkets	469	5	-	(474)	-
Markets	-	-	-	-	-
Other stores	1,200	-	-	(1,200)	-
Total	**1,669**	**5**	**-**	**(1,674)**	**-**

Allocation and changes in goodwill are presented in the table below:	Poslovni sistem Mercator d.d.				
in EUR thousand	Dec. 31, 2015	Foreign exchange differences	Increases in 2016	Impairment in 2016	Dec. 31, 2016
Hypermarkets	-	-	-	-	-
Supermarkets	-	-	-	-	-
Markets	-	-	-	-	-
Other stores	1,200	-	-	-	1,200
Total	**1,200**	**-**	**-**	**-**	**1,200**

in EUR thousand	Dec. 31, 2016	Foreign exchange differences	Increases in 2017	Impairment in 2017	Dec. 31, 2017
Hypermarkets	-	-	-	-	-
Supermarkets	-	-	-	-	-
Markets	-	-	-	-	-
Other stores	1,200	-	-	(1,200)	-
Total	**1,200**	**-**	**-**	**(1,200)**	**-**

Mercator Group

As at December 31, 2017, intangible assets amounts to EUR 20,632 thousand (2016: EUR 21,963 thousand) and includes rights, patents, licenses, trademarks and investments into software.

The value of intangible assets increased in 2017 due to investments in the amount of EUR 3,713 thousand.

The trademark value as at December 31, 2017, amounts to EUR 3,700 thousand and refers to the trademark Roda in Serbia. The estimated useful life of the trademark is unlimited. On December 31, 2017, it was tested for potential impairment, which was not identified.

The value of goodwill was entirely impaired in 2017. Goodwill was generated in previous periods upon the acquisition of Era Tornado d.o.o and Trgohit d.o.o. in Croatia and at take-over of the business activity of the company Era Good d.o.o. in Slovenia.

In 2017, impairments from intangible assets amounted to EUR 1,785 thousand (2016: EUR 1,182 thousand).

Amortization of intangible assets amounts to EUR 3,570 thousand (2016: EUR 5,861 thousand).

In the process of restructuring of financial liabilities, the Group pledged the brand Roda in Serbia, the carrying amount of which is EUR 3,700 thousand, and other brands that are not disclosed in the balance sheet.

Poslovni sistem Mercator d.d.

Intangible assets as at December 31, 2017 amounts to EUR 12,573 thousand (2016: EUR 13,455 thousand) and includes rights, patents, licenses, trademarks and investments into software.

The value of intangible assets increased in 2017 due to investments in the amount of EUR 2,630 thousand.

In 2017, impairments from intangible assets amounted to EUR 1,299 thousand (2016: EUR 0 thousand), of which EUR 1,200 thousand relates to impairment of goodwill arising from the take-over of Era Good d.o.o.

Amortization of intangible assets amounts to EUR 2,214 thousand (2016: EUR 4,306 thousand).

In the process of restructuring financial liabilities, the Company has pledged certain brands that do not qualify for recognition in accordance with IAS 19. The Company does not have pledges as a debt liability and does not have any obligations to purchase intangible assets that are recognized in the balance sheet.

16. Investment property

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
As at January 1	**9,899**	**3,352**	**3,237**	**3,352**
Investments	-	-	-	-
Transfers*	221,999	6,660	5	-
Foreign exchange rate differences	12,542	-	1,642	-
Appreciation and impairments	(716)	(13)	(46)	(15)
Disposals	592	-	-	-
Depreciation	-	(100)	-	(100)
Balance as at December 31	**244,316**	**9,899**	**4,839**	**3,237**

* Refers to transfers from long-term tangible assets.

Estimated fair value of investment property	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Estimated fair value of investment property	244,316	9,899	4,839	3,237

The following amounts were recognized in the income statement with regard to investment property:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Rental income	11,122	185	127	185
Direct expenses arising from investment property and generating rental income	(5,769)	(222)	(90)	(222)
Total	**5,353**	**(37)**	**37**	**(37)**

Mercator Group

Investment property at the Group level in 2017 amounted to EUR 244,316 thousand (2016: EUR 9,899 thousand). The increase in most cases relates to the redistribution of assets of the company Mercator - H d.o.o. from category 'Property, plant and equipment' to 'Investment property' in accordance with IAS 40.

Poslovni sistem Mercator d.d.

Investment property at the Company level in 2017 amounted to EUR 4,839 thousand (2016: EUR 3,237 thousand).

Financial liabilities as at December 31, 2017 are not secured by mortgages on investment property.

17. Equity investments in Group companies

	Poslovni sistem Mercator d.d.		
in EUR thousand	Equity interest in %	2017	2016
Other investments in shares and interests			
Investments in shares and interests in Group companies:			
In Slovenia:			
Mercator - Emba d.d.	100.0	4,011	4,011
Mercator IP d.o.o.	100.0	1,095	1,095
M - Energija d.o.o.	100.0	0	2,019
Ustanova humanitarna fundacija Mercator	100.0	2	2
Platinum - A d.o.o., Platinum - B d.o.o., Platinum - C d.o.o., Platinum - D d.o.o., Mercator Maxi d.o.o., Mercator – Velpro d.o.o.*	100.0	45	45
		5,153	**7,172**
Abroad:			
Mercator - S d.o.o.	100.0	121,992	198,397
Mercator - H d.o.o.	99.3	0	0
Mercator - BH d.o.o.	56.6	32,771	32,771
M - BL d.o.o.**	0.0	0	0
Mercator Makedonija d.o.o.e.l.	100.0	0	848
Mercator - CG d.o.o.	56.3	20,282	20,282
Investment International d.o.o.e.l.	100.0	10,599	11,287
		185,645	**263,585**
Total equity investments in Group companies		**190,798**	**270,758**

* The companies Mercator Makedonija d.o.o.e.l., Skopje, Investment International d.o.o.e.l., Skopje ter Platinum - A d.o.o., Ljubljana, Platinum - B d.o.o., Ljubljana, Platinum - C d.o.o., Ljubljana, Platinum - D d.o.o., Ljubljana, Mercator - Velpro d.o.o., Ljubljana, Mercator - Maxi d.o.o., Ljubljana, do not yet carry out business activities. The Platinum companies were established for the purpose of a property monetization project, companies Mercator - Velpro d.o.o., and Mercator - Maxi d.o.o., with the purpose of independent development of activities.
** The Company M - BL d.o.o., Banja Luka was established in august 2017 and is 100% owned by the company Mercator - BH d.o.o.

in EUR thousand	As at December 31, 2016	Recapitalization	Impairment	As at December 31, 2017	Equity interest (%) as at December 31, 2017
Investments in shares and interests Investments in shares and interests in Group companies:					
In Slovenia:					
Mercator - Emba d.d., Logatec	**4,011**	0	0	**4,011**	**100.0**
Mercator IP d.o.o., Ljubljana	**1,095**	0	0	**1,095**	**100.0**
M - Energija d.o.o., Ljubljana	**2,019**	0	-2,019	**0**	**100.0**
Ustanova humanitarna fundacija Mercator, Ljubljana	**2**	0	0	**2**	**0.0**
Platinum - A d.o.o., Platinum - B d.o.o., Platinum - C d.o.o., Platinum - D d.o.o., Platinum - E d.o.o., Platinum – F d.o.o.	**45**	0	0	**45**	**0.0**
	7,171	**0**	**-2,019**	**5,152**	
Abroad:					
Mercator - S d.o.o., Novi Sad	**198,397**	0	-76,404	**121,992**	**100.0**
Mercator - H d.o.o., Zagreb	**0**	35,620	-35,620	**0**	**99.3**
Mercator - BH d.o.o., Sarajevo	**32,771**	0	0	**32,771**	**56.6**
M - BL d.o.o., Banja Luka	**0**	0	0	**0**	**0.0**
Mercator Makedonija d.o.o.e.l., Skopje	**848**	0	-848	**0**	**100.0**
Mercator - CG d.o.o., Podgorica	**20,282**	0	0	**20,282**	**56.3**
Investment International d.o.o.e.l., Skopje	**11,287**	0	-688	**10,599**	**100.0**
	263,586	**35,620**	**-113,560**	**185,645**	
Total equity investments in Group companies	**270,758**	**35,620**	**-115,580**	**190,798**	

At least every year, the company carries out a test of impairment of investments in the capital of companies within the Group. In case of identified signs of impairment, the Company makes adjustments in accordance with IFRS.

In 2017, the Company recapitalized the company Mercator - H d.o.o. in the amount of EUR 35,620 thousand, and impaired the investment in the amount of EUR 35,620 thousand as at December 31, 2017. As at December 31, 2017, the Company also impaired investments in Mercator-S d.o.o. in the amount of EUR 76,404 thousand, M - Energija d.o.o. in the amount of EUR 2,019 thousand, Mercator Macedonia d.o.o.e.l. in the amount of EUR 848 thousand and Investment International d.o.o.e.l. in the amount of EUR 688 thousand. The Company assessed all these investments on the basis of the net asset value method. The estimated fair value of the companies is based on IAS 36, which defines the recoverable amount of the asset or cash-generating unit as the larger of the two items; its fair value decreased by the costs of sales or its value in use.

The Company also tested the impairment of the investment in Mercator - BH d.o.o., where the impairment of the investment was not established.

The Company has financial liabilities secured with a lien on shares and shares of subsidiaries Mercator IP d.o.o., M - Energija d.o.o., Mercator - Emba d.d., Mercator - S d.o.o., Mercator - H d.o.o., Mercator - BH d.o.o. and Mercator - CG d.o.o. in total amount of EUR 574,224 thousand.

18. Available-for-sale financial assets

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
As at January 1	**462**	**524**	**296**	**-**
Foreign exchange differences	-	-	-	-
Investments in insurance companies	27	-	10	42
Investments in shares and interests of other companies	(99)	(59)	(47)	254
Adjustment to market value	2	(4)	-	-
Disposals	-	-	-	-
Balance as at December 31	**391**	**462**	**259**	**296**

The Group's and the Company's available-for-sale financial assets include also assets that could not be valued at fair value; thus, these assets are valued at cost. Shares of these companies are not listed on the stock exchange.

Mercator Group

Available-for-sale financial assets at the Group level in 2017 amounted to EUR 391 thousand (2016: EUR 462 thousand).

Poslovni sistem Mercator d.d.

In the Company, these assets in 2017 amounted to EUR 259 thousand (2016: EUR 296 thousand).

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Financial assets measured at cost	211	286	206	254
Financial assets measured at fair value	180	176	52	42
Total investments in shares and interests	391	462	259	296

Revaluation to fair value for available-for-sale financial assets in recognized in equity. Impairment of available-for-sale financial assets is recognized in the income statement.

19. Taxes

Taxes recognized in profit or loss	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Current tax	1,876	773	-	-
Deferred tax	(20,020)	4,161	(19,491)	3,992
Tax	**(18,144)**	**4,934**	**(19,491)**	**3,992**

Poslovni sistem Mercator d.d.

For 2017, the Company does not disclose tax liability. The amount of uncovered tax loss as at December 31, 2017 amounts to EUR 138,497 thousand (2016: EUR 50,953 thousand).

In accordance with IAS 12 the current and deferred tax is recognized as income or expense and is included in net profit or loss. If the tax relates to the items that are disclosed directly in the comprehensive income, deferred tax is credited directly to or against the capital.

Tax recognized in other comprehensive income	Mercator Group			Poslovni sistem Mercator d.d.		
	2016			2016		
in EUR thousand	Value before tax	Tax	Value after tax	Value before tax	Tax	Value after tax
Net gains/losses recognized in revaluation surplus in relation to property, plant and equipment	-	(1,434)	(1,434)	-	-	-
Gains/losses recognized in revaluation surplus related to available-for-sale financial assets	(404)	-	(404)	-	-	-
Foreign currency translation differences - foreign operations	(2,047)	-	(2,047)	-	-	-
Provisions for termination benefits	(294)	48	(246)	(322)	75	(247)
Other changes	(1,109)	178	(931)	-	(2,047)	(2,047)
Other comprehensive income	**(3,855)**	**(1,208)**	**(5,062)**	**(322)**	**(1,972)**	**(2,294)**

	2017			2017		
in EUR thousand	Value before tax	Tax	Value after tax	Value before tax	Tax	Value after tax
Net gains/losses recognized in revaluation surplus in relation to property, plant and equipment	126,464	(20,958)	105,506	91,695	(15,997)	75,698
Gains/losses recognized in revaluation surplus related to available-for-sale financial assets	10	(5)	5	10	(2)	8
Foreign currency translation differences - foreign operations	7,704	-	7,704	-	-	-
Provisions for termination benefits	(231)	23	(207)	(191)	18	(172)
Other changes	(7,741)	194	(7,547)	68	-	68
Other comprehensive income	**126,206**	**(20,746)**	**105,460**	**91,582**	**(15,980)**	**75,602**

*Reconciliation to effective tax rate**	Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**
Profit or loss for the year	(203,726)	(78,714)
Tax	(19,491)	3,992
Profit or loss before tax	**(223,217)**	**(82,706)**
Tax calculated at tax rate	(42,411)	(13,845)
Increase/decrease in income for tax purposes	(224)	(280)
Decrease/increase in expenses for tax purposes	-	-
Tax of non-deductible expenses	6,511	9,988
Tax reliefs	16,633	(201)
Other reconciliations	-	346
Total tax	**(19,491)**	**(3,992)**
Effective tax rate	**9.6%**	**5.1%**

* The Mercator Group does not prepare consolidated tax settlements.

Movements in deferred taxes	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
At the beginning of the year – net deferred tax (liabilities)	**(7,827)**	**(11,890)**	**(4,011)**	**(6,031)**
Foreign exchange differences	(71)	20	-	-
Recognized in profit or loss	14,067	5,633	19,492	3,992
Recognized in other comprehensive income	(15,445)	(1,897)	(16,643)	(1,972)
Recognized in liabilities	663	307	663	-
At the end of the year – net deferred tax (liabilities)	**(8,614)**	**(7,827)**	**(500)**	**(4,011)**

Deferred taxes are calculated based on temporary differences under the balance sheet liability method using the tax rate effective in individual countries where Group companies operate.

Deferred tax liabilities	Mercator Group				
in EUR thousand	Revaluation of property, plant and equipment	Revaluation of available-for-sale financial assets	Depreciation of property, plant and equipment under EUR 500	Differences between tax recognized and business depreciation	Total
Balance as at January 1, 2016	**26,690**	**6**	**812**	**2,440**	**29,947**
Foreign exchange differences	(15)	-	-	(14)	(29)
Recognized in profit or loss	21	-	191	(408)	(195)
Recognized in other comprehensive income	1,434	0	-	-	1,434
Recognized under liabilities	198	-	-	-	198
Balance as at December 31, 2016	**28,329**	**6**	**1,002**	**2,019**	**31,356**
Foreign exchange differences	141	-	-	5	146
Recognized in profit or loss	(15)	-	44	(297)	(268)
Recognized in other comprehensive income	20,958	5	-	-	20,963
Recognized under liabilities	(663)	-	-	-	(663)
Balance as at December 31, 2017	**48,750**	**11**	**1,047**	**1,727**	**51,534**

Deferred tax liabilities	Poslovni sistem Mercator d.d.				
in EUR thousand	Revaluation of property, plant and equipment	Revaluation of available-for-sale financial assets	Depreciation of property, plant and equipment under EUR 500	Differences between tax recognized and business depreciation	Total
Balance as at January 1, 2016	**20,971**	**2**	**797**	**1,010**	**22,779**
Foreign exchange differences	-	-	-	-	-
Recognized in profit or loss	21	-	183	199	403
Recognized in other comprehensive income	2,047	-	-	-	2,047
Recognized under liabilities		-	-	-	-
Balance as at December 31, 2016	**23,040**	**1**	**979**	**1,210**	**25,229**
Foreign exchange differences	-	-	-	-	-
Recognized in profit or loss	(17)	-	46	90	119
Recognized in other comprehensive income	15,997	2	-	-	15,999
Recognized under liabilities	(663)	-	-	-	(663)
Balance as at December 31, 2017	**38,356**	**3**	**1,026**	**1,299**	**40,684**

Deferred tax assets	Mercator Group							
in EUR thousand	Provisions not recognized for tax purposes	Allowances for operating receivables	Tax loss	Value adjustments of merchandise inventories	Differences between tax recognized and business depreciation	Revaluation of available-for-sale financial assets and derivatives	Other	Total
Balance as at January 1, 2016	**1,800**	**2,680**	**9,441**	**45**	**2,640**	**-**	**1,451**	**18,057**
Foreign exchange differences	(2)	-	(6)	(1)	(0)	-	(0)	(9)
Recognized in profit or loss	193	1,261	2,018	(36)	368	347	1,286	5,438
Recognized in other comprehensive income	48	(3)	178	-	(206)	-	26	42
Balance as at December 31, 2016	**2,039**	**3,937**	**11,632**	**8**	**2,802**	**347**	**2,763**	**23,528**
Foreign exchange differences	6	-	43	4	21	-	1	75
Recognized in profit or loss	200	23	16,518	64	876	9	2,082	19,771
Recognized in other comprehensive income	23	-	(551)	75	-	-	-	(453)
Balance as at December 31, 2017	**2,268**	**3,961**	**27,641**	**151**	**3,699**	**356**	**4,845**	**42,921**

Deferred tax assets	Poslovni sistem Mercator d.d.							
in EUR thousand	Provisions not recognized for tax purposes	Allowances for operating receivables	Tax loss	Value adjustments of merchandise inventories	Differences between tax recognized and business depreciation	Revaluation of available-for-sale financial assets and derivatives	Other	Total
Balance as at January 1, 2016	**1,566**	**2,671**	**8,662**	**-**	**2,402**	**1,398**	**49**	**16,748**
Foreign exchange differences	-	-	-	-	-	-	-	-
Recognized in profit or loss	147	1,260	1,019	-	337	345	1,287	4,395
Recognized in other comprehensive income	75	-	-	-	-	-	-	75
Balance as at December 31, 2016	**1,788**	**3,931**	**9,681**	**-**	**2,739**	**1,743**	**1,336**	**21,218**
Foreign exchange differences	-	-	-	-	-	-	-	-
Recognized in profit or loss	209	1	17,296	-	5	1,362	737	19,611
Recognized in other comprehensive income	18	-	-	-	-	-	(663)	(645)
Balance as at December 31, 2017	**2,015**	**3,932**	**26,977**	**-**	**2,744**	**3,105**	**1,411**	**40,184**

Poslovni sistem Mercator d.d.

In 2017, the Company recognized both liabilities and deferred tax assets. Deferred tax liabilities (through profit or loss) decreases the tax bases of the Company in 2017, while deferred tax asset increases it.

Deferred tax assets were not recognized through the income statement in the amount of EUR 21,446 thousand from the revaluation of investments in the equity of subsidiaries Mercator - H d.o.o., Mercator – S d.o.o. in Mercator - Makedonija d.o.o.e.l. The reason for not recognizing these claims is that the parent company does not intend to dispose of these subsidiaries in the foreseeable future.

In 2017, the Mercator Group companies recognized deferred tax liabilities as well as deferred tax assets. Deferred tax liabilities (through profit or loss) decrease tax base of individual companies of the Group in 2017, whereas the deferred tax assets increase them.

Deferred tax assets were not recognized through the income statement in the amount of EUR 21,446 thousand from the revaluation of investments in the capital of subsidiaries Mercator - H d.o.o., Mercator – S d.o.o. in Mercator - Makedonija d.o.o.e.l. The reason for not recognizing these claims is that the parent company does not intend to dispose of these subsidiaries in the foreseeable future.

Deferred tax assets and liabilities in the balance sheet are not offset.

20. Disposal groups

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Land	37,753	-	35,913	-
Buildings	79,393	-	59,290	-
Total	**117,146**	**-**	**95,203**	**-**

Mercator Group

As at December 31, 2017, the Group reallocated EUR 117,146 thousand of non-current assets to disposal groups. As real estate monetization is underway, the Group reclassified land and buildings subject to monetization and intended for sale in 2018 in line with IFRS 5.

Poslovni sistem Mercator d.d.

As at December 31, 2017, the Company reallocated EUR 95,203 thousand of non-current assets to disposal groups. As property monetization is underway, the Company reclassified land and buildings subject to monetization and intended for sale in 2018 in line with IFRS 5.

21. Inventories

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Merchandise	208,723	224,785	108,541	125,534
Materials	5,526	7,193	370	649
Work in progress	2	2	-	-
Finished goods	850	961	-	-
Decrease: revaluation adjustment of inventories	(4,869)	(8,613)	(3,961)	(4,400)
Total	**210,233**	**224,328**	**104,950**	**121,783**

Mercator Group

Inventories of trade goods/merchandise, raw and processed materials, work-in-progress, and finished products as at December 31, 2017 amounted to EUR 210,233 thousand, which is 6.3 % less than at the end of the previous period.

The reversal of a revaluation adjustment of inventories is not possible unless these inventories have been sold. An increase in inventory adjustment is recognized in profit or loss account.

The carrying amount of inventories does not exceed their realisable value. The inventories are not pledged for loans received.

Poslovni sistem Mercator d.d.

Inventories of trade goods/merchandise, raw and processed materials, work-in-progress and finished products as at December 31, 2017 amounted to EUR 104,950 thousand, which is 13.8 % less than at the end of the previous period.

The reversal of a revaluation adjustment of inventories is not possible unless these inventories have been sold. An increase in inventory adjustment is recognized in profit or loss account.

The carrying amount of inventories does not exceed their realizable value. The inventories are not pledged for loans received.

22. Trade and other receivables

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Trade and other receivables	203,029	173,424	66,648	96,215
Deferred costs	6,030	9,609	1,646	3,745
Accrued revenues	19,453	22,675	3,367	4,489
Total trade and other receivables	**228,512**	**205,707**	**71,661**	**104,449**

Mercator Group

Accrued revenues refer mainly to the included variable considerations.

The carrying amounts of all trade receivables and other receivables in materially significant amounts are consistent with their fair values. Receivables are valued at realizable value.

As at December 31, 2017, the allowance for receivables amounted to EUR 94,311 thousand (2016: EUR 80,709 thousand). Changes in allowances for trade receivables are disclosed in Note 30 (Financial instruments).

Poslovni sistem Mercator d.d.

Deferred costs in 2017 amounted to EUR 1,646 thousand and relate primarily to assets that are collected for property reserve funds and other deferred costs.

Accrued revenues relate primarily to accrued revenues from commercial contracts with suppliers.

The carrying amounts of all trade receivables and other receivables in all significant amounts are consistent with their fair value. Receivables are valued at realizable value and are not pledged. The amount of insured receivables is disclosed in Note 30. Financial Instruments.

As at 31 December 2017, the amount of allowances for receivables was EUR 32,790 thousand (2016: EUR 26,139 thousand). Changes in allowances for trade receivables are disclosed in Note 30. Financial Instruments.

23. Loans and deposits

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Deposits for rent payments	19,322	19,869	-	-
Loans to companies	7,807	11,516	126,400	126,201
Deposits in banks	1,851	8,110	-	-
Total loans and deposits	**28,980**	**39,495**	**126,400**	**126,201**

Mercator Group

Loans and deposits at the Group level in 2017 amounted to EUR 28,980 thousand (2016: EUR 39,495 thousand).

Deposits for rent payments relate to long-term paid in advance rents for trade facilities abroad and are charged with interest. They are insured by mortgages on trade facilities. Loans granted to other companies mostly pertain to loans to companies that have built trade facilities; these loans are secured by a mortgage on these facilities. The average interest rate on loans given and deposits is 2.00%.

Poslovni sistem Mercator d.d.

Loans in the amount of EUR 126,400 thousand (2016: EUR 126,201 thousand) relate to short-term loans in the amount of EUR 27,180 thousand (2016: EUR 999 thousand) and in the amount of EUR 99,220 thousand (2016: EUR 125,202 thousand) to long-term loans.

The average interest rate on loans given is 3.51%. The Company has no secured loans given to subsidiaries and no other loans given.

24. Cash and cash equivalents

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Cash in hand	21,929	18,213	11,362	10,957
Cash in banks	2,183	8,105	274	2,386
Total cash and cash equivalents	**24,112**	**26,318**	**11,635**	**13,344**

Cash in hand includes cash in transit (daily proceeds of retail units), cash in hand, and cheques with maturity up to 90 days.

25. Equity

Share capital

Share capital of the Company amounts to EUR 254,175,051.39. It is divided into 6,090,943 ordinary, registered, no-par value shares (2016: 6,090,943), that are all entered into the Companies Register as at December 31, 2017.

Conditional capital increase

Shareholders' Assembly of the Company can adopt a resolution on conditional capital increase on the basis of provisions stated in Article 46 of the Company's Articles of Association; such possibility has not been realized so far.

Treasury shares

As at December 31, 2017, the Company held 42,192 treasury shares in the amount of EUR 3,235 thousand (2016: 42,192 treasury shares, EUR 3,235 thousand).

Reserves

Reserves of the Group and the Company comprise share premium, revenue reserves, fair value reserve and currency translation reserve. None of share premium, statutory reserves, fair value reserve and currency translation reserve can be used for payment of dividends or other participation in profit.

As at December 31, 2017, *share premium* amounted to EUR 207,523 thousand (2016: EUR 286,772 thousand). It includes the excess over nominal value of paid-up shares and surplus that was created as the difference between purchase and sales values of disposed treasury shares. In 2017, share premium was reduced on the account of covering the balance sheet loss.

Revenue reserves, as at December 31, 2017 amounted to EUR 42,830 thousand (2016: EUR 41,685 thousand) and at the Company EUR 16,624 thousand (2016: EUR 16,624 thousand), include statutory reserves, reserves for treasury shares and other revenue reserves.

- As at December 31, 2017, the Group has statutory reserves in the amount of EUR 17,947 thousand (the Company has statutory reserves in the amount of EUR 13,389 thousand);
- As at December 31, 2017, the Company owned 42,192 treasury shares in the amount of EUR 3,235 thousand;
- Other revenue reserves as at December 31, 2017 amount to EUR 21,648 thousand at the Group (the Company has no other revenue reserves). They consist of redistributed residual retained earnings from previous years. They can be used for any purpose, except for own shares reserve.

Capital and statutory reserves (tied reserves) can be used in surplus amount to increase the share capital from the company's assets and for covering the net loss of the financial year and to cover the carried forward net loss if the revenue reserves for the distribution of profit to the shareholders are not used simultaneously.

Currency translation reserve at the Group level as at December 31, 2017 amounts to EUR -84,029 thousand which increased in 2017 by EUR 7,691 thousand due to the changes in foreign currency because of consolidation of subsidiaries into consolidated financial statements.

Fair value reserve, which as at December 31, 2017, amounts to EUR 200,181 thousand (2016: EUR 104,541 thousand) for the Group and EUR 149,214 thousand (2016: EUR 76,196 thousand) for the Company, includes fair value reserve for buildings and land, which is measured using the revaluation model, fair value reserve regarding available-for-sale financial assets and fair value reserve from actuarial gains or losses arising from creation of provisions for termination benefits upon retirement. The increase of fair value reserve relates to revaluation of real estate in 2017 in accordance with Mercator Group's accounting policy, rules and International Accounting Standards, the valuation of real estate as at December 31, 2017 was carried out by an independent certified real estate appraiser. The final report was verified by the two independent appraisers that confirmed the findings of the first report.

Fair value reserve:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Property fair value reserve	205,020	108,716	154,442	80,544
Fair value reserve for available-for-sale financial assets	51	26	19	7
Fair value reserve for provisions for retirement benefits	(4,891)	(4,200)	(5,248)	(4,355)
Total fair value reserve	**200,181**	**104,541**	**149,214**	**76,196**

Changes in equity in 2017 for the Group relate to:

- decrease in equity for loss in the amount of EUR 184,435 thousand in 2017,
- increase in equity due to the revaluation of land and buildings in the amount of EUR 126,370 thousand,
- decrease in equity due to the impact of deferred taxes in the amount of EUR 20,747 thousand,
- increase in equity due to foreign exchange translation differences in the foreign subsidiaries in the amount of EUR 7,704 thousand,
- increase in equity due to other changes in the amount of EUR 7,868 thousand.

Dividends

In 2018, dividends will not be paid by the Company.

As at December 31, 2017, 1,637 shareholders were registered in the Company's share register, which means that the number of shareholders of the Company decreased by 212 compared to December 31, 2016.

Detailed ownership structure is presented in the business part of the annual report.

26. Loss per share

Basic earnings (loss) per share are calculated by dividing the net profit (loss) attributable to shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of treasury shares.

Basic net earnings (loss) per share	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	**2016**	**2017**	**2016**
Profit attributable to the owners of the parent company (EUR thousand)	(184,435)	(78,063)	(203,726)	(78,714)
Weighted average number of ordinary shares	6,048,751	6,048,751	6,048,751	6,048,751
Earnings per share (in EUR)	**(30.5)**	**(12.9)**	**(33.7)**	**(13.0)**

Weighted number of ordinary shares	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	**2016**	**2017**	**2016**
Issued ordinary shares as at January 1	6,090,943	6,090,943	6,090,943	6,090,943
Effect of treasury shares (in EUR thousand)	(42,192)	(42,192)	(42,192)	(42,192)
Effect of new issue	-	-	-	-
Weighted average number of ordinary shares as at December 31	**6,048,751**	**6,048,751**	**6,048,751**	**6,048,751**

Since the Group and the Company do not have any preference shares or convertible bonds, diluted net loss per share is the same as basic net loss per share.

27. Loans received and other financial liabilities

in EUR thousand	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016 restated	2017	2016 restated
Long-term financial liabilities				
Loans from banks, bonds and commercial paper	650,229	622,160	453,277	420,569
Loans from subsidiaries and other companies	23,444	20,400	24,937	20,500
Finance leases	91,636	127,216	61,077	91,624
Total	**765,309**	**769,776**	**539,291**	**532,693**
Short-term financial liabilities				
Bank loans, bonds and commercial papers and short-term part of long-term bank loans, bonds and commercial papers	78,440	75,603	14,064	53,535
Loans from subsidiaries and other companies and short-term part of loans to subsidiaries and other companies	3,270	40,672	18,220	27,747
Current part of finance lease	34,680	16,967	29,223	11,604
Total	**116,391**	**133,241**	**61,507**	**92,886**
Total financial liabilities	**881,700**	**903,017**	**600,798**	**625,579**

Mercator Group

As at December 31, 2017 the Group changed its accounting policy related to interest that mature on maturity of loans (PIK interest) and transferred them from long-term business to long-term financial liabilities in the amount of EUR 36,887 thousand. Due to the comparability of data between periods, changes in accounting policy are also taken into account in the 2016 business report.

As at December 31, 2017 the Group disclosed a pledged real estate in the amount of EUR 495,511 thousand.

Poslovni sistem Mercator d.d.

As at December 31, 2017, the Company transferred interest that mature on maturity of loans (PIK interest) in the amount of EUR 28,861 thousand from long-term business to long-term financial liabilities. Due to the comparability of data between periods, changes in accounting policy are also taken into account in the 2016 business report.

As at December 31, 2017, the Company had mortgaged property in the amount of EUR 285,058 thousand.

Mortgaged property and loans collateralized by a mortgage amounted:	Mercator Group	Poslovni sistem Mercator d.d.
Mortgaged property	495,511	285,058

Effective interest rates as at the balance sheet date:	Mercator Group		Poslovni sistem Mercator d.d.	
	2017	2016	2017	2016
Bank loans	3.61%	3.13%	3.53%	3.04%
Other loans	1.97%	1.99%	1.84%	1.77%

Floating interest rates are mostly interest rates related to EURIBOR. Fixed interest rates are mostly related to borrowings from domestic banks or subsidiaries, with fixed nominal interest rate.

	Mercator Group					
Finance lease liabilities - minimum lease payments:	Future minimum lease payments	Interest	Present value of minimum lease payments	Future minimum lease payments	Interest	Present value of minimum lease payments
in EUR thousand	**2017**	**2017**	**2017**	**2016**	**2016**	**2016**
Less than one year	34,531	2,860	31,671	28,310	2,240	26,070
Between one and five years	69,493	4,016	65,477	84,677	5,857	78,820
More than five years	20,727	766	19,960	40,973	1,680	39,293
Total	**124,751**	**7,643**	**117,108**	**153,960**	**9,777**	**144,183**

	Poslovni sistem Mercator d.d.					
Finance lease liabilities - minimum lease payments:	Future minimum lease payments	Interest	Present value of minimum lease payments	Future minimum lease payments	Interest	Present value of minimum lease payments
in EUR thousand	**2017**	**2017**	**2017**	**2016**	**2016**	**2016**
Less than one year	29,223	2,212	27,011	13,147	1,543	11,604
Between one and five years	45,271	2,651	42,620	65,232	4,270	60,962
More than five years	15,806	587	15,219	32,053	1,390	30,662
Total	**90,300**	**5,450**	**84,850**	**110,431**	**7,203**	**103,228**

Mercator Group

The Group has employed finance lease as a method of financing its major trade facilities in Slovenia and Croatia and some land in Slovenia. Finance leases are signed for periods of 5 to 25 years; the last such lease is to expires in 2027.

Carrying amounts of all financial liabilities approximate their fair values. The share of long-term financial liabilities in total financial liabilities as at December 31, 2017 amounted to 86.8 % (2016: 85.2 %).

Poslovni sistem Mercator d.d.

The Company has employed finance lease as a method of financing its major trade facilities and land. Finance leases are signed for periods of 7 to 25 years; the last such lease is to expires in 2026.

Carrying amounts of all financial liabilities approximate their fair values. The share of long-term financial liabilities in total financial liabilities as at December 31, 2017 amounted to 89.8 % (2016: 85.2 %).

28. Provisions

Mercator Group						
in EUR thousand	Provisions for restitution claims	Provisions for company reorganisation costs	Lawsuits received	Provisions for termination and jubilee benefits	Provisions for other purposes	Total
Balance as at January 1, 2016	**-**	**3**	**2,795**	**22,664**	**456**	**25,918**
Creation	-	-	298	3,955	2,910	7,163
Utilization	-	-	(70)	(2,599)	(226)	(2,895)
Reversal	-	(3)	(70)	(762)	(2,517)	(3,351)
Foreign exchange differences	-	-	-	(17)	-	(17)
Balance as at December 31, 2016	**-**	**-**	**2,953**	**23,241**	**624**	**26,818**
Creation	3,484	-	1,982	2,771	3,035	11,271
Utilization	-	-	(17)	(1,532)	(2,286)	(3,835)
Reversal	-	-	(1,403)	(2,365)	(850)	(4,618)
Foreign exchange differences	-	-	10	38	-	48
Balance as at December 31, 2017	**3,484**	**-**	**3,525**	**22,152**	**523**	**29,683**

Poslovni sistem Mercator d.d.						
in EUR thousand	Provisions for restitution claims	Provisions for company reorganisation costs	Lawsuits received	Provisions for termination and jubilee benefits	Provisions for other purposes	Total
Balance as at January 1, 2016	**-**	**3**	**2,269**	**19,890**	**-**	**22,162**
Creation	-	-	-	3,354	786	4,140
Utilization	-	-	-	(1,266)	(786)	(2,052)
Reversal	-	(3)	(70)	(1,137)	-	(1,210)
Foreign exchange differences	-	-	-	-	-	-
Balance as at December 31, 2016	**-**	**-**	**2,199**	**20,841**	**-**	**23,041**
Creation	3,484	-	1,350	2,456	850	8,139
Utilization	-	-	-	(1,290)	-	(1,290)
Reversal	-	-	(1,403)	(2,260)	(850)	(4,513)
Foreign exchange differences	-	-	-	-	-	-
Balance as at December 31, 2017	**3,484**	**-**	**2,146**	**19,747**	**-**	**25,377**

Provisions for termination benefits and jubilee benefits were calculated applying the following methods and assumptions:

- the discount rate used in the calculation was taken into account on the basis of the published yields of government bonds and varied between 0.8% and 5.3% between the countries;
- actuarial projected unit credit method taking into account attribution of employment benefits on a straight-line basis;
- actuarial assumptions of mortality, staff fluctuation and average employee age in the companies of the Mercator Group;
- retirement date was calculated on the basis of gender, date of birth, overall period of service as at December 31, 2017;
- in the calculations the discount rate of long-term government bonds is used;
- for the years 2017 and 2018, the rates of increase in average salaries in respect of their forecasts of movements in each country in which the Mercator Group operates are taken into account;
- jubilee benefits are paid under the assumption that the liability arises upon the expiry of a 10, 20, 30 or 40-year employment in the company;
- in the event of part-time contracts, the reason for part-time employment is taken into account (parenthood, disability) and used appropriately in the calculation of retirement benefits.

Mercator Group

Provisions at the Group level as at December 31, 2017 amounted to EUR 29,683 thousand (2016: EUR 26,818 thousand). Additionally, provisions for EUR 11,271 thousand were created. With respect to liabilities, the provisions decreased in the amount of EUR 8,453 thousand.

Lawsuits received

Provisions for lawsuits received as at December 31, 2017 amounted to EUR 3,525 thousand. On the basis of the lawsuits received and the opinion of the legal profession, in 2017 the Group created additional provisions in total amount of EUR 1,982 thousand, due to legal proceedings that were resolved in favor of Mercator the Group reversed provisions in the amount of EUR 1,403 thousand.

Severance payments and jubilee benefits

As at December 31, 2017, the amount of provisions for severance payments and jubilee benefits amounted to EUR 22,152 thousand.

Other provisions

Other provisions relate to provisions for improving the working conditions of persons with disabilities in Mercator d.d., and Mercator IP d.o.o.

Other provisions as at December 31, 2017 amounted to EUR 523 thousand. In 2017, they were utilized pursuant to relevant legislation in the amount of EUR 850 thousand, to cover the labour costs of persons with disabilities, labour costs of employees helping the persons with disabilities, and investments in property, plant and equipment related to the work of persons with disabilities.

Poslovni sistem Mercator d.d.

As at December 31, 2017, provisions amounted to EUR 25,377 thousand (2016: EUR 23,041 thousand). Additionally, provisions in the amount of EUR 8,139 thousand were recognized (reducing the costs and expenses in the amount of EUR 7,338 thousand and charged to other comprehensive income in the amount of 801 thousand EUR). Provisions debiting liabilities decreased by EUR 5,803 thousand (utilization of provisions in the amount of EUR 1,290 thousand, reversal of provisions crediting other operating income of EUR 3,903 thousand and reversal of provisions crediting other comprehensive income of EUR 610 thousand). Net effect on the income statement amounted to EUR -3,435 thousand.

Lawsuits received

Provisions for lawsuits received as at December 31, 2017 amounted to EUR 2,146 thousand. Reversed were EUR 1,403 thousand, created were EUR 1,350 thousand.

Provisions for termination benefits and jubilee benefits
As at December 31, 2017, termination benefits and jubilee benefits amounted to EUR 19,747 thousand. In 2017, termination benefits and jubilee benefits were paid in the total amount of EUR 1,290 thousand reducing the existing provisions, while new provisions were created in the amount of EUR 2,456 thousand (reducing the costs and expenses in the amount of EUR 1,655 thousand and debited to other comprehensive income in the amount of EUR 801 thousand), while provisions credited to other operating income were reversed by EUR 1,650 thousand, and provisions credited to other comprehensive income in the amount of EUR 610 thousand.

Other provisions
As at December 31, 2017, the Company had no other provisions. In 2017, they increased by EUR 850 thousand and were fully utilized for wage subsidies for people with disabilities.

29. Trade and other liabilities

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016 restated	2017	2016 restated
Trade liabilities	522,221	500,868	240,951	268,888
Payables to employees	14,541	12,523	8,788	8,760
Liabilities for taxes and contributions	21,435	26,495	18,177	19,877
Other payables	28,802	31,695	17,520	3,261
Accrued costs and deferred revenues	47,137	32,201	19,197	16,848
Total	**634,137**	**603,783**	**304,633**	**317,634**
Trade and other payables include:				
Non-current/long-term liabilities	7,174	13,762	1,012	2,552
Current/short-term liabilities	626,963	590,021	303,621	315,082

Mercator Group
As at December 31, 2017, trade and other liabilities amounted to EUR 634,137 thousand (2016: EUR 603,783 thousand).

Accrued costs pertain to accrued interest paid on borrowings, variable considerations granted but not accounted for, and compensations, the costs of unused annual leave and other accrued costs.

Deferred revenue includes particularly deferred revenue for claiming the discounts related to Pika bonus points.

As at December 31, 2017, the Group does not have any operating liabilities towards the members of the Supervisory Board, while the liabilities towards Management Board members and other employees include recognized undisbursed compensation for December 2017.

Poslovni sistem Mercator d.d.
As at December 31, 2017, trade and other liabilities amounted to EUR 304,633 thousand (2016: EUR 317,634 thousand).

Accrued costs refer to the costs of unused annual leave, superrabates granted but not accounted for and to other accrued costs.

Deferred revenue includes particularly deferred revenue for realization of discounts from collected points.

As at December 31, 2017, the Company does not disclose operating liabilities to the Supervisory Board members, members of the Management Board and other employees, although it discloses recognized undisbursed compensation for December 2017.

30. Financial instruments

Financial risk management

Risk overview

The Group and the Company are monitoring and controlling different types of financial risks to which their operations are exposed:

- credit risk,
- liquidity risk,
- market risk,
- operational risk.

Market risk management involves managing the interest rate and currency risk. The Group's and the Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's and the Company's financial performance.

This note presents the information on the Group's and the Company's exposure to the risks listed above, as well as the goals, policies, and processes for measurement and management thereof and the Group's and the Company's equity.

Risk management policy

Active risk management at the Group and the Company pursues the objective of timely recognition and response to potential threats by developing appropriate measures to hedge against identified risks or to reduce risk exposure. The parent company manages interest rate, currency and liquidity risks centrally for the entire Group, whereas credit risks are managed as a rule by subsidiaries. Risk management measures are incorporated into daily operations at all companies of the Group.

Risk management activities in the Group and the Company are the responsibility of the dedicated Risk Management Council. The council is managing a systematic risk management process which is laid down in the Rules of Procedure for Risk Management. Risk management is a central corporate function managed and coordinated by the Company.

Risks are divided into five areas, and within them, different risk groups. Within each risk group, based on the analysis of the business environment, past business results and plans and estimates for the future, risks are identified. Through detailed analysis, the level of risk value is assessed, and on the basis of a single criterion, it is estimated whether the risk is crucial.

For all key risks:

- activities are described that were carried out in the current year for the purpose of managing this risk,
- the planned risk management activities for the following year defined, and
- it is determined whether a higher of a lower exposure to that risk is assessed in the following year compared to the previous year.

The Group and the Company analyze risk for each individual company and the Group as a whole. In the case of non-compliance with certain data, an approximation for the entire Group is made with the data available.

Risks occurring in the process of preparation of financial statements are managed by employment of clear and concise accounting practices and their strict implementation, efficient organization of the accounting function, and regular internal and external audits and reviews of internal controls, business processes, and operations.

Pursuant to the Companies Act, audit of financial statements is mandatory for the Group and the Company. The purpose of the audit is to increase the level of trust among the users of financial information. The auditor applies appropriate audit procedures and methods to review the financial statements and passes an opinion as to whether they are compiled in compliance with the appropriate framework of financial reporting in all relevant aspects.

Internal audit has been in operation at the Group and the Company as an independent support function since 2000. The basic function of internal audit is perpetual development and monitoring of the internal control systems from the aspect of management, or hedging, of all sorts of operating and other risks to which the Group and the Company are exposed.

Quality performance of the supervisory function by the Supervisory Board of the Company is also supported by the Audit Committee which, among other duties, is in charge of supervising the operation of the risk management system, internal audit and the internal control system, and takes part in specifying the major auditing areas and proposes the selection of the independent external auditor for the Group and the Company.

The Group and the Company performance is affected by the entire economic environment both globally and in the markets of Mercator operations. With constantly changing trends, it is crucial for the Group and the Company to carefully manage the risks that they face in their business operations.

Credit Risk

Credit risk is the risk that the Group and the Company will suffer financial loss if a party to an agreement defers a payment and later does not settle its obligations in full or not at all. Credit risk arises mainly from receivables to wholesale customers and receivables from Pika card.

The Group's and the Company's exposure to credit risk is particularly dependent on the characteristics of individual customers. However, the Group's and the Company's exposure to customers is highly dispersed. In accordance with the adopted policy for each new customer, an analysis of its creditworthiness is performed before the Group and the Company offer its standard payment terms. The analysis of the credit rating includes external ratings and assessments, if these exist. Limits on purchases, which represent the maximum amount of open positions, are determined for each customer individually. The Group's and the Company's business with customers who do not meet the benchmark credit rating takes place only on the basis of advance payments or subject to appropriate payment insurance.

The carrying amounts of financial assets (receivables and loans) represent the maximum credit exposure.

The maximum exposure to credit risk at the reporting date:	**Mercator Group**		**Poslovni sistem Mercator d.d.**	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Trade and other receivables	228,512	205,707	71,661	104,450
Deposits for rent payments	19,322	19,869	-	-
Loans to companies	7,807	11,516	126,400	935
Loans given to subsidiaries	1,851	8,110	-	125,266
Total	**257,492**	**245,202**	**198,061**	**230,651**

Trade receivables predominantly derive from wholesale of goods, material, and services, and sale of goods to individuals, Pika card holders. Both wholesale and retail customers are dispersed; hence, there is no major exposure to an individual customer. The Group and the Company are also constantly monitoring customer payment defaults and checks the rating of external customers and Pika card holders.

The loans granted by the Group and the Company to companies are collateralized and it is assessed that the credit risk arising therefrom is low. Additional explanations regarding loans granted are given in Note 23.

Maximum exposure to credit risk for trade receivables and loans at the reporting date by geographic region:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Slovenia	99,007	105,094	62,629	78,631
Abroad	158,485	140,108	135,432	152,020
Total	**257,492**	**245,202**	**198,061**	**230,651**

Maximum exposure to credit risk for trade receivables and loans at the reporting date by type of customer:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Retail customers	12,183	10,710	7,477	6,944
Wholesale customers and related companies	148,858	152,782	42,669	71,327
Receivables from employees and the government, and other receivables	42,408	9,932	16,502	17,944
Deferred costs	4,542	9,609	1,175	2,624
Accrued revenues	20,941	22,675	3,838	5,610
Loans and deposits	28,559	39,495	126,400	126,201
Total	**257,492**	**245,202**	**198,061**	**230,650**

In the category of retail partners the Group and the Company included receivables from individuals related to purchases in company retail units with Pika and other cards; the category of wholesale customers and related companies includes all receivables from sale of goods, material, and services, to legal/corporate entities.

Security of receivables and loans (in gross amounts, excluding impairment of receivables):	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Trade receivables	241,981	234,594	70,302	111,232
secured receivables	24,256	26,793	24,256	22,652
unsecured receivables	217,725	207,801	46,046	88,580
Other receivables	96,451	81,711	160,547	145,558
Total	**338,432**	**316,305**	**230,849**	**256,790**

Trade receivables are secured with bank guarantees, paid collaterals, cash deposits, prime mortgages, and liabilities to these customers. Among other receivables, the Group and the Company report receivables from the government, employees, as well as deferred costs and accrued expenses, and the Company also loans to subsidiaries of the Group in the amount of EUR 126,398 thousand.

Ageing of receivables and loans at the reporting date:	Mercator Group				Poslovni sistem Mercator d.d.			
	Gross	**Adjustment**	**Gross**	**Adjustment**	**Gross**	**Adjustment**	**Gross**	**Adjustment**
in EUR thousand	**2017**	**2017**	**2016**	**2016**	**2017**	**2017**	**2016**	**2016**
Not past due	163,007	-	150,494	-	190,545	-	223,172	1,942
Receivables 0-60 days overdue	55,322	5,497	58,806	4,218	10,378	4,413	8,447	3,022
Receivables 61-74 days overdue	24,431	51	5,234	1,367	220	35	572	264
Receivables 75-89 days overdue	3,405	177	2,190	(457)	573	20	398	162
More than 90 days overdue	92,267	88,587	109,187	75,581	29,133	28,321	24,201	20,749
Total	**338,432**	**94,311**	**325,911**	**80,709**	**230,849**	**32,790**	**256,790**	**26,139**

Changes in revaluation adjustment to receivables and loans:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
As at January 1	**80,709**	**36,570**	**26,140**	**21,585**
Effect of foreign exchange differences	587	(56)	-	-
Allowances for receivables during the year	20,065	48,648	14,489	8,218
Final receivable write-off	(4,044)	(1,864)	(3,286)	(1,861)
Decrease of allowance for impairment during the year	(3,005)	(2,589)	(4,554)	(1,802)
Balance as at December 31	**94,311**	**80,709**	**32,790**	**26,140**

The quality of trade receivables and loans given is rated based on the policies specified by the Risk Management Council. Credit risk is monitored by classifying the trade receivables based on their characteristics.

The Company is providing guarantees to its subsidiaries for borrowings from banks, in the amount of EUR 302,837 thousand.

Liquidity risk

Liquidity risk is the risk that the Group and the Company will in the course of their business activities encounter difficulties in settlement of its current liabilities which are settled in cash or with other financial assets. In 2017, liquidity risk remains stable due to an agreement on the financial restructuring of the debt with the creditor banks and the Group.

The Group and the Company actively manage liquidity risk within the framework of the established centralized management of cash. The centralized cash management represents a system based on:
specifically defined methodology of cash flow planning based on which every company from the Group makes weekly plans of the daily cash flow for 3 months in advance, which is reflected in the weekly updated short-term consolidated liquidity plan of the Group;

- standardized daily reporting systems about the cash flow generated on the previous day and the drafting of analyses of deviations from the cash flow plan;

- centralized alignment at various decision-making levels, meaning that an appropriate amount of cash is always available at the company to repay its liabilities.

As at December 31, 2017, the Group and the Company had access to the following liquidity lines:	**Mercator Group**		**Poslovni sistem Mercator d.d.**	
in EUR thousand	**2017**	**2016**	**2017**	**2016**
Cash and cash equivalents	24,112	26,318	11,635	13,344
Standby revolving credit lines	15,224	82,939	9,489	53,813
Total	**39,336**	**109,256**	**21,124**	**67,157**

One of the most important elements of the final agreement in the context of financial restructuring, based on the consistency of the cash flow available for servicing the debt with financial liabilities, is the elimination of refinancing risk, which increases financial stability.

Following is an overview of the contractual maturity of liabilities and estimated interest expenses. The future contractual due date of the principal and interest is given based on the loan agreements as at December 31, 2017.

Contractual maturity of liabilities and estimated interest expenses:	***Mercator Group***											
2017	**Total**		Up to 6 months		6 to 12 months		1-3 years		3-5 years		Over 5 years	
in EUR thousand	**Carrying amount**	**Contractual cash flows**	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Loans from banks, bonds and commercial paper	736,821	813,332	39,997	13,040	41,026	12,352	250,460	43,047	405,338	8,072	-	1
Borrowings from related and other companies	20,128	20,128	128	-	-	-	20,000	-	-	-	-	-
Finance leases	124,751	132,394	7,077	852	27,455	2,008	44,342	2,491	25,152	1,525	20,727	766
Trade and other payables and current tax liabilities	634,137	634,210	601,390	73	18,586	-	11,657	-	8,072	-	2,504	-
Total	**1,515,837**	**1,600,064**	**648,592**	**13,966**	**87,066**	**14,360**	**326,458**	**45,538**	**438,562**	**9,597**	**23,231**	**767**

2016 (restated)	**Total**		Up to 6 months		6 to 12 months		1-3 years		3-5 years		Over 5 years	
in EUR thousand	**Carrying amount**	**Contractual cash flows**	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Bank loans and bonds	697,762	784,315	47,530	4,148	28,278	10,300	88,856	40,848	533,098	31,257	-	-
Borrowings from related and other companies	61,072	64,233	1,649	2,310	28,516	536	10,408	279	20,000	34	500	1
Finance leases	144,183	153,960	8,294	1,168	8,227	1,071	46,256	3,521	40,433	2,336	40,973	1,680
Trade and other payables and current tax liabilities	603,783	604,412	533,277	2,348	54,592	281	543	-	13,371	-	-	-
Total	**1,506,800**	**1,606,920**	**590,750**	**9,974**	**119,613**	**12,188**	**146,063**	**44,648**	**606,902**	**33,627**	**41,473**	**1,682**

Contractual maturity of liabilities and estimated interest expenses:	*Poslovni sistem Mercator d.d.*											
2017	**Total**		Up to 6 months		6 to 12 months		1-3 years		3-5 years		Over 5 years	
in EUR thousand	**Carrying amount**	**Contractual cash flows**	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Loans from banks, bonds and commercial paper	**467,341**	**524,217**	7,032	8,328	7,032	8,569	115,613	33,065	337,663	6,913	-	-
Borrowings from related and other companies	**43,157**	**44,057**	1,500	386	16,720	382	24,937	132	-	-	-	-
Finance leases	**90,300**	**95,751**	4,469	515	24,754	1,698	28,306	1,587	16,965	1,063	15,806	587
Trade and other payables and current tax liabilities	**304,633**	**304,633**	286,048	-	18,585	-	-	-	6,913	-	-	-
Total	**905,431**	**968,657**	**299,049**	**9,228**	**67,091**	**10,649**	**168,856**	**34,785**	**361,542**	**7,977**	**15,806**	**587**

2016 (restated)	**Total**		Up to 6 months		6 to 12 months		1-3 years		3-5 years		Over 5 years	
in EUR thousand	**Carrying amount**	**Contractual cash flows**	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Bank loans and bonds	**474,104**	**538,531**	26,733	1,780	26,802	7,288	48,225	28,713	372,344	26,646	-	-
Borrowings from related and other companies	**48,247**	**49,240**	800	480	26,947	441	-	36	20,000	34	500	1
Finance leases	**103,228**	**110,431**	5,767	795	5,837	748	34,466	2,448	26,496	1,822	30,662	1,390
Trade and other payables and current tax liabilities	**317,634**	**317,634**	296,202	-	21,143	-	289	-	-	-	-	-
Total	**943,213**	**1,015,836**	**329,502**	**3,055**	**80,729**	**8,477**	**82,979**	**31,197**	**418,840**	**28,502**	**31,162**	**1,392**

Market risks

Market risk is a risk that is common to the entire class of assets and liabilities. Market risk is deemed to exist when there is probability that the value of investments or financial assets in a certain period of time will decrease due to changes in economic environment or other events affecting the market.

Interest rate risk

The Group's and the Company's interest rate risk stems from financial liabilities. Financial liabilities expose the Group and the Company to the interest rate risk of cash flow.

The Group and the Company are exposed to interest rate risk as their liabilities and assets include such liabilities and assets that are sensitive to changes in interest rates, which means that some of the financial liabilities are linked to the variable interest rate EURIBOR. EURIBOR is changing on a daily basis as it is subject to market fluctuations; this can lead to increased finance expenses for the Group and the Company. Consequently, the Group and the Company are managing and controlling the increase of finance expenses in an appropriate centralized manner.

Exposure to interest rate risk:	**Mercator Group**		**Poslovni sistem Mercator d.d.**	
in EUR thousand	**2017**	**2016 restated**	**2017**	**2016 restated**
Fixed rate financial instruments				
Financial assets	28,980	38,565	99,220	125,271
Financial liabilities	(70,559)	(85,638)	(65,947)	(96,952)
Total	**(41,579)**	**(47,073)**	**33,272**	**28,319**
Floating rate financial instruments				
Financial assets	-	930	-	930
Financial liabilities	(811,141)	(817,378)	(534,851)	(528,627)
Total	**(811,141)**	**(816,448)**	**(534,851)**	**(527,697)**

Sensitivity analysis of the fair value of financial instruments at a fixed interest rate

The Group and the Company do not have financial instruments at fixed interest rates, measured at fair value through profit or loss, nor derivative financial instruments designated to hedge fair value. The change in the interest rate on the reporting date would thus not affect the net profit.

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) profit or loss and equity by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2016.

Cash flow sensitivity analysis for variable rate instruments	Mercator Group		Poslovni sistem Mercator d.d.	
	Net profit or loss		Net profit or loss	
in EUR thousand	100 bp increase	100bp decrease	100 bp increase	100bp decrease
2017				
Floating rate of financial instruments	(8,111)	8,111	(5,349)	5,349
Cash flow sensitivity (net)	**(8,111)**	**8,111**	**(5,349)**	**5,349**
2016				
Floating rate of financial instruments	(8,164)	8,164	(5,277)	5,277
Cash flow sensitivity (net)	**(8,164)**	**8,164**	**(5,277)**	**5,277**

Currency risk

Mercator Group
The Group's operations in the international environment necessarily involve exposure to currency risk. The Group is facing currency risk in the markets of Serbia and Croatia; exposure to risk has somewhat decreased on these two markets according to estimate.

In case of an increase in exposure to this type of risk, the Group has prepared a general policy of risk management that involves the following two steps:

- constant monitoring of macroeconomic background against which the movement of a particular exchange rate is taking place, and the related macroeconomic aspects and trends,
- adapting the operations based on the general trends and expectations, towards lesser exposure to currency risk.

In case of increased risk, the Group will decide with regard to implementation of any further measures based on the estimated level of exposure; needless to say, such measure will only be implemented following a thorough analysis and with consideration of the »cost-benefit« principle. The type of measure will depend on its appropriateness or viability, the nature of exposure, planned Group operations, and anticipated economic effects. There are no effective instruments to hedge currency risk in the markets where Mercator is operating; therefore, the Group is currently primarily using the so-called natural hedging or matching.

The Group's exposure to foreign currency risk was as follows:	Mercator Group		
Dec. 31, 2017			
in EUR thousand	HRK	RSD	BAM
Trade and other receivables	15,177	133,642	9,665
Available-for-sale financial assets	-	-	-
Cash and cash equivalents	162	8,463	1,766
Financial liabilities	-	(68,451)	(34,384)
Trade and other liabilities	(18,721)	(257,204)	(22,970)
Financial position statement exposure	**(3,381)**	**(183,549)**	**(45,923)**
Estimated sales	-	719,003	112,390
Estimated purchases	-	(571,251)	(90,342)
Estimated transaction exposure	**-**	**147,752**	**22,048**
Forward exchange contracts	-	-	-
Net exposure	**(3,381)**	**(35,797)**	**(23,875)**

Dec. 31, 2016 (restated) in EUR thousand	HRK	RSD	BAM
Trade and other receivables	10,709	124,982	4,417
Available-for-sale financial assets	42	5	4
Cash and cash equivalents	1,084	8,214	297
Financial liabilities	-	-	(15,617)
Trade and other liabilities	(13,963)	(208,351)	(3,732)
Financial postion statement exposure	**(2,129)**	**(75,151)**	**(14,631)**
Estimated sales	-	798,342	-
Estimated purchases	-	(697,457)	-
Estimated transaction exposure	**-**	**100,885**	**-**
Forward exchange contracts	-	-	-
Net exposure	**(2,129)**	**25,734**	**(14,631)**

As at December 31, 2017, the Mercator Group does not hold any derivative financial instruments for currency risk hedging (forward exchange contracts).

The following significant exchange rates applied during the year:	**Mercator Group**			
	Average exchange rate		Reporting date spot rate	
Units per 1 EUR	2017	2016	2017	2016
HRK	7.46	7.53	7.44	7.56
RSD	121.38	122.90	118.66	123.60
BAM	1.96	1.96	1.96	1.96

A change in the exchange rate of local currencies against the euro as at December 31, 2017 would have increased (decreased) profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

Sensitivity analysis	**Mercator Group**				
in EUR thousand	Change in exchange rate	(Estimated) transaction exposure Net profit or loss		Financial statement exposure Net profit or loss	
2017					
HRK	-/+5%	-	-	(178)	161
RSD	-/+10%	11,209	(9,171)	(20,394)	16,686
BAM	-/+5%	-	-	(2,417)	2,187
2016					
HRK	-/+5%	-	-	(112)	101
RSD	-/+10%	11,209	(9,171)	(8,350)	6,832
BAM	-/+5%	-	-	(770)	697

Poslovni sistem Mercator d.d.

The company is not exposed currency risk, as it does not have any significant receivables or liabilities denominated in foreign currencies.

Operational risk

Financial performance and results of operations

The financial performance and financial result of the Company and the Group as of December 31, 2017 and for 12 months ended this date demonstrated net loss in the amount of EUR 203,726 thousand and EUR 184,435 thousand, respectively, and operating loss EUR 87,117 thousand / consolidated EUR 172,508 thousand. The Company's Current liabilities outreached current assets by EUR 54,920 thousand and consolidated by EUR 159,886 thousand, negative working capital as of reporting date totaled EUR 127,431 thousand and EUR 188,561 thousand respectively.

At the same time as discussed in Business report the normalized EBITDA of the Company for the reporting period increased from EUR 38,159 thousand for 2016 year to EUR 71,254 thousand for 2017 year and for the Group from EUR 62,353 thousand to EUR 90,631 thousand. The Group has liquidity reserves available from credit lines in the amount of EUR 15,224 thousand and plans to raise additional liquidity from asset monetization program and the sale of other non-core assets (the proceeds thereof shall be used primarily to repay the financial obligations. The improved liquidity results from the lower rental payments in comparison to the existing debt service), generate positive cash flow from operating activities, optimize working capital management, especially in improving the management of inventories of merchandise and faster recovery of outstanding receivables. A cash flow forecast prepared by management for the following 12 months indicates that the Company and the Group will have sufficient funds to meet its obligations when they fall due.

Management estimates that the Company and the Group is able to meet its current liabilities by performing its regular business operations.

Business risk arising from uncertain economic outlook of Agrokor d.d.

During the 2017 year events have occurred indicating uncertainty in relation to Agrokor d.d., and its subsidiaries, except for Mercator Group, in future financial performance, including:

1) Multiple downgradings of credit rating by Moody's;

2) Bank liabilities that fall due in 2018 year together with uncertain position if Agrokor Group will be able to meet its obligations;

3) Changes in the Key management personnel and commencement of financial restructuring procedures following Croatian law on Extraordinary management proceedings in companies of systematic significance.

For the purpose of assessment of Mercator Group exposure to the risk arising from Agrokor Group the following matters have been considered by the Management:

1) Exposure to the risk from Business operations with Agrokor d.d. and its subsidiaries

Mercator Group is involved in the normal course of business operations with Agrokor Group. The exposure of Mercator Group to the business risk related to Agrokor Group financial performance is limited by the proportion of turnover with Agrokor Group and the volume of relative outstanding accounts.

As disclosed in Note 34, the share of revenues generated from operations with Agrokor Group is relatively insignificant and total to EUR 27,242 thousand or 1.27% of total consolidated revenue for 2017. Gross amount of trade receivables from Agrokor Group as of December 31, 2017 total to EUR 10,630 thousand. As discussed in Performance Analysis in 2017, the provision for Agrokor Group receivables as of 2017 year end totals to the amount of EUR 7,438 thousand.

Simultaneously with relatively insignificant operations with Agrokor Group, additional business risk mitigating factor is restrictive conditions provided in the financial restructuring agreement as of 2014 year. The agreement requirements include, but are not limited with: requirement to manage all the operations with Agrokor Group companies on the »arm's length basis«, restrictions on entering other than normal course of business operations, restriction on equity, debt and treasury operations, restrictions on assets and business management (including disposal of assets and change of business focus or core activities), restriction on assets distribution from Mercator Group to Agrokor Group and other restrictions.

Further to the enactment of *Croatian law on Extraordinary management proceedings in companies of systematic significance* on May 6, 2017, the Act on Conditions for Appointment of Extraordinary Management Board Member in Companies of Systemic Importance to the Republic of Slovenia (ZIČUDSP) came into effect in Slovenia. On May 18, 2017, an extraordinary Management Board member of the company Mercator was appointed pursuant to the ZIČUDSP, to be responsible exclusively for the management of transactions with the majority shareholder Agrokor and its subsidiaries. The purpose of the Act in relation to Mercator is mainly to:

- prevent any decisions by majority shareholder which are harmful for Mercator,
- restrict any corporate guarantees, loans or similar
- prevent any assumption of debt owed by Agrokor or its subsidiaries by Mercator and
- make sure that all the transactions between Mercator and Agrokor are on arm's length basis.

Based on the report prepared on a quarterly basis by the extraordinary Management Board member of the company Mercator, the Company has complied with the commitments regarding transactions with the company Agrokor and its related companies. Mercator – BH d.o.o. terminated the lease agreements for 83 commercial premises in Bosnia and Herzegovina with the company Konzum, Sarajevo and re-established Mercator operations in this country with a view to mitigate the credit risk by:

- preventing further generation of bad debt resulting from unpaid rent and
- collecting the outstanding rent payments (by way of off-seting the rent payables with the purchase of equipment and inventories located in the rented premises).

2) Risk of compliance with financial debt agreement commitments

As disclosed in Business report, Mercator Group net financial debt as of December 31, 2017 totals to EUR 828,217 thousand.

The terms of financial debt agreements comprise several provisions directly linked to the state and condition of Agrokor Group and its financial performance, including cross-default, change of control and material adverse effect provisions.

Cross default conditions were triggered by implementation of law on *Extraordinary management proceedings in companies of systematic significance* in 2017 year. An agreement with majority of lenders was reached that this clause does not effect the ability of Mercator Group to meet its financial obligations. The waiver on this condition was received from lenders on April 13, 2017. No significant changes have occurred as of financial statements date and the clause is not triggered.

Change of control clause has not been triggered as of the reporting date and date of the financial statements approval, but is expected to be triggered in the result of Agrokor lenders settlement finalization during the 2018 year, therefore as of the date of financial statements uncertainty in relation to default event occurrence during 2018 year exists. In assessment of the risk of default clause discussed above activation Management has considered the following factors:

- Mercator is, both for cashflow and EBITDA, one of the most significant entities within the Agrokor Group.
- It would be economically irrational for the Agrokor Group creditors to implement a settlement at the Agrokor level without there being an agreement with the Lenders under the Financial restructuring agreement in relation to the Change of Control.
- Any settlement at Agrokor necessarily involves the Agrokor creditors voting on a proposal to, among other things, size the debtto equity swap of their claims at the Agrokor level. Without any arrangement in relation to the Change of Control, we consider it is unthinkable to conclude that an informed vote can be taken as the appropriateness of the debt to equity split in circumstances where a material operating subsidiary (i.e. Mercator) is immediately facing a prepayment of all amounts owing to the Lenders under the CTA and related Finance Documents.
- Group Management is in the process of negotiation of a pre-emptive amendment to the *Change of Control* in contemplation of an impending Change of Control at the Agrokor Group level.

Management has the assumption that stakeholders in both Agrokor Group and Mercator Group will be highly incentivized to avoid a situation that requires immediate and full prepayment of the main debt facilities of Mercator Group as this will be immediately value destructive for all stakeholders.

Conclusion

Management acknowledges that there are certain risks arising from Agrokor Group uncertain future perspective described above and is aware of risks which can influence the ability of the Company to continue operating as an ongoing Company. However the management has a view that the Group has adequate internal and external resources and adequate risk mitigation measures in place to continue in operational existence.

Capital management

The policy of the Group and the Company is oriented to achieving adequate amount of capital so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Management Board therefore monitors on an ongoing basis the return on capital and capital structure.

The capital structure of the Group and the Company is the ratio between equity and net financial debt of the Group and the Company. As at reporting date, the said ratio was as follows:

Ratio between equity and net financial debt:	**Mercator Group**		**Poslovni sistem Mercator d.d.**	
in EUR thousand	**2017**	**2016 restated**	**2017**	**2016 restated**
Financial liabilities	881,700	903,017	600,798	625,579
Less:				
Loans and deposits	28,980	39,495	126,400	126,201
Available-for-sale financial assets	391	462	259	296
Cash and cash equivalents	24,112	26,318	11,635	13,344
Net financial debt	**828,217**	**836,742**	**462,505**	**485,738**
Equity	**478,401**	**557,376**	**423,159**	**551,283**
Ratio between equity and net financial debt	**1:1.73**	**1:1.5**	**1:1.09**	**1:0.88**

As at December 31, 2017, the Group transferred PIK's interest in the amount of EUR 36,887 thousand from long-term operating to long-term financial liabilities.

As at December 31, 2017, the Company held 42,192 treasury shares (2016: 42,192 treasury shares).

Fair Values

Fair Values in EUR thousand	Mercator Group Dec. 31, 2017 Carrying amount	Fair Value	Dec. 31, 2016 Carrying amount restated	Fair Value restated
Trade and other receivables	228,512	228,512	205,707	205,707
Current tax assets	244	244	1,230	1,230
Loans and deposits	28,980	28,244	39,495	38,492
Available-for-sale financial assets	-	-	462	462
Cash and cash equivalents	24,112	24,112	26,318	26,318
Fixed rate bank borrowings	(70,559)	(70,559)	(85,638)	(85,638)
Floating rate bank borrowings	(566,474)	(566,474)	(612,124)	(612,124)
Loans from subsidiaries and other companies	(118,350)	(118,350)	(61,072)	(61,072)
Finance leases	(126,316)	(126,316)	(144,183)	(144,183)
Trade and other liabilities	(634,136)	(634,136)	(603,782)	(603,782)

Fair Values in EUR thousand	Poslovni sistem Mercator d.d. Dec. 31, 2017 Carrying amount	Fair Value	Dec. 31, 2016 Carrying amount restated	Fair Value restated
Trade and other receivables	71,661	71,661	104,450	104,450
Current tax assets	-	-	300	300
Loans and deposits	126,400	123,188	126,201	122,994
Available-for-sale financial assets	259	259	296	296
Cash and cash equivalents	11,635	11,635	13,344	13,344
Fixed rate bank borrowings	(65,947)	(65,947)	(96,952)	(96,952)
Floating rate bank borrowings	(340,317)	(340,317)	(285,527)	(285,527)
Loans from subsidiaries and other companies	(104,234)	(104,234)	(139,871)	(48,247)
Finance leases	(90,300)	(90,300)	(103,228)	(103,228)
Trade and other liabilities	(304,633)	(304,633)	(317,634)	(317,634)

Fair value of loans (granted) and borrowings is calculated based on discounted cash flow of the principal and interest.

Fair value of financial assets measured at fair value on a recurring basis

Certain financial assets are measured at fair value at the end of each reporting period. Calculation of fair value for the discussed financial instruments is presented in the table below.

2017	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	Level 1	Valuation method	Level 1	Valuation method
Available-for-sale financial assets	180	Quoted stock prices in active market	52	Quoted stock prices in active market

2016	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	Level 1	Valuation method	Level 1	Valuation method
Available-for-sale financial assets	176	Quoted stock prices in active market	42	Quoted stock prices in active market

Fair value of financial assets not measured at fair value on a recurring basis

Based on the calculation of their fair value, financial instruments are divided into three levels:
Level 1: quoted (stock) prices for assets or liabilities;
Level 2: assets or liabilities not included within Level 1, the value of which is determined directly or indirectly based on comparable market data;
Level 3: assets or liabilities, the value of which is not based on active market basis.

2017	Mercator Group				Poslovni sistem Mercator d.d.			
in EUR thousand	Level 1	Level 2	Level 3	**Total**	Level 1	Level 2	Level 3	**Total**
Loans and deposits			28,980	**28,980**			126,400	**126,400**
Trade and other receivables			228,168	**228,168**			71,239	**71,239**
Financial liabilities			(881,700)	**(881,700)**			(600,798)	**(600,798)**
Trade and other liabilities			(634,136)	**(634,136)**			(304,633)	**(304,633)**

2016								
in EUR thousand	Level 1	Level 2	Level 3	**Total**	Level 1	Level 2	Level 3	**Total**
Loans and deposits			39,495	**39,495**			126,201	**126,201**
Trade and other receivables			205,707	**205,707**			104,450	**104,450**
Financial liabilities			(903,017)	**(903,017)**			(625,579)	**(533,954)**
Trade and other liabilities			(603,782)	**(603,782)**			(317,634)	**(317,634)**

In 2017, available-for-sale financial assets at the Group level included also investments valued at historical cost in the amount of EUR 211 thousand (2016: EUR 286 thousand).

In 2017, available-for-sale financial assets at the Company included also investments valued at historical cost in the amount of EUR 206 thousand (2016: EUR 254 thousand).

Fair values of financial assets and liabilities classified in levels 2 and 3 were determined in lien with generally accepted valuation models, which are based on the DCF analysis, using the discount rate that reflects credit risk in relation to counterparties.

31. Operating lease

Minimum lease payments pertaining to operating lease (the Group as the lessee) are as follows:

Minimum lease payments pertaining to operating lease are as follows:	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Less than one year	56,544	33,130	8,084	6,426
Between one and five years	191,662	106,162	26,029	19,247
More than five years	142,580	173,274	27,826	26,331
Total	**390,785**	**312,566**	**61,939**	**52,005**

Rents are mostly agreed upon in fixed terms, i.e. their amount does not depend on the revenue generated in leased stores.

32. Capital commitments

Capital expenditures (investment into property, plant and equipment) agreed upon and specified in contracts and agreements, which were not yet recognized in financial statements as at the statement of financial position date:

	Mercator Group		Poslovni sistem Mercator d.d.	
in EUR thousand	2017	2016	2017	2016
Property, plant and equipment	6,836	9,608	2,439	2,081

33. Contingent liabilities

Contingent liabilities	Mercator Group		Poslovni sistem Mercator, d.d.	
in EUR thousand	2017	2016	2017	2016
Property, plant and equipment	48,117	20,103	302,837	299,475

Mercator Group

Group contingencies also include guarantees provided in the amount of EUR 48,117 thousand (2016: EUR 20,103 thousand), of which EUR 20,068 thousand relate to bank guarantees and issued enforcement drafts for Mercator liabilities.

The tax authorities may, at any time within a period of 5 or 10 years after the end of the year for which a tax assessment was due, carry out an audit of the Group companies' operations, which may lead to assessment of additional tax liabilities, default interest, and penalties with regards to corporate income tax or other taxes and duties.

Poslovni sistem Mercator d.d.

Company's contingencies amount to EUR 302,837 thousand (2016: EUR 299,475 thousand), of which EUR 254,720 thousand relate to related parties.

34. Related-party transactions

The company Mercator d.d., has a controlling owner or shareholder. The biggest owner is Agrokor d.d., holding 69.57% of total equity.

Management personnel

The related persons of the Group are management personnel and related companies. The management personnel include members of management and members of the supervisory boards in the companies of the Mercator Group. At the end of 2017, the management personnel did not own any shares of the company Poslovni sistem Mercator d.d. Members of the supervisory boards of subsidiaries of the Mercator Group do not receive any payments for the purpose of performing supervision in subsidiaries, so the amounts presented refer only to the parent company. In 2017, no member of the management personnel and Supervisory Board of Mercator d.d., did not receive any remuneration for the performance of tasks in its subsidiaries (disclosure in accordance with Article 294 of the Companies Act).

Gross compensations to Management Board members and Supervisory Board members paid in 2017 in the parent company Poslovni sistem Mercator d. d. are shown in the following tables (disclosure in accordance with Article 294 of the Companies Act and Annex C of the Corporate Governance Code for Public Limited Companies).

Compensation of the Management Board of the company Poslovni sistem Mercator d.d. in 2017

Name and surname	Function	Fixed remuneration - gross (1)	Variable remuneration – gross: based on quantitative criteria	Variable remuneration – gross: based on qualitative criteria	Variable remuneration – gross: Total (2)	Deferred income (3)	Severance pays (4)	Bonuses (5)	Refund payment (claw-back) (6)	Total gross (1+2+3+4+5-6)	Total net
Anton Balažič	President of the Management Board until April 5, 2017)	86,666	-	-	-	-	338,896	6,450	-	**432,012**	65,914
Tomislav Čizmić	President of the Management Board from April 6, 2017)	272,944	-	-	-	-	-	30,263	-	**303,207**	97,659
Draga Cukjati	Member of the Management Board from April 18, 2017)	171,755	-	-	-	-	-	10,159	-	**181,914**	72,230
Igor Mamuza	Member of the Management Board	257,172	-	-	-	-	-	13,458	-	**270,630**	104,627
Gregor Planteu	extraordinary Member of the Management Board from May 24, 2017)	143,033	-	-	-	-	-	4,505	-	**147,538**	62,171

Compensation of the Supervisory Board and Committees of the company Poslovni sistem Mercator d.d. in 2017:

Name and surname	Function	Function-related payments – gross per year (1)	Attendance fees of SB and committees – gross per year (2)	Total gross (1+2)	Total net*	Commuting allowances
Ante Todorić	President of SB until April 25, 2017)	-	-	-	-	-
Ivan Crnjac	Member of SB until April 24, 2017, President of AC until April 25, 2017	-	-	-	-	-
Darko Knez	Member of SB until June 1, 2017	7,500	692	8,192	5,958	-
Ante Ramljak	President of SB from June 15, 2017	-	570	570	414	-
Matej Lahovnik	Vice-president of SB, Member of AC, member of HR	28,550	4,124	32,674	23,764	-
Damir Kuštrak	Member of SB, Member of AC	-	1,140	1,140	829	-
Ivica Mudrinić	Member of SB, Member of HR	22,900	2,922	25,822	18,780	-
Teo Vujčić	Member of SB	-	285	285	207	-
Vladimir Bošnjak	Member of SB, Member of AC	-	712	712	518	-
Veljko Tatić	Member of SB until April 11, 2017	15,200	1,650	16,850	12,255	-
Vesna Stojanović	Member of SB, Member of HR	22,900	2,475	25,375	18,455	-
Matjaž Grošelj	Member of SB	18,000	2,200	20,200	14,691	-
Jože Lavrenčič	Member of SB from November 5, 2017	2,800	550	3,350	2,436	-
Sergeja Slapničar	Extraordinary Member of AC	9,000	1,100	10,100	7,346	-

SB = Supervisory Board AC = Audit Commit HR = Human Resource Committee

Compensation of the Supervisory Committee of the company Poslovni sistem Mercator d.d. in 2017

Name and surname	Function	Function-related payments – gross per year (1)	Attendance fees of SB and committees – gross per year (2)	Total gross (1+2)	Total net*	Commuting allowances
Filipović Nenad	-	18,000	962	18,962	13,791	-

Transactions with related parties in the Agrokor Group

Sales, purchases, receivables, liabilities, loans given and loans received from related companies:	Mercator Group					
in EUR thousand	Sales	Purchases	Receivables	Liabilities	Loans given	Loans received
Agrokor Group companies:						
360 Marketing d.o.o.	3	-	-	76	-	-
A007 d.o.o.	-	-	71	-	-	-
Agkor d.o.o.	4	-	-	-	-	-
Agrokor d.d.	-	-	618	-	-	20,000
Agrokor-trgovina d.o.o.	2,462	-	201	91	-	-
Agrokor-Zagreb d.o.o. Grude	-	-	-	14	-	-
Angropromet d.o.o.	0	-	0	81	-	-
Atlas d.d.	0	-	-	1	-	-
Belje d.d.	259	-	(1)	388	-	-
Dijamant a.d.	3,674	-	795	6,916	-	-
Frikom d.o.o.	1,706	-	483	6,157	-	-
Idea d.o.o.	11	-	52	11,529	-	4,944
Jamnica d.o.o. Maribor	8	-	90	628	-	-
Kikindski mlin a.d.	307	-	12	539	-	-
Kompas d.d.	64	-	5	761	-	-
Konzum d.d.	10,770	-	4,932	2,315	-	-
Konzum d.o.o. Sarajevo	5,715	-	1,851	992	-	-
Kron a.d.	1	-	0	-	-	-
Ledo d.d.	220	-	0	-	-	-
Ledo d.o.o. Čitluk	-	-	-	355	-	-
Ledo d.o.o. Ljubljana	181	-	30	1,526	-	-
Ledo d.o.o. Podgorica	38	-	-	989	-	-
MG Mivela d.o.o. (Jamnica d.o.o. Belgrade)	385	-	313	2,635	-	-
mStart Business Solutions d.o.o.	14	-	4	5	-	-
mStart d.o.o.	37	-	-	1,695	-	-
Multiplus card d.o.o.	(6)	-	-	22	-	-
Nova sloga d.o.o.	2	-	2	82	-	-
PIK BH d.o.o. Laktaši	31	-	-	426	-	-
PIK Vrbovec d.d.	1,230	-	110	3,399	-	-
Projektgradnja d.o.o.	-	-	4	-	-	-
Sarajevski kiseljak d.d.	-	-	-	196	-	-
Solana Pag d.d.	0	-	-	28	-	-
Super kartica d.o.o. Belgrade	49	-	594	562	-	-
Super kartica d.o.o. BH	0	-	1	69	-	-
Tisak d.d.	1	-	105	4	-	-
Tisak usluge d.o.o.	18	-	-	-	-	-

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Velpro d.o.o. Sarajevo	36	-	-	0	-	-
Velpro-centar d.o.o.	-	-	229	45	-	-
Zvijezda d.o.o Sarajevo	-	-	-	345	-	-
Zvijezda d.o.o. Ljubljana	23	-	129	1,587	-	-
Zvijezda Laktaši (consolidated since 01.12.2017.)	-	-	-	29	-	-
Total	**27,242**	**-**	**10,630**	**44,485**	**-**	**24,944**
Total	**27,242**	**-**	**10,630**	**44,485**	**-**	**24,944**

Sales, purchases, receivables, liabilities, loans given and loans received from related companies:	**Poslovni sistem Mercator d.d.**					
in EUR thousand	Sales	Purchases	Receivables	Liabilities	Loans given	Loans received
The parent company and the Companies of the Mercator Group:						
M - BL, d.o.o.	1	-	1	-	-	-
M - Energija, d.o.o.	348	-	6	183	-	-
Mercator - BH, d.o.o.	221	-	218	5,200	-	4,937
Mercator – CG, d.o.o.	31	-	16	7,098	-	-
Mercator - H, d.o.o.	4,817	-	126,387	80	-	-
Mercator - S, d.o.o.	166	-	1,394	0	-	-
Mercator Emba, d.d.	475	-	116	1,907	-	-
Mercator IP, d.o.o.	1,505	-	67	6,639	-	-
Total	**7,564**	**-**	**128,205**	**21,105**	**-**	**4,937**
Agrokor Group companies:						
Agrokor d.d.	-	-	618	-	-	20,000
Agrokor-trgovina d.o.o.	2,456	-	24	91	-	-
Belje d.d.	259	-	(1)	387	-	-
Dijamant a.d.	-	-	-	777	-	-
Jamnica d.o.o. Maribor	3	-	89	628	-	-
Kompas d.d.	64	-	5	760	-	-
Konzum d.d.	128	-	1	1,212	-	-
Ledo d.o.o. Ljubljana	181	-	30	1,524	-	-
mStart d.o.o.	-	-	-	514	-	-
PIK Vrbovec d.d.	1,207	-	110	3,025	-	-
Solana Pag d.d.	0	-	-	28	-	-
Tisak d.d.	-	-	83	-	-	-
Velpro-centar d.o.o.	-	-	-	45	-	-
Zvijezda d.o.o. Ljubljana	23	-	129	1,525	-	-
Total	**4,321**	**-**	**1,087**	**10,516**	**-**	**20,000**
Total	**11,884**	**-**	**129,292**	**31,621**	**-**	**24,937**

35. Major events after the balance sheet date

Ante Ramljak resigned from the position of a Supervisory Board member at the company Poslovni sistem Mercator d.d., effective as of February 28, 2018, Teo Vujčić resigned as of April 4, 2018, and Damir Kuštrak resigned as of April 16, 2018.

Independent autitor's report

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INDEPENDENT AUDITOR'S REPORT
to the owners of Poslovni sistem Mercator, d.d.

Report on the Audit of Financial Statements

Opinion

We have audited the consolidated financial statements of the company Poslovni sistem Mercator d.d and its subsidiaries (hereinafter 'the Group'), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated income statement, consolidated statement of other comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and consolidated cash flow statement for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU (hereinafter 'IFRSs').

Basis for Opinon

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in *the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and other ethical requirements that are relevant to our audit of the financial statements in Slovenia, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Material Uncertainty Related to Going Concern

We draw attention to "Operational risk" in Note 30 of the financial statements, which describes the exposure of the Group to the risks that may affect the Group's ability to continue its operations on the going concern basis. As stated in Note 30, events and conditions disclosed indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the Material Uncertainty Related to Going Concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Key audit matter	How our audit addressed the key audit matter
Change of measurement basis for certain groups of property, plant and equipment and investment property and fair value measurement: application of revaluation model to tangible assets accounting.	
As of December 31, 2017 the Group has changed the measurement basis for buildings recognized in accordance with IAS 16 *Property, Plant and equipment* to revaluation model and investment property, recognized in accordance with IAS 40 *Investment property*, to fair value model. Land recognized in accordance with IAS 16 is carried at revaluation model. As of reporting date the Group has performed valuation of market value of land, building and investment property. Total fair value of land and buildings recognised in accordance with IAS 16 as of reporting date amounts to EUR 1.005 mln as disclosed in Note 14 and investment property EUR 244 mln as disclosed in Note 16 Cumulative effect of change of measurement principles and accounting policy is EUR 147 mln of loss recognised in income statement for 2017 year driven by devaluation of property and EUR 126 mln of revaluation surplus recognised in revaluation reserve in equity as of reporting date To assess the fair values of property the Group employed certified independent appraiser. The valuation of property, plant and equipment and investment property is considered to be a key audit matter due to the significance of the balance to the financial statements as a whole, combined with the judgment associated with determining the fair value.	Our audit procedures included the assessment whether management judgement is appropriate and whether the IAS 16, IAS 40, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 13 *Fair value measurement* requirements are met, including >> Review of appropriateness of methodological application of change in measurement basis of property, plant and equipment and change of accounting policy in relation to investment property in accordance with IAS 8, IAS 16 and IAS 40 >> Review of appropriateness, accuracy and completeness of relative accounting records and disclosures of information in the Notes to financial statement in accordance with applicable IFRS standards >> Assessment of competence, capabilities and objectivity of management's independent valuer, and verification of the qualifications of the valuer. In addition, we discussed the scope of his work with management; >> We made use of our internal experts to evaluate whether the valuation approach used by the Group Management expert is appropriate, whether the significant assumptions used are adequate for given purposes and whether the results of valuations prepared by management expert are accurate; The disclosures pertaining to the change of measurement principles, change of accounting policy and results of valuations are presented in Note 2

Other information

The other information comprises the information, included in Annual report, other than the financial statements and our auditor's report thereon. Other information were obtained prior to the date of this auditor's report, except Report from Supervisory Board, which is expected to be made available to us after that date. Management is responsible for the other information.

Our opinion on the consolidated financial statements does not cover the other information.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, assess whether the other information is materially inconsistent with the consolidated financial statements, legal requirements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law or regulation, in particular, whether the other information complies with law or regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the consolidated financial statements is, in all material respects, consistent with the consolidated financial statements; and
- The other information is prepared in compliance with applicable law or regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Group obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

Responsibilities of Management, Supervisory board and Audit committee for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so

Supervisory board and Audit committee are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the organization to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence concerning the financial statements of group companies or their business activities in order to express an opinion on the consolidated financial statements. We are responsible for conducting, overseeing and performing the audit of the Group. We have sole responsibility for the audit opinion expressed.

With Supervisory board and/or Audit committee we communicate the planned scope and timing of the audit and significant findings from the audit, including significant deficiencies in internal control we have identified during our audit.

We also provide Supervisory board and/or Audit committee with the statement of compliance with relevant ethical requirements regarding independence, and we communicate with them all relationships and other matters for which it may reasonably be thought to bear on independence, and, if appropriate, all the related safeguards.

From the matters communicated with Supervisory board and/or Audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period, and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other reporting obligations as required by EU Regulation No. 537/2014 of the European Parliament and the Council

In compliance with the Article 10(2) of EU Regulation No. 537/2014 of the European Parliament and the Council, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

Appointment of the Auditor and the Period of Engagement

We were reappointed as the statutory auditor of the Company by the shareholders on General Shareholders' Meeting held on 15 June 2017. Our total uninterrupted engagement has lasted 5 years.

Consistence with the Additional Report to the Audit Committee

We confirm that our audit opinion on the financial statements expressed herein is consistent with the additional report issued to the Audit Committee of the Group on 25 April 2018 in accordance with the Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

Provision of Non-audit Services

We declare that no prohibited non-audit services referred to in the Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided.

There are no services, in addition to the statutory audit, which we provided to the Company and its controlled undertakings, and which have not been disclosed in the Annual Report.

DELOITTE REVIZIJA d.o.o.

Barbara Žibret-Kralj,
Certified auditor

For signature please refer to the original Slovenian version.

Deloitte.

DELOITTE REVIZIJA D.O.O.
Ljubljana, Slovenija 3

Ljubljana, 25 April 2018

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INDEPENDENT AUDITOR'S REPORT
to the owners of Poslovni sistem Mercator, d.d.

Report on the Audit of Financial Statements

Opinion

We have audited the financial statements of the company Poslovni sistem Mercator d.d. (hereinafter the Company), which comprise the statement of financial position as at 31 December 2017, the income statement, statement of other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU (hereinafter 'IFRSs').

Basis for Opinon

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in *the Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and other ethical requirements that are relevant to our audit of the financial statements in Slovenia, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Material Uncertainty Related to Going Concern

We draw attention to "Operational risk" in Note 30 of the financial statements, which describes the exposure of the Company to the risks that may affect the Company's ability to continue its operations on the going concern basis. As stated in Note 30, events and conditions disclosed indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the Material Uncertainty Related to Going Concern section, we have determined the matters described below to be the key audit matters to be communicated in our report.

Key audit matter	**How our audit addressed the key audit matter**
Change of measurement basis for certain groups of property, plant and equipment and investment property and fair value measurement: application of revaluation model to tangible assets accounting.	
As of December 31, 2017 the management of the Company has changed the measurement basis for buildings recognized in accordance with IAS 16 *Property, Plant and equipment* to revaluation model and investment property, recognized in accordance with IAS 40 *Investment property,* to fair value model. Land recognized in accordance with IAS 16 is carried at revaluation model. As of reporting date the Company has performed valuation of market value of land, building and investment property. Total fair value of land and buildings recognised in accordance with IAS 16 as of reporting date amounts to EUR 674,8 mln as disclosed in Note 14 and investment property EUR 4,8 mln as disclosed in Note 16 Cumulative effect of change of measurement principles and accounting policy is EUR 98 mln of loss recognised in income statement for 2017 year driven by devaluation of property and EUR 91,7 mln of revaluation surplus recognised in revaluation reserve in equity as of reporting date To assess the fair values of property the Company employed certified independent appraiser. The valuation of property, plant and equipment and investment property is considered to be a key audit matter due to the significance of the balance to the financial statements as a whole, combined with the judgment associated with determining the fair value.	Our audit procedures included the assessment whether management judgement is appropriate and whether the IAS 16, IAS 40, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and IAS 13 *Fair value measurement* requirements are met, including >> Review of appropriateness of methodological application of change in measurement basis of property, plant and equipment and change of accounting policy in relation to investment property in accordance with IAS 8, IAS 16 and IAS 40 >> Review of appropriateness, accuracy and completeness of relative accounting records and disclosures of information in the Notes to financial statement in accordance with applicable IFRS standards >> Assessment of competence, capabilities and objectivity of management's independent valuer, and verification of the qualifications of the valuer. In addition, we discussed the scope of his work with management.; >> We made use of our internal experts to evaluate whether the valuation approach used by the Company Management expert is appropriate, whether the significant assumptions used are adequate for given purposes and whether the results of valuations prepared by management expert are accurate;
Impairment of investments in subsidiaries	
Investments in subsidiaries amount to EUR 190,8 mln as of December 31, 2017 in the Company's separate financial statements. The Company recognized EUR 115 mln of impairment in investments in subsidiaries in 2017 as disclosed in Note 17. As required by the applicable accounting standards – IAS 36 *Impairment of assets*, Management conducts annual impairment tests to assess the recoverability of the carrying value of investments. The	Our audit procedures comprised >> Assessment whether recoverable amount is appropriately determined in accordance with IAS 36 requirements; >> Evaluation whether the approach used by management to determine the fair value and cost of disposal of individual investments comply with the requirements of IAS 36 and whether assumptions used for the assessment of fair value are reasonable and

recoverable amount of investments is determined in accordance with IAS 36 as higher of value in use and fair value less cost of disposal. In the result, fair value less cost of disposal was selected for determination of recoverable amount of investments as of December 31, 2017 year. Significant Management judgment is involved in determination of recoverable amount and calculation, accordingly, the impairment test of these assets is considered to be a key audit matter.	supportable given the current macroeconomic climate and expected future performance; >> Assessment whether information disclosed in the notes to the financial statements is complete and accurate and meets the requirements of applicable financial reporting standards. Relative information disclosed in Note 17

Other information

The other information comprises the information, included in Annual report, other than the financial statements and our auditor's report thereon. Other information were obtained prior to the date of this auditor's report, except Report from Supervisory Board, which is expected to be made available to us after that date. Management is responsible for the other information.

Our opinion on the financial statements does not cover the other information.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, assess whether the other information is materially inconsistent with the financial statements, legal requirements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. In addition, we assess whether the other information has been prepared, in all material respects, in accordance with applicable law or regulation, in particular, whether the other information complies with law or regulation in terms of formal requirements and procedure for preparing the other information in the context of materiality, i.e. whether any non-compliance with these requirements could influence judgments made on the basis of the other information.

Based on the procedures performed, to the extent we are able to assess it, we report that:

- The other information describing the facts that are also presented in the financial statements is, in all material respects, consistent with the financial statements; and
- The other information is prepared in compliance with applicable law or regulation.

In addition, our responsibility is to report, based on the knowledge and understanding of the Company obtained in the audit, on whether the other information contains any material misstatement of fact. Based on the procedures we have performed on the other information obtained, we have not identified any material misstatement of fact.

Responsibilities of Management, Supervisory board and Audit committee for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so

Supervisory board and Audit committee are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the organization to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

With Supervisory board and/or Audit committee we communicate the planned scope and timing of the audit and significant findings from the audit, including significant deficiencies in internal control we have identified during our audit.

We also provide Supervisory board and /or Audit committee with the statement of compliance with relevant ethical requirements regarding independence, and we communicate with them all relationships and other matters for which it may reasonably be thought to bear on independence, and, if appropriate, all the related safeguards.

From the matters communicated with Supervisory board and/or Audit committee, we determine those matters that were of most significance in the audit of the financial statements of the current period, and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Other reporting obligations as required by EU Regulation No. 537/2014 of the European Parliament and the Council

In compliance with the Article 10(2) of EU Regulation No. 537/2014 of the European Parliament and the Council, we provide the following information in our independent auditor's report, which is required in addition to the requirements of International Standards on Auditing:

Appointment of the Auditor and the Period of Engagement

We were reappointed as the statutory auditor of the Company by the shareholders on General Shareholders' Meeting held on 15 June 2017. Our total uninterrupted engagement has lasted 5 years

Consistence with the Additional Report to the Audit Committee

We confirm that our audit opinion on the financial statements expressed herein is consistent with the additional report issued to the Audit Committee of the Company on 25 April 2018 in accordance with the Article 11 of Regulation (EU) No. 537/2014 of the European Parliament and the Council.

Provision of Non-audit Services

We declare that no prohibited non-audit services referred to in the Article 5(1) of Regulation (EU) No. 537/2014 of the European Parliament and the Council were provided.

There are no services, in addition to the statutory audit, which we provided to the Company and its controlled undertakings, and which have not been disclosed in the Annual Report.

DELOITTE REVIZIJA d.o.o.

Barbara Žibret-Kralj,
Certified auditor

For signature please refer to the original Slovenian version.

Deloitte.
DELOITTE REVIZIJA D.O.O.
Ljubljana, Slovenija 3

Ljubljana, 25 April 2018

TRANSLATION ONLY, SLOVENE ORIGINAL PREVAILS

We have room for everyone who believes in the common good. We wish to create a society of the good and to be in the company of the best.

CONTACTS MERCATOR.

MERCATOR GROUP

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